



NEW YORK STATE LOTTERY

Basic Financial Statements

March 31, 2007 and 2006

(With Independent Auditors' Report Thereon)

NEW YORK STATE LOTTERY

Basic Financial Statements

March 31, 2007 and 2006

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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, 2007 and 2006, 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, 2007 and 2006, 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, 2007 and 2006, 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

July 9, 2007

NEW YORK STATE LOTTERY

Management's Discussion and Analysis (Unaudited)

March 31, 2007 and 2006

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, 2007. 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, 2007 and 2006 have been prepared in accordance with U.S. generally accepted accounting principles.

Financial Highlights

New York Lottery revenues totaled \$7.175 billion, the highest total ever for the Lottery, while net proceeds earned for Lottery Aid to Education reached a record high \$2.358 billion for fiscal year 2007.

- New York Lottery revenues in fiscal year 2007 surpassed the revenues of 2006 by \$372.0 million or 5.5%. In fiscal year 2006, the annual revenue increase was \$423.0 million or 7.2%.
- Net proceeds earned for Lottery Aid to Education in fiscal year 2007 surpassed the net proceeds of 2006 by \$155.7 million or 7.1%. Comparatively, the annual increase in earnings for education in fiscal year 2006 was \$139.9 million or 6.8% over the earnings of 2005.
- Prize expense increased by \$117.5 million or 3.1% during fiscal year 2007. In fiscal year 2006 this increase was \$329.7 million or 9.4%.
- Operating income increased by \$143.4 million or 6.6% during fiscal year 2007. During fiscal year 2006, this increase was \$103.4 million or 5.0%.
- Nonoperating income increased by \$59.0 million during fiscal year 2007. This increase follows a \$38.4 million increase in fiscal year 2006. The increase is due largely to the impact of lower 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 \$219.4 million at the end of fiscal year 2007. This was an increase of \$39.9 million or 22.2% over fiscal year 2006. At the end of fiscal year 2006, working capital increased by \$4.3 million or 2.5% over the fiscal year ended 2005.

Overview of Financial Statements

The New York Lottery presents its financial statements using an accrual method of accounting, which is comparable to the method used by many private sector businesses. The accrual method recognizes revenues when earned, not when received. Likewise, expenses are recognized when incurred, not when paid. The Lottery prepares the following three financial statements for fiscal years 2007 and 2006:

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 2007 and 2006. 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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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. 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, 2007 and 2006

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 2007, 2006, and 2005 (in millions):

	FY 2007	FY 2006	FY 2005	FY 2007 vs. FY 2006		FY 2006 vs. FY 2005	
				Dollar change	Percent change	Dollar change	Percent change
Current assets	\$ 1,019	982	776	37	3.8%	\$ 206	26.5%
Noncurrent assets	1,126	1,173	1,247	(47)	(4.0)	(74)	(5.9)
Total assets	\$ 2,145	2,155	2,023	(10)	(0.5)	\$ 132	6.5
Current liabilities	\$ 799	802	600	(3)	(0.4)	\$ 202	33.7
Noncurrent liabilities	1,156	1,137	1,133	19	1.7	4	0.4
Total liabilities	\$ 1,955	1,939	1,733	16	0.8	\$ 206	11.9
Restricted net assets	\$ 104	130	151	(26)	(20.0)	\$ (21)	(13.9)
Unrestricted net assets	86	86	139	—	—	(53)	(38.1)
Total net assets	\$ 190	216	290	(26)	(12.0)	\$ (74)	(25.5)

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 4.4% during the fiscal year 2007. The majority of the increase was due to an increase of \$44 million in cash.

The cash increase was mainly caused by an increase in the balance of the Prize Pending accounts of \$133.9 million, an increase of \$48.0 million in the Administration accounts, and a decrease in the VLT Education account of \$144.4 million. In comparison, fiscal year 2006 current assets increased by 26.5% over the prior fiscal year. The increase was attributable to an increase in the education accounts from a \$130 million transfer from the New York State General Fund to the Video Lottery Terminal (VLT) Education account made during fiscal year 2006. This transfer was made to supplement VLT revenues to be used for Sound Basic Education aid in fiscal year 2007.

Noncurrent Assets

Noncurrent assets consist primarily of investments held in United States 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 7.0% to \$1.26 billion as of March 31, 2007. This change is attributable to an increase in short-term investment holdings to fund annuity payments to prize winners while long-term U.S. Treasury yields remains low. Comparatively, the total market value of these securities as of March 31, 2006 was \$1.36 billion (a decrease of \$81.6 million from March 31, 2005). This 5.6% decrease was related to the increase in the yield on held securities and the overall market for this investment type.

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\$1.08 billion and \$1.17 billion were invested in securities at March 31, 2007 and 2006, 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.

Noncurrent assets also include other receivables in fiscal year 2007, consisting of principal and interest on a \$6 million advance on video gaming commissions paid to the New York Racing Association (NYRA) in April 2007, and a \$23 million secured loan authorized in March 2007 pursuant to Chapter 9 of the Laws of 2007. Terms of the agreements require repayment with interest at 4% per annum from video gaming proceeds, which are not expected to commence prior to March 2008.

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, 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, and a loan due to NYRA. In total, these accounts decreased by \$3.4 million during fiscal year 2007 due in large part to a \$90.3 million decrease in Due to Education, caused by changes in the timing of receipts of cash draw downs for Aid to Education and the draw down of \$130 million from the VLT Education account for Sound Basic Education aid, a \$3.3 million increase in annuitant type prizes due to winners over the next year (Prizes Payable), an increase of \$40.8 million in prizes awarded but unclaimed (Unclaimed Prizes), a \$17.6 million increase in Accounts Payable and Accrued Expenses, and a \$23 million increase in payables due to NYRA. Capitalized Lease Obligations increased by \$2.1 million. These changes can be compared to the fiscal year ended March 31, 2006 when there was a \$201.8 million annual increase in total current liabilities. For that period, the increase was mainly due to a \$238.6 million increase in Due to Education, a decrease in Unclaimed Prizes of \$20.9 million, a decrease in Prizes Payable of \$8.1 million, and a decrease in Accounts Payable and Accrued Expenses of \$7.3 million.

Noncurrent Liabilities

Noncurrent liabilities consist of installment prizes due in fiscal years after 2008, 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 \$19.1 million. The increase was caused mainly by a \$11.5 million increase in the amount of long-term prizes payable outstanding, an increase in capitalized leases by \$6.2 million, and an increase in compensated absences of \$1.4 million. In fiscal year 2006 long term prizes payable increased by \$3.9 million. The increase in the dollar value of installment prizes payable in fiscal year 2007 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.

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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.

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 2007, 2006 and 2005 (in millions).

	FY 2007	FY 2006	FY 2005	FY 2007 vs. FY 2006		FY 2006 vs. FY 2005	
				Dollar change	Percent change	Dollar change	Percent change
Operating revenue:							
Lottery revenue, net	\$ 7,175	6,803	6,270	372	5.5%	533	8.5%
Operating expenses:							
Direct expenses	(4,723)	(4,513)	(4,092)	(210)	4.7	(421)	10.3
Indirect expenses	(142)	(123)	(115)	(19)	15.4	(8)	7.0
Total operating expenses	(4,865)	(4,636)	(4,207)	(229)	4.9	(429)	10.2
Operating income	2,310	2,167	2,063	143	6.6	104	5.0
Nonoperating income (expenses)	22	(38)	(75)	60	(157.9)	37	(49.3)
Income before required allocation	2,332	2,129	1,988	203	9.5	141	7.1
Required allocation – contribution for aid to education	(2,358)	(2,202)	(2,063)	(156)	7.1	(139)	6.7
Change in net asset: \$	(26)	(73)	(75)	47	(64.4)	2	(2.7)

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 eight licensed video lottery gaming facilities in operation in fiscal year 2007 located in Saratoga, Monticello, Farmington, Hamburg, Batavia, Tioga, Vernon, and Yonkers, New York. Five of these facilities were operating in fiscal year 2006 and four were operating in fiscal year 2005.

During the fiscal year 2007, the Lottery achieved \$3.033 billion in on-line sales, \$3.593 billion in instant sales, \$26 million in promotional raffle game sales, and \$523 million in video lottery gaming net machine income for a total of \$7.175 billion, a 5.5% (\$372 million) increase over the previous fiscal year. This record year eclipses the record set the previous year when 2006 revenues reached \$6.803 billion, a \$533 million or 8.5% increase. Significant growth was reflected in the instant game and video lottery gaming categories during both fiscal years. In fiscal year 2005 total revenues were \$6.270 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 2007, 2006, and 2005 (in millions).

Game	FY 2007		FY 2006		FY 2005	
	Revenue	Percent of total revenues	Revenue	Percent of total revenues	Revenue	Percent of total revenues
Mega Millions	\$ 455	6.3%	\$ 563	8.3%	\$ 446	7.1%
Lotto	217	3.0	253	3.7	306	4.9
Take 5	327	4.6	336	4.9	348	5.6
New York's Numbers	850	11.8	822	12.1	790	12.6
Win 4	698	9.7	658	9.7	624	9.9
Quick Draw	445	6.2	460	6.8	474	7.6
Pick 10 and Instant Win	41	0.6	42	0.6	45	0.7
Promotion Raffle Game	26	0.4	—	—	—	—
King Kong Millions ***	75	1.1	155	2.3	—	—
Instant (excl. King Kong)	3,518	49.0	3,198	47.0	3,005	47.9
Subtotal traditional lottery	6,652	92.7	6,487	95.4	6,038	96.3
Video Gaming, net *	523	7.3	316	4.6	232	3.7
Total revenues	\$ 7,175	100.0%	\$ 6,803	100.0%	\$ 6,270	100.0%

* Video Lottery revenue represents net machine income after awarding prizes. Video Lottery credits played won were as follows:

	FY 2007	FY 2006	FY 2005
Credits played	\$ 6,461	3,967	2,917
Credits won	(5,938)	(3,651)	(2,685)
Net machine income	\$ 523	316	232

*** King Kong Millions consisted of an instant game and a single high-jackpot online drawing in 2006, but only an instant game in 2007.

Direct Expenses

Direct Expenses in fiscal year 2007 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 \$117.5 million to \$3.971 billion in fiscal year 2007, which along with traditional retailer commissions which increased by \$9.5 million to \$398.4 million, video lottery gaming commissions to facilities which increased \$74.8 million to \$196.9 million, and gaming contractor fees which increased \$12.5 million to \$100.6 million, accounted for the majority of the increase in this category.

During fiscal year 2006, prize expense increased by \$329.7 million to \$3.853 billion and, along with retailer commissions, which increased by \$27.0 million to \$389.0 million and commissions to video lottery gaming facilities which increased by \$54.9 million to \$122.1 million accounted for nearly all of the increase in direct expenses.

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March 31, 2007 and 2006

Other Operating Expenses

Other operating expenses include marketing, state agency charges, personal services, fringe benefits and other administrative costs. These costs increased by \$18.5 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 \$522.7 million in net machine income for the fiscal year.

Nonoperating Revenues (Expenses)

Nonoperating revenues and expenses consist of miscellaneous income plus the net growth or decline in the fair market value of the United States Treasury Securities used to fund long term prizes. Investment income (\$102.3 million in 2007, \$47.2 million in 2006 and \$15.0 million in 2005) 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 Required Allocation and Change in Net Assets

The revenues and expenses for fiscal year 2007 resulted in income before required allocation totaling \$2.332 billion. This amount consists of a required allocation for Aid to Education of \$2.358 billion that transfers out as a contribution for Aid to Education and a \$26.5 million reduction in net assets for the year. The \$26.5 million reduction in net assets is a combination of a \$26.3 million decrease in net assets restricted for prizes and a \$0.2 million decrease in unrestricted net assets. The revenues and expenses for fiscal year 2006 resulted in income before the required allocation totaling \$2.129 billion. This amount consists of a required allocation for Aid to Education of \$2.203 billion and a \$73.2 million reduction in net assets for the year. The \$73.2 million reduction in net assets is a combination of a \$20.8 million decrease in net assets restricted for prizes and a \$52.4 million decrease in unrestricted net assets.

Summary and Outlook

The revenues reported here include those from eight video lottery gaming facilities that were operational during fiscal year 2007, as video gaming facilities opened this year in Tioga, Vernon, and Yonkers, NY. One more facility is expected to open in Jamaica, NY at the Aqueduct Racetrack but this facility is not expected to be operational until the fiscal year 2009.

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, 2007 and 2006

(In thousands)

Assets	2007	2006
Current assets:		
Cash and cash equivalents	\$ 375,220	331,317
Accounts receivable	452,094	451,198
Instant ticket inventory	12,119	10,183
Investments	179,055	189,237
Total current assets	1,018,488	981,935
Noncurrent assets:		
Long-term investments, net	1,081,364	1,165,778
Other receivables	29,235	—
Capital assets	15,853	8,067
Total noncurrent assets	1,126,452	1,173,845
Total assets	2,144,940	2,155,780
Liabilities		
Current liabilities:		
Prizes payable	198,871	195,544
Unclaimed prizes	230,015	189,229
Due to education	298,658	388,920
Accounts payable and accrued liabilities	34,796	17,217
Other liabilities	23,000	—
Capital lease obligations	4,448	2,352
Deferred ticket sales	9,251	9,133
Total current liabilities	799,039	802,395
Noncurrent liabilities:		
Compensated absences	6,229	4,840
Long-term capital lease obligations	11,557	5,358
Long-term prizes payable	1,138,237	1,126,766
Total noncurrent liabilities	1,156,023	1,136,964
Total liabilities	1,955,062	1,939,359
Net Assets		
Restricted for future prizes	103,815	130,129
Invested in capital assets	8,697	8,635
Unrestricted	77,366	77,657
Total net assets	\$ 189,878	216,421

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY

Statements of Revenue, Expenses, and Changes in Net Assets

Years ended March 31, 2007 and 2006

(In thousands)

	2007	2006
Operating revenue:		
Lottery revenue, net	\$ 7,175,104	6,802,842
Operating expenses:		
Prize expense	(3,970,739)	(3,853,270)
Retailer commissions	(595,348)	(511,059)
Gaming contractor fees	(100,554)	(88,028)
Instant ticket direct expenses	(28,095)	(32,091)
Telecommunications	(28,441)	(28,421)
Total direct expenses	(4,723,177)	(4,512,869)
Online games/jackpot marketing	(40,706)	(38,771)
Personal service and fringe benefits	(28,315)	(25,481)
Instant games marketing	(28,477)	(20,916)
All games marketing	(14,630)	(14,999)
Other administrative costs	(13,279)	(11,015)
State agency charges	(13,208)	(9,469)
Depreciation	(3,051)	(2,487)
Total indirect expenses	(141,666)	(123,138)
Total operating expenses	(4,864,843)	(4,636,007)
Operating income	2,310,261	2,166,835
Nonoperating revenue (expenses):		
Investment income	102,316	47,179
Other expense, net	(566)	(143)
Investment expense, net	(80,206)	(84,492)
Total nonoperating revenue (expense)	21,544	(37,456)
Income before required allocation	2,331,805	2,129,379
Required allocation for aid to education	(2,358,348)	(2,202,619)
Change in net assets	(26,543)	(73,240)
Net assets beginning of year	216,421	289,661
Net assets end of year	\$ 189,878	216,421

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY

Statements of Cash Flows

Years ended March 31, 2007 and 2006

(In thousands)

	<u>2007</u>	<u>2006</u>
Operating activities:		
Cash received from net lottery revenue	\$ 7,175,344	6,736,199
Cash payments for prizes	(3,995,741)	(3,957,088)
Cash payments for commissions	(595,141)	(510,785)
Cash payments for contractor fees	(100,162)	(87,966)
Cash payments for telecommunications	(28,441)	(28,421)
Cash payments for instant ticket direct expenses	(28,009)	(30,682)
Cash payments for other operating expenses	(122,906)	(125,850)
Other cash receipts (payments)	(566)	(143)
Net cash provided by operating activities	<u>2,304,378</u>	<u>1,995,264</u>
Investing activities:		
Proceeds from investment maturities	194,393	203,685
Purchases of investments	(19,591)	(89,791)
Interest on cash and cash equivalents	21,897	14,493
Net proceeds from swaps of investment securities	213	394
Vender fee advance	(6,235)	—
Net cash provided by investing activities	<u>190,677</u>	<u>128,781</u>
Noncapital financing activities:		
Cash transfer to State for Aid to Education	(2,615,455)	(2,093,988)
Cash received from State General Fund for Sound Basic Education	100,000	130,000
Cash received from State General Fund for Lottery Aid Guarantee	66,845	—
Net cash used by noncapital financing activities	<u>(2,448,610)</u>	<u>(1,963,988)</u>
Capital financing activities:		
Cash payments for equipment and leasehold improvements	(2,542)	(2,641)
Net cash used by capital financing activities	<u>(2,542)</u>	<u>(2,641)</u>
Net increase in cash and cash equivalents	43,903	157,416
Cash and cash equivalents, beginning of year	<u>331,317</u>	<u>173,901</u>
Cash and cash equivalents, end of year	<u>\$ 375,220</u>	<u>331,317</u>
Reconciliation of operating income to cash provided by operating activities:		
Operating income	\$ 2,310,261	2,166,835
Adjustments to reconcile operating income to net cash provided by operating activities:		
Other cash receipts (payments)	(566)	(143)
Depreciation and amortization	3,051	2,487
Change in operating assets and liabilities:		
(Increase) in accounts receivable, net	(896)	(60,392)
(Increase) decrease in ticket inventory	(1,936)	1,613
(Decrease) in prizes payable	(65,408)	(85,576)
Increase (decrease) in unclaimed prizes	40,786	(20,852)
Increase (decrease) in compensated absences	1,389	(726)
Increase (decrease) in accounts payable and accrued liabilities	17,579	(7,319)
Increase (decrease) in deferred ticket sales	118	(663)
Net cash provided by operating activities	<u>\$ 2,304,378</u>	<u>1,995,264</u>
Noncash investing activities:		
Decrease in unrealized gains on investments	\$ (228)	(52,465)
Amortization of investment discount	80,434	84,757

See accompanying notes to basic financial statements.

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Notes to Basic Financial Statements

March 31, 2007 and 2006

(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 Use 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 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 \$352,941,000 and \$343,656,000 for fiscal years 2007 and 2006, 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.

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(h) Capital Assets

Capital assets consist of equipment and leasehold improvements which are carried at cost. Equipment is capitalized when it has cost in excess of \$40,000 and a useful life of two years or more. Leasehold improvements are capitalized when they have a cost of \$100,000 or more. 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. Changes in capital assets and related accumulated depreciation are shown below, by major class of asset, for the years ended March 31, 2007 and 2006 (in thousands).

	<u>2005</u>	<u>Change</u>	<u>2006</u>	<u>Change</u>	<u>2007</u>
Leasehold improvements:					
Cost	\$ 4,526	—	4,526	—	4,526
Accumulated depreciation	(4,526)	—	(4,526)	—	(4,526)
Net value	—	—	—	—	—
Equipment:					
Cost	\$ 14,598	365	14,963	10,837	25,800
Accumulated depreciation	(4,409)	(2,487)	(6,896)	(3,051)	(9,947)
Net value	10,189	(2,122)	8,067	7,786	15,853
Total	\$ 10,189	(2,122)	8,067	7,786	15,853

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. Some Instant Cash Games also have jackpot prizes that are 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, 2007 and 2006 were \$230,015,000 and \$189,229,000, respectively. Prizes unclaimed for one year after the drawing date (lapsed) are forfeited by the ticket holder. Total prizes lapsed amounted to approximately \$73,655,000 and \$59,207,000 for fiscal years 2007 and 2006, respectively. These forfeited prizes are netted against prize expense in the statement of Revenues, Expenses, and Changes in Net Assets.

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Under the State Tax Law, the Lottery retains forfeited prizes for supplemental prizes in subsequent lottery games. During the fiscal years 2007 and 2006, these supplemental prizes were used for Lotto, Instant Win, Numbers, Win 4, Quick Draw, Take Five, promotional games, 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.

(l) *Reclassification*

Certain amounts in the 2006 financial statements have been reclassified to conform to the 2007 presentation.

(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 \$378,120,000 and \$335,729,000 at March 31, 2007 and 2006, 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, 2007 and 2006 the amount of accounts included in cash and cash equivalents related to the sole custody accounts were \$(2,900,000) and \$(4,412,000), respectively.

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). The fair value of these investments at March 31, 2007 and 2006 was \$1,260,419,538 and \$1,355,015,435, respectively. During fiscal years 2007 and 2006, approximately \$80,434,000 and \$84,757,000, respectively, of amortized discount was included in investment income.

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The amortized costs of these investments consisted of the following at March 31 (in thousands):

	<u>2007</u>	<u>2006</u>
Maturity value	\$ 1,777,423	1,932,985
Less unamortized discount	<u>603,067</u>	<u>664,261</u>
Total at amortized cost	1,174,356	1,268,724
Less investments, maturing within one year, at amortized cost	<u>177,284</u>	<u>187,226</u>
Long-term investments, at amortized cost	\$ <u><u>997,072</u></u>	\$ <u><u>1,081,498</u></u>

Maturities of the investments in each of the five fiscal years following March 31, 2007, and five year incremental totals thereafter, are as follows (in thousands):

2008	\$ 183,684
2009	171,272
2010	156,843
2011	137,749
2012	123,134
2013-2017	415,997
2018-2022	277,644
2023-2027	189,991
2028-2032	102,598
2033-2036	<u>18,511</u>
	\$ <u><u>1,777,423</u></u>

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 years 2007 and 2006, the face value of the securities swapped amounted to \$13,944,000 and \$31,482,000 respectively resulting in gains of approximately \$213,000 and \$394,000. The gains were included in investment income in the statements of revenue, expenses, and changes in net assets.

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.

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(4) Prizes Payable

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

	<u>2007</u>	<u>2006</u>
Total obligation	\$ 1,939,168	1,985,359
Unamortized discount	<u>(602,060)</u>	<u>(663,049)</u>
Total carrying amount	1,337,108	1,322,310
Less prizes payable within one year	<u>198,871</u>	<u>195,544</u>
Long-term prizes payable	<u>\$ 1,138,237</u>	<u>1,126,766</u>

The amortized discount on the prizes payable is based on interest rates which range from 2.07% 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 \$80,206,000 and \$84,492,000 for fiscal years 2007 and 2006, respectively.

The aggregate amount of prizes payable due in each of the five fiscal years following March 31, 2007, and the five year incremental totals thereafter, is as follows (in thousands):

2008	\$ 195,840
2009	183,454
2010	167,405
2011	151,967
2012	134,093
2013-2017	462,866
2018-2022	308,216
2023-2027	142,530
2028-2032	23,850
Thereafter	<u>168,947</u>
	<u>\$ 1,939,168</u>

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(5) Long-Term Liabilities

The Lottery's long-term liabilities, as of March 31, 2007 and 2006 are comprised of the following, (in thousands):

	<u>Balance at March 31, 2006</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at March 31, 2007</u>	<u>Current portion</u>
Capital lease obligations (note 12) \$	7,710	10,837	(2,542)	16,005	4,448
Compensated absences (note 11)	4,840	2,807	(1,418)	6,229	—
Prizes payable (note 4)	1,322,310	212,278	(197,480)	1,337,108	198,871
	<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	1,858	(2,584)	4,840	—
Prizes payable (note 4)	1,323,394	204,733	(205,817)	1,322,310	195,544

(6) Aid to Education

The required allocation and contribution transferred out for aid to education during the fiscal years ended March 31, 2007 and 2006, are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Cash transferred to education	\$ 2,615,455	2,093,988
Amount received from the State General Fund for Lottery Aid Guarantee	(66,845)	—
Amount received from the State General Fund for Sound Basic Education	(100,000)	(130,000)
Net cash transferred to Education	2,448,610	1,963,988
Prior year payable	(388,920)	(150,289)
Current year payable	298,658	388,920
Required allocation to education	\$ <u>2,358,348</u>	<u>2,202,619</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.

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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 \$2,034,000 for 2007, \$1,892,000 for 2006, and \$1,463,000 for 2005, to cover required employer contributions for retirement benefits. These payments made represent 11.65%, 11.80%, and 9.41%, of covered payroll for each of the years, respectively.

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(8) Operating Income

Composition of operating income for fiscal 2007 and 2006 by type of lottery game is as follows (in thousands):

	<u>2007</u>					<u>Net</u>
	<u>Revenue</u>	<u>Prizes**</u>	<u>Commissions</u>	<u>Fees</u>	<u>Instant direct expense</u>	
Mega Millions	\$ 454,910	(216,578)	(27,243)	(5,830)	—	205,259
Lotto	216,572	(91,148)	(12,039)	(2,592)	—	110,793
Take Five	326,775	(166,802)	(19,605)	(4,199)	—	136,169
Pick 10	31,874	(17,342)	(1,912)	(409)	—	12,211
New York Numbers	850,266	(437,044)	(51,019)	(10,927)	—	351,276
Win 4	698,180	(354,220)	(41,893)	(8,972)	—	293,095
Promotion Raffle Game	26,366	(14,800)	(1,582)	(339)	—	9,645
King Kong Millions***	75,660	(58,349)	(4,540)	(560)	(296)	11,915
Instant (excl. King Kong)	3,517,960	(2,336,626)	(211,370)	(26,221)	(27,799)	915,944
Instant Win	8,895	(5,692)	(534)	(114)	—	2,555
Quick Draw	444,978	(272,177)	(26,699)	(5,718)	—	140,384
Total traditional lottery	6,652,436	(3,970,778)	(398,436)	(65,881)	(28,095)	2,189,246
Video Lottery	522,668*	39	(196,912)	(34,673)	—	291,122
	<u>\$ 7,175,104</u>	<u>(3,970,739)</u>	<u>(595,348)</u>	<u>(100,554)</u>	<u>(28,095)</u>	2,480,368
Telecommunications						(28,441)
Other operating expenses						(141,666)
Total operating income						<u>\$ 2,310,261</u>

* Video Lottery revenue represents net machine income after awarding prizes. Video Lottery credits played and won were as follows:

Credits played	\$ 6,461,179
Credits won	(5,938,511)
Net machine income	<u>\$ 522,668</u>

** 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 in 2006. Only the Instant Game continued in 2007.

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2006						
Expenses						
	Revenue	Prizes**	Commissions	Fees	Instant direct expense	Net
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
	\$ 6,802,842	(3,853,270)	(511,059)	(88,028)	(32,091)	2,318,394
Telecommunications						(28,421)
Other operating expenses						(123,138)
Total operating income						\$ 2,166,835

* Video Lottery revenue represents net machine income after awarding prizes. Video Lottery credits played and won were as follows:

Credits played	\$ 3,966,570
Credits won	<u>(3,650,869)</u>
Net machine income	\$ <u>315,701</u>

** 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.

(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'

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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.

(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 \$6,229,000 and \$4,840,000 as of March 31, 2007 and 2006, 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 various companies. Fixed asset amounts for capital leases, which are included in capital assets on the statements of net assets, were approximately \$22,672,000 and \$11,836,000 at March 31, 2007 and 2006, respectively. Accumulated depreciation on these fixed assets was approximately \$7,173,000 and \$4,557,000 at March 31, 2007 and 2006, respectively.

The Lottery has entered into leases for equipment and building space. Rental expense was approximately \$2,105,000 and \$2,970,000 in 2007 and 2006, respectively.

Future minimum lease payments under all noncancelable leases having initial or remaining terms in excess of one year as of March 31, 2007 are as follows (in thousands):

	Operating leases	Capital leases
2008	\$ 2,039	4,949
2009	1,930	4,870
2010	1,775	2,877
2011	1,444	2,377
2012	1,203	2,149
2013 and thereafter	4,987	—
Total minimum payments required	\$ 13,378	17,222
Less amounts representing interest		1,217
Present value of minimum lease payments		16,005
Less current portion		4,448
Long-term capital lease obligations		\$ 11,557

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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, 2010. GTECH announced in January 2006 that GTECH and Lottomatica S.p.A. had entered into an agreement pursuant to which Lottomatica S.p.A. would acquire GTECH. This transaction has since been completed and 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 services provided under additional contracts:

- (1) Under a contract that expires July 23, 2009 Scientific Games, Inc. is the primary supplier of instant cash game tickets.
- (2) Under a contract expiring July 30, 2009 Pollard Banknote Limited is the secondary supplier of instant cash game tickets.
- (3) Under contracts that expire on July 27, 2009 Oberthur Gaming Technologies and Gtech Printing Corporation are tertiary suppliers of instant cash game tickets.
- (4) Instant cash game tickets are also sold through approximately 4,110 vending machines at approximately 2,600 locations. A contract with Gtech which expires on April 30, 2009, provides for maintenance of the vending machines.

Video lottery games are offered on approximately 12,700 video gaming machines spread over eight 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, 2010 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 \$4.3 million as of March 31, 2007.

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March 31, 2007 and 2006

(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.

(d) *New York Racing Association*

In April 2006, the Lottery provided approximately a \$6 million advance of vendor commissions to the New York Racing Association (NYRA) pursuant to Chapter 108 of the Laws of 2006. Repayment of the advance, including interest at 4% per annum, was to be made from NYRA's share of video lottery revenue, commencing with the start of operation of a video gaming facility at Aqueduct Racetrack. At March 31, 2007, no repayment has been received from NYRA as the facility has not yet opened. In addition, it is not anticipated that NYRA will commence video lottery operations prior to March 31, 2008. Accordingly, the outstanding receivable, including interest, has been classified as a noncurrent Other Receivable in the accompanying Statement of Net Assets as of March 31, 2007.

During March 2007, the Lottery was authorized to provide an additional \$23 million loan to NYRA pursuant to Chapter 9 of the Laws of 2007. The \$23 million was fully disbursed in April 2007. As security for the loan, the State was granted first-priority liens on substantially all of NYRA's assets. Terms of the Debtor-in-Possession Loan and Security Agreement between the State of New York and NYRA require repayment of the loan, with interest at 4% per annum, by a maturity date which is to be the earlier to occur of:

- 1) June 11, 2008;
- 2) The consummation date of any reorganization/liquidation plan; and
- 3) The first business date following the date on which an order entered by a court of competent jurisdiction has become final determining that NYRA is no longer in existence.

At March 31, 2007, the lottery has reflected the \$23 million loan as a current other liability and a noncurrent other receivable in the accompanying Statement of Net Assets.