



A N N U A L
F I N A N C I A L
R E P O R T

FISCAL YEAR 2006

November 20, 2006

Honorable Rick Perry, Governor
Honorable Carole Keeton Strayhorn, Texas Comptroller
John O'Brien, Deputy Director, Legislative Budget Board
John Keel, CPA, State Auditor

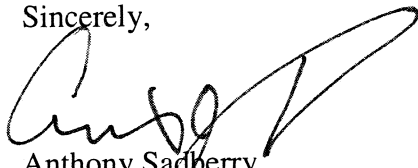
Lady and Gentlemen:

We are pleased to submit the Annual Financial Report of the Texas Lottery Commission for the year ended August 31, 2006, in compliance with TEX.GOV'T CODE ANN §2101.011 and in accordance with the requirements established by the Comptroller of Public Accounts.

Due to the statewide requirements embedded in Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments*, the Comptroller of Public Accounts does not require the accompanying annual financial report to comply with all the requirements in this statement. The financial report will be considered for audit by the State Auditor as part of the audit of the State of Texas Comprehensive Annual Financial Report; therefore, an opinion has not been expressed on the financial statements and related information contained in this report.

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

Sincerely,



Anthony Sadberry
Executive Director

TEXAS LOTTERY COMMISSION

Annual Financial Report For the Year Ended August 31, 2006

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TEXAS LOTTERY COMMISSION

Exhibits

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Texas Lottery Commission (362)

Exhibit I - Combined Balance Sheet/Statement of Net Assets – Governmental Funds

August 31, 2006

	Governmental Fund Types General Funds (Exhibit A-1)	Governmental Funds Total	Capital Assets Adjustments	Long-Term Liabilities Adjustments	Statement of Net Assets
ASSETS					
Current Assets:					
Legislative Appropriations	\$ 1,778,179.50	\$ 1,778,179.50	\$ -	\$ -	\$ 1,778,179.50
Total Current Assets	<u>1,778,179.50</u>	<u>1,778,179.50</u>	<u>-</u>	<u>-</u>	<u>1,778,179.50</u>
Non-Current Assets:					
Restricted:					
Capital Assets: (Note 2)					
Depreciable:					
Furniture and Equipment	-	-	202,192.44	-	202,192.44
Less: Accumulated Depreciation	-	-	(202,192.44)	-	(202,192.44)
Total Non-Current Assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Assets	<u><u>\$ 1,778,179.50</u></u>	<u><u>\$ 1,778,179.50</u></u>	<u><u>-</u></u>	<u><u>-</u></u>	<u><u>1,778,179.50</u></u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Current Liabilities:					
Payables From:					
Accounts	\$ 33,977.91	\$ 33,977.91	\$ -	\$ -	\$ 33,977.91
Vouchers	1,105.00	1,105.00	-	-	1,105.00
Payroll	222,481.02	222,481.02	-	-	222,481.02
Employees Compensable Leave (Note 5)	-	-	-	168,967.02	168,967.02
Total Current Liabilities	<u>257,563.93</u>	<u>257,563.93</u>	<u>-</u>	<u>168,967.02</u>	<u>426,530.95</u>
Non-Current Liabilities:					
Employees Compensable Leave (Note 5)	-	-	-	115,696.51	115,696.51
Total Non-Current Liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>115,696.51</u>	<u>115,696.51</u>
Total Liabilities	<u>257,563.93</u>	<u>257,563.93</u>	<u>-</u>	<u>284,663.53</u>	<u>542,227.46</u>
FUND FINANCIAL STATEMENT					
Fund Balances (Deficits):					
Reserved for:					
Encumbrances	4,920.00	4,920.00	-	-	4,920.00
Undesignated	1,515,695.57	1,515,695.57	-	-	1,515,695.57
Total Fund Balances	<u>1,520,615.57</u>	<u>1,520,615.57</u>	<u>-</u>	<u>-</u>	<u>1,520,615.57</u>
Total Liabilities and Fund Balances	<u><u>\$ 1,778,179.50</u></u>	<u><u>\$ 1,778,179.50</u></u>	<u><u>-</u></u>	<u><u>284,663.53</u></u>	<u><u>2,062,843.03</u></u>
GOVERNMENT-WIDE STATEMENT OF NET ASSETS					
Net Assets:					
Invested in Capital Assets,					
Net of Related Debt			-	-	-
Unrestricted			-	(284,663.53)	(284,663.53)
Total Net Assets			<u><u>\$ -</u></u>	<u><u>\$ (284,663.53)</u></u>	<u><u>\$ (284,663.53)</u></u>

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

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**Exhibit II - Combined Statement of Revenues, Expenditures and
Changes in Fund Balances/Statement of Activities – Governmental Funds
For the Fiscal Year Ended August 31, 2006**

	General Funds (Exhibit A-2)	Governmental Funds Total	Capital Assets Adjustments	Long-Term Liabilities Adjustments	Statement of Activities
REVENUES:					
Legislative Appropriations:					
Original Appropriations	\$ 2,480,812.00	\$ 2,480,812.00	\$ -	\$ -	\$ 2,480,812.00
Additional Appropriations	660,430.20	660,430.20			660,430.20
Licenses, Fees & Permits	11,455,605.88	11,455,605.88			11,455,605.88
Settlement of Claims	262,275.00	262,275.00			262,275.00
Sales of Goods and Services	500.00	500.00			500.00
Other	122,734.20	122,734.20			122,734.20
Total Revenues	<u>14,982,357.28</u>	<u>14,982,357.28</u>	<u>-</u>	<u>-</u>	<u>14,982,357.28</u>
EXPENDITURES:					
Salaries and Wages	2,256,118.50	2,256,118.50		25,838.47	2,281,956.97
Payroll Related Costs	554,744.12	554,744.12			554,744.12
Professional Fees and Services	55,515.00	55,515.00			55,515.00
Travel	85,564.15	85,564.15			85,564.15
Materials and Supplies	34,443.99	34,443.99			34,443.99
Communication and Utilities	252.72	252.72			252.72
Repairs and Maintenance	3,614.50	3,614.50			3,614.50
Rentals and Leases	6,844.46	6,844.46			6,844.46
Printing and Reproduction	3,292.94	3,292.94			3,292.94
Intergovernmental Payments	11,456,502.45	11,456,502.45			11,456,502.45
Other Expenditures	30,899.11	30,899.11			30,899.11
Depreciation Expense (Note 2)	-	-	4,579.08		4,579.08
Total Expenditures/Expenses	<u>14,487,791.94</u>	<u>14,487,791.94</u>	<u>4,579.08</u>	<u>25,838.47</u>	<u>14,518,209.49</u>
Excess (Deficiency) of Revenues over Expenditures	<u>494,565.34</u>	<u>494,565.34</u>	<u>(4,579.08)</u>	<u>(25,838.47)</u>	<u>464,147.79</u>
OTHER FINANCING SOURCES (USES)					
Gain (Loss) on Sale of Capital Assets	2,700.00	2,700.00			2,700.00
Total Other Financing Sources (Uses)	<u>2,700.00</u>	<u>2,700.00</u>	<u>-</u>	<u>-</u>	<u>2,700.00</u>
Net Change in Fund Balances/Net Assets	<u>497,265.34</u>	<u>497,265.34</u>	<u>(4,579.08)</u>	<u>(25,838.47)</u>	<u>466,847.79</u>
FUND FINANCIAL STATEMENT - FUND BALANCES					
Fund Balances, September 1, 2005	222,616.90	222,616.90			222,616.90
Restatements	885,268.59	885,268.59			885,268.59
Fund Balances, September 1, 2005, as Restated	<u>1,107,885.49</u>	<u>1,107,885.49</u>	<u>-</u>	<u>-</u>	<u>1,107,885.49</u>
Appropriations Lapsed	(84,535.26)	(84,535.26)			
Fund Balances, August 31, 2006	<u>\$ 1,520,615.57</u>	<u>\$ 1,520,615.57</u>			
GOVERNMENT-WIDE STATEMENT OF NET ASSETS					
Net Assets/Net Change in Net Assets			<u>(4,579.08)</u>	<u>(25,838.47)</u>	<u>(30,417.55)</u>
Net Assets, September 1, 2005			4,579.08	(258,825.06)	(254,245.98)
Restatements					
Net Assets, September 1, 2005, as Restated			<u>4,579.08</u>	<u>(258,825.06)</u>	<u>(254,245.98)</u>
Net Assets, August 31, 2006			<u>\$ -</u>	<u>\$ (284,663.53)</u>	<u>\$ (284,663.53)</u>

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

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Exhibit III - Combined Statement of Net Assets - Proprietary Funds

August 31, 2006

	Total Enterprise Funds (Exhibit F-1)
ASSETS	
Current Assets:	
Cash and Cash Equivalents:	
Cash in Bank (Note 3)	\$ 7,500.00
Cash in State Treasury	126,300,833.83
Restricted:	
Short Term Investments (Note 3)	173,687,706.97
Receivables from:	
Accounts	19,017,950.72
Taxes	450,035.50
Other	158,329.00
Due From Other Funds (Note 8)	535,215.72
Due From Other Agencies (Note 8)	1,369,213.21
Consumable Inventories	710,023.36
Merchandise Inventories	5,309,737.15
Deferred Charges	7,777,500.00
Total Current Assets	<u>335,324,045.46</u>
Non-Current Assets:	
Restricted:	
Investments (Note 3)	1,101,610,320.45
Capital Assets (Note 2):	
Depreciable:	
Furniture and Equipment	5,484,202.86
Less: Accumulated Depreciation	(4,741,129.56)
Vehicles, Boats, and Aircraft	32,706.57
Less: Accumulated Depreciation	(24,958.12)
Total Non-Current Assets	<u>1,102,361,142.20</u>
Total Assets	<u>\$ 1,437,685,187.66</u>
LIABILITIES	
Current Liabilities:	
Payables from:	
Voucher	\$ 6,884,518.85
Accounts	20,110,315.93
Payroll	1,449,130.23
Annuities	10,992,472.18
Other	727,030.35
Due to Other Funds (Note 8)	535,215.72
Due to Other Agencies (Note 8)	15,294,008.76
Employees' Compensable Leave (Note 5)	1,112,211.63
Payable From Restricted Assets-Current Portion	242,321,970.68
Total Current Liabilities	<u>299,426,874.33</u>
Non-Current Liabilities:	
Employees' Compensable Leave (Note 5)	639,240.59
Payable From Restricted Assets	1,105,372,244.67
Total Non-Current Liabilities	<u>1,106,011,485.26</u>
Total Liabilities	<u>\$ 1,405,438,359.59</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	750,821.75
Restricted for:	
Expendable:	
Restricted by Other	
Pooled Bond Fund	5,000,000.00
Prize Reserve Fund	13,837,358.66
Unrestricted	12,658,647.66
Total Net Assets	<u>\$ 32,246,828.07</u>

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

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Texas Lottery Commission (362)
Exhibit IV - Combined Statement of Revenues, Expenses and
Changes in Net Assets - Proprietary Funds
For the Fiscal Year Ended August 31, 2006

	Total Enterprise Funds (Exhibit F-2)
OPERATING REVENUES:	
Sales of Goods and Services:	
Lottery Proceeds	
Ticket Sales	\$ 3,774,685,562.00
Lottery License Application Fees	303,174.25
Lottery Security Proceeds	71,538.00
Other Operating Revenues	1,058,448.60
Total Operating Revenues	<u>3,776,118,722.85</u>
OPERATING EXPENSES:	
Salaries and Wages	13,811,258.12
Payroll Related Costs	3,346,542.76
Professional Fees and Services	6,329,548.22
Travel	286,682.00
Materials and Supplies	270,406.16
Communication and Utilities	594,073.31
Repairs and Maintenance	497,869.89
Rentals and Leases	7,246,814.03
Printing and Reproduction	14,883,416.01
Depreciation and Amortization	257,526.14
Bad Debt Expense	789,868.75
Interest	828.69
Lottery Prizes	2,310,561,488.27
Retailer Commissions	188,818,620.60
Retailer Bonuses	2,804,520.68
Other Operating Expenses:	
Lottery Operator Fees	102,124,102.07
Advertising	31,577,820.18
Other	2,883,908.73
Total Operating Expenses	<u>2,687,085,294.61</u>
Operating Income (Loss)	<u>1,089,033,428.24</u>
NONOPERATING REVENUES (EXPENSES):	
Investment Income (Expense)	39,459.51
Net Increase (Decrease) in Fair Value	(58,685,603.75)
Settlement of Claims	(720.00)
Total Nonoperating Revenues (Expenses)	<u>(58,646,864.24)</u>
Income (Loss) Before Other Revenues, Expenses, Gains/Losses and Transfers	<u>1,030,386,564.00</u>
OTHER REVENUES, EXPENSES, GAINS/LOSSES AND TRANSFERS:	
Transfers-Out (Note 8)	(1,090,333,057.54)
Total Other Revenues, Expenses, Gains/Losses and Transfers	<u>(1,090,333,057.54)</u>
Change in Net Assets	<u>(59,946,493.54)</u>
Total Net Assets, September 1, 2005	92,193,321.61
Restatements	-
Total Net Assets, September 1, 2005, as Restated	<u>92,193,321.61</u>
Total Net Assets, August 31, 2006	<u><u>\$ 32,246,828.07</u></u>

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

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Exhibit V - Combined Statement of Cash Flows - Proprietary Funds

For the Fiscal Year Ended August 31, 2006

	Total Enterprise Funds (Exhibit F-3)
CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from Customers	\$ 3,772,279,239.84
Payments to Suppliers for Goods and Services	(357,254,723.73)
Payments to Employees	(16,781,710.48)
Payments for Other Expenses	(2,319,513,099.31)
Net Cash Provided by Operating Activities	<u>1,078,729,706.32</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Payments for Other Uses	(162,611,000.00)
Payments for Transfers to Other Funds	(1,086,680,001.22)
Proceeds from other Financing	22,160,000.00
Net Cash Provided by Noncapital Financing Activities	<u>(1,227,131,001.22)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Payments for Additions to Capital Assets	<u>(150,666.79)</u>
Net Cash Provided by Capital and Related Financing Activities	<u>(150,666.79)</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from Sales of Investments	162,611,000.00
Proceeds from Interest and Investment Income	39,459.51
Payments to Acquire Investments	(24,963,559.20)
Net Cash Provided by Investing Activities	<u>137,686,900.31</u>
Net (Decrease) in Cash and Cash Equivalents	(10,865,061.38)
Cash and Cash Equivalents--September 1, 2005	<u>137,173,395.21</u>
Cash and Cash Equivalents--August 31, 2006	<u><u>\$ 126,308,333.83</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating Income (Loss)	\$ 1,089,033,428.24
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities	
Amortization and Depreciation	257,526.14
Bad Debt Expense	789,868.75
Operating Income and Cash Flow Categories: Changes in Assets and Liabilities:	
(Increase) Decrease in Receivables	(3,839,483.01)
(Increase) Decrease in Inventories	143,901.74
(Increase) Decrease in Deferred Charges	1,555,500.00
Increase (Decrease) in Payables	(9,211,035.54)
Total Adjustments	<u>(10,303,721.92)</u>
Net Cash Provided by Operating Activities	<u><u>\$ 1,078,729,706.32</u></u>
NON CASH TRANSACTIONS	
Net Increase (Decrease) in Fair Value of Investments	\$ (58,685,603.75)

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

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UNAUDITED**Texas Lottery Commission (362)****Exhibit VI - Combined Statement of Fiduciary Net Assets****August 31, 2006**

	Agency Funds (Exhibit J-1)	Totals
ASSETS		
Current Assets:		
Cash and Cash Equivalents:		
Cash in State Treasury	\$ 24,786.28	\$ 24,786.28
Total Assets	<u>\$ 24,786.28</u>	<u>\$ 24,786.28</u>
LIABILITIES		
Current Liabilities:		
Funds Held for Others	\$ 24,786.28	\$ 24,786.28
Total Liabilities	<u>\$ 24,786.28</u>	<u>\$ 24,786.28</u>

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

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TEXAS LOTTERY COMMISSION

Notes to the Financial Statements

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Notes to the Financial Statements

NOTE 1: Summary of Significant Accounting Policies

Entity

The Texas Lottery Commission is an agency of the State of Texas and its financial records comply with state statutes and regulations. This includes compliance with the Reporting Requirements for State Agencies as set forth by the Texas Comptroller of Public Accounts.

The Texas Lottery Commission serves the state by operating lottery games. The Texas Lottery was created on August 26, 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 5, 1991 and commenced operations on November 20, 1991. The Texas Lottery Commission was formed by 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 persons to the Texas Lottery Commission. The commissioners appoint the Executive Director of the Texas Lottery Commission and the Director of Charitable Bingo.

Effective April 1, 1994, House Bill No. 2771, 73rd Legislature, Regular Session, transferred Bingo operations from the Texas Alcoholic Beverage Commission to the Texas Lottery Commission. The Charitable Bingo Operations Division of the Texas Lottery Commission collects fees and regulates the operation of charitable bingo in the State of Texas. Fees collected are allocated to cities and counties with the balance being deposited in the General Revenue Fund.

Due to the statewide requirements embedded in Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, the Comptroller of Public Accounts does not require the accompanying annual financial report to comply with all the requirements in this statement. The financial report will be considered for audit by the State Auditor as part of the audit of the State of Texas Comprehensive Annual Financial Report; therefore, an opinion has not been expressed on the financial statements and related information contained in this report.

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 Revenue, two Enterprise Funds, and Agency Funds.

Governmental Fund Types

General Revenue Fund

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.

Capital Assets Adjustment Fund Type

Capital Assets Adjustment fund type will be used to convert governmental fund types’ capital assets from modified accrual to full accrual.

Long-Term Liabilities Adjustment Fund Type

Long-Term Liabilities Adjustment fund type will be used to convert governmental fund types’ capital assets from modified accrual to full accrual.

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

Texas Lottery Commission 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 Fund – Enterprise (06) Appd Fund, D23 Fund 0895 (0895) - This fund is used to account for investments purchased by the Texas Lottery 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 state 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 Lottery 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 Lottery Commission for debt owed to the Lottery Commission.

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

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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.

Basis of Accounting

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 Texas Lottery 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.

Governmental adjustment fund types that will build the government-wide financial statements are accounted for using the full accrual basis of accounting. This includes capital assets, accumulated depreciation, unpaid Employee Compensable Leave, and full accrual revenues and expenses. The activity will be recognized in these fund types.

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. 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.

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.

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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 Texas Lottery Commission retains 12 percent of gross Lottery revenues accruing from the sale 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 2006, 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 2007. Obligated amounts in the Lottery operations account at August 31, 2006 are included as Cash in State Treasury on the Lottery's balance sheet because the use of such funds is necessary to cover the Lottery's expenditures and prize payment obligations.

Accrued transfers in the amount of \$15,294,008.76 are recorded as "Due to Other Agencies" as of August 31, 2006. The total amount is due to the Foundation School Fund (Fund 0193).

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 acquisition date. Depreciation is charged to operations over the estimated useful life of each asset, using the straight-line method.

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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

Employees' Compensable Leave Balances represent the liability that becomes "due" upon the occurrence of relevant events such as resignations, retirements, and uses of leave balances by covered employees. Liabilities are reported separately as either current or non-current in the statement of net assets.

Prizes Payable

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 Texas Lottery Commission's behalf, as are the installment payments for Weekly Grand, Top Prize, Monthly Bonus, and Set for Life.

The amortization of the discount of investments held for prizes payable is based on yields ranging from 4.54 percent to 5.18 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, 2006:

2006	
Total Obligation	\$ 1,636,288,000.00
Less - unamortized discount	367,116,755.33
Total carrying amount	1,269,171,244.67
Less - prizes payable within one year	163,799,000.00
Long-term prizes payable	\$ 1,105,372,244.67

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

Aggregate Amount of Prizes Payable	Governmental Activities		Business-Type Activities	
	Principal	Interest	Principal	Interest
2007 (Future Year 1)			\$163,799,000.00	
2008 (Future Year 2)			163,799,000.00	
2009 (Future Year 3)			163,669,000.00	
2010 (Future Year 4)			163,669,000.00	
2011 (Future Year 5)			163,669,000.00	
2012-2016			544,260,000.00	
2017-2021			193,559,000.00	
2022-2026			77,706,000.00	
2027			2,158,000.00	
Total Prizes Payable			\$1,636,288,000.00	

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 2006, the Lottery transferred a total of \$54,222,588.78 in unclaimed lottery prize winnings on a quarterly basis to the following agencies: The Comptroller of Public Account received \$44,222,588.78 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 "Net Assets" on the government-wide, proprietary and fiduciary fund statements, and the "Fund Balance" is the difference between fund assets and liabilities on the governmental fund statements.

Reservation of Fund Balance

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 un-appropriated balance at year-end, which may be subject to lapse.

Invested In Capital Assets, Net of Related Debt

Invested in capital assets, net of related debt 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.

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.

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

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, 2006, 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 that 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 Enterprise Funds consist of the following:

Future Lottery Prizes

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

Unrestricted/Undesignated:

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

Net Assets:	
Invested in Capital Assets, Net of related Debt	\$750,821.75
Restricted-	
Reserved for Pooled Bond Fund	5,000,000.00
Reserved for Future Lotto Prizes	13,837,358.66
Unrestricted-	
Reserved for Future Lottery Prizes	(8,095,896.99)
Unrestricted/Undesignated	20,754,544.65
Total Proprietary Fund Net Assets:	\$32,246,828.07

INTERFUND ACTIVITIES AND BALANCES

The agency has the following type of transaction among funds:

Operating Transfers: Legally required transfers that are reported when incurred as 'Operating Transfers In' by the recipient fund and as 'Operating Transfers Out' by the disbursing fund.

The composition of the agency's interfund receivables and payables at August 31, 2006 is presented in Note 8.

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Transfers to Foundation School Fund during fiscal year 2006 are as follows:

Cash transfers	\$1,029,612,986.52
Accrued transfers at beginning of fiscal year	(8,796,526.52)
Amount transferred from current year revenue	1,020,816,460.00
Accrued transfers at end of fiscal year	15,294,008.76
Total Transfers to Foundation School Fund	<u>\$1,036,110,468.76</u>

Transfers to the Comptroller of Public Accounts – General Revenue Fund for unclaimed prizes during fiscal year 2006 are as follows:

Cash transfers	\$45,155,528.77
Accrued transfers at beginning of fiscal year	(932,939.99)
Amount transferred from current year revenue	44,222,588.78
Accrued transfers at end of fiscal year	0.00
Total Transfers to the Comptroller of Public Account – General Revenue	<u>\$44,222,588.78</u>

Transfers to the Department of State Health Services for unclaimed prizes during fiscal year 2006 are as follows:

Cash transfers	\$10,000,000.00
Accrued transfers at beginning of fiscal year	0.00
Amount transferred from current year revenue	10,000,000.00
Accrued transfers at end of fiscal year	0.00
Total Transfers to the Department of State Health Services	<u>\$10,000,000.00</u>

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REVENUES AND EXPENSES

Recognition of Revenue

Lottery revenues are primarily composed of 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 payment 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 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 Lottery provides retailers additional compensation in the form of 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

The Lottery operator received a fee of 2.6999 percent for fiscal year 2006 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 Texas Lottery 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.

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NOTE 2: Capital Assets

A summary of changes in Capital Assets for the year ended August 31, 2006, is presented below:

	PRIMARY GOVERNMENT							Balance 8/31/2006
	Balance 9/1/2005	Adjustments	Completed CIP	Increase Int'g'y Trans	Decrease Int'g'y Trans	Additions	Deletions	
GOVERNMENTAL ACTIVITIES								
Depreciable Assets								
Furniture and Equipment	\$ 207,457.13						\$ (5,264.69)	\$ 202,192.44
Vehicle, Boats & Aircraft								
Other Assets								
Total Depreciable Assets at Historical Costs	\$ 207,457.13						\$ (5,264.69)	\$ 202,192.44
Less Accumulated Depreciation for:								
Furniture and Equipment	\$ (202,878.05)					\$ (4,579.08)	\$ 5,264.69	\$ (202,192.44)
Total Accumulated Depreciation	(202,878.05)					(4,579.08)	5,264.69	(202,192.44)
Depreciable Assets, Net	4,579.08					(4,579.08)	-	-
Governmental Activities Capital Assets, Net	\$ 4,579.08					\$ (4,579.08)	\$ -	\$ -
	Reclassifications							Balance 8/31/2006
	Balance 9/1/2005	Adjustments	Completed CIP	Increase Int'g'y Trans	Decrease Int'g'y Trans	Additions	Deletions	
BUSINESS-TYPE ACTIVITIES								
Depreciable Assets								
Furniture and Equipment	\$ 5,907,996.93	\$ 11,400.00			\$ (5,043.88)	\$ 174,773.79	\$ (604,923.98)	\$ 5,484,202.86
Vehicle, Boats & Aircraft	32,706.57							32,706.57
Other Assets								
Total Depreciable Assets at Historical Costs	\$ 5,940,703.50	\$ 11,400.00			\$ (5,043.88)	\$ 174,773.79	\$ (604,923.98)	\$ 5,516,909.43
Less Accumulated Depreciation for:								
Furniture and Equipment	\$ (5,095,468.84)	\$ (1,899.96)			\$ 5,043.88	\$ (253,728.62)	\$ 604,923.98	\$ (4,741,129.56)
Vehicles, Boats & Aircraft	(23,060.56)					(1,897.56)		(24,958.12)
Other Capital Assets								
Total Accumulated Depreciation	(5,118,529.40)	(1,899.96)			5,043.88	(255,626.18)	604,923.98	(4,766,087.68)
Depreciable Assets, Net	822,174.10	9,500.04			-	(80,852.39)	-	750,821.75
Business-Type Activities Capital Assets, Net	\$ 822,174.10	\$ 9,500.04			\$ -	\$ (80,852.39)	\$ -	\$ 750,821.75

The Capital Assets of the Texas Lottery 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 were covered by depository insurance or fully collateralized at August 31, 2006.

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Deposits of Cash in Bank

As of August 31, 2006, the carrying amount of deposits was \$7,500.00 as presented below:

Governmental and Business Type Activities	
Cash in Bank – Carrying Amount	\$7,500.00
Total Cash in Bank per AFR	\$7,500.00
Proprietary Funds Current Assets Cash in Bank	\$7,500.00
Total Cash in Bank per AFR	\$7,500.00

These amounts consist of all cash in local banks. These amounts are included on the Combined Statement of Net assets as part of the “Cash and Cash Equivalents” account.

As of August 31, 2006, the total bank balance was as follows:

Governmental and Business Type Activities	\$6,434.24
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Investments

The Commission’s investments consist of United States Government Securities. 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, 2006, the fair value of investments are as presented below:

Governmental and Business Type Activities		Fair Value
U.S. Government Obligations (Texas Safekeeping Trust Co.)		\$1,261,610,563.40
Repurchase Agreement (Texas Safekeeping Trust Co.)		13,687,464.02
Total Investments		\$1,275,298,027.42
Reconciliation Of Investments per Exhibits – Governmental and Business – Type Activities		
Proprietary Funds Current Assets Restricted Short-Term Investments		\$173,687,706.97
Proprietary Funds Non-Current Restricted Investments		1,101,610,320.45
Investments per Exhibits		\$1,275,298,027.42

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. As of August 31, 2006, the Commission’s credit quality distribution for securities with credit risk exposure was as follows:

Standard & Poor’s

Fund Type	GAAP Fund	Investment Type	AAA	Aaa
05	5025	U.S. Government Obligations (Texas Safekeeping Trust Co.)	\$23,316,270.30	\$1,236,000,411.18

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Unrated

05	5025	U.S. Government Obligations (Texas Safekeeping Trust Co.)	\$2,293,881.92
05	5025	Repurchase Agreement (Texas Safekeeping Trust Co.)	\$13,687,464.02

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, intends to hold all of its investments to maturity. As a result, they are not affected by swings in the financial markets.

Reverse Repurchase Agreements

At August 31, 2006, 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 re-purchaser 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 face value and 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 in the name of the Comptroller of Public 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, 2006 was approximately \$107,437,556.84, at book value. The fair value of the securities underlying these agreements at August 31, 2006 was approximately \$107,158,621.17.

NOTE 4: Short-Term Debt

Not Applicable

NOTE 5: Summary of Long-Term Liabilities

Changes in Long-Term Liabilities

During the year ended August 31, 2006, the following changes occurred in liabilities.

Governmental Activities	Balance 09-01-2005	Additions	Deductions	Balance 08-31-2006	Amounts Due Within One Year
Compensable Leave	\$258,825.06	278,629.24	252,790.77	284,663.53	\$168,967.02
Total Governmental Activities	\$258,825.06	\$278,629.24	\$252,790.77	\$284,663.53	\$168,967.02

Business-Type Activities	Balance 09-01-2005	Additions	Deductions	Balance 08-31-2006	Amounts Due Within One Year
Compensable Leave	\$1,500,106.52	1,869,158.03	1,617,812.33	1,751,452.22	\$1,112,211.63
Total Business-Type Activities	\$1,500,106.52	\$1,869,158.03	\$1,617,812.33	\$1,751,452.22	\$1,112,211.63

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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 6: Capital Leases

Not Applicable

NOTE 7: Operating Lease Obligations

The Texas Lottery 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 \$7,253,658.49 in fiscal year 2006. 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 Lottery also leases office equipment under a month-to-month master-operating lease negotiated by the Texas Building and Procurement Commission. Generally, management expects that leases will be renewed or replaced by other leases in the normal course of business.

Fund Type	Amount
General Revenue	\$6,844.46
GR Dedicated – Lottery Account No. 5025	\$7,246,814.03

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,	
2007	\$4,055,004.40
2008	4,036,239.79
2009	3,843,778.76
2010	2,878,010.62
2011	44,055.48
2012-2016	139,565.52
Total Minimum Future Lease Rental Payments	\$14,996,654.57

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NOTE 8: Interfund Balances / Activities

As explained in Note 1 on Interfund Activities and Balances, there are numerous transactions between funds and agencies. At year-end, amounts to be received or paid are reported as:

- Due From Other Agencies or Due To Other Agencies
- Due From Other Funds or Due To Other Funds
- Transfers In or Transfers Out

The agency experienced routine transfers with other state agencies, which were consistent with the activities of the fund making the transfer. Repayment of interfund balances will occur within one year from the date of the financial statement.

Individual balances and activity at August 31, 2006 follows:

	DUE FROM Other Agencies	DUE TO Other Agencies	Source
ENTERPRISE (05) Appd Fund 5025, D23 Fund 1100			
(Agency 902 D23 Fund 0001)	1,369,213.21		Revenue
(Agency 701 D23 Fund 0193)		15,294,008.76	Revenue
Total Due From/To Other Agencies (Exh III)	\$1,369,213.21	\$15,294,008.76	

	DUE FROM Other Funds	DUE TO Other Funds	Source
ENTERPRISE (05) Appd Fund 5025, D23 Fund 1100			
(Appd Fund 0895, D23 Fund 0895)	535,215.72		Revenue
ENTERPRISE (05) Appd Fund 0895, D23 Funds 0895			
(Appd Fund 5025, D23 Fund 1100)		535,215.72	Revenue
Total Due From/To Other Funds (Exh III)	\$535,215.72	\$535,215.72	

	Operating TRANSFERS IN	Operating TRANSFERS OUT	Purpose
ENTERPRISE (05) Appd Fund 5025, D23 Fund 1100			
Agy 701, D23 Fund 0193		1,036,110,468.76	Operating
Agy 501, D23 Fund 5049		10,000,000.00	Operating
Agy 902, D23 Fund 0001		44,222,588.78	Operating
Total Transfers		\$1,090,333,057.54	

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NOTE 9: Contingent Liabilities

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) *Cynthia Suarez v. Texas Lottery Commission*, Cause No. D-1-GN-06-0308, in the 126th District Court Travis County, Texas, was filed on January 26, 2006, seeking monetary damages. The Legislative Budget Board and the Attorney General have been notified of this litigation.
- (2) *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.
- (3) *Stephen Martin v. Texas Lottery Commission*, Civil No. A-06-CA-287LY, in the U.S. District Court, Western District of Texas, Austin Division, was originally filed in District Court, Travis County, Texas on March 31, 2006, seeking, monetary damages. The Legislative Budget Board and the Attorney General have been notified of this litigation.
- (4) *Patsy Henry v. Texas Lottery Commission*, Cause No. GN204032, in the 353rd District Court of Travis County, Texas, was filed on November 8, 2002, seeking monetary damages. The Legislative Budget Board and the Attorney General have been notified of this litigation
- (5) *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.

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. *Earl Trawick*. On June 4, 2006, Mr. Trawick filed a claim with the EEOC, alleging claims as to equal pay and sex discrimination, seeking monetary compensation. On July 28, 2006, the EEOC issued a ruling, finding no merit to Mr. Trawick's charges. Mr. Trawick has 90 days from the date of that ruling to file a lawsuit as to his sex discrimination claim, and he has 2 years to file a suit as to his Equal Pay Act claim. This matter is under review administratively within the agency utilizing the agency's EEO procedure.
2. *SanJuanita Flores*. In 2005, Ms. Flores submitted a claim indicating that she had worked hours of unreported time during the period beginning in September 2002 and ending in September 2004. This matter is under review within the agency.

NOTE 10: Continuance Subject to Review

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

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NOTE 11: Risk Financing and Related Insurance

In the regular course of business, The Texas Lottery Commission is exposed to property and casualty loss, and worker's 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 Worker's Compensation Coverage Program. The Commission's assessment for FY 06 was \$38,969.31. The assessment covers worker's 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 2005 and 2006 were as follows:

	Beginning of Fiscal Liability	Current Year Claims and Changes in Estimates	Claims Payments	Balance at Fiscal Year-End
2005	\$0.00	\$840.00	\$840.00	\$0.00
2006	\$0.00	\$0.00	\$0.00	\$0.00

NOTE 12: Segment Information

The Texas Lottery 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 13: Bonded Indebtedness

Not Applicable

NOTE 14: Subsequent Events

Not Applicable

NOTE 15: Related Parties

Not Applicable

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NOTE 16: Stewardship, Compliance and Accountability

Not Applicable

NOTE 17: The Financial Reporting Entity and Joint Ventures

Not Applicable

NOTE 18: Restatement of Fund Balances / Net Assets

During 2006, adjustments were made that required the restatement of the amount in fund balance as shown and discussed below:

- (a) Correction of an error in the financial statements of a prior period. The restatement was made to the Enterprise fund and should have also been made to the General Fund. The restatement is for a Fiscal year 1994 transaction

	General Funds	Enterprise Funds	Total
Fund Bal/Equity August 31, 2005	\$222,616.90	\$92,193,321.61	\$92,415,938.51
Restatements:			
(a)	885,268.59	0.00	885,268.59
Net Restatements	885,268.59	0.00	885,268.59
Fund Bal/Equity Sept 1, 2005 As Restated	\$1,107,885.49	\$92,193,321.61	\$93,301,207.10

NOTE 19: Employee Retirement Plans

Not Applicable

NOTE 20: Deferred Compensation

Not Applicable

NOTE 21: Donor-Restricted Endowments

Not Applicable

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NOTE 22: Management Discussion and Analysis**Financial Highlights:**

- Instant ticket sales for the fiscal year ended August 31, 2006 increased by \$155.9 million over fiscal year 2005. This represents an increase of 5.8% from the previous year. This increase can be attributed to the continued efforts of the Commission to maintain popular and attractive instant games in the market. Games that offer a variety of play styles, prize levels, and themes (i.e. *Set for Life, Cool Millions, and Deal Or No Deal*)
- *Lotto Texas* sales for the fiscal year ended August 31, 2006 decreased from Fiscal Year 2005 by \$64.9 million, or 21.2%.
- *Pick 3* sales for the fiscal year ended August 31, 2006 increased from Fiscal Year 2005 by \$10.4 million, or 3.7%.
- *Texas Two Step* sales for the fiscal year ended August 31, 2006 increased from Fiscal Year 2005 by \$2.3 million, or 5.1%.
- *Cash Five* sales for the fiscal year ended August 31, 2006 decreased from Fiscal Year 2005 by \$12.4 million, or 12.1%.
- *Mega Millions'* sales for Fiscal Year 2006 totaled \$191.9 million. This represents an increase of 8.1% over Fiscal Year 2005. The *Megaplier* feature, which is unique to Texas, generated an additional \$46.7 million of sales.
- Total prize expense for the fiscal year ended August 31, 2006 exceeded prize expense for the previous year by \$137.5 million or 6.2%. The increase in prize expense has a direct correlation to the increase in sales.
- Commissions paid to Retailers for the fiscal year ended August 31, 2006 were \$188.8 million.
- Total sales for the fiscal year ended August 31, 2006 totaled \$3.78 billion, marking the highest level of total sales in the 14-plus history of the Commission. This represents an increase in sales from prior year of 3% or approximately \$112 million.

NOTE 23: Post Employment Health Care and Life Insurance Benefits

Not Applicable

NOTE 24: Special or Extraordinary Items

Not Applicable

NOTE 25: Disaggregation of Receivable and Payable Balances

Not Applicable

NOTE 26: Termination Benefits

Not Applicable

TEXAS LOTTERY COMMISSION

Combining Fund Exhibits

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Exhibit A-1 - Combining Balance Sheet - All General Funds

August 31, 2006

	General Revenue Fund 0001 U/F (0001)	Total (Exhibit I)
ASSETS		
Current Assets:		
Legislative Appropriations	\$ 1,778,179.50	\$ 1,778,179.50
Total Current Assets	<u>1,778,179.50</u>	<u>1,778,179.50</u>
 Total Assets	 <u><u>\$ 1,778,179.50</u></u>	 <u><u>\$ 1,778,179.50</u></u>
 LIABILITIES AND FUND BALANCES		
Liabilities:		
Current Liabilities:		
Payables From:		
Accounts	\$ 33,977.91	\$ 33,977.91
Vouchers	1,105.00	1,105.00
Payroll	<u>222,481.02</u>	<u>222,481.02</u>
Total Current Liabilities	<u>257,563.93</u>	<u>257,563.93</u>
 Total Liabilities	 <u><u>257,563.93</u></u>	 <u><u>257,563.93</u></u>
 FUND FINANCIAL STATEMENT - FUND BALANCES		
Fund Balances (Deficits):		
Reserved for:		
Encumbrances	4,920.00	4,920.00
Undesignated	<u>1,515,695.57</u>	<u>1,515,695.57</u>
Total Fund Balances	<u>1,520,615.57</u>	<u>1,520,615.57</u>
 Total Liabilities and Fund Balances	 <u><u>\$ 1,778,179.50</u></u>	 <u><u>\$ 1,778,179.50</u></u>

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

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Texas Lottery Commission (362)

**Exhibit A-2 - Combining Statement of Revenues, Expenditures and
Changes in Fund Balances – All General Funds**

For the Fiscal Year Ended August 31, 2006

	General Revenue Fund 0001 U/F (0001)	Total (Exhibit II)
REVENUES:		
Legislative Appropriations:		
Original Appropriations	\$ 2,480,812.00	\$ 2,480,812.00
Additional Appropriations	660,430.20	660,430.20
Licenses, Fees & Permits	11,455,605.88	11,455,605.88
Settlement of Claims	262,275.00	262,275.00
Sales of Goods and Services	500.00	500.00
Other	122,734.20	122,734.20
Total Revenues	<u>14,982,357.28</u>	<u>14,982,357.28</u>
EXPENDITURES:		
Salaries and Wages	2,256,118.50	2,256,118.50
Payroll Related Costs	554,744.12	554,744.12
Professional Fees and Services	55,515.00	55,515.00
Travel	85,564.15	85,564.15
Materials and Supplies	34,443.99	34,443.99
Communication and Utilities	252.72	252.72
Repairs and Maintenance	3,614.50	3,614.50
Rentals and Leases	6,844.46	6,844.46
Printing and Reproduction	3,292.94	3,292.94
Intergovernmental Payments	11,456,502.45	11,456,502.45
Other Expenditures	30,899.11	30,899.11
Total Expenditures/Expenses	<u>14,487,791.94</u>	<u>14,487,791.94</u>
Excess (Deficiency) of Revenues Over Expenditures	<u>494,565.34</u>	<u>494,565.34</u>
OTHER FINANCING SOURCES (USES):		
Gain (Loss) on Sale of Capital Assets	<u>2,700.00</u>	<u>2,700.00</u>
Total Other Financing Sources and (Uses)	<u>2,700.00</u>	<u>2,700.00</u>
Net Change in Fund Balances/Net Assets	<u>497,265.34</u>	<u>497,265.34</u>
FUND FINANCIAL STATEMENT - FUND BALANCES		
Fund Balances, September 1, 2005	222,616.90	222,616.90
Restatements	<u>885,268.59</u>	<u>885,268.59</u>
Fund Balances, September 1, 2005, as Restated	<u>1,107,885.49</u>	<u>1,107,885.49</u>
Appropriations Lapsed	<u>(84,535.26)</u>	<u>(84,535.26)</u>
Fund Balances, August 31, 2006	<u>\$ 1,520,615.57</u>	<u>\$ 1,520,615.57</u>

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

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Texas Lottery Commission (362)

Exhibit F-1 - Combining Statement of Net Assets - Proprietary Funds

August 31, 2006

	Texas Lottery Commission Fund 5025 U/F (1100)	Lotto Prize Trust Fund 0895 U/F (0895)	Totals (Exhibit III)
ASSETS			
Current Assets:			
Cash and Cash Equivalents:			
Cash in Bank (Note 3)	\$ 7,500.00	\$ -	\$ 7,500.00
Cash in State Treasury	126,300,833.83		126,300,833.83
Restricted:			
Short Term Investments (Note 3)	13,687,464.02	160,000,242.95	173,687,706.97
Receivables from:			
Accounts	19,017,950.72		19,017,950.72
Taxes	450,035.50		450,035.50
Other	158,329.00		158,329.00
Due From Other Funds (Note 8)	535,215.72		535,215.72
Due From Other Agencies (Note 8)	1,369,213.21		1,369,213.21
Consumable Inventories	710,023.36		710,023.36
Merchandise Inventories	5,309,737.15		5,309,737.15
Deferred Charges	7,777,500.00		7,777,500.00
Total Current Assets	<u>175,323,802.51</u>	<u>160,000,242.95</u>	<u>335,324,045.46</u>
Non-Current Assets:			
Restricted:			
Investments (Note 3)	-	1,101,610,320.45	1,101,610,320.45
Capital Assets (Note 2):			
Depreciable:			
Furniture and Equipment	5,484,202.86		5,484,202.86
Less: Accumulated Depreciation	(4,741,129.56)		(4,741,129.56)
Vehicles, Boats, and Aircraft	32,706.57		32,706.57
Less: Accumulated Depreciation	(24,958.12)		(24,958.12)
Total Non-Current Assets	<u>750,821.75</u>	<u>1,101,610,320.45</u>	<u>1,102,361,142.20</u>
Total Assets	<u>\$ 176,074,624.26</u>	<u>\$ 1,261,610,563.40</u>	<u>\$ 1,437,685,187.66</u>
LIABILITIES			
Current Liabilities:			
Payables from:			
Voucher	\$ 6,884,518.85	\$ -	\$ 6,884,518.85
Accounts	20,110,315.93		20,110,315.93
Payroll	1,449,130.23		1,449,130.23
Annuities	10,992,472.18		10,992,472.18
Other	727,030.35		727,030.35
Due to Other Funds (Note 8)	-	535,215.72	535,215.72
Due to Other Agencies (Note 8)	15,294,008.76		15,294,008.76
Employees' Compensable Leave (Note 5)	1,112,211.63		1,112,211.63
Payable From Restricted Assets-Current Portion (Note 1)	78,522,970.68	163,799,000.00	242,321,970.68
Total Current Liabilities	<u>135,092,658.61</u>	<u>164,334,215.72</u>	<u>299,426,874.33</u>
Non-Current Liabilities:			
Employees' Compensable Leave (Note 5)	639,240.59		639,240.59
Payable From Restricted Assets (Note 1)		1,105,372,244.67	1,105,372,244.67
Total Non-Current Liabilities	<u>639,240.59</u>	<u>1,105,372,244.67</u>	<u>1,106,011,485.26</u>
Total Liabilities	<u>\$ 135,731,899.20</u>	<u>\$ 1,269,706,460.39</u>	<u>\$ 1,405,438,359.59</u>
NET ASSETS			
Invested in Capital Assets, Net of Related Debt	750,821.75		750,821.75
Restricted for:			
Expendable:			
Restricted by Other			
Pooled Bond Fund	5,000,000.00		5,000,000.00
Prize Reserve Fund	13,837,358.66		13,837,358.66
Unrestricted	20,754,544.65	(8,095,896.99)	12,658,647.66
Total Net Assets	<u>\$ 40,342,725.06</u>	<u>\$ (8,095,896.99)</u>	<u>\$ 32,246,828.07</u>

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

UNAUDITED

Texas Lottery Commission (362)
Exhibit F-2 - Combining Statement of Revenues, Expenses and
Changes in Net Assets - Proprietary Funds
For the Fiscal Year Ended August 31, 2006

	Texas Lottery Commission Fund 5025 U/F (1100)	Lotto Prize Trust Fund 0895 U/F (0895)	Totals (Exhibit IV)
OPERATING REVENUES:			
Sales of Goods and Services:			
Lottery Proceeds			
Ticket Sales	\$3,774,685,562.00	\$ -	\$3,774,685,562.00
Lottery License Application Fees	303,174.25		303,174.25
Lottery Security Proceeds	71,538.00		71,538.00
Other Operating Revenues	1,058,448.60		1,058,448.60
Total Operating Revenues	<u>3,776,118,722.85</u>	<u>-</u>	<u>3,776,118,722.85</u>
OPERATING EXPENSES:			
Salaries and Wages	13,811,258.12		13,811,258.12
Payroll Related Costs	3,346,542.76		3,346,542.76
Professional Fees and Services	6,329,548.22		6,329,548.22
Travel	286,682.00		286,682.00
Materials and Supplies	270,406.16		270,406.16
Communication and Utilities	594,073.31		594,073.31
Repairs and Maintenance	497,869.89		497,869.89
Rentals and Leases	7,246,814.03		7,246,814.03
Printing and Reproduction	14,883,416.01		14,883,416.01
Depreciation and Amortization	257,526.14		257,526.14
Bad Debt Expense	789,868.75		789,868.75
Interest	828.69		828.69
Lottery Prizes	2,310,561,488.27		2,310,561,488.27
Retailer Commissions	188,818,620.60		188,818,620.60
Retailer Bonuses	2,804,520.68		2,804,520.68
Other Operating Expenses			
Lottery Operator Fees	102,124,102.07		102,124,102.07
Advertising	31,577,820.18		31,577,820.18
Other	2,883,908.73		2,883,908.73
Total Operating Expenses	<u>2,687,085,294.61</u>	<u>-</u>	<u>2,687,085,294.61</u>
Operating Income (Loss)	<u>1,089,033,428.24</u>	<u>-</u>	<u>1,089,033,428.24</u>
NONOPERATING REVENUES (EXPENSES):			
Investment Income (Expense)	39,459.51		39,459.51
Net Increase (Decrease) in Fair Value		(58,685,603.75)	(58,685,603.75)
Settlement of Claims	(720.00)		(720.00)
Total Nonoperating Revenues (Expenses)	<u>38,739.51</u>	<u>(58,685,603.75)</u>	<u>(58,646,864.24)</u>
Income (Loss) Before Other Revenues, Expenses, Gains/Losses and Transfers	<u>1,089,072,167.75</u>	<u>(58,685,603.75)</u>	<u>1,030,386,564.00</u>

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Texas Lottery Commission (362)

**Exhibit F-2 - Combining Statement of Revenues, Expenses and
Changes in Net Assets - Proprietary Funds (continued)**

For the Fiscal Year Ended August 31, 2006

	Texas Lottery Commission Fund 5025 U/F (1100)	Lotto Prize Trust Fund 0895 U/F (0895)	Totals (Exhibit IV)
OTHER REVENUES, EXPENSES, GAINS/LOSSES AND TRANSFERS:			
Transfers-Out (Note 8)	<u>(1,090,333,057.54)</u>		<u>(1,090,333,057.54)</u>
Total Other Revenues, Expenses, Gains/Losses and Transfers	<u>(1,090,333,057.54)</u>	<u>-</u>	<u>(1,090,333,057.54)</u>
Change in Net Assets	<u>(1,260,889.79)</u>	<u>(58,685,603.75)</u>	<u>(59,946,493.54)</u>
Total Net Assets, September 1, 2005	41,603,614.85	50,589,706.76	92,193,321.61
Restatements	<u>-</u>		<u>-</u>
Total Net Assets, September 1, 2005, as Restated	<u>41,603,614.85</u>	<u>50,589,706.76</u>	<u>92,193,321.61</u>
Total Net Assets, August 31, 2006	<u><u>\$ 40,342,725.06</u></u>	<u><u>\$ (8,095,896.99)</u></u>	<u><u>\$ 32,246,828.07</u></u>

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

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Texas Lottery Commission (362)

Exhibit F-3 - Combining Statement of Cash Flows - Proprietary Funds

For the Fiscal Year Ended August 31, 2006

	Texas Lottery Commission Fund 5025 U/F (1100)	Lotto Prize Trust Fund 0895 U/F (0895)	Totals (Exhibit V)
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from Customers	\$3,772,279,239.84	\$ -	\$ 3,772,279,239.84
Payments to Suppliers for Goods and Services	(357,254,723.73)	-	(357,254,723.73)
Payments to Employees	(16,781,710.48)	-	(16,781,710.48)
Payments for Other Expenses	(2,319,513,099.31)	-	(2,319,513,099.31)
Net Cash Provided by Operating Activities	<u>1,078,729,706.32</u>	<u>-</u>	<u>1,078,729,706.32</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Payments for Other Uses		(162,611,000.00)	(162,611,000.00)
Payments for Transfers to Other Funds	(1,086,680,001.22)	-	(1,086,680,001.22)
Proceeds from other Financing	-	22,160,000.00	22,160,000.00
Net Cash Provided by Noncapital Financing Activities	<u>(1,086,680,001.22)</u>	<u>(140,451,000.00)</u>	<u>(1,227,131,001.22)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Payments for Additions to Capital Assets	<u>(150,666.79)</u>	<u>-</u>	<u>(150,666.79)</u>
Net Cash Provided by Capital and Related Financing Activities	<u>(150,666.79)</u>	<u>-</u>	<u>(150,666.79)</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from Sales of Investments	-	162,611,000.00	162,611,000.00
Proceeds from Interest and Investment Income	39,459.51	-	39,459.51
Payments to Acquire Investments	<u>(2,803,559.20)</u>	<u>(22,160,000.00)</u>	<u>(24,963,559.20)</u>
Net Cash Provided by Investing Activities	<u>(2,764,099.69)</u>	<u>140,451,000.00</u>	<u>137,686,900.31</u>
Net (Decrease) in Cash and Cash Equivalents	(10,865,061.38)	-	(10,865,061.38)
Cash and Cash Equivalents--September 1, 2005	<u>137,173,395.21</u>	<u>-</u>	<u>137,173,395.21</u>
Cash and Cash Equivalents--August 31, 2006	<u>\$ 126,308,333.83</u>	<u>\$ -</u>	<u>\$ 126,308,333.83</u>

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

UNAUDITED

Texas Lottery Commission (362)

Exhibit F-3 - Combining Statement of Cash Flows - Proprietary Funds (continued)

For the Fiscal Year Ended August 31, 2006

	Texas Lottery Commission Fund 5025 U/F (1100)	Lotto Prize Trust Fund 0895 U/F (0895)	Totals (Exhibit V)
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES			
Operating Income (Loss)	\$ 1,089,033,428.24	\$ -	\$ 1,089,033,428.24
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities			
Amortization and Depreciation	257,526.14	-	257,526.14
Bad Debt Expense	789,868.75	-	789,868.75
Operating Income and Cash Flow Categories:			
Changes in Assets and Liabilities:			
(Increase) Decrease in Receivables	(3,839,483.01)	-	(3,839,483.01)
(Increase) Decrease in Inventories	143,901.74	-	143,901.74
(Increase) Decrease in Deferred Charges	1,555,500.00	-	1,555,500.00
Increase (Decrease) in Payables	(9,211,035.54)	-	(9,211,035.54)
Total Adjustments	<u>(10,303,721.92)</u>	<u>-</u>	<u>(10,303,721.92)</u>
Net Cash Provided by Operating Activities	<u>\$ 1,078,729,706.32</u>	<u>\$ -</u>	<u>\$ 1,078,729,706.32</u>
NON CASH TRANSACTIONS			
Net Increase (Decrease) in Fair Value of Investments			\$ (58,685,603.75)

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

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Texas Lottery Commission (362)

Exhibit J-1 - Combining Statement of Changes in Assets and Liabilities - Agency Funds

August 31, 2006

	Beginning Balance September 1, 2005	Additions	Deductions	Ending Balance August 31, 2006
UNAPPROPRIATED RECEIPTS				
<u>Suspense Fund Seized Funds (0900) U/F (0362)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ 24,136.28	\$ 48,272.56	\$ 48,272.56	\$ 24,136.28
Total Assets	<u>\$ 24,136.28</u>	<u>\$ 48,272.56</u>	<u>\$ 48,272.56</u>	<u>\$ 24,136.28</u>
LIABILITIES				
Current				
Funds Held for Others	\$ 24,136.28	\$ 48,272.56	\$ 48,272.56	\$ 24,136.28
Total Liabilities	<u>\$ 24,136.28</u>	<u>\$ 48,272.56</u>	<u>\$ 48,272.56</u>	<u>\$ 24,136.28</u>
<u>Suspense Fund (0900) U/F (0900)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ 2,700.00	\$ 577.60	\$ 3,277.60	\$ -
Total Assets	<u>\$ 2,700.00</u>	<u>\$ 577.60</u>	<u>\$ 3,277.60</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	\$ 2,700.00	\$ 577.60	\$ 3,277.60	\$ -
Total Liabilities	<u>\$ 2,700.00</u>	<u>\$ 577.60</u>	<u>\$ 3,277.60</u>	<u>\$ -</u>
<u>USPS - Overpayments to employees (0900) U/F (9015)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ 1,297.80	\$ 2,528.57	\$ 3,826.37	\$ -
Total Assets	<u>\$ 1,297.80</u>	<u>\$ 2,528.57</u>	<u>\$ 3,826.37</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	\$ 1,297.80	\$ 2,528.57	\$ 3,826.37	\$ -
Total Liabilities	<u>\$ 1,297.80</u>	<u>\$ 2,528.57</u>	<u>\$ 3,826.37</u>	<u>\$ -</u>
<u>Warrant Hold Offset (0900) U/F (9016)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 7,644.27	\$ 7,644.27	\$ -
Total Assets	<u>\$ -</u>	<u>\$ 7,644.27</u>	<u>\$ 7,644.27</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	\$ -	\$ 7,644.27	\$ 7,644.27	\$ -
Total Liabilities	<u>\$ -</u>	<u>\$ 7,644.27</u>	<u>\$ 7,644.27</u>	<u>\$ -</u>
<u>Savings Bond Fund (0901) U/F (0901)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ 600.00	\$ 6,850.00	\$ 6,800.00	\$ 650.00
Total Assets	<u>\$ 600.00</u>	<u>\$ 6,850.00</u>	<u>\$ 6,800.00</u>	<u>\$ 650.00</u>
LIABILITIES				
Current				
Funds Held for Others	\$ 600.00	\$ 6,850.00	\$ 6,800.00	\$ 650.00
Total Liabilities	<u>\$ 600.00</u>	<u>\$ 6,850.00</u>	<u>\$ 6,800.00</u>	<u>\$ 650.00</u>

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

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Texas Lottery Commission (362)

Exhibit J-1 - Combining Statement of Changes in Assets and Liabilities - Agency Funds (Continued)

August 31, 2006

	Beginning Balance September 1, 2005	Additions	Deductions	Ending Balance August 31, 2006
<u>Deferred Compensation 401K (0942) U/F (0942)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 480,975.27	\$ 480,975.27	\$ -
Other Receivables	-	521,048.63	521,048.63	-
Total Assets	<u>\$ -</u>	<u>\$ 1,002,023.90</u>	<u>\$ 1,002,023.90</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	-	521,048.63	521,048.63	-
Total Liabilities	<u>\$ -</u>	<u>\$ 521,048.63</u>	<u>\$ 521,048.63</u>	<u>\$ -</u>
<u>Correction Account - Direct Deposit (0980) U/F (0980)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 309.10	\$ 309.10	\$ -
Total Assets	<u>\$ -</u>	<u>\$ 309.10</u>	<u>\$ 309.10</u>	<u>\$ -</u>
LIABILITIES				
Current				
Funds Held for Others	-	309.10	309.10	-
Total Liabilities	<u>\$ -</u>	<u>\$ 309.10</u>	<u>\$ 309.10</u>	<u>\$ -</u>
<u>Bingo Cash Bonds (0001) Fund (1002)</u>				
ASSETS				
Current				
Cash in State Treasury	\$ -	\$ 67,907.52	\$ 67,907.52	\$ -
Total Assets	<u>\$ -</u>	<u>\$ 67,907.52</u>	<u>\$ 67,907.52</u>	<u>\$ -</u>
LIABILITIES				
Current				
Payables	-	-	-	-
Funds Held for Others	-	-	-	-
Total Liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Totals - All Agency Funds				
ASSETS				
Current				
Cash in State Treasury	\$ 28,734.08	\$ 615,064.89	\$ 619,012.69	\$ 24,786.28
Receivables:				
Other	-	521,048.63	521,048.63	-
Total Assets	<u>\$ 28,734.08</u>	<u>\$ 1,136,113.52</u>	<u>\$ 1,140,061.32</u>	<u>\$ 24,786.28</u>
LIABILITIES				
Current				
Funds Held for Others	28,734.08	587,230.73	591,178.53	24,786.28
Total Liabilities	<u>\$ 28,734.08</u>	<u>\$ 587,230.73</u>	<u>\$ 591,178.53</u>	<u>\$ 24,786.28</u>

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

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TEXAS LOTTERY COMMISSION

Addendum

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**ADDENDUM
Organizational and General Comments**

Functions & Operations

The Texas Lottery Commission has two main functions:

The Texas Lottery Commission is charged under the State Lottery Act with administering Texas Lottery games in an efficient and secure manner using appropriate marketing tools and innovative technology to generate revenue for the State of Texas while enhancing public confidence in the integrity and fairness of the games.

The Charitable Bingo Operations Division is charged under the Bingo Enabling Act with the regulation and administration of all charitable bingo-related activities in the state of Texas and contributes to the regulatory and tax and revenue collection functions of the agency. The Division licenses all bingo-related activities; collects taxes and prize fees generated from the conduct of charitable bingo; audits bingo licensees; conducts tests on bingo products intended for use in Texas, such as bingo paper, pull-tabs and electronic equipment; and makes quarterly allocations to local units of government for their share of the prize fees collected.

Organization and Governing Board

The three-member Texas Lottery Commission sets policy, promulgates rules for the agency, and performs all other duties required by law. The Governor appoints Commission members, with the advice and consent of the state Senate, to staggered six-year terms. The officials, their terms of office and hometowns are:

C. Tom Clowe, Jr.	February 1, 1999 - February 1, 2005	Waco, Texas
James A. Cox, Jr.	June 3, 2002 - February 1, 2009	Austin, Texas

The Executive Director, the Charitable Bingo Operations Division Director, and the Internal Audit Director are appointed by and report to the three-member Commission. The Texas Lottery Commission Executive Director provides leadership to nine divisions within the agency, ensuring that staff carry out applicable state law and Commission policies. The Charitable Bingo Operations Director is responsible for the day-to-day operations relating to the regulation of charitable bingo, ensuring that the staff carries out applicable state law and Commission policies. The Internal Audit Director works to ensure that internal and external controls are adequate to improve the efficiency and effectiveness the Texas Lottery Commission.

Service Responsibilities

The agency serves a number of direct and indirect customers. The primary direct customers of the Texas Lottery Commission include lottery players and licensed retailers, charitable bingo players and licensees, advisory groups, vendors, and the Texas Lottery Commissioners, and agency staff. Indirect customers are those Texas populations that benefit from the conduct of the *Games of Texas* and charitable bingo, from the agency's net revenue contributions to the state of Texas, and from associated agency activities that serve the public good.

The agency is divided into 11 divisions: Executive, Charitable Bingo Operations, Internal Audit, Administration, Enforcement, Governmental Affairs, Human Resources, Legal Services, Lottery Operations, Media Relations, and Office of the Controller.

Executive Division— The Executive Division refers to the Executive Director, Deputy Executive Director, Ombudsman, and administrative staff. The division is the focal point for the decision-making and strategic planning related to the day-to-day operation and administration of the Texas Lottery.

Texas Lottery Commission (362)

The Executive Director and Deputy Executive Director play key roles in the short- and long-term planning for the agency.

Charitable Bingo Operations Division— The Charitable Bingo Operations Division is responsible for the regulation of all activities relating to the conduct of charitable bingo games in the State of Texas. The division is organized into three sections: Audit Services, Accounting Services and Licensing Services. While each section of the Charitable Bingo Operations Division performs a distinct function, they also interact frequently with each other as well as other divisions of the Texas Lottery Commission in the regulation of charitable bingo activities in Texas. The division is managed by a Director, who reports to the three-member Commission.

Internal Audit Division— The Internal Audit Division serves as an independent appraisal function with the agency. The purpose is to provide independent, objective assurance and consulting/advisory services designed to add value and improve the agency's operations. The division is managed by a Director, who reports to the three-member Commission.

Administration Division—The Administrative Division serves the needs of the commission in the areas of information resources and support services. Information Resources is responsible for managing the agency's network infrastructure, which includes the local- and wide- area networks, telecommunications, the Intranet site and the agency's Web site and supporting a variety of software applications. The Support Services is responsible for property and facilities management, purchasing and contracts, publications and graphics, and records retention. In addition, the division coordinates the development, review and adoption of internal policies and procedures. The division is managed by a Director, who reports to the Deputy Executive Director.

Enforcement Division— The Enforcement Division investigates and prosecutes administrative violations of the Lottery Act and the Bingo Enabling Act. Commissioned peace officers and administrative investigators work closely with local law enforcement agencies, district and county attorneys, and the Lottery Operations Security Department and claims office staff. The division is managed by a Director, who reports to the Executive Director.

Governmental Affairs Division— The Governmental Affairs Division serves as the agency's primary liaison with the legislative and executive branches of state government. The division coordinates and implements legislative strategy and initiatives to further enhance the agency's goals. Its actions are designed to assist the Commissioners, the Executive Director, and the Charitable Bingo Operations Director, as well as all divisions of the agency, by providing legislative tracking analysis, representation, recommendations, and information. The Governmental Affairs Division is managed by a Director, who reports to the Executive Director.

Human Resources Division— The Human Resources Division is responsible for the recruitment and selection processes of new employees as well as workforce planning, employee retention, and training. The division also assists management with employee performance evaluations, salary actions and compensation. Human Resources is responsible for coordinating employee benefits, deferred compensation plans, savings plans, and tuition reimbursement. The division is managed by a Director, who reports to the Deputy Executive Director.

Legal Services Division—The Legal Services Division serves the agency and provides legal advice, assistance and services to the Commissioners, the Executive Director, the Charitable Bingo Operations Director, the Internal Audit Director, and agency staff. The General Counsel Section provides legal services to the agency primarily in connection with transactional matters such as procurements and contracts, processing lottery prize claimants, and rulemaking while the Office of Special Counsel provides personnel and employment law advice to the agency. The division is managed by the General Counsel, who reports directly to the Executive Director and serves as the attorney for the agency, Commissioners, Executive staff, and, when requested, other agency staff.

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Lottery Operations Division— The Lottery Operations Division is responsible for player, retailer and vendor compliance with the requirements of Chapter 466 of the Government Code and Chapter 401 of the Texas Administrative Code, as well as game security, drawings and validations and marketing functions. The Division serves the needs of the Commission and its customers in the areas of vendor compliance; jurisdictional complaint monitoring; instant ticket printing, testing, security, warehousing and distribution; retailer recruitment and development; retailer licensing and accounting; customer service through the operation of a toll-free hotline, a customer service email box on the agency's Web site, and oversight of the agency's correspondence functions; product development; claims processing; retailer surveys and inspections; lottery drawings, security of lottery drawings and validations, promotions, and the oversight of mass-media advertising. The division is organized into five distinct functional areas: Advertising and Promotions, Drawings and Validations, Retailer Services, Products, and Security. The division is managed by a Director, who reports to the Deputy Executive Director.

Media Relations Division—The Media Relations Division is the first point of contact for all inquiries from local, state and national news media. The Media Relations Director works in conjunction with the Executive Director, Deputy Executive Director, Charitable Bingo Operations Director and Commissioners to develop and execute a media relations strategy that supports the agency's mission and vision. The division is managed by a Director, who reports to the Executive Director.

Office of the Controller— The Office of the Controller provides financial services and reporting functions for the commission in accordance with statutes and requirements. The primary functions include administration of the development, submission, and management of agencies financial statements, financial reports, payroll, accounts payable, sales reports, revenue projections, allocations, fiscal notes, performance measures, annual and biennial budgets, and IRS tax reporting. The division is managed by a Director, who reports to the Deputy Executive Director.

General Comments

At August 31, 2006, there were 315 employees on the Commission's payroll. A listing of the Commission's administrative and key personnel at August 31, 2006, is presented at the end of this addendum.

Administrative personnel of the Commission are aware of and adhere to the records retention period guidelines prepared by the Records Preservation Advisory Committee and approved by the Texas State Library and Archives Commission.

UNAUDITED

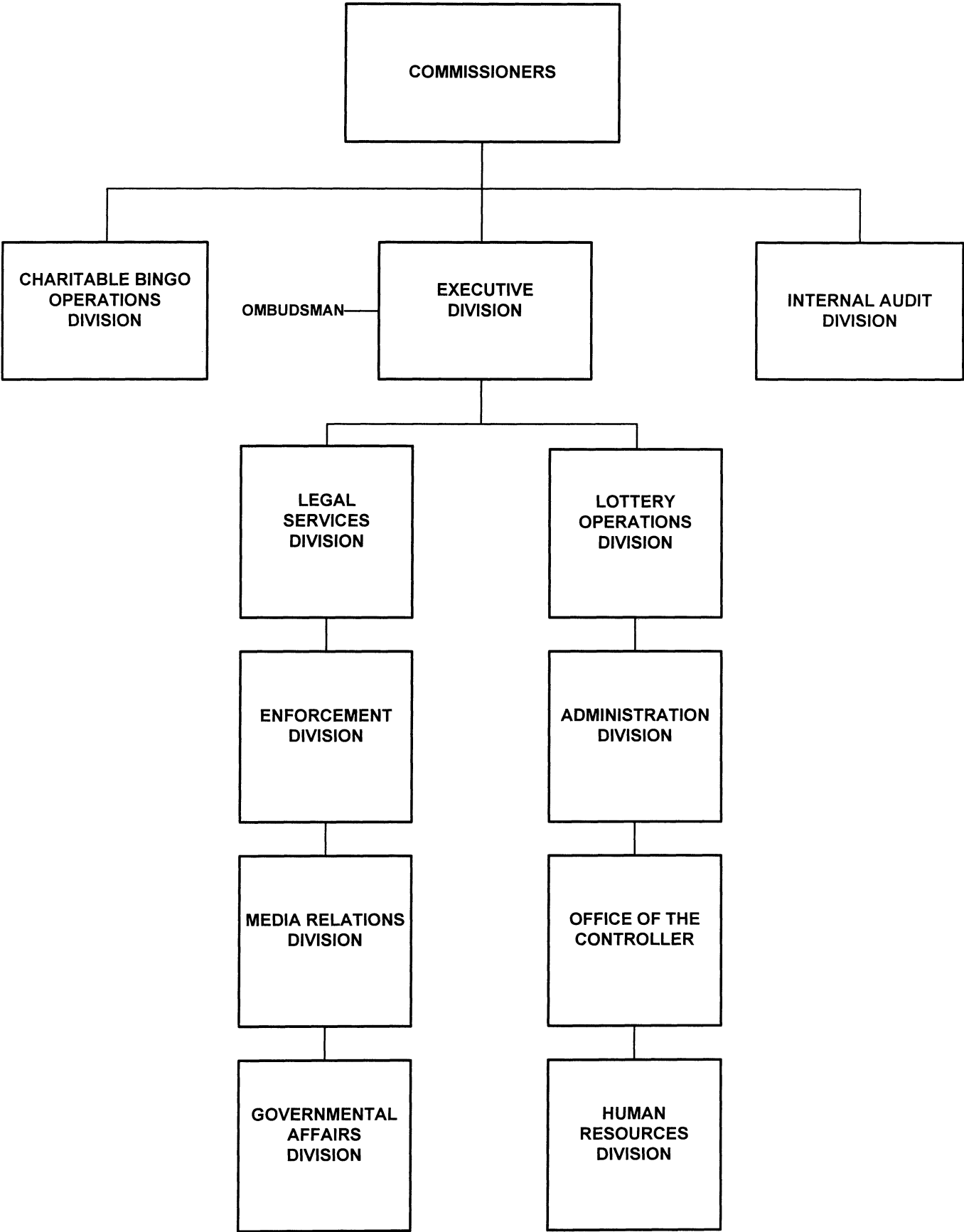
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SCHEDULE OF ADMINISTRATIVE AND KEY PERSONNEL

For the fiscal year ended August 31, 2006

Division	Director
Executive	
Executive Director	Anthony Sadberry
Deputy Executive Director	Gary Grief
Charitable Bingo Operations	Billy Atkins
Internal Audit	Catherine Melvin
Administration	Mike Fernandez
Enforcement	Ed Rogers (Acting)
Governmental Affairs	Nelda Treviño
Human Resources	Janine Mays
Legal Services	Kim Kiplin
Lottery Operations	Michael Anger
Media Relations	Robert Heith
Office of the Controller	Kathy Pyka

ORGANIZATIONAL STRUCTURE



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