

**NEW MEXICO
LOTTERY AUTHORITY**

FINANCIAL STATEMENTS

JUNE 30, 2008 and 2007

Moss Adams LLP
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New Mexico Lottery Authority

OFFICIAL ROSTER

June 30, 2008

BOARD OF DIRECTORS

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OFFICIALS OF THE NEW MEXICO LOTTERY AUTHORITY

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Evelyn McKnight	Director of Human Resources
Adriana Binns	Director of Marketing and Communications
Pam Poteat	Director of Sales
David Ramirez	Interim Director of MIS

ORGANIZATIONAL DIVISIONS OF THE NEW MEXICO LOTTERY AUTHORITY

The Executive Division, under the direction of the Chief Executive Officer, provides leadership for all activities of the New Mexico Lottery Authority (the Lottery) to carry out its objectives and overall statutory mission to maximize net revenues for the Lottery's beneficiaries. The division establishes and directs the organization's day-to-day operating strategy and plan. In addition, the division performs as a liaison between the Board, the Governor, the Legislature, governmental entities, external providers of goods and services, retailers, the public and Lottery divisions and employees. Also, within the Executive Division is Product Development, which manages and monitors the instant and online products, including such areas as game launches, game endings, and performance analysis using several key performance indicators.

The Finance Division, under the direction of the Director of Finance, performs all the activities associated with the financial and accounting functions of the Lottery, including the general ledger; cash management; retailer accounts receivable and debt collection; fixed asset accounting; game accounting; payroll and benefit accounting, payment, and review; and tax reporting and payment. In addition, the 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; 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 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 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, payroll, employee insurance reconciliation, employee relations, employment practices and procedures, employee communications and employee events.

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

The Marketing and Communications Division, under the direction of the Director of Marketing and Communications, is responsible for implementing, managing and administering the activities associated with marketing the Lottery and its products, including advertising, communications, television drawings, promotions and special events. This entails creating and producing multi-media advertising campaigns, in-store point of sale materials and player and retailer publications; as well as negotiating and overseeing the

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

Lottery's participation in a number of statewide promotions and special events. The division is also responsible for all aspects of corporate communications including creating news releases and annual reports and responding to requests for information by the public and the media.

The Management Information Systems (MIS) Division, under the direction of the Interim 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, and game management.

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 between the Attorney General's Office, District Attorney offices and law enforcement agencies in general. It is also responsible for building and employee security and safety. The warehouse component of the Security Division is responsible for the packing and shipment of the Lottery's instant scratcher tickets and for the maintenance and shipping of Lottery premium and point of sale items. The division is responsible for the management of building and grounds maintenance.

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Independent Auditors' Report

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

We have audited the accompanying 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, 2008 and 2007, which collectively comprise the Lottery's basic financial statements as listed in the table of contents. We have also audited the budgetary comparison statement presented as supplementary information in the accompanying financial statements for the year ended June 30, 2008, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express opinions on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities, and the aggregate remaining fund information of the Lottery as of June 30, 2008 and 2007, and the changes in its financial position and, where applicable, cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statements referred to above presents fairly, in all material respects, the budgetary comparison statements for the years ended June 30, 2008 and 2007 in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with *Government Auditing Standards*, we have also issued a report dated September 30, 2008 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

The additional schedules listed as supplemental information in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements.

Moss Adams LLP

Albuquerque, New Mexico
September 30, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This Management's Discussion and Analysis of the New Mexico Lottery Authority (the Lottery), offers readers of the Lottery's financial statements a narrative overview and analysis of the financial activities of the Lottery for the fiscal years ended June 30, 2008 and 2007 with comparative numbers for fiscal year ended June 30, 2006. Please read it in conjunction with the financial statements, which begins on page 19.

FINANCIAL HIGHLIGHTS

- At the end of fiscal year 2008, the Lottery's total current assets decreased by 10.1% or \$1,100,067 in comparison to fiscal year 2007, whereas at the end of fiscal year 2007 total current assets had increased by 38.6% or \$3,040,987 in comparison to the close of fiscal year 2006.
- The Lottery's total liabilities decreased by 10.7% or \$1,210,051 at the close of fiscal year 2008, while they increased by 32.9% or \$2,792,054 at the end of fiscal year 2007 in comparison to the end of the previous fiscal year.
- In fiscal year 2008 total revenues were \$147,152,459, a decrease of \$927,795 or (0.6)%, compared to total revenues for the previous fiscal year. In fiscal year 2007 total revenues were \$148,080,254, a decrease of \$1,962,146 or (1.3)%, compared to fiscal year 2006.
- From the previous fiscal years, total game expenses decreased by \$6,456,454, (6.0)%, in fiscal year 2008 and \$27,531, (0.0)%, in fiscal year 2007.
- In fiscal year 2008 total operating expenses decreased by 8.8% or \$509,709, while in fiscal year 2007 operating expenses increased by \$269,322 or 4.9% compared to the prior fiscal year.
- Total non-operating income decreased by \$57,933, (8.1)%, in fiscal year 2008, whereas in fiscal year 2007 it improved from the preceding fiscal year by \$178,517 or 33.4%.
- Net Income in fiscal year 2008 was \$40,810,571, an increase of \$5,980,435 or 17.2% over fiscal year 2007. Net Income in fiscal year 2007 was \$34,830,136, a decrease of \$2,025,420, (5.5)%, from the previous fiscal year's Net Income of \$36,855,556. 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. In fiscal year 2008, the Lottery transmitted 27.61% of its gross revenues to the State in comparison to 23.41% for the previous fiscal year.
- Including the final transfer on July 31, 2008 of June 2008's net revenues, the Lottery has transferred \$361,749,615 to the State of New Mexico since the commencement of sales in April 1996.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

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

Financial Statements. The Statements of Net Assets on Page 19 and the Statements of Revenues, Expenses, and Changes in Net Assets on page 20 report the Lottery's assets, liabilities, revenues and expenses in comparative format for fiscal year 2008 and fiscal year 2007. The Statements of Cash Flows on pages 21 and 22 report the sources and uses of cash for fiscal years 2008 and 2007. The Statements of Fiduciary Net Assets on page 23 and Statements of Changes in Fiduciary Net Assets on page 24 report the balances and activity of the Lottery's Retirement Plan for fiscal years 2008 and 2007.

Notes to Financial Statements. The Notes to Financial Statements on pages 25 to 40 provide additional information that is essential for a full understanding of the financial statements and provide more detailed data.

Budget to Actual Comparison Statements. The Budget to Actual Comparison Statements on page 41 show the variances between the budgets and actual Lottery performance.

Supplementary Statements of Percentage Return to the State of New Mexico. The Supplementary Statements of Percentage Return to the State of New Mexico on page 42 reports the percentage of gross revenue that was returned to the State for fiscal years 2008 and 2007.

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

FINANCIAL ANALYSIS

Total Net Assets

At the end of fiscal years 2008 and 2007, the Lottery's total assets and total liabilities were equal with total net assets reduced to zero. The \$50,000 balance in the reserve account since fiscal year 1996 was recorded as a liability to the Lottery Tuition Fund at the close of fiscal year 2007. As of July 1, 2007, the provision for a 2% Reserve Fund was removed from the New Mexico Lottery Act. Therefore, the \$50,000 balance in the 2% Reserve Fund was transferred with the final transfer of net revenues for fiscal year 2007 to the Lottery Tuition Fund on July 31, 2007.

In fiscal year 2007, in compliance with the 2% reserve fund, \$723,509 was set aside and expended by the Lottery for bonuses and incentives for retailers, \$65,424 for responsible gaming advertising, \$81,120 for a responsible gaming hotline, and \$41,880 for integrity, all in accordance to the specified purposes per the Lottery Act.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

OVERVIEW OF THE FINANCIAL STATEMENTS - CONTINUED

Assets

Table 1
Assets

	2008	2007	2006	Increase (Decrease) \$ Change 2007 to 2008	Increase (Decrease) % Change 2007 to 2008	Increase (Decrease) \$ Change 2006 to 2007	Increase (Decrease) % Change 2006 to 2007
Cash and cash equivalents	\$ 5,359,828	\$ 6,828,460	\$ 4,574,650	\$ (1,468,632)	(21.5)%	\$ 2,253,810	49.3%
Accounts receivable, net	1,817,274	1,650,965	837,420	166,309	10.1	813,545	97.1
Reserves on deposit	2,542,282	2,338,018	2,339,765	204,264	8.7	(1,747)	(0.1)
Inventory	15,680	15,790	15,932	(110)	(0.7)	(142)	(0.9)
Prepaid expenses	93,705	95,603	120,082	(1,898)	(2.0)	(24,479)	(20.4)
Total current assets	9,828,769	10,928,836	7,887,849	(1,100,067)	(10.1)	3,040,987	38.6
Capital assets, net	249,252	359,236	658,169	(109,984)	(30.6)	(298,933)	(45.4)
Total assets	<u>\$ 10,078,021</u>	<u>\$ 11,288,072</u>	<u>\$ 8,546,018</u>	<u>\$ (1,210,051)</u>	(10.7)%	<u>\$ 2,742,054</u>	32.1%

The Lottery's cash and cash equivalents balance at the end of fiscal year 2008 was \$1,468,632 (21.5%) less than in the previous fiscal year, whereas at the end of fiscal year 2007 it was \$2,253,810 or 49.3% in excess of the previous years. The changes in cash and cash equivalents relate to changes in accounts payable and prizes payable at the end of each year, respectively.

Accounts receivable from the Lottery's retailers are collected weekly through electronic bank transfers. Receivables are equal to sales by retailers net of any prizes paid by the retailers and any commissions earned and any miscellaneous receivables from any other source. Accounts receivable increased in both of the previous two fiscal years by \$166,309 and \$813,545, respectively. In fiscal year 2008, there were two additional days of receivables at year-end in comparison to the prior fiscal year and also include a \$194,920 receivable from the Multi-State Lottery Association (MUSL) for interest and royalty income earned for the fiscal year. In fiscal year 2007, the change was mostly due to higher sales for the last week of the fiscal year in comparison to fiscal year 2006 and also included \$158,533 due from MUSL for interest earned in fiscal year 2007 on the deposits with MUSL.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Assets - Continued

The Lottery has reserves on deposit with MUSL, as required by the Powerball® (Powerball) and Hot Lotto® (Hot Lotto) game rules. The change in these reserve amounts in fiscal year 2008 was caused by the receipt of interest earned on the reserve deposits from MUSL and additions to the Hot Lotto reserve account, as required by the Hot Lotto game rules. In fiscal year 2007 the change in the reserve accounts was insignificant.

Under a contract signed by the Lottery with its ticket printer in March 2003, instant tickets are owned by the vendor with the Lottery having an obligation to pay for the tickets when the tickets are sold. Thus, during the last few years, the inventory has declined as the tickets owned by the Lottery were distributed and replaced by tickets printed under this contract. In fiscal years 2008 and 2007 only one game owned by the Lottery remains in inventory.

As part of the contract with the ticket printer, the Lottery implemented a customer relationship management (CRM) system in June 2004. This CRM system has assisted the Lottery in more effectively managing its ticket inventory at retailer locations. The cost of this system was reflected in capital assets in fiscal years 2008 and 2007. The related liability for the CRM system was fully amortized in fiscal year 2007. There were no significant changes in capital assets other than depreciation in fiscal years 2008 and 2007; there were \$81,923 and \$95,611 in purchases and related depreciation of \$191,907 and \$391,824 for the two years, respectively.

Liabilities

Table 2
Liabilities

	2008	2007	2006	Increase (Decrease) \$ Change 2007 to 2008	Increase (Decrease) % Change 2007 to 2008	Increase (Decrease) \$ Change 2006 to 2007	Increase (Decrease) % Change 2006 to 2007
Accounts pay- able and other							
current liabilities	\$ 1,239,586	\$ 2,550,728	\$ 2,225,990	\$ (1,311,142)	(51.4)%	\$ 324,738	14.6%
Current portion of capital lease							
Obligation	-	-	106,091	-	-	(106,091)	(100.0)
Prizes payable	5,885,786	5,576,596	3,495,708	309,190	5.5	2,080,888	59.5
Due to lottery							
tuition fund	2,952,649	3,160,748	2,668,229	(208,099)	(6.6)	492,519	18.5
Total liabilities	<u>10,078,021</u>	<u>11,288,072</u>	<u>8,496,018</u>	<u>(1,210,051)</u>	<u>(10.7)%</u>	<u>2,792,054</u>	<u>32.9%</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Liabilities - Continued

Accounts payable and other current liabilities decreased by \$1,311,142 at the end of fiscal year 2008 and were \$324,738 higher at the end of fiscal year 2007 than in the previous fiscal year. In fiscal year 2008, the decrease in accounts payable was mainly due to amounts owed to four vendors for advertising, on-line, and instant ticket fees and the lottery's share of prizes payable to MUSL for Powerball and Hot Lotto, which for these four vendors alone was \$1,179,000 less than in the previous fiscal year. In fiscal year 2007, the increase in accounts payable was also primarily due to amounts owed to these same four vendors. Sales at the end of fiscal year 2007 were higher than at the end of fiscal years 2008 and 2006, thus, resulting in higher amounts owed to these four vendors as a percentage of sales.

Prizes payable is essentially comprised of amounts accrued based on the Lottery's game designs and prize structures for on-line and instant game prizes, the related unremitted federal and state taxes withheld on prizes claimed, and any unclaimed prizes in the prize fund. At the end of fiscal year 2008, prizes payable increased by \$309,190 and at the end of 2007 prize payable increased by almost \$2.1 million. These differences relate to the changes of prizes payable on individual Lottery games between the years. At the end of fiscal year 2008, the liability for Powerball prizes only was almost \$474,000 more than at the end of fiscal year 2007, thus, contributing to a higher liability for prizes payable at the end of one fiscal year compared to the other fiscal year. In addition, at the end of the previous two fiscal years, the changes in prizes payable can be contributed to an \$181,000 decrease and a \$1.5 million increase of unclaimed prizes being carried over for planned use in the game designs and prize structures of Lottery games.

At the end of fiscal years 2008 and 2007, \$2,952,649 and \$3,160,748, respectively, of net revenues for the month of June were due to the Lottery Tuition Fund. These funds were transferred to the New Mexico State Treasurer on July 31, 2008 and 2007, respectively.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Sales and Prize Expense

Table 3
Sales and Prize Expense

	2008		
	Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 86,582,636	\$ 48,995,046	\$ 37,587,590
Powerball, net of spoiled and promotional tickets	44,461,165	22,252,480	22,208,685
Roadrunner Cash, net of spoiled and promotional tickets	6,544,441	3,679,225	2,865,216
Hot Lotto, net of spoiled and promotional tickets	5,975,142	2,956,245	3,018,897
Pick 3, net of spoiled and promotional tickets	2,325,347	1,420,360	904,987
Raffle game, net of spoiled and promotional tickets	1,001,400	625,000	376,400
4 This Way!, net of spoiled and promotional tickets	215,546	163,409	52,137
Total	<u>\$ 147,105,677</u>	<u>\$ 80,091,765</u>	<u>\$ 67,013,912</u>
	2007		
	Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 91,366,360	\$ 56,153,065	\$ 35,213,295
Powerball, net of spoiled and promotional tickets	42,578,490	21,312,734	21,265,756
Roadrunner Cash, net of spoiled and promotional tickets	7,905,584	4,448,375	3,457,209
Hot Lotto, net of spoiled and promotional tickets	3,474,154	1,657,403	1,816,751
Pick 3, net of spoiled and promotional tickets	2,056,965	1,192,340	864,625
4 This Way!, net of spoiled and promotional tickets	652,910	355,838	297,072
Total	<u>\$ 148,034,463</u>	<u>\$ 85,119,755</u>	<u>\$ 62,914,708</u>
	2006		
	Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 84,814,849	\$ 51,253,084	\$ 33,561,765
Powerball, net of spoiled and promotional tickets	54,064,465	27,093,452	26,971,013
Roadrunner Cash, net of spoiled and promotional tickets	8,339,340	4,669,830	3,669,510
Pick 3, net of spoiled and promotional tickets	2,007,574	1,159,915	847,659
4 This Way!, net of spoiled and promotional tickets	768,992	450,175	318,817
Total	<u>\$ 149,995,220</u>	<u>\$ 84,626,456</u>	<u>\$ 65,368,764</u>
\$ Increase (decrease) from FY 2007 to FY 2008	<u>\$ (928,786)</u>	<u>\$ (5,027,990)</u>	<u>\$ 4,099,204</u>
% Increase (decrease) from FY 2007 to FY 2008	<u>(0.6)%</u>	<u>(5.9)%</u>	<u>6.5%</u>
\$ Increase (decrease) from FY 2006 to FY 2007	<u>\$ (1,960,757)</u>	<u>\$ 493,299</u>	<u>\$ (2,454,056)</u>
% Increase (decrease) from FY 2006 to FY 2007	<u>(1.3)%</u>	<u>0.6%</u>	<u>(3.8)%</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Sales and Prize Expense – Continued

Table 3 compares net sales, prize expense and gross margin (net sales minus prize expense) for each lottery game for fiscal year 2008, 2007, and 2006. In fiscal year 2008, Powerball, Hot Lotto and Pick 3 sales, prize expense and gross margin increased, but decreased for Roadrunner Cash and 4 This Way. For instant tickets, sales and prize expense decreased, but the gross margin increased for the fiscal year. The Lottery issued a Raffle game in fiscal year 2008. This game produced a gross margin of more than \$376,000. During the fiscal year, the Lottery ended the 4 This Way! game. In fiscal year 2007, sales, prize expense, and gross margin increased for both Instant tickets and Pick 3, but decreased for Powerball, Roadrunner Cash, and 4 This Way!. Hot Lotto started in fiscal year 2007 and produced \$1.8 million in gross margin for the fiscal year.

Sales

In both fiscal years 2008 and 2007, the Lottery continued to use the customer relationship management (CRM) system for placing instant tickets at retailer locations. The Lottery's customer service representatives placed calls to each retailer location, reviewed the inventory at each location with the retailer, and placed orders continually as needed based on the inventory turnover at that location. In fiscal year 2008, sales for fifty-four new instant ticket games were launched—16-\$1, 17-\$2, 8-\$3, 10-\$5, 2-\$10 and 1-\$20—4 less \$1, 1 less \$2, and 2 less \$3 than in the prior fiscal year. In fiscal year 2007, sales for sixty-one instant ticket games were launched—20-\$1, 18-\$2, 10-\$3, 10-\$5, 2-\$10 games and 1-\$20—two more \$2, two more \$3, three more \$5, one less \$10 and one more \$20 game than in fiscal year 2006. In fiscal year 2008, the Lottery launched 22 games with prize tickets and 32 games without prize tickets, while in fiscal year 2007, the Lottery launched 23 games with prize tickets and 38 games without prize tickets. Instant ticket sales for only one month in fiscal year 2008 (July 2007) were higher than in fiscal year 2007. Whereas, instant ticket sales for eleven months in fiscal year 2007 were higher than in the prior fiscal year.

Powerball sales are generally driven by the advertised jackpot. In fiscal year 2008, there were 4 jackpots that climbed to more than \$150 million with one going to \$314.3 million and one reaching \$276.3 million before being won. In fiscal year 2007, there were three jackpots that were more than \$200 million, the largest going to \$254 million. There were also two jackpots that rose to \$106 and \$182 million each. In fiscal year 2006, two jackpots were over \$340 million, one over \$224 million, and three jackpots over \$100 million. The difference in the jackpots amounts in these fiscal years produced an increase in Powerball sales of almost \$1.9 million in fiscal year 2008 and a drop in Powerball sales in fiscal year 2007 by almost \$11.5 million in comparison to the previous fiscal year.

Similar to Powerball, Roadrunner Cash sales are driven by the top prize amount. In fiscal year 2008, the top prize was more than \$150,000 for six drawings, going to \$330,000 and \$210,000 in September and October 2007. In fiscal year 2007, the top prize rose to more than \$150,000 on seven occasions, climbing to \$687,000 in November 2006 and to \$200,000 in April 2007. These differences in the top prizes reflected on the sales in the two fiscal years.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Sales and Prize Expense - Continued

Sales – Continued

The MUSL game, Hot Lotto, was first introduced in New Mexico on November 12, 2006 with the first drawing on November 15, 2006. In January 2008, a Sizzler multiplier feature was added to Hot Lotto. The Sizzler multiplier play costs an additional \$1. With Sizzler, each winning prize, other than the jackpot prize, is multiplied by 3. Sales for fiscal year 2008 increased by approximately \$500,000 over the annualized sales in fiscal year 2007. Hot Lotto sales for the seven and one-half months in fiscal year were almost \$3.5 million and more than met the expectations for sales for this new game during fiscal year 2007.

Pick 3 sales in fiscal year 2008 increased by approximately \$268,000 from the sales in fiscal year 2007. Pick 3 sales for fiscal years 2007 and 2006 were comparable, contributing over \$2,000,000 to on-line sales in each year. 4 This Way! sales had been decreasing during the last few fiscal years, thus, the game was ended in October 2007.

The Lottery introduced a Raffle game in October 2007. The game did not meet the expectations of the Lottery, contributing \$1,001,400 to on-line sales.

Prize Expense

Prize expense for on-line games with a rolling jackpot or a top prize is based on the overall prize payout per the game design, while prize expense for the other four on-line games is determined by the prizes won for each drawing. 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. In fiscal year 2008, prize expense decreased by about 2% prior to the application of unclaimed prizes. In fiscal year 2007, prize expense increased in relation to the decrease in sales. This was mainly due to an increase of about 1% in the instant ticket prize expense in fiscal year 2007. In fiscal year 2007, this increase in prizes for instant games produced an increase in gross margin of more than \$1.65 million or a 4.9% increase.

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

Prize Tickets

In fiscal years 2008 and 2007, prize tickets decreased in instant games by \$1,002,590 (23.12%) and \$197,376 (4.4%), respectively. Prize tickets are placed in the prize structure of the game in lieu of the breakeven prizes. Prize tickets give a player a prize of another instant game ticket of the same price point as the instant ticket that had the winning prize ticket. In the last few years, the Lottery has been studying the market to determine the optimum quantity of prize tickets to place each fiscal year in its instant ticket games 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

	2008	2007	2006	Increase (Decrease) \$ Change 2007 to 2008	Increase (Decrease) % Change 2007 to 2008	Increase (Decrease) \$ Change 2006 to 2007	Increase (Decrease) % Change 2006 to 2007
Prize expense	\$ 80,091,765	\$ 85,119,755	\$ 84,626,456	\$ (5,027,990)	(5.9)%	\$ 493,299	0.6%
Retailer							
commissions	9,676,366	9,754,742	9,859,881	(78,376)	(0.8)	(105,139)	(1.1)
On-line vendor							
Fees	6,999,633	6,597,580	7,414,912	402,053	6.1	(817,332)	(11.0)
Advertising	2,192,858	2,913,129	2,816,695	(720,271)	(24.7)	96,434	3.4
Ticket vendor							
Fees	1,648,674	1,444,683	1,282,575	203,991	14.1	162,108	12.6
Other game							
Expenses	<u>1,115,348</u>	<u>2,351,209</u>	<u>2,208,110</u>	<u>(1,235,861)</u>	<u>(52.6)</u>	<u>143,099</u>	<u>6.5</u>
Total game							
Expenses	<u>\$ 101,724,644</u>	<u>\$ 108,181,098</u>	<u>\$ 108,208,629</u>	<u>\$ (6,456,454)</u>	<u>(6.0)%</u>	<u>\$ (27,531)</u>	<u>(0.0)%</u>

Retailer commissions are paid to the Lottery's retailers for selling Lottery tickets and cashing Lottery prizes. In addition, prior to fiscal year 2008, retailers were paid quarterly incentives for meeting pre-determined sales goals and marketing the Lottery's products with point of sale advertising and display. In fiscal years 2007 and 2006, the Lottery budgeted these quarterly incentives in the 2% Reserve line item instead of as part of retailer commissions. Until July 1, 2007, the New Mexico Lottery Act allowed the Lottery to set aside, as a reserve fund, up to two percent of the gross annual revenues for incentive plans for lottery retailers. Thus, in fiscal years 2007 and 2006, these quarterly incentives were part of other game expenses. In comparing fiscal year 2008 to 2007, the change in not paying quarterly incentives is approximately \$660,000. The changes in retailer commissions for fiscal years 2008 and 2007 are consistent with the changes in gross ticket sales for the two years.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Game Expenses – Continued

retailer locations. The changes in the on-line vendor fees for the two fiscal years are consistent with the changes in on-line sales in 2008 and 2007.

Advertising is expended to market the Lottery and its products to the public and to inform the public about the games available, the jackpot and top prize amounts on the on-line games, and to keep the lottery products fresh in the public's minds, all in order to promote sales. Advertising expense in fiscal year 2008 was decreased by approximately \$720,000 from the previous fiscal year. Fiscal years' 2008 and 2007 advertising expense was approximately 1.48% and 1.96% of revenues, respectively.

In fiscal year 2003, the Lottery signed a new contract with its ticket printer effective in March 2003. Under this new contract, the instant tickets are owned by the vendor with the Lottery paying for the tickets as a percentage of sales when the tickets are sold. The cost for the tickets under this new contract also included a cost for the CRM system and the allocated cost for maintenance on the system in fiscal year 2007. In fiscal year 2008, the cost for any licensing fees or special printing costs were also included in this line item rather than allocated to the prize structure for the game. The ticket vendor fees for fiscal year 2008 were slightly higher as a percentage of sales in comparison to fiscal year 2007 because of these changes.

Included in other game expenses are promotions, shipping and postage, instant ticket vending machine lease, responsible gaming, drawing game and game membership expenses. In fiscal year 2007, the 2% reserve fund expense, which had included responsible gaming, was also included in other game expenses. In fiscal year 2008 other game expenses decreased by \$1,235,861. The elimination of the 2% reserve fund expense reflects an \$830,813 change on the financial statements in the fiscal year. Some of the costs for security system maintenance and testing and game testing, which had previously been reflected in the 2% reserve fund expense, were reclassified and are now reflected in other line items since these costs are necessary to maintain the security and integrity of the Lottery and could not be eliminated as costs. The cost for the lease for instant ticket vending machines was reduced in fiscal year 2008 by \$172,932. In fiscal year 2007, the expense primarily contributing to the increase in other game expenses was the purchase of electronic signs to display the jackpot and top prizes at retailer locations for on-line games for the next drawing. These signs are being used in lieu of a number of outdoor board signs throughout New Mexico that have been eliminated to decrease costs.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Operating Expenses

Table 5
Operating Expenses

	2008	2007	2006	(Decrease) \$ Change 2007 to 2008	(Decrease) % Change 2007 to 2008	Increase (Decrease) \$ Change 2006 to 2007	Increase (Decrease) % Change 2006 to 2007
Salaries, wages, and benefits	\$ 3,387,288	\$ 3,685,704	\$ 3,644,557	\$ (298,416)	(8.1)%	\$ 41,147	1.1%
Leases and insurance	617,220	632,380	636,560	(15,160)	(2.4)	(4,180)	(0.7)
Other operating expenses	<u>1,267,611</u>	<u>1,463,744</u>	<u>1,231,389</u>	<u>(196,133)</u>	(13.4)	<u>232,355</u>	18.9
Total operating expenses	<u>\$ 5,272,119</u>	<u>\$ 5,781,828</u>	<u>\$ 5,512,506</u>	<u>\$ (509,709)</u>	(8.8)%	<u>\$ 269,322</u>	4.9%

Other operating expenses include depreciation and amortization, utilities and maintenance, professional fees, materials and supplies, travel, and other expenses. In fiscal year 2008, the Lottery decreased its operating expenses by more than half-a-million dollars. To bring about this change, the Lottery eliminated more than 10 employee positions and reduced the replacement of infrastructure assets and materials and supplies purchases. Professional fees in fiscal year 2008 increased by approximately \$82,000, mainly due to the cost of legal fees for continuing litigation. Operating expenses in fiscal year 2007 were more than in the previous year essentially because of professional fees and materials and supplies expense being higher. In fiscal year 2007, as in fiscal year 2008, the Lottery's professional fees were more as a result of higher legal fees related to litigation, and also, because of the issuance of the RFP for on-line and related services and the procurement of a performance audit during the year. In addition, in fiscal year 2007, the Lottery's capitalization threshold was changed from \$1,000 to \$5,000 in accordance to the Audit Act and, therefore, items purchased that previously would have been capitalized were expensed into non-capitalized items that are included in materials and supplies. This change in capitalization threshold also resulted in a decrease in depreciation expense in both fiscal year 2008 and 2007.

Non-Operating Income

Non-operating income decreased in fiscal year 2008 mainly due to the decrease in interest rates and the related interest earned on the Lottery's deposits. In the prior year, non-operating income increased by over 33.4% or over \$178,500 primarily because of the interest income earned on the Lottery's cash balances in the bank and in the MUSL reserve accounts.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Income

	<u>Total Revenues</u>	<u>Net Income</u>
Fiscal Year 2008	<u>\$ 147,152,459</u>	<u>\$ 40,810,571</u>
Fiscal Year 2007	<u>148,080,254</u>	<u>34,830,136</u>
Fiscal Year 2006	<u>150,042,400</u>	<u>36,855,556</u>
Increase (decrease) from FY 2007 to FY 2008	<u>\$ (927,795)</u>	<u>\$ 5,980,435</u>
% Increase (decrease) from FY 2007 to FY 2008	<u>(.6%)</u>	<u>(17.2%)</u>
(Decrease) from FY 2006 to FY 2007	<u>\$ (1,962,146)</u>	<u>\$ (2,025,420)</u>
% (Decrease) from FY 2006 to FY 2007	<u>(1.3%)</u>	<u>(5.5%)</u>

Effective July 1, 2007, the New Mexico Lottery Act, Chapter 6, Article 24 NMSA 2978, 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 year 2008, the Lottery transmitted its net income each month, totaling \$40,810,571 for the year. The gross revenue percentage return for fiscal year 2008 was 27.61% in comparison to 23.41% for the previous fiscal year.

The changes in net income for fiscal years 2008 and 2007 were related to the changes in sales for the Lottery's games during the two years netted against the cost of the product and operating expenses during the two fiscal years.

In order to meet the mandated 27% gross revenue return in fiscal year 2008, prize payout per the game structures of the Lottery's games was decreased by about 2% prior to the application of unclaimed prizes; prize tickets in instant games were reduced causing claims for prize tickets to be decreased by over \$1,000,000; advertising expenditures were decreased by approximately \$720,000 for the year; \$660,000 in quarterly sales incentives paid to retailers for meeting pre-determined sales goals and marketing the Lottery's products with point of sale advertising and display were eliminated; eleven employee positions were not filled (a 16% reduction in personnel); incentives paid to sales employees for meeting sales goals were eliminated; and materials and supplies purchases and the replacement of infrastructure assets were reduced. At this time, the impact of these specific changes to this fiscal year's sales and future year's sales and net income cannot be readily determined.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison

	2008				
	Original Budget	Final Budget	Actual	Variance with Final Budget	% Variance with Final Budget
Total revenues	\$ 150,850,000	\$ 141,475,000	\$ 147,152,459	\$ 5,677,459	4.0%
Total game expenses	103,977,000	97,972,000	101,724,644	3,752,644	3.8
Total operating expenses	<u>5,833,000</u>	<u>5,642,000</u>	<u>5,272,119</u>	<u>(369,881)</u>	(6.6)
Operating income	41,040,000	37,861,000	40,155,696	2,294,696	6.1
Total non-operating income	<u>460,000</u>	<u>491,000</u>	<u>654,875</u>	<u>163,875</u>	33.4
Net income before transfers to Lottery Tuition Fund	<u>\$ 41,500,000</u>	<u>\$ 38,352,000</u>	<u>\$ 40,810,571</u>	<u>\$ 2,458,571</u>	6.4%

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

In March 2008, the original fiscal year 2008 budget was revised as a result of sales not performing as planned during the first half of the fiscal year. The total revenues budget was reduced by over \$9.3 million. The Lottery revised its fiscal year 2008 annual budget to decrease instant ticket sales by \$4.5 million, Powerball sales by \$2 million, Roadrunner Cash sales by \$1.2 million, and the Raffle game sales by almost \$1.5 million and increased Hot Lotto sales by \$200,000, Pick 3 sales by \$100,000, and revised 4 This Way! sales to actual of \$215,000. The budget for prize tickets was increased by \$700,000. The related game expenses for prize expense, retailer commissions, on-line vendor fees, ticket vendor fees, and shipping and postage were also decreased in relation to the change in budgeted sales. Advertising expense was increased by \$200,000 to combat the decrease in sales. Operating expenses were reduced in total by \$191,000 in the revised budget. Because of the change in budgeted sales, the projected net income was decreased by over \$3.1 million to \$38,352,000.

During the 2nd half of the year, sales for Instant ticket, Powerball, Hot Lotto and Pick 3 improved, so that sales for the fiscal year surpassed the revised budget by over \$2.9 million, \$1.5 million, \$700,000, and \$227,000 for these games, respectively. Roadrunner Cash did not reach the revised budget by nearly \$750,000. At the end of the fiscal year, total revenues were nearly \$5.7 million more than the revised budget or 104% of the revised budget. The game expenses budget had also been decreased for the fiscal year by over \$6,000,000 to coincide with the change in sales. Game expenses ended the fiscal year at 103.8% of the revised budget and directly in correlation with the increase in sales. At the end of the fiscal year, operating expenses totaled 93.4% of the budget or almost \$370,000 under the revised budget. The final net income was over \$2.4 million more than the revised budget at 106.4% of its budget.

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

\$70,000. Although sales were reduced by \$2.7 million, net income was increased by \$285,000 or .8%.

Game expenses, such as prize expense, retailer commissions, on-line vendor fees, ticket printing, shipping and postage are directly affected by increases or decreases in sales and went up or down accordingly during the two fiscal years. Final operating expense amounts for the two years were less than budgeted amounts. Continual monitoring of divisional and departmental budgets kept operating expenses to about 93% of the final budgeted amounts for the two years.

Factors Impacting Future Periods

Conversion to a new on-line gaming system.

Effective on November 15, 2007, the Lottery entered into an agreement with Intralot, 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 system will include the supply, installation, maintenance, service, and operation of a communication network, lottery terminals and peripheral equipment for the Lottery's existing and future retailers, 500 ticket scanners to enable players to check their tickets for prizes, 225 self service ticket vending machines that sell both instant and on-line 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 has been on-going in fiscal year 2008 with conversion to the new system planned for November 16, 2008.

Powerball Matrix change.

In January 2009, the Powerball prize structure will be changing. The matrix will change from a 5 picks in 55 numbers plus 1 pick in 42 numbers matrix to a 5 picks in 59 numbers plus 1 pick in 39 numbers matrix. With this change, the starting jackpot will increase from \$15 million to \$20 million, the Match 5 prize with Power Play option will have a guaranteed 5 times multiplier, the overall odds will change from 1:36.61 to 1:35.11 and the jackpot odds will change from 1:146,107,962 to 1:195,249,054. The price point for the ticket will remain at \$1, the core game payout % will continue at 50%, the 9 prize levels will stay the same, and the Power Play continues to be available on the bottom seven prize levels (a 2 times to 5 times multiplier).

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Requests for Additional Financial Information

This financial report is designed to provide the executive and legislative branches of the State of New Mexico, the public, the Lottery's retailers, vendors, creditors, and other interested parties with a general overview of the financial position as of June 30, 2008 and 2007, and results of its operations, cash flows, variances from budgets, and percentage return to the state for the years then ended for the New Mexico Lottery Authority and to demonstrate the Lottery's accountability for the revenues it receives.

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

New Mexico Lottery Authority

STATEMENTS OF NET ASSETS

June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 5,359,828	\$ 6,828,460
Accounts receivable (net of allowance for doubtful accounts)	1,817,274	1,650,965
Reserves on deposit	2,542,282	2,338,018
Inventory	15,680	15,790
Prepaid expenses	<u>93,705</u>	<u>95,603</u>
 Total current assets	 9,828,769	 10,928,836
 CAPITAL ASSETS, NET	 <u>249,252</u>	 <u>359,236</u>
 Total assets	 <u>\$ 10,078,021</u>	 <u>\$ 11,288,072</u>
 CURRENT LIABILITIES		
Accounts payable and other current liabilities	\$ 1,239,586	\$ 2,550,728
Prizes payable	5,885,786	5,576,596
Due to lottery tuition fund	<u>2,952,649</u>	<u>3,160,748</u>
 Total liabilities	 <u>\$ 10,078,021</u>	 <u>\$ 11,288,072</u>
 NET ASSETS		
Invested in capital assets	\$ 249,252	\$ 359,236
Unrestricted net assets (deficit)	<u>(249,252)</u>	<u>(359,236)</u>
 Total net assets	 <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 ASSETS

Years ended June 30, 2008 and 2007

	2008	2007
REVENUES		
Instant ticket sales	\$ 89,925,612	\$ 95,729,489
Powerball sales	44,504,959	42,625,468
Roadrunner Cash sales	6,552,774	7,934,309
Hot Lotto sales	6,004,241	3,476,503
Pick 3 sales	2,327,283	2,058,844
Raffle game sales	1,001,400	-
4 This Way! sales	215,546	653,662
Retailer fees	46,782	45,791
Prize tickets	(3,333,227)	(4,335,817)
Spoiled, stolen, and promotional tickets	(92,911)	(107,995)
Total revenues	<u>147,152,459</u>	<u>148,080,254</u>
GAME EXPENSES		
Prize expense	80,091,765	85,119,755
Retailer commissions	9,676,366	9,754,742
On-line vendor fees	6,999,633	6,597,580
Advertising	2,192,858	2,913,129
Ticket vendor fees	1,648,674	1,444,683
Shipping and postage	376,029	415,265
Promotions	368,766	650,133
Drawing game	142,298	109,704
Responsible gaming	81,120	81,120
Instant ticket vending machine lease	81,000	253,932
Game membership	66,135	10,242
Reserve Fund expense	-	830,813
Total game expenses	<u>101,724,644</u>	<u>108,181,098</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	3,387,288	3,685,704
Leases and insurance	617,220	632,380
Utilities and maintenance	421,690	415,924
Professional fees	402,993	320,784
Depreciation and amortization	191,907	391,824
Materials and supplies	108,370	203,024
Travel	73,312	66,340
Other	69,339	65,848
Total operating expenses	<u>5,272,119</u>	<u>5,781,828</u>
OPERATING INCOME	<u>40,155,696</u>	<u>34,117,328</u>
NON-OPERATING INCOME		
Interest income	492,351	582,916
Other income	162,524	129,892
Total non-operating income	<u>654,875</u>	<u>712,808</u>
Net income before transfers	40,810,571	34,830,136
Transfers to Lottery Tuition Fund	<u>(40,810,571)</u>	<u>(34,880,136)</u>
Change in net assets	-	(50,000)
Net assets at beginning of year	<u>-</u>	<u>50,000</u>
Net assets at end of year	<u>\$ -</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, 2008 and 2007

Increase (Decrease) in Cash and Cash Equivalents

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities		
Cash received:		
From retailers-sales net of commissions, incentives, and prize, spoiled, and stolen ticket credits	\$ 137,504,704	\$ 137,670,500
From MUSL - Powerball and Hot Lotto Jackpots	4,117,513	29,450,223
Cash payments:		
To prize winners and related taxes	(70,519,847)	(100,723,950)
To suppliers of goods or services	(15,680,192)	(15,163,549)
To MUSL	(13,380,242)	(11,765,140)
To employees for services and related taxes	<u>(2,793,486)</u>	<u>(3,124,154)</u>
Net cash provided by operating activities	<u>39,248,450</u>	<u>36,343,930</u>
Cash flows from investing activities		
Additions to MUSL Reserve Accounts	-	6,225
Receipts of interest	258,773	369,496
Receipts of rent	131,204	126,404
Other	<u>319</u>	<u>234</u>
Net cash provided by investing activities	<u>390,296</u>	<u>502,359</u>
Cash flows from noncapital financing activities		
Transfers to Lottery Tuition Fund	<u>(41,018,670)</u>	<u>(34,387,617)</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	(88,708)	(98,771)
Principal payments under capital lease	<u>-</u>	<u>(106,091)</u>
Net cash used by related financing activities	<u>(88,708)</u>	<u>(204,862)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,468,632)	2,253,810
Cash and cash equivalents at beginning of year	<u>6,828,460</u>	<u>4,574,650</u>
Cash and cash equivalents at end of year	<u>\$ 5,359,828</u>	<u>\$ 6,828,460</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, 2008 and 2007

Increase (Decrease) in Cash and Cash Equivalents

	<u>2008</u>	<u>2007</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating Income	\$ 40,155,696	\$ 34,117,328
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	191,907	391,824
Change in MUSL Accounts	-	(6,225)
Interest on MUSL Unreserved Account	179,283	24,478
Vendor's non-cash transactions	(2,775)	(3,250)
Net changes in assets and liabilities:		
Accounts receivable	28,611	(655,012)
Reserves on Deposit	(204,264)	1,747
Inventory	110	142
Prepaid expenses	1,898	24,479
Accounts payable and other liabilities	(1,311,142)	324,738
Accrued	(100,064)	42,793
Prizes payable	<u>309,190</u>	<u>2,080,888</u>
Net cash provided by operating activities	<u>\$ 39,248,450</u>	<u>\$ 36,343,930</u>

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

New Mexico Lottery Authority

STATEMENTS OF FIDUCIARY NET ASSETS

June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Cash and cash equivalents	\$ 213,131	\$ 193,339
Marketable securities and other investments	2,630,150	3,160,686
Contribution receivable	<u>13,957</u>	<u>15,625</u>
Total assets	<u>\$ 2,857,238</u>	<u>\$ 3,369,650</u>
NET ASSETS		
Pension plan participants' benefits	<u>\$ 2,857,238</u>	<u>\$ 3,369,650</u>

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

New Mexico Lottery Authority

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

Years ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ADDITIONS		
Investment earnings	\$ 42,659	\$ 491,186
Employer contributions	<u>312,122</u>	<u>365,686</u>
Total additions	354,781	856,872
DEDUCTIONS		
Investment losses	354,824	-
Distributions to participants	<u>512,369</u>	<u>197,292</u>
Total deductions	867,193	197,292
Change in net assets	(512,412)	659,580
Net assets - beginning	<u>3,369,650</u>	<u>2,710,070</u>
Net assets - ending	<u>\$ 2,857,238</u>	<u>\$ 3,369,650</u>

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

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

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

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

2. Basis of Presentation

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

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

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

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

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

3. Budgets and Budgetary Accounting.

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

4. Cash and Cash Equivalents

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

5. Accounts Receivable

Accounts receivable represent the unremitted receipts on ticket sales, net of retailer commissions and prizes paid by the retailers. Receipts are transferred weekly from

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

5. Accounts Receivable - Continued

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, 2008 and 2007, an allowance for doubtful accounts of \$82,597 and \$94,251, respectively, has been provided to recognize future uncollectible billings. In fiscal years 2008 and 2007, ten customers (463 and 460 retailer locations) represented 52% and 50% of sales and 51% and 50% 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) and Hot Lotto® (Hot Lotto) games for the Lottery. Each MUSL member sells Powerball and Hot Lotto game tickets through its retailers and makes weekly wire transfers to MUSL in an amount equivalent to the member lottery's share of the estimated grand prize liability for each game. Lesser prizes are paid directly to the winners by each member lottery. The prize pools for both Powerball and Hot Lotto are 50% of each game's drawing period's sales after the prize reserve accounts are funded to the amounts set by the MUSL product group. MUSL included 2% of the Lottery's Powerball drawing period's sales in two prize reserve accounts until the Lottery's share of the prize reserve accounts reached the amounts designated by the MUSL product group. Both the Lottery's Powerball Prize Reserve Account (PRA) and the Set Prize Reserve Account are fully funded. MUSL includes from 1% to 3% of the Lottery's Hot Lotto drawing period's sales, depending on the annuitized value of the Grand Prize, into a prize reserve account until the Lottery's share of the prize reserve account reaches the amount designated by the MUSL product group. At June 30, 2008, the Lottery's remaining Hot Lotto prize reserve buy-in amount was \$311,593. MUSL has placed a \$100,000,000 cap on the two Powerball prize reserve funds and a \$9,000,000 cap on the Hot Lotto prize reserve fund. Once the prize reserve funds exceed these designated caps, the excess becomes part of the grand prize pool. The prize reserve funds serve as contingency reserves to protect MUSL from unforeseen prize liabilities and the money in these reserve funds are to be used at the discretion of the MUSL Board of Directors. The prize reserve funds are refundable to MUSL members if MUSL disbands, a member leaves MUSL, or a game is discontinued. In these instances, members must wait one year before receiving their remaining share, if any, of the prize reserve funds. The Lottery also has an unreserved fund with MUSL. Interest earned on the MUSL funds and any unclaimed grand prizes may be deposited into the unreserved fund and game membership fees and other MUSL costs may be paid from this fund. At June 30, 2008 and 2007, the Lottery's share of the Powerball prize reserve funds was \$1,854,490 and \$1,906,630, respectively; the Lottery's share of the

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

6. Reserves on Deposit - Continued

Hot Lotto prize reserve funds was \$351,530 and \$193,251 respectively; and the Lottery's share of the unreserved fund was \$336,262 and \$238,137, respectively.

A winner of a Powerball grand prize or a Hot Lotto grand prize may select that the prize be paid at the cash value of the prize or as an annuity. A Powerball grand prize annuity is paid out in 30 installments and a Hot Lotto grand prize annuity is paid out in 25 installments. Government securities at the discounted value of the grand prize annuity are purchased by MUSL to fund all future installments and are held in trust. Maturities are staggered in order to provide adequate cash flow for each annual installment. These assets and related liabilities are reflected in MUSL's financial statements and therefore are not reflected in the Lottery's financial statements. MUSL is responsible for transferring the cash or the annuity installment amounts to the member lottery prior to the payment to any grand prize winner. Currently, the Lottery is not paying any prize winner any annuity prize payments.

7. Inventory

Since the inception of the Lottery, inventory, which has mainly consisted of lottery instant tickets for future use, has been carried at the lower of cost or market using the specific identification method. In March 2003, the Lottery entered into an agreement with its instant ticket printer whereby the vendor retains title to the instant ticket inventory until the instant tickets are sold. At that time, the Lottery pays the vendor a fee based on a fixed percentage of the instant tickets sold. In fiscal year 2004, the Lottery commenced distributing games printed under this new agreement and through June 30, 2008 has substantially depleted any instant ticket inventory that it owns.

8. Capital Assets

Capital assets, which include data processing software and hardware, tenant improvements, vehicles, furniture and fixtures, and equipment are stated at cost net of accumulated depreciation. In fiscal years prior to 2007, the Lottery capitalized all assets that had a cost greater than \$1,000 and an expected useful life of more than one year. The legislature of the State of New Mexico amended Section 12-6-10, NMSA 1978 that allowed for the capitalization threshold for capital assets to increase from \$1,000 to \$5,000 effective July 1, 2005. Effective October 19, 2006, the Lottery increased its capital asset threshold to \$5,000. Depreciation is computed using the straight-line method over the estimated useful lives of 2 to 5 years, except for leasehold improvements, which are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the results from operations in the period of disposal.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

9. Revenue and Accounts Receivable Recognition

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

10. Prizes

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

11. Commissions

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

12. Advertising Costs

Advertising costs are expensed as incurred.

13. Income Taxes

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

14. Custodial Credit Risk and Interest Rate Risk

At June 30, 2008 and 2007, the Lottery maintained its cash balances in one financial institution. The balances for demand deposits and time deposits were insured by the Federal Deposit Insurance Corporation up to \$100,000, each respectively, at this financial institution.

Custodial credit risk – Deposits. In the case of deposits, this is the risk that in the event of a bank failure, the Lottery's deposits may not be returned to it. The Lottery does not have a deposit policy for custodial credit risk. The Lottery limits its custodial risk for its cash and requires collateral in an amount greater than or equal to 50% of any deposit not insured by Federal Insuring Agencies. A greater amount of collateral is required when the Lottery determines it is prudent. Collateral must meet State of New Mexico "Security of Public Money" standards and be held in the third party safekeeping.

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

14. Custodial Credit Risk and Interest Rate Risk - Continued

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 certificates of deposit and overnight repurchase agreements. Investments are made through a local financial institution and are held in safekeeping in its trust departments. Repurchase agreements are collateralized by the Federal National Mortgage Association Securities with a market value of at least 102% of the principal and are used for overnight investment only. Collateral must meet State of New Mexico "Security of Public Money" standards and be held in third party safekeeping.

As of June 30, 2008 and 2007, the Lottery's bank balance of \$5,582,168 and \$8,720,910, respectively, was exposed to custodial credit risk as follows:

	<u>2008</u>	<u>2007</u>
Uninsured and uncollateralized	\$ -	\$ 667,907
Collateral held by the pledging bank's trust department not in the Lottery's name	<u>5,582,168</u>	<u>7,953,003</u>
	<u>\$ 5,582,168</u>	<u>\$ 8,620,910</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, 2008 and 2007, the Lottery had an overnight yield repurchase agreement with a one-day maturity. At June 30, 2007, the Lottery also had an investment in a certificate of deposit with a seven-day maturity.

15. Bank Accounts

<u>Description</u>	<u>Bank</u>	<u>Balance per Bank</u>
Operating account - overnight repurchase Agreement	First Community Bank	\$ 5,523,943
Operating account – checking	First Community Bank	<u>58,225</u>
Total amount deposited in bank		5,582,168
Less: FDIC coverage		<u>(58,225)</u>
*Total uninsured funds – deposits and overnight repurchase agreement		<u>\$ 5,523,943</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

15. Bank Accounts - Continued

102% pledged collateral requirement per statute for repurchase agreement	\$ 5,634,422
* Total pledged security	<u>(5,645,328)</u>
Amount under (over) requirement at June 30, 2008	<u>\$ (10,906)</u>

* Securities are held in safekeeping at the Federal Home Loan Bank in Dallas, Texas. Presented at fair value, CUSIP Numbers 31371K2U4 (fair market value \$490,072), 31371K4D0 (fair market value \$4,481,178), and 31371K5T4 (fair market value \$674,078), mature March 1,2023, May 1, 2018, and June 1, 2013, respectively.

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

Cash and cash equivalents per bank at June 30, 2008	\$ 5,582,168
Less reconciling items--outstanding checks	<u>(223,840)</u>
Reconciled cash in bank at June 30, 2008	5,358,328
Cash in vault	<u>1,500</u>
Total cash and cash equivalents per statements of net assets	<u>\$ 5,359,828</u>

16. Risk Management

The Lottery is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery purchases commercial insurance to cover these risks. The amount of coverage has not been exceeded by claims in the last three years.

17. Shipping and Handling Costs

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

18. Reserve Fund

Prior to July 1, 2007, the Act (see note A1) had required that “an amount up to 2% of the gross annual revenues shall be set aside as a Reserve Fund to cover bonuses and incentive plans for Lottery retailers, special promotions for retailers, purchasing special promotional giveaways, sponsoring special promotional events, compulsive gambling rehabilitation and other purposes as the Board deems necessary to maintain the integrity and meet the revenue goals of the Lottery.” As of July 1, 2007, the provision for a 2% Reserve Fund was removed from the New Mexico Lottery Act. Prior to this time, the Board of Directors had elected to set aside up to 2% of gross revenues into the reserve account. Accordingly, at June 30, 2007, the amount that had been set aside and expended was \$911,933. In fiscal year 2007, \$723,509 was set aside and expended for bonuses and incentives for retailers, \$65,424 for responsible gaming advertising, \$81,120 for a responsible gaming hotline, and \$41,880 for integrity, all in accordance to the specified purposes per the Act.

19. Net Assets

Net assets are categorized as invested in capital assets (net of related debt), restricted and unrestricted.

Invested in Capital Assets - is intended to reflect the portion of net assets which is associated with non-liquid, capital assets

Restricted Assets-are liquid assets (generated from revenues and not bond proceeds), which have third-party (statutory, bond covenant or granting agency) legally enforceable, limitations on their use. Any Reserve Fund amounts not expended by fiscal year end for the defined purposes (see note 18) were to be transferred to the Lottery Tuition Fund, except for unexpended amounts up to \$50,000, which until July 1, 2007 could be retained by the Lottery for future defined expenditures. Since the provision for a 2% Reserve Fund was removed from the Lottery Act as of July 1, 2007, the \$50,000 balance in the 2% Reserve Fund was transferred to the Lottery Tuition Fund on July 31, 2007.

Unrestricted Assets-represent unrestricted liquid assets.

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.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -CONTINUED

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. Compensated Absences Payable

As of January 1, 2007, the Lottery replaced paid time off leave with annual and sick leave. Prior to that time, paid time off was accrued at rates specified by the Lottery's Paid Time Off Policy. Employees were limited on the total accumulated hours they could keep in their respective Reserve Bank. Employees with time in service less than or equal to 5 years could accumulate a maximum of 320 hours and employees with time in service greater than 5 years could accumulate a maximum of 360 hours, any excess was forfeited at the end of the calendar year. The new annual leave and sick leave are accrued at rates specified by the Lottery's Leave Policy. Annual leave is awarded based on the employee's years of service, leave status, and employment status (full-time or part-time) and sick leave is awarded at 3.7 hours biweekly for full-time employees. The maximum number of annual leave 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, 2008 and 2007, the following changes occurred in the compensated absences liabilities:

Balance July 1, 2007	<u>Increase</u>	<u>Decrease</u>	Balance June 30, 2008
\$ 177,892	\$ 20,148	\$ (28,165)	\$ 169,875
Balance July 1, 2006	<u>Increase</u>	<u>Decrease</u>	Balance June 30, 2007
\$ 323,980	\$ 9,198	\$ (155,286)	\$ 177,892

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -CONTINUED

22. Compensated Absences Payable - Continued

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

23. Long-term Liabilities - Capital Lease Obligations

During the years ended June 30, 2008 and 2007 the following changes occurred in the capital lease obligations:

<u>Balance July 1, 2007</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance June 30, 2008</u>	<u>Amounts Due Within One Year</u>
\$ -	\$ -	\$ -	\$ -	\$ -

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

24. Accounts payable and other current liabilities

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

	<u>2008</u>	<u>2007</u>
Accounts payable	\$ 759,397	\$ 1,917,479
Accrued liabilities, vendors*	135,099	118,647
Accrued liabilities, retailers*	20,120	146,971
Accrued payroll, and payroll taxes and benefits	155,095	189,739
Compensated absences	<u>169,875</u>	<u>177,892</u>
	<u>\$ 1,239,586</u>	<u>\$ 2,550,728</u>

* The Lottery has accrued an estimated amount of services delivered by its vendors and retailers for the months of June 2008 and 2007, respectively.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE B – CAPITAL ASSETS

Capital assets at June 30, 2008 consisted of:

	Beginning Balance	Reclassification	Increases	Decreases	Ending Balance
Data processing software	\$ 2,075,202	\$ -	\$ 9,000	\$ -	\$ 2,084,202
Data processing equipment	1,815,102	-	5,932	-	1,821,034
Tenant improvements	797,602	-	-	-	797,602
Vehicles	483,143	-	42,966	(53,117)	472,992
Furniture and fixtures	245,048	-	-	-	245,048
Equipment - drawing	155,622	-	24,025	-	179,647
Equipment - warehouse	156,698	-	-	-	156,698
Equipment - communications	116,260	-	-	-	116,260
Equipment - office	75,050	-	-	-	75,050
Obsolete capital assets	499,015	-	-	-	499,015
Capital assets	6,418,742	-	81,923	(53,117)	6,447,548
Data processing software	(2,069,794)	-	(4,661)	-	(2,074,455)
Data processing equipment	(1,728,397)	-	(46,838)	-	(1,775,235)
Tenant improvements	(714,434)	-	(28,635)	-	(743,069)
Vehicles	(386,308)	-	(55,052)	53,117	(388,243)
Furniture and fixtures	(240,232)	-	(1,779)	-	(242,011)
Equipment - drawing	(124,372)	-	(22,235)	-	(146,607)
Equipment - warehouse	(153,545)	-	(1,515)	-	(155,060)
Equipment - communications	(89,850)	-	(19,919)	-	(109,769)
Equipment - office	(53,559)	-	(11,273)	-	(64,832)
Obsolete capital assets	(499,015)	-	-	-	(499,015)
Accumulated depreciation	(6,059,506)	-	(191,907)	53,117	(6,198,296)
Capital assets, net	\$ 359,236	\$ -	\$ (109,984)	\$ -	\$ 249,252

Included in data processing software and data processing equipment are \$400,786 in assets under a capital lease at June 30, 2008 and 2007. There was \$0 and \$106,091, respectively for each fiscal year, in related amortization on these assets.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE B – CAPITAL ASSETS - CONTINUED

Capital assets at June 30, 2007 consisted of:

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

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, 2007	\$ 3,160,748	\$ 3,110,748	\$ 50,000	\$ -
Current year net income	40,810,571	40,810,571	-	-
Current year transfers	(41,018,670)	(40,968,670)	(50,000)	-
Balance at June 30, 2008	<u>\$ 2,952,649</u>	<u>\$ 2,952,649</u>	<u>\$ -</u>	<u>\$ -</u>

In accordance with the Lottery 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, SHARE fund number 63700. As of July 31, 2008 and 2007, the Lottery has transferred \$40,810,571 and \$34,830,136, respectively, for the periods ended June 30, 2008 and 2007 to the New Mexico State Treasurer. In addition, the \$50,000 balance in the 2% Reserve Fund was transferred to the New Mexico State Treasurer, for deposit in the Lottery Tuition Fund, on July 31, 2007.

NOTE D - RETIREMENT PLAN

Plan Description

All of the Lottery's eligible employees participate in a plan provided by the Lottery pursuant to the New Mexico Lottery Act (Chapter 6, Article 24 NMSA 1978). The Lottery is the administrator of the Plan, which is a defined contribution money purchase pension plan. The New Mexico Lottery Authority Retirement Plan provides for retirement benefits to plan members and their beneficiaries. The balances and activity of the Plan as of and for the years ended June 30, 2008 and 2007 are presented in the Statements of Fiduciary Net Assets and Statements of Changes in Fiduciary Net Assets. There are no separately issued financial statements available for the New Mexico Lottery Authority Retirement Plan.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE D - RETIREMENT PLAN - CONTINUED

Funding Policy

The Lottery contributes 13.25% of compensation for eligible employees to the Plan. Lottery contributions are 100% vested when deposited monthly. For the years ended June 30, 2008 and 2007, the Lottery recognized \$312,122 and \$365,686 of pension expense for the Plan on eligible compensation of \$2,355,638 and \$2,759,894, respectively. The entire pension amounts have been paid to the Plan by June 30, 2008 and 2007, respectively, for all compensation paid during the respective fiscal years.

NOTE E - CREDIT AGREEMENT

In July 2005, the Lottery entered an agreement with First Community Bank (formerly First State Bank) effective May 15, 2005 for an automatic unsecured overdraft line of credit sweep in the amount of \$1,000,000 with a fixed interest rate at the Wall Street Journal interest rate less .500 percentage points (4.5% and 7.5% respectively at June 30, 2008 and 2007). The line matured in May 2008 and was extended through May 14, 2010. For the periods ended June 30, 2008 and 2007, the Lottery had no outstanding borrowings against the line.

NOTE F - LEASES

The Lottery has entered into operating leases for the rental of office and warehouse space, and vending machines. Rent expense was \$556,860 and \$727,842 for the years ending June 30, 2008 and 2007, respectively. In August 2002, the Lottery renegotiated its leases for office and warehouse space. These leases were extended for an additional seven years at the same lease amounts that were paid for the final year of the original lease in 2006. Future minimum rental payments on non-cancelable leases with original terms of one year or more are scheduled as follows:

<u>Year</u>	<u>Amount</u>
2009	378,886
2010	431,485
2011	431,485
2012	431,485
2013	323,615
	<u>\$ 1,996,956</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE F – LEASES - CONTINUED

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

<u>Year</u>	<u>Amount</u>
2009	\$ <u>52,600</u>

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

	<u>2008</u>	<u>2007</u>
Minimum rentals	\$ 512,485	\$ 685,417
Less: Sublease rentals	<u>(122,000)</u>	<u>(117,200)</u>
	<u>\$ 390,485</u>	<u>\$ 568,217</u>

As part of the agreement with Scientific Games International, Inc. for the procurement of instant lottery ticket printing/related services and customer relationship management system (CRM), the Lottery installed and implemented a CRM system in fiscal year 2004. The CRM system cost is included in the fixed fee paid to the vendor as a percentage of instant tickets sold that have been printed under this contract. The Lottery has accounted for this transaction as a capital lease. The CRM system cost was projected over the life of the contract remaining at the time of installation and has been capitalized on the books of the Lottery at the present value of this cost, as determined with a discount rate of 4%. As of June 30, 2007, the cost of the CRM system has been fully amortized.

NOTE G - COMMITMENT

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

On November 15, 2007, the Lottery entered into an online agreement with INTRALOT, Inc. to provide an online gaming system. See Note I for additional disclosures.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2008 and 2007

NOTE H - OTHER EXPENSES

Other expenses at June 30, consisted of:

	<u>2008</u>	<u>2007</u>
Training	\$ 24,152	\$ 8,734
Registrations and memberships	23,681	29,048
Other	18,613	24,877
Publications and subscriptions	<u>2,893</u>	<u>3,189</u>
	<u>\$ 69,339</u>	<u>\$ 65,848</u>

NOTE I - SUBSEQUENT EVENTS

Conversion to a new on-line gaming system.

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 system will include the supply, installation, maintenance, service, and operation of a communication network, lottery terminals and peripheral equipment for the Lottery's existing and future retailers, 500 ticket scanners to enable players to check their tickets for prizes, 225 self service ticket vending machines that sell both instant and on-line 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 has been on-going in fiscal year 2008 with conversion to the new system planned for November 16, 2008.

New Mexico Lottery Authority

BUDGETARY COMPARISON STATEMENT

Years ended June 30, 2008 and 2007

	2008			2007			Variance with Final Budget
	Original Budget	Final Budget	Actual	Original Budget	Final Budget	Actual	
Revenues							
Instant ticket sales	\$ 91,500,000	\$ 87,000,000	\$ 89,925,612	\$ 91,500,000	\$ 93,500,000	\$ 95,729,489	\$ 2,229,489
Powerball sales	45,000,000	43,000,000	44,504,959	50,000,000	45,000,000	42,625,468	(2,374,532)
Roadrunner Cash sales	8,500,000	7,300,000	6,552,774	8,500,000	8,500,000	7,934,309	(565,691)
Hot Lotto sales	5,100,000	5,300,000	6,004,241	2,500,000	3,000,000	3,476,503	476,503
Pick 3 sales	2,000,000	2,100,000	2,327,283	2,000,000	2,000,000	2,058,844	58,844
Raffle game sales	2,500,000	1,001,000	1,001,400	-	-	-	-
4 This Way! sales	-	215,000	215,546	800,000	600,000	653,662	53,662
Retailer fees	42,000	45,000	46,782	44,000	43,000	45,791	2,791
Prize tickets	(3,600,000)	(4,300,000)	(3,333,227)	(4,800,000)	(5,000,000)	(4,335,817)	664,183
Spoiled, stolen, and promotional tickets	(180,000)	(180,000)	(92,911)	(118,000)	(131,000)	(107,995)	23,005
Bad debts	(12,000)	(6,000)	-	(24,000)	(12,000)	-	12,000
Total revenues	150,850,000	141,475,000	147,152,459	150,402,000	147,500,000	148,080,254	580,254
Total game expenses	103,977,000	97,972,000	101,724,644	109,621,000	107,001,000	108,181,098	1,180,098
Total operating expenses	5,833,000	5,642,000	5,272,119	6,680,000	6,183,000	5,781,828	(401,172)
Operating income	41,040,000	37,861,000	40,155,696	34,101,000	34,316,000	34,117,328	(198,672)
Total non-operating income	460,000	491,000	654,875	386,000	456,000	712,808	256,808
Net income before transfers to Lottery Tuition Fund	\$ 41,500,000	\$ 38,352,000	\$ 40,810,571	\$ 34,487,000	\$ 34,772,000	\$ 34,830,136	\$ 58,136

New Mexico Lottery Authority

SCHEDULE OF PERCENTAGE RETURN TO THE STATE OF NEW MEXICO

Years ended June 30, 2008 and 2007

	2008	2007
REVENUES		
Instant ticket sales	\$ 89,925,612	\$ 95,729,489
Powerball sales	44,504,959	42,625,468
Roadrunner Cash sales	6,552,774	7,934,309
Hot Lotto sales	6,004,241	3,476,503
Pick 3 sales	2,327,283	2,058,844
Raffle game sales	1,001,400	-
4 This Way! Sales	215,546	653,662
Retailer fees	46,782	45,791
Prize tickets	(3,333,227)	(4,335,817)
Spoiled, stolen, and promotional tickets	(92,911)	(107,995)
Total revenues	<u>147,152,459</u>	<u>148,080,254</u>
NON-OPERATING INCOME		
Interest income	492,351	582,916
Other income	162,524	129,892
Total non-operating income	<u>654,875</u>	<u>712,808</u>
GROSS REVENUES	147,807,334	148,793,062
GAME EXPENSES		
Prize expense	80,091,765	85,119,755
Retailer commissions	9,676,366	9,754,742
On-line vendor fees	6,999,633	6,597,580
Advertising	2,192,858	2,913,129
Ticket vendor fees	1,648,674	1,444,683
Shipping and postage	376,029	415,265
Promotions	368,766	650,133
Drawing game	142,298	109,704
Responsible gaming	81,120	81,120
Instant ticket vending machine lease	81,000	253,932
Game membership	66,135	10,242
Reserve Fund expense	-	830,813
Total game expenses	<u>101,724,644</u>	<u>108,181,098</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	3,387,288	3,685,704
Leases and insurance	617,220	632,380
Utilities and maintenance	421,690	415,924
Professional fees	402,993	320,784
Depreciation and amortization	191,907	391,824
Materials and supplies	108,370	203,024
Travel	73,312	66,340
Other	69,339	65,848
Total operating expenses	<u>5,272,119</u>	<u>5,781,828</u>
OPERATING INCOME	<u>40,155,696</u>	<u>34,117,328</u>
NET INCOME	<u>\$ 40,810,571</u>	<u>\$ 34,830,136</u>
GROSS REVENUE PERCENTAGE RETURN	<u>27.61%</u>	<u>23.41%</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. Hector H. Balderas
New Mexico State Auditor

We have audited the basic financial statements of the New Mexico Lottery Authority (the Lottery) and its fiduciary fund as of and for the year ended June 30, 2008, including the budget to actual comparison statement presented as supplemental information and have issued our report thereon dated September 30, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting.

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

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

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

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

Compliance and Other Matters

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

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

Moss Adams LLP

Albuquerque, New Mexico
September 30, 2008

New Mexico Lottery Authority

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year Ended June 30, 2008

2007-01	Professional Service Contracts	Cleared
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SCHEDULE OF CURRENT YEAR AUDIT FINDINGS

None

New Mexico Lottery Authority

EXIT CONFERENCE

For the year ended June 30, 2008

An exit conference was held at the New Mexico Lottery Authority on September 30, 2008. The following individuals participated:

<u>Name</u>	<u>Title</u>
<i>New Mexico Lottery Authority Audit Committee</i> Reta Jones, CPA, CVA	Chairman of the Board
<i>New Mexico Lottery Authority Employees</i> Tom Romero Sylvia Ann Jaramillo, CPA Michael Boland	Chief Executive Officer Director of Finance Internal Auditor
<i>Moss Adams LLP</i> Scott Eliason, CPA Corrine Zajac-Clarkson	Audit Partner Supervisor

Financial Statement Preparation

The New Mexico Lottery Authority's financial statements have been prepared by the New Mexico Lottery Authority's accountants.