



NEW MEXICO LOTTERY AUTHORITY

FINANCIAL STATEMENTS

JUNE 30, 2013 and 2012

MOSS ADAMS_{LLP}

Certified Public Accountants | Business Consultants

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New Mexico Lottery Authority

OFFICIAL ROSTER

June 30, 2013

BOARD OF DIRECTORS

Vacant*	Chairman
Clifford Stroud, MBA**	Vice Chairman
Dan Salzwedel	Treasurer
Amy Bailey	Secretary
Reta Jones, CPA**	Assistant Secretary-Treasurer
Mark Koson	Member
Salvatore Baragiola	Member

* Ken Hoeksema's term was to end on June 30, 2013. He resigned his position in May 2013.

** - The term of appointment for Clifford Stroud and Reta Jones ended on June 30, 2013. Three new board members have been appointed in fiscal year 2014. They are John Kubiak, CPA, Dr. Paul Guerin, and Claude Austin.

OFFICIALS OF THE NEW MEXICO LOTTERY AUTHORITY

Tom Romero	Chief Executive Officer
J. Vince Torrez	Executive Vice President of Security
Sylvia Ann Jaramillo, CPA	Director of Finance
Evelyn McKnight	Director of Human Resources
Adriana Binns	Director of Marketing and Communications
David Ramirez	Director of MIS
Pam Poteat	Director of Sales

ORGANIZATIONAL DIVISIONS OF THE NEW MEXICO LOTTERY AUTHORITY

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

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

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

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

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

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 by division for Board of Directors' approval. Furthermore, the division is responsible for the procurement of materials and services; claims center payment of prizes and sales of tickets; and accounts payable.

The Human Resources Division, under the direction of the Director of Human Resources, oversees the development and implementation of human resources policies, programs and services, including recruitment, selection, retention, legal compliance, employee benefits, employee insurance reconciliation, employee relations, employment practices and procedures, employee communications and employee events.

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

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

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

point of sale materials and player and retailer publications; as well as negotiating and overseeing the Lottery's participation in a number of statewide promotions and special events. The 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, game management, monitoring of game activities and draw game vendors, and providing data and analysis to divisions.

The Sales Division, under the direction of the Director of Sales, is responsible for developing and implementing all sales activities and programs for the Lottery, including retailer visits, customer relationship management, ticket sales, inventory management, point of sales material distribution, retailer installations, promotional and event participation and preparation, as well as maximizing sales initiatives.

The Security Division, under the direction of the Executive Vice President of Security, statutorily as a law enforcement agency is responsible for administering, enforcing and ensuring compliance with the security provisions of the New Mexico Lottery Act. The division conducts backgrounds of all prospective employees, lottery retailers, lottery vendors and lottery contractors. It also supervises ticket verification and Lottery drawings and conducts drawings when the prize amount is more than \$5,000. The division functions as liaison among the Attorney General's Office, District Attorney Offices and law enforcement agencies in general. It is also responsible for building and employee security and safety. 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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REPORT OF INDEPENDENT AUDITORS

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

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities, and the aggregate remaining fund information of the State of New Mexico Lottery Authority (Lottery), a component unit of the State of New Mexico, as of and for the years ended June 30, 2013 and 2012, which collectively comprise the Lottery's basic financial statements as listed in the table of contents. We have also audited the budgetary comparison statements and the schedules of percentage return to the State of New Mexico presented as supplementary information in the accompanying financial statements as of and for the years ended June 30, 2013 and 2012, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, and the aggregate remaining fund information of the Lottery as of June 30, 2013 and 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statements referred to previously present fairly, in all material respects, the budgetary comparison statements and schedules of percentage return to the State of New Mexico for the years ended June 30, 2013 and 2012 in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, on pages 4 through 22, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

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

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 29, 2013 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control over financial reporting and compliance.

Mess Adams LLP

Albuquerque, New Mexico
October 29, 2013

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This Management's Discussion and Analysis of the New Mexico Lottery Authority (Lottery), offers readers of the Lottery's financial statements a narrative overview and analysis of the financial activities of the Lottery for the fiscal years ended June 30, 2013 and 2012 with comparative numbers for the fiscal year ended June 30, 2011. Please read it in conjunction with the financial statements, which begin on page 23.

FINANCIAL HIGHLIGHTS

- At the end of fiscal years 2013 and 2012, the Lottery's total current assets increased by \$2,677,330, or 23.0%, and \$2,124,932, or 22.4%, respectively, in comparison to June 30th of each previous fiscal year.
- Compared to the end of the two preceding fiscal years, the Lottery's total liabilities increased by \$3,001,125 or 25.2% at the end of fiscal year 2013 and by \$2,262,417 or 23.4% at the end of fiscal year 2012.
- In fiscal year 2013, total net sales were \$141,758,522, an increase of \$7,971,170, or 6.0% from the prior fiscal year. In fiscal year 2012, total net sales were \$133,787,352, a decrease of \$1,753,682, (1.3) %, compared to total net sales of \$135,541,034 in fiscal year 2011.
- From the prior fiscal years, total game expenses increased by \$5,668,837, or 6.5%, in fiscal year 2013, while total game expenses decreased by \$1,913,734, (2.1)%, in fiscal year 2012.
- Total operating expenses decreased by 1.3% or \$66,197 in fiscal year 2013, whereas operating expenses increased by 3.4% or \$171,155 in fiscal year 2012, each in comparison to the previous fiscal year.
- Non-operating income decreased by \$16,917 or (26.5) % in fiscal year 2013, while it increased by \$28,980 or 82.9% in fiscal year 2012, each year compared to the preceding fiscal year.
- Net income in fiscal year 2013 was \$43,684,681, a \$2,355,938 or 5.7% increase over the previous fiscal year. Net Income in fiscal year 2012 was \$41,328,743, a \$21,453 or .1% increase compared to the previous fiscal year's net income of \$41,307,290. 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 2013, the Lottery transmitted 30.80% in net revenues to the State, while in fiscal year 2012, the Lottery transmitted 30.88% in net revenues to the State. In each of the last two fiscal years the Lottery surpassed the 30% required gross revenue return each month. The Lottery has continued to transfer its actual net income at year end, regardless of whether or not the amount of net income exceeded the statutory requirement.
- Including the final transfer on July 31, 2013 of June 2013's net revenues (net income); the Lottery has transferred \$572,493,527 to the State of New Mexico since the commencement of sales in April 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

Financial Statements. The Statements of Net Position on Page 23 and the Statements of Revenues, Expenses, and Changes in Net Position on page 24 report the Lottery's assets, liabilities, revenues and expenses in comparative format for fiscal year 2013 and fiscal year 2012. The Statements of Cash Flows on pages 25 and 26 report the sources and uses of cash for fiscal years 2013 and 2012. The Statements of Fiduciary Net Position on page 27 and Statements of Changes in Fiduciary Net Position on page 28 report the balances and activity of the Lottery's Retirement Plan for fiscal years 2013 and 2012.

Notes to Financial Statements. The Notes to Financial Statements on pages 29 to 49 provide additional information that is essential for a full understanding of the financial statements and provide more detailed data.

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

Schedules of Percentage Return to the State of New Mexico. The Schedules of Percentage Return to the State of New Mexico on page 51 reports the percentages of gross revenues that were returned to the State of New Mexico for fiscal years 2013 and 2012 in compliance with the New Mexico Lottery Act.

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

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS

Total Net Position

At the end of fiscal years 2013 and 2012, the Lottery's total assets and total liabilities were equal with total net position reduced to zero. The Lottery has no reserve balances on its books at fiscal yearend; transferring all its net revenues for the fiscal year to the Lottery Tuition Fund.

Total Assets

Table 1
Total Assets

	2013	2012	2011	Increase \$ Change 2012 to 2013	Increase % Change 2012 to 2013	Increase (Decrease) \$ Change 2011 to 2012	Increase (Decrease) % Change 2011 to 2012
Cash and cash equivalents	\$ 9,340,237	\$ 6,885,806	\$ 5,561,825	\$ 2,454,431	35.6%	\$ 1,323,981	23.8%
Accounts receivable, (net of allowance for doubtful accounts)	1,371,427	1,225,638	885,691	145,789	11.9	339,947	38.4
Reserves on deposit	3,405,568	3,396,831	2,925,251	8,737	0.3	471,580	16.1
Inventory	36,964	33,077	11,334	3,887	11.8	21,743	191.8
Prepaid expenses	145,172	80,686	113,005	64,486	79.9	(32,319)	(28.6)
Total current assets	14,299,368	11,622,038	9,497,106	2,677,330	23.0	2,124,932	22.4
Capital assets, net	629,345	305,550	168,065	323,795	106.0	137,485	81.8
Total assets	\$ 14,928,713	\$ 11,927,588	\$ 9,665,171	\$ 3,001,125	25.2%	\$ 2,262,417	23.4%

Compared to each prior fiscal year, the Lottery's cash and cash equivalents increased at the end of fiscal year 2013 and 2012 by \$2,454,431 or 35.6% and by \$1,323,981 or 23.8%, respectively. The changes in cash and cash equivalents relate mainly to changes in accounts receivable, accounts payable and prizes payable at the end of each fiscal year compared to the prior fiscal year.

Accounts receivable from the Lottery's retailers are collected weekly each Thursday through electronic bank transfers. Receivables are equal to sales by retailers net of any prizes paid by the retailers and any commissions earned, less the allowance for bad debts and plus any miscellaneous receivables from any other source. Accounts receivable increased by \$145,789 or 11.9% at the end of fiscal year 2013. This increase can be attributed to having eight days of transactions in accounts receivable at year end compared to only seven at the end of the

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Total Assets - Continued

previous fiscal year. Accounts receivable increased by \$339,947 or 38.4% in fiscal year 2012. This increase at year-end from the prior fiscal year can be attributed to having seven days of sales in receivables compared to only five days in the prior 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 and other income on the deposits. The changes in these accounts in both fiscal years 2013 and 2012 of \$8,737 and \$471,580, respectively, were caused by the receipts of interest earned and other income on the deposits with MUSL; payments of game expenses; changes to the Hot Lotto reserve account, as required by the Hot Lotto game rules; and the re-balancing of the Powerball reserve accounts. In addition, in fiscal year 2013 the payment of the Lottery's portion of intellectual property purchased for MUSL games was deducted from the unreserved account and in fiscal year 2012 the receipt of the Lottery's portion of an unclaimed Powerball jackpot was added to the unreserved account. Additionally, in fiscal year 2010, a reserve account for Mega Millions was established in compliance with the Mega Millions game rules and in fiscal years 2013 and 2012, this reserve account grew by \$123,669 and \$149,951, respectively.

The inventory balance at the end of both fiscal year 2013 and 2012 increased by \$3,887, an 11.8% increase, and \$21,743, a 191.8% increase, respectively. 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. Therefore, these tickets are not included in the Lottery's inventory. But, under an agreement signed with a secondary instant ticket printer in March 2010, the Lottery began purchasing the instant tickets printed by this vendor. The Lottery has accounted for games printed under this agreement as ticket inventory using the specific identification method at the lower of cost or market. At the end of each of the two fiscal years 2013 and 2012, the Lottery had remaining inventory of \$9,633 and \$33,077 for 2 games in each year purchased under this agreement. In addition at the end of fiscal year 2013, the Lottery had inventory of \$3,192 for a promotional game purchased and had merchandise prizes of \$24,139 for a second chance drawing promotion included in inventory. At the end of fiscal years 2012, there were no merchandise prizes for second chance drawings included in inventory.

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

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Total Assets - Continued

The Lottery has accounted for this transaction as a capital lease and, therefore, the ICS cost of \$43,600 is reflected in capital assets. The related liability for the ICS is included in the current portion of capital lease obligation (\$6,229 and \$6,228 at June 30, 2013 and 2012, respectively) and in the noncurrent portion of capital lease obligation (\$8,823 and \$15,052 at June 30, 2013 and 2012, respectively).

As part of the facility lease agreements signed in 2002 and 2012, the landlord paid for \$29,975 and \$51,858 in tenant improvements for the Lottery's corporate facility in fiscal years 2013 and 2012, respectively. The Lottery has capitalized \$72,543 as tenant improvements with a related deferred liability, while the remaining purchases of tenant improvements totaling \$9,290 were expensed because the items purchased did not meet the \$5,000 threshold for capitalization. In fiscal year 2013 and 2012, \$7,835 and \$4,787, respectively, are included in the current portion of capital lease obligation and \$68,559 and \$46,673, respectively, are included in the noncurrent portion of capital lease obligation.

The changes in capital assets in fiscal years 2013 and 2012 are attributable to \$463,188 and \$253,418 in capital asset purchases and \$139,393 and \$115,933 in depreciation, for the two fiscal years, respectively.

Total Liabilities

Table 2
Total Liabilities

	2013	2012	2011	Increase \$ Change 2012 to 2013	Increase % Change 2012 to 2013	Increase (Decrease) \$ Change 2011 to 2012	Increase (Decrease) % Change 2011 to 2012
Accounts pay- able and other current liabilities	\$ 1,977,904	\$ 1,955,328	\$ 1,829,650	\$ 22,576	1.2%	\$ 125,678	6.9%
Current portion of capital lease obligation	14,064	11,015	6,228	3,049	27.7	4,787	76.9
Prizes payable	9,355,989	6,860,315	4,592,530	2,495,674	36.4	2,267,785	49.4
Due to Lottery Tuition Fund	3,503,374	3,039,205	3,215,482	464,169	15.3	(176,277)	(5.5)
Total current liabilities	14,851,331	11,865,863	9,643,890	2,985,468	25.2	2,221,973	23.0
Noncurrent por- tion of capital lease obligation	77,382	61,725	21,281	15,657	25.4	40,444	190.0
Total liabilities	\$ 14,928,713	\$ 11,927,588	\$ 9,665,171	\$ 3,001,125	25.2%	\$ 2,262,417	23.4%

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Total Liabilities - Continued

Accounts payable and other current liabilities increased by \$22,576 or 1.2% and \$125,678 or 6.9% at the end of fiscal years 2013 and 2012, respectively. In both fiscal years, the changes compared to the prior fiscal year were mainly due to amounts owed to four vendors for advertising, the on-line gaming system, instant ticket printing fees, and the lottery's share of prizes payable to MUSL for Powerball, Hot Lotto, and Mega Millions. Sales amounts and advertising placed during the last few weeks of each fiscal year will generally determine the amounts owed at the end of each fiscal year to these vendors and whether that amount is higher or lower than in the prior fiscal year.

Prizes payable is essentially comprised of amounts accrued based on the Lottery's game designs and prize structures for 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 fiscal years 2013 and 2012, prizes increased by \$2,495,674 or 36.4% and \$2,267,785 or 49.4%. These differences relate to the changes of prizes payable on individual Lottery games between the fiscal years as a result of sales in each fiscal year and prizes not yet claimed.

At the end of fiscal years 2013 and 2012, \$3,503,274 and \$3,039,205, respectively, of net revenues for the month of June were due to the Lottery Tuition Fund. These funds were transferred to the New Mexico State Treasurer by the end of July of each year.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Net Ticket Sales and Prize Expense

Table 3
Net Ticket Sales and
Prize Expense

2013	Net Ticket Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 69,886,435	\$ 40,283,399	\$ 29,603,036
Powerball, net of spoiled and promotional tickets	46,734,439	23,332,651	23,401,788
Mega Millions, net of spoiled and promotional tickets	8,078,050	4,027,633	4,050,417
Roadrunner Cash, net of spoiled and promotional tickets	6,767,906	4,016,276	2,751,630
Hot Lotto, net of spoiled and promotional tickets	5,933,935	2,959,006	2,974,929
Pick 3, net of spoiled and promotional tickets	3,492,915	1,973,715	1,519,200
Quicksters, net of spoiled and promotional tickets	864,842	475,878	388,964
Total net ticket sales	\$ 141,758,522	\$ 77,068,558	\$ 64,689,964
2012	Net Ticket Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 68,736,331	\$ 38,273,594	\$ 30,462,737
Powerball, net of spoiled and promotional tickets	33,767,315	16,897,832	16,869,483
Mega Millions, net of spoiled and promotional tickets	14,255,730	7,230,117	7,025,613
Roadrunner Cash, net of spoiled and promotional tickets	7,509,592	4,586,920	2,922,672
Hot Lotto, net of spoiled and promotional tickets	5,430,132	2,723,879	2,706,253
Pick 3, net of spoiled and promotional tickets	3,634,804	2,068,225	1,566,579
Quicksters, net of spoiled and promotional tickets	453,448	246,741	206,707
Total net ticket sales	\$ 133,787,352	\$ 72,027,308	\$ 61,760,044
2011	Net Ticket Sales	Prize Expense	Gross Margin
Instant ticket, net of prize, stolen, and promotional tickets	\$ 75,763,424	\$ 42,313,901	\$ 33,449,523
Powerball, net of spoiled and promotional tickets	29,080,968	14,519,181	14,561,787
Mega Millions, net of spoiled and promotional tickets	10,655,528	5,450,887	5,204,641
Roadrunner Cash, net of spoiled and promotional tickets	8,748,662	5,524,466	3,224,196
Hot Lotto, net of spoiled and promotional tickets	7,563,516	3,655,097	3,908,419
Pick 3, net of spoiled and promotional tickets	3,728,936	2,149,805	1,579,131
Total net ticket sales	\$ 135,541,034	\$ 73,613,337	\$ 61,927,697
\$ Increase from FY 2012 to FY 2013	\$ 7,971,170	\$ 5,041,250	\$ 2,929,920
% Increase from FY 2012 to FY 2013	6.0%	7.0%	4.7%
\$(Decrease) from FY 2011 to FY 2012	\$ (1,753,682)	\$ (1,586,029)	\$ (167,653)
%(Decrease) from FY 2011 to FY 2012	(1.3)%	(2.2)%	(0.3)%

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Net Ticket 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 2013, 2012, and 2011. In fiscal year 2013 net sales, prize expense and gross margin increased for Powerball, Hot Lotto, and Quicksters, while net sales, prize expense and gross margin decreased for Mega Millions, Roadrunner Cash, and Pick 3. In fiscal year 2013, net sales and prize expense increased for instant sales, but the gross margin for the year decreased in comparison to the prior fiscal year. This decrease in gross margin for instant sales was the due to an increase in the overall payout percentage for instant tickets from 57.97% in fiscal year 2012 to 58.94% in fiscal year 2013, primarily to bring players back to purchasing instant games and stop the decline of instant sales over the last six years.

In fiscal year 2012, Powerball and Mega Millions net sales, prize expense and gross margin increased, but net sales, prize expense, and gross margin decreased for instant tickets, Roadrunner Cash, Hot Lotto, and Pick 3. Quicksters were introduced in March 2012 and contributed \$206,707 in gross margin.

Net Ticket Sales

In both fiscal years 2013 and 2012, 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 2013, forty-five new instant ticket games were launched - 16 - \$1, 10 - \$2, 6 - \$3, 9 - \$5, 3 - \$10 and 1 - \$20—1 more \$1, 2 less \$3, 1 more \$5 and 3 more \$10 game than in fiscal year 2012. In fiscal year 2012, forty-two new instant ticket games were launched - 15 - \$1, 10 - \$2, 8 - \$3, 8 - \$5, and 1 - \$20—5 less \$1, 1 more \$3, 1 less \$5 and 1 less \$10 game than in fiscal year 2011. In fiscal year 2013, the Lottery launched 22 games with free (prize) tickets and 23 games without free tickets, while in fiscal year 2012, the Lottery launched 22 games with free tickets and 20 games without free tickets. Instant ticket sales for 7 months (including the last five months of the fiscal year) were higher than the comparable month in fiscal year 2012. Instant ticket sales for every month of fiscal year 2012 were lower than the comparable month in the previous fiscal year. Since fiscal year 2007, when net instant ticket sales were a record \$91.37 million, net instant ticket sales have decreased by \$21.48 million or an approximate 23.5% drop to \$69.89 million in fiscal year 2013.

In January 2012, the Powerball game was changed from a \$1 price point to a \$2 price point. Along with this price change, the jackpot now starts at \$40 million, up from the previous starting jackpot of \$20 million. The matrix was changed from a 5 of 59 and 1 of 39 game to a 5 of 59 and 1 of 35 game. Two prize levels were changed; the Match 5 + 0 prize level going from

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Ticket Sales and Prize Expense - Continued

Net Ticket Sales – Continued

a \$200,000 cash prize to a \$1 million cash prize and the Match 0 + 1 going from a \$3 prize to a \$4 prize. The overall odds and the jackpot odds were improved. The Powerplay option remained in the game, but the multiplier option was discontinued and instead increased set prize levels are included in the Power Play option. The roll down option was eliminated.

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

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

Since fiscal year 2006 when net sales were a record \$54.1 million, Powerball net sales have decreased by \$7.4 million, a decrease of approximately 13.7%, to \$46.7 million in fiscal year 2013.

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Ticket Sales and Prize Expense – Continued

Net Ticket Sales – Continued

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

The MUSL game, Hot Lotto, is another smaller national jackpot game offered by the Lottery. Hot Lotto started fiscal year with a jackpot of just over \$1 million and grew to \$1.4 million before being won in July 2012. It then climbed to \$9.4 million in January, when it was won. The jackpot then continued to rise from \$1 million until year end where it ended the year at nearly \$6.9 million. Hot Lotto started fiscal year 2012 at \$1.1 million and continued to climb to \$7.5 million in November 2011. It climbed again to \$1.2 million in November, to \$2.61 million in January, to \$2.99 million in March, to \$1.54 million in April, and to \$3.4 million the last week of June. These changing jackpots reflect on net sales during each fiscal year with fiscal year 2013 showing a 9.3% increase in net sales.

Pick 3 net sales in fiscal year 2013 decreased by \$141,889 or 3.9%. Pick 3 net sales in the fiscal year 2012 decreased by \$94,132 or a 2.5% decrease. Pick 3 has become a core game for the Lottery bringing in steady monthly net sales of nearly \$300,000 each month with no major sales changes from month-to-month.

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

Prize Expense

Prize expense for the drawing games of Powerball, Mega Millions and Hot Lotto is based on the overall prize payout per the game design, while prize expense for Roadrunner Cash, Pick 3 and Quicksters is determined by the prizes won each month for each drawing or game. The prizes included in the prize structure for each instant game printed determine prize expense for instant games. In general, prize expense increases or decreases from year-to-year relative to the increases or decreases in sales for each Lottery product and the prize structures of the games.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Net Ticket Sales and Prize Expense – Continued

Prize Expense - Continued

In fiscal years 2013 the prize payout increased by approximately .01%, whereas in fiscal year 2012 the prize payout decreased by approximately .69% respectively, prior to the application of unclaimed prizes.

At the end of the claim period for each game, unclaimed prizes for the Lottery's instant games and 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 years 2013 and 2012, prize (free) tickets claimed for instant games decreased by \$411,456 or 14.23% and \$195,471 or 6.33%, respectively, in comparison to the previous fiscal years. Prize tickets are placed in the prize structure of the game in lieu of the breakeven prizes. Prize tickets give a player a prize of another instant game ticket of the same price point as the instant ticket that had the winning prize ticket. The Lottery continues to study the market to determine the optimum quantity of prize tickets to place each fiscal year in its instant ticket games in order to optimize its instant ticket sales.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Game Expenses

Table 4
Game Expenses

	2013	2012	2011	Increase (Decrease) \$ Change 2012 to 2013	Increase (Decrease) % Change 2012 to 2013	Increase (Decrease) \$ Change 2011 to 2012	Increase (Decrease) % Change 2011 to 2012
Prize expense	\$ 77,068,558	\$ 72,027,308	\$ 73,613,337	\$ 5,041,250	7.0%	\$ (1,586,029)	(2.2)%
Retailer							
commissions	9,153,204	8,696,851	8,859,206	456,353	5.2	(162,355)	(1.8)
On-line vendor							
fees	2,269,623	2,139,754	2,170,366	129,869	6.1	(30,612)	(1.4)
Advertising	2,263,221	2,277,892	2,286,794	(14,671)	(0.6)	(8,902)	(0.4)
Ticket vendor							
fees	1,158,028	1,177,708	1,350,379	(19,680)	(1.7)	(172,671)	(12.8)
Other game							
expenses	<u>1,136,751</u>	<u>1,061,035</u>	<u>1,014,200</u>	<u>75,716</u>	<u>7.1</u>	<u>46,835</u>	<u>4.6</u>
Total game							
expenses	<u>\$ 93,049,385</u>	<u>\$ 87,380,548</u>	<u>\$ 89,294,282</u>	<u>\$ 5,668,837</u>	<u>6.5%</u>	<u>\$ (1,913,734)</u>	<u>(2.1)%</u>

The changes in retailer commissions for fiscal years 2013 and 2012 are consistent with the changes in gross ticket sales for the two years and are equivalent to 6.45% and 6.50% of gross revenues for the two years, respectively. Retailer commissions are paid to the Lottery's retailers for selling Lottery tickets, cashing Lottery prizes and for selling a jackpot/grand prize for Powerball, Mega Millions or Hot Lotto, for selling a match 5 prize for Powerball or Mega Millions, and for selling a jackpot prize of more than \$100,000 for Roadrunner Cash.

Since November 21, 2008, the on-line vendor fee has been a fixed percentage of net sales, plus applicable gross receipts taxes, with no additional terminal fees. The on-line fee increases or decreases as drawing game and instant ticket net sales increase or decrease. The changes in the on-line vendor fees for the two fiscal years are consistent with the changes in drawing game and instant ticket net sales in fiscal years 2013 and 2012 and are equivalent to 1.60% of gross revenues for the two years.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Game Expenses - Continued

Advertising 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 games, to provide security tips and gambling awareness for our players and benefit messages to New Mexico students and their families, and to keep the lottery products fresh in the public's minds, all in order to maximize sales. Advertising expense was approximately 1.60% and 1.70% of gross revenues, respectively, for fiscal years 2013 and 2012 and stayed within the Lottery Board approved budgets of \$2,300,000 for each fiscal year.

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 2013 and 2012, the cost for any licensing fees or special printing costs are also included in ticket vendor fees. The ticket vendor fees for both fiscal year 2013 and 2012 are less due to the instant ticket sales in each year, but also as a result of payment of a lower percentage of net sales to the primary ticket printer compared to previous fiscal years where the percentage was higher and was paid on gross sales rather than net sales. This lower fee is reflected in the lower percentage to gross revenues for ticket vendor fees of .82% and .88%, compared to the previous year's 1.00% of gross revenues.

Included in other game expenses are promotions, shipping and postage, drawing game, responsible gaming, and game membership expenses. Fiscal years 2013 and 2012 reflect increases of \$75,716 or 7.1% and \$46,835 or 4.6%, respectively. In fiscal year 2013, the increase was partially due to the purchase of lottery information centers to enable the Lottery to replace the aging equipment at some of the lottery's retailers and an increase in shipping and postage due to shipping additional instant tickets to lottery retailers, offset by a decrease in the amounts spent for marketing and sales promotions, for premium items and for other retailer equipment. In fiscal year 2012, this change was primarily due to an increase in TV and radio promotions and events, offset with a savings in shipping costs to distribute instant tickets to the Lottery's retailers.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) – CONTINUED

FINANCIAL ANALYSIS – CONTINUED

Operating Expenses

Table 5
Operating Expenses

	2013	2012	2011	Increase (Decrease) \$ Change 2012 to 2013	Increase (Decrease) % Change 2012 to 2013	Increase (Decrease) \$ Change 2011 to 2012	Increase (Decrease) % Change 2011 to 2012
Salaries, wages, and benefits	\$ 3,614,032	\$ 3,583,778	\$ 3,456,748	\$ 30,254	0.8%	\$ 127,030	3.7%
Leases and insurance	514,990	585,629	593,740	(70,639)	(12.1)	(8,111)	(1.4)
Other operating expenses	951,025	976,837	924,601	(25,812)	(2.6)	52,236	5.6
Total operating expenses	<u>\$ 5,080,047</u>	<u>\$ 5,146,244</u>	<u>\$ 4,975,089</u>	<u>\$ (66,197)</u>	-1.3%	<u>\$ 171,155</u>	3.4%

Operating expenses are made up of salaries, wages and benefits, leases and insurance, and other operating expenses, which include utilities and maintenance, depreciation and amortization, materials and supplies, professional fees, travel, and other expenses. In fiscal year 2013, the Lottery decreased its operating expenses by \$66,197 or (1.3)%, while in fiscal year 2012, the Lottery increased its total operating expenses by \$171,155 or 3.4%.

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

The change in fiscal year 2012 is mainly due to increases in the cost of salary, wages and benefits. In fiscal year 2012, the Lottery was nearly fully staffed most of the year with an average of 55.5 employees during the year, while in the prior fiscal year the Lottery employed fewer employees all year at an average of 53 employees when vacated positions were not immediately filled. In fiscal year 2012, the cost of health insurance for the Lottery also

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Operating Expenses - continued

increased by approximately twelve percent. In addition, replacement computer equipment was purchased and the cost for building and vehicle maintenance, gas, and legal fees increased. These costs were offset with savings on lease and insurance costs and a smaller amount of depreciation and amortization for capitalized assets.

Non-Operating Income

Non-operating income decreased in fiscal year 2013, while it increased in fiscal year 2012. Interest income increased slightly in 2013 due to a small increase in the interest rate earned and higher cash deposits, whereas in fiscal year 2012 interest income decreased mainly due to the decrease in interest rates on the Lottery's deposits. For fiscal year 2013, other income decreased compared to fiscal year 2012, where liquidated damages had been received on a Lottery contract.

Net Income

	<u>Total Operating Revenues</u>	<u>Net Income</u>
Fiscal Year 2013	<u>\$ 141,767,097</u>	<u>\$ 43,684,681</u>
Fiscal Year 2012	<u>\$ 133,791,602</u>	<u>\$ 41,328,743</u>
Fiscal Year 2011	<u>\$ 135,541,708</u>	<u>\$ 41,307,290</u>
Increase from FY 2012 to FY 2013	<u>\$ 7,975,495</u>	<u>\$ 2,355,938</u>
% Increase from FY 2012 to FY 2013	<u>6.0%</u>	<u>5.7%</u>
Increase (Decrease) from FY 2011 to FY 2012	<u>\$ (1,750,106)</u>	<u>\$ 21,453</u>
% Increase (Decrease) from FY 2011 to FY 2012	<u>(1.3)%</u>	<u>0.1%</u>

Effective July 1, 2007, the New Mexico Lottery Act, Chapter 6, Article 24 NMSA 1978, was changed to require the Lottery to transmit at least twenty-seven percent of its gross revenues to the State Treasurer until December 31, 2008 and at least thirty percent of its gross revenues thereafter. In fiscal years 2012 and 2011, the Lottery transmitted its net income

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Net Income - Continued

each month, totaling \$43,684,681 and \$41,328,743, respectively. The gross revenue percentage return for fiscal year 2013 was 30.80%, while for fiscal year 2012, it was 30.88%. The Lottery was able to meet the 30% gross revenue percentage returns each month in both fiscal years.

The changes in net income for fiscal years 2013 and 2012 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 of reducing staffing, retailer and sales staff incentives, advertising costs, and prize expense to meet the statutory requirement of 27% through December 2008 and 30% thereafter for gross revenue percentage return; the Lottery also commenced a new on-line system agreement in November 2008, whereby the fee to the on-line vendor was reduced, and separate terminal communication fees and vending machine fees that had previously been paid were eliminated. This change has continued to provide a percentage reduction of the on-line vendor fees to gross revenues of over 3% in both fiscal year 2013 and 2012 compared to fiscal year 2008. In addition, the Lottery has continued to realize a savings on instant ticket printing fees year over year since 2010 based on the contract that was signed with the primary vendor in that year.

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison

	2013				% Variance with Final Budget
	Original Budget	Final Budget	Actual	Variance with Final Budget	
Total operating revenues	\$ 135,000,000	\$ 132,600,000	\$ 141,767,097	\$ 9,167,097	6.9%
Total game expenses	88,742,000	87,350,000	93,049,385	5,699,385	6.5
Total operating expenses	<u>5,763,000</u>	<u>5,339,000</u>	<u>5,080,047</u>	<u>(258,953)</u>	(4.9)
Operating income	40,495,000	39,911,000	43,637,665	3,726,665	9.3
Total non-operating income	<u>18,000</u>	<u>24,000</u>	<u>47,016</u>	<u>23,016</u>	95.9
Net income before transfers to Lottery Tuition Fund	<u>\$ 40,513,000</u>	<u>\$ 39,935,000</u>	<u>\$ 43,684,681</u>	<u>\$ 3,749,681</u>	9.4%
	2012				
	Original Budget	Final Budget	Actual	Variance with Final Budget	% Variance with Final Budget
Total operating revenues	\$ 136,400,000	\$ 134,143,000	\$ 133,791,602	\$ (351,398)	(0.3)%
Total game expenses	89,964,000	88,173,000	87,380,548	(792,452)	(0.9)
Total operating expenses	<u>5,456,000</u>	<u>5,368,000</u>	<u>5,146,244</u>	<u>(221,756)</u>	(4.1)
Operating income	40,980,000	40,602,000	41,264,810	662,810	1.6
Total non-operating income	<u>80,000</u>	<u>42,000</u>	<u>63,933</u>	<u>21,933</u>	52.2
Net income before transfers to Lottery Tuition Fund	<u>\$ 41,060,000</u>	<u>\$ 40,644,000</u>	<u>\$ 41,328,743</u>	<u>\$ 684,743</u>	1.7%

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

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

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

In fiscal year 2012, the original budget was revised because instant ticket, Roadrunner Cash and Hot Lotto sales were under performing and Powerball and Mega Millions were well ahead of their original budgeted sales amounts. Pick 3 was also revised upward by a small amount. The new game, Quicksters, had originally been planned to start in late October or early November, but was not launched until the end of March, therefore, the Quickster sales were also revised to a lower sales amount. The sales budget was decreased by \$2.6 million, which was made up of a reduction in instant ticket sales of \$8 million, in Roadrunner Cash sales of \$2.2 million, in Hot Lotto sales of \$2.4 million, and in Quickster sales of \$1.6 million and an increase of \$7 million for Powerball sales, \$4.5 for Mega Millions sales and \$100,000 for Pick 3 sales. Prize tickets were also reduced by \$300,000, spoiled, stolen and promotional tickets reduced by \$40,000; and retailer fees increased by \$3,000. All of these changes decreased total operating revenues by \$2,257,000. Non-operating income was reduced by \$38,000 due to continuing decreases in interest rates in the current year and less other income expected. In total, gross revenues were decreased by \$2,295,000.

Related game expenses for prize expense, retailer commissions, on-line vendor fees, ticket vendor fees, and other game expenses were adjusted in fiscal year 2012 in accordance to the changes in sales with a total adjustment of \$1,791,000 to game expenses. Each line item in operating expenses, except for leases and insurance was reduced for a total reduction of

New Mexico Lottery Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED

FINANCIAL ANALYSIS - CONTINUED

Budgetary Comparison - Continued

\$88,000 and net income was decreased by \$416,000, still returning over 30% of gross revenues.

Actual net sales for fiscal year 2012 did not meet the budget, underperforming by \$351,398. With cost savings in game expenses of \$792,452 and in operating expenses of \$221,756 and additional non-operating income of \$21,933, the Lottery was able to surpass the fiscal year 2012 revised annual budget net income by \$684,743; ending the fiscal year at 101.68% of 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 of the Lottery as of June 30, 2013 and 2012, and results of its operations, cash flows, variances from budgets, and percentage return to the state for the years then ended and to demonstrate the Lottery's accountability for the revenues it receives. If you have any questions about this report or need additional information, contact the Director of Finance at the New Mexico Lottery Authority, P.O. Box 93130, Albuquerque, New Mexico 87199.

New Mexico Lottery Authority

STATEMENTS OF NET POSITION

June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 9,340,237	\$ 6,885,806
Accounts receivable (net of allowance for doubtful accounts)	1,371,427	1,225,638
Reserves on deposit	3,405,568	3,396,831
Inventory	36,964	33,077
Prepaid expenses	<u>145,172</u>	<u>80,686</u>
Total current assets	14,299,368	11,622,038
CAPITAL ASSETS, NET	<u>629,345</u>	<u>305,550</u>
Total assets	<u>\$ 14,928,713</u>	<u>\$ 11,927,588</u>
CURRENT LIABILITIES		
Accounts payable and other current liabilities	\$ 1,977,904	\$ 1,955,328
Current portion of capital lease obligation	14,064	11,015
Prizes payable	9,355,989	6,860,315
Due to Lottery Tuition Fund	<u>3,503,374</u>	<u>3,039,205</u>
Total current liabilities	14,851,331	11,865,863
LONG-TERM LIABILITIES		
Noncurrent portion of capital lease obligation	<u>77,382</u>	<u>61,725</u>
Total liabilities	<u>\$ 14,928,713</u>	<u>\$ 11,927,588</u>
NET POSITION		
Net investment in capital assets	\$ 629,345	\$ 305,550
Unrestricted (deficit)	<u>(629,345)</u>	<u>(305,550)</u>
Total net position	<u>\$ -</u>	<u>\$ -</u>

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

New Mexico Lottery Authority

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

Years ended June 30, 2013 and 2012

	2013	2012
OPERATING REVENUES		
Instant ticket sales	\$ 72,397,663	\$ 71,632,710
Powerball sales	46,767,095	33,795,664
Mega Millions sales	8,088,972	14,330,230
Roadrunner Cash sales	6,784,566	7,520,021
Hot Lotto sales	5,996,195	5,438,475
Pick 3 sales	3,496,279	3,638,558
Quickster sales	867,111	453,448
Less tickets provided as prizes	(2,479,354)	(2,890,810)
Less spoiled, stolen, and promotional tickets	(160,005)	(130,944)
Net ticket sales	141,758,522	133,787,352
Retailer fees	20,575	16,250
Bad debts	(12,000)	(12,000)
Total operating revenues	141,767,097	133,791,602
GAME EXPENSES		
Prize expense	77,068,558	72,027,308
Retailer commissions	9,153,204	8,696,851
On-line vendor fees	2,269,623	2,139,754
Advertising	2,263,221	2,277,892
Ticket vendor fees	1,158,028	1,177,708
Promotions	437,704	381,179
Shipping and postage	428,532	410,422
Drawing game	116,081	116,532
Responsible gaming	87,400	87,400
Game membership	67,034	65,502
Total game expenses	93,049,385	87,380,548
OPERATING EXPENSES		
Salaries, wages, and benefits	3,614,032	3,583,778
Leases and insurance	514,990	585,629
Utilities and maintenance	439,041	431,189
Depreciation and amortization	139,393	115,933
Materials and supplies	125,050	153,867
Professional fees	112,893	150,651
Other	71,640	55,727
Travel	63,008	69,470
Total operating expenses	5,080,047	5,146,244
OPERATING INCOME	43,637,665	41,264,810
NON-OPERATING INCOME		
Other income	25,692	45,464
Interest income	21,324	18,469
Total non-operating income	47,016	63,933
Net income before transfers	43,684,681	41,328,743
Transfers to Lottery Tuition Fund	43,684,681	41,328,743
Change in net position	-	-
Net position at beginning of year	-	-
Net position at end of year	\$ -	\$ -

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

New Mexico Lottery Authority

STATEMENTS OF CASH FLOWS

Years ended June 30, 2013 and 2012

Increase (Decrease) in Cash and Cash Equivalents

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities		
Cash received:		
From retailers-sales net of commissions, incentives, and prize, spoiled, and stolen ticket credits	\$ 132,472,895	\$ 124,762,104
From MUSL - Hot Lotto jackpot	-	1,153,023
Cash payments:		
To prize winners and related taxes	(58,375,753)	(57,149,803)
To MUSL	(16,197,131)	(13,762,743)
To suppliers of goods or services	(9,058,917)	(9,200,911)
To employees for services and related taxes	<u>(2,880,565)</u>	<u>(2,838,626)</u>
Net cash provided by operating activities	<u>45,960,529</u>	<u>42,963,044</u>
Cash flows from investing activities		
Receipts of interest	10,254	7,861
Other	<u>367</u>	<u>23,971</u>
Net cash provided by investing activities	<u>10,621</u>	<u>31,832</u>
Cash flows from noncapital financing activities		
Transfers to Lottery Tuition Fund	<u>(43,220,512)</u>	<u>(41,505,020)</u>
Cash flows from capital and related financing activities		
Purchases of capital assets	(284,938)	(159,248)
Principal payments under capital lease	<u>(11,269)</u>	<u>(6,627)</u>
Net cash used by capital and related financing activities	<u>(296,207)</u>	<u>(165,875)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,454,431	1,323,981
Cash and cash equivalents at beginning of year	<u>6,885,806</u>	<u>5,561,825</u>
Cash and cash equivalents at end of year	<u>\$ 9,340,237</u>	<u>\$ 6,885,806</u>

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

New Mexico Lottery Authority

STATEMENTS OF CASH FLOWS - CONTINUED

Years ended June 30, 2013 and 2012

Increase (Decrease) in Cash and Cash Equivalents

	<u>2013</u>	<u>2012</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 43,637,665	\$ 41,264,810
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	139,393	115,933
Vendor's non-cash transactions	(119,759)	(18,678)
Interest on MUSL unreserved account	3,088	1,167
Net changes in assets and liabilities:		
Accounts receivable	(140,998)	(332,647)
Reserves on deposit	(8,737)	(471,580)
Inventory	(3,887)	(21,743)
Prepaid expenses	(64,486)	32,319
Accounts payable and other liabilities	22,576	125,678
Prizes payable	<u>2,495,674</u>	<u>2,267,785</u>
Net cash provided by operating activities	<u>\$ 45,960,529</u>	<u>\$ 42,963,044</u>

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

New Mexico Lottery Authority

STATEMENTS OF FIDUCIARY NET POSITION

June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash and cash equivalents	\$ 500,847	\$ 461,989
Marketable securities and other investments	4,259,724	3,599,443
Contribution receivable	8,121	6,931
Total assets	<u>\$ 4,768,692</u>	<u>\$ 4,068,363</u>
NET POSITION		
Pension plan participants' benefits	<u>\$ 4,768,692</u>	<u>\$ 4,068,363</u>

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

New Mexico Lottery Authority

STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

Years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ADDITIONS		
Investment earnings	\$ 559,478	\$ 739,810
Employer contributions	344,578	335,375
Other activity	-	-
Total additions	<u>904,056</u>	<u>1,075,185</u>
DEDUCTIONS		
Investment losses	-	776,116
Distributions to participants	<u>203,727</u>	<u>341,313</u>
Total deductions	<u>203,727</u>	<u>1,117,429</u>
Change in net position	700,329	(42,244)
Net position - beginning	<u>4,068,363</u>	<u>4,110,607</u>
Net position - ending	<u>\$ 4,768,692</u>	<u>\$ 4,068,363</u>

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The financial reporting entity as defined by Governmental Accounting Standards Board (GASB) Statement 14 consists of the primary government, organizations for which the primary government is financially accountable, and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading. 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 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, the Lottery has elected to follow all GASB pronouncements, and as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements. In instances where GASB guidance conflicts with private sector principles, the Lottery conforms to GASB.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

2. Basis of Presentation – Continued

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

The pension trust fund per Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position and Note D reflects the activities of the New Mexico Lottery Authority Retirement Plan (Plan) pursuant to a trust agreement with 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 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 2013 and 2012 there were no restricted resources.

3. Budgets and Budgetary Accounting

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

4. Cash and Cash Equivalents

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

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, 2013 and 2012, an allowance for doubtful accounts of \$36,165 and \$29,688, respectively, has been provided to recognize future uncollectible billings. In fiscal years 2013 and 2012, ten retail customers (477 and 481 retailer locations) represented 58% and 55% of sales for each year, respectively, and 59% and 52% 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 accounts may also be carried forward to a replacement game's prize reserve account. 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 \$80 million and for the SPRA is \$40 million for all member lotteries. At June 30, 2013 and 2012, the Lottery's share in the Powerball PRA was \$1,150,604 and \$1,430,961, respectively, and in the SPRA was \$554,595 and \$440,966, respectively. Both Powerball reserve funds are fully funded.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

6. Reserves on Deposit - Continued

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 nine million dollars for all party lotteries. At June 30, 2013 and 2012, the Lottery's share in the Hot Lotto PRA was \$735,241 and \$696,149, respectively. The Lottery's remaining Hot Lotto prize reserve buy-in amount was \$0.00 and \$70,645, respectively, as of June 30, 2013 and 2012.

The Lottery commenced sales of Mega Millions tickets on January 31, 2010. MUSL includes an additional amount up to 5% of the Lottery's Mega Millions drawing period's sales and included 4.9338682% until September 13, 2010 and then 1.5801572% of the Megaplier sales into the Prize Reserve Account (PRA). As of March 22, 2013, the MUSL product group set the maximum Mega Millions PRA balance at \$45 million for all party lotteries. At June 30, 2013 and 2012, the Lottery's share in the Mega Millions PRA was \$409,688 and \$286,019, respectively. The Lottery's remaining Mega Millions prize reserve buy-in amount was \$114,165 as of June 30, 2013.

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, 2013 and 2012, the Lottery's share of the unreserved fund was \$555,440 and \$542,736, respectively.

A winner of a Powerball grand prize or Mega Millions grand prize may select that the prize be paid at the cash value of the prize or as an annuity. A Powerball grand prize annuity is paid out in 30 annual installments over 29 years and a Mega Millions grand prize is paid out in 26 annual installments over 25 years. Government securities at the discounted value of the grand prize annuity are purchased to fund all future installments and are held in trust. Maturities are staggered in order to provide adequate cash flow for each annual installment. These assets and related liabilities are reflected in MUSL's financial statements and therefore are not reflected in the Lottery's financial statements. MUSL is responsible for transferring the cash or the annuity installment amounts to the member lottery prior to the payment to any grand prize winner. Currently, the Lottery is not paying any prize winner any annuity prize payments.

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

7. Inventory

In March 2003 and then again in March 2010, the Lottery entered into agreements with its primary instant ticket printers, whereby the printers retain title to the instant ticket inventory 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 2013, the Lottery was distributing games printed under the two March 2010 agreements; while at the end of fiscal year 2012, the Lottery was distributing games printed under the March 2003 agreement and the two March 2010 agreements.

As of June 30, 2013 and 2012, \$12,825 and \$33,077, respectively, of instant tickets are included in inventory. For each year respectively, \$24,139 and \$0 of merchandise prizes for second chance drawings are also included in inventory.

8. Capital Assets

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

9. Revenue and Accounts Receivable Recognition

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

10. Prizes

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

11. Commissions

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

12. Advertising Costs

Advertising costs are expensed as incurred.

13. Income Taxes

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

14. Custodial Credit Risk and Interest Rate Risk

At June 30, 2013, the Lottery maintained its cash balances in one financial institution, while at June 30, 2012, the Lottery maintained its cash balances in two financial institutions. The balances for demand deposits were insured by the Federal Deposit Insurance Corporation up to \$250,000 at these financial institutions.

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

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

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

14. Custodial Credit Risk and Interest Rate Risk - Continued

Securities with a market value of at least 102% of the principal and are used for overnight investment only. Collateral must meet State of New Mexico "Security of Public Money" standards and be held in third party safekeeping. As of June 30, 2013 and 2012, the Lottery's bank balances of \$9,523,952 and \$7,027,864, respectively, were exposed to custodial credit risk as follows:

	<u>2013</u>	<u>2012</u>
Uninsured and uncollateralized	\$ -	\$ -
Collateral held by the pledging bank's trust department in the Bank's name	-	-
Collateral held by the pledging bank's trust department in the Lottery's name	<u>9,523,952</u>	<u>7,027,864</u>
	<u>\$ 9,523,952</u>	<u>\$ 7,027,864</u>

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

At June 30, 2013 and 2012, the Lottery had overnight yield repurchase agreements with one-day maturities.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

15. Bank Accounts

At June 30, 2013:

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

15. Bank Accounts - Continued

At June 30, 2012:

<u>Description</u>	<u>Bank</u>	<u>Balance per Bank</u>
Operating account – overnight repurchase Agreement	Wells Fargo Bank, NA	\$ 6,864,002
Operating account – checking	Wells Fargo Bank, NA	-
Operating account - overnight repurchase Agreement	US Bank	163,862
Operating account – checking	US Bank	-
Total amount deposited in bank		<u>7,027,864</u>
Less: FDIC coverage		<u>-</u>
*Total uninsured funds – deposits and overnight repurchase agreement		<u><u>\$ 7,027,864</u></u>
102% pledged collateral requirement per statute for repurchase agreement		\$ 7,168,421
* Total pledged security		<u>(7,168,423)</u>
Amount under (over) requirement at June 30, 2012		<u><u>\$ (2)</u></u>

*Wells Fargo Bank, NA Securities are held in safekeeping at the Federal Reserve Bank in San Francisco, CA. Presented at fair value, CUSIP Numbers 31292LE35 (fair market value \$7,001,283), matures March 1, 2042. The repurchase agreement is collateralized with securities held in the name of the New Mexico Lottery Authority.

*US Bank securities are held in safekeeping at the Federal Reserve Bank in Cleveland, OH. Presented at fair value, CUSIP Number 3128DFAU2 (fair market value \$167,140), matures October 1, 2035. The repurchase agreement is collateralized with securities held in the name of the New Mexico Lottery Authority.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

15. Bank Accounts - Continued

Cash and cash equivalents per bank at June 30, 2012	\$ 7,027,864
Less reconciling items--outstanding checks	<u>(156,979)</u>
Reconciled cash in bank at June 30, 2012	6,870,885
Cash in vault	<u>14,921</u>
Total cash and cash equivalents per Statements of Net Position	<u>\$ 6,885,806</u>

16. Risk Management

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

17. Shipping and Handling Costs

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

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

18. Net Position

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

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

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

Unrestricted – consists of the net amount of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

19. Unclaimed Prizes

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

20. Use of Estimates in Preparation of Financial Statements

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

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. Accrued sick leave hours will not be paid to an employee upon separation from service. During the years ended June 30, 2013 and 2012, the following changes occurred in the compensated absences liabilities:

<u>Balance</u> <u>July 1, 2012</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2013</u>
\$ 212,919	\$ 23,898	\$ (9,108)	\$ 227,709
<u>Balance</u> <u>July 1, 2011</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2012</u>
\$ 193,831	\$ 30,259	\$ (11,171)	\$ 212,919

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

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -CONTINUED

22. Long-term Liabilities - Capital Lease Obligations

During the years ended June 30, 2013 and 2012, the following changes occurred in the capital lease obligations:

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

<u>Balance July 1, 2011</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance June 30, 2012</u>	<u>Amounts Due Within One Year</u>
\$ 27,509	\$ 51,858	\$ (6,627)	\$ 72,740	\$ 11,015

23. Accounts Payable and Other Current Liabilities

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

	<u>2013</u>	<u>2012</u>
Accounts payable	\$ 1,478,280	\$1,458,049
Accrued liabilities, vendors*	115,042	142,146
Accrued liabilities, retailers*	28,000	30,500
Accrued payroll, and payroll taxes and benefits	128,873	111,714
Compensated absences	<u>227,709</u>	<u>212,919</u>
	<u>\$ 1,977,904</u>	<u>\$1,955,328</u>

* The Lottery has accrued an estimated amount of services delivered by its vendors and deposits for its retailers as of June 30, 2013 and 2012, respectively.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE B – CAPITAL ASSETS

Capital assets at June 30, 2013 consisted of:

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

Included in data processing software, data processing equipment, and tenant improvements are \$116,143 and \$86,167 in assets reported as capital leases at June 30, 2013 and 2012, respectively. For each fiscal year, there were \$11,269 and \$6,627, respectively, in related amortization on these assets.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE B - CAPITAL ASSETS - CONTINUED

Capital assets at June 30, 2012 consisted of:

	Beginning Balance	Reclass- ification	Increases	Decreases	Ending Balance
Data processing software	\$ 2,503,323	\$ (84,388)	\$ -	\$ -	\$ 2,418,935
Data processing equipment	1,281,648	(530,259)	101,468	-	852,857
Equipment - Security and disaster recovery	572,479	(25,908)	94,170	(1,137)	639,604
Vehicles	432,500	-	-	-	432,500
Tenant improvements	339,670	(16,939)	51,437	-	374,168
Furniture and fixtures	233,172	-	-	-	233,172
Intellectual property	-	-	-	-	-
Equipment - communications	116,260	2,375	-	-	118,635
Equipment - drawing	116,478	-	-	-	116,478
Equipment - warehouse	69,831	-	6,343	(5,000)	71,174
Equipment - office	50,837	(1,329)	-	-	49,508
Obsolete capital assets	780,733	656,448	-	(535,310)	901,871
Capital assets	<u>6,496,931</u>	<u>-</u>	<u>253,418</u>	<u>(541,447)</u>	<u>6,208,902</u>
Data processing software	(2,485,425)	84,388	(17,898)	-	(2,418,935)
Data processing equipment	(1,257,806)	530,259	(10,929)	-	(738,476)
Equipment - Security and disaster recovery	(566,399)	25,908	(2,612)	1,137	(541,966)
Vehicles	(318,944)	-	(76,087)	-	(395,031)
Tenant improvements	(339,670)	16,939	(2,410)	-	(325,141)
Furniture and fixtures	(233,172)	-	-	-	(233,172)
Intellectual property	-	-	-	-	-
Equipment - communications	(116,260)	(2,375)	-	-	(118,635)
Equipment - drawing	(109,789)	-	(5,733)	-	(115,522)
Equipment - warehouse	(69,831)	-	(264)	5,000	(65,095)
Equipment - office	(50,837)	1,329	-	-	(49,508)
Obsolete capital assets	(780,733)	(656,448)	-	535,310	(901,871)
Accumulated depreciation	<u>(6,328,866)</u>	<u>-</u>	<u>(115,933)</u>	<u>541,447</u>	<u>(5,903,352)</u>
Capital assets, net	<u>\$ 168,065</u>	<u>\$ -</u>	<u>\$ 137,485</u>	<u>\$ -</u>	<u>\$ 305,550</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

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

	Net Income	Due to Lottery Tuition Fund	Net Position
	<u> </u>	<u> </u>	<u> </u>
Balance at June 30, 2012	\$ 3,039,205	\$ 3,039,205	\$ -
Current year net income	43,684,681	43,684,681	-
Current year transfers	<u>(43,220,512)</u>	<u>(43,220,512)</u>	<u>-</u>
Balance at June 30, 2013	<u>\$ 3,503,374</u>	<u>\$ 3,503,374</u>	<u>\$ -</u>

In accordance with the Lottery Act, no later than the last business day of each month, the Lottery shall transmit at least thirty percent of the gross revenue of the previous month, to the New Mexico State Treasurer, who shall deposit it into state agency number 950, New Mexico Higher Education Department, the Lottery Tuition Fund, SHARE fund number 63700. As of July 31, 2013 and 2012, the Lottery has transferred \$43,684,681 and \$41,328,743, respectively, for the years ended June 30, 2013 and 2012 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. Employees become eligible to participate for the purposes of money purchase contributions when they have completed six months of service. Contributions start on the first day of the quarter coinciding with or next following the date in which the employee satisfied the eligibility requirement. The 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, 2013 and 2012 are presented in the Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position. There are no separately issued financial statements available for the New Mexico Lottery Authority Retirement Plan.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

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, 2013 and 2012, the Lottery recognized \$344,578 and \$335,375 of pension expense for the Plan on eligible compensation of \$2,600,589 and \$2,531,132, respectively. There were no forfeitures of employee balances for the years ended June 30, 2013 and 2012, respectively. The entire pension amounts applicable to all compensation paid during the respective fiscal years have been paid to the Plan by June 30, 2013 and 2012, respectively. For the years ended June 30, 2013 and 2012, the Lottery recognized a contribution liability of \$8,121 and \$6,931, respectively, for contributions due on compensation earned, but not paid, for the last few days of each fiscal year.

NOTE E - CREDIT AGREEMENT

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

In July 2005, the Lottery had entered an agreement with First Community Bank (US 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. This line matured on May 14, 2008, May 14, 2010, and finally on May 14, 2012, with no further extension.

For the years ended June 30, 2013 and 2012, the Lottery had no outstanding borrowings against either line of credit.

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE F - LEASES

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

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

Rent expense was \$391,495 and \$465,653 for the years ended June 30, 2013 and 2012, respectively.

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

<u>Year</u>	<u>Amount</u>
2014	\$ 280,165
2015	280,165
2016	280,165
2017	280,165
2018	281,664
2019-2023	<u>1,359,282</u>
	<u>\$ 2,761,606</u>

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

	<u>2013</u>	<u>2012</u>
Minimum rentals	\$ 368,813	\$ 431,087
Less: Subleases	<u>-</u>	<u>-</u>
	<u>\$ 368,813</u>	<u>\$ 431,087</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE F - LEASES - CONTINUED

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:

2014	\$ 8,238
2015	8,237
2016	<u>3,432</u>
Total minimum payments	19,907
Less the amount representing interest	<u>(4,855)</u>
Present value of net minimum payments	<u>\$ 15,052</u>

As part of the 2002 lease extension with NMLB, LLC, the Lottery received \$50,000 in 2012 to be used for tenant improvements to the facility. In addition, as part of the 2012 lease, the Lottery received \$1,858 in 2012 and \$29,975 in fiscal year 2013 for tenant improvements to the facility. The Lottery has recorded the \$81,833 as tenant improvements with a related deferred liability to be amortized over the life of the lease using the straight-line method.

Years ending June 30:

2014	\$ 7,835
2015	7,836
2016	7,835
2017	7,835
2018	7,835
2019-2023	<u>37,218</u>
Total minimum payments	<u>\$ 76,394</u>

New Mexico Lottery Authority

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2013 and 2012

NOTE G - COMMITMENT

Effective on November 15, 2007, the Lottery entered into an agreement with INTRALOT, Inc., a Georgia-based company, to provide an updated on-line gaming system for a total of seven years with the option of three additional one year periods or any combination thereof. The system includes the supply, installation, maintenance, service, and operation of a communication network, lottery terminals and peripheral equipment for the Lottery's existing and future retailers, ticket scanners to enable players to check their tickets for prizes, self service ticket vending machines that sell both instant and 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:

	<u>2013</u>	<u>2012</u>
Registrations and memberships	\$ 30,044	\$ 25,712
Training	20,250	15,982
Other	17,404	10,723
Publications and subscriptions	<u>3,942</u>	<u>3,310</u>
	<u>\$ 71,640</u>	<u>\$ 55,727</u>

New Mexico Lottery Authority

**SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON STATEMENTS**

Years ended June 30, 2013 and 2012

	2013				2012			
	Original Budget	Final Budget	Actual	Variance with Final Budget	Original Budget	Final Budget	Actual	Variance with Final Budget
Operating revenues								
Instant ticket sales	\$ 71,100,000	\$ 70,000,000	\$ 72,397,663	\$ 2,397,663	\$ 80,000,000	\$ 72,000,000	\$ 71,632,710	\$ (367,290)
Powerball sales	36,000,000	41,000,000	46,767,095	5,767,095	27,000,000	34,000,000	33,795,664	(204,336)
Mega Millions sales	12,000,000	7,700,000	8,088,972	388,972	9,500,000	14,000,000	14,330,230	330,230
Roadrunner Cash sales	8,000,000	6,800,000	6,784,566	(15,434)	10,000,000	7,800,000	7,520,021	(279,979)
Hot Lotto sales	5,000,000	5,600,000	5,996,195	396,195	8,000,000	5,600,000	5,438,475	(161,525)
Pick 3 sales	3,700,000	3,400,000	3,496,279	96,279	3,600,000	3,700,000	3,638,558	(61,442)
Quickster sales	2,500,000	800,000	867,111	67,111	1,900,000	300,000	453,448	153,448
Less tickets provided as prizes	(3,000,000)	(2,500,000)	(2,479,354)	20,646	(3,400,000)	(3,100,000)	(2,890,810)	209,190
Less spoiled, stolen, and promotional tickets	(287,000)	(197,000)	(160,005)	36,995	(187,000)	(147,000)	(130,944)	16,056
Net ticket sales	135,013,000	132,603,000	141,758,522	9,155,522	136,413,000	134,153,000	133,787,352	(365,648)
Retailer fees	11,000	21,000	20,575	(425)	11,000	14,000	16,250	2,250
Bad debts	(24,000)	(24,000)	(12,000)	12,000	(24,000)	(24,000)	(12,000)	12,000
Total operating revenues	135,000,000	132,600,000	141,767,097	9,167,097	136,400,000	134,143,000	133,791,602	(351,398)
Total game expenses	88,742,000	87,350,000	93,049,385	5,699,385	89,964,000	88,173,000	87,380,548	(792,452)
Total operating expenses	5,763,000	5,339,000	5,080,047	(258,953)	5,456,000	5,368,000	5,146,244	(221,756)
Operating income	40,495,000	39,911,000	43,637,665	3,726,665	40,980,000	40,602,000	41,264,810	662,810
Total non-operating income	18,000	24,000	47,016	23,016	80,000	42,000	63,933	21,933
Net income before transfers to Lottery Tuition Fund	\$ 40,513,000	\$ 39,935,000	\$ 43,684,681	\$ 3,749,681	\$ 41,060,000	\$ 40,644,000	\$ 41,328,743	\$ 684,743

New Mexico Lottery Authority

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

Years ended June 30, 2013 and 2012

	2013	2012
OPERATING REVENUES		
Instant ticket sales	\$ 72,397,663	\$ 71,632,710
Powerball sales	46,767,095	33,795,664
Mega Millions sales	8,088,972	14,330,230
Roadrunner Cash sales	6,784,566	7,520,021
Hot Lotto sales	5,996,195	5,438,475
Pick 3 sales	3,496,279	3,638,558
Quickster sales	867,111	453,448
Less tickets provided as prizes	(2,479,354)	(2,890,810)
Less spoiled, stolen, and promotional tickets	(160,005)	(130,944)
Net ticket sales	<u>141,758,522</u>	<u>133,787,352</u>
Retailer fees	20,575	16,250
Bad debts	(12,000)	(12,000)
Total operating revenues	<u>141,767,097</u>	<u>133,791,602</u>
NON-OPERATING INCOME		
Other income	25,692	45,464
Interest income	21,324	18,469
Total non-operating income	<u>47,016</u>	<u>63,933</u>
GROSS REVENUES	<u>141,814,113</u>	<u>133,855,535</u>
GAME EXPENSES		
Prize expense	77,068,558	72,027,308
Retailer commissions	9,153,204	8,696,851
On-line vendor fees	2,269,623	2,139,754
Advertising	2,263,221	2,277,892
Ticket vendor fees	1,158,028	1,177,708
Promotions	437,704	381,179
Shipping and postage	428,532	410,422
Drawing game	116,081	116,532
Responsible gaming	87,400	87,400
Game membership	67,034	65,502
Total game expenses	<u>93,049,385</u>	<u>87,380,548</u>
OPERATING EXPENSES		
Salaries, wages, and benefits	3,614,032	3,583,778
Leases and insurance	514,990	585,629
Utilities and maintenance	439,041	431,189
Depreciation and amortization	139,393	115,933
Materials and supplies	125,050	153,867
Professional fees	112,893	150,651
Other	71,640	55,727
Travel	63,008	69,470
Total operating expenses	<u>5,080,047</u>	<u>5,146,244</u>
OPERATING INCOME	<u>43,637,665</u>	<u>41,264,810</u>
NET INCOME	<u>\$ 43,684,681</u>	<u>\$ 41,328,743</u>
GROSS REVENUE PERCENTAGE RETURN	<u>30.80%</u>	<u>30.88%</u>

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities, and the aggregate remaining fund information of the New Mexico Lottery Authority (Lottery) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, including the budget to actual comparison statement and the schedules of percentage return to the State of New Mexico are presented as supplementary information and have issued our report thereon dated October 29, 2013.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we

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

consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings and responses as item 2010-03 that we consider to be a significant deficiency.

Compliance and Other Matters

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

The Lottery's Response to Finding

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

Purpose of this Report

This purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Mess Adams LLP

Albuquerque, New Mexico
October 29, 2013

New Mexico Lottery Authority

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year Ended June 30, 2013

2010-02	Document Programming Changes in the AS400	Cleared
2010-03	Update and Test Disaster Recovery Plan	Revised and Repeated
2012-01	Lack of Contingency Reserve	Cleared

SCHEDULE OF FINDINGS AND RESPONSES

Year Ended June 30, 2013

2010-03 DISASTER RECOVERY AND BUSINESS CONTINUITY PLANS

Condition

At June 30, 2013, the Disaster Recovery Plan and Business Continuity Plans were not completed. The Plans were finalized in August 2013. Additionally, the Lottery has not completed its implementation of an offsite redundant server that mirrors the production server on an online-real time basis.

Criteria

In accordance with ISACA's Control Objectives for Information and related Technology (COBIT) 4.1 framework (DS4), to ensure continuous service, a Disaster Recovery and Business Continuity Plans need to be developed and tested to reduce impact of a major disruption on key business functions and processes. The plans should be based on risk understanding of potential business impacts and address requirements for resilience, alternative processing and recovery capability of all critical IT services. They should also cover usage guidelines, roles and responsibilities, procedures, communication processes, and the testing approach.

Effect

Missing components in Disaster Recovery Plan may pose question as to the Lottery's ability to respond and recover its critical data and applications, and deliver some services or functions in the event of an unforeseen disaster.

Cause

At June 30, 2013, The Lottery has not implemented and tested its redundant server nor tested its Plans.

Recommendation

We recommend that once the Lottery implements and tests the redundant server, it also updates the Disaster Recovery Plan.

We also recommend that system recovery testing and backup tape restoration be conducted periodically and the tests should be formally documented.

SCHEDULE OF FINDINGS AND RESPONSES - CONTINUED

Year Ended June 30, 2013

Management's Response

The New Mexico Lottery Authority is in the process of creating the recovery procedures for all systems and applications to ensure the availability of critical data. The New Mexico Lottery Authority will schedule an annual review and test of the Disaster Recovery Plan for late Spring 2014 and will add sections to the next release for disaster recovery updates, changes incorporated in underlying systems and recovery procedures, and test conditions and results.

Currently, a backup of all New Mexico Lottery Authority financial and back office data is performed on a daily basis and stored at an offsite facility, BIGBYTE, a Tier III compliant data center offering secured 24/7/365 media storage. Our secondary disaster recovery site is a secondary fail-over production environment replicated real time. This redundancy minimizes outages and provides instant recovery to production systems. The New Mexico Lottery Authority currently tests backup tape restoration and does agree to formalize and document the process in the Disaster Recovery Plan.

New Mexico Lottery Authority

EXIT CONFERENCE

For the Year Ended June 30, 2013

An exit conference was held at the New Mexico Lottery Authority on October 14, 2013. The following individuals participated:

Name	Title
<i>New Mexico Lottery Authority</i>	
<i>Finance/Audit Committee</i>	
Dan Salzwedel	Board Chair
Mark Koson	Board Vice-Chair
<i>New Mexico Lottery Authority Employees</i>	
Tom Romero	Chief Executive Officer
Sylvia Ann Jaramillo, CPA	Director of Finance
David Ramirez	Director of MIS
Michael Boland, CPA	Internal Auditor
<i>Moss Adams LLP</i>	
Scott Eliason, CPA	Audit Partner
Corrine Zajac-Clarkson	Audit in-charge
Jaime Rumbaoa	IT Senior Manager

Financial Statement Preparation

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