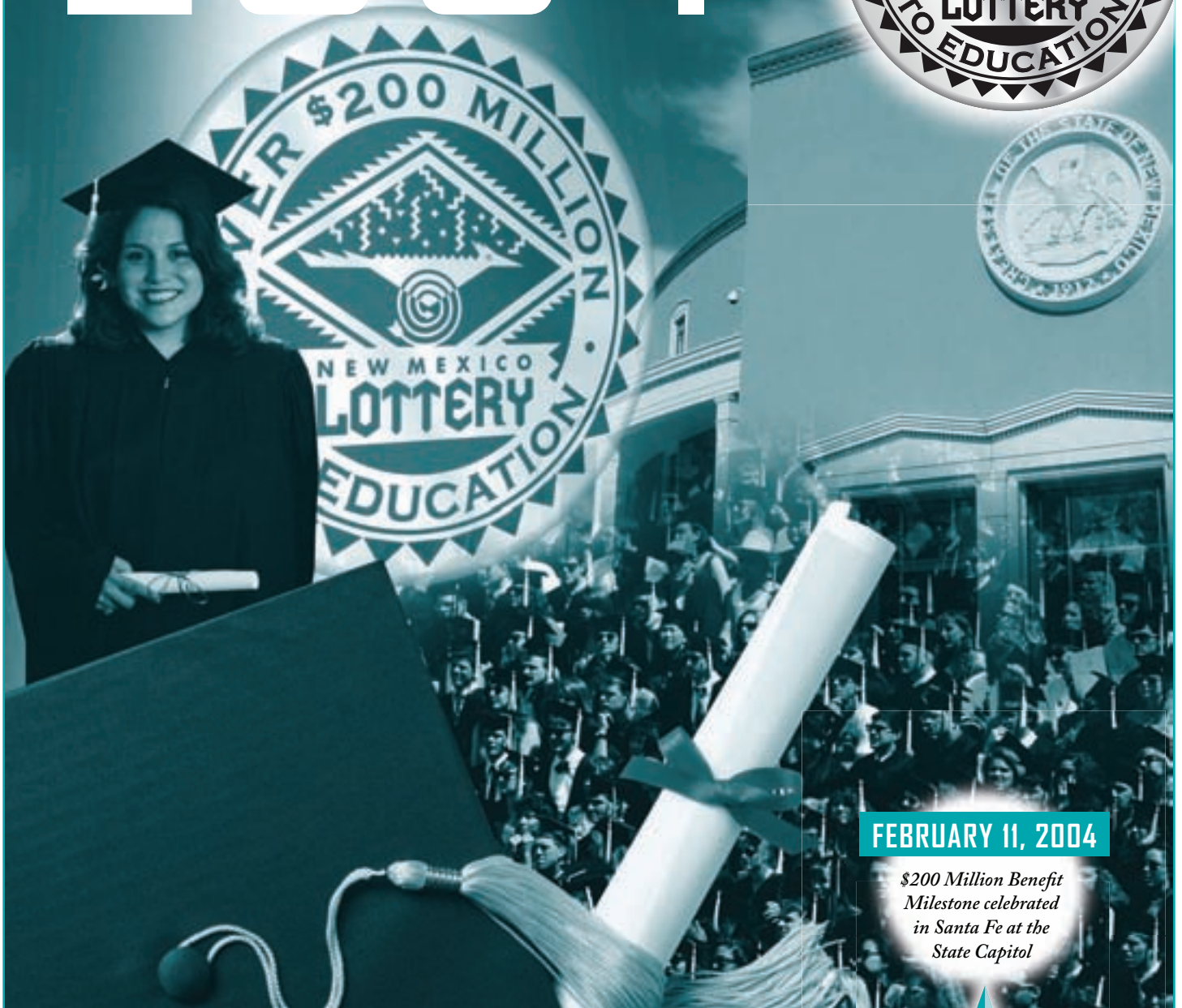


2004

A New Mexico Milestone

NEW MEXICO LOTTERY AUTHORITY ANNUAL REPORT



FEBRUARY 11, 2004

*\$200 Million Benefit
Milestone celebrated
in Santa Fe at the
State Capitol*

A Message From The Board of Directors

Serving the Lottery in Fiscal Year 2004

This was another milestone year for the New Mexico Lottery Authority (NMLA) and its seven-member Board of Directors. By statute, board members are unpaid citizen volunteers appointed by the Governor and confirmed by the State Senate. Our private sector perspective helps guide a large marketing enterprise. We also have the responsibility to exercise sound and prudent business judgment in the management and promotion of the Lottery.

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

By statute, the NMLA board membership must include accounting, business, law enforcement and legal professionals. There were no new appointments made during Fiscal Year 2004. Membership included former Governor David Cargo of Albuquerque (who was appointed during the fourth quarter of Fiscal Year 2003 but was not sworn in until the first quarter of Fiscal Year 2004); Claydean Claiborne, Mayor of Jal; Rudy Garcia, a Gallup business executive; Dan Girand of Roswell, a law enforcement veteran; Jill Gutierrez, a Las Cruces bank president; Reta Jones, an Albuquerque CPA; and, Cody Kelley, an Albuquerque attorney. Ms. Jones and Mr. Garcia were appointed to full terms, having filled unexpired terms during Fiscal Year 2003. At the beginning of the fiscal year, Ms. Claiborne was re-elected to chair the board, and Mr. Kelley was re-elected vice chair.

The board's statutory responsibilities include, but are not limited to: the adoption of rules, policies and procedures; maximizing net revenue for Lottery beneficiaries; appointment of the Lottery's CEO; setting and oversight of the corporation's annual budget; conducting on-going studies of this and other lotteries to continually improve efficiency, profitability and security; and the preparation of reports for the Legislature and the people of New Mexico. It is also the board's responsibility to "pursue any



David Cargo, Jill Gutierrez, Reta Jones, Claydean Claiborne, Cody Kelley, Dan Girand and Rudy Garcia.

and all other matters necessary, desirable or convenient for the efficient and effective operation of lottery games, the continued entertainment and convenience of the public and the integrity of the lottery."

The following annual report to the people of New Mexico highlights the Lottery Authority's proud accomplishments for Fiscal Year 2004, including the strengthening of the commitment to educate the college students of this State.

Respectfully submitted,
 Claydean Claiborne, *Chair*
 Cody Kelley, *Vice Chair*
 Jill Gutierrez, *Secretary*
 Dan Girand, *Treasurer*
 Reta Jones, *Member*
 Rudy Garcia, *Member*
 David Cargo, *Member*

*The New Mexico Lottery Authority
 Board of Directors
 for Fiscal Year 2004*

Base Roadrunner Cash top prize raised to \$20,000; TV drawings combined, featuring animated characters



Measuring Success In Degrees

A Letter from the CEO

On behalf of the New Mexico Lottery Authority, I am pleased to submit this annual report to the citizens of New Mexico for the fiscal year that ended June 30, 2004.

The New Mexico Lottery ended the 2004 fiscal year with a record \$148.7 million in gross sales for its seventh straight year of sales growth. The Lottery also posted a record \$35.9 million profit. All profits were earmarked by the State for the Lottery Success Scholarship program.

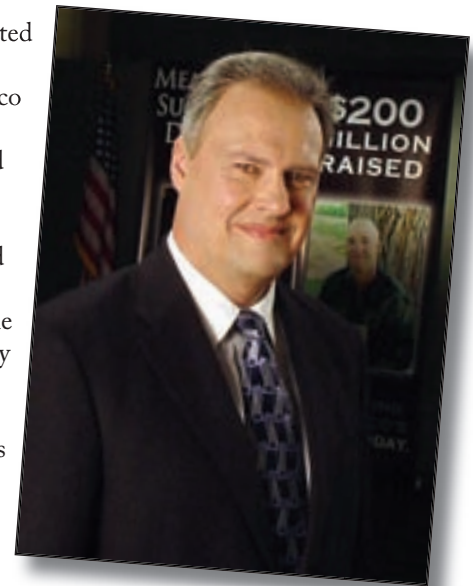
Strong profits result from increasing efficiencies in daily operations, achieving cost reductions, and creating new and innovative ways to do business. The higher the Lottery's profit, the more money there is for Lottery Success Scholarships. And during 2004, the Lottery's return to New Mexico education since inception surpassed \$200 million. To mark the occasion we presented a ceremonial check to State leaders at the Roundhouse in Santa Fe. By the end of the school year, more than 32,000 students had received Lottery Success Scholarships since the Lottery began.

New Mexico is one of only two U.S. lotteries to have seven consecutive full years of sales increases since start-up. In addition, the New Mexico Lottery has set in-state net profit records each of the last five years. These achievements have contributed significantly to the financial strength of the Lottery Success Scholarship program.

Sales are driven by a strong mix of products: Powerball and its massive multi-state jackpots; New Mexico's own Roadrunner Cash with a rolling top prize; Pick 3 with a top prize of \$500; and over 50 instant (scratcher) games that change constantly and are available at any given time throughout the year.

The Lottery Success Scholarship has touched the entire state. Every county, school district and legislative district has students who have received their in-state college tuition from this program. The Lottery has continued to do exactly what it was supposed to do: provide an incentive for New Mexico students to remain in high school and graduate, and provide them with an unprecedented opportunity to attend college. Tuition has been made available for students whose families come from all walks of life, allowing them to attend college even if they might otherwise not have been able to afford it. Lottery Success

Scholarships started a new legacy for many New Mexico families. Many students reported that they were the first in their families to attend a college or university. All the while, the Lottery remained a form of entertainment for New Mexico's adults with the purpose of increasing the educational opportunities for young people.



Thomas N. Shaheen

Because of the strong support from the citizens, elected officials and Lottery retailers of New Mexico, you have truly put "Success" in the Lottery Success Scholarship, as well as helped create the success of the New Mexico Lottery as evidenced in surpassing the \$200 million milestone.

Sincerely,

Thomas N. Shaheen
CEO

*First "\$100,000 Holiday Treasures"
scratcher top prize won by
Cheryl Sanchez of Roswell*

Fiscal Year 2004

The Year in Review

The New Mexico Lottery has had the distinction of reaching milestones for its beneficiaries and players year after year, and Fiscal Year 2004 was no exception.

Sales and scholarship profits broke records despite the lack of a record Powerball jackpot, as in the previous year. While important to the continued success of the NMLA, Powerball is just one component. A record Roadrunner Cash prize and another strong mix of instant (scratcher) products were among the many factors driving sales. So was the continued popularity of the Lottery Success Scholarship, which is often cited by New Mexicans as a reason to play.

There were more than 1,100 New Mexico businesses licensed as Lottery retailers, serving as front line representatives for products and information. This network of dedicated professionals sold innovative and enjoyable games that accrued \$78.9 million in prizes for the fiscal year, and once again raised more money than ever for the Lottery Success Scholarship program.



Governor Bill Richardson praised the Lottery Success Scholarship program during a ceremony marking \$200 million raised by the Lottery for New Mexico education. "The value of the Lottery Scholarship program is ... reflected in the faces and the lives of the New Mexicans who turn their scholarships into personal success," the Governor said.



The Lottery's \$200 million ceremonial check is presented during Roundhouse ceremonies. From left: House Speaker Ben Lujan, Nambé; Lottery Authority board chair Claydean Claiborne; Senator Michael Sanchez, Belen; and, Lottery Authority CEO Tom Shabeen.

FEBRUARY 11, 2004

*\$200 Million Benefit
Milestone celebrated in Santa Fe
at the State Capitol.*



Scratchers

For the second year in a row instant tickets constituted a strong 58.6 percent of overall sales. Scratcher sales were \$87 million, about \$6.8 million and 8.5 percent higher than the previous fiscal year.

The combination of licensed and locally-designed games provided a mix players like: innovative, appealing new products and play styles along with returning favorites. The mix also featured a variety of price points (\$1 to \$10) and top prizes (\$999 to \$100,000). The growing popularity of \$10 instant games was reflected in scratcher sales, with five \$100,000 instant top prizes claimed during the fiscal year ... a first for the New Mexico Lottery. In addition to cash prizes, other instant games featured trips and motor-cycles.

During Fiscal Year 2004, 53 instant games were launched. It was also the first full year of a new instant ticket partnership with Scientific Games International. This contract, approved in 2003, lowered printing costs and shared the risk of unsold tickets. The contract also provided for new concepts to be tested in regional focus groups before they are introduced.

Among top sellers for Fiscal Year 2004 were \$100,000 Holiday Treasures, the Lottery's third \$10 ticket, and the return engagement of silver screen icon Betty Boop® for the second consecutive year.

Fiscal Year 2004 was also the final full year for "Powerball – Instant Millionaire," which combined a scratcher product with the name recognition of the popular Powerball lotto game. New Mexico players of this scratcher game were selected as contestants to appear each week on the nationally-syndicated television game show, and their prizes included trips to Las Vegas. Kathi Silvas of Roswell won \$129,000, breaking the previous



New Mexico record of almost \$71,000.

New Mexico Lottery players claimed a record \$56.8 million in instant game prizes during Fiscal Year 2004.

On-line Games

Drawing games featuring numbers chosen by players or computer "quick picks" continued a pattern of sales growth. The \$61.7 million in on-line sales during Fiscal Year 2004 accounted for 41.4 percent of gross sales and represented an 8.6 percent increase over Fiscal Year 2003.

Roadrunner Cash and Pick 3 drawing results continued to be televised six nights a week on three CBS affiliates serving New Mexico, based in Albuquerque (KROQ), Roswell (KBIM) and Durango/Farmington (KREZ). They were also televised on Univision affiliate KLUZ in Albuquerque. Powerball results have been televised immediately after both drawings each week on numerous stations.

A new on-line game, 4 This Way!, was developed during Fiscal Year 2004, for launch during Fiscal Year 2005. This will add to the variety of products available to players while generating additional revenues for the Lottery and its educational beneficiaries.

Powerball®

Powerball is New Mexico's traditional lotto-style game. During the fiscal year it was sold in 26 states, the District of Columbia and the U.S. Virgin Islands. As a multi-state game, the population base allowed larger jackpots to grow quickly. Powerball offers players nine ways to win prizes ranging from \$3 to jackpot annuities that began at \$10 million, and rolled upwards until won. Players select five numbers from 1 to 53, and one Powerball from 1 to 42.

New Mexico Powerball sales grew by \$4 million, or 8.4 percent over Fiscal Year 2003. Powerball sales represented about 34.6 percent of Lottery gross sales.

Mark Adcox of
Rio Rancho wins
"\$100,000 Holiday Treasures"
scratcher top prize



Sales were boosted by three Powerball jackpot run-ups exceeding \$200 million. No Powerball jackpot records were set in Fiscal Year 2004.

Powerball prizes included 14 \$100,000 second prize-winning tickets sold in New Mexico. There were also 97 winners of the Powerball third prize, which ranged from \$5,000 to \$25,000, depending upon whether the optional Power Play® multiplier was purchased. This Powerball enhancement, implemented in Fiscal Year 2003, allows players to multiply any Powerball prize from two to five times, except for the jackpot. Overall, New Mexico Lottery players claimed more than \$7.8 million in Powerball prizes.



Teresa Magyari of Albuquerque won a \$100,000 Powerball second prize. "I told a co-worker I'm either going to get a raise or win the lottery," she joked.

Roadrunner Cash

Record top prizes led to record sales for New Mexico's in-state five digit game. Roadrunner Cash turned six years old, with several enhancements during Fiscal Year 2004.

During the second quarter, the base prize was increased from \$15,000 to \$20,000. A bonus ball was added, featuring new prize levels. Within five months after the changes, the "rolling" top prize had grown to a record \$362,000.

These changes and strong marketing of the game resulted in a rebound of Roadrunner Cash sales from the slight dip of the previous fiscal year. Game sales were \$8.1 million, a 9.5 percent increase above Fiscal Year 2003. Roadrunner Cash sales represented 5.4 percent of overall Lottery sales, unchanged from the previous fiscal year.



Rodney Zamora (left) of Carrizozo claimed a record \$362,000 Roadrunner cash prize. He was joined at Lottery headquarters by his parents, Mary Lee and Nazario Zamora.

There were 41 winning tickets during Fiscal Year 2004 for the Roadrunner Cash top prize, ranging from \$15,000 to the record \$362,000. That record prize was won by Carrizozo resident Rodney Zamora and his family. New Mexico Lottery players claimed more than \$4.1 million in Roadrunner Cash prizes.

Pick 3

Sales grew for New Mexico's newest on-line game, Pick 3, which continued to develop a growing player base. Unlike other New Mexico on-line games, only three numbers are chosen for each drawing. Players have nine different ways to win eight different prize levels, ranging from \$5 to \$500.

Pick 3 sales totaled \$2.1 million for Fiscal Year 2004. Pick 3 sales increased 10.5 percent over Fiscal Year 2003. Unchanged from the previous year, Pick 3 accounted for about 1.4 percent of Lottery gross sales. There were 675 \$500 top prize winning tickets. New Mexico Lottery players claimed \$1.2 million in Pick 3 prizes.

MARCH 12, 2004

Rodney Zamora of Carrizozo claims record \$362,000 Roadrunner Cash prize



\$10.2 Million

In Commissions and Incentives Paid to New Mexico Lottery Retailers

Retailers and New Programs

There were 1,173 authorized New Mexico Lottery retailers at the beginning of Fiscal Year 2004. Over the year there were 61 new retailers added and 105 retailers removed, for a net loss of 44 retailers. These changes reflect primarily non-Lottery related matters, including store closures, mergers, consolidations or ownership changes. Each ownership change registers as one closed retailer and one new retailer. The NMLA ended Fiscal Year 2004 with 1,129 authorized retailers.

Retailers serve as front-line representatives of the Lottery. They handle tens of millions of Lottery transactions every year. As authorized agents for Lottery games, they sell tickets and provide player instructions. And they also help educate New Mexicans by providing brochures, messages and information about issues as diverse as the Lottery Success Scholarship, responsible gaming and scams which may target our citizenry.

Since the beginning, the Lottery has recognized the significant role played by retailers. As in prior years, the Lottery hosted an informational exchange for retailers, this year in northern New Mexico. Retailers not only received up-to-date details and future plans from Lottery management, but management received ideas and suggestions from retailers. Similar forums will be planned in future fiscal years for other portions of New Mexico.

Through sales and cashing commissions, plus winning ticket and promotional incentives, NMLA retailers earned a record \$10.2 million in compensation during the fiscal year. That was more than \$700,000 higher than the previous year.

*First "\$100,000 Bankroll"
scratcher won by Karen Keeley
of Farmington*



Retailers from across northern New Mexico were invited to join Lottery representatives at an informational exchange in Santa Fe.

New Mexico's overall top retailer locations for FY 2004, by sales, were:

1. Cigarette Outlet, Santa Teresa
2. McNutt Howdy's Shell Foodmart #10, Santa Teresa
3. Sunland Park Grocery, Sunland Park
4. Stires Mini Mart, Chaparral
5. Circle K #379, Albuquerque (*)
6. Stires Supermarket, Chaparral
7. Food Jet #1, Carlsbad
8. J & S (John Brooks) Supermarket, Albuquerque
9. Lowe's Supermarket #55, Alamogordo
10. JR's Fuel Stop #813, Raton

The ten largest chains, representing overall sales rankings, are:

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

(*) Previously sold Powerball jackpot winner
(**) Merged with Conoco during FY 2004

Other Developments

During the New Mexico Lottery's Eighth Full Year of Operations

The fiscal year began with the Lottery, its contracted retailers statewide and the Lottery's on-line gaming system provider, GTECH, joining the New Mexico State Police and local law enforcement agencies as Amber Alert participants. The program helps locate missing or kidnapped children. A child's name, age, weight, height, hair and eye color and, when possible, suspect and vehicle description, will be posted.

Once notified by New Mexico State Police, the Lottery transmits a short Amber Alert message, which is displayed on retailers' Lottery terminal screens. Retailers then print out copies of the detailed alert, posting information in a Lottery-provided Amber Alert display. These actions add hundreds of extra "eyes and ears" across the State. Retailers provide extra copies for customers, and a number of high-volume retailers with Lottery lighted electronic display (L-E-D) signage also flash the information on their equipment.

The program is named for nine-year old Amber Hagerman, who was abducted in Arlington, Texas, and later found murdered. About 33 state lotteries nationwide now participate in the Amber Alert program, or will shortly. GTECH has already helped launch Amber Alert efforts for 18 U.S. lotteries.

- One of the most significant developments in Lottery operations during the fiscal year involved strategic and contractual changes to the instant ticket printing, distribution and management processes.

As part of the contract with the ticket printer, Scientific Games International, extensive planning and programming efforts throughout the year led to the implementation of a customer relationship management (CRM) system during the fourth quarter of Fiscal Year 2004. This CRM system will assist the Lottery to more effectively manage retailer ticket inventories.

The CRM system, however, was just one component of the new Scientific Games contract. Previously, the cost of printing tickets varied, depending upon factors such as the number of tickets printed, the size of the tickets, the number of games printed at the same time, the number of colors on the ticket and the finishes placed on the ticket. Consequently, the cost per ticket changed from game to game. In addition, the Lottery paid for the tickets

upon printing and delivery to the Lottery at the specific inventory cost, and expensing the tickets when they were shipped to the retailer. As indicated in this and the previous annual report, the Lottery signed a new contract with its ticket printer effective in March 2003. Under this new contract, the Lottery pays for instant tickets as they are sold based upon a percentage of sales. The cost



Lottery Authority CEO Tom Shabeen (left) and State Police Chief Carlos Maldonado (right) announce the Lottery's participation in the Amber Alert program during a news conference at Albuquerque retailer Winners Chevron #63 (Conway Oil).

for the tickets under this contract has proven to be less than the average cost for tickets in previous years. While instant ticket sales grew more than eight percent in Fiscal Year 2004, ticket vendor fees were reduced due to the new contract printing fees.

- Internal auditors for the Lottery completed a comprehensive Lottery-wide risk assessment. This was done in conjunction with the preparation of the annual audit plan.

*Six members of the Tobyas family
of Albuquerque split \$195,000
Roadrunner Cash prize*

Other Developments

During the New Mexico Lottery's Eighth Full Year of Operations -contin-

- Statutory changes required the Lottery to seek new bids for an external independent auditor. The successful bidder was Neff + Ricci LLP of Albuquerque.
- The Lottery moved from live drawings to an animated program featuring that night's Roadrunner Cash and Pick 3 winning numbers. The move to the new technology provided long-term cost savings. It also enabled the Lottery to show both drawings in one break during a 10 pm newscast. By providing the animated drawing show components to the local Univision affiliate, KLUZ, the drawing results were also made immediately available to a Spanish-language audience.
- The Lottery's security division began preparations to change the methods of the nightly on-line drawings from a traditional ball machine to a state-of-the-art digital draw system. This new process will be launched during Fiscal Year 2005.
- The New Mexico Problem Gambling Alliance received support from the NMLA for a fourth consecutive year. Primary activities for the organization increased public awareness of problem gambling issues during Problem Gambling Awareness Week. Several non-profit organizations and governmental agencies formed the Alliance to explore gaming issues and serve as a focal point for resources directed to the prevention of problem gaming, as well as treatment and assistance options for current problem gamblers in New Mexico. Three goals of this Alliance are Awareness, Education and Treatment. The Lottery's participation included distribution of problem gambling awareness information and brochures.
- In addition, the Lottery continued the dissemination of its "Play it Safe" and "Please Play Responsibly" messages in both print and broadcast advertising. The Lottery also maintained its fiscal support of the New Mexico Council on Problem Gambling and its toll-free help line accessible from anywhere in New Mexico 24 hours-per-day. In Fiscal Year 2004, the Lottery and the New Mexico Council on Problem Gambling entered into a new annual contract that includes up to three one-year extensions.

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



New animated game balls, each designed with individual personalities, were launched in October 2003. The popular Roadrunner Cash and Pick 3 fixtures were featured during televised drawing results on KRQE and KLUZ in Albuquerque, KBIM in Roswell and KREZ in Durango/Farmington.

JUNE 6, 2004

Lottery launches new customer relationship management (CRM) software, designed to better manage scratcher inventory

The New Mexico Lottery in the Community

Events, Sponsorships and Special Programs

The \$200 million milestone return to the State provided the New Mexico Lottery with unique opportunities for community participation. Beginning in February and continuing through April, events integrating advertising and public relations efforts were held in retail locations across New Mexico. In addition to sales and marketing staff, the entire Lottery management team participated in one or more of these events, interacting with media, players and retailers about their roles at the Lottery and thanking all for the support that enabled the Lottery to reach the \$200 million mark.

Throughout the year, the Lottery participated in numerous community events and activities providing the Lottery the opportunity to sell Lottery products and answer questions about Lottery games and the Lottery Success Scholarship. Others, such as intercollegiate sports sponsorships, provided additional exposure for the Lottery directly with its educational beneficiaries.

Promotional activities during FY 2004 included:

- Albuquerque Isotopes minor league professional baseball team
- Albuquerque Summerfest
- Bike Night on Route 66 – Albuquerque
- Chili Cook-Off – Carlsbad
- Eastern New Mexico University Athletics – Portales
- Fathers Day at the Aquarium – Albuquerque
- Fiesta del Cinco – Albuquerque
- Great American Duck Race – Deming
- Journal Pavilion Concert Series – Albuquerque
- Lea County Fair – Lovington
- Mother Road Rally – Tucumcari
- New Mexico College Awareness Coalition - Statewide
- New Mexico Scorpions minor league professional hockey team
- New Mexico State University Athletics – Las Cruces
- Numerous radio remotes promoting Lottery games and the Lottery Success Scholarship, held in conjunction with local retailers
- Problem Gaming Day (State Fair) – Albuquerque
- Speedway of Southern New Mexico – Las Cruces
- University of New Mexico Athletics – Albuquerque
- Western New Mexico University Athletics – Silver City
- Whole Enchilada Fiesta – Las Cruces



A Lottery player in Farmington prepares to spin the prize wheel at a player appreciation event. Multiple events were held statewide to celebrate the \$200 Million milestone in money raised for New Mexico education.



Keith Padilla of Albuquerque was the winner of a Lottery-sponsored halftime promotion during a men's basketball game at the University of New Mexico. That night's nationally-televised game was also sponsored by Citadel Broadcasting Corporation radio stations KKOB and KNML, Comcast Corporation and ESPN.

JUNE 11, 2004

21 members of the Roswell business exchange "Tips Club" split \$100,000 Powerball prize



\$148.7 Million

In Gross Ticket Sales for the New Mexico Lottery

Fiscal Year 2004: A Financial Overview

The New Mexico Lottery marked its eighth anniversary of sales in April 2004 and began its ninth year of business. Sales and net income once again exceeded projections for a fifth consecutive year.

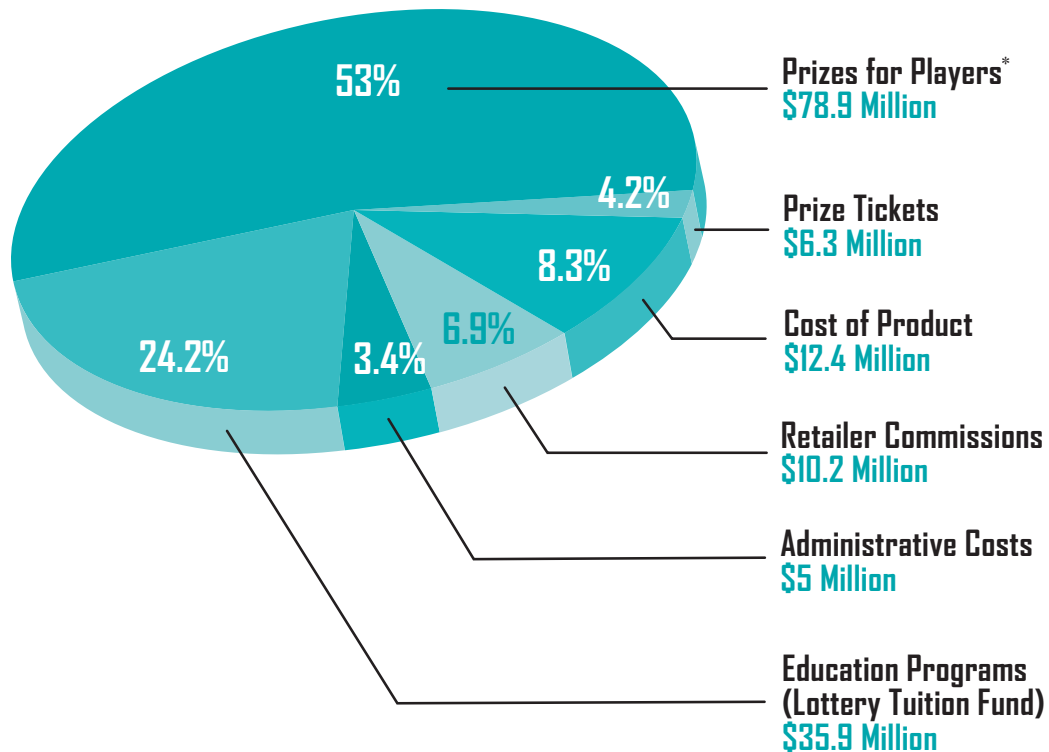
Gross revenues totaled approximately \$148.7 million, with a record profit of \$35.9 million for New Mexico education programs. All Lottery net proceeds were statutorily earmarked for the Lottery Tuition Fund, which finances the Lottery Success Scholarship program for in-state college tuition.

Sales revenues were approximately \$11.7 million higher than the previous fiscal year, and net profits for the Lottery Success Scholarship were \$2.8 million higher than the previous year.

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

Where \$148.7 Million in Ticket Sales Go

(rounded)



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

Historical Review

A History of New Mexico Lottery Performance

The following is a history of New Mexico Lottery gross sales and net revenues since inception. Each full year has set a sales record. Fiscal Year 1996 sales were only about nine weeks long; all other fiscal years run July 1 – June 30. Of the total amount of money transferred for New Mexico education, almost \$66.6 million was used for school construction and repairs from Fiscal 1997 through Fiscal Year 2001.

All annualized figures are rounded.

	<i>Gross Sales</i>	<i>Net Profits for Public Education</i>
FY '96	\$28.5 Million(*)	\$6.3 Million
FY '97	\$82.2 Million ↑	\$21.9 Million ↑
FY '98	\$84.9 Million ↑	\$20.1 Million ↓
FY '99	\$89.2 Million ↑	\$19.6 Million ↓
FY '00	\$110.6 Million ↑	\$24.5 Million ↑
FY '01	\$115.6 Million ↑	\$25.9 Million ↑
FY '02	\$133.9 Million ↑	\$29.6 Million ↑
FY '03	\$137.0 Million ↑	\$33.1 Million ↑
FY '04	\$148.7 Million ↑	\$35.9 Million ↑
TOTALS:	\$930.6 Million	\$216.9 Million
Lottery Success Scholarship/Lottery Tuition Fund:		\$150,418,985 (1996 to 2004)
Public School Capital Outlay Fund:		\$66,553,850 (1996 to 2001)
Cumulative Total Through Fiscal Year 2004:		\$216,972,835

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

12,288

Spring Semester Lottery Success Scholarships

Spring 2004 Semester

Name of School	Students	Total LSS Awards (Fall '97 – Spring '04)
FOUR YEAR UNIVERSITIES		
Eastern New Mexico University - Main Campus, Portales	711	\$ 5,551,474
New Mexico Highlands University – Las Vegas ⁽¹⁾	218	\$ 1,810,221
New Mexico Institute of Mining and Technology – Socorro	315	\$ 2,793,997
New Mexico State University – Las Cruces (Main Campus)	3,415 ▲	\$ 33,139,812
University of New Mexico – Albuquerque (Main Campus)	5,264 ▲	\$ 53,904,467
Western New Mexico University – Silver City	143 ▲	\$ 996,774
TWO-YEAR BRANCH COLLEGES		
Eastern New Mexico University – Roswell	169 ▲	\$ 485,812
Eastern New Mexico University – Ruidoso	32 ▲	\$ 54,633
New Mexico State University – Alamogordo	105	\$ 473,365
New Mexico State University – Carlsbad	13	\$ 432,347
New Mexico State University – Doña Ana	300 ▲	\$ 790,131
New Mexico State University – Grants	48	\$ 164,980
University of New Mexico – Gallup	81 ▲	\$ 253,733
University of New Mexico – Los Alamos	81 ▲	\$ 263,686
University of New Mexico – Taos	36	\$ 109,830
University of New Mexico – Valencia (Los Lunas)	120	\$ 549,776
INDEPENDENT COMMUNITY/JUNIOR COLLEGES		
Albuquerque Technical Vocational Institute	572 ▲	\$ 1,241,534
Clovis Community College	102 ▲	\$ 252,368
Luna Community College – Las Vegas ⁽¹⁾⁽²⁾	0	\$ 27,150
Mesalands Community College – Tucumcari ⁽³⁾	28	\$ 106,547
New Mexico Junior College –Hobbs	58	\$ 261,554
New Mexico Military Institute – Roswell	8	\$ 89,231
Northern New Mexico Community College – Española & El Rito ⁽¹⁾	62	\$ 310,760
San Juan College – Farmington	270 ▲	\$ 450,000
Santa Fe Community College	137	\$ 426,656
TOTAL CAMPUSES – 25⁽¹⁾		
TOTAL STUDENTS SPRING 2004 SEMESTER⁽⁴⁾⁽⁵⁾	12,288 ▲	
TOTAL since inception⁽⁴⁾⁽⁵⁾		\$104,940,838

Appropriated by New Mexico Commission on Higher Education for the Lottery Success Scholarship Program Through FY 2004⁽⁴⁾

Fall '97	\$ 1,398,445	(2,192 students)
Spring '98	\$ 3,024,521	(5,087 students)
Fall '98	\$ 2,809,491	(4,139 students)
Spring '99	\$ 5,230,796	(7,802 students)
Fall '99	\$ 5,001,758	(6,406 students)
Spring '00	\$ 7,686,597	(10,014 students)
Fall '00	\$ 6,773,604	(7,593 students)
Spring '01	\$ 8,849,942	(10,429 students)
Fall '01	\$ 8,369,094	(8,181 students)
Spring '02	\$10,605,208	(11,001 students)
Fall '02	\$ 9,532,303	(8,875 students)
Spring '03	\$11,735,843	(11,352 students)
Fall '03	\$10,833,452	(9,608 students)
Spring '04	\$13,089,784	(12,288 students)
TOTAL	\$104,940,838⁽⁴⁾	

(1) Some satellite campuses are reflected in the main campus information
 (2) LCC was formerly known as Luna Vocational Technical Institute
 (3) MCC was formerly known as Mesa Technical College
 (4) LSS debits and student count may be adjusted by CHE in subsequent semesters, pending reviews, audits and/or appeals; these may also reflect minor financial differences due to overall decimal point rounding, and are statistically insignificant
 (5) This figure will always differ from the transfer amounts shown on the following page, because of official reconciliation and adjustments between CHE and the various institutions
 (▲) Reflects record LSS enrollment for the Spring '04 semester

32,120

High School Graduates Have Received Lottery Success Scholarships Since Inception

**Lottery Success Scholarship Program Student Count By County
Fall 1997 – Spring 2004**

County	Attended College ⁽¹⁾	Total Grads ⁽²⁾	Total Awards
Bernalillo	9,585	2,631	\$ 37,450,487
Catron	53	18	\$ 195,915
Chaves	1,149	291	\$ 2,771,863
Cibola	422	150	\$ 1,173,256
Colfax	200	55	\$ 684,259
Curry	902	255	\$ 1,998,997
De Baca	61	17	\$ 164,786
Doña Ana	3,360	975	\$ 11,933,605
Eddy	1,115	330	\$ 3,073,045
Grant	572	179	\$ 1,843,423
Guadalupe	67	21	\$ 170,693
Harding	42	19	\$ 139,021
Hidalgo	89	32	\$ 354,493
Lea	884	289	\$ 1,315,767
Lincoln	315	95	\$ 918,211
Los Alamos	574	171	\$ 2,175,016
Luna	255	67	\$ 752,198
McKinley	855	224	\$ 2,090,223
Mora	105	28	\$ 326,594
Otero	1,101	382	\$ 3,387,229
Quay	232	55	\$ 596,992
Rio Arriba	926	326	\$ 2,592,728
Roosevelt	476	122	\$ 1,270,959
San Juan	1,755	553	\$ 3,862,176
San Miguel	575	182	\$ 1,789,802
Sandoval	1,415	292	\$ 4,998,910
Santa Fe	2,133	559	\$ 6,796,868
Sierra	122	36	\$ 453,865
Socorro	214	76	\$ 719,052
Taos	459	130	\$ 1,379,991
Torrance	243	59	\$ 776,931
Union	76	26	\$ 244,299
Valencia	1,338	375	\$ 3,887,945
Other ^(*)	314	70	\$ 618,944
No Response	136	26	\$ 444,189
TOTAL:	32,120⁽⁴⁾	9,116	\$ 103,352,732⁽³⁾

Source: New Mexico Commission on Higher Education, (800) 279-9777 / www.nmche.org

The Lottery previously provided \$66,553,850 to the Public School Capital Outlay Fund for State-awarded school construction and repair grants; following action by the New Mexico Legislature, the Lottery's contribution to this fund ended in Fiscal Year 2001 and the last grants made with Lottery revenues occurred in Fiscal Year 2002

This report was prepared using the institution-supplied student and student financial aid files

Rio Rancho High School's first graduating class was in FY 1999; some student data may be split between Bernalillo and Sandoval Counties

(*) Refers to New Mexico students who graduated from a Texas or Arizona high school under a reciprocal agreement with the State Department of Public Education and Arizona residents on the Navajo Reservation who qualify for Lottery Success Scholarships

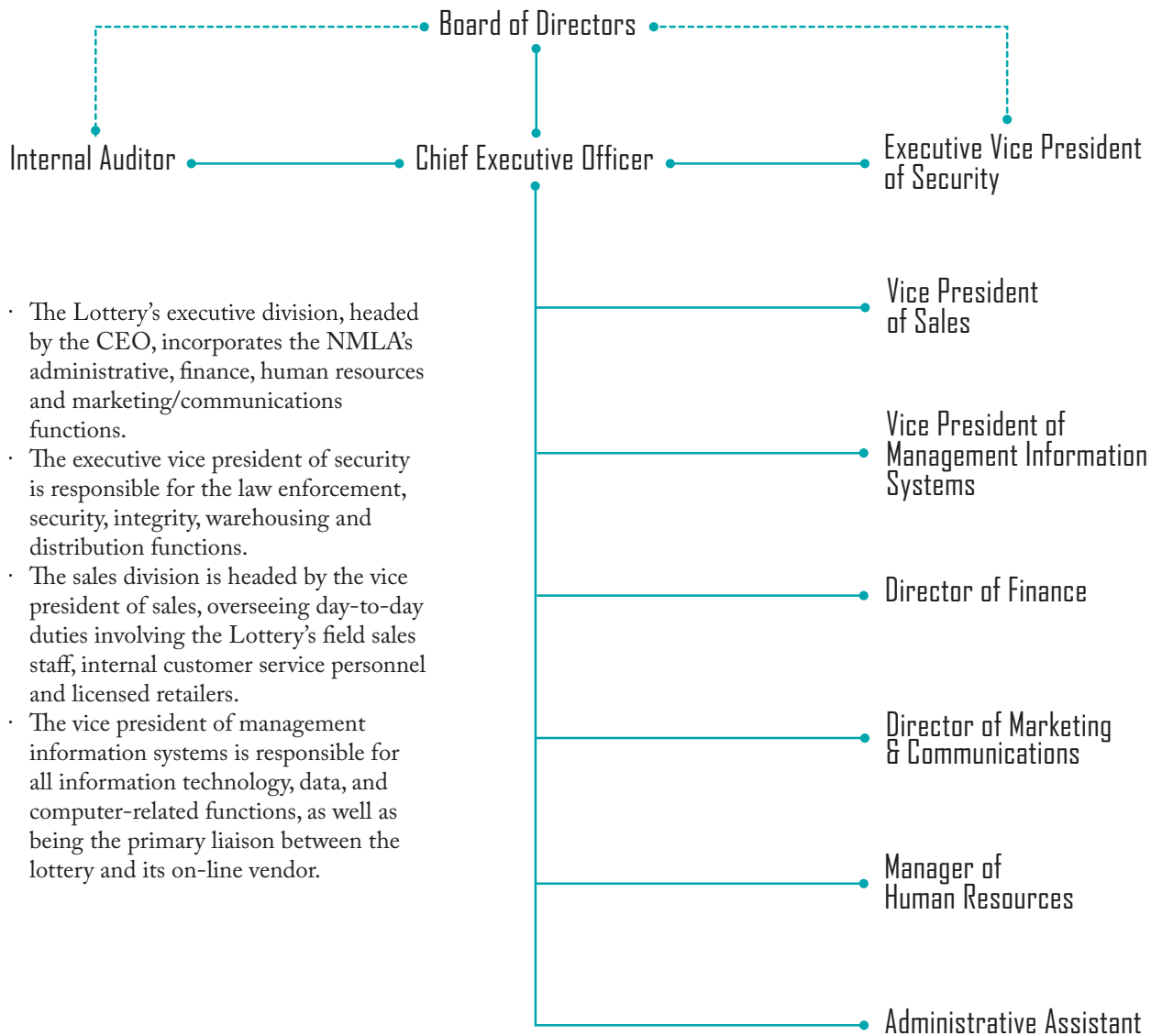
Student count is cumulative and includes all students that were awarded a Lottery Success Scholarship at any time

Graduates and degrees may include duplicates if a student attained more than one degree – i.e., a student received an Associates degree and continued for a Bachelors degree; degrees include bachelors, associate, certificate and professional; some graduate students are also included, because their Lottery scholarships applied to undergraduate tuition that was part of their simultaneous graduate programs

- (1) Based on data submitted by institutions
- (2) Graduates so far; non-graduates may still be enrolled, may no longer be on LSS, or may have left the institution
- (3) This figure will always differ from the transfer amounts shown on the previous page, due to official reconciliation and adjustments between CHE and the various institutions
- (4) Some students may be counted more than once because of transfers or other factors, according to CHE

Organizational Chart

New Mexico Lottery Authority (Direct Reports)



- The Lottery's executive division, headed by the CEO, incorporates the NMLA's administrative, finance, human resources and marketing/communications functions.
- The executive vice president of security is responsible for the law enforcement, security, integrity, warehousing and distribution functions.
- The sales division is headed by the vice president of sales, overseeing day-to-day duties involving the Lottery's field sales staff, internal customer service personnel and licensed retailers.
- The vice president of management information systems is responsible for all information technology, data, and computer-related functions, as well as being the primary liaison between the lottery and its on-line vendor.

Independent Auditors' Report

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

We have audited the accompanying basic financial statements of the State of New Mexico Lottery Authority (Lottery), a blended component unit of the State of New Mexico, as of and for the year ended June 30, 2004. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the New Mexico Lottery Authority for the year ended June 30, 2003, were audited by other auditors whose report dated September 5, 2003, expressed an unqualified opinion on those statements.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2004, and the changes in its financial position and cash flows where applicable, thereof and the respective budgetary comparison, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 3, 2004 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

For the year ended June 30, 2004, the New Mexico Lottery Authority has not presented in this annual report the Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of the basic financial statements.



Albuquerque, New Mexico
September 3, 2004

NEW MEXICO LOTTERY AUTHORITY

STATEMENTS OF NET ASSETS

June 30, 2004 and 2003

	2004	2003
CURRENT ASSETS		
Cash	\$ 3,049,084	\$ 2,852,217
Accounts receivable (net of allowance for doubtful accounts)	1,751,903	2,574,639
Reserves on deposit	2,667,769	3,575,676
Inventory	17,377	241,261
Prepaid expenses	104,879	95,869
Total current assets	7,591,012	9,339,662
CAPITAL ASSETS, NET		
Total assets	942,876	619,324
CURRENT LIABILITIES		
Accounts payable and other current liabilities	\$ 2,304,373	\$ 2,669,549
Current portion of capital lease obligation	141,454	-
Prizes payable	3,057,302	4,222,533
Due to lottery tuition fund	2,733,214	3,016,904
Total current liabilities	8,236,343	9,908,986
LONG-TERM LIABILITIES		
Noncurrent portion of capital lease obligation	247,545	-
Total liabilities	\$ 8,483,888	\$ 9,908,986
NET ASSETS		
Invested in capital assets, net of related debt	\$ 553,877	\$ 619,324
Net assets – Restricted	50,000	50,000
Unrestricted net assets	(553,877)	(619,324)
Total net assets	\$ 50,000	\$ 50,000

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

NEW MEXICO LOTTERY AUTHORITY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Years ended June 30, 2004 and 2003

	2004	2003
REVENUES		
Instant ticket sales	\$87,019,208	\$80,246,191
Powerball sales	51,473,388	47,475,815
Roadrunner Cash sales	8,067,945	7,373,482
Pick 3 sales	2,091,054	1,916,140
Retailer fees	31,523	30,038
Prize tickets	(6,292,089)	(3,710,114)
Spoiled, stolen, and promotional tickets	(73,864)	(81,845)
Total revenues	142,317,165	133,249,707
GAME EXPENSES		
Prize expense	78,875,562	73,945,533
Retailer commissions	10,131,112	9,415,801
On-line vendor fees	6,997,562	6,696,618
Advertising	2,494,471	2,481,138
Ticket vendor fees	1,236,725	1,290,129
Shipping and postage	415,019	396,776
Instant ticket vending machine lease	394,200	394,200
Promotions	379,011	417,575
Game membership	208,484	138,615
Drawing game	134,997	146,447
Reserve Fund expense	91,027	(38,792)
Total game expenses	101,358,170	95,284,040
OPERATING EXPENSES		
Salaries, wages, and benefits	3,581,334	3,496,504
Leases and insurance	599,606	596,028
Utilities and maintenance	368,217	341,205
Depreciation and amortization	332,085	314,889
Professional fees	176,633	135,474
Other	90,979	116,783
Materials and supplies	77,615	102,197
Travel	76,282	75,264
Total operating expenses	5,302,751	5,178,344
OPERATING INCOME	35,656,244	32,787,323
NON-OPERATING INCOME		
Other income	180,199	159,437
Interest income	99,952	146,637
Total non-operating income	280,151	306,074
Net income before transfers	35,936,395	33,093,397
Transfers to Lottery Tuition Fund	(35,936,395)	(33,093,397)
Change in net assets	-	-
Net assets at beginning of year	50,000	50,000
Net assets at end of year	\$ 50,000	\$ 50,000

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

NEW MEXICO LOTTERY AUTHORITY

BUDGET TO ACTUAL COMPARISON STATEMENTS

Years ended June 30, 2004 and 2003

	2004				2003		
	Original Budget	Revised Budget	Actual	Variance with Revised Budget	Original Budget*	Actual	Variance with Revised Budget
Revenues							
Instant ticket Sales	\$ 81,000,000	\$ 84,200,000	\$ 87,019,208	\$ 2,819,208	\$ 80,000,000	\$ 80,246,191	\$ 246,191
Powerball sales	45,000,000	51,000,000	51,473,388	473,388	33,000,000	47,475,815	14,475,815
Roadrunner Cash sales	7,800,000	7,300,000	8,067,945	767,945	7,500,000	7,373,482	(126,518)
Pick 3 sales	2,000,000	2,000,000	2,091,054	91,054	1,500,000	1,916,140	416,140
Retailer fees	24,000	32,000	31,523	(477)	24,000	30,038	6,038
Prize tickets	(5,000,000)	(6,500,000)	(6,292,089)	207,911	(5,850,000)	(3,710,114)	2,139,886
Spoiled, stolen, and promotional tickets	(174,000)	(132,000)	(73,864)	58,136	(174,000)	(81,845)	92,155
Total revenues	130,650,000	137,900,000	142,317,165	4,417,165	116,000,000	133,249,707	17,249,707
Total game expenses	95,469,000	98,831,000	101,358,170	(2,527,170)	83,821,000	95,284,040	(11,463,040)
Total operating expenses	6,268,000	5,763,000	5,302,751	460,249	6,333,000	5,178,344	1,154,656
Operating income	28,913,000	33,306,000	35,656,244	2,350,244	25,846,000	32,787,323	6,941,323
Total non-operating income	256,000	286,000	280,151	(5,849)	310,000	306,074	(3,926)
Net income before transfer to Lottery Tuition Fund	\$ 29,169,000	\$ 33,592,000	\$ 35,936,395	\$ 2,344,395	\$ 26,156,000	\$ 33,093,397	\$ 6,937,397

*There were no revisions to the 2003 Original Budget.

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

NEW MEXICO LOTTERY AUTHORITY

STATEMENTS OF CASH FLOWS

Years ended June 30, 2004 and 2003

Increase (Decrease) in Cash

	2004	2003
Cash flows from operating activities		
Cash received:		
From retailers—sales net of commissions, incentives, and prize, spoiled, and stolen ticket credits	\$ 133,008,789	\$ 122,279,986
Cash payments:		
To prize winners and related taxes	(63,044,549)	(58,412,605)
To suppliers of goods or services	(14,319,714)	(13,147,231)
To employees for services and related taxes	(2,920,821)	(3,018,078)
To MUSL	(16,996,244)	(13,653,268)
Net cash provided by operating activities	35,727,461	34,048,804
Cash flows from investing activities		
Deletions/(additions) to MUSL Reserve Accounts	819,224	(1,061,384)
Receipts of interest	29,372	38,947
Receipts of rent	113,304	109,704
Other	78,290	10,581
Net cash provided (used) in investing activities	1,040,190	(902,152)
Cash flows from noncapital financing activities		
Transfers to Lottery Tuition Fund	(36,220,085)	(32,080,221)
Cash flows from capital and related financing activities		
Purchases of capital assets	(350,699)	(359,764)
NET INCREASE IN CASH	196,867	706,667
Cash at beginning of year	2,852,217	2,145,550
Cash at end of year	\$ 3,049,084	\$ 2,852,217

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

STATEMENTS OF CASH FLOWS - CONTINUED

Years ended June 30, 2004 and 2003

Increase (Decrease) in Cash

	<u>2004</u>	<u>2003</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 35,656,244	\$ 32,787,323
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	332,085	314,889
Additional contributions to MUSL Reserve Accounts	57,732	184,428
Portion of Unclaimed Powerball Grand Prize	-	876,956
Interest on MUSL Unreserved Account	70,580	107,690
Vendor's non-cash transactions	(11,395)	946
Net changes in assets and liabilities:		
Accounts receivable	822,736	(1,553,920)
Reserves on deposit	30,951	(1,031,470)
Inventory	223,884	186,683
Prepaid expenses	(9,010)	39,646
Accounts payable and other liabilities	(223,722)	223,738
Lawsuit liability	-	38,206
Accrued capital purchases	(57,393)	(5,971)
Prizes payable	(1,165,231)	1,879,660
Net cash provided by operating activities	<u>\$ 35,727,461</u>	<u>\$ 34,048,804</u>

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2004 and 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**1. Reporting Entity**

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

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

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

2. Basis of Presentation

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

In accordance with Governmental Accounting Standards Board (GASB) Statement Number 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Lottery has elected to follow

2. Basis of Presentation - continued

all GASB pronouncements, and all Statements and Interpretations of the Financial Accounting Standards Board, Opinions of the Accounting Principles Board, Accounting Research Bulletins, and authoritative pronouncements of the American Institute of Certified Public Accountants, issued on or before November 30, 1989 (collectively representing the generally accepted private-sector accounting hierarchy in the United States of America). In instances where GASB guidance conflicts with private sector principles, the Lottery conforms to GASB.

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

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

The Lottery distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing goods and services in connection with the Lottery's principal ongoing operations. The principal operating revenues of the Lottery are sales of instant and on-line tickets. Operating expenses include administrative expenses required to manage and operate the Lottery. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

3. Budgets and Budgetary Accounting

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

4. Cash

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2004 and 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued***5. Restricted Cash**

The Lottery was required by the terms of its main office building lease agreement to deposit an amount equal to five months of rent in an interest-bearing escrow account. Accrued interest on the security deposit has been paid monthly to the Lottery. The amount of the security deposit was reduced every six months, beginning six months from the occupancy date, by an amount equal to one month's rent until the security deposit equaled the amount of one month's rent, which will remain the required security deposit for the balance of the term. The restricted cash is held in an escrow account at an interest rate of less than 1%. At June 30, 2004 and 2003, restricted cash balances were \$22,086 and \$21,997, respectively.

6. Accounts Receivable

Accounts receivable represent the unremitted receipts on ticket sales, net of retailer commissions and prizes paid by the retailers. Receipts are transferred weekly from retailer bank accounts to the Lottery. Credit losses relating to contracted retailers have been within management expectations. Generally, collateral is not required on receivables. At June 30, 2004 and 2003, an allowance for doubtful accounts of \$118,931 and \$130,744, respectively, has been provided to recognize future uncollectible billings.

7. Reserves on Deposit

The Lottery is a member of the Multi-State Lottery Association (MUSL), which operates games on behalf of participating lotteries. MUSL operates the POWERBALL® (Powerball) game and Powerball Instant Millionaire TV Game Show for the Lottery. Each MUSL member sells Powerball game tickets through its retailers and makes weekly wire transfers to MUSL in an amount equivalent to the member lottery's share of the estimated grand prize liability. Lesser prizes are paid directly to the winners by each member lottery. The prize pool for Powerball is 50% of each drawing period's sales. MUSL has included 2% of each drawing period's sales as part of each MUSL member's prize liability in prize reserve funds. MUSL has placed a \$100,000,000 cap on the prize reserve funds and once the prize reserve funds exceed this designated cap, the excess becomes part of

7. Reserves on Deposit - *continued*

the prize pool. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities and the money in this reserve fund is to be used at the discretion of the MUSL Board of Directors. The prize reserve fund monies are refundable to MUSL members if MUSL disbands or if a member leaves MUSL. Members leaving MUSL must wait one year before receiving their remaining share, if any, of the prize reserve funds. The Lottery also has an unreserved fund with MUSL. Interest earned on the MUSL funds and any unclaimed grand prizes may be deposited into this account and game membership fees and other MUSL costs may be paid from this fund. At June 30, 2004 and 2003, the Lottery's share of the Powerball prize reserve was \$2,601,102 and \$2,543,370, respectively, and the Lottery's share of the Powerball unreserved fund was \$66,667 and \$1,032,306, respectively.

A winner of a Powerball grand prize may select that the prize be paid at the cash value of the prize or as an annuity. A grand prize annuity is paid out in 30 installments. Bonds at the discounted value of grand prize annuity are purchased by MUSL to fund all future installments and are held in trust. Bond maturities are staggered in order to provide adequate cash flow for each annual installment. These assets and related liabilities are reflected in MUSL's financial statements and therefore are not reflected in the Lottery's financial statements. MUSL is responsible for transferring the cash or the annuity installment amounts to the member lottery prior to the payment to the grand prize winner. The Lottery currently is not paying any prize winner any annuity prize payments.

8. Inventory

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2004 and 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

9. Capital Assets

Capital assets, which include data processing software and hardware, tenant improvements, vehicles, and equipment are stated at cost net of accumulated depreciation. The Lottery capitalizes all capital assets that have a cost greater than \$1,000 and an expected useful life of more than one year. Depreciation is computed using the straight-line method over the estimated useful lives of 2 to 5 years, except for leasehold improvements, which are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the results from operations in the period of disposal.

10. Revenue and Accounts Receivable Recognition

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

11. Prizes

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

12. Commissions

Retailers receive a commission of 6% on gross ticket sales and a 1% cashing commission on winning ticket validations for prizes up to \$599.

13. Advertising Costs

Advertising costs are expensed as incurred.

14. Income Taxes

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

15. Cash and Concentrations of Credit Risk

At June 30, 2004, the Lottery's cash deposits were categorized to give an indication of the level of risk assumed by the Lottery. Category One includes cash on hand, deposits insured by federal depository insurance, or amounts collateralized with securities held by the Lottery or by its agent in the Lottery's name. Category Two includes deposits collateralized with securities held by the pledging financial institution's trust department or agent in the Lottery's name. Category Three represents uncollateralized deposits and bank balances collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the Lottery's name. The Company maintains its cash balances in one financial institution. The balances for demand deposits are insured by the Federal Deposit Insurance Corporation up to \$100,000 for this financial institution. The Lottery does not believe it is exposed to any significant credit risk with respect to its cash balances.

The following is a reconciliation of cash balances to the financial statements:

	Category			Bank Balance	Carrying Amount
	One	Two	Three		
Demand deposits	\$ 25,481	\$ 3,076,535	\$ -	\$ 3,102,016	\$ 3,046,584
Cash on hand	2,500	-	-	-	2,500
Total	\$ 27,981	\$ 3,076,535	\$ -	\$ 3,102,016	\$ 3,049,084

In fiscal years 2004 and 2003, ten customers (420 retailer locations) represented 44% and 45% of sales and 43% and 46% of accounts receivable, respectively.

16. Bank Accounts

Description	Bank	Balance per Bank
Operating account-checking	Bank of America	\$3,079,930
Payables account-checking	Bank of America	-
Receiving account-checking	Bank of America	-
Payroll account-checking	Bank of America	-
Prize account-checking	Bank of America	-
Escrow account-investment	Bank of America	22,086
Total amount deposited in bank		3,102,016
Less: FDIC coverage		(25,481)

Total uninsured funds - repurchase agreement \$3,076,535

102% collateral requirement for repurchase agreement \$3,138,066
 *Pledged security (3,138,066)

Amount under (over) requirement at June 30, 2004 \$ -

*Security is held in safekeeping at the Federal Reserve in Richmond, Virginia. Federal National Mortgage Association, presented at fair value, CUSIP Number 31404LX70, matures October 1, 2033.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2004 and 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

16. Bank Accounts - *continued*

Cash per bank at June 30, 2004	\$3,102,016
Less reconciling items – outstanding checks	<u>(55,432)</u>
Reconciled cash in bank at June 30, 2004	<u>\$3,046,584</u>

17. Insurance

The Lottery is exposed to various risks of loss related to torts, theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery has purchased commercial insurance to cover these risks.

18. Reserve Fund

The Act (see note A1) requires that “an amount up to 2% of the gross annual revenues shall be set aside as a Reserve Fund to cover bonuses and incentive plans for Lottery retailers, special promotions for retailers, purchasing special promotional giveaways, sponsoring special promotional events, compulsive gambling rehabilitation and other purposes as the Board deems necessary to maintain the integrity and meet the revenue goals of the Lottery.” Accordingly, the Board of Directors has elected to set aside up to 2% of gross revenues into the reserve account. At June 30, 2004 and 2003, the amounts that had been set aside and expended were \$91,027 and \$(38,792), respectively.

19. Net Assets - Restricted

Any Reserve Fund amounts not expended by fiscal year end for the defined purposes (see note 18) are to be transferred to the Lottery Tuition Fund, except for unexpended amounts up to \$50,000, which can be retained by the Lottery for future defined expenditures.

20. Unclaimed Prizes

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

21. Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

22. Shipping and Handling Costs

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

23. Compensated Absences Payable

Paid time off is accrued at rates specified by the Lottery’s Paid Time Off Policy. Employees are limited on the total accumulated hours they may keep in their respective Reserve Bank. Employees with time in service less than or equal to 5 years may accumulate a maximum of 320 hours and employees with time in service greater than 5 years may accumulate a maximum of 360 hours, any excess is forfeited. During the year ended June 30, 2004, the following changes occurred in the compensated absences liabilities:

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

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2004 and 2003

NOTE B - CAPITAL ASSETS

Capital assets at June 30, 2004 consisted of:

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

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

Capital assets at June 30, 2003 consisted of:

	Beginning Balance	Additions	Deletions	Ending Balance
Data processing software	\$ 1,797,002	\$ -	\$ -	\$ 1,797,002
Data processing equipment	1,555,265	86,568	-	1,641,833
Tenant improvements	647,809	33,004	-	680,813
Vehicles	514,058	240,465	(284,087)	470,436
Equipment - communications	243,035	-	-	243,035
Furniture and fixtures	281,027	4,019	-	285,046
Equipment - drawing	242,002	-	-	242,002
Equipment - warehouse	150,638	-	-	150,638
Equipment - office	42,716	1,679	-	44,395
Capital assets	5,473,552	365,735	(284,087)	5,555,200
Data processing software	(1,771,665)	(8,680)	-	(1,780,345)
Data processing equipment	(1,359,043)	(124,783)	-	(1,483,826)
Tenant improvements	(522,308)	(30,849)	-	(553,157)
Vehicles	(382,825)	(92,826)	284,087	(191,564)
Equipment - communications	(243,035)	-	-	(243,035)
Furniture and fixtures	(281,027)	(201)	-	(281,228)
Equipment - drawing	(178,371)	(49,221)	-	(227,592)
Equipment - warehouse	(147,741)	(2,640)	-	(150,381)
Equipment - office	(19,059)	(5,689)	-	(24,748)
Accumulated depreciation	(4,905,074)	(314,889)	284,087	(4,935,876)
Capital assets, net	\$ 568,478	\$ 50,846	\$ -	\$ 619,324

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2004 and 2003

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

	Net Income	Due to Lottery Tuition Fund	Reserve Fund	Net Assets
Balance at June 30, 2003	\$ 3,066,904	\$ 3,016,904	\$ -	\$50,000
Current year net income	35,936,395	35,936,395	-	-
Current year transfers	(36,220,085)	(36,220,085)	-	-
Balance at June 30, 2004	<u>\$ 2,783,214</u>	<u>\$ 2,733,214</u>	<u>\$ -</u>	<u>\$50,000</u>

In accordance with the Act, the Lottery shall transmit all net revenues monthly to the New Mexico State Treasurer, who shall deposit the net revenues into state agency number 950, the Lottery Tuition Fund, CAS fund number 637. As of August 1, 2004 and 2003, the Lottery has transferred \$35,936,395 and \$33,093,397, respectively, for the periods ended June 30, 2004 and 2003 to the New Mexico State Treasurer.

NOTE D - RETIREMENT PLAN

Plan Description

All of the Lottery's eligible employees participate in a plan provided by the Lottery pursuant to the New Mexico Lottery Act (Chapter 6, Article 24 NMSA 1978). The Lottery is the administrator of the Plan, which is a defined contribution money purchase pension plan. The New Mexico Lottery Authority Retirement Plan provides for retirement benefits to plan members and their beneficiaries.

Funding Policy

The Lottery contributes 13.25% of compensation for eligible employees to the Plan. Lottery contributions are 100% vested when deposited monthly.

For the periods ended June 30, 2004 and 2003, the Lottery recognized \$341,145 and \$344,526 of pension expense for the Plan on eligible compensation of

NOTE D - RETIREMENT PLAN - *continued*

Funding Policy - *continued*

\$2,574,679 and \$2,600,196, respectively. Except for the June 2004 and June 2003 contributions, the entire pension expense amounts had been paid to the Plan by June 30, 2004 and 2003, respectively. The June pension contributions were made in July 2004 and 2003, respectively.

Presented below are the June 30, 2004 and 2003 Statements of Fiduciary Net Assets and Statements of Change in Net Assets:

	<u>2004</u>	<u>2003</u>
ASSETS		
Cash and equivalents	\$171,460	\$100,710
Marketable securities and other investments	1,763,656	1,333,556
Contribution receivable	38,216	33,361
Total assets	<u>\$ 1,973,332</u>	<u>\$ 1,467,627</u>
NET ASSETS		
Pension plan participants' benefits	<u>\$ 1,973,332</u>	<u>\$ 1,467,627</u>
	<u>2004</u>	<u>2003</u>
ADDITIONS		
Investment earnings	\$ 225,973	\$ 12,455
Employer contributions	341,145	344,526
Total additions	567,118	356,981
DEDUCTIONS		
Distributions to participants	61,413	80,459
Change in net assets	505,705	276,522
Net assets - beginning	<u>1,467,627</u>	<u>1,191,105</u>
Net assets - ending	<u>\$ 1,973,332</u>	<u>\$ 1,467,627</u>

NOTE E - CREDIT AGREEMENT

The Lottery entered into an unsecured credit agreement with Bank of America in May 2001. The agreement provides an overdraft protection facility for the Lottery's operating bank account in the amount of \$1,000,000, with an interest rate at the Bank of America's Prime Rate of 4.00% at June 30, 2004 and 2003. For the periods ended June 30, 2004 and 2003, the Lottery had no outstanding borrowings against the line. The line matures in May 2005.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2004 and 2003

NOTE F - LEASES

The Lottery has entered into operating leases for the rental of office and warehouse space, and vending machines. Rent expense was \$837,472 and \$820,225 for the years ending June 30, 2004 and 2003, respectively. Certain leases contain provisions for scheduled rental increases for inflationary purposes and are renewable at the option of the Lottery. In August 2002, the Lottery renegotiated its leases for office and warehouse space. These leases were extended for an additional seven years at the same lease amounts that will be paid for the final year of the original lease in 2006. Future minimum rental payments on non-cancelable leases with original terms of one year or more are scheduled as follows:

Year	Amount
2005	\$ 671,879
2006	318,986
2007	314,285
2008	309,485
2009	378,886
2010-2013	1,618,070
	<u>\$ 3,611,591</u>

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

Year	Amount
2005	\$ 108,800
2006	112,500
2007	117,200
2008	122,000
2009	52,600
	<u>\$ 513,100</u>

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

	2004	2003
Minimum rentals	\$ 815,043	\$ 799,467
Less: Sublease rentals	(104,100)	(100,500)
	<u>\$ 710,943</u>	<u>\$ 698,967</u>

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

Years ending June 30:	
2005	\$ 174,950
2006	136,076
2007	140,769
Total minimum payments	<u>451,795</u>
Less the amount representing interest	<u>(62,796)</u>
Present value of net minimum payments	<u>\$ 388,999</u>

NOTE G - COMMITMENT

The Lottery has an agreement for the On-line Gaming System (the GTECH Agreement) with GTECH Corporation (GTECH) until November 20, 2008 at a rate of 8.5236% of on-line sales less than \$60 million. The GTECH Agreement calls for GTECH to provide on-line gaming systems and services, and entitles the Lottery to certain liquidated damages upon the occurrence of defined incidences.

NOTE H - OTHER EXPENSES

Other expenses at June 30, consisted of:

	2004	2003
Training	\$ 31,218	\$ 61,188
Other	28,584	21,292
Registrations and memberships	28,102	31,360
Publications and subscriptions	3,075	2,943
	<u>\$ 90,979</u>	<u>\$ 116,783</u>

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

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

We have audited the financial statements of the New Mexico Lottery Authority (the Lottery) as of and for the year ended June 30, 2004, and have issued our report thereon dated September 3, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted other matters involving the internal control over financial reporting that we have described in the accompanying schedule of findings and responses as items 04-01 to 04-03.

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



Albuquerque, New Mexico
September 3, 2004

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