



ANNUAL FINANCIAL REPORT FOR THE
YEAR ENDED AUGUST 31, 2007 AND
INDEPENDENT AUDITORS' REPORT

TEXAS LOTTERY COMMISSION

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James A. Cox, Jr.
Chairman

C. Tom Clowe, Jr.
Commissioner



TEXAS LOTTERY COMMISSION

Anthony J. Sadberry, *Executive Director*

Philip D. Sanderson, *Charitable Bingo Operations Director*

December 20, 2007

Honorable Rick Perry, Governor
Honorable Susan B. Combs, Texas Comptroller
John O'Brien, Director, Legislative Budget Board
John Keel, CPA, State Auditor

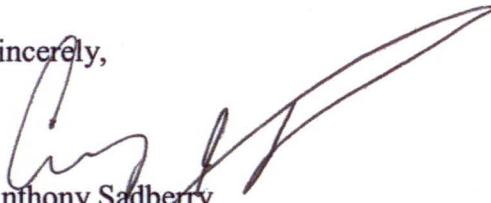
Lady and Gentlemen:

We are pleased to submit the Annual Financial Report of the Texas Lottery Commission for the year ended August 31, 2007, in compliance with TEX.GOV'T CODE ANN §2101.011 and in accordance with the requirements established by the Comptroller of Public Accounts.

The accompanying annual financial report has been prepared in accordance with GAAP reporting requirements. The financial report has been audited by an independent Auditor as required by statute.

If you have any questions, please contact Kathy Pyka, Controller, at 344-5410.

Sincerely,



Anthony Sadberry
Executive Director

P.O. Box 16630 • Austin, Texas 78761-6630

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TEXAS LOTTERY COMMISSION

FINANCIAL SECTION

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INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners of the
Texas Lottery Commission:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Texas Lottery Commission (the "Commission"), an agency of the State of Texas, as of and for the year ended August 31, 2007, which collectively comprise the Commission's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express opinions on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Commission's 2006 financial statements that were audited by other auditors whose report dated December 18, 2006, expressed unqualified opinions on the respective financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Commission as of August 31, 2007, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Affiliated Companies

ML&R PERSONNEL SOLUTIONS LLC

"The Resource for Direct Hire & Project Staffing"

ML&R WEALTH MANAGEMENT LLC

"A Registered Investment Advisor"

This firm is not a CPA firm

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2007, on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages 7 through 14 and 57 through 58, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commission's basic financial statements. The combining financial statement is presented for purposes of additional analysis and is not a required part of the basic financial statements. The combining financial statement has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Maywell Locke & Ritter LLP

December 14, 2007

Texas Lottery Commission
Management's Discussion and Analysis
For the Year Ended August 31, 2007
(Unaudited)

This section of the Texas Lottery Commission's (Commission) annual financial report presents a comparative discussion and analysis of the Commissions' financial performance for the fiscal year ended August 31, 2007, with summarized comparative totals for the year ended August 31, 2006. This analysis is to be considered in conjunction with the transmittal letter at the front of this report and the Commission's basic financial statements to provide an objective analysis of the Commission's financial activities based on facts, decisions, and conditions currently facing management.

Financial Highlights

Government-wide:

- The assets of the Commission exceeded its liabilities at the close of fiscal year 2007 by \$37 million (reported as *net* assets), an increase of \$3.5 million from the previous fiscal year.

Fund Level:

- As of the close of fiscal year 2007, the Commission's governmental funds reported a combined ending fund balance of \$.6 million, all of which is *unreserved fund balance*. This amount in fund balance reflects a decrease of \$.9 million from fiscal year 2006.
- The proprietary funds reported net assets at year-end 2007 of \$36.7 million, an increase of \$4.4 million during the year.

More detailed information regarding these activities and funds begins on page 20.

Understanding the Commission's Financial Statements

This discussion and analysis is an introduction to the Commission's basic financial statements, which are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the basic financial statements. This report also contains other supplementary information in addition to the basic financial statements.

Government-wide Statements (Reporting the Commission as a whole)

The Statement of Net Assets and the Statement of Activities are two financial statements that report information about the Commission, as a whole, and about its activities that should help answer this question: Is the Commission more (or less) effective in achieving its defined objective? These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current fiscal year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Net Assets on page 17 presents all of the Commission's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets measure whether the Commission's financial position is improving or deteriorating.

The Statement of Activities on page 18 presents information showing how the Commission's net assets changed during fiscal year 2007. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will result in changes in cash flows in future fiscal periods (e.g. earned but unused compensatory leave).

Both statements report two activities:

- *Governmental Activities* – The Commission's Charitable Bingo Operations Division is reported under this category. Intergovernmental revenues and service fees are the only source of funding for these services.
- *Business-type Activities* – The Commission's operations are accounted for under this category. Sales of lottery tickets and fees charged to retailers provide funding for the business-type activities. The primary focus of business-type activities is to generate revenue for the State's Foundation School Fund, rather than the change in net assets of the Commission.

This report includes two schedules (pages 21 and 23) that reconcile the amounts reported on the governmental fund financial statements (modified accrual accounting) with governmental activities (accrual accounting) on the appropriate government-wide statements. The following summarizes the impact of transitioning from modified accrual to full accrual accounting:

- Capital assets used in governmental activities are not reported on governmental fund statements.
- Unless due and payable, long-term liabilities such as compensated absences only appear as liabilities in the government-wide statements.
- Capital outlay spending results in capital assets on the government-wide statements, but are reported as expenditures on the governmental fund statements.
- Certain other outflows represent either increases or decreases in liabilities on the government-wide statements, but are reported as expenditures on the governmental fund statements.

The Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found beginning on page 35 of this report.

Fund Financial Statements (Reporting the Commission's Major Funds)

Because the Commission operates with few funds, management determined that, for fair presentation, all funds except for the fiduciary funds would be considered major. The fund financial statements begin on page 20 and provide detailed information about all the individual funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the Commission uses to keep track of specific sources of funding and spending for a particular purpose. The Commission's funds are divided into three categories: governmental, proprietary, and fiduciary; and use different accounting methods.

- *Governmental funds* – The Commission's Charitable Bingo Operations Division and its services are reported in the governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for future spending. The governmental fund financial statements provide a detailed short-term view of the Commission's Charitable Bingo Operation Division operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance Charitable Bingo programs. These funds are reported using modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. Governmental funds include the General Fund and the General Fund Consolidated Account.
- *Proprietary funds* – Proprietary funds utilize accrual accounting - the same method used by private sector businesses. There are two types of proprietary funds. Enterprise funds report activities that provide supplies and services to the general public. Internal service funds report activities that

provide supplies and service for the governments other programs and activities. The Commission records all transactions related to the operation of the State Lottery and its investment activities in Enterprise Funds.

- *Fiduciary funds* – The Commission acts as a trustee or fiduciary for its Employee Savings Bond Account, Direct Deposit Correction Account and Suspense Fund. The Commission's fiduciary activities are reported in separate Statements of Fiduciary Assets and Liabilities and Changes in Fiduciary Net Assets beginning on page 31, and 61 and 62, respectively. These funds, which include agency funds, are reported using accrual accounting. The government-wide statements exclude fiduciary fund activities and balances because these assets are restricted in purpose and do not represent discretionary assets of the Commission to finance its operations.

Additional Required Supplementary Information

Following the basic financial statements is additional Required Supplementary Information that further explains and supports the information in the financial statements. The Required Supplementary Information includes a budgetary comparison schedule reconciling the statutory and generally accepted accounting principles (GAAP) fund balances at fiscal year-end for the General Fund.

Financial Analysis of the Government as a Whole

Statement of Net Assets (in millions)

	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Totals</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Current and other non-current Assets	\$ 28.56	\$ 1.78	\$ 1,491.08	\$ 1,436.40	\$ 1,519.64	\$ 1,438.18
Capital Assets	-	-	0.65	0.75	0.65	0.75
Totals Assets	28.56	1.78	1,491.73	1,437.15	1,520.29	1,438.93
Long-term liabilities	0.12	0.11	1,086.75	1,106.02	1,086.87	1,106.13
Other liabilities	28.10	0.43	368.31	298.89	396.41	299.32
Total Liabilities	28.22	0.54	1,455.06	1,404.91	1,483.28	1,405.45
Net Assets:						
Invested in capital assets, net of related debt	-	-	0.65	0.75	0.65	0.75
Restricted	-	-	16.84	18.84	16.84	18.84
Unrestricted	0.34	1.24	19.18	12.65	19.52	13.89
Total Net Assets	0.34	1.24	36.67	32.24	37.01	33.48

The largest component – 52.7% of the Commission's net assets - is comprised of **unrestricted net assets** of \$19.52 million, which may be used at the Commission's discretion, but often have limitations on use based on State statutes. **Restricted net assets** are the next largest component, comprising 45.5%. These net assets represent resources that are subject to external restrictions, constitutional provisions, or enabling legislation on how they can be used. The remaining portion represents the amount invested in capital assets, net of related debt. The Commission uses these capital assets to provide services; consequently, these assets are *not* available for future spending.

The majority of the Commission's assets consist of cash, cash equivalents and investments used to fund future installment payments. At August 31, 2007, the Commission's assets included \$100.6 million in cash and cash equivalents as compared with \$126.3 million at August 31, 2006. The Commission's short and long-term investments approximated \$1,276.8 and \$1,275.3 million, respectively, at August 31, 2007 and 2006.

The Commission's liabilities included at the balance sheet date are amounts owed to the State's Foundation School Fund for unspent administrative funds for fiscal year 2007, vendor payables, and prize payment obligations. The amount due to the Foundation School Fund was approximately \$17.5 million at August 31, 2007 as compared with \$15.3 million at August 31, 2006. Prize obligations, made up largely of instant ticket games and *Lotto Texas* installment payments, were \$1,406.3 million and \$1,358.7 million at August 31, 2007 and 2006, respectively. Vendor payables were \$27.64 million at August 31, 2007 as compared to \$27.7 million at August 31, 2006. Other payable balances totaled \$31.6 million and \$3.6 million, at August 31, 2007 and 2006, respectively.

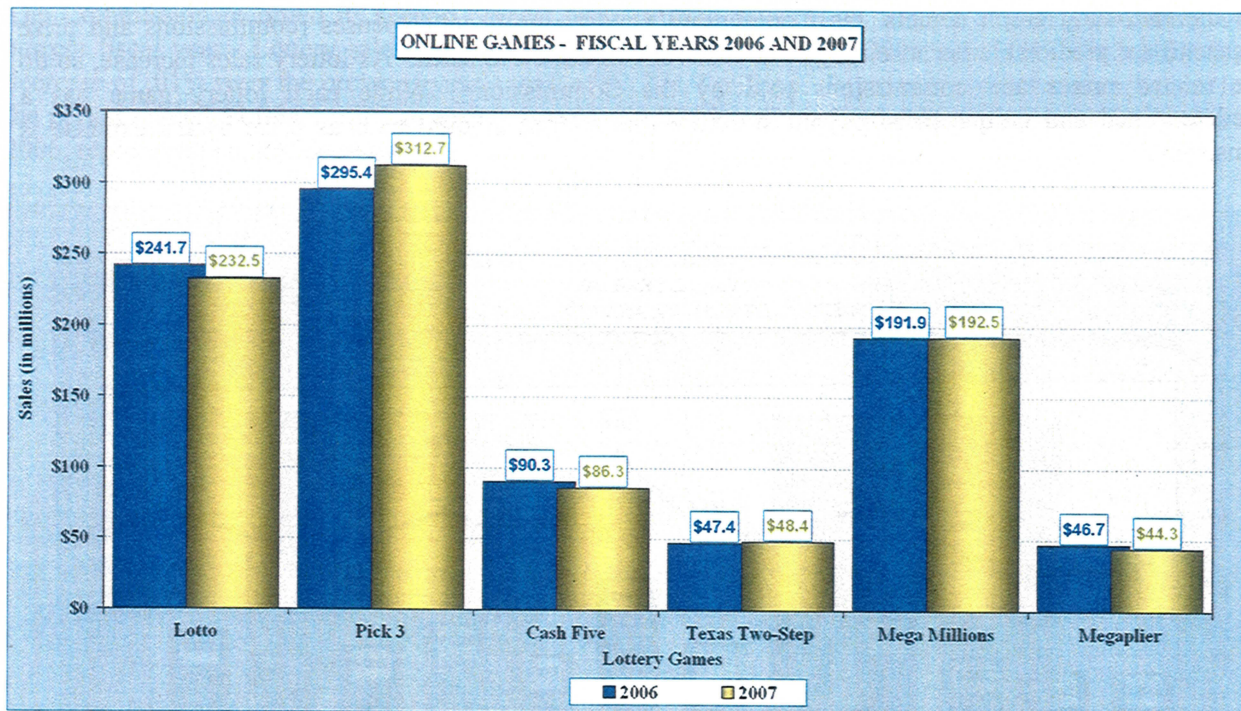
The majority of the Commission's assets represent current resources necessary to pay the current liabilities owed to vendors, prizewinners, and ultimately the State's Foundation School Fund.

Statement of Activities and Changes in Net Assets (in millions)

	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Program Revenue - Lottery Sales	\$ -	\$ -	\$ 3,774.18	\$ 3,774.69	\$ 3,774.18	\$ 3,774.69
General Revenue:						
Intergovernmental	3.16	3.14	-	-	3.16	3.14
Other income (loss)	11.69	11.84	14.48	1.43	26.17	13.27
Total Revenue	14.85	14.98	3,788.66	3,776.12	3,803.51	3,791.10
Program Expense:						
Prize expense	-	-	(2,315.30)	(2,310.56)	(2,315.30)	(2,310.56)
Commissions	-	-	(188.75)	(188.82)	(188.75)	(188.82)
Operating and other expense	(15.75)	(14.60)	(1,280.18)	(1,336.69)	(1,295.93)	(1,351.29)
Total Expense	(15.75)	(14.60)	(3,784.23)	(3,836.07)	(3,799.98)	(3,850.67)
Change in net assets	(0.90)	0.38	4.43	(59.95)	3.53	(59.57)
Beginning net assets,	1.24	(0.03)	32.24	92.19	33.48	92.16
Restatements	-	0.89	-	-	-	0.89
Ending net assets	\$ 0.34	\$ 1.24	\$ 36.67	\$ 32.24	\$ 37.01	\$ 33.48

Sales

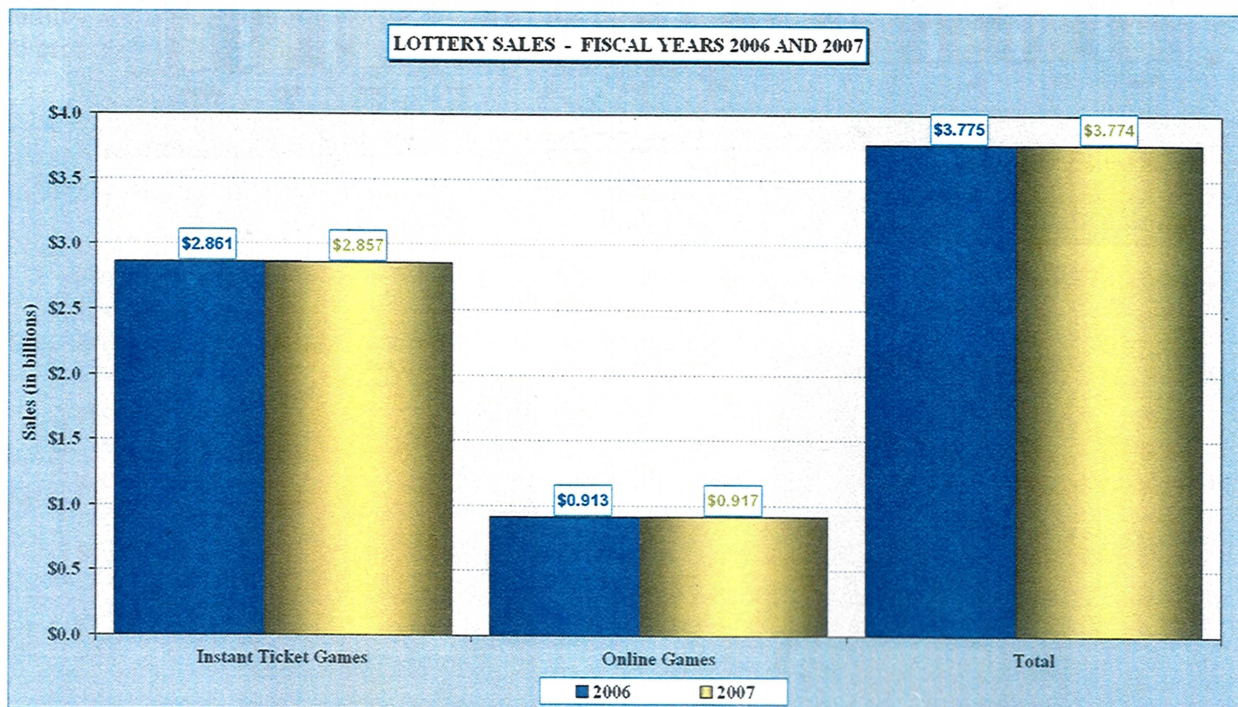
Lottery sales consist of on-line and instant lottery games. The first category is on-line games, which included *Lotto Texas*, *Pick 3*, *Cash Five*, *Texas Two Step* and *Mega Million* with *Megaplier* at August 31, 2007. In total, on-line sales increased by \$3.39 million from the prior year sales total. *Pick 3* sales increased by 5.9%, marking the thirteenth consecutive year of increased sales. Sales for *Pick 3*, at August 31, 2007, totaled \$312.67 million. Other on-line games such as *Cash Five* and *Lotto Texas* were not as successful during fiscal year 2007. These games decreased in total by \$13.2 million at August 31, 2007. The following graph depicts the Commission's on-line sales for the fiscal year ended August 31, 2007 and 2006.



Source: Texas Lottery Commission

Instant tickets or “scratch-off” tickets are the other category of Lottery games offered to the public. Instant ticket sales for the fiscal year ended August 31, 2007 decreased by \$3.9 million or 0.1% over the preceding fiscal year’s sales.

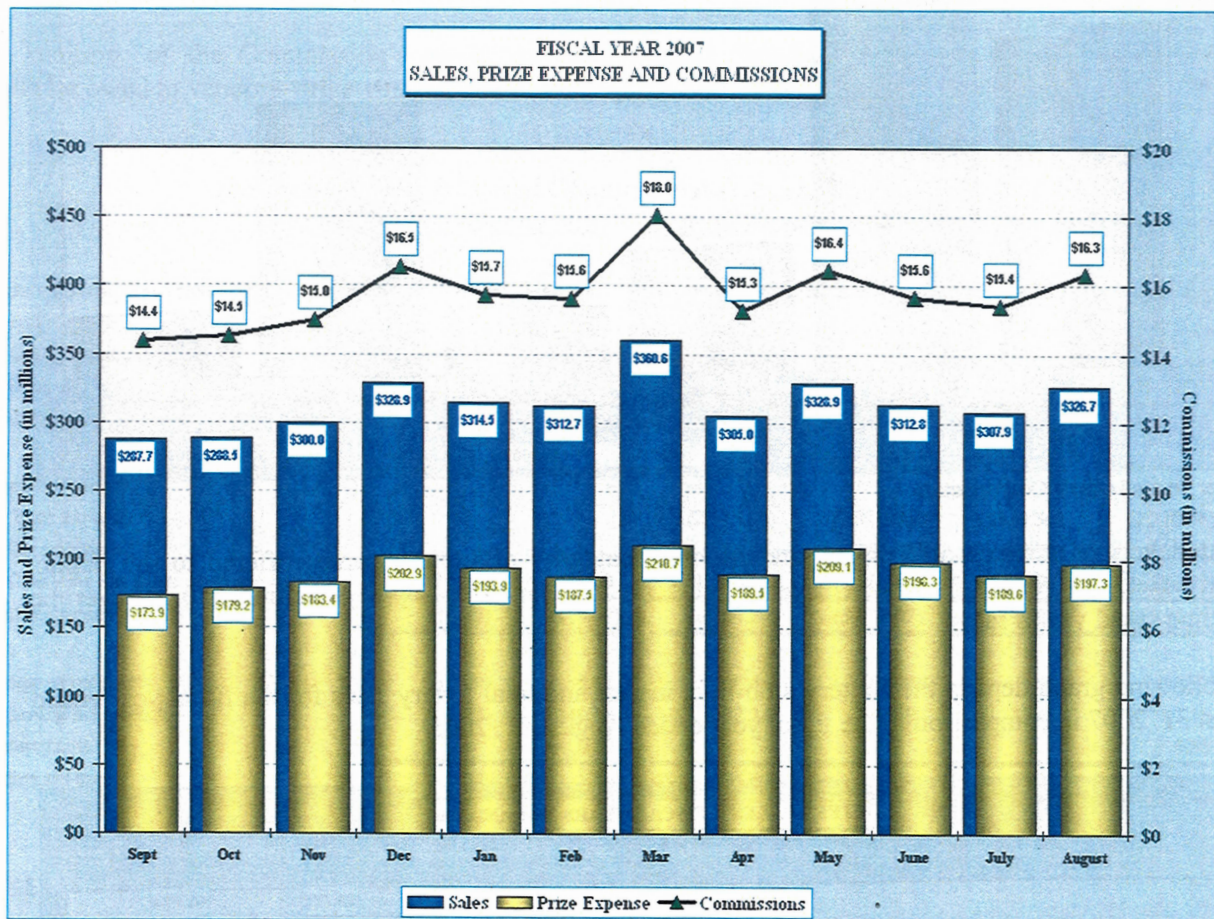
The following graph depicts the Lottery’s on-line, instant and total lottery sales for the fiscal year ended August 31, 2007 in comparison to the fiscal year ended August 31, 2006.



Source: Texas Lottery Commission

Commissions and Prize Awards Expense

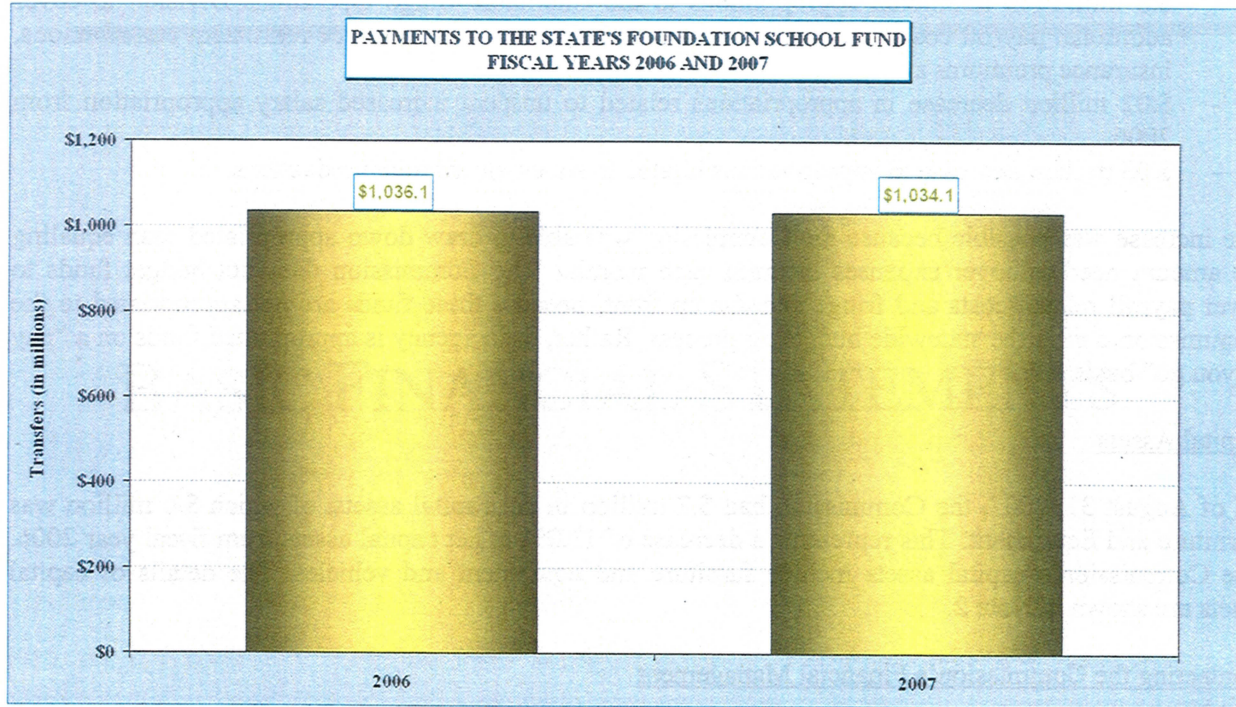
As the following graph depicts, the Commission's most significant expenses (commissions and prize expense) are predictable because they have a direct correlation to sales. As lottery sales increase, so do the related prizes and commissions paid by the Commission. While each lottery game has a predetermined and unique prize payout structure, the overall amount paid as prize award expense is consistent.



Source: Texas Lottery Commission

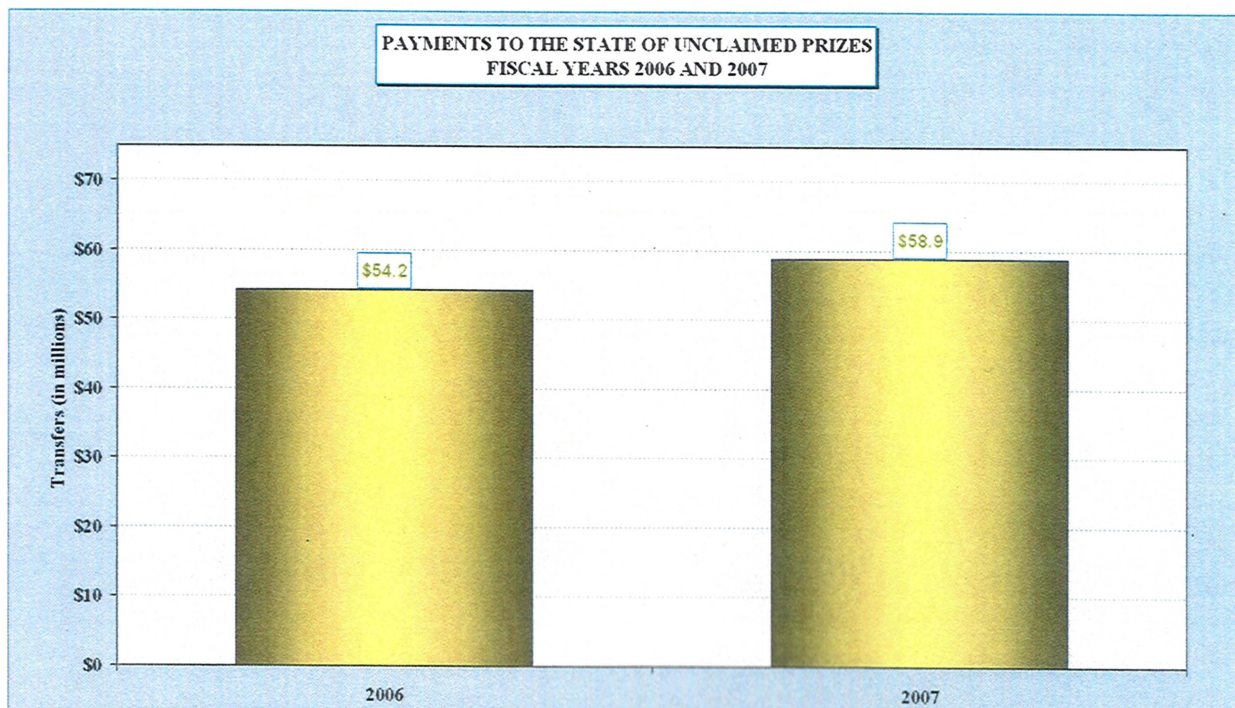
Payments to the State

The Commission recorded its second highest level of total sales in its 15-plus year history during the current fiscal year. Lottery sales for the fiscal year ended August 31, 2007 totaled \$3,774.2 million, a decrease of .01% over the previous year's total of \$3,774.7 million. Payments to other state agencies for the period totaled \$1,034.1 million, as compared to \$1,036.1 million for the fiscal year ended August 31, 2006, representing a .2% decrease.



Source: Texas Lottery Commission

During fiscal years 2007 and 2006, the Lottery transferred unclaimed lottery prize winnings totaling \$58.9 million and \$54.2 million respectively. This represents an increase of \$4.7 million or 8.7% as compared to prior year.



Source: Texas Lottery Commission

General Fund Budgetary Highlights

During the year there was a \$.7 million increase in appropriations between the original and final amended budget. Following are the main components of the change:

- \$.8 million in additional appropriations to the Charitable Bingo Operations Division to cover additional payroll costs related to the Division's share of the employee retirement contributions, insurance premiums and FICA contribution.
- \$.02 million decrease in appropriations related to unspent increased salary appropriation from 2006.
- \$.03 million decrease in appropriations related to statewide air travel reductions.

The increase was possible because the Commission was able to draw down appropriated cash equaling the amount need to cover expenses incurred each month. The Commission does not budget funds to cover payroll related costs and fringe benefits up front, because these funds are not appropriated to the Commission during the statewide budgeting process. Rather, each agency is appropriated funds on a "pay as you go" basis.

Capital Assets

As of August 31, 2007, the Commission had \$.7 million in net capital assets, of which \$.6 million was Furniture and Equipment. This represents a decrease of 13.2% in net capital assets from fiscal year 2006. The Commission's capital assets include furniture and equipment and vehicles. The details of capital assets are shown in Note 2.

Contacting the Commission's Financial Management

This financial report is designed to provide a general overview of the Commission's financial activity for all those interested in the Commission's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Texas Lottery Commission Attn: Office of the Controller, P.O. Box 16630, Austin, Texas 78761-6630.

TEXAS LOTTERY COMMISSION

BASIC FINANCIAL STATEMENTS

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Texas Lottery Commission
Government-wide Statement of Net Assets
August 31, 2007
With Summarized Comparative Totals for August 31, 2006

	Primary Government			Total
	Governmental Activities	Business-type Activities	Total 2007	Total 2006
ASSETS				
Current Assets:				
Cash and Cash Equivalents:				
Cash in Bank	\$ -	\$ 7,500.00	\$ 7,500.00	\$ 7,500.00
Cash in State Treasury	-	100,603,491.83	100,603,491.83	126,300,833.83
Restricted:				
Short Term Investments	-	181,688,113.28	181,688,113.28	173,687,706.97
Legislative Appropriations	28,567,807.78	-	28,567,807.78	1,778,179.50
Receivables from:				
Accounts	-	38,327,427.05	38,327,427.05	19,017,950.72
Taxes	-	-	-	450,035.50
Other	-	34,477,479.00	34,477,479.00	158,329.00
Due from Other Agencies	-	84,068.50	84,068.50	1,369,213.21
Due from Other Funds	-	27,728,561.52	27,728,561.52	-
Consumable Inventories	-	449,328.14	449,328.14	710,023.36
Merchandise Inventories	-	6,406,273.25	6,406,273.25	5,309,737.15
Deferred Charges	-	6,222,000.00	6,222,000.00	7,777,500.00
Total Current Assets	28,567,807.78	395,994,242.57	424,562,050.35	336,567,009.24
Non-Current Assets:				
Restricted:				
Investments	-	1,095,086,541.29	1,095,086,541.29	1,101,610,320.45
Capital Assets:				
Furniture and Equipment	202,192.44	5,555,457.06	5,757,649.50	5,686,395.30
Less accumulated depreciation	(202,192.44)	(4,909,938.97)	(5,112,131.41)	(4,943,322.00)
Vehicles, Boats, and Aircraft	-	32,706.57	32,706.57	32,706.57
Less accumulated depreciation	-	(26,855.68)	(26,855.68)	(24,958.12)
Total Non-Current Assets	-	1,095,737,910.27	1,095,737,910.27	1,102,361,142.20
Total Assets	\$ 28,567,807.78	\$ 1,491,732,152.84	\$ 1,520,299,960.62	\$ 1,438,928,151.44
LIABILITIES				
Current Liabilities:				
Payables from:				
Accounts	\$ 12,304.85	\$ 23,968,648.10	\$ 23,980,952.95	\$ 20,144,293.84
Vouchers	-	2,692,089.00	2,692,089.00	6,885,623.85
Payroll	208,233.27	1,543,580.12	1,751,813.39	1,671,611.25
Annuities	-	11,366,339.20	11,366,339.20	10,992,472.18
Other	-	975,102.51	975,102.51	727,030.35
Due to Other Agencies	-	17,635,841.38	17,635,841.38	15,294,008.76
Due to Other Funds	27,728,561.52	-	27,728,561.52	-
Employees' Compensable Leave	150,935.54	1,101,353.81	1,252,289.35	1,281,178.65
Payable From Restricted Assets-Current	-	309,029,102.85	309,029,102.85	242,321,970.68
Total Current Liabilities	28,100,035.18	368,312,056.97	396,412,092.15	299,318,189.56
Non-Current Liabilities:				
Employees' Compensable Leave	124,651.72	786,061.43	910,713.15	754,937.10
Payable From Restricted Assets	-	1,085,958,954.13	1,085,958,954.13	1,105,372,244.67
Total Non-Current Liabilities	124,651.72	1,086,745,015.56	1,086,869,667.28	1,106,127,181.77
Total Liabilities	28,224,686.90	1,455,057,072.53	1,483,281,759.43	1,405,445,371.33
NET ASSETS				
Invested in Capital Assets	-	651,368.98	651,368.98	750,821.75
Expendable restricted for:				
Pooled Bond Fund	-	5,000,000.00	5,000,000.00	5,000,000.00
Prize Reserve Fund	-	11,844,680.34	11,844,680.34	13,837,358.66
Unrestricted	343,120.88	19,179,030.99	19,522,151.87	13,894,599.70
Total Net Assets	\$ 343,120.88	\$ 36,675,080.31	\$ 37,018,201.19	\$ 33,482,780.11
Total Liabilities and Net Assets	\$ 28,567,807.78	\$ 1,491,732,152.84	\$ 1,520,299,960.62	\$ 1,438,928,151.44

The accompanying notes to the financial statement are an integral part of this statement.

Texas Lottery Commission
Government-wide Statement of Activities
For the Fiscal Year Ended August 31, 2007
With Summarized Comparative Totals for the Year Ended August 31, 2006

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>	
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>
Primary government:			
Governmental Activities:			
Bingo Prize Fee Collections and Accounting	\$ 11,956,629.60	\$ 11,642,659.42	\$ -
Bingo Licensing	1,430,469.71	25,680.00	-
Bingo Law Compliance Field Operations	2,078,298.27	14,000.00	-
Bingo Education and Development	276,973.94	3,429.20	-
Total governmental activities	<u>15,742,371.52</u>	<u>11,685,768.62</u>	<u>-</u>
Business-type activities:			
Lottery Operations	2,641,241,783.75	3,774,924,645.10	-
Marketing, Research, and Promotion	35,081,920.04	-	-
Central Administration	11,816,127.68	(95,911.57)	-
Enforcement	3,070,629.35	1,619.85	-
Intergovernmental	1,093,020,004.88	-	-
Lottery Prize Investments	-	13,828,364.56	-
Total business-type activities	<u>3,784,230,465.70</u>	<u>3,788,658,717.94</u>	<u>-</u>
Total primary government	<u>\$ 3,799,972,837.22</u>	<u>\$ 3,800,344,486.56</u>	<u>\$ -</u>

<u>Functions/Programs</u>	Net (Expense) Revenue and Changes in Net Assets			
	Primary Government			Total 2006
	Governmental Activities	Business-type Activities	Total 2007	
Primary government:				
Governmental Activities:				
Bingo Prize Fee Collections and Accounting	\$ (313,970.18)	\$ -	\$ (313,970.18)	\$ (236,933.71)
Bingo Licensing	(1,404,789.71)	-	(1,404,789.71)	(951,120.84)
Bingo Law Compliance Field Operations	(2,064,298.27)	-	(2,064,298.27)	(1,388,172.92)
Bingo Education and Development	(273,544.74)	-	(273,544.74)	(182,702.20)
Total governmental activities	(4,056,602.90)	-	(4,056,602.90)	(2,758,929.67)
Business-type activities:				
Lottery Operations	-	1,133,682,861.35	1,133,682,861.35	1,112,688,336.71
Marketing, Research, and Promotion	-	(35,081,920.04)	(35,081,920.04)	(2,695,298.64)
Central Administration	-	(11,912,039.25)	(11,912,039.25)	(19,149,608.30)
Enforcement	-	(3,069,009.50)	(3,069,009.50)	(1,771,262.02)
Intergovernmental	-	(1,093,020,004.88)	(1,093,020,004.88)	(1,090,333,057.54)
Lottery Prize Investments	-	13,828,364.56	13,828,364.56	(58,685,603.75)
Total business-type activities	-	4,428,252.24	4,428,252.24	(59,946,493.54)
Total primary government	\$ (4,056,602.90)	\$ 4,428,252.24	\$ 371,649.34	\$ (62,705,423.21)
General Revenues - detailed				
Legislative appropriations	\$ 3,163,771.74	\$ -	\$ 3,163,771.74	\$ 3,141,242.20
Change in net assets	(892,831.16)	4,428,252.24	3,535,421.08	(59,564,181.01)
Net Assets, Beginning of Year	1,235,952.04	32,246,828.07	33,482,780.11	93,046,961.12
Net Assets, End of Year	\$ 343,120.88	\$ 36,675,080.31	\$ 37,018,201.19	\$ 33,482,780.11

The accompanying notes to the financial statements are an integral part of this statement.

Texas Lottery Commission
Balance Sheet – Governmental Funds
August 31, 2007
With Summarized Comparative Totals for August 31, 2006

	<u>General Fund</u>	<u>Total Governmental Funds</u>	<u>2007</u>	<u>2006</u>
ASSETS				
Current Assets -				
Legislative Appropriations	\$ 28,567,807.78	\$ 28,567,807.78	\$ 1,778,179.50	
Total Current Assets	<u>28,567,807.78</u>	<u>28,567,807.78</u>	<u>1,778,179.50</u>	
Total Assets	<u>\$ 28,567,807.78</u>	<u>\$ 28,567,807.78</u>	<u>\$ 1,778,179.50</u>	
LIABILITIES AND FUND BALANCES				
Liabilities:				
Current Liabilities -				
Payables From:				
Accounts	\$ 12,304.85	\$ 12,304.85	\$ 33,977.91	
Vouchers	-	-	1,105.00	
Payroll	208,233.27	208,233.27	222,481.02	
Due To Other Funds	27,728,561.52	27,728,561.52	-	
Total Current Liabilities	<u>27,949,099.64</u>	<u>27,949,099.64</u>	<u>257,563.93</u>	
Total Liabilities	<u>27,949,099.64</u>	<u>27,949,099.64</u>	<u>257,563.93</u>	
FUND FINANCIAL STATEMENT-FUND BALANCES				
Fund Balances:				
Reserved for -				
Encumbrances	-	-	4,920.00	
Unreserved-Undesignated	618,708.14	618,708.14	1,515,695.57	
Total Fund Balances	<u>618,708.14</u>	<u>618,708.14</u>	<u>1,520,615.57</u>	
Total Liabilities and Fund Balances	<u>\$ 28,567,807.78</u>	<u>\$ 28,567,807.78</u>	<u>\$ 1,778,179.50</u>	

The accompanying notes to the financial statement are an integral part of this statement.

Texas Lottery Commission
Reconciliation of Total Governmental Funds Balance
to Net Assets of Governmental Activities
August 31, 2007

Total Governmental Funds Balance \$ 618,708.14

Amounts reported for governmental activities in the statement
of net assets are different because:

Capital assets used in governmental activities are not
financial resources and therefore are not reported
in the fund. These assets consist of:

Furniture and equipment	202,192.44
Accumulated depreciation	(202,192.44)
Total Capital Assets	(202,192.44)

Some liabilities are not due and payable in the current
period and therefore are not reported in the fund.
Those liabilities consist of:

Employee compensable leave	(275,587.26)	
Total long-term liabilities	(275,587.26)	(275,587.26)

Net Assets of Governmental Activities **\$ 343,120.88**

The accompanying notes to the financial statements are an integral part of this statement.

Texas Lottery Commission
Statement of Revenues, Expenditures and
Changes in Fund Balances – Governmental Funds
for the Fiscal Year Ended August 31, 2007
With Summarized Comparative Totals for the Year Ended August 31, 2006

	<u>General Fund</u>	<u>Total Governmental Funds</u>	<u>2007</u>	<u>2006</u>
REVENUES				
Legislative Appropriations:				
Original Appropriations	\$ 2,474,406.00	\$ 2,474,406.00	\$ 2,480,812.00	
Additional Appropriations	689,365.74	689,365.74	660,430.20	
Licenses, Fees and Permits	11,642,659.42	11,642,659.42	11,455,605.88	
Settlement of Claims	-	-	262,275.00	
Other	43,109.20	43,109.20	123,234.20	
Total Revenues	<u>14,849,540.36</u>	<u>14,849,540.36</u>	<u>14,982,357.28</u>	
EXPENDITURES				
Current:				
Salaries and Wages	2,102,119.01	2,102,119.01	2,256,118.50	
Payroll Related Costs	515,669.09	515,669.09	554,744.12	
Professional Fees and Services	37,655.00	37,655.00	55,515.00	
Travel	39,317.12	39,317.12	85,564.15	
Materials and Supplies	31,293.31	31,293.31	34,443.99	
Communication and Utilities	252.72	252.72	252.72	
Repairs and Maintenance	3,534.00	3,534.00	3,614.50	
Rentals and Leases	(1,825.75)	(1,825.75)	6,844.46	
Printing and Reproduction	2,471.76	2,471.76	3,292.94	
Other Expenditures	15,881.80	15,881.80	30,899.11	
Appropriations Lapsed	1,407,365.04	1,407,365.04	84,535.26	
Intergovernmental Payments	11,597,714.69	11,597,714.69	11,456,502.45	
Total Expenditures	<u>15,751,447.79</u>	<u>15,751,447.79</u>	<u>14,572,327.20</u>	
Excess (Deficiency) of Revenues				
Over (Under) Expenditures	<u>(901,907.43)</u>	<u>(901,907.43)</u>	<u>410,030.08</u>	
OTHER FINANCING SOURCES (USES)				
Gain on Sale of Capital Assets	-	-	2,700.00	
Total Other Financing Sources (Uses)	<u>-</u>	<u>-</u>	<u>2,700.00</u>	
Net Change in Fund Balances	(901,907.43)	(901,907.43)	412,730.08	
FUND FINANCIAL STATEMENT-FUND BALANCES				
Fund Balances, Beginning of Year	<u>1,520,615.57</u>	<u>1,520,615.57</u>	<u>1,107,885.49</u>	
Fund Balances, End of Year	<u>\$ 618,708.14</u>	<u>\$ 618,708.14</u>	<u>\$ 1,520,615.57</u>	

The accompanying notes to the financial statements are an integral part of this statement.

Texas Lottery Commission
Reconciliation of Changes in Fund Balances of Governmental Funds
to Changes in Net Assets of Governmental Activities
for the Fiscal Year Ended August 31, 2007

Net Change In Fund Balance Total - Governmental Fund **\$ (901,907.43)**

Amounts reported for governmental activities in the statement of activities
are different because:

Some items reported in the statement of activities do not require the use
of current financial resources and therefore are not reported as
expenditures in governmental funds. These activities consist of:

Increase in compensable leave	9,076.27	
Total long-term liabilities		9,076.27

Change in Net Assets of Governmental Activities	\$ (892,831.16)
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The accompanying notes to the financial statement are an integral part of this statement.

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Texas Lottery Commission
Statement of Net Assets - Proprietary Funds
August 31, 2007
With Summarized Comparative Totals for August 31, 2006

	Enterprise		
	Lottery	Total Proprietary Funds	
	Fund	2007	2006
ASSETS			
Current Assets:			
Cash and Cash Equivalents:			
Cash in Bank	\$ 7,500.00	\$ 7,500.00	\$ 7,500.00
Cash in State Treasury	100,603,491.83	100,603,491.83	126,300,833.83
Restricted:			
Short Term Investments	181,688,113.28	181,688,113.28	173,687,706.97
Receivables from:			
Accounts	38,327,427.05	38,327,427.05	19,017,950.72
Taxes	-	-	450,035.50
Other	34,477,479.00	34,477,479.00	158,329.00
Due from Other Funds	27,728,561.52	27,728,561.52	-
Due From Other Agencies	84,068.50	84,068.50	1,369,213.21
Consumable Inventories	449,328.14	449,328.14	710,023.36
Merchandise Inventories	6,406,273.25	6,406,273.25	5,309,737.15
Deferred Charges	6,222,000.00	6,222,000.00	7,777,500.00
Total Current Assets	<u>395,994,242.57</u>	<u>395,994,242.57</u>	<u>334,788,829.74</u>
Non-Current Assets:			
Restricted:			
Investments	1,095,086,541.29	1,095,086,541.29	1,101,610,320.45
Capital Assets:			
Depreciable:			
Furniture and Equipment	5,555,457.06	5,555,457.06	5,484,202.86
Less accumulated depreciation	(4,909,938.97)	(4,909,938.97)	(4,741,129.56)
Vehicles, Boats, and Aircraft	32,706.57	32,706.57	32,706.57
Less accumulated depreciation	(26,855.68)	(26,855.68)	(24,958.12)
Total Non-Current Assets	<u>1,095,737,910.27</u>	<u>1,095,737,910.27</u>	<u>1,102,361,142.20</u>
Total Assets	<u><u>\$ 1,491,732,152.84</u></u>	<u><u>\$ 1,491,732,152.84</u></u>	<u><u>\$ 1,437,149,971.94</u></u>
LIABILITIES			
Current Liabilities:			
Payables from:			
Accounts	\$ 23,968,648.10	\$ 23,968,648.10	\$ 20,110,315.93
Voucher	2,692,089.00	2,692,089.00	6,884,518.85
Payroll	1,543,580.12	1,543,580.12	1,449,130.23
Annuities	11,366,339.20	11,366,339.20	10,992,472.18
Other	975,102.51	975,102.51	727,030.35
Due to Other Agencies	17,635,841.38	17,635,841.38	15,294,008.76
Employees' Compensable Leave	1,101,353.81	1,101,353.81	1,112,211.63
Payable From Restricted Assets	309,029,102.85	309,029,102.85	242,321,970.68
Total Current Liabilities	<u>368,312,056.97</u>	<u>368,312,056.97</u>	<u>298,891,658.61</u>
Non-Current Liabilities:			
Employees' Compensable Leave	786,061.43	786,061.43	639,240.59
Payable From Restricted Assets	1,085,958,954.13	1,085,958,954.13	1,105,372,244.67
Total Non-Current Liabilities	<u>1,086,745,015.56</u>	<u>1,086,745,015.56</u>	<u>1,106,011,485.26</u>
Total Liabilities	<u>1,455,057,072.53</u>	<u>1,455,057,072.53</u>	<u>1,404,903,143.87</u>
NET ASSETS			
Invested in Capital Assets	651,368.98	651,368.98	750,821.75
Restricted for:			
Expendable:			
Restricted by Other:			
Pooled Bond Fund	5,000,000.00	5,000,000.00	5,000,000.00
Prize Reserve Fund	11,844,680.34	11,844,680.34	13,837,358.66
Unrestricted	19,179,030.99	19,179,030.99	12,658,647.66
Total Net Assets	<u>36,675,080.31</u>	<u>36,675,080.31</u>	<u>32,246,828.07</u>
Total Liabilities and Net Assets	<u><u>\$ 1,491,732,152.84</u></u>	<u><u>\$ 1,491,732,152.84</u></u>	<u><u>\$ 1,437,149,971.94</u></u>

The accompanying notes to the financial statement are an integral part of this statement.

Texas Lottery Commission
Statement of Revenues, Expenses, and
Changes in Net Assets - Proprietary Funds
for the Fiscal Year Ended August 31, 2007
With Summarized Comparative Totals for the Year Ended August 31, 2006

	<u>Enterprise Fund</u>	<u>Total Proprietary Funds</u>	
	<u>Lottery Fund</u>	<u>2007</u>	<u>2006</u>
OPERATING REVENUES:			
Sales of Goods and Services:			
Lottery Proceeds:			
Ticket Sales	\$ 3,774,178,801.50	\$ 3,774,178,801.50	\$ 3,774,685,562.00
Lottery License Application Fees	303,735.00	303,735.00	303,174.25
Lottery Security Proceeds	72,287.50	72,287.50	71,538.00
Other Operating Revenues	259,913.17	259,913.17	1,058,448.60
Total Operating Revenues	<u>3,774,814,737.17</u>	<u>3,774,814,737.17</u>	<u>3,776,118,722.85</u>
OPERATING EXPENSES:			
Salaries and Wages	14,869,314.71	14,869,314.71	13,811,258.12
Payroll Related Costs	3,591,358.37	3,591,358.37	3,346,542.76
Professional Fees and Services	3,236,773.44	3,236,773.44	6,329,548.22
Travel	267,635.01	267,635.01	286,682.00
Materials and Supplies	1,587,462.73	1,587,462.73	270,406.16
Communication and Utilities	522,509.33	522,509.33	594,073.31
Repairs and Maintenance	240,343.78	240,343.78	497,869.89
Rentals and Leases	8,330,479.94	8,330,479.94	7,246,814.03
Printing and Reproduction	14,919,787.89	14,919,787.89	14,883,416.01
Depreciation and Amortization	234,299.61	234,299.61	257,526.14
Bad Debt Expense	291,491.26	291,491.26	789,868.75
Interest	11,000.05	11,000.05	828.69
Lottery Prizes	2,315,304,967.42	2,315,304,967.42	2,310,561,488.27
Retailer Commissions	188,751,041.10	188,751,041.10	188,818,620.60
Retailer Bonuses	4,423,160.96	4,423,160.96	2,804,520.68
Other Operating Expenses:			
Lottery Operator Fees	102,470,284.89	102,470,284.89	102,124,102.07
Advertising	30,733,057.91	30,733,057.91	31,577,820.18
Other	1,299,784.84	1,299,784.84	2,883,908.73
Intergovernmental Payments	1,093,020,004.88	1,093,020,004.88	1,090,333,057.54
Total Operating Expenses	<u>3,784,104,758.12</u>	<u>3,784,104,758.12</u>	<u>3,777,418,352.15</u>
Operating Loss	<u>(9,290,020.95)</u>	<u>(9,290,020.95)</u>	<u>(1,299,629.30)</u>
NONOPERATING REVENUES (EXPENSES):			
Investment Income	15,616.21	15,616.21	39,459.51
Loss on Disposal of Capital Assets	-	-	-
Net Increase/(Decrease) Fair Value	13,828,364.56	13,828,364.56	(58,685,603.75)
Settlement of Claims	(125,707.58)	(125,707.58)	(720.00)
Total Nonoperating Revenues (Expenses)	<u>13,718,273.19</u>	<u>13,718,273.19</u>	<u>(58,646,864.24)</u>

Texas Lottery Commission
Statement of Revenues, Expenses, and
Changes in Net Assets - Proprietary Funds
for the Fiscal Year Ended August 31, 2007
With Summarized Comparative Totals for the Year Ended August 31, 2006

	<u>Enterprise Fund</u>	<u>Total Proprietary Funds</u>	
	<u>Lottery Fund</u>	<u>2007</u>	<u>2006</u>
Change in Net Assets	<u>4,428,252.24</u>	<u>4,428,252.24</u>	<u>(59,946,493.54)</u>
Total Net Assets, Beginning of Year	<u>32,246,828.07</u>	<u>32,246,828.07</u>	<u>92,193,321.61</u>
Total Net Assets, End of Year	<u><u>36,675,080.31</u></u>	<u><u>36,675,080.31</u></u>	<u><u>32,246,828.07</u></u>

The accompanying notes to the financial statement are an integral part of this statement.

Texas Lottery Commission
Statement of Cash Flows - Proprietary Funds
For the Fiscal Year Ended August 31, 2007
With Summarized Comparative Totals for the Year Ended August 31, 2006

	<u>Enterprise Lottery Fund</u>	<u>Total Proprietary Funds 2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from Customers	\$ 3,694,151,309.28	\$ 3,694,151,309.28	\$ 3,772,279,239.84
Payments to Suppliers for Goods and Services	(356,407,760.43)	(356,407,760.43)	(357,254,723.73)
Payments to Employees	(18,230,260.17)	(18,230,260.17)	(16,781,710.48)
Payments for Other Expenses	(3,343,789,923.62)	(3,343,789,923.62)	(3,406,193,100.53)
Net Cash Provided by Operating Activities	<u>(24,276,634.94)</u>	<u>(24,276,634.94)</u>	<u>(7,950,294.90)</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES			
Payments for Other Uses	(163,799,000.00)	(163,799,000.00)	(162,611,000.00)
Proceeds from Other Financing	151,411,292.42	151,411,292.42	22,160,000.00
Net Cash Used in Noncapital Financing Activities	<u>(12,387,707.58)</u>	<u>(12,387,707.58)</u>	<u>(140,451,000.00)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Payments for Additions to Capital Assets	(134,846.84)	(134,846.84)	(150,666.79)
Net Cash Used in Capital and Related Financing Activities	<u>(134,846.84)</u>	<u>(134,846.84)</u>	<u>(150,666.79)</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from Sales of Investments	163,799,000.00	163,799,000.00	162,611,000.00
Proceeds from Interest and Investment Income	15,616.21	15,616.21	39,459.51
Payments to Acquire Investments	(152,712,768.85)	(152,712,768.85)	(24,963,559.20)
Net Cash Provided by Investing Activities	<u>11,101,847.36</u>	<u>11,101,847.36</u>	<u>137,686,900.31</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(25,697,342.00)	(25,697,342.00)	(10,865,061.38)
Cash and Cash Equivalents, Beginning of Year	<u>126,308,333.83</u>	<u>126,308,333.83</u>	<u>137,173,395.21</u>
Cash and Cash Equivalents, End of Year	<u>\$ 100,610,991.83</u>	<u>\$ 100,610,991.83</u>	<u>\$ 126,308,333.83</u>

Texas Lottery Commission
Statement of Cash Flows - Proprietary Funds
For the Fiscal Year Ended August 31, 2007
With Summarized Comparative Totals for the Year Ended August 31, 2006

	<u>Enterprise</u>		
	<u>Lottery</u>	<u>Total Proprietary Funds</u>	
	<u>Fund</u>	<u>2007</u>	<u>2006</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities			
Operating Loss	\$ (9,290,020.95)	\$ (9,290,020.95)	\$ (1,299,629.30)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities			
Amortization and Depreciation	234,299.61	234,299.61	257,526.14
Bad Debt Expense	291,491.26	291,491.26	789,868.75
Operating Income and Cash Flow Categories:			
Changes in Assets and Liabilities:			
(Increase) Decrease in Receivables	(80,663,427.89)	(80,663,427.89)	(3,839,483.01)
(Increase) Decrease in Inventories	(835,840.88)	(835,840.88)	143,901.74
Increase (Decrease) in Deferred Charges	1,555,500.00	1,555,500.00	1,555,500.00
Increase (Decrease) in Payables	64,431,363.91	64,431,363.91	(5,557,979.22)
Total Adjustments	<u>(14,986,613.99)</u>	<u>(14,986,613.99)</u>	<u>(6,650,665.60)</u>
Net Cash Provided by Operating Activities	<u>\$ (24,276,634.94)</u>	<u>\$ (24,276,634.94)</u>	<u>\$ (7,950,294.90)</u>
Non Cash Transactions			
Net Increase (Decrease) in Fair Value of Investments		13,828,364.56	(58,685,603.75)

The accompanying notes to the financial statement are an integral part of this statement.

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Texas Lottery Commission
Statement of Fiduciary Assets and Liabilities - Fiduciary Funds
August 31, 2007
With Summarized Comparative Totals for August 31, 2006

		<u>Total</u>	
	<u>Agency Funds</u>	<u>2007</u>	<u>2006</u>
ASSETS			
Current Assets:			
Cash and Cash Equivalents -			
Cash in State Treasury	<u>\$ 25,036.28</u>	<u>\$ 25,036.28</u>	<u>\$ 24,786.28</u>
Total Assets	<u><u>\$ 25,036.28</u></u>	<u><u>\$ 25,036.28</u></u>	<u><u>\$ 24,786.28</u></u>
LIABILITIES			
Current Liabilities -			
Funds Held for Others	<u>25,036.28</u>	<u>25,036.28</u>	<u>24,786.28</u>
Total Liabilities	<u><u>\$ 25,036.28</u></u>	<u><u>\$ 25,036.28</u></u>	<u><u>\$ 24,786.28</u></u>

The accompanying notes to the financial statement are an integral part of this statement.

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TEXAS LOTTERY COMMISSION

NOTES TO THE FINANCIAL STATEMENTS

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TEXAS LOTTERY COMMISSION

Notes to the Financial Statements

For The Year Ended August 31, 2007

<i>NOTE 1: Summary of Significant Accounting Policies</i>
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Entity

The Texas Lottery Commission (the "Commission") is an agency of the State of Texas and its financial records comply with state statutes and regulations. This includes compliance with the Texas Comptroller of Public Accounts' Reporting Requirements for State Agencies.

The Commission serves the State by operating Lottery games. The Texas Lottery was created on August 12, 1991, with the enactment of House Bill No. 54, as a division of the Office of the Comptroller of Public Accounts. The Texas Lottery was approved by the voters of Texas in a general election on November 7, 1991, and commenced operations on November 20, 1991. The Commission was formed by the State lawmakers during the 1993 legislative session and became effective September 1, 1993. On November 9, 1993, the Governor of the State of Texas announced the appointment of three commissioners. The commissioners appoint the Executive Director, the Charitable Bingo Operations Director and the Internal Audit Director.

Effective April 1, 1994, House Bill No. 2771 transferred Bingo operations from the Texas Alcoholic Beverage Commission to the Commission. The Charitable Bingo Operations Division of the Commission collects fees and regulates the operations of charitable bingo in the State of Texas. Fees collected are allocated to cities and counties with the balance deposited in the General Revenue Fund.

The Commission includes within this report all components as determined by an analysis of their relationship to the Commission. No component units have been identified as defined by Governmental Accounting Standards Board (GASB) Statement No. 14, which should have been blended or presented by discrete columns into an appropriate fund.

BASIS OF PRESENTATION

The accompanying financial statements of the Commission have been prepared to conform with Generally Accepted Accounting Principles (GAAP) as prescribed by the GASB.

FINANCIAL REPORTING STRUCTURE

The basic financial statements include both government-wide (based on the Commission as a whole) and fund financial statements. Both the government-wide and fund financial statements categorize primary activities as either governmental or business type. The prior year summarized comparative totals column do not include sufficient detail to constitute a presentation in conformity with accounting principals generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Commission's financial statements for the year ended August 31, 2006, from which the summarized information was derived.

Government-wide Financial Statements

The government-wide financial statements (Statement of Net Assets and Statement of Activities) display information about the Commission as a whole, except for its fiduciary activities. These statements include separate columns for the governmental and business-type activities of the Commission. Eliminating adjustments have been made in the Statement of Activities so that certain allocated expenses are recorded only once (by the function to which they were allocated).

The focus of the government-wide statements is on the sustainability of the Commission as an entity and the change in aggregate financial position resulting from the activities of the fiscal period.

In the government-wide Statement of Net Assets, both the governmental and business-type activities columns are presented on a consolidated basis by column, and are reflected on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations.

The government-wide Statement of Activities reflects both the gross and net cost per functional category (Bingo Operations, Bingo Education, etc.), which are otherwise supported by general government revenues (General Appropriations). The Statement of Activities reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, if any. Depreciation expense and other related payroll costs for both the business-type activities and governmental activities are allocated to functional categories based on full time equivalent units of number of employees. The program revenues must be directly associated with the function, or with a business-type activity. The operating grants column includes operating-specific and discretionary (either operating or capital) grants, while the capital grants column reflects capital-specific grants. The Commission does not use capital grants to finance any of its operations.

Program revenues include charges for services, special assessments, and payments made by external third parties if that money is restricted to a particular program. Internally dedicated resources are reported as general revenues rather than program revenues. Program revenues are netted within program expenses in the statement of activities to present the net cost of each program.

The net costs (program expenses less program revenues) of all activities are normally covered by general revenues. The previous reporting model did not present net cost by function or activity.

Amounts paid to acquire capital assets are capitalized as assets in the government-wide financial statements, rather than reported as expenditures. Proceeds of long-term debt are recorded as liabilities in the government-wide financial statements, rather than as other financing sources. Amounts paid to reduce long-term indebtedness of the reporting government are reported as reductions of the related liabilities, rather than as expenditures.

The Commission's fiduciary funds are presented in the fund financial statements by type (pension, private-purpose, and agency). Since the assets are held for the benefit of others and cannot be used to address activities or obligations of the government, the funds are not incorporated into the government-wide statements.

Fund Structure

The accompanying financial statements are presented on the basis of funds, each of which is considered a separate accounting entity. The Fund Types used to account for the operations of the Texas Lottery Commission include the General Fund, Enterprise Funds, and Agency Funds.

Governmental Fund Types

General Revenue Funds

The General Revenue Fund (Fund 0001) is used to account for all financial resources of the state except those required to be accounted for in another fund. The General Revenue Fund is used to account for the Charitable Bingo Operations, including allocation of Bingo Prize Fees.

Proprietary Fund Types

Enterprise Funds

Enterprise funds account for any activity for which a fee is charged to external users for goods or services. Activities must be reported as enterprise funds if any one of the following criteria is met.

1. The activity is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity.
2. Laws or regulations require that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges.
3. The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs.

The Commission accounts for its proprietary activities in two separate funds, as discussed below:

GR Dedicated - Lottery Account Fund – Enterprise (06) Appd Fund, D23 Fund 1100 (5025) - This fund is used to record all transactions related to the operation of the State Lottery.

Lotto Prize Trust – Enterprise (06) Appd Fund, D23 Fund 0895 (0895) - This fund is used to account for investments purchased by the Commission to meet future installment obligations to prize winners. In fiscal years prior to 1998, this fund was reported as an Agency Fund. Due to the implementation of GASB 31, the presentation was changed in fiscal year 1998.

Fiduciary Fund Types

Agency Funds

Agencies use agency funds to account for assets the government holds on behalf of others in a purely custodial capacity. Agency funds involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments.

The funds established by the Commission to account for such transactions are described below:

Suspense Fund (0900) - This fund is used to hold money prior to the ultimate disposition of the funds to other governmental entities or the General Revenue Fund.

Warrant Hold Offset (9016) – This fund is used to account for monies collected on behalf of the Commission for debt owed to the Commission.

Suspense Fund-Seized Funds (0362) – This fund is used to account for funds seized as a result of enforcement action taken by the Commission.

USPS – Overpayments to Employees (9015) – This fund is used to account for funds recovered due to payroll overpayments to employees.

Savings Bond Fund (0901) - This fund is used to accumulate money withheld from the salaries of employees for the purpose of purchasing United States Savings Bonds. Bonds are purchased when an individual has accumulated a sufficient amount.

Deferred Compensation 401k (0942) – This fund is used to provide a temporary depository for fund pending transmittal, by electronic means, to the administrator of the state deferred compensation 401k program.

Correction Account - Direct Deposit (0980) – This fund is used to hold money prior to the ultimate disposition of funds to vendors, employees, other governmental entities, or other funds.

Bingo Cash Bonds (1002) – This fund is used to accumulate security funds for tax on gross rentals or the fee on prizes imposed under Chapter 2001, Section 514, Texas Occupation Code.

Fund Financial Statements

The fund financial statements are similar to the financial statements presented in the previous model. The emphasis is on the major funds in either the governmental or business-type categories. Due to the number of funds used by the Commission to account for its activities, management has decided to present all funds as major funds. Therefore, non-major funds will not be presented in the fund financial statements.

The major governmental funds in the fund financial statements are presented on a current financial resource and modified accrual basis of accounting. This presentation is deemed most appropriate to demonstrate (a) compliance with legal and covenant requirements; (b) the source and use of financial resources; and (c) how the Commission's actual experience conforms to the budget. Since the governmental fund statements are presented using a different measurement focus and basis of accounting than the government-wide statements' governmental column, a reconciliation is presented which explains the adjustments required to restate the fund-based financial statements to the governmental activities column in the government-wide financial statements. The fund financial statements are presented after the government-wide financial statements.

The Commission uses funds to report its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

BASIS OF ACCOUNTING, MEASUREMENT FOCUS AND FUND FINANCIAL STATEMENT PRESENTATION

The basis of accounting determines when revenues and expenditures or expenses are recognized in the accounts reported in the financial statements. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The governmental fund types that build the fund financial statements are accounted for using the modified accrual method basis of accounting. Under modified accrual, revenues are recognized in the period in which they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year-end. The Commission considers receivables collected within sixty days after year-end to be available and recognizes them as revenues of the current year for Fund Financial Statements prepared on the modified accrual basis. Expenditures and other uses of financial resources are recognized when their related liability is incurred.

The governmental fund types included in the Statement of Net Assets and Statement of Activities are accounted for using the accrual basis of accounting. Under accrual accounting, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred.

The proprietary funds are accounted for on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time liabilities are incurred. As required under GASB 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Commission will continue to apply all applicable GASB pronouncements, as well as the Financial Accounting Standards Board (FASB) Statements and Interpretations, the Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBS) issued on or before November 30, 1989, that do not conflict with or contradict GASB pronouncements. The Commission has elected under GASB 20 to not apply FASB pronouncements issued after November 30, 1989, due to the governmental nature of the Commission's operations.

Proprietary funds distinguish operating from non-operating items. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the proprietary funds' principal ongoing operations. Operating expenses for the enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Fiduciary funds are reported using the economic resources measurement focus.

Budgets and Budgetary Accounting

The budget is prepared biennially and represents appropriations authorized by the legislature and approved by the Governor (the General Appropriations Act).

Unencumbered appropriations are generally subject to lapse 60 days after the end of the fiscal year for which they were appropriated.

Assets, Liabilities, and Fund Balances/Net Assets

ASSETS

Cash and Cash Equivalents

For the purpose of the statement of cash flows, the Commission considers cash and cash equivalents to be cash in bank and cash held in State Treasury.

Allocation of Income

Revenues from instant and on-line lottery ticket sales and fees, net of retailer commissions and direct retailer prize payments, are deposited directly into an account in the Enterprise Fund (5025). From this account, prize payment reimbursements are made to a separate local bank account ("Lottery Prize Payment Account") to provide for prize payments. The Commission retains 12 percent of gross lottery revenues, subject to appropriation limitation, accruing from the sales of tickets for the payment of costs incurred in the operation and administration of the lottery operations, including not less than 5 percent for retailer commissions.

For fiscal year 2007, unspent administrative funds were transferred to the Foundation School Fund. Net proceeds will continue to be transferred to the Foundation School Fund during fiscal year 2008. Obligated amounts in the lottery operating account at August 31, 2007 are included as Cash in State Treasury on the Commission's balance sheet because the use of such funds is necessary to cover the Commission's expenditures and prize payment obligations.

Accrued payments in the amount of \$17,635,841.38 are recorded as "Due to Other Agencies" as of August 31, 2007. \$51,918.71 is due to General Revenue for unclaimed prizes and the balance is due to the Foundation School Fund (Fund 0193) for August sales and unspent administrative funds.

Investments

Investments are stated at fair value in accordance with GASB Statement 31 – Accounting and Financial Reporting for Certain Investments and for External Investment Pools. Investments are purchased to meet future installment payments to prize winners. The investments are shown at fair value and the related payable is reported at amortized cost. The net unrealized gain (loss) on investment securities, which is the difference between the fair value and the amortized cost, is reflected as Unrestricted-Net Assets in the "Combined Statement of Net Assets-Proprietary Funds".

Restricted Assets

Restricted Assets include monies or other resources restricted by legal or contractual requirements. These assets include proceeds held in a repurchase agreement for payment of lottery prizes and investments held by a third party to satisfy future lotto prizes.

Inventories

Inventories consist of instant game tickets on hand at year-end, held for sale and consumable inventories. The instant ticket inventory, recorded as Merchandise Inventory, is carried at cost, as determined by the weighted average method. The consumable inventory is valued at cost, generally utilizing the last-in, first-out method. The consumption method of accounting is used to account for the inventories that appear in the proprietary fund types. The cost of these items is expensed when the items are consumed.

Capital Assets

Assets with an initial individual cost equal to or greater than \$5,000 and an estimated useful life in excess of one year are capitalized. These assets are capitalized at cost or, if not purchased, at appraised fair value as of the date of acquisition. Purchases of assets by governmental funds are reported as expenditures. Depreciation is reported on all "exhaustible" assets. Assets are depreciated over the estimated useful life of the asset using the straight-line method.

All capital assets acquired by proprietary funds are reported at cost or estimated historical cost, if actual historical cost is not available. Donated assets are reported at fair value on the donation date. Depreciation is charged to operations over the estimated useful life of each asset, using the straight-line method.

Accounts Receivable – Other

The balance in Accounts Receivable – Other consists of amounts owed to the Commission by member states of the Mega Millions group on August 31, 2007 for their portion of (a) jackpot funds paid out in the amount of \$34,418,070.00; and (b) fixed prizes in the amount of \$59,409.00, for a balance of \$34,477,479.00.

LIABILITIES

Accounts Payable

Accounts Payable represents the liability for the value of assets or services received at the balance sheet date for which payment is pending.

Payroll Payable

Payroll Payable represents the liability for the salaries and related payroll cost earned by employees at the balance sheet date for which payment is pending.

Employees' Compensable Leave Balances

GASB Statement No. 16, *Accounting for Compensated Absences*, establishes standards of accounting and reporting for compensated absences (vacation, unpaid overtime and sick leave) by state and local governmental entities. GASB Statement No. 34 requires governments to report and disclose the portion of compensated absences that is due within one year of the statement date.

Annual leave, commonly referred to as vacation leave, and other compensated absences with similar characteristics is accrued as a liability as the benefits are earned by the employee, if both the employee's right to receive compensation is attributable to services already rendered and it is probable that the employer will compensate the employee for the benefits through paid time off or some other means, such as cash payments at termination or retirement. Employees accrue vacation time at a rate of 8 to 21 hours per month depending on years of employment. The maximum number of hours that can be carried forward to the next fiscal year ranges from 180 hours to 532 hours based on years of service.

Overtime, under the federal Fair Labor Standards Act (FLSA) and state laws, can be accumulated in lieu of immediate payment as compensatory leave (at 1.5 hours x overtime hours worked), for non-exempt, non-emergency employees to a maximum of 240 hours. All overtime exceeding 240 hours must be paid with the next regular payroll. At termination or death, all overtime balances must be paid in full. Unpaid overtime is included in the calculation of current and non-current liabilities for each employee since it may be used like compensatory time or be paid to the employee.

Compensatory leave is allowed for exempt employees not eligible for overtime pay. This leave is accumulated on an hour-for-hour basis and must be taken within one year from date earned or it lapses. There is no death or termination benefit for compensatory leave and it is non-transferable. Compensatory leave is reported as a current liability.

Sick leave is accrued at a rate of 8 hours per month with no limit on the amount that can be carried forward to the next fiscal year. Accumulated sick leave is not paid at employee termination, although an employee's estate may be paid for one-half of the accumulated sick leave to a maximum of 336 hours. An employee who retires based on service or a disability is entitled to service credit in the retirement system for unused sick leave on the last day of employment. The maximum amount of the Commission's contingent obligation for sick leave has not been determined. However, the probability of a material impact on agency operations in any given fiscal year is considered remote.

Liabilities Payable from Restricted Assets - Current

Lotto Texas and **Mega Millions** jackpots are payable in a lump sum or in annual installments. Prior to February 1997, the *Lotto Texas* prizes were paid in twenty installments. Beginning in February 1997, the players were given a choice at the time of purchase of receiving either a lump sum payment or twenty-five annual installments. *Mega Millions* jackpot prizes are paid in twenty-six annual installments, unless the lump sum option is selected by the player. The first installment is processed on the day the prize is claimed. The subsequent installments are funded with United States Guaranteed Securities purchased by the Texas Treasury Safekeeping Trust Company on the Commission's behalf, as are the installment payments for Weekly Grand, Top Prize, Deal or No Deal, Monthly Bonus, and Set for Life.

The amortization of the discount of investments held for prizes payable is based on yields ranging from 2.32 percent to 7.33 percent and reflects interest rates earned by the investments held to fund the prizes payable. The prizes payable relating to annual installments consisted of the following at August 31, 2007:

		2007
Total Obligation	\$	1,624,026,000.00
Less – unamortized discount		367,847,045.87
Total carrying amount		1,256,178,954.13
Less – prizes payable within one year		170,220,000.00
Long-term prizes payable	\$	1,085,958,954.13

The aggregate amount of prizes payable due in each of the five fiscal years following August 31, 2007 and 2006, and the total thereafter are as follows:

Aggregate Amount of Prizes Payable Business-Type Activities			
Principal 2007		Principal 2006	
		2007 (Future Year 1)	\$ 163,799,000.00
2008 (Future Year 1)	\$ 170,220,000.00	2008 (Future Year 2)	163,799,000.00
2009 (Future Year 2)	170,090,000.00	2009 (Future Year 3)	163,669,000.00
2010 (Future Year 3)	170,090,000.00	2010 (Future Year 4)	163,669,000.00
2011 (Future Year 4)	170,090,000.00	2011 (Future Year 5)	163,669,000.00
2012 (Future Year 5)	170,090,000.00	2012-2016	544,260,000.00
2013-2017	452,015,000.00	2017-2021	193,559,000.00
2018-2022	214,431,000.00	2022-2026	77,706,000.00
2023-2027	81,265,000.00	2027	2,158,000.00
2028-2032	25,735,000.00		
Total Prizes Payable	\$ 1,624,026,000.00		\$ 1,636,288,000.00

There were no prizes payable for the governmental activities, as of August 31, 2007 and 2006.

Unclaimed Prizes

In accordance with Subsection 466.408, of the State Lottery Act, the ticket holder forfeits prizes that remain unclaimed for 180 days after the on-line drawing date or 180 days after the close of an instant game. During fiscal year 2007, the Lottery transferred a total of \$58,947,387.71 in unclaimed lottery prize winnings on a quarterly basis to the following agencies: The Comptroller of Public Account received \$48,947,387.71 for credit to the General Revenue Fund, and Department of State Health Services received \$10,000,000.00 for credit to the Multi-categorical Teaching Hospital Account.

FUND BALANCE/NET ASSETS

The difference between fund assets and liabilities is called "Net Assets" on the government-wide, proprietary and fiduciary fund statements, and the difference between fund assets and liabilities on the governmental fund statements is called "Fund Balances".

Reservation of Fund Balances

Fund balances for governmental funds are classified as either reserved or undesignated in the fund financial statements. Reservations are legally restricted to a specific future use or not available for expenditure.

Reserved for Encumbrances

This represents commitments for the value of contracts awarded or assets ordered prior to year-end but not received as of that date. Encumbrances are not included with expenditures or liabilities. They represent current resources designated for specific expenditures in subsequent operating periods.

Unreserved/Undesignated:

This represents the unappropriated balance at year-end, which may be subject to lapse.

Invested In Capital Assets

Invested in capital assets consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bond, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets. No related debt was noted to affect net of debt. Net assets invested in capital assets at August 31, 2007 was \$651,368.98.

Restricted Net Assets

Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provision or enabling legislation.

Restricted Net Assets in the Proprietary Funds consist of the following:

	2007
Reserved for Pooled Bond Fund	\$ 5,000,000.00
Prize Reserve Fund (Reserved for Future Lotto Prizes)	\$11,844,680.34

Pooled Bond Fund

The Reserve for Pooled Bond Fund is established in accordance with the Texas Government Code, Chapter 466. Specifically, Texas Government Code, Section 466.156 authorizes the Executive Director of the Commission to establish a pooled bond fund from the collection of cash from each sales agent to be used to reimburse the State for losses to the State from the operation of the Commission's sales. As of August 31, 2007, the balance in the Pooled Bond Fund did not exceed the statutory cap of \$5 million.

Future Lotto Prizes

The Reserve for Future Lotto Prizes consists of accumulated balances from prior years resulting from an allocation of 2 percent of the Lotto Texas prize pool. As a result of a rule change effective April 23, 2006, there is no longer an allocation from the prize pool into the reserve fund. The fund may only be decreased by supplements to Lotto Texas prizes including jackpot amounts and guaranteed prizes.

Unrestricted Net Assets

Unrestricted net assets consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often have constraints on resources, which are imposed by management, but can be removed or modified. Unrestricted net assets in the Proprietary Funds consist of the following:

	2007
Future Lottery Prizes	\$ 5,732,467.57
Unrestricted/Undesignated	\$ 13,446,563.42

Future Lottery Prizes

The Reserve for Future Lottery Prizes is used to account for the investments in Proprietary Funds (0895) and the difference between fair value and amortized cost.

Unrestricted/Undesignated:

This represents other balances at year-end, retained by the Commission for operational purposes.

INTERAGENCY TRANSACTIONS AND BALANCES

The Commission has the following types of transactions among funds:

Intergovernmental Payments: Legally required payments that are reported when incurred by the Commission.

Payments to Foundation School Fund during fiscal year 2007 were as follows:

	2007
Cash payments	\$1,031,866,772.00
Accrued payments at beginning of fiscal year	(15,294,009.00)
Amount paid from current year revenue	1,016,572,763.00
Accrued payments at end of fiscal year	17,499,854.17
Total Payments to Foundation School Fund	\$1,034,072,617.17

Payments to the Department of State Health Services for credit to the Multicategorical Teaching Hospital Account for unclaimed prizes during fiscal year 2007 were as follows:

	2007
Cash payments	\$10,000,000.00
Accrued payments at beginning of fiscal year	0.00
Amount paid from current year revenue	10,000,000.00
Accrued payments at end of fiscal year	0.00
Total Payments to Multicategorical Teaching Hospital	\$10,000,000.00

Payments to the Comptroller of Public Accounts for credit to the General Revenue Fund for unclaimed prizes during fiscal year 2007 were as follows:

	2007
Cash payments	\$48,895,469.00
Accrued payments at beginning of fiscal year	0.00
Amount paid from current year revenue	48,895,469.00
Accrued payments at end of fiscal year	51,918.71
Total Payments to the Comptroller of Public Accounts – General Revenue	\$48,947,387.71

REVENUES AND EXPENSES

Operating and Non-operating Revenues or Expenses

Operating revenues are those derived directly from the operation of lottery activities. Revenues arising from transactions peripheral to lottery activities, gains and losses, investment income, and other contributions are treated as non-operating revenues.

Operating expenses are those costs that are either directly connected to the operation of lottery activities or necessary for the maintenance of the business enterprise. Expenses incurred for non-operating properties or in the performance of activities not directly related to the basic business enterprise are categorized as non-operating.

Recognition of Revenue

Lottery revenues are primarily composed of revenues from instant and on-line lottery ticket sales and retailer fees. Instant ticket sales are recognized as revenue when settled with retailers. Ticket packs are considered settled on the earlier of the date when 70 percent of the low-tier prizes in the pack are validated or 45 days after the pack is activated by the retailer. On-line ticket sales are recognized as revenue when tickets are purchased by lottery players. Revenues from retailer license and application fees are recorded when licenses are granted.

Lottery revenues are used for payments of prizes and to pay costs incurred in the operation and administration of the lottery, such costs being limited to 12 percent of gross lottery revenues, subject to appropriation limitation, accruing from the sales of tickets, including not less than 5 percent for retailer commissions. Any funds not used for these purposes are transferred to the Foundation School Fund of the State of Texas ("Foundation School Fund") at the end of each fiscal year.

Lottery Prizes

Prize expense for instant and on-line games is estimated as a function of sales based on the predetermined prize structure for each game.

Retailer Commissions

Retailers receive a commission of not less than 5 percent based on total ticket sales.

Retailer Bonuses

The Commission provides retailers additional compensation in the form of Retailer Bonuses for selling high tier prizes. The following table identifies the games offering a bonus option and the amount of the bonus.

Game	Bonus Structure
Lotto Texas	1% bonus of advertised jackpot, capped at \$500,000; retailer bonus is pari-mutuel.
Texas Two Step	1% bonus of advertised jackpot, capped at \$10,000; retailer bonus is pari-mutuel.
Cash Five	1% of the top-prize winning ticket, no maximum; retailer bonus is pari-mutuel.
Mega Millions	1% bonus of advertised grand/jackpot portion won in Texas up to \$1,000,000. Retailer bonus is pari-mutuel.
Instant Games *	\$10,000 bonus on top-prize tickets of \$1,000,000 or higher

* Not all games offer high tier prizes of \$1,000,000 or more.

Lottery Operator Fees

A Lottery Operator received a fee of 2.6999 percent for fiscal year 2007, respectively, based on the total lottery tickets sold, as defined in Section 10.3 of the contract for Lottery Operations and Services, dated October 10, 2001. In addition to the operator, the Commission contracts for other goods and services in the ordinary course of business. Payments under such contracts are charged to expense as the goods and services are received.

Use of Estimates

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

NOTE 2: Capital Assets

Assets are capitalized at cost or, if not purchased, at appraised fair value as of the date of acquisition. Based on the requirements of GASB Statement No. 34, depreciation is reported on all exhaustible assets. All capital assets acquired by proprietary funds or trust funds are reported at cost or estimated historical cost, if actual historical cost is not available.

The following schedules present the composition of the Commission's capital assets, adjustments, reclassifications, additions, and deletions during fiscal year 2007. The reclassifications column shows completed construction projects and transfers of capital assets between agencies, if any. The additions column includes current year purchases and depreciation. The deletions column shows assets removed during a fiscal year.

A summary of changes in Capital Assets and capitalization threshold and useful lives for the year ended August 31, 2007 is presented below:

Fiscal Year 2007

GOVERNMENTAL ACTIVITIES	PRIMARY GOVERNMENT							
	Balance 9/1/2006	Adjustments	Reclassifications			Additions	Deletions	Balance 8/31/2007
			Completed CIP	Increase Int'gy Trans	Decrease Int'gy Trans			
Depreciable Assets								
Furniture and Equipment	\$ 202,192.44							\$ 202,192.44
Vehicle, Boats & Aircraft								
Other Assets								
Total Depreciable Assets at Historical Costs	\$ 202,192.44							\$ 202,192.44
Less Accumulated Depreciation for:								
Furniture and Equipment	\$ (202,192.44)							\$ (202,192.44)
Total Accumulated Depreciation	(202,192.44)							(202,192.44)
Depreciable Assets, Net	-							-
Governmental Activities Capital Assets, Net	\$ -							\$ -

BUSINESS-TYPE ACTIVITIES	Balance 9/1/2006	Adjustments	Reclassifications			Additions	Deletions	Balance 8/31/2007
			Completed CIP	Increase Int'gy Trans	Decrease Int'gy Trans			
	Depreciable Assets							
Furniture and Equipment	\$ 5,484,202.86	\$ (20,342.64)				\$ 134,846.84	\$ (43,250.00)	\$ 5,555,457.06
Vehicle, Boats & Aircraft	32,706.57							32,706.57
Other Assets								
Total Depreciable Assets at Historical Costs	\$ 5,516,909.43	\$ (20,342.64)				\$ 134,846.84	\$ (43,250.00)	\$ 5,588,163.63
Less Accumulated Depreciation for:								
Furniture and Equipment	\$ (4,741,129.56)	\$ 20,342.64				\$ (232,402.05)	\$ 43,250.00	\$ (4,909,938.97)
Vehicles, Boats & Aircraft	(24,958.12)					(1,897.56)		(26,855.68)
Other Capital Assets								
Total Accumulated Depreciation	(4,766,087.68)	20,342.64				(234,299.61)	43,250.00	(4,936,794.65)
Depreciable Assets, Net	750,821.75	-				(99,452.77)	-	651,368.98
Business-Type Activities Capital Assets, Net	\$ 750,821.75	\$ -				\$ (99,452.77)	\$ -	\$ 651,368.98

The Capital Assets of the Commission are depreciated by using the Straight-Line Method. Capital Assets depreciable lives are established by the State's Property Accounting Division as follows:

Description	Life
Furniture and Equipment	3-10
Vehicles, Boats, & Aircraft	5-7
Leasehold Improvements	Life of the Lease

NOTE 3: Deposits, Investments, & Repurchase Agreements

The Commission's deposits are collateralized under a program administered by the Texas Treasury Safekeeping Trust Company. State law requires that all State funds administered by the Texas Treasury Safekeeping Trust Company deposited in financial institutions above the federally insured amounts be fully collateralized by the pledging of eligible securities valued at market excluding accrued interest to the state.

All securities pledged to the state must be held by a third-party bank domiciled in Texas; the Federal Reserve Bank of Dallas or one of its branches; or in the vault of the Texas Treasury Safekeeping Trust Company. The deposits in the Lottery Prize Payment account were fully collateralized at August 31, 2007.

Deposits of Cash in Bank

As of August 31, 2007, the carrying amounts of deposits was \$7,500.00 as presented below

Governmental and Business-Type Activities	
CASH IN BANK - CARRYING VALUE	7,500.00
Total Cash in Bank	\$ 7,500.00
Proprietary Funds Current Assets Cash in Bank	7,500.00
Governmental Funds Current Assts Cash in Bank	-
Total Cash in Bank	\$ 7,500.00

As of August 31, 2007 the total bank balance was as follows.

Governmental and Business Type Activities	\$5,759.59
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Investments

The Commission's investments consist of United States Government Securities (Treasury and REFCO Strips). These investments have been purchased to provide for the payment of the *Lotto Texas* and *Mega Millions* jackpot prizes that are payable annually to the winners over a nineteen-year, twenty-four year or twenty-six year period, as well as the installment payments for several instant ticket games. All investments are held to maturity; therefore, fluctuations in market price have no effect on the ability of the Commission to meet installment payment obligations as they become due. The Commission's investments are held by the Texas Treasury Safekeeping Trust Company or its agent in the Texas Treasury Safekeeping Trust Company's name.

As of August 31, 2007, the fair value of investments are as presented below.

Governmental and Business-Type Activities	Fair Value
U.S. Government	
U.S. Treasury Strips	\$15,213,280.92
Resolution Funding Corporation Strips	1,246,698,140.78
Repurchase Agreement (Texas Safekeeping Trust Co.)	14,863,232.87
Total Investments	\$1,276,774,654.57

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
U.S. Government Investments	\$ 1,261,911,421.70	\$ 166,824,880.41	\$ 719,261,505.64	\$ 243,795,568.30	\$ 132,029,467.35
Repurchase Agreement	14,863,232.87	14,863,232.87	-	-	-
Total	\$ 1,276,774,654.57	\$ 181,688,113.28	\$ 719,261,505.64	\$ 243,795,568.30	\$ 132,029,467.35

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. By rule, the Commission, through the Texas Treasury Safekeeping Trust Company, can only invest in U.S. Government Agency Obligations. These investments are explicitly guaranteed by the U.S. Government and therefore are not rated by nationally recognized statistical rating organizations.

Interest rate risk is the risk that the changes in interest rates will adversely affect the fair value of an investment. The Commission, through the Texas Treasury Safekeeping Trust Company, manages its exposure to fair value losses arising from increasing interest rates by limiting the modified duration of its investment portfolio.

Texas Lottery Commission	
	Modified Duration Years
U.S. Government –	
U.S. Treasury Strips	4.69
Resolution Funding Corporation Strips	10.42

Reverse Repurchase Agreements

At August 31, 2007, certain investments were subject to reverse repurchase agreements entered into by the Texas Treasury Safekeeping Trust Company. Such reverse repurchase agreements, which are permitted by statute, consist of sales of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. Proceeds are invested in securities that mature at or near the same date as the reverse repurchase agreement and the proceeds from those securities will be used to liquidate the agreement, resulting in a matched position and minimizing market risk because the Texas Treasury Safekeeping Trust Company will hold the securities to maturity and liquidate them at face value. The market value of securities underlying reverse repurchase agreements normally exceeds the cash received, providing a margin against decline in market value. If the repurchaser defaults on the obligation to sell these securities to the Texas Treasury Safekeeping Trust Company or provide securities or cash of equal value, an economic loss could result equal to the difference between the market value plus accrued interest of the underlying securities. Any such loss incurred would be the responsibility of the Texas Treasury Safekeeping Trust Company rather than the Commission. To minimize the risk of such default, all securities backing the reverse repurchase agreements are held by the Federal Reserve Bank of Dallas in the name of the Comptroller of Accounts, Treasury Operations. There were no significant violations of legal or contractual provisions during the year.

The amount of investments subject to reverse repurchase agreements at August 31, 2007 were approximately \$105,001,517.29 at cost. The fair value of the securities underlying these agreements at August 31, 2007 were approximately \$106,155,931.46.

NOTE 4: Summary of Long Term Liabilities

Changes in Long-Term Liabilities

During the year ended August 31, 2007, the following changes occurred in long-term liabilities.

Year Ended August 31, 2007

Governmental Activities	Balance 09-01-2006	Additions	Deductions	Balance 08-31-2007	Amounts Due Within One Year
Compensable Leave	\$284,663.53	\$233,443.06	\$242,519.33	\$275,587.26	\$150,935.54
Total Governmental Activities	\$284,663.53	\$233,443.06	\$242,519.33	\$275,587.26	\$150,935.54

Business-Type Activities	Balance 09-01-2006	Additions	Deductions	Balance 08-31-2007	Amounts Due Within One Year
Compensable Leave	\$1,751,452.22	\$1,879,018.19	\$1,743,055.17	\$1,887,415.24	\$1,101,353.81
Total Business-Type Activities	\$1,751,452.22	\$1,879,018.19	\$1,743,055.17	\$1,887,415.24	\$1,101,353.81

Employees' Compensable Leave

A state employee is entitled to be paid for all unused vacation time accrued, in the event of the employee's resignation, dismissal, or separation from State employment, provided the employee has had continuous employment with the State for six months. Expenditures for accumulated annual leave balances are recognized in the period paid or taken in governmental fund types. For these fund types, the liability for unpaid benefits is recorded in the Statement of Net Assets. An expense and liability for proprietary fund types are recorded in the proprietary funds as the benefits accrue to employees. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits.

NOTE 5: Operating Lease Obligations

The Commission leases its central office, which includes the lottery drawing studio and a claim center, a parking garage for the central office, and a warehouse/disaster recovery center in Austin. Also, ten claim centers and five regional offices throughout the State are under the terms of operating leases expiring at various dates through 2016. Rent expense for Charitable Bingo and Lottery operations under these and other leases amounted to \$8,229,715.61 in fiscal year 2007. These lease agreements generally do not require payment of taxes, insurance and maintenance by the Commission, except for utility costs directly attributable to computer equipment at the central office and utility and janitorial costs at some claim/regional centers. The Commission also leases office equipment under a month-to-month master-operating lease negotiated by the Texas Facilities Commission. Generally, management expects that leases will be renewed or replaced by other leases in the normal course of business.

Future minimum lease rental payments under non-cancelable operating leases having an initial term of more than one year are as follows:

Year Ended August 31,	
2008	\$4,068,423.81
2009	3,851,772.96
2010	2,892,155.03
2011	60,105.00
2012	44,566.64
2013-2017	104,599.20
Total Minimum Future Lease Rental Payments	\$ 11,021,622.64

NOTE 6: Interfund Balances/Activities

Interfund services are sales and purchases of goods and services between funds for a price approximating their external exchange value. This activity is reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as receivables and payables.

Balances as of August 31, 2007, follows:

Current Portion	2007	
	Current Interfund Receivable	Current Interfund Payable
GENERAL REVENUE (01) Appd Fund 0001, D23 Fund 0001 (Agency 362 Appd Fund 5025, D23 Fund 1100)		\$27,728,561.52
ENTERPRISE (05) Appd Fund 5025, D23 Fund 1100 (Agency 362 Appd Fund 0001, D23 Fund 0001)	\$27,728,561.52	
Total Interfund Receivable/Payable (Exh. I & III)	\$27,728,561.52	\$27,728,561.52

NOTE 7: Employees Retirement Plans

The State of Texas has joint contributory retirement plans for substantially all of its employees. The Commission participates in the defined benefit pension plans administered by the Employees Retirement System of Texas (the "System"). Each participating employee contributes six percent (6%) of their annual salary to the plan and the State, on behalf of the Commission, contributes 6.45% of the employee's annual salary to the plan. The State's portion of the contribution is recognized by the Commission as revenue or additional appropriations, in addition to recognizing an equal and corresponding expenditure. For Fiscal Year 2007 the States contribution totaled \$224,834.42.

Future pension costs are the liabilities of the System. The System does not account for each state agency separately. Annual financial reports prepared by the System include audited financial statements and actuarial assumptions and conclusions. The audited financial report for the Employees Retirement Plan is available by writing: Employees Retirement System of Texas, P.O. Box 13207, Austin, Texas, 78711.

NOTE 8: Deferred Compensation

State employees may elect to defer a portion of their earnings for income tax and investment purposes pursuant to authority granted in TEX.GOV'T CODE ANN., sec 609.001. The plan available for employees complies with Internal Revenue Code 457 and is accounted for by the State in accordance with the provisions of GASB Statement No. 32 *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. Neither the State or the Commission have any liability for losses under the plan.

The State also administers another plan: "TexaSaver", created in accordance with Internal Revenue Code Sec. 401(k). However, the assets of this plan do not belong to the state or the Commission. Accordingly, neither the State or the Commission have a liability related to this plan.

NOTE 9: Continuance Subject to Review

Under the Texas Sunset Act, the Commission will be abolished effective September 1, 2011, unless continued by the 82nd Legislature as provided by the Act. If abolished, the Commission may continue until September 1, 2012 to close out its operations.

NOTE 10: Segment Information

The Commission is not required to disclose segment information because information is already provided in the basic financial statements in the form of major individual enterprise funds.

NOTE 12: Concentration

The Commission entered into a contract (from October 10, 2001 through August 31, 2011) with a lottery operator as the sole provider of gaming systems, certain application control systems, instant ticket services and warehousing of lottery tickets to the Commission. The contract with the lottery operator represents a significant concentration of business with one vendor.

NOTE 13: Commitments and Contingencies

The following are pending lawsuits seeking monetary damages against the Commission. None of these pending cases is likely to result in a recovery against the Commission in a material amount, as "material" includes only amounts exceeding \$5,000,000 individually or in the aggregate.

- (1) Shelton Charles v. Texas Lottery and Gary Grief, Civil No. A-06-CA-158LY, in the U.S. District Court, Western District of Texas, Austin Division, was originally filed in District Court, Travis County, Texas on February 2, 2006, seeking monetary damages. The Legislative Budget Board and the Attorney General have been notified of this litigation.
- (2) William G. West, Trustee (In re: Bijani, Hamid H. Debtor) v. Texas Lottery Commission, Case No. 05-93546-H5-7 (Chapter 7), Adversary No. 06-3466, in the U.S. Bankruptcy Court, Southern District of Texas Houston Division, was filed on July 11, 2006, seeking a monetary judgment. The Attorney General has been notified of this litigation.
- (3) James T. Jongebloed v. Texas Lottery Commission; Cause No. GN304825; In the 353rd District Court of Travis County Texas, was filed in 2004, seeking judicial review of an administrative contested case order denying the Petitioner's request for a refund of approximately \$40,000. The Attorney General has been notified of this litigation.

The following are pending claims against the Commission. None of these pending claims is likely to result in a recovery against the Commission in a material amount, as "material" includes only amounts exceeding \$5,000,000 individually or in the aggregate.

1. Cynthia Edmondson-Smith. On August 27, 2007, Cynthia Edmondson-Smith filed a claim with the Texas Workforce Commission (TWC), alleging claims as to race, national origin, and age, seeking monetary compensation. The Commission was willing to engage in TWC's mediation; however, Complainant was not. This matter will now be assigned to a TWC investigator for a thorough investigation of the merits of the complaint

NOTE 14: Risk Financing

In the regular course of business, the Commission is exposed to property and casualty loss, and workers' compensation claims. The Commission retains the risk to cover losses to which it may be exposed.

The Commission assumes substantially all risks with tort claims and liability claims due to the performance of its duties. Currently, there is no purchase of commercial insurance. The Commission also participates in the State Office of Risk Management's (SORM) Risk Management and Workers' Compensation Coverage Program. The Commission's assessment for Fiscal Year 07 was \$36,201.33. The assessment covers workers' compensation and risk management costs.

The Commission's liabilities are reported when it is both probable that the loss has occurred and the amount of the loss can be reasonably estimated. Potential liabilities are re-evaluated periodically to consider settlements, frequency of claims, past experience and economic factors.

Changes in the balances of the Commission's claims liabilities during fiscal years 2006 and 2007 were as follows:

	Beginning of Fiscal Liability	Current Year Claims and Changes in Estimates	Claims Payments	Balance at Fiscal Year-End
2006	\$0.00	\$840.00	\$840.00	\$0.00
2007	\$0.00	\$125,707.58	\$84,000.00	\$41,707.58

NOTE 15: Subsequent Events

On September 30, 2007, Daily 4 and Sum It Up were made available for sale to the public. This is the first time in nearly four years the Commission has introduced a new game. As the name suggests, Daily 4 drawings feature four winning numbers. Players may select all four numbers or choose the two-number option by selecting only the front, middle or back pair of numbers. In addition to the new game, a new add-on feature was also released, Sum It Up. This feature allows players to win a prize even if the numbers they pick are not drawn. For an additional wager, players whose numbers add up to the sum of the numbers drawn receive the Sum It Up prize.

TEXAS LOTTERY COMMISSION

REQUIRED SUPPLEMENTARY INFORMATION OTHER THAN MD&A

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Texas Lottery Commission
Budgetary Comparison Schedule - General Fund
for the Fiscal Year Ended August 31, 2007
(Unaudited)

	GENERAL FUND			
	Budgetary Amounts			
	Budget (Original)	Budget (Final)	Actual Amounts* (Budgetary Basis)	Variance with Budget
REVENUES				
Legislative Appropriations:				
Original Appropriations	\$ 2,510,439.00	\$ 2,478,009.00	\$ 2,474,406.00	\$ (3,603.00)
Additional Appropriations	741,853.00	719,423.00	689,365.74	(30,057.26)
Licenses, Fees and Permits	10,801,500.00	11,597,715.00	11,642,659.42	44,944.42
Other	-	-	43,109.20	43,109.20
Total Revenues	14,053,792.00	14,795,147.00	14,849,540.36	54,393.36
EXPENDITURES				
Salaries and Wages	2,451,309.00	2,451,309.00	2,102,119.01	349,189.99
Payroll Related Costs	591,800.00	591,800.00	515,669.09	76,130.91
Professional Fees and Services	36,000.00	36,000.00	37,655.00	(1,655.00)
Travel	79,640.00	79,640.00	39,317.12	40,322.88
Materials and Supplies	8,256.00	8,256.00	31,293.31	(23,037.31)
Communication and Utilities	253.00	253.00	252.72	0.28
Repairs and Maintenance	2,592.00	2,592.00	3,534.00	(942.00)
Rentals and Leases	20,000.00	20,000.00	(1,825.75)	21,825.75
Printing and Reproduction	2,155.00	2,155.00	2,471.76	(316.76)
Other Expenditures	53,250.00	53,250.00	15,881.80	37,368.20
Appropriations Lapsed	-	-	1,407,365.04	(1,407,365.04)
Intergovernmental Allocations	10,801,500.00	10,801,500.00	11,597,714.69	(796,214.69)
Total Expenditures/Expenses	14,046,755.00	14,046,755.00	15,751,447.79	(1,704,692.79)
Excess (Deficiency) of Revenues Over Expenditures	7,037.00	748,392.00	(901,907.43)	(1,650,299.43)
FUND FINANCIAL STATEMENT-FUND BALANCES				
Fund Balances, Beginning of Year	1,520,615.57	1,520,615.57	1,520,615.57	-
Fund Balances, August 31, 2007	\$ 1,527,652.57	\$ 2,269,007.57	\$ 618,708.14	\$ (1,650,299.43)

* Actual amounts reflect expenditures paid in Fiscal Year 2007 regardless of budget appropriation year.

**NOTE TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING
FOR THE FISCAL YEAR ENDED AUGUST 31, 2007**

The financial statements for the Commission are prepared in accordance with generally accepted accounting principles - "GAAP basis". Since the Commission, like most other agencies of the state, prepares its annual budget using the modified accrual basis, which differs from the "GAAP basis", additional schedules of revenues and expenditures are presented for the General Fund to provide a meaningful comparison of actual results.

Adjustments necessary to convert the results of operations of the General Fund for the year ended August 31, 2007 from "budget basis" to "GAAP basis" are as follows:

RECONCILIATION OF BUDGETARY BASIS TO GAAP
--

Total Governmental Funds Balance	\$ 618,708.14
---	---------------

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the fund. These assets consist of:

Furniture and equipment	202,192.44
Accumulated depreciation	<u>(202,192.44)</u>
Total Capital Assets	

Some liabilities are not due and payable in the current period and therefore are not reported in the fund. Those liabilities consist of:

Employee compensable leave	<u>(275,587.26)</u>
Total long-term liabilities	<u>(275,587.26)</u>

Net Assets of Governmental Activities	<u>\$ 343,120.88</u>
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TEXAS LOTTERY COMMISSION

OTHER SUPPLEMENTARY INFORMATION – COMBINING FINANCIAL STATEMENTS

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Texas Lottery Commission
Combining Statement of Changes in Assets and Liabilities -
Agency Funds
For the Fiscal Year Ended August 31, 2007

	Beginning Balance September 1, 2006	Additions	Deductions	Ending Balance August 31, 2007
UNAPPROPRIATED RECEIPTS				
<u>Suspense Fund Seized Funds (0900) U/F (0362)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ 24,136.28	\$ 24,136.28	\$ 24,136.28	\$ 24,136.28
Total Assets	<u>\$ 24,136.28</u>	<u>\$ 24,136.28</u>	<u>\$ 24,136.28</u>	<u>\$ 24,136.28</u>
LIABILITIES				
Current				
Funds Held for Others	\$ 24,136.28	\$ 24,136.28	\$ 24,136.28	\$ 24,136.28
Total Liabilities	<u>\$ 24,136.28</u>	<u>\$ 24,136.28</u>	<u>\$ 24,136.28</u>	<u>\$ 24,136.28</u>
<u>Suspense Fund (0900) U/F (0900)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 10,814.86	\$ 10,814.86	\$ -
Total Assets	<u>\$ -</u>	<u>\$ 10,814.86</u>	<u>\$ 10,814.86</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	\$ -	\$ 10,814.86	\$ 10,814.86	\$ -
Total Liabilities	<u>\$ -</u>	<u>\$ 10,814.86</u>	<u>\$ 10,814.86</u>	<u>\$ -</u>
<u>Warrant Hold Offset (0900) U/F (9016)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 5,908.77	\$ 5,908.77	\$ -
Total Assets	<u>\$ -</u>	<u>\$ 5,908.77</u>	<u>\$ 5,908.77</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	\$ -	\$ 5,908.77	\$ 5,908.77	\$ -
Total Liabilities	<u>\$ -</u>	<u>\$ 5,908.77</u>	<u>\$ 5,908.77</u>	<u>\$ -</u>
<u>Savings Bond Fund (0901) U/F (0901)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ 650.00	\$ 5,900.00	\$ 5,650.00	\$ 900.00
Total Assets	<u>\$ 650.00</u>	<u>\$ 5,900.00</u>	<u>\$ 5,650.00</u>	<u>\$ 900.00</u>
LIABILITIES				
Current				
Funds Held for Others	\$ 650.00	\$ 5,900.00	\$ 5,650.00	\$ 900.00
Total Liabilities	<u>\$ 650.00</u>	<u>\$ 5,900.00</u>	<u>\$ 5,650.00</u>	<u>\$ 900.00</u>

Texas Lottery Commission
Combining Statement of Changes in Assets and Liabilities -
Agency Funds
For the Fiscal Year Ended August 31, 2007

	Beginning Balance September 1, 2006	Additions	Deductions	Ending Balance August 31, 2007
<u>Deferred Compensation 401K (0942) U/F (0942)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 523,711.57	\$ 523,711.57	\$ -
Other Receivables	-	569,265.28	569,265.28	-
Total Assets	<u>\$ -</u>	<u>\$ 1,092,976.85</u>	<u>\$ 1,092,976.85</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	\$ -	\$ 569,265.28	\$ 569,265.28	\$ -
Total Liabilities	<u>\$ -</u>	<u>\$ 569,265.28</u>	<u>\$ 569,265.28</u>	<u>\$ -</u>
<u>Correction Account - Direct Deposit (0980) U/F (0980)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 90.74	\$ 90.74	\$ -
Total Assets	<u>\$ -</u>	<u>\$ 90.74</u>	<u>\$ 90.74</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	\$ -	\$ 90.74	\$ 90.74	\$ -
Total Liabilities	<u>\$ -</u>	<u>\$ 90.74</u>	<u>\$ 90.74</u>	<u>\$ -</u>
<u>Bingo Cash Bonds (0001) Fund (1002)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 204,935.98	\$ 204,935.98	\$ -
Total Assets	<u>\$ -</u>	<u>\$ 204,935.98</u>	<u>\$ 204,935.98</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	\$ -	\$ 213,743.94	\$ 213,743.94	\$ -
Total Liabilities	<u>\$ -</u>	<u>\$ 213,743.94</u>	<u>\$ 213,743.94</u>	<u>\$ -</u>
Totals - All Agency Funds				
ASSETS				
Current				
Cash in State Treasury	\$ 24,786.28	\$ 775,498.20	\$ 775,248.20	\$ 25,036.28
Receivables:				
Other	-	569,265.28	569,265.28	-
Total Assets	<u>\$ 24,786.28</u>	<u>\$ 1,344,763.48</u>	<u>\$ 1,344,513.48</u>	<u>\$ 25,036.28</u>
LIABILITIES				
Current				
Funds Held for Others	24,786.28	829,859.87	829,609.87	25,036.28
Total Liabilities	<u>\$ 24,786.28</u>	<u>\$ 829,859.87</u>	<u>\$ 829,609.87</u>	<u>\$ 25,036.28</u>

TEXAS LOTTERY COMMISSION

COMPLIANCE SECTION – INDEPENDENT AUDITOR’S REPORT

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Board of Commissioners of the
Texas Lottery Commission:

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Texas Lottery Commission (the "Commission"), as of and for the year ended August 31, 2007, which collectively comprise the Commission's basic financial statements and have issued our report thereon dated December 14, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commission's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

Affiliated Companies

ML&R PERSONNEL SOLUTIONS LLC

"The Resource for Direct Hire & Project Staffing"

ML&R WEALTH MANAGEMENT LLC[®]

"A Registered Investment Advisor"

[®]This firm is not a CPA firm

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Commission's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Commission's financial statements that is more than inconsequential will not be prevented or detected by the Commission's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Responses to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Commission's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we believe that none of the significant deficiencies described in the accompanying Schedule of Findings and Responses is a material weakness.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Commission, in a separate letter dated December 14, 2007.

The Commission's written responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses and have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of Commissioners, management, and other regulatory bodies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Maxwell Locke & Ritter LLP

December 14, 2007

SCHEDULE OF FINDINGS AND RESPONSES

Prizes Payable Reconciliation

The Commission accumulates prizes payable unrelated to investment purchases, which is included in the current portion of “payable from restricted assets” in its financial statements. Although the aggregate prizes payable balance of approximately \$139 million was significant to the financial statements at August 31, 2007, management does not have a process in place to perform a general ledger reconciliation of these accounts. The primary transactions which affect these prizes payable accounts are i) recognition of prize expense; ii) validations of winning tickets, iii) transfers of unclaimed prizes; iv) the net change in the Prize Reserve Fund; and v) certain timing differences related to Mega Millions activity. Although this information is readily available, the reconciliation is expected to be complex due to the manner in which PROSYS reports certain activity and the difficulty in researching differences due to the sheer volume of transactions. Management should develop a reconciliation procedure as the recording of prizes payable represents a major process in the daily activities of the Office of the Controller and the balance is significant to the financial statements as a whole.

Commission’s response:

The Commission agrees with the recommendation.

Prize Disbursements and Related Bank Reconciliation

While performing audit procedures on the Commission’s cash balances, we noted that a bank reconciliation of the prize payment cash account was unavailable as of August 31, 2007. Management explained that an error was discovered in early fiscal year 2006 whereby certain check numbers for prize disbursements were duplicated between claim centers. This error recurred during the year ended August 31, 2007. As a result, the automated process used to generate an outstanding checklist for the prize payment cash account has been halted until the duplicated check numbers can be manually investigated and cleared. Although the monthly disbursement activity has been reconciled since September 2005, this process does not provide a detailed list of cleared and outstanding items and it cannot be relied upon to uncover potential errors that should be discovered by performing a traditional reconciliation. We recommend that the Commission review and update its procedures surrounding the automated assignment of check numbers at its claim centers. In addition, we recommend that the Commission make the correction of the prize payment outstanding checklist a priority as the current process does not provide useful, detailed information for management.

Commission’s response:

The Commission agrees with the recommendation.



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