

NEW MEXICO LOTTERY AUTHORITY

FINANCIAL STATEMENTS

JUNE 30, 2010 and 2009

OFFICIAL ROSTER

June 30, 2010

BOARD OF DIRECTORS

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OFFICIALS OF THE NEW MEXICO LOTTERY AUTHORITY

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ORGANIZATIONAL DIVISIONS OF THE NEW MEXICO LOTTERY AUTHORITY

The Executive Division, under the direction of the Chief Executive Officer, provides leadership for all activities of the New Mexico Lottery Authority (the Lottery) to carry out its objectives and overall statutory mission to maximize net revenues for the Lottery's beneficiaries. The division establishes and directs the organization's day-to-day operating strategy and plan. In addition, the division performs as a liaison among the Board, the Governor, the Legislature, governmental entities, external providers of goods and services, retailers, the public and Lottery divisions and employees. Also, within the Executive Division is Product Development, which manages and monitors the instant 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 of New Mexico; the financial audit and related compilation of financial statements, related notes, and the Management's Discussion and Analysis (MDA) for the fiscal year; the statutorily required annual proposed operating budget for the Lottery for the succeeding fiscal year and the final proposed budget 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, 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

ORGANIZATIONAL DIVISIONS OF THE NEW MEXICO LOTTERY AUTHORITY - CONTINUED

and player and retailer publications; as well as negotiating and overseeing the Lottery's participation in a number of statewide promotions and special events. The 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 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 among the Attorney General's Office, District Attorney Offices and law enforcement agencies in general. It is also responsible for building and employee security and safety. 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

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, 2010 and 2009, which collectively comprise the Lottery's basic financial statements as listed in the table of contents. We have also audited the budgetary comparison statements presented as supplementary information in the accompanying financial statements for the years ended June 30, 2010 and 2009, 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. 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 opinion.

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, 2010 and 2009, 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, 2010 and 2009 in conformity with accounting principles generally accepted in the United States of America.

Board of Directors New Mexico Lottery Authority

The management's discussion and analysis, on pages 3 through 19, 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 schedule listed as supplemental information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements.

Mess adams LLP

Albuquerque, New Mexico October 15, 2010

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, 2010 and 2009 with comparative numbers for the fiscal year ended June 30, 2008. Please read it in conjunction with the financial statements, which begin on page 20.

FINANCIAL HIGHLIGHTS

- At the end of fiscal year 2010 and 2009, the Lottery's total current assets decreased by 5.4% or \$464,295 and 12.8% or \$1,257,964, respectively, in comparison to June 30th of the previous fiscal years.
- The Lottery's total liabilities decreased by \$401,391 and \$1,252,623, (4.5)% and (12.4)%, respectively at the end of fiscal year 2010 and 2009, compared to the end of the two previous fiscal years.
- In fiscal year 2010, total revenues were \$143,538,772, an increase of \$1,222,555 or a 0.9% increase, compared to total revenues for fiscal year 2009. In fiscal year 2009, total revenues were \$142,316,217, a decrease of \$4,836,242 or (3.3)%, compared to the total revenues for fiscal year 2008 of \$147,152,459.
- From the prior fiscal years, total game expenses decreased by \$1,370,167 (1.4)% in fiscal year 2010 and \$5,368,125, (5.3)%, in fiscal year 2009.
- Total operating expenses decreased by 7.1% or \$383,045 in fiscal year 2010, whereas, in fiscal year 2009 total operating expenses increased by 2.3% or \$121,555 in comparison to the previous fiscal years.
- Non-operating income decreased in both fiscal years 2010 and 2009 by \$181,313, (73.0)%, and \$406,527, (62.1)%, respectively.
- Net income in fiscal year 2010 was \$43,608,826, a \$2,794,454 or a 6.8% increase over fiscal year 2009. In fiscal year 2009, net income was \$40,814,372, an increase of \$3,801 over the net income for fiscal year 2008 of \$40,810,571. Beginning July 1, 2007, the Lottery was required by the New Mexico Lottery Act to transmit at least twenty-seven percent of its gross revenues to the State of New Mexico and then at least 30% beginning in January 2009. In fiscal year 2009, the Lottery transmitted 30.37% in net revenues to the State. In fiscal year 2009, the Lottery transmitted 28.63%, surpassing the blended rate of 28.5%,--27% for the first six months and 30% for the second six months. In fiscal year 2008, the Lottery transmitted 27.61% of its gross revenues to the State, also surpassing the 27% required rate, in comparison to 23.41% for the previous fiscal year. The Lottery has continued to transfer its actual net income each month, regardless of whether or not the amount of net income exceeded the statutory requirement.
- Including the final transfer on July 30, 2010 of June 2010's net revenues (net income); the Lottery has transferred \$446,172,813 to the State of New Mexico since the commencement of sales in April 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

Financial Statements. The Statements of Net Assets on Page 20 and the Statements of Revenues, Expenses, and Changes in Net Assets on page 21 report the Lottery's assets, liabilities, revenues and expenses in comparative format for fiscal year 2010 and fiscal year 2009. The Statements of Cash Flows on pages 22 and 23 report the sources and uses of cash for fiscal years 2010 and 2009. The Statements of Fiduciary Net Assets on page 24 and Statements of Changes in Fiduciary Net Assets on page 25 report the balances and activity of the Lottery's Retirement Plan for fiscal years 2010 and 2009.

Notes to Financial Statements. The Notes to Financial Statements on pages 26 to 42 provide additional information that is essential for a full understanding of the financial statements and provide more detailed data.

Budgetary Comparison Statements. The Budgetary Comparison Statements on page 43 show the variances between the budgets and actual Lottery performance.

Schedules of Percentage Return to the State of New Mexico. The Schedules of Percentage Return to the State of New Mexico on page 44 reports the percentage of gross revenues that was returned to the State of New Mexico for fiscal years 2010 and 2009.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS

Total Net Assets

At the end of fiscal years 2010 and 2009, the Lottery's total assets and total liabilities were equal with total net assets reduced to zero. The Lottery has no reserve balances on its books, transferring its net revenues for the previous month to the Lottery Tuition Fund each month.

Assets

Table 1 Assets

| | 2010 | 2009 | 2008 | Increase (Decrease) \$ Change 2009 to 2010 | Increase (Decrease) % Change 2009 to 2010 | Increase (Decrease) \$ Change 2008 to 2009 | Increase (Decrease) % Change 2008 to 2009 |
|----------------------|--------------|--------------|---------------|---|--|---|--|
| Cash and cash | | | | | | | |
| Equivalents | \$ 2,988,826 | \$ 4,089,266 | \$ 5,359,828 | \$ (1,100,440) | (26.9)% | \$ (1,270,562) | (23.7)% |
| Accounts receivable, | | | | | | | |
| net | 2,219,806 | 1,717,935 | 1,817,274 | 501,871 | 29.2 | (99,339) | (5.5) |
| Reserves on deposit | 2,698,135 | 2,648,344 | 2,542,282 | 49,791 | 1.9 | 106,062 | 4.2 |
| Inventory | 96,342 | 9,262 | 15,680 | 87,080 | 940.2 | (6,418) | (40.9) |
| Prepaid expenses | 103,401 | 105,998 | 93,705 | (2,597) | (2.5) | 12,293 | 13.1 |
| Total current assets | 8,106,510 | 8,570,805 | 9,828,769 | (464,295) | (5.4) | (1,257,964) | (12.8) |
| Capital assets, net | 317,497 | 254,593 | 249,252 | 62,904 | 24.7 | 5,341 | 2.1 |
| Total assets | \$ 8,424,007 | \$ 8,825,398 | \$ 10,078,021 | \$ (401,391) | (4.5)% | \$ (1,252,623) | (12.4)% |

The Lottery's cash and cash equivalents decreased at the end of both fiscal years 2010 and 2009 by \$1,100,440 (26.9)% and \$1,270,562 (23.7)% compared to the prior fiscal years. The changes in cash and cash equivalents relate mainly to changes in accounts payable and prizes payable at the end of each fiscal year compared to the prior fiscal year.

Accounts receivable from the Lottery's retailers are collected weekly each Thursday through electronic bank transfers. Receivables are equal to sales by retailers net of any prizes paid by the retailers and any commissions earned, plus any miscellaneous receivables from any other source. Accounts receivable increased at the end of fiscal year 2010 by \$501,871 or 29.2%, whereas in fiscal year 2009, accounts receivable decreased by \$99,339, (5.5)%. In fiscal year 2010, sales for the last week and a half were higher than in the prior fiscal year, partially from including one additional day of sales in accounts receivable. In fiscal year 2009, a major

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Total Assets -Continued

component of the change was the reduction by \$178,198 in the amount of receivable from the Multi-State Lottery Association (MUSL) for interest and royalty income earned on its reserve accounts for the fiscal year.

The Lottery has amounts on deposit with MUSL called reserves on deposit, as required by the Powerball® (Powerball), Hot Lotto® (Hot Lotto), and Mega Millions® (Mega Millions) game rules and an unreserved account for payment of expenses and to record receipts of interest on the deposits. The changes in these accounts in both fiscal years 2010 and 2009 were caused by the receipt of interest earned on the deposits with MUSL; payments of game expenses; additions to the Hot Lotto reserve account, as required by the Hot Lotto game rules; and small changes to one of the Powerball reserve accounts. Additionally in fiscal year 2010, a reserve account for the new game, Mega Millions, was established in compliance with the Mega Millions game rules.

The inventory balance at the end of fiscal year 2010 increased by \$87,080, a 940.2% increase. The Lottery has agreements signed in March 2003 and 2010, with its primary instant ticket printer, whereby the tickets printed are owned by the vendor with the Lottery having an obligation to pay for the tickets when the tickets are sold. But, under an agreement signed with a secondary instant ticket printer in March 2010, the Lottery began purchasing the instant tickets printed by this vendor. The Lottery has accounted for four games printed under this agreement as ticket inventory using the specific identification method at the lower of cost or market. The inventory balance for these tickets at June 30, 2010 was \$96,342. In fiscal year 2009, instant ticket inventory from a pre-2003 agreement owned by the Lottery was depleted. In fiscal year 2009, the balance reflected in inventory represented Second Chance merchandise prizes of \$9,262.

As part of the agreement with INTRALOT, Inc. to provide an updated on-line gaming system, the Lottery installed and implemented a new internal control system (ICS) in fiscal year 2009. The cost of the ICS is included in the fixed fee paid to the vendor as a percentage of net sales. The Lottery has accounted for this transaction as a capital lease and, therefore, the ICS cost of \$43,600 is reflected in capital assets. The related liability for the ICS is included in the current portion of capital lease obligation (\$6,228 at June 30, 2010 and 2009) and in the noncurrent portion of capital lease obligation (\$27,510 and \$33,738 at June 30, 2010 and 2009, respectively).

There were no significant changes in capital assets in fiscal years 2010 and 2009; \$201,536 and \$177,656, including the \$43,600 capital lease purchase, in capital asset purchases and \$138,632 and \$172,315 in depreciation, for the two fiscal years, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED FINANCIAL ANALYSIS – CONTINUED

Liabilities

Table 2 Liabilities

| | 2010 | 2009 | 2008 | Increase (Decrease) \$ Change 2009 to 2010 | Increase (Decrease) % Change 2009 to 2010 | Increase (Decrease) \$ Change 2008 to 2009 | Increase (Decrease) % Change 2008 to 2009 |
|------------------------------|--------------|--------------|---------------|---|--|---|--|
| Accounts pay- | | | | | | | |
| able and other | | | | | | | |
| current liabilities | \$ 1,674,615 | \$ 1,883,818 | \$ 1,239,586 | \$ (209,203) | (11.1)% | \$ 644,232 | 52.0% |
| Current portion | | | | | | | |
| of capital lease | | | | | | | |
| obligation | 6,228 | 6,228 | | - | - | 6,228 | 100.0 |
| Prizes payable | 3,314,240 | 4,142,150 | 5,885,786 | (827,910) | (20.0) | (1,743,636) | (29.6) |
| Due to Lottery | | | | | | | |
| Tuition Fund | 3,401,414 | 2,759,464 | 2,952,649 | 641,950 | 23.3 | (193,185) | (6.5) |
| Total current Liabilities | 8,396,497 | 8,791,660 | 10,078,021 | (395,163) | (4.5) | (1,286,361) | (12.8) |
| Noncurrent por- | | | | | | | |
| tion of capital | | | | | | | |
| lease obligation | 27,510 | 33,738 | | (6,228) | (18.5) | 33,738 | 100.0 |
| | | | | | | | |
| Total liabilities | \$ 8,424,007 | \$ 8,825,398 | \$ 10,078,021 | \$ (401,391) | (4.5)% | \$ (1,252,623) | (12.4)% |

Accounts payable and other current liabilities decreased by \$209,203 (11.1)% at the end of fiscal year 2010, while in fiscal year 2009 the balance increased by \$644,232 or 52%. In both fiscal years, the changes compared to the prior fiscal year were mainly due to amounts owed to four vendors for advertising, on-line system, and instant ticket printing fees and the lottery's share of prizes payable to MUSL for Powerball, Hot Lotto, and Mega Millions. Sales amounts and advertising placed during the last few weeks of each fiscal year will generally determine the amounts owed at the end of each fiscal year to these vendors and whether that amount is higher or lower than in the prior fiscal year.

Prizes payable is essentially comprised of amounts accrued based on the Lottery's game designs and prize structures for drawing game and instant game prizes, the related unremitted federal and state taxes withheld on prizes claimed, and any unclaimed prizes in the prize fund. At the end of both fiscal year 2010 and 2009, prizes payable decreased by \$827,910 or (20.0)% and \$1,743,636 or (29.6) %, respectively. These differences relate to the changes of

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Liabilities - Continued

prizes payable on individual Lottery games between the years as a result of sales in each year and prizes not yet claimed. At the end of fiscal year 2010, the liability decreased from the previous fiscal year for instant game prizes by \$431,888, for Powerball by \$448,813, for Pick 3 by \$6,255, and for Hot Lotto Payable by \$9,724. The Prize Payable was more than for the previous fiscal year for Roadrunner Cash and the new game, Mega Millions by \$36,441 and \$47,303, respectively. At the end of fiscal year 2009, the liability for instant game prizes and Powerball prizes was approximately \$333,000 and \$218,000 less than at the end of the previous year. These changes in individual prize liability contributed to the change in prizes payable at the end of one fiscal year compared to the prior fiscal year. In addition, at the end of the previous two fiscal years, the changes in prizes payable can also be attributed to decreases of about \$17,464 and \$1,222,000 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 2010 and 2009, \$3,401,415 and \$2,759,464, respectively, of net revenues for the month of June were due to the Lottery Tuition Fund. These funds were transferred to the New Mexico State Treasurer by the end of July of each year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Sales and Prize Expense

Table 3 Sales and Prize Expense

Instant ticket, net of prize, stolen, and promotional tickets Powerball, net of spoiled and promotional tickets Hot Lotto, net of spoiled and promotional tickets Roadrunner Cash, net of spoiled and promotional tickets Mega Millions, net of spoiled and promotional tickets Pick 3, net of spoiled and promotional tickets Total

Instant ticket, net of prize, stolen, and promotional tickets Powerball, net of spoiled and promotional tickets Hot Lotto, net of spoiled and promotional tickets Roadrunner Cash, net of spoiled and promotional tickets Pick 3, net of spoiled and promotional tickets Total

| Sales | | Prize Sales Expense | | | Gross Margin |
|-------|-------------|------------------------|------------|----|-----------------|
| \$ | 78,420,660 | \$ | 45,033,793 | \$ | 33,386,867 |
| | 41,134,525 | | 20,583,573 | | 20,550,952 |
| | 9,130,469 | | 4,467,962 | | 4,662,507 |
| | 7,648,383 | | 4,469,653 | | 3,178,730 |
| | 3,846,692 | | 2,002,238 | | 1,844,454 |
| | 3,405,693 | | 2,049,350 | | 1,356,343 |
| \$ | 143,586,422 | \$ | 78,606,569 | \$ | 64,979,853 |

| 2009 | | | | | | | | | |
|-------|-------------|------------------------|------------|----|-----------------|--|--|--|--|
| Sales | | Prize Sales Expense | | | Gross Margin | | | | |
| \$ | 80,579,767 | \$ | 46,955,185 | \$ | 33,624,582 | | | | |
| | 43,938,481 | | 21,996,737 | | 21,941,744 | | | | |
| | 8,418,573 | | 4,129,217 | | 4,289,356 | | | | |
| | 6,444,473 | | 3,489,220 | | 2,955,253 | | | | |
| | 2,894,735 | | 1,736,980 | | 1,157,755 | | | | |
| \$ | 142,276,029 | \$ | 78,307,339 | \$ | 63,968,690 | | | | |

Instant ticket, net of prize, stolen, and promotional tickets Powerball, net of spoiled and promotional tickets Hot Lotto, net of spoiled and promotional tickets Roadrunner Cash, net of spoiled and promotional tickets Pick 3, net of spoiled and promotional tickets Raffle game, net of spoiled and promotional tickets 4 This Way!, net of spoiled and promotional tickets Total

\$ Increase (decrease) from FY 2009 to FY 2010
% Increase (decrease) from FY 2009 to FY 2010
\$ (Decrease) from FY 2008 to FY 2009
% (Decrease) from FY 2008 to FY 2009

| | 2008 | | | |
|-------------------|-------------------|-------------------|--|--|
| Sales | Prize Expense | Gross Margin | | |
| \$ 86,582,636 | \$ 48,995,046 | \$ 37,587,590 | | |
| 44,461,165 | 22,252,480 | 22,208,685 | | |
| 5,975,142 | 2,956,245 | 3,018,897 | | |
| 6,544,441 | 3,679,225 | 2,865,216 | | |
| 2,325,347 | 1,420,360 | 904,987 | | |
| 1,001,400 | 625,000 | 376,400 | | |
| 215,546 | 163,409 | 52,137 | | |
| \$ 147,105,677 | \$ 80,091,765 | \$ 67,013,912 | | |
| \$ 1,310,393 | \$ 299,230 | \$ 1,011,163 | | |
| 0.9% | 0.4% | 1.6% | | |
| \$ (4,829,648) | \$ (1,784,426) | \$ (3,045,222) | | |
| (3.3)% | (2.2)% | (4.5)% | | |

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Net 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 years 2010, 2009, and 2008. In fiscal year 2010, Hot Lotto, Roadrunner Cash and Pick 3 net sales, prize expense and gross margin increased, but decreased for instant games and Powerball. Mega Millions was introduced at the end of January 2010. In fiscal year 2009, Hot Lotto and Pick 3 net sales, prize expense and gross margin increased, but decreased for instant game and Powerball. For Roadrunner Cash, both net sales and prize expense decreased, but gross margin increased in comparison to the previous fiscal year. The Raffle game and 4 This Way! Games were discontinued in fiscal year 2008.

Net Sales

In both fiscal years 2010 and 2009, the Lottery has continued to use the customer relationship management (CRM) system for placing instant game tickets at retailer locations. The Lottery's customer service representatives continue to place calls each week to each retailer location, review the inventory at each location with the retailer, and place orders continually as needed based on the inventory turnover at each location. In fiscal year 2010, fifty-four new instant ticket games were launched - 22 - \$1, 14 - \$2, 7 - \$3, 8 - \$5, 2 - \$10, 1 - \$20-5 more \$1, 2 less \$3, 2 less \$5, 1 less \$20 than in fiscal year 2009. In fiscal year 2009, fifty-four new instant ticket games were launched - 17-\$1, 14-\$2, 9-\$3, 10-\$5, 2-\$10, and 2-\$20-1 more \$1, 3 less \$2, 1 more \$3, and 1 more \$20 than in the previous fiscal year, but the same total number of games were launched for each fiscal year. In fiscal year 2010, the Lottery launched 22 games with free tickets and 32 games without free tickets, while in fiscal year 2009, the Lottery launched 18 games with prize tickets and 36 games without prize tickets. Instant tickets sales for 9 months of fiscal year 2010 were lower than in the comparable month in the previous fiscal year, with only November 2009, December 2009, and March 2010 sales being higher in fiscal year 2010. Instant ticket sales for every month in fiscal year 2009 were lower than for the comparable month in fiscal year 2008.

Powerball sales are generally driven by the advertised jackpot. In fiscal year 2010, there were 3 jackpots that surpassed \$250 million with one other jackpot reaching \$211.7 million and two jackpots exceeding \$125 million. In fiscal year 2009, there were 4 jackpots that surpassed \$150 million with two jackpots exceeding \$200 million (\$206.9 million and \$232.1 million). In fiscal year 2009, there was also a jackpot that rose to \$144 million. During these two fiscal years, there were no jackpots that reached the level of fiscal year 2008's \$314.3 million jackpot or \$276.3 million jackpot before being won. At the end of January 2010, the Lottery introduced another big jackpot game, Mega Millions. Two Powerball jackpots of \$258.5 million and \$261.6 million following the introduction of Mega Millions did not produce the sales that a similar jackpot of \$259.9 million had produced in August 2009.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Sales and Prize Expense - Continued

Net Sales – Continued

Adding a new big jackpot game in fiscal year 2010 and the differences in the jackpot amounts for each of these fiscal years reflect in the net sales for each fiscal year.

Mega Millions' sales are also driven by the jackpot amount. Following the commencement of sales on January 31, 2010, there was one jackpot that climbed to \$266 million before being won and one jackpot that climbed to \$133 million. Net sales for the five month period in fiscal year 2010 were \$3,846,692 or an average of \$769,338 per month. For fiscal year 2010, Powerball net sales averaged \$3,427,877 per month.

Similar to the Powerball and Mega Millions games, Roadrunner Cash sales are driven by the jackpot prize amount. In fiscal year 2010 the jackpot rose to more than \$150,000 on eight occasions; climbing to \$502,000 and \$462,000 in April and January 2010. In fiscal year 2009, the top prize was more than \$150,000 for five drawings, climbing to \$280,000, \$245,000 and \$230,000. In fiscal year 2008, the top prize was more than \$150,000 for six drawings, going to \$330,000 and \$210,000. These differences in the top prizes reflected on the net sales in these fiscal years.

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. Net sales for fiscal year 2010 increased by \$711,896 compared to fiscal year 2009. Net sales for fiscal year 2009 were more than \$2.4 million greater than in the prior fiscal year. During the current fiscal year the jackpot prize climbed to \$16.6 million, to \$6.78 million, to \$3.61 million, and to \$9.9 million. During fiscal year 2009 the jackpot reached \$12.2 million before being won and ended the year at \$10.1 million. These higher jackpots each year may have lent to higher sales in each fiscal year compared to the prior fiscal year.

Pick 3 net sales in the last two fiscal years increased by \$510,958 and \$569,388, respectively, compared to the net sales in the previous fiscal years. 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 drawing game net sales. Thus, another Raffle game was not held in fiscal years 2010 and 2009.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Sales and Prize Expense - Continued

Prize Expense

Prize expense for drawing 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 drawing 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 2010, prize payout for all the Lottery's games decreased by approximately .25% prior to the application of unclaimed prizes, while in fiscal year 2009, prize payout increased by about 1% prior to the application of unclaimed prizes.

At the end of the claim period for each game, unclaimed prizes for the Lottery's instant games and drawing 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 drawing games and for second chance drawings and, therefore, reduce the prize expense for Lottery products and help the Lottery to maximize its sales and its return to education.

Prize Tickets

In fiscal year 2010, prize tickets claimed for instant games increased by \$1,210,236 or 76.2%, while in fiscal year 2009, prize tickets claimed for instant games decreased by \$1,744,558, (52.3) %, in comparison to the previous fiscal years. Prize tickets are placed in the prize structure of the game in lieu of the breakeven prizes. Prize tickets give a player a prize of another instant game ticket of the same price point as the instant ticket that had the winning prize ticket. In the past 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Game Expenses

Table 4

| Game | Expenses | |
|-------|----------|--|
| Guine | Empenses | |

| | 2010 | 2009 | 2008 | Increase (Decrease) \$ Change 2009 to 2010 | Increase (Decrease) % Change 2009 to 2010 | (Decrease) \$ Change 2008 to 2009 | (Decrease) % Change 2008 to 2009 |
|----------------|---------------|---------------|----------------|---|--|---|--|
| Prize expense | \$ 78,606,569 | \$ 78,307,339 | \$ 80,091,765 | \$ 299,230 | 0.4% | \$ (1,784,426) | (2.2)% |
| Retailer | | | | | | | |
| commissions | 9,363,616 | 9,271,602 | 9,676,366 | 92,014 | 1.0 | (404,764) | (4.2) |
| On-line vendor | | | | | | | |
| fees | 2,290,586 | 4,009,103 | 6,999,633 | (1,718,517) | (42.9) | (2,990,530) | (42.7) |
| Advertising | 2,160,112 | 2,177,579 | 2,192,858 | (17,467) | (0.8) | (15,279) | (0.7) |
| Ticket vendor | | | | | | | |
| fees | 1,597,118 | 1,596,931 | 1,648,674 | 187 | 0.0 | (51,743) | (3.1) |
| Other game | | | | | | | |
| expenses | 968,351 | 993,965 | 1,115,348 | (25,614) | (2.6) | (121,383) | (10.9) |
| | | | | | | | |
| Total game | | | | | | | |
| expenses | \$ 94,986,352 | \$ 96,356,519 | \$ 101,724,644 | \$ (1,370,167) | (1.4)% | \$ (5,368,125) | (5.3)% |

The changes in retailer commissions for fiscal years 2010 and 2009 are consistent with the changes in gross ticket sales for the two years. Retailer commissions are paid to the Lottery's retailers for selling Lottery tickets, cashing Lottery prizes and for selling a jackpot prize for Powerball, Mega Millions and Hot Lotto and a top prize of more than \$100,000 for Roadrunner Cash.

Prior to November 21, 2008, on-line vendor fees were made up of two fees that were paid to the provider of the Lottery's on-line gaming system. One fee was 8.5236% of drawing game sales. The other fee was a weekly communication fee of \$24.00 for each retailer terminal. Since November 21, 2008, the on-line vendor fee has been a fixed 1.5% of net sales with no additional terminal fee. Normally, the on-line fee, the old and new fee, increases or decreases as drawing game/net sales increase or decrease and the communication fee increased or decreased depending on the number of sales terminals located at the Lottery's retailer locations. The changes in the on-line vendor fees for the two fiscal years are consistent with the changes in drawing game sales/net sales and changes in fee structure in fiscal years 2010 and 2009.

Advertising is expended to market the Lottery and its products to the public and to inform the public about the games that are available, the jackpot and top prize amounts for the drawing

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Game Expenses - Continued

games, to provide security tips and gambling awareness for our players and benefit messages to New Mexico students and their families, and to keep the lottery products fresh in the public's minds, all in order to maximize sales. Advertising expense amounts in fiscal year 2010 and 2009 are consistent between the two years. Advertising expense was approximately 1.50% and 1.53% of gross revenues, respectively, for fiscal years 2010 and 2009.

In fiscal years 2010 and 2003, the Lottery signed contracts with its primary ticket printer effective in March of each respective year. Under these contracts, the instant tickets are owned by the vendor with the Lottery expensing the cost to ticket vendor fees and paying for the tickets as a percentage of sales when the tickets are sold. The cost for the tickets under the 2003 contract also included the cost for the CRM system used by the Lottery. In addition, in March 2010, the Lottery signed a contract with a secondary printer, whereby the Lottery would be purchasing the tickets printed. These tickets are included in inventory with the cost of the tickets being recorded as ticket vendor fees as the tickets are consigned to retailers. In fiscal year 2010 and 2009, the cost for any licensing fees or special printing costs are also included in ticket vendor fees, rather than being allocated to the prize structure for the game as in previous years. The ticket vendor fees for fiscal years 2010 and 2009 are consistent with each other at 1.11% and 1.12%, respectively, of gross revenues for each of the two years.

Included in other game expenses are shipping and postage, promotions, drawing game, responsible gaming, game membership, and instant ticket vending machine lease expenses. Fiscal years 2010 and 2009 reflect a \$25,614 (2.6)% and a \$121,382 (10.9)% decrease in other game expenses, respectively. In fiscal year 2010 this decrease is primarily due to savings in the lease for the ticket vending machines and in game membership expenses offset with an increase in shipping and postage expenses for instant ticket shipments to retailers. In fiscal year 2009 this decrease is mainly due to savings in promotion expense and in the lease for the ticket vending machines for both drawing game tickets and instant game tickets were included as part of the on-line system agreement's percentage of net sales fee, effective on November 21, 2008.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Operating Expenses

| | 2010 | 2009 | 2008 | Increase (Decrease) \$ Change 2009 to 2010 | Increase (Decrease) % Change 2009 to 2010 | Increase (Decrease) \$ Change 2008 to 2009 | Increase (Decrease) % Change 2008 to 2009 |
|------------------|--------------|--------------|--------------|---|--|---|--|
| Salaries, wages, | | | | | | | |
| and benefits | \$ 3,468,593 | \$ 3,580,649 | \$ 3,387,288 | \$ (112,056) | (3.1)% | \$ 193,361 | 5.7% |
| Leases and | | | | | | | |
| insurance | 613,877 | 610,217 | 617,220 | 3,660 | 0.6 | (7,003) | (1.1) |
| Other operating | | | | | | | |
| expenses | 928,159 | 1,202,808 | 1,267,611 | (274,649) | (22.8) | (64,803) | (5.1) |
| | | | | | | | |
| Total operating | | | | | | | |
| expenses | \$ 5,010,629 | \$ 5,393,674 | \$ 5,272,119 | \$ (383,045) | (7.1)% | \$ 121,555 | 2.3% |

Table 5 Operating Expenses

Other operating expenses include utilities and maintenance, professional fees, depreciation and amortization, materials and supplies, travel, and other expenses. In fiscal year 2010, the Lottery decreased its total operating expenses by \$383,045 (7.1)%, while in fiscal year 2009, the Lottery increased its total operating expenses by \$121,555 or 2.3%. The decrease in fiscal year 2010 is partially due to \$112,056 savings in salaries, wages and benefits. Several vacated positions were not immediately filled in fiscal year 2010, thus, resulting in some cost savings in this area. In addition, in fiscal year 2010, the Lottery did not have the on-line conversion costs from the previous fiscal year and had a decrease in depreciation and professional fees expenses. In fiscal year 2009, the increase was essentially due to the salaries and related benefits for a few additional employee positions that were needed for the on-line conversion and for the day-to-day operations of the Lottery, as well as, the costs for the conversion to the new on-line system.

Non-Operating Income

Non-operating income decreased in fiscal year 2010 and 2009 mainly due to the decrease in interest rates and the related interest earned on the Lottery's deposits. In addition, in both fiscal years other income was reduced because the sublease for the building occupied by the former on-line vendor ended in January 2009.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Income

| | Total Revenues | Net Income |
|---|----------------|---------------|
| Fiscal Year 2010 | \$ 143,538,772 | \$ 43,608,826 |
| Fiscal Year 2009 | \$ 142,316,217 | \$ 40,814,372 |
| Fiscal Year 2008 | \$ 147,152,459 | \$ 40,810,571 |
| Increase from FY 2009 to FY 2010 | \$ 1,222,555 | \$ 2,794,454 |
| % Increase from FY 2009 to FY 2010 | 0.9% | 6.8% |
| Increase (decrease) from FY 2008 to FY 2009 | \$ (4,836,242) | \$ 3,801 |
| % Increase (decrease) from FY 2008 to FY 2009 | (3.3)% | 0.0% |

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 2010, the Lottery transmitted its net income each month, totaling \$43,608,826. The gross revenue percentage return for fiscal year 2010 was 30.37%. The Lottery was able to meet the 30% return each month in fiscal year 2010. In fiscal year 2009, the Lottery transmitted its net income each month, totaling \$40,814,372. The gross revenue percentage return for fiscal year 2010. In fiscal year 2009, the Lottery transmitted its net income each month, totaling \$40,814,372. The gross revenue percentage return for fiscal year 2009 was 28.63%, exceeding the required blended rate of 28.5%; 27% for the first six months and 30% for the last six months in the fiscal year.

The changes in net income for fiscal years 2010 and 2009 were related to the changes in sales for the Lottery's games during the two years netted against savings in the cost of the product and operating expenses during the two fiscal years.

In addition to the changes that had been made in fiscal year 2008 to meet the statutory requirement of 27% through December 2008 and 30% thereafter, the Lottery also commenced a new on-line system agreement in November 2008, whereby the fee to the on-line vendor was reduced, and separate terminal communication fees and vending machine fees that had previously been paid were eliminated. This change provided a percentage reduction of the on-line vendor fees to gross revenues of over 3% in fiscal year 2010 and almost 2% in fiscal year 2009 compared to fiscal year 2008.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Budgetary Comparison

| | | | 2010 | | | |
|---|--------------------|-----------------|----------------|------|----------------------------|---------------------------------------|
| | Original Budget | Final Budget | Actual | with | Variance n Final Budget | % Variance with Final Budget |
| Total revenues | \$ 139,000,000 | \$ 140,930,000 | \$ 143,538,772 | \$ | 2,608,772 | 1.9% |
| Total game expenses | 91,560,000 | 93,254,000 | 94,986,352 | | 1,732,352 | 1.9 |
| Total operating expenses | 5,900,000 | 5,378,000 | 5,010,629 | | (367,371) | (6.8) |
| Operating income | 41,540,000 | 42,298,000 | 43,541,791 | | 1,243,791 | 2.9 |
| Total non-operating income Net income before | 228,000 | 125,000 | 67,035 | | (57,965) | (46.4) |
| transfers to | | | | | | |
| Lottery Tuition Fund | \$ 41,768,000 | \$ 42,423,000 | \$ 43,608,826 | \$ | 1,185,826 | = 2.8% |
| | | | 2009 | | | |
| | Original Budget | Final Budget | Actual | with | Variance 1 Final Budget | % Variance with Final Budget |
| Total revenues | \$ 147,124,000 | \$ 138,140,000 | \$ 142,316,217 | \$ | 4,176,217 | 3.0% |
| Total game expenses | 99,383,000 | 92,885,000 | 96,356,519 | | 3,471,519 | 3.7 |
| Total operating expenses | 6,067,000 | 5,631,000 | 5,393,674 | | (237,326) | (4.2) |
| Operating income | 41,674,000 | 39,624,000 | 40,566,024 | | 942,024 | 2.4 |
| Total non-operating income Net income before transfers to | 398,000 | 251,000 | 248,348 | | (2,652) | (1.1) |
| Lottery Tuition Fund | \$ 42,072,000 | \$ 39,875,000 | \$ 40,814,372 | \$ | 939,372 | 2.4% |

In fiscal year 2010, the original fiscal year budget was revised as a result of adding a new jackpot game, Mega Millions, at the end of January 2010 and due to Instant ticket and Powerball sales under performing and Roadrunner Cash, Hot Lotto, and Pick 3 sales staying ahead of the original budget. The sales budget was increased by \$1.5 million made up of a reduction in instant ticket sales of \$3 million and in Powerball sales of \$4 million; an increase of \$1 million for Roadrunner Cash sales, \$1.5 million for Hot Lotto sales, and \$700,000 for

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

Pick 3 sales; and adding \$5.3 million as Mega Million sales for the five months remaining in the fiscal year. Prize tickets were also reduced by \$300,000 and spoiled, stolen and promotional tickets were reduced by \$117,000; and retailer fees were increased by \$13,000. All of these changes increased total operating revenues by \$1,930,000. Non-operating income was reduced by \$103,000 due to a decrease in interest rates in the current year. Gross revenues increased by \$1,827,000.

Related game expenses for prize expense, retailer commissions, on-line vendor fees, advertising, ticket vendor fees, and other game expenses were adjusted in accordance to the changes in sales with a total adjustment of \$1,694,000 to game expenses. Each line item in Operating expenses was reduced for a total reduction of \$522,000 and Net income was increased by \$655,000, still returning over 30% of Gross revenues.

In fiscal year 2009, the original fiscal year budget was revised as a result of sales not performing as planned. The total revenues budget was reduced by almost \$9 million. The Lottery revised its fiscal year 2009 original annual budget to decrease instant ticket sales by \$9 million, Powerball sales by \$3 million, Roadrunner Cash sales by \$900,000 and to increase Hot Lotto sales by \$2.2 million and Pick 3 sales by \$200,000. Prize tickets and spoiled, stolen and promotional tickets were reduced by approximately \$1.5 million.

Related game expenses for prize expense, retailer commissions, on-line vendor fees, ticket vendor fees, and shipping and postage, along with expenses for promotions, drawing game, and responsible gaming expenses were also reduced by a total of \$6.5 million. Each line item of operating expenses was also reduced in total by \$436,000 in the revised budget. These changes to sales and expenses resulted in a reduction to net income of \$2,197,000.

Net sales for the fiscal year exceeded expectation for 2010 with actual total revenues surpassing the revised budget by \$2,608,772 or ending the year at 101.9% of the revised budget. Along with the increase in net sales, game expenses directly increased by \$1,732,352 staying in line with the increase in net sales and at 101.9% of the revised budget. Operating expenses were \$367,371 less than the revised budget at 93.17%, with cost savings in salaries, wages and benefits of \$161,407, in professional fees of \$60,006, in utilities and maintenance of \$45,308 and in each of the other operating expense line items of \$100,650. Net income exceeded the revised budget by \$1,185,826 and ended the year at 102.8% of the revised budget.

Actual net sales for fiscal year 2009 improved, surpassing the sales projected for each product per the revised budget and providing about \$4.2 million in total revenues in excess of the revised budget; ending the fiscal year at 103.0% of the revised budget. Net income exceeded the revised budget by \$939,372. The Powerball run-ups in April 2009 and May 2009 lent to the game's net sales exceeding the revised FY 2009 budget by almost \$2 million. Net sales for instant tickets and the other three drawing games contributed the remaining \$2.2 million

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

during the last months of the fiscal year to surpass the revised net sales budget for their respective line items. Game expenses ended the fiscal year at 103.7% of the revised budget and were directly in correlation with the total revenues revised budget percentage. At the end of the fiscal year, total operating expenses were at 95.8% of the revised budget or almost \$240,000 less than the revised budget.

Requests for Additional Financial Information

This financial report is designed to provide the executive and legislative branches of the State of New Mexico, the public, the Lottery's retailers, vendors, creditors, and other interested parties with a general overview of the financial position as of June 30, 2010 and 2009, 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.

STATEMENTS OF NET ASSETS

June 30, 2010 and 2009

| | | 2010 | 2009 | | |
|---|----|-----------|------|-----------|--|
| CURRENT ASSETS | | | | | |
| Cash and cash equivalents | \$ | 2,988,826 | \$ | 4,089,266 | |
| Accounts receivable (net of allowance | | | | | |
| for doubtful accounts) | | 2,219,806 | | 1,717,935 | |
| Reserves on deposit | | 2,698,135 | | 2,648,344 | |
| Inventory | | 96,342 | | 9,262 | |
| Prepaid expenses | | 103,401 | | 105,998 | |
| Total current assets | | 8,106,510 | | 8,570,805 | |
| CAPITAL ASSETS, NET | | 317,497 | | 254,593 | |
| Total assets | \$ | 8,424,007 | \$ | 8,825,398 | |
| CURRENT LIABILITIES | | | | | |
| Accounts payable and other current liabilities | \$ | 1,674,615 | \$ | 1,883,818 | |
| Current portion of capital lease obligation | | 6,228 | | 6,228 | |
| Prizes payable | | 3,314,239 | | 4,142,150 | |
| Due to Lottery Tuition Fund | | 3,401,415 | | 2,759,464 | |
| Total current liabilities | | 8,396,497 | | 8,791,660 | |
| LONG-TERM LIABILITIES | | | | | |
| Noncurrent portion of capital lease obligation | - | 27,510 | - | 33,738 | |
| Total liabilities | \$ | 8,424,007 | \$ | 8,825,398 | |
| NET ASSETS | | | | | |
| Invested in capital assets, net of related debt | \$ | 317,497 | \$ | 254,593 | |
| Unrestricted net assets (deficit) | | (317,497) | | (254,593) | |
| Total net assets | \$ | | \$ | - | |

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years ended June 30, 2010 and 2009

| | 2010 | 2009 | | | | |
|--|---------------|---------------|--|--|--|--|
| REVENUES | | 0 170 010 | | | | |
| Instant ticket sales | \$ 81,231,127 | \$ 82,178,010 | | | | |
| Powerball sales | 41,177,600 | 43,983,020 | | | | |
| Hot Lotto sales | 9,138,601 | 8,424,318 | | | | |
| Roadrunner Cash sales | 7,654,480 | 6,451,302 | | | | |
| Mega Millions sales | 3,846,692 | 2 807 012 | | | | |
| Pick 3 sales | 3,408,240 | 2,897,012 | | | | |
| Retailer fees | 32,350 | 40,188 | | | | |
| Prize tickets | (2,798,905) | (1,588,669) | | | | |
| Spoiled, stolen, and promotional tickets | (71,413) | (68,964) | | | | |
| Bad Debts | (80,000) | 140.01/ 017 | | | | |
| Total revenues | 143,538,772 | 142,316,217 | | | | |
| GAME EXPENSES | | | | | | |
| Prize expense | 78,606,569 | 78,307,339 | | | | |
| Retailer commissions | 9,363,616 | 9,271,602 | | | | |
| On-line vendor fees | 2,290,586 | 4,009,103 | | | | |
| Advertising | 2,160,112 | 2,177,579 | | | | |
| Ticket vendor fees | 1,597,118 | 1,596,931 | | | | |
| Shipping and postage | 396,779 | 366,280 | | | | |
| Promotions | 292,958 | 289,495 | | | | |
| Drawing game | 134,059 | 133,113 | | | | |
| Responsible gaming | 82,690 | 81,120 | | | | |
| Game membership | 61,865 | 90,207 | | | | |
| Instant ticket vending machine lease | | 33,750 | | | | |
| Total game expenses | 94,986,352 | 96,356,519 | | | | |
| OPERATING EXPENSES | | | | | | |
| Salaries, wages, and benefits | 3,468,593 | 3,580,649 | | | | |
| Leases and insurance | 613,877 | 610,217 | | | | |
| Utilities and maintenance | 429,692 | 417,736 | | | | |
| Professional fees | 155,994 | 200,270 | | | | |
| Depreciation and amortization | 138,632 | 172,315 | | | | |
| Materials and supplies | 93,130 | 102,952 | | | | |
| Travel | 55,589 | 47,638 | | | | |
| Other | 55,122 | 261,897 | | | | |
| Total operating expenses | 5,010,629 | 5,393,674 | | | | |
| OPERATING INCOME | 43,541,791 | 40,566,024 | | | | |
| NON-OPERATING INCOME | | | | | | |
| Interest income | 51,663 | 142,683 | | | | |
| Other income | 15,372 | 105,665 | | | | |
| Total non-operating income | 67,035 | 248,348 | | | | |
| Net income before transfers | 43,608,826 | 40,814,372 | | | | |
| Transfers to Lottery Tuition Fund | (43,608,826) | (40,814,372) | | | | |
| Change in net assets | - | | | | | |
| Net assets at beginning of year | | <u> </u> | | | | |
| Net assets at end of year | <u> </u> | \$ - | | | | |

STATEMENTS OF CASH FLOWS

Years ended June 30, 2010 and 2009

Increase (Decrease) in Cash and Cash Equivalents

| | 2010 | 2009 |
|--|----------------|----------------|
| Cash flows from operating activities | | |
| Cash received: | | |
| From retailers-sales net of commissions, incentives, | | |
| and prize, spoiled, and stolen ticket credits | \$ 133,667,712 | \$ 133,127,232 |
| From MUSL - Powerball and Hot Lotto jackpots | 2,957,650 | 102,903,653 |
| Cash payments: | | |
| To prize winners and related taxes | (66,896,189) | (170,567,957) |
| To MUSL | (15,495,941) | (12,386,671) |
| To suppliers of goods or services | (9,354,158) | (10,593,510) |
| To employees for services and related taxes | (2,820,576) | (2,907,184) |
| | | |
| Net cash provided by operating activities | 42,058,498 | 39,575,563 |
| Cash flows from investing activities | | |
| Receipts of interest | 15,547 | 226,578 |
| Receipt of royalties | - | 28,226 |
| Receipts of rent | _ | 79,169 |
| Other | 154 | 8,749 |
| | | |
| Net cash provided by investing activities | 15,701 | 342,722 |
| Cash flows from noncapital financing activities | | |
| Transfers to Lottery Tuition Fund | (42,966,875) | (41,007,557) |
| Transfers to Lottery Tuttion Fund | (42,900,875) | (41,007,557) |
| Cash flows from capital and related financing activities | | |
| Purchases of capital assets | (201,536) | (177,656) |
| Principal payments under capital lease | (6,228) | (3,634) |
| | (-,==-) | |
| Net cash used by capital and related financing | (207,764) | (181,290) |
| Activities | | |
| | | |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,100,440) | (1,270,562) |
| ~ | | |
| Cash and cash equivalents at beginning of year | 4,089,266 | 5,359,828 |
| | | |
| Cash and cash equivalents at end of year | \$ 2,988,826 | \$ 4,089,266 |
| | | |

STATEMENTS OF CASH FLOWS - CONTINUED

Years ended June 30, 2010 and 2009

Increase (Decrease) in Cash and Cash Equivalents

| | | 2010 | | 2009 | |
|--|----------|------------|----|-------------|--|
| Reconciliation of operating income to net cash | | | | | |
| provided by operating activities | | | | | |
| Operating income | \$ | 43,541,791 | \$ | 40,566,024 | |
| Adjustments to reconcile operating income to net | | | | | |
| cash provided by operating activities | | | | | |
| Depreciation | | 138,632 | | 172,315 | |
| Vendor's non-cash transactions | | 49,466 | | (525) | |
| Interest on MUSL unreserved account | | 8,279 | | 8,347 | |
| Net changes in assets and liabilities: | | | | | |
| Accounts receivable | | (507,444) | | 82,617 | |
| Reserves on deposit | | (49,791) | | (106,062) | |
| Inventory | | (87,080) | | 6,418 | |
| Prepaid expenses | | 2,597 | | (12,293) | |
| Accounts payable and other liabilities | | (209,203) | | 644,232 | |
| Accrued liabilities | | (838) | | (41,874) | |
| Prizes payable | <u>.</u> | (827,911) | - | (1,743,636) | |
| | | | | | |
| Net cash provided by operating activities | \$ | 42,058,498 | \$ | 39,575,563 | |

STATEMENTS OF FIDUCIARY NET ASSETS

June 30, 2010 and 2009

| | 2010 | | 2009 | | |
|---|------|-----------|------|-----------|--|
| ASSETS | | | | | |
| Cash and cash equivalents | \$ | 330,059 | \$ | 292,788 | |
| Marketable securities and other investments | | 2,705,464 | | 2,211,022 | |
| Contribution receivable | | 15,654 | | 16,765 | |
| Total assets | \$ | 3,051,177 | \$ | 2,520,575 | |
| | | | | | |
| NET ASSETS | | | | | |
| Pension plan participants' benefits | \$ | 3,051,177 | \$ | 2,520,575 | |

STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS

Years ended June 30, 2010 and 2009

| | 2010 | | 2009 | | |
|-------------------------------|------|-----------|------|----|-----------|
| ADDITIONS | | | | | |
| Investment earnings | \$ | 624,893 | | \$ | 282,355 |
| Employer contributions | | 339,579 | | | 340,012 |
| Total additions | | 964,472 | | | 622,367 |
| DEDUCTIONS | | | | | |
| Investment losses | | 289,667 | | | 863,892 |
| Distributions to participants | | 144,203 | | | 95,030 |
| Fees | | - | | | 108 |
| Total deductions | | 433,870 | | | 959,030 |
| Change in net assets | | 530,602 | | | (336,663) |
| Net assets - beginning | | 2,520,575 | | | 2,857,238 |
| Net assets - ending | \$ | 3,051,177 | | \$ | 2,520,575 |

NOTES TO FINANCIAL STATEMENTS

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. <u>Reporting Entity</u>

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 drawing game tickets on October 20, 1996.

2. Basis of Presentation

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

In accordance with Governmental Accounting Standards Board (GASB) Statement Number 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, 2010 and 2009

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 non-operating items. Operating revenues and expenses generally result from providing goods and services in connection with the Lottery's principal ongoing operations. The principal operating revenues of the Lottery are sales of instant and drawing game 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 non-operating revenues and expenses.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the Lottery's policy is to first apply the expense toward unrestricted resources and then toward restricted resources. At the end of fiscal years 2010 and 2009 there were no 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 Statements of Cash Flows, the Lottery considers cash and cash equivalents to be cash on hand, demand deposits, time deposits with an original maturity of ninety days or less, and overnight repurchase agreements.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

5. Accounts Receivable

Accounts receivable represent the unremitted receipts on ticket sales, net of retailer commissions and prizes paid by the retailers. Receipts are transferred weekly from retailer bank accounts to the Lottery. Credit losses relating to contracted retailers have been within management expectations. Generally, collateral is not required on receivables. At June 30, 2010 and 2009, an allowance for doubtful accounts of \$115,750 and \$72,338, respectively, has been provided to recognize future uncollectible billings. In fiscal years 2010 and 2009, ten customers (459 and 457 retailer locations) represented 52% of sales for each year, respectively, and 49% and 54% of accounts receivable for each year, respectively.

6. Reserves on Deposit

The Lottery is a member of the Multi-State Lottery Association (MUSL), which operates games on behalf of participating lotteries. MUSL currently operates the POWERBALL® (Powerball), Hot Lotto® (Hot Lotto) and Mega Millions® (Mega Millions) games for the Lottery. The Lottery sells Powerball, Hot Lotto and Mega Millions game tickets through its retailers and makes weekly wire transfers to MUSL in an amount equivalent to the member lottery's share of the estimated grand prize liability for each game. Lesser prizes are paid directly to the winners by each member lottery. The prize pools for the three games 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 has established prize reserve accounts for the games it operates. These prize reserve accounts are funded out of the prize pools for the games until the accounts reach amounts set by the MUSL product groups for each game. Once the prize reserve funds exceed these designated maximums, the excess becomes part of the grand prize pool. The prize reserve funds serve as contingency reserves to protect MUSL and the party lotteries from unforeseen prize liabilities. The money in these reserve funds is used at the discretion of the MUSL Board of Directors. The prize reserve funds are refundable to MUSL members if MUSL disbands, a member leaves MUSL, or a game is discontinued. In these instances, members must wait one year before receiving their remaining share, if any, of the prize reserve funds. The prize reserve funds.

MUSL included 2% of the Lottery's Powerball drawing period's sales in two prize reserve accounts, the Powerball Prize Reserve Account (PRA) and the Set Prize Reserve Account (SPRA), until the Lottery's share in both the PRA and SPRA were fully funded. The maximum amounts designated by the MUSL Powerball product group for the PRA is \$100 million and for the SPRA is \$25 million for all member lotteries. At June 30, 2010 and 2009, the Lottery's share in the Powerball PRA was \$1,399,800 for each period and in the SPRA was \$454,690 and \$449,464, respectively. Both Powerball reserve funds are fully funded.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

6. <u>Reserves on Deposit - Continued</u>

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 (PRA). The MUSL product group has set the maximum Hot Lotto PRA balance at \$9 million for all party lotteries. At June 30, 2010 and 2009, the Lottery's share in the Hot Lotto PRA was \$570,096 and \$468,757, respectively. The Lottery's remaining Hot Lotto prize reserve buy-in amount was \$171,569 and \$272,908, respectively, as of June 30, 2010 and 2009.

The Lottery commenced sales of Mega Millions tickets on January 31, 2010. MUSL includes an additional amount up to 1% of the Lottery's Mega Millions drawing period's sales and 4.93338682% of the Megaplier sales into the Prize Reserve Account (PRA). The MUSL product group has not determined a maximum balance for the Mega Millions Prize Reserve Account (PRA). At June 30, 2010, the Lottery's share in the Mega Millions PRA is (\$9,941).

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, 2010 and 2009, the Lottery's share of the unreserved fund was \$283,490 and \$330,323, respectively.

A winner of a Powerball grand prize, a Hot Lotto grand prize, or Mega Millions grand prize may select that the prize be paid at the cash value of the prize or as an annuity. A Powerball grand prize annuity is paid out in 30 annual installments, a Hot Lotto grand prize annuity is paid out in 25 annual installments, and a Mega Millions grand prize is paid out in 26 annual installments. Government bonds or securities at the discounted value of the grand prize annuity are purchased to fund all future installments and are held in trust. Maturities are staggered in order to provide adequate cash flow for each annual installment. These assets and related liabilities are reflected in MUSL's financial statements and therefore are not reflected in the Lottery's financial statements. MUSL is responsible for transferring the cash or the annuity installment amounts to the member lottery prior to the payment to any grand prize winner. Currently, the Lottery is not paying any prize winner any annuity prize payments.

7. <u>Inventory</u>

Since the inception of the Lottery, inventory, which mainly consisted of lottery instant tickets for future use, was carried at the lower of cost or market using the specific identification method. During fiscal year 2009, the Lottery depleted the remaining instant ticket inventory that it owned under pre-2003 agreements.

In March 2003 and then again in March 2010, the Lottery entered into agreements with its primary instant ticket printers, whereby the vendors retain title to the instant ticket inventory

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

7. <u>Inventory - Continued</u>

until the instant tickets are sold. Under the March 2003 agreement, the Lottery pays the vendor a fee based on a fixed percentage of the instant tickets sold. Under the March 2010 agreement, the Lottery pays the vendor a fee based on a fixed percentage of the net instant tickets sold; net instant tickets representing instant tickets less prize, spoiled, stolen, and promotional tickets.

In addition, in March 2010, the Lottery signed an agreement with a secondary instant ticket printer, whereby the Lottery purchases and owns the tickets printed. These tickets are carried at the lower of cost or market using the specific identification method.

At the end of fiscal year 2010, the Lottery is distributing games printed under the March 2003 agreement and the two March 2010 agreements.

As of June 30, 2010 and 2009, \$96,342 and \$0, respectively, of instant tickets and \$0 and \$9,262, respectively, in merchandise prizes for second chance drawings are included in inventory.

8. <u>Capital Assets</u>

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

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 drawing 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.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

10. Prizes

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

11. <u>Commissions</u>

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, 2010 and 2009, the Lottery maintained its cash balances in one financial institution. The balances for demand deposits were insured by the Federal Deposit Insurance Corporation up to \$250,000 at this financial institution.

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

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

14. Custodial Credit Risk and Interest Rate Risk - Continued

The Lottery's custodial risk for investments is in accordance with Article 10, NMSA, 1978 Compilation. The Lottery's investments are made in 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 Government 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, 2010 and 2009, the Lottery's bank balances of \$3,105,229 and \$4,195,040, respectively, were exposed to custodial credit risk as follows:

| | <u>2010</u> | <u>2009</u> |
|---|-----------------|-----------------|
| Uninsured and uncollateralized Collateral held by the pledging bank's trust department in | \$ - | \$ - |
| the Lottery's name | 3,105,229 | 4,195,040 |
| - | \$ 3,105,229 | \$ 4,195,040 |

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, 2010 and 2009, the Lottery had an overnight yield repurchase agreement with a one-day maturity.

15. Bank Accounts

| | | | Balance |
|---|----------------------|----|-----------|
| Description | Bank | p | er Bank |
| Operating account - overnight repurchase | | | |
| Agreement | First Community Bank | \$ | 3,106,044 |
| Operating account – checking | First Community Bank | | (815) |
| Total amount deposited in bank | | | 3,105,229 |
| Less: FDIC coverage | | | - |
| *Total uninsured funds – deposits and overnight | repurchase agreement | \$ | 3,105,229 |

- -

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

15. Bank Accounts - Continued

| 102% pledged collateral requirement per | |
|---|-----------------|
| statute for repurchase agreement | \$ 3,168,165 |
| * Total pledged security | (3,190,164) |
| | |
| Amount under (over) requirement | |
| at June 30, 2010 | \$ (21,999) |

*Securities are held in safekeeping at the Federal Home Loan Bank in Dallas, Texas. Presented at fair value, CUSIP Numbers 36225BZQ4 (fair market value \$2,115,152) and 36225B5Y0 (fair market value \$1,075,012), mature September 15, 2018 and June 15, 2019. The deposits and repurchase agreement are collateralized with securities held in the name of the New Mexico Lottery Authority.

| Cash and cash equivalents per bank at June 30, 2010 Less reconciling itemsoutstanding checks | \$ 3,105,229 (121,846) |
|---|------------------------------|
| Reconciled cash in bank at June 30, 2010 | 2,983,383 |
| Cash in vault | 5,443 |
| Total cash and cash equivalents per Statements of Net Assets | \$ 2,988,826 |

16. <u>Risk Management</u>

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, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

18. Net Assets

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

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

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.

Unrestricted Assets-represent unrestricted liquid assets.

19. Unclaimed Prizes

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

20. Use of Estimates in Preparation of Financial Statements

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -CONTINUED

21. Compensated Absences Payable

Annual leave and sick leave are accrued at rates specified by the Lottery's Leave Policy. Annual leave is awarded based on the employee's years of 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. During the years ended June 30, 2010 and 2009, the following changes occurred in the compensated absences liabilities:

| Balance July 1, 2009 | Increase | Decrease | Balance June 30, 2010 |
|-------------------------|-----------|-------------|--------------------------|
| July 1, 2009 | micrease | Decrease | Julie 30, 2010 |
| \$ 173,094 | \$ 13,858 | \$ (11,914) | \$ 175,038 |
| Balance | | | Balance |
| | ~ | - | |
| July 1, 2008 | Increase | Decrease | June 30, 2009 |
| \$ 169,875 | \$ 13,491 | \$ (10,272) | \$ 173,094 |

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.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -CONTINUED

22. Long-term Liabilities - Capital Lease Obligations

During the years ended June 30, 2010 and 2009, the following changes occurred in the capital lease obligations:

| Balance July 1, 2009 | Increase | Decrease | Balance June 30, 2010 | Amounts Due Within One Year |
|-------------------------|-----------|------------|--------------------------|-----------------------------------|
| \$ 39,966 | \$ - | \$ (6,228) | \$ 33,738 | \$ 6,228 |
| Balance July 1, 2008 | Increase | Decrease | Balance June 30, 2009 | Amounts Due Within One Year |
| \$ - | \$ 43,600 | \$ (3,634) | \$ 39,966 | \$ 6,228 |

23. Accounts Payable and Other Current Liabilities

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

| | <u>2010</u> | 2009 |
|--|----------------------------------|-----------------------------------|
| Accounts payable Accrued liabilities, vendors* Accrued liabilities, retailers* Accrued payroll, and payroll | \$ 1,250,884 79,838 12,500 | \$ 1,373,368 145,605 14,500 |
| taxes and benefits Compensated absences | 156,355 | 177,251 <u>173,094</u> |
| | <u>\$ 1,674,615</u> | <u>\$ 1,883,818</u> |

* The Lottery has accrued an estimated amount of services delivered by its vendors and deposits for its retailers as of June 30, 2010 and 2009, respectively.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2010 and 2009

NOTE B – CAPITAL ASSETS

Capital assets at June 30, 2010 consisted of:

| | Beginning Balance | Reclass- ification | Increases | Decreases | Ending Balance |
|----------------------------|----------------------|-----------------------|-----------|-----------|-------------------|
| Data processing software | \$ 2,109,933 | \$ - | \$ 35,111 | \$ - | 2,145,044 |
| Data processing equipment | 1,849,014 | - | 14,338 | (4,679) | 1,858,673 |
| Equipment - Security and | | | | | |
| disaster recovery | 572,479 | - | - | .=. | 572,479 |
| Vehicles | 446,081 | - | 134,887 | (148,468) | 432,500 |
| Tenant improvements | 340,587 | - | | - | 340,587 |
| Furniture and fixtures | 251,074 | - | - | - | 251,074 |
| Equipment - drawing | 147,528 | - | 17,200 | (48,250) | 116,478 |
| Equipment - communications | 116,260 | - | - | - | 116,260 |
| Equipment - warehouse | 69,831 | - | - | - | 69,831 |
| Equipment - office | 51,987 | - | - | - | 51,987 |
| Obsolete capital assets | 531,134 | - | | - | 531,134 |
| | | | | | |
| Capital assets | 6,485,908 | <u> </u> | 201,536 | (201,397) | 6,486,047 |
| Data processing software | (2,087,207) | | (17,366) | _ | (2,104,573) |
| Data processing equipment | (1,808,158) | - | (25,984) | 4,679 | (1,829,463) |
| Equipment - Security and | (1,000,150) | | (23,764) | 4,075 | (1,029,405) |
| disaster recovery | (529,843) | | (20,233) | | (550,076) |
| Vehicles | (311,390) | - | (59,276) | 148,468 | (222,198) |
| Tenant improvements | (340,587) | | (39,270) | - | (340,587) |
| Furniture and fixtures | (249,212) | - | (1,176) | | (250,388) |
| Equipment - drawing | (137,309) | - | (12,994) | 48,250 | (102,053) |
| Equipment - communications | (115,882) | - | (378) | 40,250 | (116,260) |
| • • | (69,086) | - | (745) | - | (69,831) |
| Equipment - warehouse | (51,507) | - | (480) | - | (51,987) |
| Equipment - office | | - | (480) | - | (531,134) |
| Obsolete capital assets | (531,134) | | | | (551,154) |
| Accumulated depreciation | (6,231,315) | | (138,632) | 201,397 | (6,168,550) |
| Capital assets, net | \$ 254,593 | <u> </u> | \$ 62,904 | \$ - | \$ 317,497 |

Included in data processing software and data processing equipment are \$43,600 in assets under a capital lease at June 30, 2010 and 2009. For each fiscal year, there were \$6,228 and \$3,634, respectively, in related amortization on these assets.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

June 30, 2010 and 2009

NOTE B – CAPITAL ASSETS - CONTINUED

Capital assets at June 30, 2009 consisted of:

| | Beginning Balance | Reclass- ification | Increases | Decreases | Ending Balance |
|----------------------------|----------------------|-----------------------|-----------|-----------|-------------------|
| Data processing software | \$ 2,084,202 | \$- | \$ 25,731 | \$- | 2,109,933 |
| Data processing equipment | 1,821,034 | - | 27,980 | - | 1,849,014 |
| Equipment - Security and | | | | | |
| disaster recovery | - | 572,479 | - | - | 572,479 |
| Vehicles | 472,992 | - | 112,385 | (139,296) | 446,081 |
| Tenant improvements | 797,602 | (468,575) | 11,560 | - | 340,587 |
| Furniture and fixtures | 245,048 | 6,026 | - | - | 251,074 |
| Equipment - drawing | 179,647 | (32,119) | - | - | 147,528 |
| Equipment - communications | 116,260 | - | - | - | 116,260 |
| Equipment - warehouse | 156,698 | (86,867) | - | - | 69,831 |
| Equipment - office | 75,050 | (23,063) | - | - | 51,987 |
| Obsolete capital assets | 499,015 | 32,119 | | | 531,134 |
| | | | | | |
| Capital assets | 6,447,548 | - | 177,656 | (139,296) | 6,485,908 |
| Data processing software | (2,074,455) | - | (12,752) | - | (2,087,207) |
| Data processing equipment | (1,775,235) | - | (32,923) | | (1,808,158) |
| Equipment - Security and | | | | | |
| disaster recovery | _ | (526,137) | (3,706) | - | (529,843) |
| Vehicles | (388,243) | - | (62,443) | 139,296 | (311,390) |
| Tenant improvements | (743,069) | 422,232 | (19,750) | - | (340,587) |
| Furniture and fixtures | (242,011) | (6,025) | (1,176) | - | (249,212) |
| Equipment - drawing | (146,607) | 32,119 | (22,821) | - | (137,309) |
| Equipment - communications | (109,769) | - | (6,113) | - | (115,882) |
| Equipment - warehouse | (155,060) | 86,867 | (893) | - | (69,086) |
| Equipment - office | (64,832) | 23,063 | (9,738) | - | (51,507) |
| Obsolete capital assets | (499,015) | (32,119) | - | - | (531,134) |
| Accumulated depreciation | (6,198,296) | | (172,315) | 139,296 | (6,231,315) |
| Capital assets, net | \$ 249,252 | \$ - | \$ 5,341 | \$ - | \$ 254,593 |

NOTES TO FINANCIAL STATEMENTS – CONTINUED

June 30, 2010 and 2009

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

| Net Income | | Due to Lottery Tuition Fund | Net Assets | |
|-----------------------------|----|--|-------------------|---------|
| Balance at June 30, 2009 | \$ | 2,759,464 | \$ 2,759,464 | \$ - |
| Current year net income | | 43,608,826 | 43,608,826 | - |
| Current year transfers | | (42,966,875) | (42,966,875) | |
| Balance at June 30, 2010 | \$ | 3,401,415 | \$ 3,401,415 | \$ - |

In accordance with the Lottery Act, no later than the last business day of each month, the Lottery shall transmit at least twenty-seven percent of the gross revenue of the previous month until December 31, 2008 and at least thirty percent of the gross revenue of the previous month, thereafter, to the New Mexico State Treasurer, who shall deposit it into state agency number 950, the Lottery Tuition Fund, SHARE fund number 63700. As of July 31, 2010 and 2009, the Lottery has transferred \$43,608,826 and \$40,814,372, respectively, for the years ended June 30, 2010 and 2009 to the New Mexico State Treasurer.

NOTE D - RETIREMENT PLAN

Plan Description

All of the Lottery's eligible employees participate in a plan provided by the Lottery pursuant to the New Mexico Lottery Act (Chapter 6, Article 24 NMSA 1978). The Lottery is the administrator of the Plan, which is a defined contribution money purchase pension plan. The New Mexico Lottery Authority Retirement Plan provides for retirement benefits to plan members and their beneficiaries. The balances and activity of the Plan as of and for the years ended June 30, 2010 and 2009 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.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

June 30, 2010 and 2009

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, 2010 and 2009, the Lottery recognized \$339,579 and \$339,981 of pension expense for the Plan on eligible compensation of \$2,562,862 and \$2,565,894, respectively. The entire pension amounts have been paid to the Plan by June 30, 2010 and 2009, 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 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 (2.75% at June 30, 2010 and 2009, respectively). The line matured in May 2008 and again on May 14, 2010 and was extended through May 14, 2012. For the years ended June 30, 2010 and 2009, 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 \$481,439 and \$509,560 for the years end June 30, 2010 and 2009, 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:

| Year | Amount | | | |
|------|--------|-----------|--|--|
| 2011 | \$ | 431,485 | | |
| 2012 | | 431,485 | | |
| 2013 | | 323,615 | | |
| | | | | |
| | \$ | 1,186,585 | | |

NOTES TO FINANCIAL STATEMENTS – CONTINUED

June 30, 2010 and 2009

NOTE F - LEASES - CONTINUED

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

| | 2010 | 2009 |
|------------------------------------|------------|---------------------------|
| Minimum rentals Less: Subleases | \$ 431,485 | \$ 465,235 (73,800) |
| | \$ 431,485 | \$ 391,435 |

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

| Years ending June 30: | |
|---------------------------------------|--------------|
| 2011 | \$ 8,237 |
| 2012 | 8,237 |
| 2013 | 8,237 |
| 2014 | 8,237 |
| 2015 | 8,237 |
| 2016 | 3,434 |
| Total minimum payments | 44,619 |
| Less the amount representing interest | (10,881) |
| Present value of net minimum payments | \$ 33,738 |

NOTES TO FINANCIAL STATEMENTS – CONTINUED

June 30, 2010 and 2009

NOTE G - COMMITMENT

The Lottery had an agreement for the on-line gaming system with GTECH Corporation until November 20, 2008.

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 includes the supply, installation, maintenance, service, and operation of a communication network, lottery terminals and peripheral equipment for the Lottery's existing and future retailers, 500 ticket scanners to enable players to check their tickets for prizes, 225 self service ticket vending machines that sell both instant and drawing game tickets, a disaster recovery and business continuity facility, and various employees to operate the system and provide sales and marketing support to the Lottery. The transition to this new on-line gaming system took place on November 16, 2008. Since November 21, 2008, the on-line vendor fee has been fixed at 1.5% of net sales, plus the applicable gross receipts tax.

NOTE H - OTHER EXPENSES

Other expenses at June 30 consisted of:

| | N <mark>ai ta ta ta ta ta ta</mark> | 2010 | 2009 |
|--------------------------------|-------------------------------------|--------|---------------|
| Registrations and memberships | \$ | 23,088 | \$ 22,368 |
| Other | | 19,353 | 218,408 |
| Training | | 10,330 | 18,323 |
| Publications and subscriptions | | 2,351 | 2,798 |
| | \$ | 55,122 | \$ 261,897 |

BUDGETARY COMPARISON STATEMENTS

Years ended June 30, 2010 and 2009

| | | 2 | 2010 | | | 2(| 2009 | |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|---------------|
| | Original | Final | | Variance with | Original | Final | | Variance with |
| | Budget | Budget | Actual | Final Budget | Budget | Budget | Actual | Final Budget |
| Revenues | | | | | | | | |
| Instant ticket sales | \$ 84,500,000 | \$ 81,500,000 | \$ 81,231,127 | \$ (268,873) | \$ 91,000,000 | \$ 82,000,000 | \$ \$2,178,010 | \$ 178,010 |
| Powerball sales | 42,000,000 | 38,000,000 | 41,177,600 | 3,177,600 | 45,000,000 | 42,000,000 | 43,983,020 | 1,983,020 |
| Hot Lotto sales | 8,000,000 | 9,500,000 | 9,138,601 | (361,399) | 5,800,000 | 8,000,000 | 8,424,318 | 424,318 |
| Roadrunner Cash sales | 6,000,000 | 7,000,000 | 7,654,480 | 654,480 | 6,900,000 | 6,000,000 | 6,451,302 | 451,302 |
| Mega Millions sales | 1 | 5,300,000 | 3,846,692 | (1, 453, 308) | 1 | 1 | 1 | I |
| Pick 3 sales | 2,500,000 | 3,200,000 | 3,408,240 | 208,240 | 2,300,000 | 2,500,000 | 2,897,012 | 397,012 |
| Retailer fees | 16,000 | 29,000 | 32,350 | 3,350 | 24,000 | 33,000 | 40,188 | 7,188 |
| Prize tickets | (3, 800, 000) | (3,500,000) | (2,798,905) | 701,095 | (3,700,000) | (2, 300, 000) | (1,588,669) | 711,331 |
| Spoiled, stolen, | | | | | | | | |
| and promotional tickets | (192,000) | (75,000) | (71, 413) | 3,587 | (188,000) | (83,000) | (68,964) | 14,036 |
| Bad debts | (24,000) | (24,000) | (80,000) | (56,000) | (12,000) | (10,000) | ı | 10,000 |
| Total revenues | 139,000,000 | 140,930,000 | 143,538,772 | 2,608,772 | 147,124,000 | 138,140,000 | 142,316,217 | 4,176,217 |
| Total game expenses | 91,560,000 | 93,254,000 | 94,986,352 | 1,732,352 | 99,383,000 | 92,885,000 | 96,356,519 | 3,471,519 |
| Total operating expenses | 5,900,000 | 5,378,000 | 5,010,629 | (367,371) | 6,067,000 | 5,631,000 | 5,393,674 | (237,326) |
| Operating income | 41,540,000 | 42,298,000 | 43,541,791 | 1,243,791 | 41,674,000 | 39,624,000 | 40,566,024 | 942,024 |
| Total non-operating income | 228,000 | 125,000 | 67,035 | (57,965) | 398,000 | 251,000 | 248,348 | (2,652) |
| Met income hefore tranefere | | | | | | | | |
| to Lottery Tuition Fund | \$ 41,768,000 | \$ 42,423,000 | \$ 43,608,826 | \$ 1,185,826 | \$ 42,072,000 | \$ 39,875,000 | \$ 40,814,372 | \$ 939,372 |

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SCHEDULES OF PERCENTAGE RETURN TO THE STATE OF NEW MEXICO

Years ended June 30, 2010 and 2009

| | 2010 | 2009 |
|--|---------------|---|
| REVENUES | | 00 170 010 |
| Instant ticket sales | \$ 81,231,127 | \$ 82,178,010 |
| Powerball sales | 41,177,600 | 43,983,020 |
| Hot Lotto sales | 9,138,601 | 8,424,318 |
| Roadrunner Cash sales | 7,654,480 | 6,451,302 |
| Mega Millions sales | 3,846,692 | - |
| Pick 3 sales | 3,408,240 | 2,897,012 |
| Retailer fees | 32,350 | 40,188 |
| Prize tickets | (2,798,905) | (1,588,669) |
| Spoiled, stolen, and promotional tickets | (71,413) | (68,964) |
| Bad debts | (80,000) | |
| Total revenues | 143,538,772 | 142,316,217 |
| NON-OPERATING INCOME | | |
| Interest income | 51,663 | 142,683 |
| Other income | 15,372 | 105,665 |
| Total non-operating income | 67,035 | 248,348 |
| GROSS REVENUES | 143,605,807 | 142,564,565 |
| GAME EXPENSES | | |
| Prize expense | 78,606,569 | 78,307,339 |
| Retailer commissions | 9,363,616 | 9,271,602 |
| On-line vendor fees | 2,290,586 | 4,009,103 |
| Advertising | 2,160,112 | 2,177,579 |
| Ticket vendor fees | 1,597,118 | 1,596,931 |
| Shipping and postage | 396,779 | 366,280 |
| Promotions | 292,958 | 289,495 |
| Drawing game | 134,059 | 133,113 |
| Responsible gaming | 82,690 | 81,120 |
| | 61,865 | 90,207 |
| Game membership | 01,805 | 33,750 |
| Instant ticket vending machine lease | 04.086.252 | the second se |
| Total game expenses | 94,986,352 | 96,356,519 |
| OPERATING EXPENSES | 2 1/0 502 | 2,590,640 |
| Salaries, wages, and benefits | 3,468,593 | 3,580,649 |
| Leases and insurance | 613,877 | 610,217 |
| Utilities and maintenance | 429,692 | 417,736 |
| Professional fees | 155,994 | 200,270 |
| Depreciation and amortization | 138,632 | 172,315 |
| Materials and supplies | 93,130 | 102,952 |
| Travel | 55,589 | 47,638 |
| Other | 55,122 | 261,897 |
| Total operating expenses | 5,010,629 | 5,393,674 |
| OPERATING INCOME | 43,541,791 | 40,566,024 |
| NET INCOME | \$ 43,608,826 | \$ 40,814,372 |
| GROSS REVENUE PERCENTAGE RETURN | 30.37% | 28.63% |

EXIT CONFERENCE

For the Year Ended June 30, 2010

An exit conference was held at the New Mexico Lottery Authority on October 8, 2010. The following individuals participated:

| Title |
|--------------------------------|
| |
| |
| Board Asst. Secretary / |
| Treasurer; Committee |
| Chairman |
| Board Secretary |
| |
| Chief Executive Officer |
| Director of Finance |
| Internal Auditor |
| Director of MIS |
| |
| |
| |
| |

| Moss Adams LLP | |
|------------------------------------|--|
| Scott Eliason, CPA | |
| Jaime Rumbaoa, CPA/CITP, CFE, CISA | |

Audit Partner Manager

Financial Statement Preparation

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