



NEW YORK STATE LOTTERY

Basic Financial Statements

March 31, 2006 and 2005

(With Independent Auditors' Report Thereon)

NEW YORK STATE LOTTERY

Basic Financial Statements

March 31, 2006 and 2005

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KPMG LLP
515 Broadway
Albany, NY 12207

Independent Auditors' Report

New York State Lottery:

We have audited the accompanying statements of net assets of the New York State Lottery (Lottery) as of March 31, 2006 and 2005, and the related statements of revenue, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements of the New York State Lottery are intended to present the financial position, and changes in financial position and cash flows, of only that portion of the financial reporting entity of the State of New York that is attributable to the transactions of the Lottery. They do not purport to, and do not, present fairly the financial position of the State of New York as of March 31, 2006 and 2005, and the changes in financial position and its cash flows, where applicable, for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the New York State Lottery as of March 31, 2006 and 2005, and changes in net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The Management's Discussion and Analysis on pages 2 through 8 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting standards. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

May 31, 2006

NEW YORK STATE LOTTERY

Management's Discussion and Analysis (Unaudited)

March 31, 2006 and 2005

The management of the New York State Lottery (New York Lottery or Lottery) offers readers the following general overview and analysis of the New York Lottery's financial position and activities for the fiscal year ending March 31, 2006. We encourage readers to consider this information in conjunction with the detailed financial statements and explanatory notes that follow. The New York Lottery's basic financial statements for the fiscal years ending March 31, 2006 and 2005 have been prepared in accordance with U.S. generally accepted accounting principles.

Financial Highlights

New York Lottery revenues totaled \$6.803 billion, the highest total ever for the Lottery, while net proceeds earned for Lottery Aid to Education reached a record high \$2.203 billion for fiscal year 2006.

- New York Lottery revenues in fiscal year 2006 surpassed the revenues of 2005 by \$533 million or 8.5%. In fiscal year 2005, the annual revenue increase was \$423.0 million or 7.2%.
- Net proceeds earned for Lottery Aid to Education in fiscal year 2006 surpassed the net proceeds of 2005 by \$139.9 million or 6.8%. Comparatively, the annual increase in earnings for education in fiscal year 2005 was \$155.3 million or 8.1% over the earnings of 2004.
- Prize expense increased by \$329.7 million or 9.4% during fiscal year 2006. In fiscal year 2005 this increase was \$217.2 million or 6.6%. Prize expense generally increases directionally with increased sales.
- Operating income increased by \$103.4 million or 5.0% during fiscal year 2006. During fiscal year 2005, this increase was \$108.8 million or 5.6%.
- Nonoperating expense decreased by \$38.4 million during fiscal year 2006. This decrease follows a \$60.0 million increase in fiscal year 2005. The decrease is due largely to the impact of rising bond yields on the unrealized fair market value of the securities purchased by the New York State Lottery for the purpose of paying long-term prizes.
- Working Capital (current assets minus current liabilities) increased to \$179.5 million at the end of fiscal year 2006. This was an increase of \$4.3 million or 2.5% over fiscal year 2005. At the end of fiscal year 2005, working capital decreased by \$0.8 million or 0.5% over the fiscal year ended 2004.

Overview of Financial Statements

The New York Lottery presents its financial statements using an accrual method of accounting as an enterprise fund, which is comparable to the method used by many private sector businesses. The accrual method recognizes revenues when earned, not necessarily when received. Likewise, expenses are recognized when incurred, not necessarily when paid. The Lottery prepares the following three financial statements for fiscal years 2006 and 2005:

Statements of Net Assets

The statement on page nine provides information on the nature and amount of the Lottery's assets, liabilities and net assets at the close of fiscal years 2006 and 2005. The relationship of assets to liabilities and resulting net assets is one indicator of the financial condition of the Lottery and can also be a reflection of changes within the Lottery.

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Management's Discussion and Analysis (Unaudited)

March 31, 2006 and 2005

Statements of Revenues, Expenses, and Changes in Net Assets

The statement on page 10 reflects the Lottery's operating and non operating revenues and expenses for the year. "Income before transfers out" is the accounting equivalent to "net income before taxes" for a nongovernmental business. Also illustrated in this statement is the change in net assets for the year.

Statements of Cash Flows

The comparative statement on page 11 is presented on the direct method of reporting and reflects cash flows from operating activities as well as capital and noncapital financing and investing activities. Cash collections and payments are reflected in this statement to arrive at the net increase or decrease in cash and cash equivalents for the year.

The above mentioned financial statements, the footnotes and this management discussion and analysis provide information about the Lottery's overall financial condition.

This management discussion and analysis is meant to be an introduction to the financial statements and to assist readers in understanding the results of the operation and the financial condition of the New York Lottery. The notes to the financial statements are an integral part of the statements and include additional data and explanations which are to be used in concert with the financial statements.

The New York Lottery deposits its net proceeds into six accounts held in joint custody with the New York State Office of the State Comptroller. These six accounts and the purpose of the funds are as follows:

- Lottery Education Account – Accumulates the required deposits for Aid to Education from revenues, not including video gaming revenues.
- Prize Pending Account – Consists of Lottery prizes that have not yet been paid from revenues, excluding video gaming revenues.
- Administration – Utilized to pay for the Lottery's administrative costs that are not related to or funded by video gaming revenues.
- Video Gaming Education – Accumulates the required Education proceeds from video gaming operations.
- Video Gaming Prize Pending – Consists of video gaming prizes awarded that have not yet been claimed.
- Video Gaming Administration – Utilized to pay the administrative costs of video gaming.

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Management's Discussion and Analysis (Unaudited)

March 31, 2006 and 2005

Financial Analysis

Summary of Net Assets

The comparative statement of net assets represents the Lottery's financial position as of the fiscal years ended for 2006, 2005, and 2004 (in millions):

	FY 2006	FY 2005	FY 2004	FY 2006 vs. FY 2005		FY 2005 vs. FY 2004	
				Dollar change	Percent change	Dollar change	Percent change
Current assets	\$ 982	776	838	206	26.5%	\$ (62)	(7.4)%
Noncurrent assets	1,173	1,247	1,370	(74)	(5.9)	(123)	(9.0)
Total assets	\$ 2,155	2,023	2,208	132	6.6	\$ (185)	(8.4)
Current liabilities	\$ 802	600	662	202	33.7	\$ (62)	(9.4)
Noncurrent liabilities	1,137	1,133	1,181	4	0.4	(48)	(4.1)
Total liabilities	\$ 1,939	1,733	1,843	206	11.9	\$ (110)	(6.0)
Restricted net assets	\$ 130	151	142	(21)	(13.9)	\$ 9	6.3
Unrestricted net assets	86	139	223	(53)	(38.1)	(84)	(37.7)
Total net assets	\$ 216	290	365	(74)	(25.2)	\$ (75)	(20.5)

Current Assets

Current assets consist of cash and cash equivalents, accounts receivable, instant ticket inventory and the current portion of annuity investments. The total current assets increased by 26.5% during the fiscal year 2006. The majority of the increase was due to an increase of \$157 million in cash offset by a \$60 million increase in accounts receivable.

The cash increase was mainly caused by an increase in the balance of the two Education accounts of \$215.5 million and a decrease in the two Prize Pending accounts of \$56.4 million. The increase in the education accounts is mainly attributable to a \$130 million transfer from the New York State General Fund to the Video Lottery Terminal (VLT) Education account made during fiscal year 2006 to supplement VLT revenues to be used for Sound Basic Education aid in fiscal year 2007. The accounts receivable increase was caused by the increase in instant cash game sales. In comparison, fiscal year 2005 current assets decreased by 7.4% over the prior fiscal year caused primarily by a \$99 million decrease in cash, the majority of which occurred in the two Education accounts.

Noncurrent Assets

Noncurrent assets consist primarily of investments held in United State Treasury Securities utilized to fund installment payments to the Lottery's Lotto, Mega Millions and select instant game top-prize winners. The total market value for these securities decreased by 5.6% to \$1.36 billion as of March 31, 2006. This change is due to the increase in the yield on United States Treasury Securities in the market. Comparatively, the total fair market value of these Securities as of March 31, 2005 was \$1.44 billion (a decrease of \$142.4 million from March 31, 2004). This 9.0% decrease was related to the increase in the yield on held securities and the overall market for this investment type.

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\$1.17 billion and \$1.24 billion were invested in securities at March 31, 2006 and 2005, respectively, for prizes that are payable beyond one year from that date. The remaining value of securities at each fiscal year end is related to prizes that are due during the next fiscal year and that value is reflected in current assets.

Current Liabilities

Current liabilities consist of the current portion of long-term prizes payable, prizes awarded in the past year that remain unclaimed, amounts Due to Education on an accrual basis, accrued expenses, accounts payable, the value of Lottery tickets purchased in advance of game drawings (deferred ticket sales) and the short-term portion of capitalized leases. In total, these accounts increased by \$201.8 million during fiscal year 2006 due in large part to a \$238.6 million increase in Due to Education (caused by changes in the timing of receipts of cash draw downs for Aid to Education and the \$130 million transfer to the VLT Education account for Sound Basic Education aid), (an \$8.1 million decrease in annuitant type prizes due to winners over the next year (Prizes Payable)), a drop of \$20.9 million in prizes awarded but unclaimed (Unclaimed Prizes) a \$7.3 million reduction in Accounts Payable and Accrued Expenses and a decrease of \$0.6 million in Deferred Ticket Sales. Capitalized Lease Obligations increased by \$0.1 million. These changes can be compared to the fiscal year ended March 31, 2005 when a \$62.0 million annual decrease in total current liabilities was recorded. For that period, the decrease was mainly due to a \$30.5 million decrease in Due to Education, a decrease in Unclaimed Prizes of \$10.3 million, a decrease in Prizes Payable of \$13.2 million, and a decrease in Accounts Payable and Accrued Expenses of \$8.7 million.

Noncurrent Liabilities

Noncurrent or long-term liabilities consist of installment prizes due in fiscal years after 2006, the amount due to employees for unused vacation and sick leave, and the long-term portion of capitalized leases. During the fiscal year this category of liabilities increased by \$3.9 million. The increase was caused mainly by a \$7 million increase in the amount of long-term prizes payable outstanding offset by a decrease in capitalized leases by \$2.4 million. In fiscal year 2005 long term prizes payable declined by \$48.4 million. The increase in the dollar value of installment prizes payable in fiscal year 2006 is the result of an increase in the number of instant game top prize winners to be paid over an extended period of time.

Net Assets

Unrestricted Net Assets listed on the statement of net assets are largely the cumulative result of increased fair market value of United States guaranteed marketable securities held by the Lottery to pay prize winners on an annuity basis. The New York Lottery's policy and practice is to hold these investments to maturity to meet these prize payment obligations. As such, the Lottery does not expect to realize any fair value gain on these investments. Investments consist of United States Government-backed obligations of zero coupon bonds and stripped securities that equal the face amount of the bond or security upon maturity.

Restricted Net Assets for future prizes consist of prize funds that are in excess of prizes actually claimed at the fiscal year end, but which are necessary to ensure future prize payments. For example, prize funds from past sales, which are to be utilized to pay an accumulating or future New York Lotto or Mega Millions jackpot or contributions toward a created but unclaimed instant ticket prize. These amounts are available by statute for this purpose.

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Summary of Revenues, Expenses, and Changes in Net Assets

The following summary compares the Lottery's operating revenues, expenses and changes in net assets for the fiscal years 2006, 2005 and 2004 (in millions).

	FY 2006	FY 2005	FY 2004	FY 2006 vs. FY 2005		FY 2005 vs. FY 2004	
				Dollar change	Percent change	Dollar change	Percent change
Operating revenue:							
Lottery revenue, net	\$ 6,803	6,270	5,847	533	8.5%	\$ 423	7.2%
Operating expenses:							
Direct expenses	(4,513)	(4,092)	(3,788)	(421)	10.3	(304)	8.0
Indirect expenses	(123)	(115)	(105)	(8)	7.0	(10)	9.5
Total operating expenses	(4,636)	(4,207)	(3,893)	(429)	10.2	(314)	8.1
Operating income	2,167	2,063	1,954	104	5.0	109	5.6
Nonoperating income (expenses)	(38)	(75)	(16)	37	(49.3)	(59)	368.8
Income before transfers out	2,129	1,988	1,938	141	7.1	50	2.6
Transfers out – contribution for aid to education	(2,202)	(2,063)	(1,907)	(139)	6.7	(156)	8.2
Change in net assets	\$ (73)	(75)	31	2	(2.7)	(106)	(341.9)

Revenues

The New York Lottery exists for the sole purpose of raising revenue to help support Aid to Education. The Lottery achieves its mission through the sale of Lottery tickets at approximately 16,000 licensed retail locations across the state and through video lottery gaming at five licensed video lottery gaming facilities in operation in fiscal year 2006 located in Saratoga, Monticello, Farmington, Hamburg, and Batavia, New York. Four of these facilities were operating in 2005 and three were operating in 2004.

During the fiscal year 2006, the Lottery achieved \$3.134 billion in on-line sales, \$3.198 billion in instant sales, \$155 million in promotional game sales (King Kong), and \$316 million in video lottery gaming net machine income for a total of \$6.803 billion, a 8.5% (\$533 million) increase over the previous fiscal year. This record year eclipses the record set the previous year when 2005 revenues reached \$6.270 billion, a \$423 million or 7.2% increase. Significant growth was reflected in the instant game and video lottery gaming categories during both fiscal years. In fiscal year 2004 total revenues were \$5.847 billion.

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The following compares the Lottery's revenues by game and the percentage of total revenues by game for the fiscal years 2006, 2005, and 2004 (in millions).

Game	FY 2006		FY 2005		FY 2004	
	Revenue	Percent of total revenues	Revenue	Percent of total revenues	Revenue	Percent of total revenues
Mega Millions	\$ 563	8.3%	\$ 446	7.1%	\$ 474	8.1%
Lotto	253	3.7	306	4.9	356	6.1
Take 5	336	4.9	348	5.6	363	6.2
New York's Numbers	822	12.1	790	12.6	758	13.0
Win 4	658	9.7	624	9.9	593	10.1
Quick Draw	460	6.8	474	7.6	500	8.5
Pick 10 and Instant Win	42	0.6	45	0.7	47	0.8
King King Millions ***	155	2.3	—	—	—	—
Instant (excl. King Kong)	3,198	47.0	3,005	47.9	2,734	46.8
Subtotal traditional lottery	6,487	95.4	6,038	96.3	5,825	99.6
Video Gaming, net	316	4.6	232	3.7	22	0.4
Total revenues	\$ 6,803	100.0%	\$ 6,270	100.0%	\$ 5,847	100.0%

*** King King Millions consisted of an Instant Game and single high-jackpot online drawing

Direct Expenses

Direct Expenses consist of prize expense for traditional Lottery games, commissions to Lottery retailers and video lottery gaming facilities, fees to gaming contractors, expenses of providing instant tickets to players, and telecommunications. The largest expenditure in this category is prize expense. This expense increased by \$329.7 million to \$3.853 billion in fiscal year 2006, which along with traditional retailer commissions which increased by \$27.0 million to \$389.0 million, video lottery gaming commissions to facilities which increased \$54.9 million to \$122.1 million, and gaming contractor fees which increased \$10.0 million to \$88.0 million, accounted for the majority of the increase in this category.

During fiscal year 2005, prize expense increased by \$217.2 million to \$3.524 billion and, along with retailer commissions, which increased by \$12.6 million to \$362 million and commissions to video lottery gaming facilities which increased by \$60.9 million to \$67.2 million account for nearly all of the increase in direct expenses. Approximately 63% of revenues have gone toward direct expenses in the past three fiscal years.

Other Operating Expenses

Other operating expenses include marketing, state agency charges, personal services, fringe benefits and other administrative costs. These costs increased by \$8.0 million during the fiscal year as administrative costs related to video lottery gaming increased due to the continued expansion of the video lottery gaming program. As stated previously, these facilities generated \$316.0 million in net machine income for the fiscal year.

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Management's Discussion and Analysis (Unaudited)

March 31, 2006 and 2005

Nonoperating Revenues (Expenses)

Nonoperating revenues and expenses consist of small amounts of miscellaneous income plus the net growth or decline in the book and fair value of the United States Treasury Securities used to fund long term prizes. Investment income (\$47.2 million in 2006, \$15.0 million in 2005 and \$83.6 million in 2004) consists of both the fair value adjustments of investments plus the normal growth of the value of Lottery investments as the securities move closer to maturity. The market driven, fair value adjustment is the primary factor in the fluctuation in this amount from year to year. Investment expense is a reflection of the Lottery expending the investment income to increase the valuation of the long-term prizes payable to winners. The annual fair value adjustments of investments (shown here as income) flows to the unrestricted net assets balance on the statement of net assets. This fair value adjustment is unrealized by the Lottery since it expects to hold investments to maturity.

Income Before Transfers Out and Change in Net Assets

The revenues and expenses for fiscal year 2006 resulted in income before transfers out totaling \$2.129 billion. This amount consists of \$2.203 billion that transfers out as a contribution for Aid to Education and a \$73.2 million reduction in net assets for the year. The \$73.2 million reduction in net assets is a combination of \$20.8 million decrease in net assets restricted for prizes and \$52.4 million decrease in unrestricted net assets. During fiscal year 2005, the income before transfers out totaled \$1.988 billion. \$2.063 billion of this income transferred out as a contribution for aid to education and \$75.1 million flowed to the Statement of Net Assets. \$8.9 million of the amount flowing to the Statement of Net Assets was transferred as an increase in net assets restricted for prizes and the remaining \$84.0 million decreased unrestricted net assets.

Summary and Outlook

The revenues reported here include those from the five video lottery gaming facilities that were operational during fiscal year 2006. Additional revenues are expected in the 2007 fiscal year from a sixth facility, located in Tioga, NY that is expected to open on July 4, 2006, and from a seventh facility, located in Yonkers, NY that is expected to open in September, 2006. An eighth facility, located in Vernon, NY may also open before March 31, 2007. The video lottery gaming facility in Yonkers, NY will be the largest facility of its kind in the State, housing nearly 5,500 video gaming machines after completion of the phase-in of operations during the fourth quarter of next fiscal year.

Contacting New York Lottery's Financial Management of the New York State Lottery

This financial report is designed to provide the State of New York, the public and other interested parties with an overview of the financial results of the New York State Lottery and an explanation of the Lottery's financial condition. If you have any questions about this report or require additional information, email Questions@Lottery.state.ny.us or write to The New York Lottery Communications office, One Broadway Center, P.O. Box 7500, Schenectady, NY 12301-7500.

NEW YORK STATE LOTTERY

Statements of Net Assets

March 31, 2006 and 2005

(In thousands)

Assets	2006	2005
Current assets:		
Cash and cash equivalents	\$ 331,317	173,901
Accounts receivable	451,198	390,806
Instant ticket inventory	10,183	11,796
Investments	<u>189,237</u>	<u>199,295</u>
Total current assets	981,935	775,798
Long-term investments, net	1,165,778	1,237,322
Other assets	<u>8,067</u>	<u>10,189</u>
Total assets	<u>2,155,780</u>	<u>2,023,309</u>
Liabilities		
Current liabilities:		
Prizes payable	195,544	203,601
Unclaimed prizes	189,229	210,081
Due to Education	388,920	150,289
Accounts payable and accrued liabilities	17,217	24,536
Capital lease obligations	2,352	2,276
Deferred ticket sales	<u>9,133</u>	<u>9,796</u>
Total current liabilities	802,395	600,579
Compensated absences	4,840	5,566
Long-term capital lease obligations	5,358	7,710
Long-term prizes payable	<u>1,126,766</u>	<u>1,119,793</u>
Total liabilities	<u>1,939,359</u>	<u>1,733,648</u>
Net Assets		
Restricted for future prizes	130,129	150,905
Unrestricted	<u>86,292</u>	<u>138,756</u>
Total net assets	<u>\$ 216,421</u>	<u>289,661</u>

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY

Statements of Revenue, Expenses, and Changes in Net Assets

Years ended March 31, 2006 and 2005

(In thousands)

	2006	2005
Operating revenue:		
Lottery revenue, net	\$ 6,802,842	6,270,487
Operating expenses:		
Prize expense	(3,853,270)	(3,523,530)
Retailer commissions	(511,059)	(429,182)
Gaming contractor fees	(88,028)	(78,008)
Instant ticket direct expenses	(32,091)	(31,174)
Telecommunications	(28,421)	(29,946)
Total direct expenses	(4,512,869)	(4,091,840)
Online games/jackpot marketing	(38,771)	(32,555)
Personal service and fringe benefits	(25,481)	(24,934)
Instant games marketing	(20,916)	(20,357)
All games marketing	(14,999)	(17,793)
Other administrative costs	(13,502)	(12,717)
State agency charges	(9,469)	(6,811)
Total indirect expenses	(123,138)	(115,167)
Total operating expenses	(4,636,007)	(4,207,007)
Operating income	2,166,835	2,063,480
Nonoperating revenue and (expenses):		
Investment income	47,179	14,957
Other revenues (expense), net	(143)	166
Investment expense, net	(84,492)	(90,968)
Total nonoperating expense	(37,456)	(75,845)
Income before transfers out	2,129,379	1,987,635
Transfers out – contribution for aid to education	(2,202,619)	(2,062,702)
Change in net assets	(73,240)	(75,067)
Net assets beginning of year	289,661	364,728
Net assets end of year	\$ 216,421	289,661

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY

Statements of Cash Flows

Years ended March 31, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Operating activities:		
Cash received from net Lottery revenue	\$ 6,736,199	6,231,696
Cash payments for prizes	(3,957,088)	(3,706,983)
Cash payments for commissions	(510,785)	(429,267)
Cash payments for contractor fees	(87,966)	(78,003)
Cash payments for telecommunications	(28,421)	(29,946)
Cash payments for instant ticket direct expenses	(30,682)	(34,329)
Cash payments for other operating expenses	(125,850)	(113,947)
Net cash provided by operating activities	<u>1,995,407</u>	<u>1,839,221</u>
Investing activities:		
Proceeds from investment maturities	203,685	214,711
Purchases of investments	(89,791)	(65,353)
Interest on cash and cash equivalents	14,493	7,701
Net proceeds from swaps of investment securities	394	—
Other	(143)	166
Net cash provided by investing activities	<u>128,638</u>	<u>157,225</u>
Noncapital financing activities:		
Cash transfer to State for Aid to Education	(2,093,988)	(2,093,237)
Cash received from State General Fund for Sound Basic Education	130,000	—
Net cash used by noncapital financing activities	<u>(1,963,988)</u>	<u>(2,093,237)</u>
Capital financing activities:		
Cash payments for equipment and leasehold improvements	(2,641)	(1,902)
Net cash used by capital financing activities	<u>(2,641)</u>	<u>(1,902)</u>
Net increase (decrease) in cash and cash equivalents	157,416	(98,693)
Cash and cash equivalents, beginning of year	173,901	272,594
Cash and cash equivalents, end of year	\$ <u>331,317</u>	<u>173,901</u>
Reconciliation of operating income to cash provided by operating activities:		
Operating income	\$ 2,166,835	2,063,480
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	2,487	1,916
Change in operating assets and liabilities:		
(Increase) in accounts receivable, net	(60,392)	(47,572)
Decrease (increase) in ticket inventory	1,613	(3,452)
(Decrease) in prizes payable	(85,576)	(156,742)
(Decrease) in unclaimed prizes	(20,852)	(10,319)
(Decrease) increase in compensated absences	(726)	303
(Decrease) in accounts payable and accrued liabilities	(7,319)	(8,687)
(Decrease) increase in deferred ticket sales	(663)	294
Net cash provided by operating activities	\$ <u>1,995,407</u>	<u>1,839,221</u>
Noncash investing activities:		
Decrease in unrealized gains on investments	\$ (52,465)	(84,036)
Amortization of investment discount	84,757	90,942

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY

Notes to Basic Financial Statements

March 31, 2006 and 2005

(1) Summary of Significant Accounting Policies

The New York State Lottery (Lottery) was established in 1967. The Lottery is currently administered by the Division of the Lottery, an independent unit of the New York State Department of Taxation and Finance, which operates in accordance with the provisions of the New York State Lottery for Education Law (Tax Law Article 34). The purpose of the Lottery is to raise revenue for education in the State of New York (State) through the administration of lottery games.

The Lottery is included in the State of New York's Basic Financial Statements as an enterprise fund. These financial statements present only the Lottery and do not present the financial position of the State nor changes in the State's financial position and cash flows.

The Lottery prepares its financial statements under the economic resources measurement focus whereby all inflows, outflows and balances affecting net assets are reported, and uses the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The primary operating revenue of the Lottery is ticket sales from games. Nonoperating income consists mostly of investment income and unrealized gains on investments. Operating expenses consist of direct expenses for prizes, commissions to Lottery retailers, fees to gaming contractors, expenses for providing instant tickets to players, and telecommunications. Other operating expenses that are indirect to the results of each game include marketing, state agency charges, personal services, and fringe benefits. Nonoperating expense is the amortization of the discount on long-term prizes payable. The Lottery applies all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Statements and Interpretations of the Financial Accounting Standards Board (FASB), Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB's) of the Committee on Accounting Procedure. The Lottery has elected the option, under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Government Entities that Uses Proprietary Funds*, not to apply all FASB Statements and Interpretations issued after November 30, 1989.

The more significant accounting policies of the Lottery are described below:

(a) Revenue Recognition

(i) On-Line Games

Revenue from ticket sales for Lotto, Quick Draw, Take Five, Pick 10, Mega Millions, Instant Win, New York's Numbers and Win-4 games, and promotional games (on-line games) is recognized when the related drawing takes place. Receipts from subscription sales and other ticket sales for future drawings are recorded as deferred revenue and recognized when the related drawings take place.

(ii) Instant Cash Games

Revenue from instant cash games is recognized based on the dollar value of the total number of tickets available for sale. Tickets are available for sale upon being activated on the Lottery Validation System at the retailer locations.

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(iii) Video Lottery

Revenue from video lottery gaming is recognized based on net machine income, which is defined as amounts played less prizes won.

(b) Commissions and Fees

Retailers selling online and instant cash game tickets receive a commission of 6% based on the total tickets sold. For video lottery gaming, the entertainment facilities received a commission of 29% of net machine income until April 13, 2005 when the commission was changed by state law to an incremental percent of the annual net machine income at each video lottery gaming facility as follows: 32% of the first \$50 million, 29% of the next \$100 million, and 26% thereafter. In addition, each facility receives a marketing allowance of 8% of the first \$100 million and 5% thereafter with the exception of facilities located in Queens or Westchester County which would receive 4% on all net machine income. The on-line game contractor and the video lottery central processing contractor receive fees equal to a contractual percentage of the sales generated through the network maintained by the respective contractor. The instant game contractor is paid a fee equal to a contractual percentage of instant sales. Video lottery terminal contractors receive a fee equal to a contractual percentage of revenue, adjusted for the units of service provided. All other gaming contractors are paid fees based on the units of service provided (see note 13).

(c) Accounts Receivable

Accounts receivable represents amounts due from retailers through a Lottery gaming contractor and video lottery gaming facilities, net of commissions and fees, as well as amounts due from agents for instant cash game tickets which have been activated, but not yet settled. Instant ticket settlements occur within 45 days after a book of tickets is activated. Video lottery gaming receivables are received two business days after each sales day and online games are collected within four business days after the close of each sales week.

(d) Allocation of Revenue from Ticket Sales

The allocation of ticket sales is made in accordance with the provisions of the New York State Lottery for Education Law which requires:

- Allocations of ticket sales revenue to New York for educational purposes to be at least 20% for the New York State Lottery instant cash games, 35% for Take Five, New York's Numbers, Win-4, Mega Millions and Pick 10, 45% for Lotto, promotional games and Instant Win, and 25% for Quick Draw. In addition, the Lottery has legislative authority to issue up to three Instant Games per year with at least 10% for educational purposes. For video lottery, the required allocation to education was 61% of net sales revenue (after payout for prizes), until April 13, 2005 when it became an incremental percent of each facility's annual sales: the incremental percentages are 50% for the first \$50 million, 53% for the second \$50 million, 56% for the third \$50 million, and 59% thereafter in all counties except Westchester and Queens. In these last two counties the required allocation is 54% of the first \$50 million, 57% of the next \$100 million, and 60% thereafter.

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- Allocations of ticket sales revenue for the payment of lottery prizes are not to exceed 65% for the New York State Lottery instant cash games, 50% for Take Five, New York's Numbers, Win-4, Mega Millions, and Pick 10, 40% for Lotto, promotional games and Instant Win, and 60% for Quick Draw. In addition, the Lottery has legislative authority to issue up to three Instant Games per year with up to 75% allocated to prizes. Video lottery is required to pay prizes that average no less than 90% of gross sales.
- Allocations of ticket sales revenue from all traditional games for the payment of Lottery administrative expenses (including agent commissions and contractor fees) are not to exceed 15%. For video lottery, 10% of net revenue (the total revenue wagered after payout for prizes) is allocated for Lottery Administration. Unlike traditional games, video lottery administrative expenses do not include commissions and fees which are described separately in note 1b. Any excess of the maximum allocation over actual administrative expenses is allocated to education. Such allocations amounted to approximately \$343,656,000 and \$312,709,000 for fiscal years 2006 and 2005, respectively. Administrative expenses incurred by the Lottery represent telecommunications, advertising, salary and other operating costs.

(e) Cash and Cash Equivalents

For purposes of the statements of cash flows, the Lottery considers cash equivalents to be amounts held with banks and amounts held under the joint custody of the Commissioner of Taxation and Finance and the Comptroller of the State of New York through the Short-Term Investment Pool, which have a maturity of one year or less when purchased, which is used for the temporary investment of funds not required for immediate payments.

(f) Investments

Investments, consisting of U.S. Government-backed obligations (zero coupon bonds and stripped Government securities), are carried at fair value. Investment income represents amortized discount, interest on deposits, realized gains and losses, and change in net unrealized gains (losses) on investments.

(g) Inventory

Instant cash game tickets are purchased from printing vendors. Tickets not activated for sale are held in inventory and are valued at cost by game. Tickets are charged to instant ticket direct expense under the first-in, first-out (FIFO) accounting method when activated for sale by the lottery retailers. At the conclusion of an instant cash ticket game, unused inventory is charged to instant ticket direct expense.

(h) Capital Assets

Capital assets consists of equipment and leasehold improvements which are carried at cost and are recorded in Other Assets. Depreciation of equipment is computed using the straight-line method over five years, the estimated useful lives of the assets. Leasehold improvements and equipment acquired under capital leases are amortized using the straight-line method over ten and five years, respectively, which is the lesser of their useful lives or the term of the leases.

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When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is reflected in other revenues, net in the period of disposal.

(i) Prizes Payable

Lotto and Mega Millions jackpot players have the option at the time of ticket purchase of selecting a lump sum payment in lieu of long-term annuity payments. Prizes payable represents the liability for those prizes which are payable in annual installments. Such prize payments are funded by the Lottery's investment in U.S. Government-backed securities. The periodic amortization of discount is recorded as investment expense in these financial statements. Any excess of investment maturities over prize payments is made available for prizes.

(j) Unclaimed Prizes

Unclaimed prizes at March 31, 2006 and 2005 were \$189,229,000 and \$210,081,000, respectively. Prizes unclaimed for one year after the drawing date (lapsed) are forfeited by the ticket holder. Total prizes lapsed amounted to approximately \$59,207,000 and \$75,054,000 for fiscal years 2006 and 2005, respectively. These forfeited prizes are netted against prize expense in the statement of Revenues, Expenses, and Changes in Net Assets.

Under the State Tax Law, the Lottery retains forfeited prizes for supplemental prizes in subsequent lottery games. During the fiscal years 2006 and 2005, these supplemental prizes were used for Lotto, Mega Millions, Instant Win, Numbers, Win 4, Quick Draw, Take Five, King Kong Millions, and various Instant Games.

(k) Restricted Net Assets

Restricted net assets for prizes includes forfeited prizes and other prize assets that are restricted under State Tax Law Sections 1612 and 1614 for the purpose of meeting future prize expense.

(2) Cash and Cash Equivalents

Lottery deposits of cash and cash equivalents are made in accordance with State Finance Law Sections 92c and 98a and State Tax Law Sections 1611 and 1612. Lottery sales receipts are allocated and deposited in separate fund accounts for prizes, education, and administration under the joint custody of the Commissioner of Taxation and Finance and the Comptroller of the State of New York. Per Section 98a of the State Finance Law, the accounts for prizes and administration earn interest through participation in a short-term investment pool administered by the Office of the State Comptroller of the state of New York. The prize account interest is used for future lottery prizes. The carrying amount of the accounts included in cash and cash equivalents were \$335,729,000 and \$178,020,000 at March 31, 2006 and 2005, respectively. The carrying value of cash equivalents approximates market value.

The Lottery also maintains sole custody accounts which are used for daily cash management purposes. The Lottery manages the investment of its cash balances to minimize its uninvested funds. At March 31, 2006 and 2005 the amount of accounts included in cash and cash equivalents related to the sole custody accounts were \$(4,412,000) and \$(4,119,000), respectively.

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The Lottery's deposits are collateralized under a program administered by the Office of the State Comptroller of the State of New York. To manage credit risk, the State requires that its depository banks pledge collateral based on available bank balances. All securities pledged as collateral are held by the State's fiscal agent in the name of the State. The Lottery's deposits with financial institutions were fully collateralized at fiscal year-end. The Lottery manages custodial credit risk by using several financial institutions and by minimizing balances in the sole custody accounts.

(3) Investments

The Lottery is authorized by State statute to invest in U.S. Government-backed obligations (U.S. Treasury strips), which will provide for the payment of prizes payable (see note 4). During fiscal years 2006 and 2005, approximately \$84,757,000 and \$90,942,000, respectively, of amortized discount was included in investment income.

These investments consisted of the following at March 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Maturity value	\$ 1,932,985	1,974,676
Less unamortized discount	<u>664,261</u>	<u>676,816</u>
Total at amortized cost	1,268,724	1,297,860
Less investments, maturing within one year, at amortized cost	<u>187,226</u>	<u>196,550</u>
Long-term investments, at amortized cost	\$ <u>1,081,498</u>	<u>1,101,310</u>
Total fair value of investments reported	\$ 1,355,015	1,436,617

Maturities of the investments in each of the five fiscal years following March 31, 2006, and five year incremental totals thereafter, are as follows (in thousands):

2007	\$ 194,012
2008	182,861
2009	170,386
2010	155,893
2011	136,736
2012-2016	478,730
2017-2021	270,632
2022-2026	202,809
2027-2031	122,415
2032-2036	<u>18,511</u>
	\$ <u>1,932,985</u>

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The Lottery periodically enters into certain transactions whereby stripped government securities are exchanged, through sales and purchases, for other stripped government securities with substantially identical terms and characteristics. During fiscal year 2006, the face value of the securities swapped amounted to \$31,482,000 resulting in a gain of approximately \$394,000 which was included in investment income in the statement of revenue, expenses, and changes in net assets. No such transactions took place during fiscal year 2005.

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to perform on a transaction, the Lottery will not be able to recover the value of investment securities that are in the possession of an outside party. In order to manage this risk, all of the Lottery's investments are insured or registered securities held by the Lottery or its agent in the Lottery's name.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Lottery's policy for managing this risk is to hold investment securities to maturity, at which time the fair value of the investment is equal to its stated maturity value.

(4) Prizes Payable

Prizes payable consisted of the following at March 31 (in thousands):

	<u>2006</u>	<u>2005</u>
Total obligation	\$ 1,985,359	1,998,741
Unamortized discount	(663,049)	(675,347)
Total carrying amount	1,322,310	1,323,394
Less prizes payable within one year	195,544	203,601
Long-term prizes payable	<u>\$ 1,126,766</u>	<u>1,119,793</u>

The amortized discount on the prizes payable is based on interest rates which range from 1.49% to 10.70% and reflect the interest rates earned by the investments held to fund the related liabilities. The amortization of discount is recorded as investment expense in the statements of revenues, expenses, and changes in net assets and amounted to \$84,492,000 and \$90,618,000 for fiscal years 2006 and 2005, respectively. Also, included in investment expense for the year ended March 31, 2005 is approximately \$350,000 of interest expense related to a lapsed Mega Millions jackpot.

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The aggregate amount of prizes payable due in each of the five fiscal years following March 31, 2006, and the five year incremental totals thereafter, is as follows (in thousands):

2007	\$	196,799
2008		184,764
2009		172,343
2010		156,091
2011		140,646
2012-2016		477,041
2017-2021		251,785
2022-2026		134,235
2027-2031		11,246
Thereafter		260,409
	\$	<u>1,985,359</u>

(5) Long-Term Liabilities

The Lottery's long-term liabilities, as of March 31, 2006 and 2005 are comprised of the following, (in thousands):

	<u>Balance at March 31, 2005</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at March 31, 2006</u>	<u>Current portion</u>
Capital lease obligations (note 12) \$	9,986	—	(2,276)	7,710	2,352
Compensated absences (note 11)	5,566	—	(726)	4,840	—
Prizes payable (note 4)	1,323,394	204,733	(205,817)	1,322,310	195,544
	<u>Balance at March 31, 2004</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at March 31, 2005</u>	<u>Current portion</u>
Capital lease obligations (note 12) \$	4,281	7,487	(1,782)	9,986	2,276
Compensated absences (note 11)	5,263	368	(65)	5,566	—
Prizes payable (note 4)	1,389,517	153,977	(220,100)	1,323,394	203,601

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(6) Aid to Education

The required allocation and contribution transferred out for aid to education during the fiscal years ended March 31, 2006 and 2005, are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Cash transferred to education	\$ 2,093,988	2,093,237
Amount received from the State General Fund for Sound Basic Education	<u>(130,000)</u>	<u>—</u>
Net cash transferred to Education	1,963,988	2,093,237
Prior year payable	<u>(150,289)</u>	<u>(180,824)</u>
Current year payable	388,920	150,289
Required allocation to education	\$ <u>2,202,619</u>	<u>2,062,702</u>

(7) Pension Benefits

Substantially all employees of the Lottery are members of the State and Local Employees' Retirement System (ERS) and the Public Employees' Group Life Insurance Plan (GLIP). The two programs are part of the State and Local Retirement System (System) which is a cost-sharing, multiple employer public employee retirement system. The Comptroller of the State of New York is sole trustee and administrative head of the System. The System issues a publicly available financial report that includes financial statements and required supplementary information which may be obtained by writing to New York State and Local Employees' Retirement Systems, 110 State Street, Albany, New York 12236.

The System provides retirement benefits as well as death and disability benefits. All benefits vest after five years of accredited service. Retirement benefits are established by the New York State Retirement and Social Security Law. Retirement benefits and contributory requirements depend upon the point in time at which an employee last joined the System. Most members of the System who joined before July 27, 1976 are enrolled in a noncontributory plan; the Lottery contributes the entire amount determined to be payable to the System. Personnel who joined the System after July 27, 1976 are required by law to contribute 3% of their gross salary for their first ten years of employment; the Lottery withholds and contributes the balance payable to the System for these employees.

The Lottery paid to the Office of the State Comptroller of the State of New York \$1,892,000 for 2006, \$1,463,000 for 2005, and \$798,000 for 2004, to cover required employer contributions for retirement benefits. These payments made represent 11.80%, 9.41%, and 5.29% of covered payroll for each of the years, respectively.

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(8) Operating Income

Composition of operating income for fiscal 2006 and 2005 by type of lottery game is as follows (in thousands):

	2006					
	Revenue	Expenses				Instant direct expense
Prizes **		Commissions	Fees			
Mega Millions	\$ 563,151	(268,843)	(33,828)	(7,236)	—	253,244
Lotto	252,643	(134,956)	(14,451)	(3,058)	—	100,178
Take Five	335,533	(168,143)	(20,155)	(4,312)	—	142,923
Pick 10	32,527	(14,975)	(1,954)	(418)	—	15,180
New York Numbers	822,342	(415,144)	(49,398)	(10,567)	—	347,233
Win 4	657,706	(315,688)	(39,507)	(8,452)	—	294,059
King Kong Millions ***	154,881	(138,114)	(9,303)	(1,262)	(521)	5,681
Instant (excl. King Kong)	3,197,895	(2,111,635)	(192,094)	(23,848)	(31,570)	838,748
Instant Win	9,935	(6,357)	(597)	(128)	—	2,853
Quick Draw	460,528	(279,557)	(27,664)	(5,918)	—	147,389
Total traditional lottery	6,487,141	(3,853,412)	(388,951)	(65,199)	(32,091)	2,147,488
Video Lottery	315,701*	142	(122,108)	(22,829)	—	170,906
	<u>\$ 6,802,842</u>	<u>(3,853,270)</u>	<u>(511,059)</u>	<u>(88,028)</u>	<u>(32,091)</u>	2,318,394
Telecommunications						(28,421)
Other operating expenses						(123,138)
Total operating income						<u>\$ 2,166,835</u>

* Video Lottery revenue represents net machine income after awarding prizes.

** Prizes unclaimed after one year are forfeited and are netted against prizes.

*** King Kong millions consisted of an Instant Game and single high-jackpot online drawing.

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	2005					Net
	Expenses					
	Revenue	Prizes **	Commissions	Fees	Instant direct expense	
Mega Millions	\$ 446,205	(207,089)	(26,837)	(5,734)	—	206,545
Lotto	305,863	(141,687)	(17,511)	(3,737)	—	142,928
Take five	348,179	(175,303)	(20,938)	(4,474)	—	147,464
Pick 10	33,764	(16,247)	(2,029)	(434)	—	15,054
New York's Numbers	790,470	(397,357)	(47,490)	(10,157)	—	335,466
Win 4	624,200	(309,207)	(37,501)	(8,021)	—	269,471
Instant	3,005,589	(1,983,561)	(180,571)	(22,336)	(31,174)	787,947
Instant Win	10,905	(6,956)	(655)	(140)	—	3,154
Quick Draw	473,594	(286,150)	(28,452)	(6,085)	—	152,907
Total traditional lottery	6,038,769	(3,523,557)	(361,984)	(61,118)	(31,174)	2,060,936
Video Lottery	231,718*	27	(67,198)	(16,890)	—	147,657
	<u>\$ 6,270,487</u>	<u>(3,523,530)</u>	<u>(429,182)</u>	<u>(78,008)</u>	<u>(31,174)</u>	2,208,593
Telecommunications						(29,946)
Other operating expenses						(115,167)
Total operating income						<u>\$ 2,063,480</u>

* Video Lottery revenue represents net machine income after awarding prizes.

** Prizes unclaimed after one year are forfeited and are netted against prizes.

(9) Deferred Compensation

The State offers its employees, including Lottery employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the plan are placed in trust for the participants and their beneficiaries.

(10) Postretirement Benefits

In addition to the pension benefits described in note 7, the State provides health insurance coverage and survivor benefits for retired employees and their survivors. Substantially all of the State's employees may become eligible for these benefits if they reach normal retirement age while working for the State. Health care benefits are provided through an insurance company whose premiums are based on the benefits paid during the year. The State recognizes the cost of providing health insurance by recording its share of insurance premiums as an expenditure in the general fund in the year paid. Additionally, the survivors' benefit program provides for a death benefit to be paid by the State to a retiree's designated beneficiary. The Lottery is not directly charged for these benefits to or on behalf of its former employees.

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(11) Employees' Compensated Absences

Under the terms of the Lottery's personnel policies and its union agreements, vacation pay benefits may be paid upon termination up to a maximum of 225 hours. In addition, unused sick leave benefits may be paid upon retirement up to a maximum of 1,500 hours. The Lottery recognizes employees' compensated absence benefits when earned. The liability for employees' compensated absences was approximately \$4,840,000 and \$5,566,000 as of March 31, 2006 and 2005, respectively, and is recorded as a long-term liability in the statements of net assets.

(12) Leases

The Lottery leases surveillance equipment at its video lottery gaming facilities under capital leases with Key Government Finance, Inc. and Koch Financial Corporation. Fixed asset amounts for capital leases, which are included in other assets on the statements of net assets, were approximately \$11,836,000 at March 31, 2006 and 2005. Accumulated depreciation on these fixed assets was approximately \$4,557,000 and \$1,875,000 at March 31, 2006 and 2005, respectively.

The Lottery has entered into leases for equipment and building space. Rental expense was approximately \$2,970,000 and \$4,744,000 in 2006 and 2005, respectively.

Future minimum lease payments under all noncancelable leases having initial or remaining terms in excess of one year as of March 31, 2006 are as follows:

	<u>Operating leases</u>	<u>Capital leases</u>
2007	\$ 2,019,000	2,571,000
2008	1,793,000	2,571,000
2009	1,775,000	2,493,000
2010	1,615,000	500,000
2011	1,280,000	—
2012 and thereafter	<u>5,066,000</u>	<u>—</u>
Total minimum payments required	\$ <u>13,548,000</u>	8,135,000
Less amounts representing interest		<u>425,000</u>
Present value of minimum lease payments		7,710,000
Less current portion		<u>2,352,000</u>
Long-term capital lease obligations		\$ <u><u>5,358,000</u></u>

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(13) Commitments and Contingencies

(a) *Contractual Arrangements*

The Lottery maintains a gaming network of approximately 16,000 on-line locations where all traditional lottery games are sold. GTECH Holdings Corporation (GTECH) is responsible for operating all traditional Lottery games under a contract expiring on March 1, 2007. GTECH announced in January 2006 that GTECH and Lottomatica S.p.A. entered into an agreement pursuant to which Lottomatica S.p.A. will acquire GTECH. This transaction while not yet completed is not anticipated to have any effect on Lottery operations based on the terms of the agreement.

Instant cash game sales are also supported by the services of three contractors:

- (1) Under a contract that expired May 21, 2006, Pollard Banknote Limited is responsible for production of instant cash game tickets.
- (2) Under a contract expiring October 15, 2006, Scientific Games, Inc. is a back-up instant cash game ticket supplier.
- (3) Instant cash game tickets are also sold through approximately 3,800 vending machines at approximately 2,600 locations. A contract with Interlott, Inc., which expires on April 30, 2007, provides for maintenance of the vending machines.

The Lottery awarded instant ticket production contracts in February 2006. The Primary contract was awarded to Scientific Games Corporation, the secondary contract to Pollard Banknote Limited. Additionally, tertiary printing contracts were awarded to Oberthur Gaming Technologies and Creative Games International, Inc. These contracts are currently in the process of receiving approval.

Video lottery games are offered on approximately 5,500 video gaming machines spread over five video lottery gaming facilities. Multimedia Games, Inc. provides a central processing system for the operation of video lottery games under a contract expiring on January 27, 2010. Video lottery gaming machines are provided under contracts expiring December 31, 2007 with four different companies (Bally Gaming, International Game Technology, Sierra Design Group, Inc., and Spielo USA, Inc.).

(b) *Insurance Contracts*

Prior to 1983, the Lottery had entered into agreements with New York insurance companies under which the Lottery purchased contracts that provide payments corresponding to the Lottery's obligation to the prizewinners. The types of contracts entered into include agreements that pay installments for a specific term (investment contracts) as well as agreements to make installment payments to prizewinners over the winners' lifetime. It is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner. Accordingly, the present value of the future payments under these contracts are not reflected in the accompanying financial statements. The Lottery may be liable for such future payments if the insurance companies were to default on their payments. All amounts under the investment contracts have been paid. For contracts other than investment contracts, the insurance companies are carrying long-term liabilities of approximately \$4,506,000 as of March 31, 2006.

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(c) *Litigation*

The Lottery has been named as a defendant in several lawsuits. While the ultimate outcome of these lawsuits cannot be predicted at this time, it is the opinion of management and in-house counsel that the disposition of any litigation in which the Lottery is involved will not have a material adverse effect on the financial position of the Lottery.

(14) *Subsequent Events*

Chapter 9 of the Laws of 2006 authorized the Lottery to advance a maximum of \$20 million to the New York Racing Association (NYRA) to finance racetrack operations. These advances are considered prepayments of the vendor's fee and marketing allowance for operating a future video gaming facility at the Aqueduct Racetrack. As of June 30, 2006, \$6 million has been advanced to NYRA. It is anticipated that the remaining \$14 million will be advanced in the next fiscal year. Legislation has been passed by the legislature to require a repayment plan be developed jointly by the Lottery and NYRA. Legislation also included an additional \$5 million of prepaid vendor fees and marketing allowance for NYRA. The repayment plan is subject to the approval of the racing association oversight board. Nothing has been recorded in the Lottery's financial statements as of March 31, 2006.