



Today could be the day.

*Georgia Lottery Corporation
2006 Annual Report*



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GEORGIA LOTTERY CORPORATION

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With every dollar raised by the Georgia Lottery Corporation, the ultimate winners are the students of Georgia.

This year's record-breaking sales and profits to education are another significant milestone in the history of the Georgia Lottery Corporation (GLC). Through the end of fiscal year 2006 the GLC has raised more than \$8.4 billion for the specific educational programs funded with lottery proceeds – including the nationally-recognized HOPE Scholarship and Pre-K Programs.

Over the past year, we launched exciting new games and introduced several innovative and fun promotional campaigns. We traveled the state, awarding more than \$1.8 billion in prizes to players.

With every dollar raised by the Georgia Lottery Corporation, the ultimate winners are the students of Georgia. Lottery funds have allowed more than 900,000 students to attend college on HOPE and more than 700,000 4-year-olds the opportunity to attend high quality, lottery-funded Pre-K – this is something all Georgians can celebrate.

Thank you for your continued support of Georgia's lottery.

Margaret R. DoFrancisco

BOARD OF DIRECTORS

*Not only is the GLC
good for education –
it's good for business.*

The Georgia Lottery Corporation (GLC) continues to rank among the top performing lotteries worldwide with sales surpassing \$3 billion in fiscal year 2006. What's even more impressive is the impact lottery funds have had on the lives of millions of Georgians.

The benefits that are a product of the GLC's success are far reaching. Not only is the GLC good for education – it's good for business. From commissions paid to small businesses, to job creation, to educational opportunities resulting in financial savings for families, the lottery has had a positive impact on Georgia's economy.

(photos top to bottom):

Barbara M. Dooley, Chair

Tony Campbell

Rayna Casey

David C. Garrett III

Martin Kogon

Celeste Osborn

Not pictured: Ann B. Crowder



EDUCATION



More than 900,000 students have benefited from HOPE, and more than 700,000 4-year-olds have attended lottery-funded prekindergarten

The students of Georgia remained the ultimate winners in fiscal year 2006. The Georgia Lottery raised its highest amount ever for education, transferring more than \$822 million to the Lottery for Education Account for the HOPE Scholarship and Prekindergarten Programs. Since inception, the Georgia Lottery has generated more than \$8.4 billion for these important programs. More than 900,000 students have benefited from HOPE, and more than 700,000 4-year-olds have attended lottery-funded prekindergarten. For Georgia's students, *today could be the day* for invaluable opportunities and infinite possibilities.

The GLC marked a significant milestone for Georgia's students and families with the transfer of its 8 billionth dollar to education since inception.

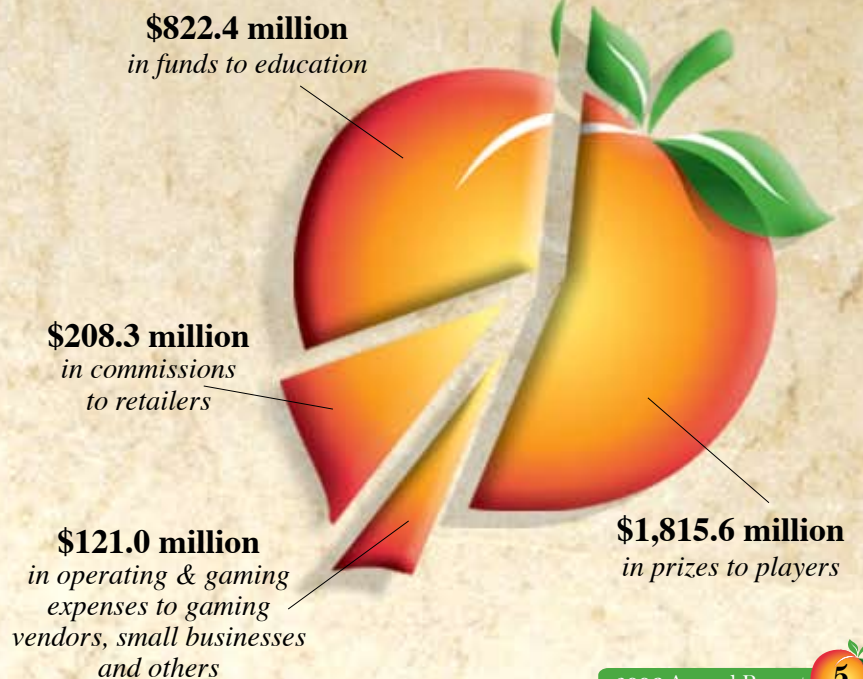




***The Georgia Lottery Corporation
raised more than \$2.2 million a day
for HOPE and Pre-K this year.***

WHERE THE MONEY GOES!

The Georgia Lottery Corporation is committed to providing opportunities to all Georgians. Every dollar spent on Georgia Lottery tickets is reinvested into Georgia's economy. Lottery funds go towards educating Georgia's students and workforce. Businesses across the state have benefitted from a successful partnership with the GLC, and players won over \$1.8 billion in prizes last year alone.



GAMES & PROMOTIONS



The Georgia Lottery ranked among the highest performing lotteries in the world, crossing the \$3 billion sales mark for the first time.

Georgia Lottery online and instant games were a winning combination in fiscal year 2006 with ticket sales soaring to a record \$3.17 billion. The Georgia Lottery ranked among the highest performing lotteries in the world, crossing the \$3 billion sales mark for the first time.

Georgia Lottery games continued to provide a source of fun and entertainment with long-time favorites including CA\$H 3, CA\$H 4, Fantasy 5 and Mega Millions, and new introductions like Win for Life and a revamped KENO! Instant games debuted with top prizes that soared to \$2.5 million, and several exciting promotions were tied-in to instant and online games. Georgia Lottery players enjoy their favorite games and look forward to new ones, knowing that *today could be the day*.



The Georgia Lottery introduced a new online game in February 2006, Win for Life! The fun and exciting game offers lifetime security with a top prize of \$1,000 a week for life! The new game also offers better odds, more winners and a great second prize of \$1,000 a week for a year! Win for Life is a multi-state game offered in Georgia, Kentucky and Virginia that replaced Lotto South.



The GLC's KENO! game received a facelift in October 2005 when it reintroduced itself to players around the state with a new look, new logo and more emphasis on playing in quality social establishments. Several KENO! promotions were conducted to demonstrate to players the fun and excitement of the game, including KENO! Madness Escape, KENO! Corvette Cruisin' and KENO! Bonus Nights. KENO! sales increased 19 percent in fiscal year 2006.



Gold fever swept across Georgia with the launch of \$300 Million Gold Rush, an instant game with 30 millionaires and the highest instant game top prize in Georgia history. Adding to the excitement of \$300 Million Gold Rush, the Georgia Lottery conducted its biggest statewide promotion ever – Rush to Win. “Treasure Trucks” traveled around the state of Georgia to promote \$300 Million Gold Rush and Rush to Win, giving players the opportunity to “crack the vault” and win great prizes at over 100 on-site events.



The promotion culminated with the Rush to Win Grand Prize Event held at Philips Arena in Atlanta. Ten lucky players were randomly selected from more than one million entries in the Rush to Win second chance drawing. The 10 contestants each chose one of 300 money bags in wheelbarrows for the chance to win the \$1 MILLION grand prize or a 2006 Hummer H3. While no one selected the grand prize or Hummer bag, each contestant walked away with \$1,000 and memories to last a lifetime.



WINNERS



*In fiscal year 2006,
prize payouts reached an
all-time high of \$1.8 billion*

From instant and on-line games to exciting statewide promotions, Georgia Lottery players enjoyed a record-breaking year of winning. In fiscal year 2006, prize payouts reached an all-time high of \$1.8 billion, topping the previous year's record by more than \$182 million.

Adding to the excitement in fiscal year 2006, the Georgia Lottery began celebrating with winners in their hometowns. Lottery officials traveled around the state to present oversized checks and brand-new cars to happy winners, who celebrated with family and friends. They also flashed winning smiles and shared their stories with the media of how *today could be the day*.

HOPE mom strikes gold, wins \$1 million

Amelia Johnson of Marietta was the first to win a \$1 million top prize playing \$300 Million Gold Rush. With a daughter graduating from college on HOPE, Johnson was already considered a Georgia Lottery winner.



Here comes the bride... all dressed in a half-million dollars

all dressed in a half-million dollars. Mallory Freeman of Cohutta was pumping gas when her fiancé presented her with a top prize winning Jumbo Jumbo Bucks ticket. When she walked down the aisle a month later, Freeman had 500,000 reasons to be a blushing bride.



HOPE grad wins \$564,000 on Fantasy 5

David Stines, a resident of Chatsworth, played Fantasy 5 and won \$564,898. According to Stines, he is just as excited to have attended Dalton State College on a HOPE Scholarship.

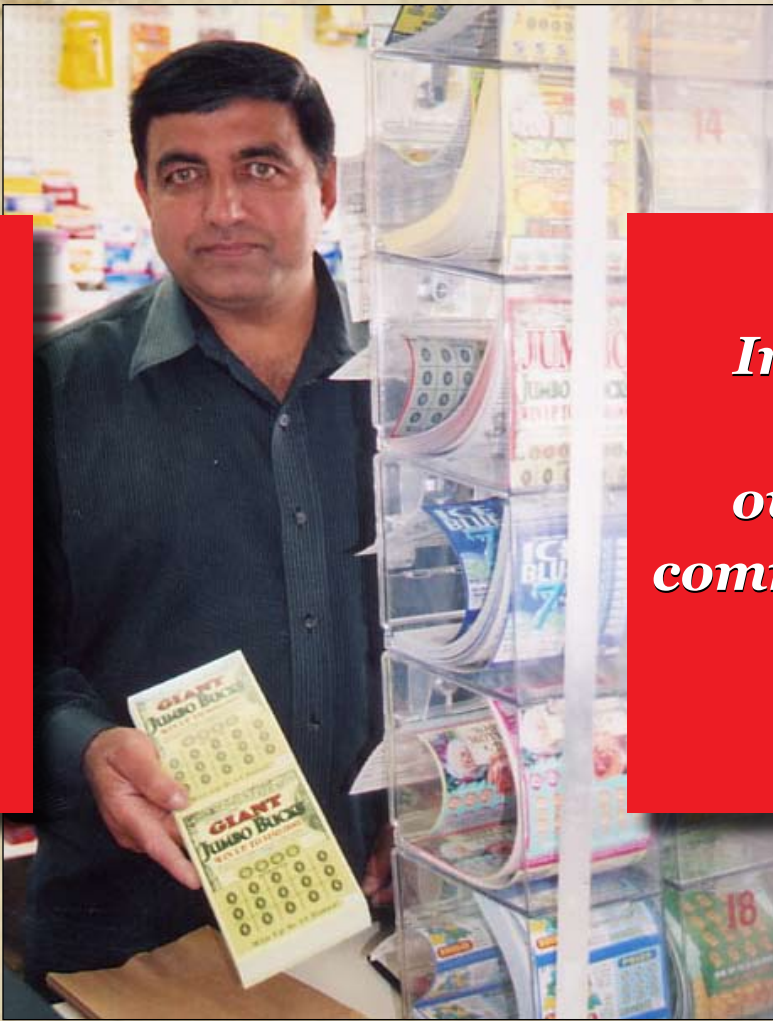


Half-million dollars, whole-hearted win

Walter Blackmon won \$500,000 playing Jumbo Jumbo Bucks. The Richland resident laughed and said, "It caused my heart to do a few things it doesn't normally do."



RETAILERS



*In Fiscal Year 2006,
retailers earned
over \$208 million in
commissions and bonuses
for their efforts.*

Over 7,800 retailers played an integral role in the Georgia Lottery's success this past fiscal year. Our retail partners act as ambassadors of the Georgia Lottery while interacting with our players – whether selling games, cashing prizes or explaining how to play a game. Without their partnership, our success could not be possible. In fiscal year 2006, retailers earned over \$208 million in commissions and bonuses for their efforts.

*Our retail partners act as
ambassadors of the Georgia Lottery
while interacting with our players.*

SENIOR STAFF



The GLC team is comprised of dedicated and professional men and women committed to the organization's mission to maximize revenues for education.

The GLC is headed by President and Chief Executive Officer Margaret DeFrancisco. The President is responsible for developing long-term vision for the corporation and overseeing its day-to-day operations.

The Sales and Marketing Division coordinates and oversees all sales and retailer activities, including corporate account management and retailer sales. The advertising and special events staff conducts promotions throughout the state and executes marketing plans.

The Technology and Operations Division encompasses retailer services, information technology and systems development activities. The systems development department is instrumental in coordinating new software on the gaming system. The information technology department maintains state-of-the-art computer systems, technology and telecommunications systems.

The Corporate Affairs Division is responsible for internal and external communications including winner awareness, publications, website, media relations, public and player information, and legislative affairs.

The Administration Division incorporates human resources, facilities management, prize validation and retailer contract administration.

The Finance, Planning and Development Division provides services related to financial accounting and reporting, cash management, budget, collections and procurement.

The Legal Affairs Division provides legal advice and assistance, drafts policies, directs security and investigations, handles internal auditing, and manages contract compliance.

The Georgia Lottery Corporation currently employs approximately 260 people statewide and has eight district offices (Atlanta, Augusta, Columbus, Dalton, Duluth, Macon, Savannah and Thomasville) in addition to the GLC headquarters in downtown Atlanta.

(photos left to right):

Rear row:

Doug Parker, Vice President of Human Resources;
Rosemarie Morse, Vice President of Legal Affairs;
J.B. Landroche, Vice President of Corporate Affairs;
James Hutchinson, Vice President of Marketing;
Mar-D Greer, Vice President of Security;
Jack Dimling, Vice President of Sales.

Front row:

Kurt Freedlund, Senior Vice President and General Counsel;
Larry Sipes, Vice President of Applied Technology;
Teri Rosa, Vice President of Customer Operations;
Joan Schoubert, Senior Vice President of Finance,
Planning and Development;
Sharman Lawrence, Vice President of Financial Management;
Gerald Mecca, Senior Vice President of Administration;
Margaret DeFrancisco, President and CEO;
Daniel Johnson, Chief Technology Officer

INDEPENDENT

AUDITORS' REPORT



To the Board of Directors of the Georgia Lottery Corporation:

We have audited the accompanying basic financial statements of the Georgia Lottery Corporation, a component unit of the state of Georgia, (the "GLC") as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the GLC's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the GLC as of June 30, 2005, were audited by other auditors whose report dated October 25, 2005, expressed an unqualified opinion on those statements.

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

In our opinion, the 2006 financial statements referred to above present fairly, in all material respects, the financial position of the Georgia Lottery Corporation as of June 30, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 13 through 19 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

Mauldin & Jenkins, LLC

Atlanta, Georgia
August 30, 2006

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Management's Discussion and Analysis

As management of the Georgia Lottery Corporation (the "GLC"), we offer readers of the GLC's financial statements this narrative overview and analysis of the financial activities for the fiscal years ended June 30, 2006 and June 30, 2005. We encourage readers to consider the information presented here in conjunction with the financial statements, which begin on page 20.

Financial Highlights

The GLC had another record-breaking year in fiscal year 2006. Gross ticket sales surpassed \$3.1 billion, representing the highest sales total in the GLC's thirteen-year history. For fiscal year 2005, gross ticket sales were over \$2.9 billion. For fiscal year 2006, the net proceeds paid to the Lottery for Education Account were \$822.4 million, also setting a GLC record. The net proceeds paid to the Lottery for Education Account represents an increase of \$20.2 million over last year. For fiscal year 2005, net proceeds paid were \$802.2 million, which represented an increase of \$19.5 million over fiscal year 2004. Other significant financial highlights include the following:

- For fiscal year 2006, gross tickets sales increased by \$255.3 million, more than 8.7% over the previous fiscal year. For fiscal year 2005, gross ticket sales increased by \$211.9 million, more than an 8% increase over 2004.
- Prize expense increased \$182.3 million during fiscal year 2006 and \$153.0 million in fiscal year 2005. This expense increases or decreases in direct proportion to ticket sales and represented approximately 57% of gross ticket sales in 2006 and 56% in 2005. Prize expense represented approximately 55% of gross ticket sales in 2004.
- Direct gaming expenses, which include retailer commissions and bonuses, contractor fees, advertising, and retailer merchandising and marketing, increased \$22 million in fiscal year 2006. These expenses also fluctuate in proportion to ticket sales and represented approximately 9.5% of gross ticket sales in 2006 and in 2005. For fiscal year 2005, direct gaming expenses increased \$12.9 million over 2004. These expenses represented approximately 10% of gross ticket sales in 2004.
- Fiscal year 2006 operating expenses, which include salaries and benefits, rent, utilities and maintenance, professional fees, depreciation, and other expenses increased \$3.0 million over the previous fiscal year, resulting primarily from increases in health insurance premiums and bad debt expenses. Operating expenses remained at less than 1% of gross ticket sales for fiscal years 2006 and 2005. Fiscal year 2005 operating expenses increased \$27,000 over 2004 expenses.
- Nonoperating revenues, net of expenses, decreased \$18.3 million in 2006 as compared to 2005. This decrease is attributable to the change in the fair value of grand prize investments held by the GLC for funding future grand prize payments, partially offset by the increase in interest revenue over the prior fiscal year. Nonoperating revenues, net of expenses, increased \$23.0 million or approximately 148%, in 2005 as compared to 2004. For fiscal year 2005, this increase was also attributable to the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments and the increase of interest revenue.

Overview of the Financial Statements

The GLC is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the GLC's basic financial statements, along with the notes to the financial statements. The statements of net assets on page 11 the statements of revenues, expenses, and changes in net assets on page 12, and the statements of cash flows on pages 13 and 14 report the GLC's net assets and changes therein. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements begin on page 15 of this report.

The GLC pays its net proceeds each fiscal year to the General Fund of the state treasury for credit to the Lottery for Education Account. As a result, the GLC's net assets consist of funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds (as required by the Georgia Lottery for Education Act) and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments which are held to fund grand prizes payable. The GLC expects to hold these investments to maturity to meet our future grand prize winner obligations and, therefore, will not realize any gains or losses related to the current value of these investments for distribution as net proceeds. The reader of these financial statements should review the assets and liabilities in the statements of net assets and the operating revenues and expenses and the payment to and due to Lottery for Education Account in the statements of revenues, expenses, and changes in net assets to assess the GLC's financial position as of June 30, 2006 and 2005, and the results of its operations for the years then ended.

Financial Analysis

Assets

Total assets at the end of fiscal year 2006 were \$487.8 million compared to \$481.3 million at the end of fiscal year 2005, representing an increase of \$6.5 million. At the end of fiscal year 2005, total assets were \$481.3 million compared to \$465.8 million at the end of fiscal year 2004, representing an increase of \$15.6 million.

Current assets increased from \$260.7 million in 2005 to \$287.5 million in 2006, representing an increase of \$26.8 million. This increase is primarily due to a \$24.4 million increase in cash and cash equivalents and a \$2.1 million increase in retailer accounts receivable due to the timing of billing and collections from our retailers at year-end cutoff. Current assets increased from \$250.8 million in 2004 to \$260.7 million in 2005, representing an increase of \$9.9 million. This increase resulted primarily from a \$6.8 million decrease in cash and cash equivalents and a \$16.5 million increase in retailer accounts receivable due to the timing of collections from our retailers.

Noncurrent assets decreased from \$220.6 million in 2005 to \$200.3 million in 2006, representing a decrease of \$20.3 million. This decrease is primarily due to grand prize investments decreasing from \$218.4 million in 2005 to \$197.0 million in 2006, a decrease of \$21.4 million. The decrease resulted from net purchases of \$6.4 million, payments to grand prize winners totaling \$23.5 million, interest earned on current-year maturities of \$11.1 million, and a \$15.4 million decrease in the fair value of the investments. Capital assets increased from \$2.2 million in 2005 to \$3.4 million in 2006, an increase of \$1.2 million. The increase resulted from capital asset purchases of \$2.1 million less depreciation expense of \$0.9 million.

In fiscal year 2005, noncurrent assets increased to \$220.6 million from \$215.0 million in 2004, representing an increase of \$5.6 million. This increase was primarily due to grand prize investments increasing from \$213.2 million in 2004 to \$218.4 million in 2005, an increase of \$5.3 million. The increase resulted from net purchases of \$11.5 million, payments to grand prize winners totaling \$22.9 million, interest earned on current-year maturities of \$11.5 million, and a \$5.1 million increase in the fair value of the investments. Capital assets increased from \$1.8 million in 2004 to \$2.2 million in 2005, an increase of \$0.4 million. The increase resulted from capital asset purchases of \$1.3 million less depreciation expense of \$0.9 million.

Liabilities

Total liabilities at the end of fiscal year 2006 were \$490.2 million compared to \$465.7 million at the end of fiscal year 2005, representing an increase of \$24.5 million. Total liabilities at the end of fiscal year 2004 were \$456.8 million compared to \$465.7 million at the end of fiscal year 2005, representing an increase of \$8.9 million.

Current liabilities increased from \$258.3 million in 2005 to \$288.6 million in 2006, an increase of \$30.3 million. The increase is due to a \$33.8 million increase in prizes payable, increases of \$.5 million and \$0.1 million in the retailer escrow and fidelity funds, respectively, a \$2.6 million decrease in the funds due to the Lottery for Education Account, and a \$1.5 million decrease in accounts payable and accrued liabilities. The increase in prizes payable was primarily due to a higher liability for the instant games at the end of fiscal year 2006 versus 2005. The decrease in funds due to the Lottery for Education Account resulted from lower fourth quarter sales in fiscal year 2006 versus 2005. The decrease in accounts payable and accrued liabilities was primarily due to a lower year-end accrued payment for advertising.

For fiscal year 2005, current liabilities increased to \$258.3 million from \$250.1 million in 2004, an increase of \$8.2 million. The increase was due to a \$9.1 million increase in the funds due to the Lottery for Education Account, a \$3.5 million increase in accounts payable and accrued liabilities, a \$4.7 million decrease in prizes payable, and a \$0.3 million increase in the fidelity fund. The increase in funds due to the Lottery for Education Account resulted from higher fourth quarter sales in fiscal year 2005 versus 2004. The increase in accounts payable and accrued liabilities was primarily due to higher year-end accrued payments for vendors, which provide gaming products, systems, and advertising. The decrease in prizes payable was primarily due to a lower accrued liability for the advertised Mega Millions jackpot at the end of fiscal year 2005 versus 2004.

Noncurrent liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. Grand prizes payable experienced a net decrease of \$6.0 million in 2006. The net decrease is primarily attributable to two factors. Grand prize payables of \$12.4 million became due and payable in fiscal year 2006 as an annual payment obligation to our grand prize winners, thus reducing the long-term liabilities. The GLC increased its grand prizes payable by \$6.4 million as the result of new annual payment obligations for grand prize winners for two games, Win For Life and \$100 Million Cash Spectacular. The GLC has purchased or will purchase U.S. Treasury securities to fund these future payment obligations. During fiscal year 2006, all eligible grand prize winners in our online games elected to receive their prizes in a single cash payment.

Net Assets and Changes in Net Assets

Net assets decreased \$17.9 million in 2006 from \$15.6 million in fiscal year 2005, to an end of year balance of (\$2.3) million. This decrease primarily resulted from a \$15.4 million unrealized loss in the fair value of grand prize investments held by the GLC for funding of future grand prize payments and the \$2.2 million increase in funds invested in capital assets resulting from inclusion of these capital costs in the determination of net proceeds as required by the Georgia Lottery for Education Act. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value, and the change in the fair value is recorded as nonoperating revenue (expense) annually. The GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations.

Net assets increased to \$15.6 million in fiscal year 2005 from \$9.0 million in fiscal year 2004, representing a \$6.6 million increase. This increase primarily resulted from a \$5.1 million unrealized gain in the fair value of grand prize investments held by the GLC for funding of future grand prize payments and the \$1.3 million increase in funds invested in capital assets.

Sales

Total lottery ticket sales for fiscal year 2006 were \$3.178 billion, as compared to \$2.922 billion in 2005. This represents an increase of over \$255.3 million and average weekly gross ticket sales for fiscal year 2006 of \$61.1 million versus \$56.2 million in 2005. Total lottery ticket sales for fiscal year 2005 increased by \$211.9 million over fiscal year 2004 sales of \$2.710 billion. Average weekly gross ticket sales for fiscal year 2005 were \$56.2 million versus \$52.1 million in 2004.

Gross instant ticket sales increased significantly during fiscal year 2006, up \$213.5 million over one year ago, from \$1.841 billion in 2005 to \$2.055 billion in 2006. The 11.6% increase is attributable to several factors, including the GLC's administration of a sound marketing strategy, ongoing development and introduction of new instant ticket games, and effective management of the instant product mix offering giving players the opportunity to choose among a variety of games at different price points: \$1, \$2, \$3, \$5, and \$10. During fiscal year 2006, the GLC introduced two new \$10 games with significant top prize offerings and overall prize payouts: \$200 Million Cash Spectacular in August 2005 and \$300 Million Gold Rush in January 2006. The strength of the \$10 price point category spanned the entire fiscal year for 2006, as compared to only six months for 2005, and became a much larger part of the overall sales and product mix. In addition, the GLC introduced several instant games at lower price points during fiscal year 2006 offering a variety of respective prize opportunities which appeal to different players. New instant games included a \$5 King Kong game; two \$3 vehicle prize themed games, Mustang Money and Corvette Cash; a \$2 Bingo game; and a \$1 Fill'er Up game. GLC players continued demonstrating loyalty to our most popular core games such as Jumbo Bucks Classic, Mini Mega Bucks, Mega Bucks, Junior Jumbo Bucks, Mighty Mega Bucks, Giant Jumbo Bucks, and Jumbo Jumbo Bucks. Ticket sales for the four holiday season instant games increased by more than 21% from approximately \$61 million in fiscal year 2005 to \$74 million in fiscal year 2006, as a result of a strong integrated marketing plan for these games.

For fiscal year 2005, gross instant ticket sales increased significantly, up \$284.3 million, from \$1.557 billion in 2004 to \$1.841 billion. In February 2005, the GLC introduced a new \$10 game, \$100 Million Cash Spectacular providing players with the highest ever top prize and prize payout for any of our instant games. Loyal GLC players continued supporting their favorite instant games, including our most popular core games such as Jumbo Bucks Classic, Mega Bucks, Junior Jumbo Bucks, and Jumbo Jumbo Bucks. In 2005, the GLC expanded a core game, Lucky 7's, by introducing a new instant game at the \$5 price point, Triple Lucky 7's, in addition to offering Lucky 7's and Double Lucky 7's, at the \$1 and \$2 price points, respectively.

In 2006, Cash 3 sales decreased \$7.2 million (approximately 1%) to \$544.3 million from \$551.5 million in 2005. Cash 3 is a twice-daily drawing game whereby the player chooses a three-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. The actual prize payout experienced for both fiscal years 2006 and 2005 remained constant at approximately 50%. Management continues to enhance its marketing plan to stabilize sales for Cash 3.

In 2005, Cash 3 sales decreased \$45.4 million to \$551.5 million compared to \$596.9 million in 2004. The actual prize payout experienced for fiscal years 2005 and 2004 was 50% and 47%, respectively.

In 2006, Cash 3 sales decreased \$7.2 million (approximately 1%) to \$544.3 million from \$551.5 million in 2005. Cash 3 is a twice-daily drawing game whereby the player chooses a three-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. The actual prize payout experienced for both fiscal years 2006 and 2005 remained constant at approximately 50%. Management continues to enhance its marketing plan to stabilize sales for Cash 3.

In 2005, Cash 3 sales decreased \$45.4 million to \$551.5 million compared to \$596.9 million in 2004. The actual prize payout experienced for fiscal years 2005 and 2004 was 50% and 47%, respectively.

Mega Millions sales increased \$37.1 million (approximately 21.8 %) in 2006 to \$207.5 million compared to \$170.4 million in 2005. Mega Millions is a multi-state lottery game operated with eleven other states—California, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Texas, Virginia, and Washington. Drawings are held twice weekly on Tuesday and Friday. With the addition of the California Lottery in June 2005, the player base increased, and changes were made to the game matrix. The matrix change resulted in an increase in the overall odds for winning, an increase of the prize amounts for two of eight fixed prize levels, and raising the starting minimum jackpots from \$10 million to \$12 million. Mega Millions sales produced larger jackpots and faster jackpot growth. During fiscal year 2006, Mega Millions experienced a record-setting \$315 million winning jackpot in November 2005, and three other jackpots over \$250 million, including jackpots of \$258 million in September 2005, \$270 million in March 2006, and \$265 million in April 2006. In comparison, this game had only two jackpots over \$200 million during the previous fiscal year: \$294 million in July 2004 and \$208 million in April 2005.

Mega Millions sales decreased \$15.6 million in 2005 to \$170.4 million compared to \$186.0 million in 2004. In fiscal year 2005, Mega Millions produced two jackpots over \$200 million. In comparison, the second largest Mega Millions jackpot since the game's inception, \$239 million was generated during the previous fiscal year in February 2004.

Cash 4 sales increased \$3.4 million (approximately 2%), from \$174.2 million in 2005 to \$177.6 million in 2006. Cash 4 is a twice-daily drawing game whereby the player chooses a four-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. Actual prize payouts in fiscal years 2006 and 2005 were 45% and 51%, respectively. Although the prize payout for fiscal year 2006 was well below the industry average of 50%, Cash 4 sales increased over 2005. Management believes growing player loyalty to this online game, stemming from the immense popularity in the Cash 3 game, contributed to the sales increase.

In fiscal year 2005, Cash 4 sales increased \$2.3 million, from \$171.9 million in 2004 to \$174.2 million. Actual prize payouts in fiscal years 2005 and 2004 were 51% and 58%, respectively. Historically, as the prize amounts won for this game increase above the industry average, a corresponding increase in sales will occur. In fiscal year 2005, actual prize payouts continued to exceed the industry average. Consequently, the higher than expected actual prize payouts in fiscal year 2005 resulted in a continued increase in Cash 4 sales over fiscal year 2004.

Lotto South sales were \$43.0 million and \$67.4 million in fiscal years 2006 and 2005, respectively. The decrease in sales is attributable to the GLC ending this multi-state pari-mutuel lottery game on February 25, 2006, four months prior to the end of fiscal year 2006.

In 2005, Lotto South sales decreased \$8.7 million to \$67.4 million compared to \$76.1 million in 2004. Lotto South was a multistate pari-mutuel lottery game operated with two other states—Kentucky and Virginia. Drawings were held weekly on Wednesdays and Saturdays. Lotto South produced only one jackpot over \$20 million in both fiscal years 2004 and 2005.

In its continuing effort to provide players with exciting games, the GLC decided to launch a new multi-state fixed prize online game, Win For Life, operated in conjunction with lotteries in Kentucky and Virginia. Win For Life contributed \$21.5 million in sales since its launch on February 26, 2006. Win For Life drawings are held twice weekly on Wednesday and Saturday. Six winning numbers followed by one “free ball” number are drawn from a single set of 42 balls. By matching the six winning numbers, players win the top prize of \$1,000 a Week for Life payable in quarterly payments of \$13,000. Players matching five of the six winning numbers plus the “free ball” number win the second tier prize of \$1,000 a week for one year. Matching the “free ball” number also increases other lower level prize amounts.

Fantasy 5 sales increased \$3.5 million (approximately 4.6%) in 2006 to \$79.4 million from \$75.9 million in 2005. During August 2005, GLC management revised the prize payout distribution for all prize levels. A greater payout percentage was reallocated to two prize levels, matching 3 of 5 numbers and 4 of 5 numbers, and the payout percentage for the top prize level, matching 5 of 5 numbers was reduced. This prize distribution change, coupled with a full fiscal year of sales including an additional prize level (matching 2 of 5 numbers winning a free “Quik Pik” ticket), contributed to increased Fantasy 5 sales in 2006. The additional prize level, matching 2 of 5 numbers, was implemented during the previous fiscal year in April 2005.

For fiscal year 2005, Fantasy 5 sales increased \$1.2 million to \$75.9 million compared to \$74.7 million in 2004. Historically, as the jackpot prize amount for this game exceeds \$500,000, an increase in sales has occurred. Jackpot prizes exceeding \$500,000 occurred more frequently in fiscal year 2005 than in fiscal year 2004. Consequently, these jackpot prizes contributed over \$32.8 million in sales for fiscal year 2005, as compared to \$30.0 million in fiscal year 2004. During April 2005, the GLC enhanced the overall odds for winning Fantasy 5 by adding an additional prize level. Players receive a free Fantasy 5 quick pick ticket for the next scheduled drawing for matching two of five winning draw numbers.

Quick Cash Keno was relaunched in October 2005 as Keno! Sales for Keno! were \$49.7 million in fiscal year 2006, up \$ 7.9 million (approximately 19%) over fiscal year 2005 sales of \$41.8 million. During fiscal year 2006, management implemented initiatives to increase sales by expanding the number and type of retailer locations offering Keno!, increasing game prize payouts, assigning dedicated Keno! sales staff, and increasing player game awareness through on-site events and cross-promotions with other lottery products. The re-launch of Keno! was supported by an integrated marketing and advertising campaign.

Sales for our Quick Cash Keno game were \$47.2 million and \$41.8 million in fiscal year 2004 and 2005, respectively. The \$5.3 million decrease in sales during 2005 is attributed to the lack of a dedicated marketing and promotion plan to support the game, as well as the less-than-optimum game design and prize payout levels

Other Operating Revenue

Other operating revenue includes online fees and other miscellaneous revenue. Other operating revenue increased \$.2 million to \$4.9 million in fiscal year 2006, from \$ 4.7 million in fiscal year 2005. For both fiscal years 2005 and 2004, other operating revenue was \$4.7 million.

Prize Expense

Gross prize expense for instant games increased to \$1,277 million in fiscal year 2006 from \$1,124 million in 2005, an increase of \$182.3 million (approximately 16.2%). Gross prize expense for instant games was \$1,124 million in fiscal year 2005 versus \$934.3 million in 2004, an increase of \$189.7 million (approximately 20.3%). Instant games prize expense is managed through the number of tickets printed for each game and value of prizes as determined prior to ticket production. Prize expense is recognized based on an established prize structure and related percentage of sales for each game introduced and is recognized when products are made available for sale to the public. The increase in instant game prize expense, in excess of that attributable to proportional growth in game sales, is a result of the increase in sales of the higher price point games as a percentage of total instant sales. Higher price point games offer a larger prize payout than lower price point games.

Instant game prize expense is reduced using unclaimed prizes recognized during the fiscal year. For fiscal year 2006, prize expense, net of unclaimed prizes for instant games, totaled \$1,249.2 million as compared to \$1,087.2 million in 2005, and \$896.8 million in 2004. Gross instant prize expense was reduced by \$27.4 million, \$36.9 million, and \$37.5 million, by using unclaimed prizes in 2006, 2005, and 2004, respectively.

Prize expense for online games generally increases or decreases each year in direct proportion to ticket sales of the related game. For pari-mutuel online games (Lotto South and Fantasy 5), actual prize expense is recognized as a percentage of ticket sales, 50%, and 50%, respectively. For nonpari-mutuel games (Cash 3, Cash 4, Mega Millions, Win For Life, and Quick Cash Keno / Keno!), actual prize expense is impacted by the number and prize value of winning tickets. To recognize prize expense on a consistent basis for these games, the GLC recognizes prize expense based on the greater of actual prizes paid or the estimated payout experience over the life of the game or based on industry averages. The GLC has established prize liability limits, per draw, for nonpari-mutuel games.

Total online prize expense increased \$20.4 million in 2006 to \$566.4 million compared to \$546.0 million in 2005. For fiscal year 2005, total online prize expense decreased \$37.5 million to \$546.0 million compared to \$583.5 million in 2004. The net increase is comprised of the following increases and decreases by game as follows:

- Prize expense for Cash 3 decreased \$3.6 million in fiscal year 2006 as compared to 2005. Prize expense for Cash 3 decreased \$22.9 million in fiscal year 2005 as compared to 2004.
- Prize expense for Mega Millions increased \$18.5 million in 2006 versus 2005. Prize expense for Mega Millions decreased \$7.8 million in 2005 versus 2004.
- Prize expense for Cash 4 increased \$.9 million over 2005. Prize expense for Cash 4 increased \$1.2 million over 2004.
- Prize expense for Lotto South decreased \$12.2 million in 2006 as compared to 2005. Prize expense for Lotto South decreased \$4.3 million in 2005 as compared to 2004.
- Prize expense for Fantasy 5 decreased \$1.2 million in 2006 versus 2005. Prize expense for Fantasy 5 decreased \$0.2 million in 2005 versus 2004.
- Prize expense for Quick Cash Keno / Keno! increased \$7.3 million in 2006 as compared to 2005. Prize expense for Quick Cash Keno decreased \$3.0 million in 2005 as compared to 2004.
- Prize expense for Win For Life was \$10.8 million in 2006.

Direct Gaming and Operating Expenses

Direct gaming expenses usually change in proportion with changes in ticket sales. For fiscal year 2006, increased ticket sales resulted in a corresponding increase in the largest component of direct gaming expenses, retailer commissions and bonuses. Contractor (vendor) fees increased and advertising expenses decreased slightly in fiscal year 2006 versus 2005. For fiscal year 2005, contractor fees and advertising expenses decreased versus 2004.

Retailer commissions and bonuses for fiscal year 2006 were \$208.3 million compared to \$192.5 million in 2005, and \$178.0 million in 2004. This represents a \$15.8 million increase in fiscal year 2006, and a 14.5 million increase in 2005 over the preceding fiscal year. The GLC compensates its retailers through three commission/incentive plans. These are:

- A set commission percentage for selling tickets.
- A ticket cashing bonus for validating and paying winning prizes up to \$600.
- Winning jackpot ticket incentives.

Contractor (vendor) fees represent payments made to our two major suppliers of the gaming products, systems, and services. The payments are determined based on a percentage of sales formula. On September 7, 2003, the GLC began operating under its new seven-year vendor contracts for Online Gaming Systems and Services and Instant Ticket Printing and Associated Services. In fiscal year 2006, contractor (vendor) fees were \$64.7 million as compared to \$58.6 million in 2005, representing an increase of \$6.1 million, directly attributable to the increase in ticket sales. For fiscal year 2005, contractor (vendor) fees decreased \$4.5 million from \$63.1 million in 2004 to \$58.6 million in 2005. The decrease in fiscal year 2005 was attributable to the reduction of 1.03% in online and 1.15% in instant contracted vendor fees under the new vendor contracts being applicable to the entire 2005 fiscal year versus approximately ten months in fiscal year 2004.

Advertising expense decreased \$0.1 million to \$19.4 million in 2006 from \$19.5 million in 2005. For fiscal year 2005, advertising expense decreased \$0.4 million to \$19.5 million from \$19.9 million in 2004

Retailer merchandising and marketing expenses increased to \$9.4 million in 2006 from \$9.2 million in 2005. For fiscal year 2005, retailer merchandising and marketing expenses increased \$3.4 million over fiscal year 2004. This increase was primarily the result of new game development expenses associated with new instant games and several marketing initiatives to increase player awareness about our lottery games. During fiscal year 2005, the GLC distributed promotional coupons for a free lottery ticket with an instant or online ticket purchase and offered several second-chance drawings, special promotional events, contests, and giveaways, including the \$100 Million Dollar Spectacular Hoopla promotional event and the Fantasy 5 Getaway and Mega Road Trips.

Operating expenses increased \$3.0 million to \$27.6 million in 2006 from \$24.6 million in 2005. The GLC experienced higher employer health insurance premiums, which increased personnel service expenses in 2006. Bad debt expense was \$.4 million in 2006 versus \$.4 million net revenue in the previous fiscal year due to a \$1.1 million retailer accounts receivable recovery being applied to a prior bad debt write-off during fiscal year 2005. Operating expenses increased to \$24.6 million in 2005 from \$24.5 million in 2004.

Nonoperating Revenues (Net of Expenses)

Nonoperating revenues, net of expenses, consist primarily of payments to/due to Lottery for Education Account, interest revenue, and the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. Nonoperating expenses, net of revenues, increased \$38.4 million from \$794.8 million in 2005 to \$833.2 million in 2006. The increase is attributable to a \$20.2 increase in payments to/due to Lottery for Education Account and a \$20.5 million decrease in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. The increases or decreases in the fair value of grand prize investments are the result of current period market fluctuations. The \$20.5 million change resulted from a \$15.4 million decrease in the fair value of grand prize investments as of June 30, 2006, compared to a \$5.1 million increase in fair value of grand prize investments as of June 30, 2005.

For fiscal year 2005, nonoperating expenses, net of revenues, decreased \$3.4 million from \$798.2 million in 2004 to \$794.8 million in 2005. This decrease was primarily attributable to the \$21.9 million change in the fair value of grand prize investments. The \$21.9 million change resulted from a \$5.1 million increase in the fair value of grand prize investments as of June 30, 2005, compared to a \$16.8 million decrease in the fair value of grand prize investments as of June 30, 2004.

Interest income increased \$2.2 million due to higher earnings realized from funds held in a pooled short term investment fund managed by the State of Georgia Office of Treasury and Fiscal Services. This fund is a combined state General Fund and local government investment pool and is used by the GLC for funds not needed in the short-term for operating purposes. These funds generally represent net proceeds held, pending quarterly transfer to the education account.

Significant Factors Impacting Next Year

The state of North Carolina started a lottery in April 2006. The GLC could experience an effect on sales along the border between Georgia and North Carolina as that lottery matures and adds new games.

During the upcoming fiscal year, the GLC plans to expand its corporate visibility by opening kiosks in the North and South terminals at the Hartsfield-Jackson International Airport.

The impact of rising fuel costs on available discretionary income available to lottery players may have an adverse effect on future lottery sales.

Contacting the GLC's Financial Management

This financial report is designed to provide the state of Georgia, the public, and other interested parties with an overview of the financial results of the GLC's activities and to show the GLC's accountability for conducting business in a fiscally responsible manner. If you have questions about this report or require additional financial information, contact the GLC's Corporate Affairs Division at the Georgia Lottery Corporation, 250 Williams Street, INFORUM, Suite 3000, Atlanta, Georgia 30303.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF NET ASSETS AS OF JUNE 30, 2006 AND 2005

| | <u>2006</u> | <u>2005</u> |
|---|-----------------------|-----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 182,443,000 | \$ 158,037,000 |
| Restricted fidelity fund cash | 494,000 | 440,000 |
| Restricted retailers' escrow fund cash | 526,000 | - |
| Retailer accounts receivable—net | 103,194,000 | 101,057,000 |
| Prepaid expenses and other assets | <u>838,000</u> | <u>1,152,000</u> |
| Total current assets | <u>287,495,000</u> | <u>260,686,000</u> |
| NONCURRENT ASSETS: | | |
| Grand prize investments | 196,990,000 | 218,424,000 |
| Capital assets - net | <u>3,355,000</u> | <u>2,205,000</u> |
| Total noncurrent assets | <u>200,345,000</u> | <u>220,629,000</u> |
| TOTAL ASSETS | <u>\$ 487,840,000</u> | <u>\$ 481,315,000</u> |
| LIABILITIES AND NET ASSETS | | |
| CURRENT LIABILITIES: | | |
| Due to Lottery for Education Account | \$ 200,094,000 | \$ 202,726,000 |
| Prizes payable | 76,747,000 | 42,945,000 |
| Accounts payable and accrued liabilities | 10,691,000 | 12,235,000 |
| Restricted fidelity fund | 494,000 | 440,000 |
| Restricted retailers' escrow fund | <u>526,000</u> | <u>-</u> |
| Total current liabilities | <u>288,552,000</u> | <u>258,346,000</u> |
| NONCURRENT LIABILITIES: | | |
| Grand prizes payable | 199,285,000 | 205,264,000 |
| Noncurrent portion of other long-term liabilities | <u>2,342,000</u> | <u>2,105,000</u> |
| Total noncurrent liabilities | <u>201,627,000</u> | <u>207,369,000</u> |
| Total liabilities | <u>490,179,000</u> | <u>465,715,000</u> |
| NET ASSETS (DEFICIT): | | |
| Invested in capital assets | 3,355,000 | 2,205,000 |
| Unrestricted | <u>(5,694,000)</u> | <u>13,395,000</u> |
| Total net assets (deficit) | <u>(2,339,000)</u> | <u>15,600,000</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 487,840,000</u> | <u>\$ 481,315,000</u> |

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

| | <u>2006</u> | <u>2005</u> |
|--|-----------------------|----------------------|
| OPERATING REVENUES: | | |
| Ticket sales | \$ 3,177,596,000 | \$ 2,922,332,000 |
| Less tickets provided as prizes | <u>(222,219,000)</u> | <u>(187,985,000)</u> |
| Net ticket sales | 2,955,377,000 | 2,734,347,000 |
| Online fees | 4,181,000 | 4,557,000 |
| Other | <u>688,000</u> | <u>145,000</u> |
| Net operating revenues | <u>2,960,246,000</u> | <u>2,739,049,000</u> |
| OPERATING EXPENSES: | | |
| Prizes | 1,815,567,000 | 1,633,277,000 |
| Retailer commissions and bonuses | 208,328,000 | 192,482,000 |
| Contractor fees | 64,685,000 | 58,585,000 |
| Advertising | 19,386,000 | 19,500,000 |
| Salaries and benefits | 20,461,000 | 18,911,000 |
| Retailer merchandising and marketing | 9,370,000 | 9,187,000 |
| Rent, utilities, and maintenance | 3,456,000 | 3,313,000 |
| Depreciation | 863,000 | 930,000 |
| Professional fees | 1,293,000 | 983,000 |
| Other | <u>1,530,000</u> | <u>484,000</u> |
| Total operating expenses | <u>2,144,939,000</u> | <u>1,937,652,000</u> |
| Operating income | <u>815,307,000</u> | <u>801,397,000</u> |
| NONOPERATING REVENUES (EXPENSES): | | |
| Payments to and due to Lottery for Education Account | (822,399,000) | (802,240,000) |
| Interest revenue and other | 4,558,000 | 2,357,000 |
| Net increase (decrease) in fair value of grand prize investments | <u>(15,405,000)</u> | <u>5,113,000</u> |
| Total nonoperating revenues (expenses) | <u>(833,246,000)</u> | <u>(794,770,000)</u> |
| Change in net assets | (17,939,000) | 6,627,000 |
| NET ASSETS—Beginning of year | <u>15,600,000</u> | <u>8,973,000</u> |
| NET ASSETS (DEFICIT)—End of year | <u>\$ (2,339,000)</u> | <u>\$ 15,600,000</u> |

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

| | <u>2006</u> | <u>2005</u> |
|---|-----------------------|-----------------------|
| OPERATING ACTIVITIES: | | |
| Cash received from customers | \$ 2,953,208,000 | \$ 2,717,895,000 |
| Other operational cash received | 4,870,000 | 4,702,000 |
| Cash paid to prize winners | (1,798,641,000) | (1,648,975,000) |
| Cash paid to retailers | (110,069,000) | (102,988,000) |
| Cash paid to contractors and employees | (208,328,000) | (192,482,000) |
| Other operating payments | <u>(10,513,000)</u> | <u>(3,631,000)</u> |
| Net cash provided by operating activities | <u>830,527,000</u> | <u>774,521,000</u> |
| NONCAPITAL FINANCING ACTIVITIES: | | |
| Payments to Lottery for Education Account | (825,031,000) | (793,114,000) |
| Payments to Department of Human Resources | <u>(200,000)</u> | <u>(200,000)</u> |
| Net cash used in noncapital financing activities | <u>(825,231,000)</u> | <u>(793,314,000)</u> |
| CAPITAL AND RELATED FINANCING ACTIVITIES: | | |
| Purchases of property and equipment | (2,022,000) | (1,314,000) |
| Proceeds from disposals of property and equipment | <u>2,000</u> | <u>37,000</u> |
| Net cash used in capital and related financing activities | <u>(2,020,000)</u> | <u>(1,277,000)</u> |
| INVESTING ACTIVITIES: | | |
| Interest received | 4,558,000 | 2,200,000 |
| Purchases of grand prize investments | (8,485,000) | (11,500,000) |
| Investments sold | 2,125,000 | - |
| Maturities of grand prize investments | <u>23,512,000</u> | <u>22,862,000</u> |
| Net cash provided by investing activities | <u>21,710,000</u> | <u>13,562,000</u> |
| NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH | 24,986,000 | (6,508,000) |
| CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—Beginning of year | <u>158,477,000</u> | <u>164,985,000</u> |
| CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—End of year | <u>\$ 183,463,000</u> | <u>\$ 158,477,000</u> |

Continued



GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

| | <u>2006</u> | <u>2005</u> |
|---|-----------------------|-----------------------|
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | |
| Operating income | \$ 815,307,000 | \$ 801,397,000 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 863,000 | 930,000 |
| Provision for doubtful retailer accounts | 364,000 | (418,000) |
| Gains (Losses) on disposals of property and equipment | 2,000 | (37,000) |
| Changes in assets and liabilities: | | |
| Retailer accounts receivable | (2,500,000) | (16,066,000) |
| Prepaid expenses and other assets | 314,000 | 221,000 |
| Accounts payable and accrued liabilities | (1,544,000) | 3,490,000 |
| Prizes payable | 34,002,000 | (4,498,000) |
| Grand prizes payable | (17,100,000) | (11,200,000) |
| Restricted fidelity fund | 54,000 | 320,000 |
| Restricted Retailer Escrow | 526,000 | - |
| Other liabilities | 239,000 | 382,000 |
| Net cash provided by operating activities | <u>\$ 830,527,000</u> | <u>\$ 774,521,000</u> |
| SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES: | | |
| Increase (decrease) in fair value of investments | \$ (15,405,000) | \$ 5,113,000 |
| Accretion of grand prizes payable | 11,123,000 | 11,505,000 |
| Increase in unrealized gain on other assets | - | 157,000 |
| | <u>\$ (4,282,000)</u> | <u>\$ 16,775,000</u> |

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

1. REPORTING ENTITY

The Georgia Lottery Corporation (the “GLC”) was established as an instrumentality of the state with the enactment of the Georgia Lottery for Education Act (the “Act”) on November 2, 1992. The GLC is responsible for the provision of lotteries on behalf of the state of Georgia in accordance with the Act and is a component unit of the state of Georgia.

The GLC’s ticket sales include instant ticket sales and online ticket sales for Cash 3, Cash 4, Lotto South, Fantasy 5, Keno, Mega Millions, and Win for Life. On February 25, 2006, the GLC ended sales of Lotto South and began the Win For Life online game, with sales beginning February 26, 2006 for the initial draw on March 1, 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation—The GLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or (2) where the periodic determination of net income is considered appropriate.

Basis of Accounting—The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”). Under this method, revenues are recognized when earned and expenses are recognized and recorded when a liability is incurred, regardless of the timing of cash flows. In accordance with Statement of Governmental Accounting Standards (“SGAS”) No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the GLC is required to follow all applicable Governmental Accounting Standards Board (“GASB”) pronouncements, and has elected not to follow any pronouncements of the Financial Accounting Standards Board subsequent to November 30, 1989.

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

Revenue Recognition—Lottery games are sold to the public by contracted retailers. Revenue is recognized for online games when tickets are sold to players and the related draw has occurred. Revenue is recognized for instant games when the product is made available for sale to the public, which is based on ticket activations by the retailers. Certain games include free tickets, which entitle the holder to exchange one ticket for another of equal value. The selling price of free tickets reduces ticket revenue when the prize is claimed by a player.

Revenue and Expenses—Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues generally result from providing services in connection with a proprietary fund’s principal ongoing operations. The principal operating revenues of the Georgia Lottery Corporation’s enterprise fund are primarily revenues from ticket sales and online fees. “Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.” All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal nonoperating revenues and expenses of the Georgia Lottery Corporation’s enterprise fund are primarily interest income revenue, payments to and due to the Lottery for Education Account (an expense), and the net increase (revenue) or decrease (expense) in the fair value of grand prize investments.

Commissions and Bonuses—Retailers receive a commission of 5% on ticket sales, except for Cash 3 sales, on which retailers receive a commission of 7%, and a 2% cashing bonus on all ticket validations at their location. In addition, retailers receive bonuses for selling winning jackpot tickets for Lotto South, Win For Life, Fantasy 5, and Mega Millions. Four instant ticket games were introduced during 2006 and 2005 with a retailer sales commission of 10%.

Contractor Fees—The GLC has contracted with three vendors for the majority of the gaming systems and supplies.

The GLC entered into a seven-year vendor contract effective September 7, 2003, with GTECH Corporation (“GTECH”) for the operation of the gaming network that consists of over 7,700 instant and online retailer ticket terminals and associated software. Under the contract, GTECH receives a fee of 1.28% of net ticket revenue.

The GLC entered into a seven-year vendor contract effective September 7, 2003, with Scientific Games, Inc. for the printing and distribution of instant game tickets. Scientific Games, Inc. receives a fee of 1.2875% of net instant game tickets distributed to retailers.

The GLC entered into a vendor contract effective January 27, 2006, with Pollard Banknote Limited Partnership (“Pollard”) for the printing of various instant game tickets for which the vendor has exclusive rights. Pollard receives a fee based on the quantity of instant tickets printed. The contract continues until June 30, 2011, unless terminated upon a sixty-day written notice by either the GLC or Pollard. During fiscal year 2006, Pollard printed a \$2 *Bingo* instant game for the GLC.

Prizes—In accordance with the Act, as nearly as practical, at least 45% of ticket sales must be returned to the public in the form of prizes. Prize expense for instant games is recognized based on the predetermined prize structure for each game. Generally, prize expense for Cash 3, Cash 4, Mega Millions, Keno, and the Win For Life online game is recognized based on the estimated payout experience over the life of the games or the industry averages. Prize expense for Lotto South and Fantasy 5 is recorded on a pari-mutuel basis according to the game structure based on a percentage of revenue recognized.

Mega Millions, Lotto South, and the Win For Life online game are multi-state lottery games operated by member lotteries. The Mega Millions, Lotto South, and Win For Life prizes are shared based on contributions to the prize pools by the member lotteries. Grand prize investments for jackpot winners who purchased tickets in Georgia are held by the GLC.

The Powerball grand prize is a shared prize from contributions to the prize pool by all member lotteries of the Multi-State Lottery Association (“MUSL”). All Powerball grand prizes won by players who purchased tickets in Georgia are funded by investments purchased by MUSL. The investments are held by MUSL in trust for the GLC and are paid in 20 annual installments. Investments of \$8,785,000 and \$10,026,000 included in the GLC’s grand prize investments in the statements of net assets at June 30, 2006 and 2005, respectively, were held by MUSL in trust. The GLC withdrew from MUSL on August 31, 1996.

Unclaimed Prizes—Prizes must be claimed no later than 90 days after game-end for instant games and within 180 days after the draw date for online games. An estimate of the unclaimed prizes is based upon the historical experience rate as a percentage of ticket sales. In accordance with the Act, \$200,000 of unclaimed prizes must be transferred to the Department of Human Resources for the treatment of compulsive gambling and related educational programs. Transfers for this purpose for each fiscal year have been \$200,000. The remainder of unclaimed prizes is used to fund future prizes or special prize promotions, as defined by the statute.

Net Assets—Net assets represent cumulative revenues less expenses in excess of net proceeds transferred to the Lottery for Education Account, as defined under the Act (see Note 7). Net assets include funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds as required by the Act and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. Grand prize investments are purchased to finance future payments to Lotto South, Win For Life, Mega Millions, and certain instant game grand prize winners. Any increases or decreases in the fair value of these investments are determined to be unrealized and will not affect (i) the future ability to hold these investments or (ii) the amount of funds available for distribution to the Lottery for Education Account. Unrealized gains and losses on grand prize investments at June 30, 2006 and 2005, were \$(2,338,000) and \$13,066,000, respectively.

Cash and Cash Equivalents—The GLC considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash, and balances on account in Georgia Fund 1.

Retailer Accounts Receivable—Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions, cashing bonuses, and prizes paid by the retailers. Lottery proceeds are collected weekly from retailer bank accounts held in trust for the GLC. An allowance for doubtful accounts is established based on management’s estimate of retailer receivables that will not be collected. At June 30, 2006 and 2005, the allowance for uncollectible retailer receivables was \$2,195,000 and \$1,939,000, respectively.

Capital Assets—Capital assets are stated at cost less accumulated depreciation. Depreciation on capital assets is computed using the straight-line method over the estimated useful lives of three to ten years. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

Fidelity Fund—In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a GLC retailer. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. At the end of each year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the GLC subject to transfer to the Lottery for Education Account. There were no fidelity funds available for transfer as net proceeds for the years ended June 30, 2006 and 2005. The fidelity fund proceeds are held in a separate account and are presented in the statements of net assets as restricted fidelity fund cash and in liabilities as restricted fidelity funds

Retailer Escrow Fund—Retailers pledge cash deposits to an escrow funds management service offered by a commercial bank selected by the GLC. This is one of the acceptable forms of Financial Security Deposits from Retailers pursuant to Section 19 of the Georgia Lottery for Education Act, Chapter 2 of the GLC Policies entitled ‘Retailer Rules and Regulations’, and Chapter 8.2 of the GLC Policies entitled ‘Retailer Credit and Financial Security Policy’, and appropriate Executive Orders. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. The retailers’ escrow funds are not subject to transfer to the Lottery for Education Account. The retailer escrow fund proceeds are held in a separate account and are presented in the statements of net assets as restricted retailer escrow fund cash and in liabilities as restricted retailer escrow funds.

Compensated Absences—Employees earn the right to be compensated during absences for vacation and illness. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and vested sick leave benefits is accrued in the period in which it was earned. In March 2005, the GLC adopted a new policy concerning payments of accrued sick leave upon termination. Sick leave accrued by employees prior to March 1, 2005, and not used prior to termination is paid at a 50% rate upon termination. No payments will be made for sick leave accrued after March 1, 2005, and not used by the employee before termination.

Budget—Georgia Statute requires the GLC to submit to the Office of Planning and Budget (“OPB”) and the State Auditor, annually by June 30, a proposed operating budget for the next fiscal year. Additionally, the GLC is required to submit to the OPB annually, on September 1, a proposed operating budget for the GLC and an estimate of net proceeds for the succeeding fiscal year. The GLC complied with these requirements in 2006 and 2005.

Future Accounting Pronouncements—The Government Accounting Standards Board (“GASB”) issued Statement of Governmental Accounting Standard (“SGAS”) No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries*. SGAS No. 42 was adopted effective July 1, 2005, and did not have a material impact on the financial statements of the GLC.

In August 2004, GASB issued SGAS No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and establishes accounting and financial reporting standards for employer costs and obligations related to postemployment health care and other nonpension benefits (“OPEB”). This statement generally requires that state and local governmental employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The provisions of SGAS No. 45 may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. The earliest that SGAS No. 45 provisions will be effective is for financial statement periods beginning after December 15, 2006. GLC management has not yet determined the impact that implementation of SGAS No. 45 will have on the GLC’s financial statements.

3. CASH, CASH EQUIVALENTS, AND GRAND PRIZE INVESTMENTS

During the year ended June 30, 2005, the GLC adopted the provisions of SGAS No. 40, *Deposit and Investment Risk Disclosures*, which amends SGAS No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, which recognizes that deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This statement establishes and modifies disclosure requirements related to investment and deposit risks; accordingly, the GLC's note disclosures on cash, cash equivalents, and investments are in conformity with the provisions of SGAS No. 40. Following "exception-based reporting," the GLC is not required to disclose risks that do not apply to it.

Cash—Cash is held in demand deposits at various financial institutions. The majority of the GLC's daily operating cash is held in a master operating account with Bank of America. Other miscellaneous cash accounts for accounts payable, prizes payable, retailer return items, district offices, promotions, payroll, and petty cash are held in accounts with Bank of America, except for the Columbus district office account which is held with SunTrust Bank. At June 30, 2006, the GLC's Master Operating Account had a book balance of \$3,839,000 and a bank balance of \$3,851,000. At June 30, 2006, the other miscellaneous accounts had a bank balance of \$57,000 and net book balance of (\$2,411,000) which was primarily due to outstanding checks for the accounts payable and prize check zero balance cash accounts. These accounts are funded through automatic transfers from the master operating cash account as checks are presented for payment by the payee. The net carrying value and bank balance of all GLC cash accounts were \$1,428,000 and \$3,908,000. These deposits were entirely insured by FDIC insurance or collateralized by investment securities held by the GLC's agent in the GLC's name.

Cash Equivalents—Cash equivalents represent surplus cash invested in Georgia Fund 1 administered by the State of Georgia's Office of Treasury and Fiscal Services (OTFS). The voluntary fund is a short-term investment vehicle that is available for use by state entities and local governments. Georgia Fund 1 invests its assets in U.S. Treasury bills, U.S. Treasury notes, securities issued by federal agencies and instrumentalities, banker's acceptances, and repurchase agreements.

The Georgia Fund 1 is an external investment pool that is not registered with the Securities and Exchange Commission (SEC), but does operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. The OTFS manages Georgia Fund 1 in accordance with policies and procedures established by state law and the State Depository Board, the oversight Board for OTFS. This investment is valued at the pool's share price, \$1.00 per share. The Georgia Fund 1 is an AAAM rated investment pool by Standard & Poor's, and the portfolio's weighted average maturity is twenty-eight days. Under SGAS No. 40, since these funds represent an externally managed pool it is not exposed to custodial credit risk, and therefore, no custodial credit risk disclosures are required. The GLC's investment in Georgia Fund 1 was approximately \$181,015,000 and \$155,876,000 at June 30, 2006 and 2005, respectively. Interest earned on the GLC's investments was approximately \$4,558,000 and \$2,200,000 for the years ended June 30, 2006 and 2005, respectively.

Other Deposits—Cash maintained in the Retailer Escrow Fund bank account had a book balance and bank balance of \$526,000 as of June 30, 2006. Cash maintained in the Fidelity Fund bank account has a bank and book balance of \$483,000 and \$494,000, respectively, as of June 30, 2006. The Retailer Escrow Fund and Fidelity Fund accounts were maintained with Bank of America, and Carver State Bank, respectively, and both accounts were entirely insured by FDIC insurance or collateralized by investment securities held by the GLC's agent in the GLC's name.

Grand Prize Investments—All grand prize investments represent funds held to pay grand prize winners who are entitled to multiyear payments. Grand prize investments are recorded at their fair values. Increases or decreases in the fair value of these investments is recorded as nonoperating revenue (expense).

Grand prize investments at June 30, 2006 and 2005, consist of the following:

| | <u>Fair Value</u> | |
|--------------------------|----------------------|----------------------|
| | <u>2006</u> | <u>2005</u> |
| U.S. Treasury securities | \$188,205,000 | \$208,496,000 |
| Government agencies | <u>8,785,000</u> | <u>9,928,000</u> |
| | <u>\$196,990,000</u> | <u>\$218,424,000</u> |

Grand prize investments are not presented as current assets, as they are not part of the GLC's current operations.

Changes in grand prize investments for the years ended June 30, 2006 and 2005, consisted of the following:

| | |
|--|-----------------------|
| Fair value—June 30, 2004 | \$ 213,168,000 |
| Purchases | 11,500,000 |
| Payments to grand prize winners | (22,862,000) |
| Investments sold | - |
| Interest earned on current-year maturities | 11,505,000 |
| Change in fair value | <u>5,113,000</u> |
| Fair value—June 30, 2005 | 218,424,000 |
| Purchases | 8,485,000 |
| Payments to grand prize winners | (23,512,000) |
| Investments sold | (2,125,000) |
| Interest earned on current-year maturities | 11,123,000 |
| Change in fair value | <u>(15,405,000)</u> |
| Fair value—June 30, 2006 | <u>\$ 196,990,000</u> |

Custodial credit risk for Deposits—Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. State statutes require all deposits and investments (other than federal or state government instruments) to be collateralized by depository insurance, obligations of the U.S. government, or bonds of public authorities, counties, or municipalities. As of June 30, 2006, all deposits are considered insured.

Investments—The GLC's investments consist of U.S. Treasury Strips (principal and interest) that are held to maturity to fund grand prize winners for Lotto Georgia, The Big Game, Lotto South, and various Instant Games with annuity prizes such as Win For Life. In addition, MUSL (Multistate Lottery Association) holds U.S. government agency securities on behalf of the GLC that are held to maturity to fund Georgia's two Powerball grand prize winners. At June 30, 2006, the GLC's investment balances consisted of:

| <u>Investment Type</u> | <u>Fair Value</u> | <u>Maturity</u> |
|-------------------------|----------------------|--|
| U.S Treasury Strips | \$188,205,000 | Weighted average maturity of 5.6 years |
| U.S Government Agencies | <u>\$8,785,000</u> | Weighted average maturity of 4.7 years |
| Total | <u>\$196,990,000</u> | |

U.S Treasury Strips held by the GLC are AAA-rated and current holdings mature quarterly beginning August 2006 through August 2029. U.S. government agency securities held for the GLC by MUSL are AAA-rated with maturities each year in September and May through the year 2015.

Interest Rate Risk—The GLC’s deposits in the master operating account with Bank of America are subject to fluctuations in short-term interest rates. The GLC purchases investments to fund future prize payments at fixed amounts for grand prize winner obligations, as detailed in Note 5, Grand Prizes Payable. Periodic market fluctuations affect the fair value of grand prize investments. The GLC expects to hold grand prize investments to maturity to meet future grand prize payments and, therefore will not realize any gains or losses related to the changes in the market. The only exposure that the GLC has in regards to interest rate sensitivity is for the GLC’s master operating account, since there is no investment related impact on the GLC resulting from the effect of interest rate changes on grand prize investments.

Credit Risk—State laws limit the investment sources available to the GLC to United States Treasury securities, federal agency securities, state of Georgia securities, repurchase or reverse repurchase agreements, bank certificates of deposits, Georgia Fund 1, life insurance annuity contracts, and investments that would be permissible for the legal reserves of domestic life insurance companies under the laws of the state of Georgia.

Custodial Credit Risk—For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the GLC will not be able to recover the value of its investments in the possession of an outside party. The GLC’s investments in U.S. Treasury Strips include strips with a fair value of \$55,711,000 that were purchased from Bank of America and are also held by Bank of America in a safekeeping account on the behalf of the GLC.

4. CAPITAL ASSETS

Capital assets at June 30, 2006 and 2005, consisted of the following:

| | Balance at June 30, 2005 | Increases | Decreases | Balance at June 30, 2006 |
|--|-------------------------------------|--------------------|-------------------|-------------------------------------|
| Capital assets: | | | | |
| Furniture and fixtures | \$ 2,511,000 | \$ 20,000 | \$ - | \$ 2,531,000 |
| Computer and communications equipment | 7,865,000 | 708,000 | (118,000) | 8,455,000 |
| Vehicles | 2,247,000 | 388,000 | (36,000) | 2,599,000 |
| Leasehold improvements | 2,396,000 | 210,000 | - | 2,606,000 |
| Software | 437,000 | 694,000 | - | 1,131,000 |
| Other assets | <u>1,396,000</u> | <u>2,000</u> | <u>-</u> | <u>1,398,000</u> |
| Total capital assets at historical cost | 16,852,000 | 2,022,000 | (154,000) | 18,720,000 |
| Less accumulated depreciation | <u>(14,647,000)</u> | <u>(863,000)</u> | <u>145,000</u> | <u>(15,365,000)</u> |
| Capital assets—net | <u>\$ 2,205,000</u> | <u>\$1,159,000</u> | <u>\$ (9,000)</u> | <u>\$ 3,355,000</u> |

| | Balance at June 30, 2004 | Increases | Decreases | Balance at June 30, 2005 |
|--|-------------------------------------|-------------------|------------------|-------------------------------------|
| Capital assets: | | | | |
| Furniture and fixtures | \$ 2,487,000 | \$ 24,000 | \$ - | \$ 2,511,000 |
| Computer and communications equipment | 7,276,000 | 848,000 | (259,000) | 7,865,000 |
| Vehicles | 2,195,000 | 338,000 | (286,000) | 2,247,000 |
| Leasehold improvements | 2,365,000 | 31,000 | - | 2,396,000 |
| Software | 392,000 | 45,000 | - | 437,000 |
| Other assets | <u>1,368,000</u> | <u>28,000</u> | <u>-</u> | <u>1,396,000</u> |
| Total capital assets at historical cost | 16,083,000 | 1,314,000 | (545,000) | 16,852,000 |
| Less accumulated depreciation | <u>(14,262,000)</u> | <u>(930,000)</u> | <u>545,000</u> | <u>(14,647,000)</u> |
| Capital assets—net | <u>\$ 1,821,000</u> | <u>\$ 384,000</u> | <u>\$ -</u> | <u>\$ 2,205,000</u> |

5. GRAND PRIZES PAYABLE

Grand prizes payable is recorded at the net present value of the U.S. Treasury securities purchased for each jackpot winner. Grand prizes payable was accreted by approximately \$11,123,000 and \$11,505,000 for the years ended June 30, 2006 and 2005, respectively. Grand prizes payable are not presented as current liabilities, as they are not part of the GLC's current operations.

Future payments of grand prizes payable at June 30, 2006, are scheduled as follows:

| | |
|---|----------------------|
| 2007 | \$ 23,993,000 |
| 2008 | 23,944,000 |
| 2009 | 23,943,000 |
| 2010 | 23,944,000 |
| 2011 | 23,943,000 |
| 2012–2016 | 96,155,000 |
| 2017–2021 | 21,600,000 |
| 2022–2026 | 15,395,000 |
| 2027–2031 | 13,109,000 |
| 2032–2036 | 4,900,000 |
| 2037–2041 | <u>508,000</u> |
| | 271,434,000 |
| Less imputed interest | <u>(72,149,000)</u> |
| Net present value of grand prizes payable | <u>\$199,285,000</u> |

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (the "Omnibus Act") was enacted into federal law on October 21, 1998. Included in this Omnibus Act is a Special Rule for Cash Options for Receipt of Qualified Prizes ("Special Rule"). Pursuant to the Special Rule, the GLC may extend to recipients of "qualified prizes" the opportunity, within a certain period after the drawing, to select a lump-sum payment equivalent to the cash value of an annuitized prize. Qualified prizes, as defined in the Omnibus Act, include multiple-year payments of a minimum of ten years.

Claimants of qualified prizes, as defined in the GLC Rules and Regulations, on or after the date of enactment of the Omnibus Act, can make an irrevocable election to receive a lump-sum cash payment equivalent of the annuitized prize within 60 days of the claim date. Grand prizes payable at June 30, 2006, consist of no qualified prizes under this provision of the Special Rule.

6. OPERATING LEASES

The GLC has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the GLC.

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

| Year Ending June 30, | Operating Leases |
|---------------------------------|-----------------------------|
| 2007 | \$ 2,004,000 |
| 2008 | 2,286,000 |
| 2009 | 2,049,000 |
| 2010 | 2,049,000 |
| 2011 | 2,049,000 |
| 2012–2014 | <u>6,048,000</u> |
| | 16,485,000 |
| Less sublease revenues | <u>(1,879,000)</u> |
| Total | <u>\$14,606,000</u> |

Rental expense under all operating leases totaled approximately \$1,924,000 and \$2,072,000 for the years ended June 30, 2006 and 2005, respectively.

7. DUE TO LOTTERY FOR EDUCATION ACCOUNT

In accordance with the Act, all net proceeds of the GLC are due to the Lottery for Education Account within the state of Georgia Treasury. Net proceeds is defined under the Act as “all revenue derived from the sale of lottery tickets or shares and all other monies derived from the GLC less operating expenses.” Any unrealized gain or loss resulting from changes in fair value of grand prize investments does not represent funds received from GLC operations and is excluded from determination of “net proceeds.”

“Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.”

Net proceeds and operating expenses for the years ended June 30, 2006 and 2005, are summarized as follows:

| | <u>2006</u> | <u>2005</u> |
|---|-----------------------|-----------------------|
| Operating revenues: | | |
| Ticket sales | \$ 3,177,596,000 | \$ 2,922,332,000 |
| Less tickets provided as prizes | (222,251,000) | (187,953,000) |
| Less sales return allowance | <u>32,000</u> | <u>(32,000)</u> |
| Net ticket sales | 2,955,377,000 | 2,734,347,000 |
| Online fees and other revenues | 4,869,000 | 4,702,000 |
| Interest revenue and other | <u>4,558,000</u> | <u>2,357,000</u> |
| GLC proceeds | <u>2,964,804,000</u> | <u>2,741,406,000</u> |
| Operating expenses—as defined: | | |
| Gaming | 2,117,336,000 | 1,913,031,000 |
| Operating | 27,602,000 | 24,621,000 |
| Other | <u>2,222,000</u> | <u>1,514,000</u> |
| Total operating expenses—as defined | <u>2,147,160,000</u> | <u>1,939,166,000</u> |
| Net proceeds before distribution of unrestricted net assets | <u>817,644,000</u> | <u>802,240,000</u> |
| Other: | | |
| Funds resulting from current year capital purchases | 2,022,000 | - |
| Funds resulting from previous years' capital purchases | 2,133,000 | - |
| Funds for current year compulsive gambling education and treatment | 200,000 | - |
| Funds for previous years' compulsive gambling education and treatment | <u>400,000</u> | <u>-</u> |
| Total other | <u>4,755,000</u> | <u>-</u> |
| Net proceeds subject to transfer | <u>\$ 822,399,000</u> | <u>\$ 802,240,000</u> |
| Amount due to Lottery for Education Account for year | \$ 822,399,000 | \$ 802,240,000 |
| Amount paid during year | <u>(622,305,000)</u> | <u>(599,514,000)</u> |
| Amount due to Lottery for Education Account— End of year | <u>\$ 200,094,000</u> | <u>\$ 202,726,000</u> |

8. EMPLOYEE BENEFITS

401(k) Defined Contribution Plan—Effective July 1, 1998, House Bill 441 was enacted into law, allowing the Georgia Lottery Corporation to participate in the Deferred Compensation Plan offered by the state of Georgia for public employees pursuant to Section 401(k) of the Internal Revenue Code.

There were 182 GLC employees participating in the 401(k) plan at June 30, 2006. For the years ended June 30, 2006 and 2005, GLC contributed \$852,000 and \$331,000, respectively, to the plan. During the year ended June 30, 2005, the GLC did not have to pay any employer contributions from December 2004 to June 2005 due to an employer contribution holiday being granted by the state of Georgia as the payments for those months were funded from plan forfeitures. Total employer contributions funded from plan forfeitures for the year ended June 30, 2005 was \$485,000. Contributions by plan participants during fiscal years ended June 30, 2006 and 2005, were \$564,000 and \$533,000, respectively. For the years ended June 30, 2006 and 2005, the GLC paid \$3,000 of plan administrative fees, on behalf of GLC employees.

457 Deferred Compensation Plan—Beginning in December 1994, the GLC offered its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all full-time employees at their option, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency.

Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Service Code to provide that all assets and income under a Section 457(b) plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. Nationwide Retirement Solutions is the custodian of the plan's assets. As of June 30, 2006 and 2005, the fair value of the plan's assets was \$1,577,000 and \$1,397,000, respectively. Contributions by participants during the years ended June 30, 2006 and 2005, were \$142,000 and \$124,000, respectively.

Compensated Absences—At June 30, 2006 and 2005, the balance for compensated absences was \$1,963,000 and \$1,833,000, respectively. The year-end balances are comprised of earned and unused vacation and sick leave hours. At separation, employees are compensated for all earned vacation and any remaining sick leave hours accrued prior to March 1, 2005. Increases to the compensated absences balance represent vacation and sick leave hours earned by employees and decreases represent their usage of leave. During the year ended June 30, 2006, employees earned and used leave totaling \$973,000 and \$843,000, respectively. The current portion of the compensated absence liability, expected to be due within one year of the statement date, June 30, 2006, is estimated using historical trends. At June 30, 2006 and 2005, the estimated current portion of the compensated absences liability was \$218,000 and \$222,000, respectively.

9. CONTINGENCIES

The GLC is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the GLC.

10. RISK MANAGEMENT

The GLC is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and injuries to employees. The GLC obtains umbrella insurance coverage for property, liability, vehicle fleet, workers' compensation, and unemployment compensation through the State of Georgia's Department of Administrative Services ("DOAS"). The GLC purchases commercial insurance coverage for property and liability for the Augusta, Dalton, and Savannah District Offices, and the Thomasville Claim Office. Property and liability insurance for the Columbus, Duluth, and Macon District Offices, and GLC Headquarters are included in the related lease agreements. The GLC purchased additional commercial insurance for certain company-owned vehicles. DOAS, as a component of the State of Georgia, utilizes self-insurance programs established by individual agreement, statute or administrative action to provide property insurance covering fire and extended coverage and automobile insurance and to pay losses that might occur from such causes; liability insurance for employees against personal liability for damages arising out of performance of their duties; survivors' benefits for eligible members of the Employees' Retirement System; consolidating processing of unemployment compensation claims against state agencies and the payment of sums due to the Department of Labor; and workers' compensation statutes of the State of Georgia. These self-insurance funds are accounted for as internal service funds of the State of Georgia where assets are set aside for claim settlements. The majority of the risk management programs are funded by assessments charged to participating organizations. A limited amount of commercial insurance is purchased by the self-insurance funds applicable to property, employee and automobile liability, fidelity and certain other risks to limit the exposure to catastrophic losses. Otherwise, the risk management programs service all claims against the state for injuries and property damage.

Financial information relative to self-insurance funds is presented in the financial reports of the Department of Administrative Services and the Employees' Retirement System for the years ended June 30, 2006 and 2005.

Annually, the GLC negotiates and currently contracts with Blue Cross Blue Shield of Georgia for its employee health insurance coverage and Genworth Financial for dental, short-term disability, long-term disability, and term life insurance coverage. The GLC's health and dental insurance plans are funded by contributions from plan participants and by GLC employer contributions.



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