



BUREAU OF STATE LOTTERY

An Enterprise Fund of the State of Michigan

Comprehensive Annual Financial Report
For the Fiscal Years Ended September 30, 2006 and 2005





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Prepared by Accounting Division



Bureau of State Lottery, State of Michigan
Comprehensive Annual Financial Report
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Michigan's school children are the beneficiaries of the Lottery's profits. The Lottery has transferred more than \$12.9 billion to education in Michigan since its inception in 1972.

INTRODUCTORY SECTION





JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
BUREAU OF STATE LOTTERY
LANSING



GARY C. PETERS
COMMISSIONER

December 5, 2006

The Honorable Jennifer M. Granholm, Governor
Members of the Legislature
Citizens of the State of Michigan

We are pleased to present to you the Comprehensive Annual Financial Report (CAFR) of the Bureau of State Lottery (Lottery) for the fiscal years ending September 30, 2006 and 2005. Lottery management is responsible for the accuracy of the financial data and the completeness of the contents of this report.

The Lottery is an enterprise fund within the State of Michigan and its financial statements are included in the State's Comprehensive Annual Financial Report. This report presents only the activity of the Lottery as a single enterprise fund and is an overview of the Lottery's operations.

The mission statement of the Lottery is as follows:

- To maximize net revenues to supplement state education programs.
- To provide fun and entertaining games of chance.
- To operate all games and bureau functions with nothing less than total integrity.

Within the financial section of this CAFR, the Lottery's Management Discussion and Analysis (MD&A) provides a detailed narrative of activities that occurred over this time period. This letter of transmittal is intended to complement the MD&A and should be read in conjunction with the MD&A.

The report is organized into three sections. The Introductory Section includes this letter of transmittal and an organizational chart with principal officials. The Financial Section includes the independent auditors' report, management's discussion and analysis, audited financial statements with accompanying notes, and supplementary information schedules. Demographic, historical and industry comparative information are presented in the Statistical Section of this report. The auditors' report on compliance and internal control follows the Statistical Section.

The enabling legislation of the Lottery requires biannual and special post audits of all accounts and transactions of the Lottery by the Auditor General or by an independent public accounting firm appointed by the Auditor General. The Auditor General has contracted with an independent public accounting firm for these audits. The financial statements have been audited 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.

Profile of the Lottery

History

The Lottery was established under the authority of Public Act 239 of 1972 to generate funds to support Michigan's public school system. The first lottery ticket was the Green Ticket which went on sale on November 13, 1972. On October 7, 1975, the first instant game ticket was sold. Online sales began June 6, 1977 with the introduction of the Daily 3 game. The first multi-state ticket sales for the Lottery were on August 31, 1996 for The Big Game (now called Mega Millions). Since its inception, more than \$12.9 billion has been contributed to the School Aid Fund.

Lottery Products

The Lottery offers a variety of games in several styles of play: instant also known as "scratch" games; online games, where daily or more frequent drawings are conducted to select winning numbers; and Pull Tabs, which are similar to instant games but players pull a perforated tab instead of scratching off the ticket. These games are available to the playing public through more than 11,000 licensed Lottery retailers.



Instant Games

Instant games are played by scratching latex covering on each ticket to reveal prize symbols. A variety of games with different themes, play styles, price points and prize structures are available with an ongoing product offering of over 70 new games a year. The games offered are priced between \$1 and \$20 and prizes range from \$1 to \$2 million dollars.



Online Games

Online game tickets are generated by a terminal connected to a central system and drawings are conducted to determine the winning numbers. Drawings are every five minutes, twice a day, daily or twice a week, depending on the game. Online games currently offered are Mega Millions, Classic Lotto 47, Fantasy 5, Daily 3, Daily 4, Keno and Club Keno and are played as follows:



Mega Millions

Mega Millions is a multi-state online game, formerly known as The Big Game. Players select from two pools of numbers: five numbers between 1 and 56 and one number between 1 and 46 for a chance to win a multi-million dollar jackpot prize. The jackpot starts at \$12 million. This game offers nine ways to win with guaranteed prize amounts on lower prize levels. Drawings are conducted twice a week.

A total of 12 states participate in the Mega Millions game with Michigan, including California, Georgia, Illinois, Maryland, Massachusetts, New Jersey, New York, Ohio, Texas, Virginia and Washington.



Classic Lotto 47

Classic Lotto 47 is an in-state Lotto game. It was introduced May 15, 2005 and replaced the Winfall game. Players select 6 of 47 numbers in twice weekly drawings. Jackpots start at \$1 million. Classic Lotto 47 offers four ways to win, with guaranteed prize amounts at the lower prize levels.



Fantasy 5

Fantasy 5 was introduced September 12, 2004, replacing the Rolldown game. Players pick 5 of 39 numbers, with rolling jackpots starting at \$100,000 and daily drawings. Jackpots increase a minimum of \$5,000 per draw and roll until a player matches all five numbers in a drawing. This game offers four ways to win with guaranteed prize amounts at the lower prize levels.



Daily 3 & 4 Games

The Daily 3 & 4 games are the Lottery's longest running and most consistently popular games, representing 32% of total sales. Drawings are conducted twice a day, seven days a week. These games offer a wide variety of winning combinations and fixed prizes. The top prize for Daily 3 is \$500; for Daily 4, \$5,000.



Keno!

Keno! is another long-running game which started in 1990. Although the sales are less than 1% of total sales, it has a very strong and loyal player base. In this game, players chose 10 numbers from a pool of 80. The Lottery draws 22 numbers and if the player matches 10 of those 22 numbers, they win the jackpot prize of \$250,000. There are also five other ways to win by matching combinations of the numbers drawn. Drawings are conducted daily.



Club Games

Club Games were introduced in October 2003. Club Games are played by patrons of bars, restaurants and bowling centers. Club Games consist of an online Club Keno game and Pull Tab games. To play Club Keno, players select up to 10 numbers from a pool of 80. The Lottery draws 20 numbers and the more numbers the player matches, the more he or she wins. Results of the drawings, which are conducted every five minutes, are displayed on TV monitors located in the retailers' establishments. Club Keno can be played every day from 6:05 a.m. to 1:45 a.m. Wagers can be placed from \$1 to \$20 and the top prize is \$2 million. A Kicker option was added in November of 2005, allowing players to multiply their Club Keno prizes as much as 10 times.

Pull Tab games are similar to instant tickets but players pull a perforated tab instead of scratching off the ticket. A variety of different Pull Tab games are offered at one time. Ticket prices are 50 cents, \$1 and \$2 and top prizes range from \$50 to \$500. Pull Tab winning tickets must be redeemed by the selling retailer.



Player City Internet Club

In June 2005 the Lottery introduced an Internet-based VIP club for players called Player City. Player City offers a variety of on-site activities in which players can participate. Points are earned for participation in surveys and other activities and these points are redeemable for entry into drawings for event tickets and other prizes. In addition, players who become members receive many benefits such as special prize drawings, exclusive offers only for Player City members, anniversary rewards redeemable for exclusive members-only rewards, and email alerts for jackpots and winning numbers. Membership in Player City is free.

Highlights of Fiscal Year 2006

Record Contribution to the School Aid Fund

The Lottery had yet another outstanding year in fiscal 2006 with a record \$688 million being transferred to the School Aid Fund. This marks the third consecutive year of record contributions to the School Aid Fund.

Sales

Sales for 2006 surpassed \$2 billion and were at a record high for the third consecutive year.

Retailers Win Big with Record Commissions

Not only did the Lottery have record School Aid Fund transfers and sales in both 2005 and 2006, but retailer commissions were also at an all-time high in both years. Retailer commissions totaled \$152.7 million in 2005 and \$165.3 million in 2006.

Instant Game \$2 Million Dollar Drawings

The Lottery conducted three separate instant game \$2 million grand prize drawings in March, June and December of fiscal 2006. Players who win \$1,000 on any \$20 instant game are entered in the drawings automatically. The March and December drawings were conducted at the Palace of Auburn Hills during halftime at Detroit Pistons games. The June drawing was conducted at the International Freedom Festival in Detroit.

New Club Keno Kicker Option

An option for Club Keno players called Kicker was introduced in November of this fiscal year. For an additional \$1 for each \$1 wagered, players can select the Kicker option to multiply Club Keno prizes up to 10 times. Kicker has been a great success generating \$80.2 million in sales in its first year.

Sales Incentive Program

A new sales incentive program was implemented for the sales staff. District Sales Representatives (DSRs) were given quarterly instant ticket sales goals. Those DSRs achieving their goals were awarded quarterly incentive bonus commissions ranging from \$156 to \$625. Instant sales for the year increased by 7.3% the largest margin in over 10 years under this program.

Budgetary System and Controls

The Lottery works with the Department of Management and Budget, Office of the Budget and the Legislature to create an annual appropriated budget for the administrative costs for the Lottery. The proposed budget is approved by the Legislature annually. This approved budget becomes a spending cap for administrative expenses and ticket revenues provide funding for operations. Revenue and net income forecasts are prepared throughout the fiscal year comparing estimates and forecasts to actual sales and expenses. This information is provided to the Office of the Budget with appropriate action taken as needed.

Economic Condition and Financial Information

Local Economy

Michigan's economy continues to struggle. Michigan's employment forecasts show a continued decline in overall employment in 2006 and 2007. Although there is slight growth in some job sectors, particularly services, the manufacturing sector continues to decline. Michigan's economy relies heavily on the performance of the manufacturing sector in general and the auto industry specifically. Even with job growth in other sectors, Michigan's unemployment rate is forecast to rise to 7.1% in 2006 and 7.5% in 2007, well above the national average forecast of 4.6%.

In addition to high unemployment, the downturn in the housing market causes further concern. These issues and uncertainties in the economy will impact spending patterns and could impact Lottery sales.

Financial Information

The sale of Lottery tickets provides all funding for operations and the net income is transferred to the School Aid Fund for K-12 education. The operations involve sale of tickets, determination of winning tickets, payment of prizes, compensation to retailers, and administrative functions. The Lottery also provides \$1 million a year to the Department of Community Health for gambling addiction programs. The Lottery's Commissioner is responsible to the Governor, Legislature and the citizens of the State for Lottery operations.

The Lottery's goals and objectives ensure there is an ongoing effort to achieve operational efficiencies to not only maximize revenues but maximize profits for the School Aid Fund. Operational results are included in the Financial and Statistical Sections.

The Charitable Gaming Division's net proceeds are dedicated to the state's General Fund. These activities are discussed in the MD&A.

Accounting Systems and Policies

As an enterprise fund of the State of Michigan, the Lottery operates as a business within state government structure. The Lottery uses the accrual basis of accounting, following generally accepted accounting principles (GAAP) and governmental accounting standards board (GASB) pronouncements.

Internal Controls

The Michigan Lottery and the State of Michigan policies and procedures tightly control assets, inventory, computer systems, drawing studios and accounting. Separation of duties, internal controls, ongoing monitoring and evaluation of information as well as stringent employee, retailer and contractor standards all minimize risk of loss or theft. All employees, retailers and contractor employees must pass a security background check prior to being hired.

Debt Administration

Long-term liabilities for the Lottery are for payments owed to Lotto, Mega Millions and Instant Game grand prize installment winners. These prize liabilities are funded by investments in U. S. Treasury zero-coupon bonds which are held to maturity.

Cash Management

Cash due from retailers for Lottery transactions is collected weekly by automated clearing house (ACH) electronic funds transfer. Monthly net income from Lottery operations is transferred to the School Aid Fund. Any excess cash is maintained in an account managed by the Michigan Department of Treasury. Any short-term investing in the common cash fund is done by Treasury following its policies and guidelines.

Risk Management

The Michigan Department of Management and Budget (DMB) controls risk management through two internal service funds administratively established during fiscal year 1989-1990. These funds are self-insured for most general liability, property losses, portions of employee insurance benefit, employee bonding programs, employee theft, workers compensation and unemployment compensation claims. The Lottery is assessed annual premiums by DMB for risk management.

Awards and Acknowledgements

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Lottery for its comprehensive annual financial report for the fiscal year ended September 30, 2005. This was the first year that the Lottery has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. The report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgements

Preparation of this report would not be possible without the efficient and dedicated efforts of the Accounting Division of the Lottery. Their teamwork has greatly contributed to the success of this informative document.

Respectfully submitted,



Margery S. Reh
Deputy Commissioner for Administration



Gary Peters
Commissioner

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Bureau of State Lottery,
Michigan

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
September 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



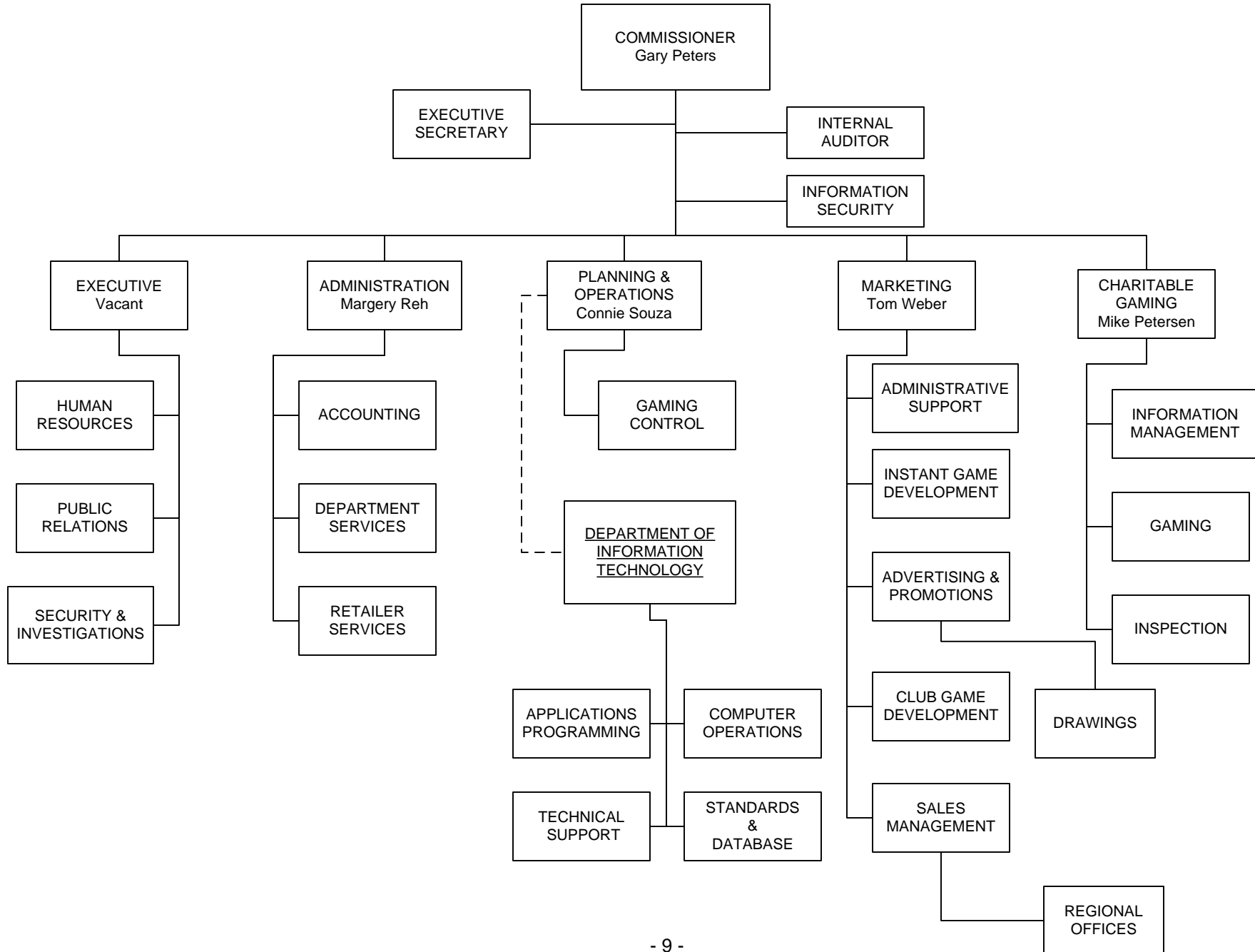
Carla E. Fudge

President

Jeffrey R. Emer

Executive Director

Bureau of State Lottery
Organization Chart and Principal Officials
September 2006







Players won over \$1.2 billion in prizes in fiscal year 2006.

FINANCIAL SECTION



Independent Auditors' Report

Mr. Gary C. Peters, Commissioner
Bureau of State Lottery, State of Michigan
and
Mr. Thomas H. McTavish, Auditor General
State of Michigan

We have audited the accompanying financial statements of the Bureau of State Lottery, State of Michigan (the "Lottery"), a proprietary fund of the State of Michigan, as of and for the six month periods and years ended, September 30, 2006 and 2005, which collectively comprise the Lottery's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express opinions on these financial statements based on our audit.

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 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.

As discussed in Note 1, the financial statements present only the Bureau of State Lottery, State of Michigan, and are not intended to present the financial position of the State of Michigan and the results of its operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery, as of September 30, 2006 and 2005, and the changes in financial position and cash flows for the six month periods and years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 17, 2006, on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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.

Management's discussion and analysis presented on pages 13 through 22 is not a required part of the basic financial statements but is 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 an opinion on the financial statements that collectively comprise the Lottery's basic financial statements. The accompanying supplementary schedules, as listed in the foregoing table of contents, are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The supplementary schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Yeo & Yeo, P.C.

Lansing, Michigan
November 17, 2006

Management's Discussion and Analysis

The following discussion of the Michigan Bureau of State Lottery's (Lottery's) financial performance provides an overview of the Lottery's financial activities for the fiscal year ended September 30, 2006. Please read it in conjunction with the financial statements, which begin on page 23.

Using This Report

The Lottery is accounted for as an enterprise activity/proprietary fund, reporting on all of the activity's assets and liabilities using the accrual basis of accounting, much like a private business entity. As such, this semi-annual report consists of a series of financial statements, along with explanatory notes to the financial statements and supplementary schedules. The Statement of Net Assets on page 23 and the Statement of Revenues, Expenses and Changes in Fund Net Assets on page 24, report the Lottery's net assets and changes in them.

By law, the Lottery is required to transfer all of its net income each fiscal year to either the State School Aid Fund (for income related to Lottery gaming activities) or the General Fund (for income related to Charitable Gaming activities). As a result, the net assets of the Lottery consist largely of capital assets (leasehold improvements and equipment) and investments held to fund future payments due on Lottery prizes that are annuities. To assess the Lottery's financial position and financial health, the reader of these statements should pay particular attention to changes in the components of assets and liabilities as set forth in the Statement of Net Assets, and in changes in operating revenues, expenses, and transfers to other funds as set forth in the Statement of Revenues, Expenses, and Changes in Fund Net Assets. In addition the reader should also refer to the accompanying notes to the financial statements.

Financial Highlights 2005 to 2006

- Gross revenues for Lottery gaming activities set a record for the third consecutive year surpassing the \$2.2 billion mark. These revenues increased by \$142.1 million, or 6.8%.
- Total revenues for all activities (including non-operating) increased \$156.5 million or 7.4%.
- Net non-operating revenues (expenses) decreased by \$9.2 million. There was an unrealized loss of \$16.3 million in 2006, and an unrealized loss of \$24.6 million in 2005. Therefore, the decrease in net non-operating expenses is attributable to a smaller reduction of the fair market valuation of investments from 2005 to 2006. These investments are held to fund future payments that are due to annuity prizes winners.
- Total operating expenses for 2006 increased \$123.9 million, or 8.8%. Of this increase, prize awards (net of unclaimed prizes) related to operating revenues from gaming activities increased by \$106.2 million, or 9.1%, retailer and vendor commissions increased \$15.0 million, or 7.8%, while other operating expenses increased by \$1.9 million, or 4.4%.
- Total expenses (including non-operating) for all activities increased \$129.1 million or 8.9%.

- Back-to-back record setting transfers were made to the School Aid Fund in fiscal years 2005 and 2006. Transfers to the School Aid Fund were \$667.6 million in 2005 and \$688.0 million in 2006. Net income before transfers increased by \$27.4 million, or 4.2%. Net income transferred to the General Fund related to Charitable Gaming activities decreased by \$1.2 million or 10.2%.

Net Assets

A summary of the Lottery's net assets is presented below:

Table 1 - Net Assets
(in millions)

	September 30,		
	2006	2005	2004
Current and other assets	\$ 546.8	\$ 567.7	\$ 471.6
Investments - noncurrent	350.8	420.9	496.8
Capital assets (net of accumulated depreciation)	0.4	0.5	0.5
Total assets	<u>898.0</u>	<u>989.1</u>	<u>968.9</u>
Current liabilities	543.6	562.8	459.8
Long-term liabilities	<u>318.3</u>	<u>373.9</u>	<u>432.0</u>
Total liabilities	<u>861.9</u>	<u>936.7</u>	<u>891.8</u>
Net assets			
Invested in capital assets	0.4	0.5	0.5
Restricted for unrealized gains on investments	36.1	52.4	77.1
Unrestricted (deficit)	<u>(0.4)</u>	<u>(0.5)</u>	<u>(0.5)</u>
Total net assets	<u>\$ 36.1</u>	<u>\$ 52.4</u>	<u>\$ 77.1</u>

As shown in Table 1 above, the Lottery's net assets decreased from \$77.1 million in September 2004 to \$36.1 million in September 2006. The steady decrease is attributable to the decrease in investment holdings as well as a decrease in market value of investments the Lottery holds to fund future payments due on annuitized lottery prizes.

Capital assets consist of equipment and leasehold improvements. During fiscal year 2006 there were no additions or deletions of capital assets. Additional detailed information on capital assets may be found in the accompanying notes to the financial statements.

Accounting principles dictate that the Lottery record in the financial records, the gain or loss related to the change in market value of investments. U. S. Treasury zero-coupon bonds have been purchased for the payment of installment prize awards and are generally held to maturity. Therefore, the difference between the market value of these investments and the amortized book value is recorded as a restriction for unrealized gains on investments. The unrealized gain on investments is not available for transfer to the School Aid Fund.

A detail of the Lottery's liabilities is presented in Table 2 below:

Table 2 - Liabilities
(in millions)

	September 30,		
	2006	2005	2004
Current:			
Warrants authorized and warrants outstanding	\$ 9.8	\$ 8.1	\$ 9.4
Accounts payable and other liabilities	3.3	3.2	2.9
Due to School Aid Fund	18.0	10.6	9.9
Obligation for security lending	391.9	409.2	301.9
Prize awards payable (net of discount)	<u>\$ 120.7</u>	<u>\$ 131.7</u>	<u>\$ 135.7</u>
Total current	<u>543.7</u>	<u>562.8</u>	<u>459.8</u>
Long-term:			
Prize awards payable (net of discount)	316.3	371.9	430.2
Compensated absences	<u>2.0</u>	<u>2.0</u>	<u>1.8</u>
Total long-term	<u>318.3</u>	<u>373.9</u>	<u>432.0</u>
Total liabilities	<u><u>\$ 862.0</u></u>	<u><u>\$ 936.7</u></u>	<u><u>\$ 891.8</u></u>

Current liabilities in 2005 included an adjustment of \$13.2 million in increased prize liability. This adjustment was also reflected in a decrease in unclaimed prize revenue. The adjustment was a change in estimate and was the result of improved information technology which provided the resources necessary for the Lottery to reconcile the general ledger prize liability with the actual gaming system prize liability. This reconciliation provided additional assurance of the accuracy of the financial statements and adjusted prize liability balances carried forward in the general ledger since the inception of the Lottery. Refer to Note 1 in the accompanying financial statements for more information.

Security lending liability is identical to and directly related to security lending collateral listed in current assets. These represent short-term lending of the Lottery's securities managed by the Department of Treasury.

The amount due other state agencies has increased from 2005 to 2006 and represents a timing issue of cash available at the end of the fiscal year.

Long-term liabilities (net of discount) consist principally of prize liability for prizes paid in installments over several years. Long-term prize liability decreased by \$55.6 million from 2005 to 2006 and decreased \$113.9 million from 2004 to 2006. The decrease is attributable to the maturing of some long-term prize liabilities as well as minimal additions to the pool of annuitized installment prizes in all three years. Most prize winners eligible for annuity payments chose to have their payment in a lump sum rather than paid in installments.

A summary of the Lottery's change in net assets is presented in Table 3 below:

Table 3 - Changes in Net Assets
(in millions)

	September 30,		
	2006	2005	2004
Operating revenues	\$ 2,232.2	\$ 2,090.1	\$ 1,995.3
Operating expenses:			
Prizes and direct game expenses			
Prizes less unclaimed prize/adjustment	1,268.2	1,162.0	1,099.7
Commissions and game related expenses	225.3	209.5	199.5
Total prizes and direct game expenses	1,493.5	1,371.5	1,299.2
Income before other operating expenses	738.7	718.6	696.1
Other operating expenses	45.3	43.4	41.2
Operating income	693.4	675.2	654.9
Non-operating revenues (expenses)	(10.3)	(19.5)	(24.9)
Income before transfers out	683.1	655.7	630.0
Transfers out			
Transfer to School Aid Fund	688.0	667.6	644.9
Transfer to General Fund	10.5	11.7	12.2
Transfer to Community Health	1.0	1.0	1.0
Total transfers out	699.5	680.3	658.1
Change in net assets	(16.4)	(24.6)	(28.1)
Total net assets beginning of period	52.5	77.1	105.2
Total net assets end of period	\$ 36.1	\$ 52.5	\$ 77.1

Because the Lottery is required by law to transfer all of its net income (excluding the unrealized gain or loss on investments discussed above) to the School Aid Fund or General Fund, change in net assets does not reflect the result of the Lottery's operating activities. The \$688.0 million transferred to the School Aid Fund reflects the Lottery's operating activities for the fiscal year 2006 and is another record amount. Both fiscal years 2005 and 2004 were record years for the Lottery's transfers to the School Aid Fund, with an increase of \$20.4 million or 3.1% from 2005 and an increase of \$43.1 million or 6.7% over 2004. The transfer to the General Fund reflects Charitable Gaming activities. Charitable Gaming activities experienced a slight decline in net revenue and the 2006 transfer is a slight decrease from 2005 and 2004. Charitable Gaming net income is transferred annually to the General Fund.

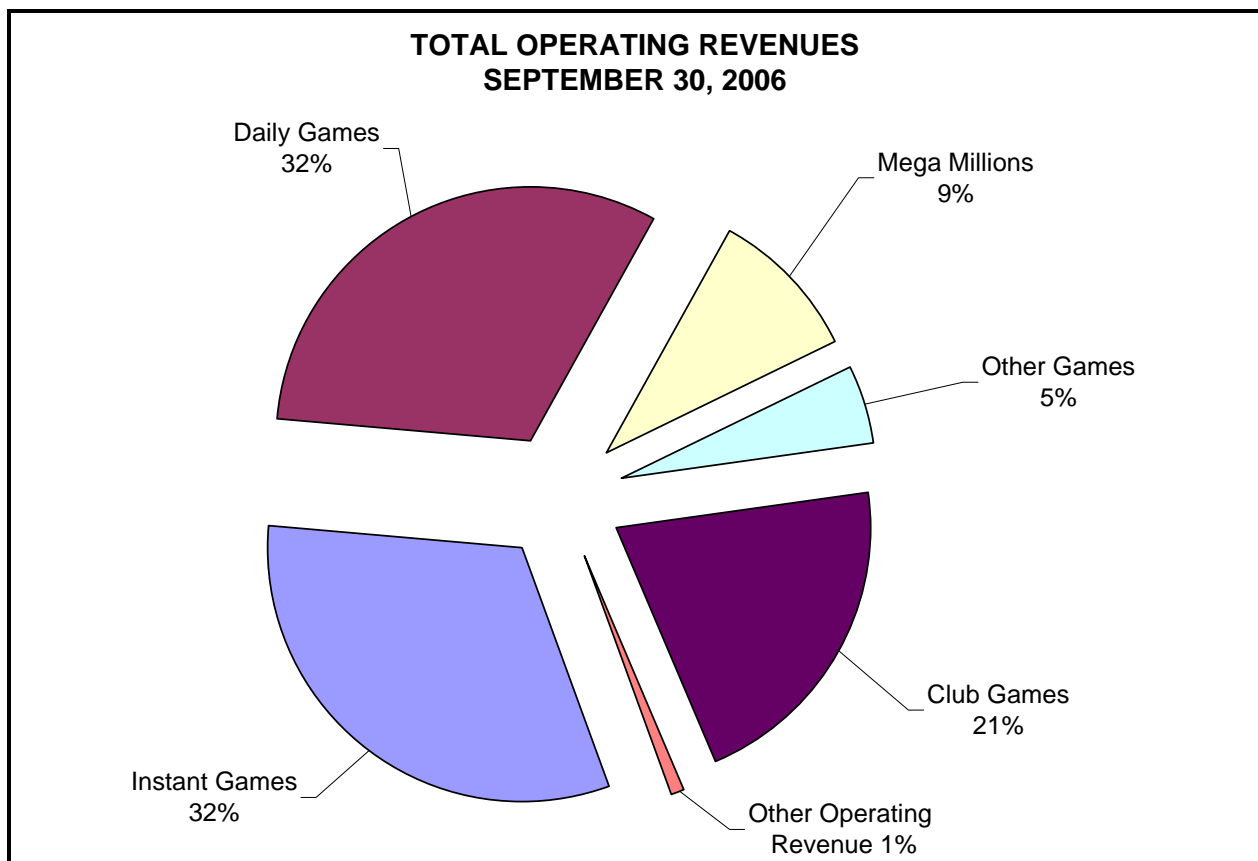
Transfers are detailed in Table 4 below:

Table 4 - Transfers
(in millions)

	September 30,		
	2006	2005	2004
Transfer to School Aid Fund	\$ 688.0	\$ 667.6	\$ 644.9
Transfer to General Fund	10.5	11.7	12.2
Transfer to Community Health	1.0	1.0	1.0
Total Transfers	<u>\$ 699.5</u>	<u>\$ 680.3</u>	<u>\$ 658.1</u>

Revenues

The following chart shows the major sources and the percentages of revenues for the fiscal year ended September 30, 2006:



A detail of the Lottery's revenues is presented in Table 5 below:

Table 5 - Revenues
(in millions)

	September 30,		
	2006	2005	2004
Operating revenues			
Instant tickets	\$ 710.8	\$ 662.5	\$ 690.2
Daily games	708.7	712.6	733.4
Mega Millions	216.4	203.9	206.6
Club games	465.7	371.4	229.6
Other games	110.8	119.1	114.1
Other operating revenue	19.8	20.6	21.4
Total operating revenues	<u>2,232.2</u>	<u>2,090.1</u>	<u>1,995.3</u>
Non-operating revenues:			
Unrealized (loss) on investments	(16.3)	(24.6)	(28.1)
Amortization on bonds	31.0	35.9	41.1
Other income	20.4	9.4	5.6
Total non-operating revenue	<u>35.1</u>	<u>20.7</u>	<u>18.6</u>
Total revenues	<u>\$ 2,267.3</u>	<u>\$ 2,110.8</u>	<u>\$ 2,013.9</u>

Operating revenues for the fiscal year 2006, primarily Lottery ticket sales, increased overall from both 2005 and 2004. The overall sales increase in fiscal year 2006 over 2005 was \$142.1 million or 6.8%. A new Club Game option, Club Keno Kicker, was introduced in November 2005. New online games and variations of games are introduced periodically to keep player interest and maintain sales.

Instant game ticket sales increased by \$48.3 million or 7.3% for fiscal year 2006 compared to fiscal year 2005. Recent marketing changes have fueled the strong growth in instant tickets.

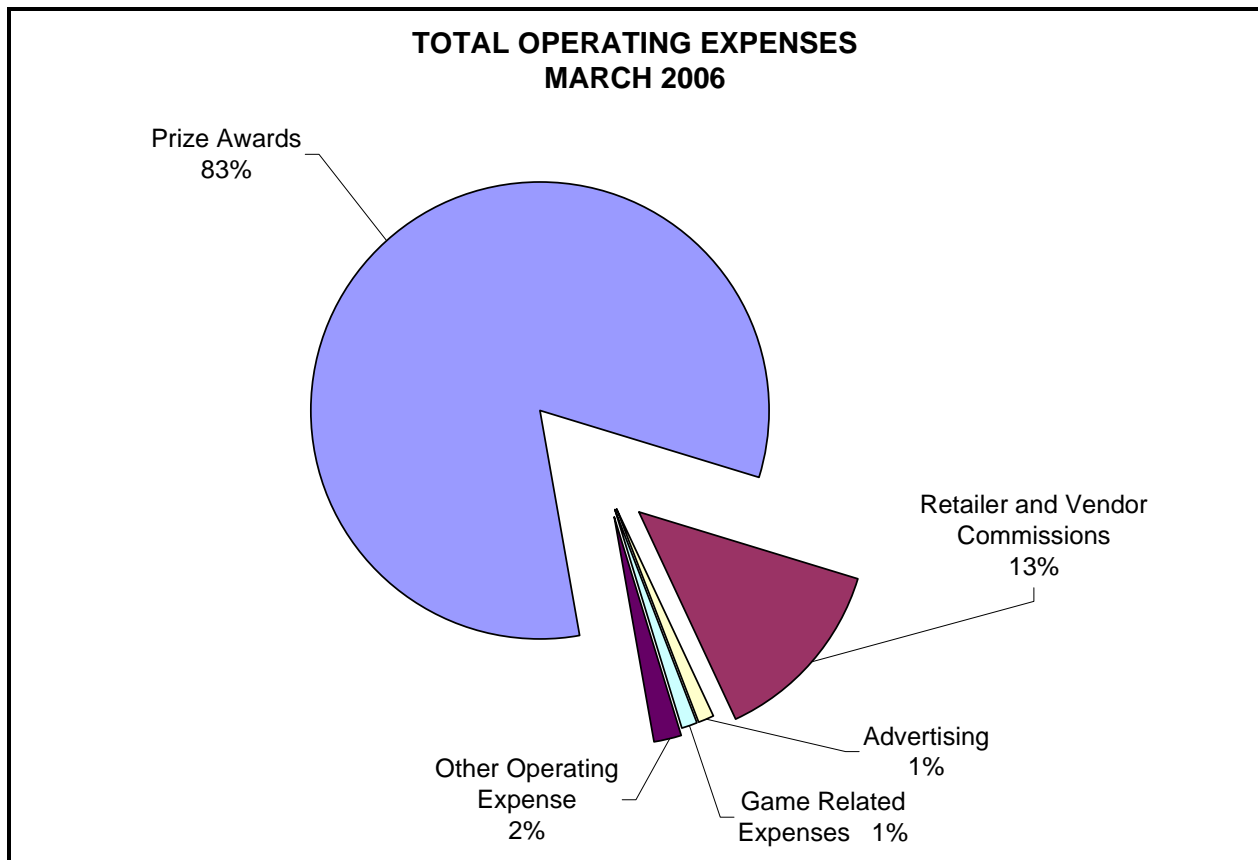
Mega Millions is a multi-state game offering larger jackpots with an occasional "mega-jackpot". The states participating in Mega Millions with Michigan are California, Georgia, Illinois, Maryland, Massachusetts, New Jersey, New York, Ohio, Texas, Virginia and Washington. Sales for the fiscal year ended 2006 increased by \$12.5 million or 6.1% compared to the fiscal year ended 2005. Sales in 2006 were \$9.8 million more than in 2004. This increase is primarily due to more frequent large jackpot rolls in 2006 compared to 2005 and 2004 and by California's addition to the group in 2005.

Club Games, which include Club Keno and Pull Tabs, experienced solid growth due to strong per terminal sales and the introduction of Club Keno Kicker. Kicker is an option for Club Keno that offers players the opportunity to multiply their prizes by up to 10 times. The Club Games sales increased in 2006 by \$94.3 million or 25.4% over 2005. Club Games were introduced October 27, 2003. Currently there are approximately 2,216 active Club Games retailers. Club Games are primarily sold in bars and restaurants licensed for on-premise alcohol consumption. Recruitment is ongoing to continue retailer expansion into this market.

The increase in non-operating revenues from 2005 to 2006 resulted from a smaller unrealized loss on investments. As previously discussed, the unrealized loss on investments is a reflection of the market value of the investments and does not impact the transfer to the School Aid Fund. The reduction in bond amortization is due to a decreasing bond portfolio from maturing investments as well as the fact that prize winners have elected the cash option, instead of installment payments. Other income increased from 2005 to 2006 due to higher interest rates which resulted in greater interest on common cash and also because of increased security lending revenue.

Expenses

The following chart shows prizes, game costs and other operating expenses as a percentage of total operating expenses for the fiscal year ended September 30, 2006:



A detail of the Lottery's expenditures is presented in Table 6 below:

Table 6 - Expenses
(in millions)

	September 30,		
	2006	2005	2004
Prizes:			
Instant prizes	\$ 460.7	\$ 417.8	\$ 435.6
Online prizes	534.9	519.5	543.6
Club game prizes	302.9	242.3	151.6
Total prizes	1,298.5	1,179.6	1,130.8
Less: unclaimed prizes	30.3	17.6	31.1
Net prize awards	1,268.2	1,162.0	1,099.7
Direct game expenses:			
Retailer commissions	165.3	152.7	145.4
Vendor commissions	40.9	38.5	36.9
Game related expenses	19.1	18.3	17.2
Total direct game expenses	225.3	209.5	199.5
Other operating expenses:			
Salaries, wages and benefits	14.2	13.0	11.3
Other professional services	5.3	5.3	5.1
Printing and supplies	2.2	2.3	2.5
Other general and administrative	6.1	5.2	4.8
Advertising	17.5	17.6	17.5
Total other operating expenses	45.3	43.4	41.2
Total operating expenses	1,538.8	1,414.9	1,340.4
Non-operating expenses:			
Security lending expenses	16.0	6.0	4.3
Amortization of prize discount	29.4	34.2	39.2
Total non-operating expenses	45.4	40.2	43.5
Total expenses	\$ 1,584.2	\$ 1,455.1	\$ 1,383.9

The Daily Games prize payout increased overall in 2006 compared to 2005. Daily 3 prize payout decreased to 46.6% in 2006, compared to 47.2% in 2005. The Daily 4 players experienced a greater percentage of winning number combinations with a prize payout of 58.8% in 2006, compared to 51.9% in 2005. Daily games are designed to yield an average prize payout of 50.0% and combined the games averaged a payout of 52.2% in 2006 compared to 49.3% in 2005.

The Club Games prize payout percentage for 2006 of 65.0% was slightly lower than the 2005 pay out of 65.2%. The higher Club Games payout is an important part of the appeal of this latest style of game in this new market. The other online games have a 50%-55% anticipated payout.

Instant games had an overall payout of 64.8% in 2006, compared to 63.1% in 2005 and 63.2% in 2004. The games vary in payout percentage depending on selling price of a ticket for a game. Instant game prize payouts range from 60% for a \$1 game to 73% for a \$20 game. The increase in overall payout is related to adjustments in the prize structure in the various price payouts. The increase in instant game prize expense of 10.3% is related to the instant games sales increase and an increase in the overall payouts.

Retailer, vendor commissions and game-related expenses have increased commensurate with higher overall online sales.

Salaries, wages and benefits increased due to a 1% salary increase for employees effective October 1, 2005; a 1% salary increase effective April 9, 2006; and the discontinuation of the banked leave program early in the 2006 fiscal year. Under the banked leave program, employees worked 80 hours each bi-weekly pay period but were paid for 76 hours. Also, seven new positions were added in January 2006 to support Club Game sales.

Unclaimed Prizes

By law, Lottery prizes not claimed within one year of their drawing date are to be transferred to the state School Aid Fund.

The Lottery recognizes the value of unclaimed prizes using an allowance methodology. Under the method, historical averages are utilized to estimate the amount of prizes awarded during the current year that will not be paid out due to claims not being filed for those prizes. The amounts estimated under the allowance method are recorded as a reduction of current year prize expense to match true prize expense to related sales.

Unclaimed prizes and adjustments increased by \$12.7 million from 2005 to 2006. The change primarily is due to the liability estimate adjustment in 2005, as previously discussed.

Charitable Gaming

Table 7 - Charitable Gaming Revenue, Expense, and Net Income
(in millions)

	September 30,		
	2006	2005	2004
Gross revenue	\$ 18.6	\$ 19.6	\$ 20.0
Operating expenses	8.1	7.9	7.8
Net income	<u>\$ 10.5</u>	<u>\$ 11.7</u>	<u>\$ 12.2</u>

Charitable Gaming activities overseen by the Lottery include the licensing and regulation of charitable and certain other not-for-profit organizations that conduct bingo games, millionaire parties and raffles for fund-raising purposes. The Lottery also oversees the distribution and sale of break-open tickets, (also for fund-raising purposes), to these same organizations. The mission of the Lottery with respect to charitable gaming activities is to ensure that only qualified organizations are licensed to conduct fund-raising activities and that said activities are conducted in accordance with existing laws, rules and regulations. Revenues received through the issuance of licenses and from the distribution of break-open tickets are intended to cover the costs of overseeing the program activities and are not intended as a primary goal to generate revenue for the State. Any revenue in excess of program costs is transferred annually to the state's General Fund.

Other Potentially Significant Factors Impacting Next Year

The Lottery had a record sales year in 2005 and again in 2006 due to the large success of Club Games as well as strong Mega Millions and Instant Game sales. Management anticipates continued growth of the Club Games as the retailer base continues to expand. Beginning December 18, 2006, Club Keno drawings will be conducted every four minutes instead of every five minutes and in the spring of 2007 it is anticipated that a new Club Keno-style game will be launched. A new type of online game, Millionaire Raffle, was launched on November 12, 2006. This game had only 500,000 tickets available for purchase with a unique raffle number printed on each ticket. The drawing for this first raffle game is scheduled for January 2007. Tickets were available at any online or Club Keno retailer location. Based on the success of the first raffle game, additional raffle games may be introduced in fiscal year 2007.

In November of 2004, a proposal limiting gambling expansion in the state was passed by a vote of the people. This proposal amended the constitution requiring a statewide vote of the people for any future expansion of gambling. The language in the proposal was very broad and has the potential to negatively impact the Lottery's ability to generate revenue in the form of new games. This creates uncertainty in the continued growth of Lottery revenues.

Contacting the Lottery's Financial Management

This financial report is designed to provide the Legislature and the executive branch of government, the public, and other interested parties with an overview of the financial results of the Lottery's activities and to show the Lottery's accountability for the money it receives. Percentages presented in the Management's Discussion and Analysis are based on the rounded figures presented in the tables. If you have questions about this report or need additional financial information, contact the Deputy Commissioner for Administration at the Michigan Lottery, P.O. Box 30023, Lansing, Michigan, 48909.

Bureau of State Lottery, State of Michigan
Statement of Net Assets
September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Assets		
Current assets		
Equity in State Treasurer's Common Cash Fund	\$ 4,216,557	\$ 6,201,864
Investments, at fair value	85,072,951	93,378,340
Security lending collateral	391,854,831	409,169,719
Receivables from retailers - net	61,310,613	55,584,934
Inventory	4,304,479	3,358,586
Other current assets	61,324	29,779
	<u>546,820,755</u>	<u>567,723,222</u>
Total current assets		
	<u>546,820,755</u>	<u>567,723,222</u>
Noncurrent assets		
Investments, at fair value	350,780,390	420,884,559
Capital assets		
Leasehold improvements and equipment	4,018,994	4,018,994
Accumulated depreciation	(3,632,016)	(3,475,300)
	<u>386,978</u>	<u>543,694</u>
Total capital assets		
	<u>386,978</u>	<u>543,694</u>
Total noncurrent assets	<u>351,167,368</u>	<u>421,428,253</u>
	<u>351,167,368</u>	<u>421,428,253</u>
Total assets	<u>897,988,123</u>	<u>989,151,475</u>
	<u>897,988,123</u>	<u>989,151,475</u>
Liabilities		
Current liabilities		
Warrants outstanding	2,587,391	790,299
Warrants authorized	7,177,818	7,351,788
Accounts payable and other liabilities	3,319,443	3,234,779
Due to School Aid Fund	18,017,340	10,579,438
Obligations under security lending	391,854,831	409,169,719
Prize awards payable - net of discount	120,692,745	131,682,198
	<u>543,649,568</u>	<u>562,808,221</u>
Total current liabilities		
	<u>543,649,568</u>	<u>562,808,221</u>
Noncurrent liabilities		
Prize awards payable - net of discount	316,303,775	371,916,697
Accrual for compensated absences	1,955,901	1,975,191
	<u>318,259,676</u>	<u>373,891,888</u>
Total noncurrent liabilities		
	<u>318,259,676</u>	<u>373,891,888</u>
Total liabilities	<u>861,909,244</u>	<u>936,700,109</u>
	<u>861,909,244</u>	<u>936,700,109</u>
Net assets		
Invested in capital assets	386,978	543,694
Restricted for unrealized gains on investments	36,078,879	52,451,366
Unrestricted (deficit)	(386,978)	(543,694)
	<u>\$ 36,078,879</u>	<u>\$ 52,451,366</u>
Total net assets		
	<u>\$ 36,078,879</u>	<u>\$ 52,451,366</u>

See Accompanying Notes to Financial Statements



Bureau of State Lottery, State of Michigan
Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Six Months and Years Ended September 30, 2006 and 2005

	Six Months Ended		Years Ended	
	2006	2005	2006	2005
Operating revenues				
Ticket sales	\$ 1,065,755,856	\$ 1,031,146,502	\$ 2,212,367,975	\$ 2,069,493,348
Charitable gaming and other	9,626,741	10,108,683	19,836,342	20,638,899
Total operating revenues	1,075,382,597	1,041,255,185	2,232,204,317	2,090,132,247
Operating expenses				
Prize awards	633,304,473	580,474,986	1,298,478,473	1,179,642,069
Less - unclaimed prizes	(15,161,204)	(17,516,337)	(30,303,532)	(17,634,462)
Net prize awards	618,143,269	562,958,649	1,268,174,941	1,162,007,607
Agent and vendor commissions	99,418,312	94,801,190	206,249,080	191,174,540
Game related expenses	9,494,368	8,933,753	19,103,390	18,369,818
Depreciation expense	75,056	67,575	156,716	136,651
Other operating expenses	22,018,952	20,484,214	45,138,056	43,233,420
Total operating expenses	749,149,957	687,245,381	1,538,822,183	1,414,922,036
Operating income	326,232,640	354,009,804	693,382,134	675,210,211
Non-operating revenues (expenses)				
Investment revenue	14,825,788	12,898,794	14,672,062	11,803,031
Interest on equity in State Treasurer's Common Cash Fund	2,342,389	1,723,699	4,083,998	2,540,807
Revenue from security lending	8,508,813	3,628,907	16,349,413	6,363,685
Security lending expenses	(8,297,374)	(3,446,371)	(15,975,968)	(6,013,676)
Amortization of prize award obligation discount	(14,109,605)	(16,512,669)	(29,387,661)	(34,251,841)
Total non-operating revenues (expenses)	3,270,011	(1,707,640)	(10,258,156)	(19,557,994)
Income before transfers out	329,502,651	352,302,164	683,123,978	655,652,217
Transfers out				
Transfer to School Aid Fund	(324,185,525)	(351,201,017)	(688,017,340)	(667,579,438)
Transfer to General Fund	(4,851,195)	(5,530,674)	(10,489,125)	(11,728,945)
Transfer to Community Health	(495,000)	(495,000)	(990,000)	(990,000)
Total transfers out	(329,531,720)	(357,226,691)	(699,496,465)	(680,298,383)
Change in net assets	(29,069)	(4,924,527)	(16,372,487)	(24,646,166)
Total net assets at beginning of period	36,107,948	57,375,893	52,451,366	77,097,532
Total net assets at end of period	\$ 36,078,879	\$ 52,451,366	\$ 36,078,879	\$ 52,451,366

See Accompanying Notes to Financial Statements

Bureau of State Lottery, State of Michigan
Statement of Cash Flows
For the Six Months and Years Ended September 30, 2006 and 2005

	Six Months Ended		Years Ended	
	2006	2005	2006	2005
Cash Flows From Operating Activities				
Cash collections from customers	\$ 1,081,269,697	\$ 1,041,573,345	\$ 2,226,295,802	\$ 2,089,744,974
Payments to employees	(7,123,546)	(6,192,515)	(14,017,865)	(12,522,503)
Payments to suppliers	(30,158,792)	(28,151,484)	(51,095,235)	(48,359,870)
Payments to prize winners	(671,035,045)	(621,463,859)	(1,364,164,977)	(1,258,585,335)
Payments for retailer commissions	(99,418,312)	(94,801,190)	(206,249,080)	(191,174,540)
Net cash provided by operating activities	273,534,002	290,964,297	590,768,645	579,102,726
Cash Flows From Noncapital Financing Activities				
Transfer to other funds	(386,479,125)	(414,718,946)	(692,058,563)	(679,601,787)
Cash Flows From Capital and Related Financing Activities				
Acquisition of capital assets	-	(167,510)	-	(167,510)
Cash Flows From Investing Activities				
Proceeds from the sale and maturity of investment securities	47,300,020	171,025,936	95,130,020	222,098,936
Purchase of investments	(2,048,400)	(116,773,232)	(2,048,400)	(123,873,062)
Interest received	3,300,273	2,245,336	4,083,998	2,540,807
Security lending proceeds	8,470,806	3,630,822	16,317,869	6,343,725
Security lending payments	(8,297,374)	(3,446,371)	(15,975,968)	(6,013,676)
Net cash provided by investing activities	48,725,325	56,682,491	97,507,519	101,096,730
Net increase (decrease) in cash and cash equivalents	(64,219,798)	(67,239,668)	(3,782,399)	430,159
Cash and cash equivalents at beginning of period	65,848,964	72,651,233	5,411,565	4,981,406
Cash and cash equivalents at end of period	\$ 1,629,166	\$ 5,411,565	\$ 1,629,166	\$ 5,411,565

Bureau of State Lottery, State of Michigan
Statement of Cash Flows
For the Six Months and Years Ended September 30, 2006 and 2005

	Six Months Ended		Years Ended	
	2006	2005	2006	2005
Reconciliation of net operating income to net cash provided by operating activities				
Operating income	\$ 326,232,640	\$ 354,009,804	\$ 693,382,134	\$ 675,210,211
Adjustments to reconcile operating income to net cash provided by operating activities				
Depreciation expense	75,056	67,575	156,716	136,651
Bad debt expense	105,481	54,389	182,836	134,729
Amortization of prize award obligation discount	(14,109,605)	(16,512,669)	(29,387,661)	(34,251,841)
Net changes in assets and liabilities:				
Inventory	635,209	1,641,416	(945,892)	393,488
Receivables from retailers	5,887,100	318,160	(5,908,515)	(387,272)
Warrants authorized, compensated absences, accounts payable, other liabilities	(6,509,708)	(6,621,837)	(108,598)	192,647
Prize awards payable	(38,782,171)	(41,992,541)	(66,602,375)	(62,325,887)
Net cash provided by operating activities	\$ 273,534,002	\$ 290,964,297	\$ 590,768,645	\$ 579,102,726
Reconciliation of cash and cash equivalents				
Cash at beginning of period				
Equity in State Treasurer's Common Cash Fund	\$ 68,081,861	\$ 74,232,824	\$ 6,201,864	\$ 6,738,077
Warrants outstanding	(2,232,897)	(1,581,591)	(790,299)	(1,756,671)
Net cash and cash equivalents at beginning of period	\$ 65,848,964	\$ 72,651,233	\$ 5,411,565	\$ 4,981,406
Cash at end of period				
Equity in State Treasurer's Common Cash Fund	\$ 4,216,557	\$ 6,201,864	\$ 4,216,557	\$ 6,201,864
Warrants outstanding	(2,587,391)	(790,299)	(2,587,391)	(790,299)
Net cash and cash equivalents at end of period	\$ 1,629,166	\$ 5,411,565	\$ 1,629,166	\$ 5,411,565
Schedule of noncash investing, capital, and financing activities				
Decrease in fair value of investments	\$ (29,069)	\$ (4,924,527)	\$ (16,372,487)	\$ (24,646,166)
Transfers to other funds (accrual)	(18,017,340)	(10,579,438)	(18,017,340)	(10,579,438)
Total noncash investing, capital, and financing activities	\$ (18,046,409)	\$ (15,503,965)	\$ (34,389,827)	\$ (35,225,604)

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Bureau of State Lottery (the Lottery) was established by Public Act No. 239, Public Acts of 1972, as amended.

Public Act 95 of 1996 allows the Lottery to participate in joint enterprises, such as multi-state lotteries, with other sovereignties. Michigan participates in Mega Millions, a jointly operated multi-state lottery comprised of 12 states: California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Texas, Virginia and Washington. Net income from Mega Millions is transferred to the School Aid Fund.

Basis of Presentation

The Lottery is classified as an enterprise fund of the State of Michigan. Accordingly, the Lottery's financial statements are included in the State's Comprehensive Annual Financial Report. The accompanying financial statements are not intended to present the financial position and results of operations of the State of Michigan or its enterprise funds.

Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. The Lottery distinguishes operating revenue and expenses from non-operating items. The principal operating revenue of the Lottery is primarily comprised of sales from instant and online tickets. Operating expenses mainly consist of payments to instant and online prize winners and commissions to retailer agents and vendors. Excess revenue over expenses is designated for payment to the state School Aid Fund, except for the excess of revenue over expenses from charitable gaming activities, which is designated for payment to the State General Fund. All other revenues and expenses are reported as non-operating.

In accordance with Governmental Accounting Standards Board Statement 20, the Lottery has elected not to apply Financial Accounting Standards Board statements and interpretations issued after November 30, 1989, to its financial statements.

Statement of Cash Flows

For the purposes of the statement of cash flows, the Lottery considers equity in the State Treasurer's Common Cash pool net of warrants outstanding to be cash equivalents.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U. S. 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. During the year ended September 30, 2005, the Lottery improved its methods of estimating current prize liability for instant and on line games. The net effect was an additional prize expense of \$13,212,140 in the period ended September 30, 2005.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

Equity in State Treasurer's Common Cash Fund

The State Treasurer manages the State's Common Cash pool, which is used by the Lottery. The pooling of cash allows the Treasurer to invest monies not needed to pay immediate obligations so that investment earnings on available cash are maximized. Investments of the pool are not segregated by fund; rather, each contributing fund's balance is treated as equity in the pool and presented in this report as "Equity in State Treasurer's Common Cash."

Investment policies and risk categorization are included in the State of Michigan's comprehensive annual financial report.

Investments

Investments are reported at fair value. Investments are in U. S. Treasury zero-coupon bonds and are purchased to meet future installment payments to prize winners. There are generally no available realized gains or losses on investments, as it is the State Treasurer's policy to hold the Lottery's investments to maturity or liquidation. The difference between the fair value and the amortized cost is reflected as a restriction of Net Assets for unrealized gains on investments.

Inventory

Inventory consists of instant game tickets, Pull Tab game tickets and charity game tickets on hand and for sale at year end as well as merchandize prizes for games that have not started as of September 30, 2006. The inventory is valued at cost, primarily using the weighted average method.

Provision for Doubtful Accounts

The Lottery establishes an allowance for bad debt for any retailer accounts receivable greater than 90 days old. A bad debt expense is recorded when the allowance is set up for these receivables. The amount of the allowance for doubtful accounts totaled \$1,421,507 for the year ended September 30, 2006 and \$1,500,811 for the year ended September 30, 2005.

Capital Assets

The Lottery has established a \$5,000 threshold for capitalization of purchases of assets, which include equipment and leasehold improvements, and they are reported in the Statement of Net Assets. Such assets are recorded at historical cost. Depreciation of equipment is computed using the straight-line method over five years, the estimated useful life of the assets. Information technology equipment is depreciated over three years, the estimated useful life of the assets. Building leasehold improvements are depreciated over eight years, the estimated useful life of the improvements. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

Advance Wagers

All on line games may be played on an advance wager basis. An associated liability is recognized for all wagers received for drawings to be conducted after the end of the reporting period.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

Warrants Authorized and Warrants Outstanding

Most of the Lottery's disbursements are made through warrants issued by the State. Warrants requested by the Lottery are charged to the Lottery's equity in the State Treasurer's Common Cash Fund as they clear the State Treasurer's account. Therefore, warrants outstanding represent drafts issued against the State Treasurer's account, which have not cleared. Warrants requested by the Lottery, but not yet issued by the State, are reported as warrants authorized.

Unclaimed Prizes

Prizes not claimed within one year after the drawing date or after the expiration date indicated on the back of the instant game tickets are forfeited by the ticket holder. The Lottery estimates the amount of winning online and instant tickets which will not be claimed within one year after the drawing date for online tickets or after the expiration date for instant tickets. All unclaimed prizes are transferred to the state School Aid Fund as provided by state statute.

NOTE 2 - EQUITY IN STATE TREASURER'S COMMON CASH

The Lottery participates in the State Treasurer's Common Cash pool. The investment authority for the pool is found in Public Act 105 of 1855, as amended. The pool functions as both a cash management pool and a demand deposit account. The State Treasurer may invest surplus funds belonging to the State in the bonds, notes and other evidences of indebtedness of the United States Government and its agencies and in prime commercial paper. The Treasurer invests excess cash in short-term investments, mostly prime commercial paper.

The following paragraphs provide disclosures about deposits and investments of the State Treasurer's Common Cash Fund:

Common Cash Deposits

Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the State's deposits may not be recovered.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

- a. Uncollateralized
- b. Collateralized with securities held by the pledging financial institution, or
- c. Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

The State Treasurer's policy requires the following criteria to lessen the custodial credit risk: All financial institutions holding the State's money must pledge collateral equal to the amount of the account balance for all demand and time deposits, to secure the State funds. A bank, savings and loan association or credit union holding State funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the state of Michigan. No deposit in any financial organization may be in excess of 50 percent of the net worth of the organization.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a deposit.

Public Act 35 of 1997 requires State deposits to be held in a financial institution which maintains a principal office or branch office located in the state of Michigan.

No deposits were exposed to foreign currency risk, as is precluded by State policy.

Common Cash Investments

Risk

In accordance with GASB Statement No. 40, investments also require certain disclosures regarding policies and practices with respect to the risks associated with them. Custodial credit risk, credit risk and interest rate risk are discussed in the following paragraphs:

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the State will not be able to recover the value of the investment or collateral securities that are in the possession of the outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government and are held by either:

The counterparty or

The counterparty's trust department or agent but not in the government name.

The State Treasurer does not have an investment policy for managing custodial credit risk. At September 30, 2006 Common Cash investments were not exposed to custodial credit risk.

Credit Risk

Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

Prime commercial paper investments must be rated A-1 or P-1 at the time of purchase as rated by the two major rating services Standard and Poor (A-1); and Moody's (P-1). Borrowers must have at least \$400 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10% of the borrower's outstanding debt. The investments are further limited to \$200 million in any borrower, unless the borrower has an A-1+ rating in which case the investment is not to exceed \$300 million.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The State Treasurer's policy states that cash equivalents are invested in short term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk.

NOTE 3 - INVESTMENTS

Investments totaling \$435,853,341 at September 30, 2006, and \$514,262,899 at September 30, 2005, are in the form of U. S. Treasury zero-coupon bonds. These investments were purchased to fund future payments due to annuity prize winners. The zero-coupon bonds are reported at fair value. The corresponding liability to the prize winners is recorded in prizes payable and is disclosed in Note 6. Cash receipts from the maturity of investments in prize annuities totaled \$95,130,020 in the year ended September 30, 2006 and \$104,833,000 in the year ended September 30, 2005.

Investments at September 30 consist of the following:

As reported on the Statement of Net Assets:	2006	2005
Current investments	\$ 85,072,951	\$ 93,378,340
Noncurrent investments	350,780,390	420,884,559
Total Investments	<u>\$ 435,853,341</u>	<u>\$ 514,262,899</u>

Policy Disclosures

Investment authority with regard to the State Lottery Fund is delegated to the State Treasurer per the McCauley-Traxler-Law-Bowman-McNeely Lottery Act 239 of 1972 section 432.41 paragraph 2. This authority is the same investment authority with regard to retirement system funds which is the Public Employee Retirement System Investment Act 314 of 1965, as amended by Act 55 of 1982. The Act incorporates the prudent person rule and requires that investment fiduciaries act solely in the interest of the entities' participants and beneficiaries. This act allows the State Treasurer, as investment fiduciary, to make diverse investments in stocks, corporate and government bonds and notes, mortgages, real estate, venture capital, and other investments. However, the Lottery had no such investments at September 30, 2006 and 2005, respectively. The Lottery has no policy, but the procedure is to invest solely in U. S. Treasury zero-coupon bonds and hold them to maturity.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

Interest Rate Risk

Investments at September 30, 2006 consist of the following:

<u>Maturities</u> <u>In years</u>	<u>Investments in United States</u> <u>Treasury Zero Coupon Bonds</u>	<u>Interest Rate</u> <u>Low to High</u>
Less than 1	\$ 85,072,951	5.57% to 11.04%
1-5	259,612,815	5.58% to 11.10%
6-10	69,836,444	5.15% to 10.87%
11-15	12,575,165	6.31% to 6.39%
16-20	4,239,826	5.09% to 6.54%
21-26	<u>4,516,140</u>	5.00% to 5.06%
Fair Market Value	<u><u>\$ 435,853,341</u></u>	

Interest rate risk is the risk that an investment's fair value decreases as market interest rates increase. Typically, this risk is higher in debt securities with longer maturities. The State does not have a policy regarding interest rate risk. The investments are subject to fluctuations in fair value due to interest rate risk, but these bonds are held to maturity to satisfy the annual installment obligations to the prize winners. The fair value at maturity is the face value of the bonds regardless of the fluctuations in value during the time period that the investments are outstanding, thus minimizing the interest rate risk, if held to maturity.

Credit Risk

U. S. Treasury zero-coupon bonds are explicitly guaranteed by the U. S. government and credit quality ratings are therefore not required. The Lottery procedure to invest in this type of bond does not require a specific credit rating, but credit quality is inherently high as the bonds are explicitly guaranteed by the U. S. government.

Concentration of Credit Risk

Investments are in U. S. Treasury zero-coupon bonds which are guaranteed by the United States government. Therefore, there is no concentration of credit risk.

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Lottery will not be able to recover the value of its investments that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the entity, and are held by either the counterparty, or the counterparty's trust department or agent, but not in the entity's name. The Lottery does not have any of these types of investments.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

The Lottery does participate in a security lending program. However the investments remain in the name of the Lottery and 102% collateral is required as explained below.

State statutes do not prohibit the Lottery from participating in securities lending transactions and the Lottery has, via a Securities Lending Authorization Agreement, authorized the agent bank to lend its securities to broker dealers and banks pursuant to a form of loan agreement.

The following represents the balances relating to the securities lending transactions as of September 30, 2006:

Securities Lent	Underlying Securities	Collateral Received	Investment Value	Type of Collateral
U. S. Treasury zero-coupon bonds	\$ 385,822,874	\$ 391,854,831	\$ 391,854,831	Custodian's short- term investment pool

During the year, the agent bank lent, at the direction of the State Treasurer, the Lottery's securities and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds and irrevocable bank letters of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to: (i) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 102% of market value of the loaned securities; and (ii) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 105% of the market value of loaned securities.

The Lottery did not impose any restrictions during the year on the amount of the loans that the agent bank made on its behalf and the agent bank indemnified the Lottery by agreeing to purchase replacement securities, or return cash collateral in the event borrower failed to return the loaned security or pay distributions thereon. There were no failures by any borrowers during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the year, the Lottery and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested in a collateral account dedicated to the Lottery. As of September 30, 2006, such account had an average weighted maturity to next reset of 22.46 days and an average weighted maturity of 678.37 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2006, the Lottery had no credit risk exposure to borrowers.

Gross income from securities lending for the six months and year ended September 30, 2006, was \$8,508,813 and \$16,349,413, respectively. Expenses associated with this income for the six months and year ended September 30, 2006, were \$8,242,979 and \$15,865,451, respectively, for the borrower's rebates and \$54,395 and \$110,517, respectively, for bank fees and fees paid to the agent.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Lottery had no short-term external collateral investment pool deposits subject to foreign currency risk at September 30, 2006.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

NOTE 4 - CAPITAL ASSETS

A summary of capital asset activity for the years ended September 30, 2006 and 2005 was as follows:

<u>Period Ending</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
<u>September 30, 2006</u>				
Capital assets, being depreciated:				
Leasehold improvements	\$ 1,917,979	\$ -	\$ -	\$ 1,917,979
Equipment	2,101,015	-	-	2,101,015
Total capital assets, being depreciated	4,018,994	-	-	4,018,994
Less: accumulated depreciation				
Leasehold improvements	1,705,706	47,552	-	1,753,258
Equipment	1,769,594	109,164	-	1,878,758
Total accumulated depreciation	3,475,300	156,716	-	3,632,016
Total capital assets, being depreciated, net	<u>\$ 543,694</u>	<u>\$ (156,716)</u>	<u>\$ -</u>	<u>\$ 386,978</u>
<u>September 30, 2005</u>				
Capital assets, being depreciated:				
Leasehold improvements	\$ 1,917,979	\$ -	\$ -	\$ 1,917,979
Equipment	2,193,988	167,510	260,483	2,101,015
Total capital assets, being depreciated	4,111,967	167,510	260,483	4,018,994
Less: accumulated depreciation				
Leasehold improvements	1,655,971	49,735	-	1,705,706
Equipment	1,943,161	86,916	260,483	1,769,594
Total accumulated depreciation	3,599,132	136,651	260,483	3,475,300
Total capital assets, being depreciated, net	<u>\$ 512,835</u>	<u>\$ 30,859</u>	<u>\$ -</u>	<u>\$ 543,694</u>

NOTE 5 - DISAGGREGATION OF PAYABLE BALANCE

Accounts payable and other liabilities at September 30, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
Accounts payable vendors	\$ 364,362	\$ 498,795
Retailer security deposits/accounts payable	2,024,589	1,867,588
Accrued salaries	738,675	673,542
Compensated absences	191,817	194,854
Total	<u>\$ 3,319,443</u>	<u>\$ 3,234,779</u>

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

NOTE 6 - PRIZE AWARDS

Installment prize awards are recorded at their present value using discount rates ranging from 5.0% to 8.5%. U.S. Treasury zero-coupon bonds have been purchased to provide for the payment of installment prize awards in addition to cash maintained in the State's common cash fund. Prize awards payable as of September 30, were as follows:

	2006	2005
Current - at face amount	\$ 123,698,181	\$ 134,965,339
Less - unamortized discount	(3,005,436)	(3,283,141)
Current - at present value	120,692,745	131,682,198
Long-term - at face amount	443,354,795	527,301,740
Less - unamortized discount	(127,051,020)	(155,385,043)
Long-term - at present value	316,303,775	371,916,697
Total	<u>\$ 436,996,520</u>	<u>\$ 503,598,895</u>

Installment prize awards payable for the twelve-month period ending September 30,

2007	\$ 86,458,945
2008	75,701,569
2009	68,516,070
2010	56,742,595
2011	50,082,461
2012-2016	133,629,500
2017-2021	28,338,500
2022-2026	14,580,700
2027-2031	7,076,500
2032-2036	4,430,900
Later years	4,256,000
Total	529,813,740
Less - unamortized discount	(130,056,456)
Total installment prize awards payable at present value	399,757,284
Non-installment prize awards payable	37,239,236
Total prize awards payable	<u>\$ 436,996,520</u>

Long-term liability activity of installment prize awards payable for the years ended September 30, was as follows:

Period Ending	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year at Present Value
2006	\$ 463,350,059	\$ 31,211,728	\$ 94,804,503	\$ 399,757,284	\$ 83,453,509
2005	\$ 530,013,607	\$ 36,888,678	\$ 103,552,226	\$ 463,350,059	\$ 91,433,362

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

NOTE 7 - COMPENSATED ABSENCES

The Lottery records as a liability estimated vested vacation, sick pay and longevity. Employees are granted vacation pay in varying amounts based on length of service. Accumulated unused vacation pay is paid to employees or their beneficiaries upon death, retirement or resignation. Sick leave accrues for all employees at the rate of four hours for each two week period worked. Up to 50% of accumulated, unused sick leave of employees hired prior to October 1, 1980, is paid to the employees or their beneficiaries upon death, retirement or resignation. For employees hired after September 30, 1980, unused sick leave is forfeited upon termination of employment. In accordance with state Civil Service Rules, longevity compensation payments, which are separate from regular compensation, are paid based on employee years of service. The Lottery accrues for vacation, vested sick leave and longevity to be paid upon death, retirement or resignation during the period of active employment.

The State instituted a banked leave time program October 12, 2003 whereby eligible employees worked a regular schedule but received pay for a reduced number of hours. The banked leave time program was discontinued November 5, 2005. Upon an employee's separation, death or retirement from State service, unused banked leave time hours shall be contributed by the State to the employee's account within the State's 401k plans, and if applicable to the State's 457 plans. The banked leave liability is valued at the pay rates in effect as of September 30, 2006.

Long-term liability activity of these benefits for the years ended September 30 was as follows:

Fiscal Year Ending	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
2006	\$ 2,170,045	\$ 839,281	\$ 861,608	\$ 2,147,718	\$ 191,817
2005	\$ 1,987,957	\$ 1,095,017	\$ 912,929	\$ 2,170,045	\$ 194,854

NOTE 8 - PENSION

The Lottery's employees hired prior to March 31, 1997, are enrolled in a noncontributory defined benefit plan through the State Employees' Retirement System (Plan 1) upon meeting certain eligibility requirements. The Plan provides for pension, dental, vision and major medical coverage. A member may retire with an age and service allowance after completing: (1) at least 10 years of credited service and (2) attaining the minimum retirement age of 60, or at least age 55 with 30 years of service credit. Pension benefits are determined using 1.5% times a member's final average compensation, calculated as the average of a member's monthly pay during the period of 36 consecutive months of credited service producing the highest monthly average multiplied by length of service.

The Lottery's employees hired after March 31, 1997, are enrolled in a defined contribution plan through the State Employee's Retirement System (Plan 2) upon meeting certain eligibility requirements. Qualified participants are generally eligible to retire at age 55, with 30 years of service or at age 60 with 10 years of service. The Lottery contributes a mandatory 4% of the employees' salary and matches up to an additional 3% of the employees' contributions.

Bureau of State Lottery, State of Michigan

Notes to Financial Statements

Participants in Plan 2 are 100% vested for any employee contributions. Participants become vested for 50% of the employer contributions after 2 years of service, 75% after 3 years of service and 100% after 4 years of service. Employees become vested for retiree health insurance benefits with 10 or more years of service.

The cost of these benefits is allocated to the Lottery as a percentage of gross payroll. The payroll for the Lottery employees covered by the Plan 1 and Plan 2 was approximately \$4,667,446, \$4,196,769, and \$3,670,803 for the six months ended September 30, 2006, 2005, and 2004, respectively and approximately \$9,191,425, \$8,569,264, and \$7,414,633 for the years ended September 30, 2006, 2005, and 2004, respectively. The Lottery's actuary determined contribution requirements and contributions actually made were approximately \$1,469,618, \$1,277,796 and \$903,453 for the six month periods ended September 30, 2006, 2005, and 2004, respectively and approximately \$2,903,256, \$2,598,929, and \$2,011,560 for the years ended September 30, 2006, 2005 and 2004, respectively. Contributions represent approximately 31.6%, 30.3%, and 27.1% of annual covered payroll during 2006, 2005 and 2004, respectively.

Additional detail and data regarding Plan 1 and Plan 2 descriptions, vesting and eligibility requirements, actuarial cost methods and assumptions, funding requirements, accounting policies and a three-year historical trend information is provided in the State of Michigan Comprehensive Annual Financial Report and the detailed financial report issued by the Bureau of Retirement Systems. The reports may be obtained by writing to the Department of Management and Budget, Office of Retirement Services, 7150 Harris Dr., P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-5103.

NOTE 9 - LEASE AND RENTAL COMMITMENTS

The total lease payments on long-term lease commitments for years ended September 30, 2006 and 2005 were \$101,286 and \$68,939, respectively. These leases represent leases for buildings. There were no capital lease obligations.

A summary of building lease commitments follows:

<u>Year Ended September 30</u>	<u>Operating Leases</u>
2007	\$ 102,224
2008	103,049
2009	105,674
2010	107,549
2011	77,361
	<u>\$ 495,857</u>

The total rent and lease expenses paid for all buildings for the years ended September 30, 2006 and 2005 were \$2,385,510 and \$2,264,303, respectively.

Bureau of State Lottery, State of Michigan
Notes to Financial Statements

NOTE 10 - TRANSACTIONS WITH OTHER STATE AGENCIES

As a State agency, the Lottery is required to utilize services, supplies and equipment provided by other State agencies. Following is a summarization of these charges for the year ended September 30, 2006:

Department of Management and Budget		
Support services	\$ 115,500	
Space rental - Lottery Central, Detroit, Saginaw offices	2,249,741	
Vehicle and Travel Services	776,481	
Other - Telephone, mailing and other offices services	<u>334,677</u>	
Total Department of Management and Budget		\$ 3,476,399
Civil Service		147,505
Department of Treasury		273,621
Attorney General		180,253
Department of Information Technology (DIT)		
Direct costs	3,222,382	
Michigan Administrative Information Network (MAIN), Lansing		
Metropolitan Area Network (LMAN), Unisys Platform Charges	132,144	
Michigan Gov Portal Web Charges	410,679	
Overhead	<u>124,060</u>	
Total DIT Charges		3,889,265
History, Arts, & Library		20,800
Other Agencies		<u>41,603</u>
 Total all State agencies		 <u><u>\$ 8,029,446</u></u>

NOTE 11 - RISK MANAGEMENT

The Lottery is exposed to various risks related to torts: property damage and destruction, errors and omissions, workers' compensation and unemployment compensation. The State of Michigan has elected not to purchase commercial insurance for many of the risks of losses to which the Lottery is exposed, but to self-insure for such risks. More detailed information on risk management is available in the State of Michigan's comprehensive annual financial report.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

From time to time, the Lottery is party to lawsuits and claims arising in the normal course of business. The Lottery has defended and intends to continue to defend these actions vigorously and believes, based on currently available information, that adverse settlements, if any, will not be material to its financial position or results of operation.

Bureau of State Lottery, State of Michigan
Supplementary Schedule of Revenues, Expenses and Transfers
For the Six Months and Year Ended September 30, 2006

		Six Months Ended		Year Ended	
		Amount	Percent of Sales	Amount	Percent of Sales
Lottery ticket sales:	Daily 3	\$ 189,126,165	17.7%	\$ 384,244,363	17.4%
	Daily 3 Double	744,275	0.1%	1,530,618	0.1%
	Daily 4	161,796,305	15.2%	322,272,944	14.6%
	Daily 4 Double	314,132	0.1%	672,889	0.0%
	Classic Lotto 47	25,741,887	2.4%	50,702,028	2.3%
	Mega Millions	93,231,343	8.8%	216,407,615	9.8%
	Keno	7,219,867	0.7%	14,593,412	0.7%
	Fantasy Five	21,666,873	2.0%	45,514,034	2.0%
	Club Keno	163,590,259	15.3%	343,824,930	15.5%
	Club Keno Kicker	44,986,904	4.2%	80,236,800	3.6%
	Pull-Tab tickets	18,075,194	1.7%	41,599,354	1.9%
	Instant tickets	339,262,652	31.8%	710,768,988	32.1%
Total lottery ticket sales		1,065,755,856	100.0%	2,212,367,975	100.0%
Prize awards:	Daily 3	86,595,486	8.1%	179,067,975	8.1%
	Daily 3 Double	426,500	0.1%	874,450	0.0%
	Daily 4	104,472,678	9.8%	189,515,901	8.6%
	Daily 4 Double	185,875	0.0%	398,750	0.0%
	Classic Lotto 47	14,052,592	1.3%	27,735,588	1.3%
	Mega Millions	45,956,631	4.3%	107,668,218	4.9%
	Keno	2,576,463	0.2%	6,242,140	0.3%
	Fantasy Five	11,515,846	1.1%	23,341,005	1.0%
	Club Keno	106,801,396	10.0%	224,645,470	10.2%
	Club Keno Kicker	28,752,156	2.7%	51,098,670	2.3%
	Pull-Tab tickets	11,784,537	1.1%	27,202,039	1.2%
	Instant tickets	220,184,313	20.7%	460,688,267	20.8%
Total prize awards		633,304,473	59.4%	1,298,478,473	58.7%
Less: unclaimed prizes		(15,161,204)	-1.4%	(30,303,532)	-1.4%
Net prize awards		618,143,269	58.0%	1,268,174,941	57.3%
Gross margin		447,612,587	42.0%	944,193,034	42.7%
Retailer and vendor commission expense		(99,418,312)	-9.3%	(206,249,080)	-9.3%
Game related expense		(9,494,368)	-0.9%	(19,103,390)	-0.9%
Net ticket revenue		338,699,907	31.8%	718,840,564	32.5%
Other operating expense		(18,016,526)	-1.7%	(37,228,184)	-1.7%
Other miscellaneous revenue		698,064	0.1%	1,280,629	0.1%
Net lottery operating income		321,381,445	30.2%	682,893,009	30.9%
Charitable gaming					
Charitable gaming revenue		8,928,677	0.8%	18,555,713	0.8%
Charitable gaming expense		(4,077,482)	-0.4%	(8,066,588)	-0.4%
Net charitable gaming income		4,851,195	0.4%	10,489,125	0.4%

Continued

Bureau of State Lottery, State of Michigan
Supplementary Schedule of Revenues, Expenses and Transfers
For the Six Months and Year Ended September 30, 2006

	Six Months Ended		Year Ended	
	Amount	Percent of Sales	Amount	Percent of Sales
Non-operating revenues (expenses)				
Amortization expense - prize discount	(14,109,605)	-1.3%	(29,387,661)	-1.3%
Amortization revenue - investment discount	14,854,837	1.4%	31,044,549	1.4%
Unrealized (loss) on investments	(29,069)	0.0%	(16,372,487)	-0.7%
Interest revenue - common cash fund	2,342,409	0.2%	4,083,998	0.2%
Net security lending income	211,439	0.0%	373,445	0.0%
Net non-operating revenues (expenses)	3,270,011	0.3%	(10,258,156)	-0.4%
Net income before transfers	329,502,651	30.9%	683,123,978	30.9%
Unrealized loss on investments	29,069	0.0%	16,372,487	0.7%
Net income available for transfer	<u>\$ 329,531,720</u>	<u>30.9%</u>	<u>\$ 699,496,465</u>	<u>31.6%</u>
Amount transferred to:				
School Aid Fund	\$ 324,185,525	30.4%	\$ 688,017,340	31.1%
General Fund	4,851,195	0.4%	10,489,125	0.5%
Community Health	495,000	0.1%	990,000	0.0%
Total amount transferred out	<u>\$ 329,531,720</u>	<u>30.9%</u>	<u>\$ 699,496,465</u>	<u>31.6%</u>

Concluded

Bureau of State Lottery, State of Michigan
Supplementary Schedule of Revenues, Expenses and Transfers
For the Six Months and Year Ended September 30, 2005

		Six Months Ended		Year Ended	
		Amount	Percent of Sales	Amount	Percent of Sales
Lottery ticket sales:	Daily 3	\$ 194,353,643	18.8%	\$ 401,071,740	19.5%
	Daily 3 Double	860,384	0.1%	1,827,075	0.1%
	Daily 4	150,427,470	14.5%	308,845,176	14.9%
	Daily 4 Double	392,076	0.0%	833,898	0.0%
	Winfall	7,945,640	0.8%	37,179,827	1.8%
	Classic Lotto 47	18,463,251	1.8%	18,463,251	0.9%
	Mega Millions	117,263,887	11.4%	203,902,214	9.8%
	Keno	6,824,025	0.7%	13,520,419	0.7%
	Michigan Rolldown	(1,136)	0.0%	(6,443)	0.0%
	Fantasy Five	24,385,432	2.4%	49,899,126	2.4%
	Club Keno	168,122,562	16.3%	332,356,189	16.1%
	Pull-Tab tickets	16,173,528	1.6%	39,066,984	1.9%
	Instant tickets	325,935,740	31.6%	662,533,892	31.9%
Total lottery ticket sales		1,031,146,502	100.0%	2,069,493,348	100.0%
Prize awards:	Daily 3	92,330,083	9.0%	189,245,384	9.1%
	Daily 3 Double	486,500	0.0%	1,061,150	0.1%
	Daily 4	74,003,016	7.2%	160,256,378	7.7%
	Daily 4 Double	237,500	0.0%	522,000	0.0%
	Winfall	3,454,460	0.4%	23,785,095	1.1%
	Classic Lotto 47	10,435,121	1.0%	10,435,121	0.5%
	Mega Millions	58,223,350	5.6%	101,554,158	4.9%
	Keno	3,036,394	0.3%	6,549,239	0.3%
	Fantasy Five	12,673,156	1.2%	26,195,281	1.3%
	Club Keno	109,800,262	10.6%	216,752,935	10.5%
	Pull-Tab tickets	10,543,789	1.0%	25,521,544	1.2%
	Instant tickets	205,251,355	19.9%	417,763,784	20.3%
Total prize awards		580,474,986	56.2%	1,179,642,069	57.0%
Less: unclaimed prizes		(17,516,337)	-1.7%	(17,634,462)	-0.9%
Net prize awards		562,958,649	54.5%	1,162,007,607	56.1%
Gross margin		468,187,853	45.5%	907,485,741	43.9%
Agent and vendor commission expense		94,801,190	9.2%	191,174,540	9.2%
Game related expense		8,933,753	1.0%	18,369,818	1.0%
Net ticket revenue		364,452,910	35.3%	697,941,383	33.7%
Other operating expense		16,507,386	1.6%	35,459,978	1.6%
Other miscellaneous revenue		533,606	0.2%	999,861	0.0%
Net lottery operating income		348,479,130	33.9%	663,481,266	32.1%
Charitable gaming					
Charitable gaming revenue		9,575,077	0.9%	19,639,038	1.0%
Charitable gaming expense		4,044,403	0.4%	7,910,093	0.4%
Net charitable gaming income		5,530,674	0.5%	11,728,945	0.6%

Continued

Bureau of State Lottery, State of Michigan
Supplementary Schedule of Revenues, Expenses and Transfers
For the Six Months and Year Ended September 30, 2005

	Six Months Ended		Year Ended	
	Amount	Percent of Sales	Amount	Percent of Sales
Non-operating revenues (expenses)				
Amortization expense - prize discount	(16,512,669)	-1.6%	(34,251,841)	-1.7%
Amortization revenue - investment discount	17,330,617	1.7%	35,956,493	1.7%
Realized gain on investment	492,704	0.0%	492,704	0.0%
Unrealized (loss) on investments	(4,924,527)	-0.5%	(24,646,166)	-1.1%
Interest revenue - common cash fund	1,723,699	0.2%	2,540,807	0.1%
Net security lending income	182,536	0.0%	350,009	0.0%
Net non-operating revenues (expenses)	<u>(1,707,640)</u>	<u>-0.2%</u>	<u>(19,557,994)</u>	<u>-0.9%</u>
Net income before transfers	352,302,164	34.2%	655,652,217	31.8%
Unrealized loss on investments	<u>4,924,527</u>	<u>0.5%</u>	<u>24,646,166</u>	<u>1.2%</u>
Net income available for transfer	<u>\$ 357,226,691</u>	<u>34.7%</u>	<u>\$ 680,298,383</u>	<u>32.9%</u>
Amount transferred to:				
School Aid Fund	\$ 351,201,017	34.1%	\$ 667,579,438	32.3%
General Fund	5,530,674	0.6%	11,728,945	0.6%
Community Health	<u>495,000</u>	<u>0.0%</u>	<u>990,000</u>	<u>0.0%</u>
Total amount transferred out	<u>\$ 357,226,691</u>	<u>34.7%</u>	<u>\$ 680,298,383</u>	<u>32.9%</u>

Bureau of State Lottery, State of Michigan
Supplementary Schedule of Other Operating Expenses
For the Six Months and Years Ended September 30, 2006 and 2005

	Six Months Ended		Years Ended	
	2006	2005	2006	2005
Salaries and wages	\$ 4,721,196	\$ 4,196,769	\$ 9,260,175	\$ 8,569,264
Employee benefits and taxes	2,220,359	2,038,119	4,862,843	4,408,372
Advertising	8,193,329	7,789,653	17,508,861	17,597,101
Talent	145,685	138,609	277,139	272,978
Printing and supplies, including purchase of charitable gaming tickets	1,059,373	1,123,894	2,176,591	2,325,458
Other contractual services	2,584,338	2,408,711	5,059,232	4,509,356
Building rent and leases	1,193,350	1,123,690	2,385,510	2,264,303
Travel	536,267	486,846	986,843	913,590
Utilities	212,217	196,811	425,948	412,561
Postage	199,710	177,394	411,195	362,558
Equipment maintenance and rental	829,828	738,056	1,568,956	1,447,068
Bad debt expense	105,481	54,389	182,836	134,729
Interest paid on security deposits	17,819	11,273	31,927	16,082
Total	<u>\$ 22,018,952</u>	<u>\$ 20,484,214</u>	<u>\$ 45,138,056</u>	<u>\$ 43,233,420</u>



The Lottery paid over \$165 million in retailer commissions in fiscal year 2006.

STATISTICAL SECTION



Bureau of State Lottery, State of Michigan Statistical Section

This part of the Lottery's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the Lottery's overall financial health.

The Michigan Bureau of State Lottery began operating in October 1972 and commenced ticket sales in November 1972. Data from the last 10 fiscal years of Lottery operations are presented in the following charts and graphs.

<u>Contents</u>	<u>Page</u>
Financial Trends	
These schedules contain trend information to help the reader understand how the Lottery's financial performance and well-being have changed over time.	47
Revenue Capacity	
This schedule and graph contains information to help the reader assess the Lottery's most significant revenue source, ticket sales.	50
<ul style="list-style-type: none"> • Instant Games – represent the face value of tickets activated by retailers. • Online Games – represents the face value of tickets sold to the public. • Club Games – represents the face value of tickets sold to the public. 	
Debt Capacity	
This schedule presents information to help the reader assess the installment prize awards liability of the Lottery. Prize liability is determined by prize structure and luck of the draw. Investments in U.S. Treasury zero-coupon bonds are purchased to meet future installment payments to prize winners.	53
Demographic and Economic Information	
This schedule offers demographic and economic indicators to help the reader understand the environment within which the Lottery's financial activities take place.	54
Operating Information	
This schedule contains service, retailer data, prize data, expenses and amounts transferred to the state School Aid Fund and prize winner data to help the reader understand how the Lottery's financial report relates to the products the Lottery provides and the service it performs for the State.	55
Industry Comparative Information	
These schedules show comparative information regarding sales, profits and expenses of all United States Lotteries.	58
Compliance Information	60
Independent Auditors' Report on Internal Control	

Sources: Unless otherwise noted, the information in these schedules is derived from the comprehensive annual reports for September 30, 2006. The Lottery implemented GASB Statement 34 in 2001; schedules include information beginning in the preceding year.





Bureau of State Lottery, State of Michigan

Financial Trends

Net Assets

Fiscal Years Ending September 30, 1997 through September 30, 2006

(In Millions)

	2000	2001	2002	2003	2004	2005	2006
Net assets							
Invested in capital assets	\$ 0.5	\$ 0.3	\$ 0.4	\$ 0.6	\$ 0.5	\$ 0.5	\$ 0.4
Restricted for unrealized gains on investments	50.9	95.7	128.0	105.2	77.1	52.4	36.1
Unrestricted (deficit)	<u>(0.5)</u>	<u>(0.3)</u>	<u>(0.4)</u>	<u>(0.6)</u>	<u>(0.5)</u>	<u>(0.5)</u>	<u>(0.4)</u>
Total net assets	<u>\$ 50.9</u>	<u>\$ 95.7</u>	<u>\$ 128.0</u>	<u>\$ 105.2</u>	<u>\$ 77.1</u>	<u>\$ 52.4</u>	<u>\$ 36.1</u>

Note: The Lottery implemented GASB Statement 34 in 2001; schedules include information beginning in the preceding year.



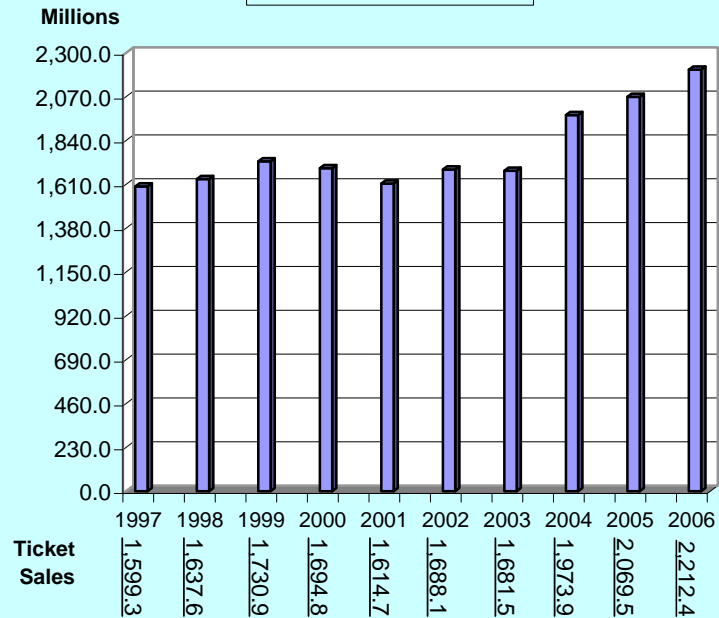
Bureau of State Lottery, State of Michigan
Financial Trends
Changes in Net Assets
Fiscal Years Ending September 30, 1997 through September 30, 2006
(In Millions)

	2000	2001	2002	2003	2004	2005	2006
Operating revenues							
Ticket sales	\$ 1,694.7	\$ 1,614.7	\$ 1,688.1	\$ 1,681.5	\$ 1,973.9	\$ 2,069.5	\$ 2,212.4
Charitable gaming and other	15.2	17.7	20.6	20.3	21.4	20.6	19.8
Total operating revenues	1,709.9	1,632.4	1,708.7	1,701.8	1,995.3	2,090.1	2,232.2
Operating expenses							
Prize awards	920.8	873.3	918.1	919.2	1,130.8	1,179.6	1,298.5
Less - unclaimed prizes	(26.5)	(23.3)	(44.4)	(19.5)	(31.1)	(17.6)	(30.3)
Net prize awards	894.3	850.0	873.7	899.7	1,099.7	1,162.0	1,268.2
Retailer commissions	120.4	114.9	120.7	121.8	145.4	152.7	165.3
Game related expenses	43.0	41.8	44.1	45.1	54.1	56.8	60.0
Other operating expenses	38.4	39.0	40.0	40.3	41.2	43.4	45.3
Total operating expenses	1,096.1	1,045.7	1,078.5	1,106.9	1,340.4	1,414.9	1,538.8
Operating income	613.8	586.7	630.2	594.9	654.9	675.2	693.4
Nonoperating revenues (expenses)							
Investment revenue	58.6	103.6	75.1	23.2	13.0	11.8	14.7
Interest on equity in State Treasurer's Common Cash Fund	8.2	4.2	1.6	1.0	0.9	2.5	4.1
Revenue from security lending	15.2	11.5	5.6	3.6	4.7	6.4	16.3
Security lending expenses	(14.2)	(10.6)	(4.8)	(3.3)	(4.3)	(6.0)	(16.0)
Net gain (loss) on sale of assets	-	(0.1)	-	-	-	-	-
Amortization of prize obligation discount	(67.1)	(53.1)	(48.7)	(44.1)	(39.2)	(34.2)	(29.4)
Total non-operating revenue	0.7	55.5	28.8	(19.6)	(24.9)	(19.5)	(10.3)
Transfers out							
Transfer to School Aid Fund	(618.5)	(587.0)	(613.5)	(586.0)	(644.9)	(667.6)	(688.0)
Transfer to General Fund	(7.0)	(9.4)	(12.1)	(11.2)	(12.2)	(11.7)	(10.5)
Transfer to Community Health	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Total transfers out	(626.5)	(597.4)	(626.6)	(598.2)	(658.1)	(680.3)	(699.5)
Increase (Decrease) in net assets	\$ (12.0)	\$ 44.8	\$ 32.4	\$ (22.9)	\$ (28.1)	\$ (24.6)	\$ (16.4)

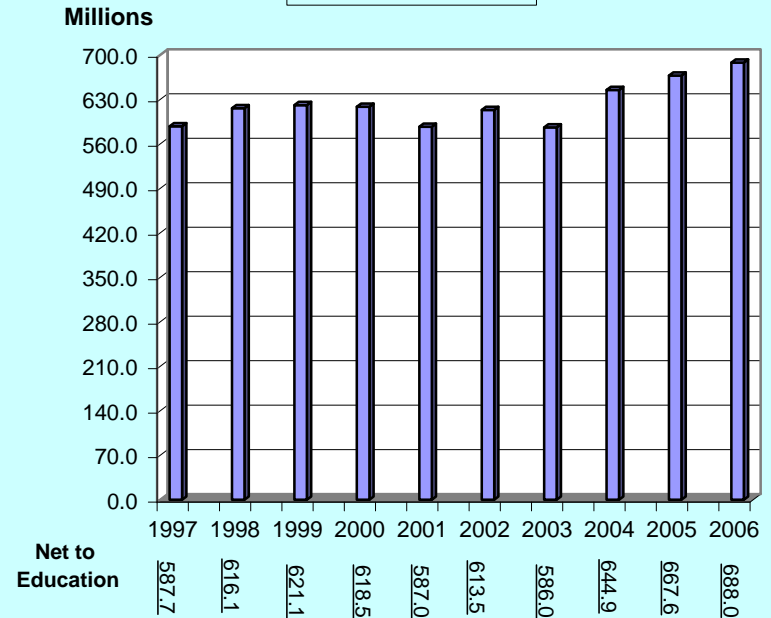
Source: Bureau of State Lottery, State of Michigan

**Bureau of State Lottery, State of Michigan
Financial Trends 1997 through 2006**

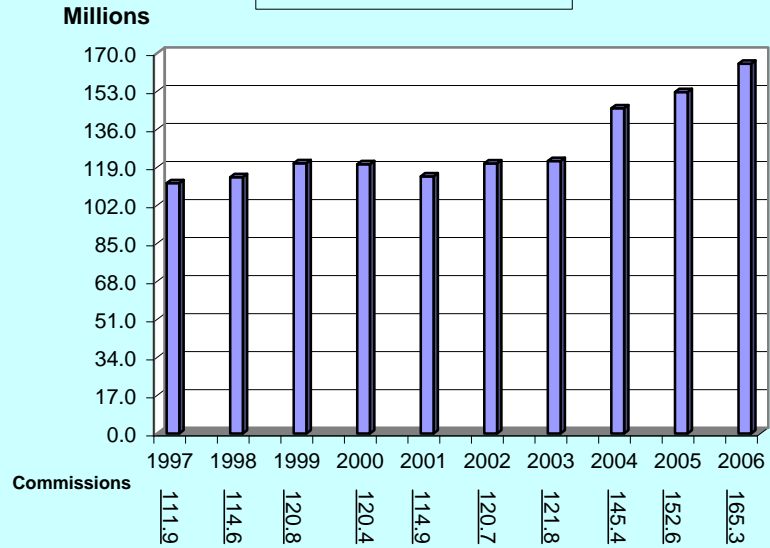
Ticket Sales History



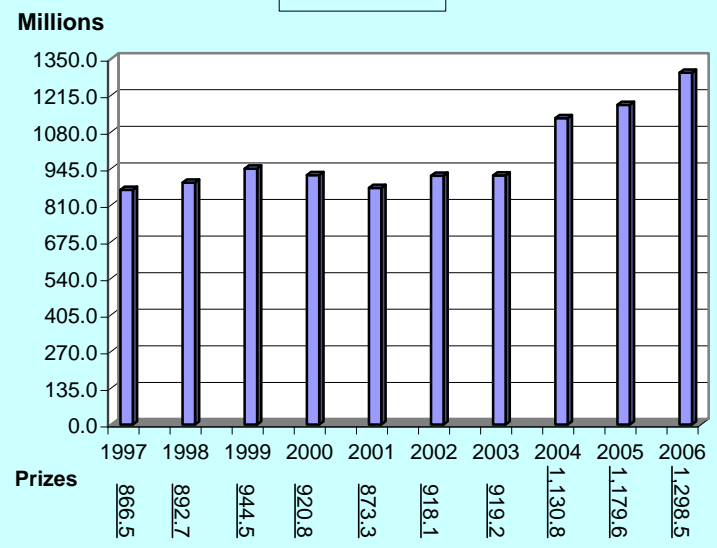
Net To Education



Retailer Commissions



Prizes Won



Source: Bureau of State Lottery, State of Michigan



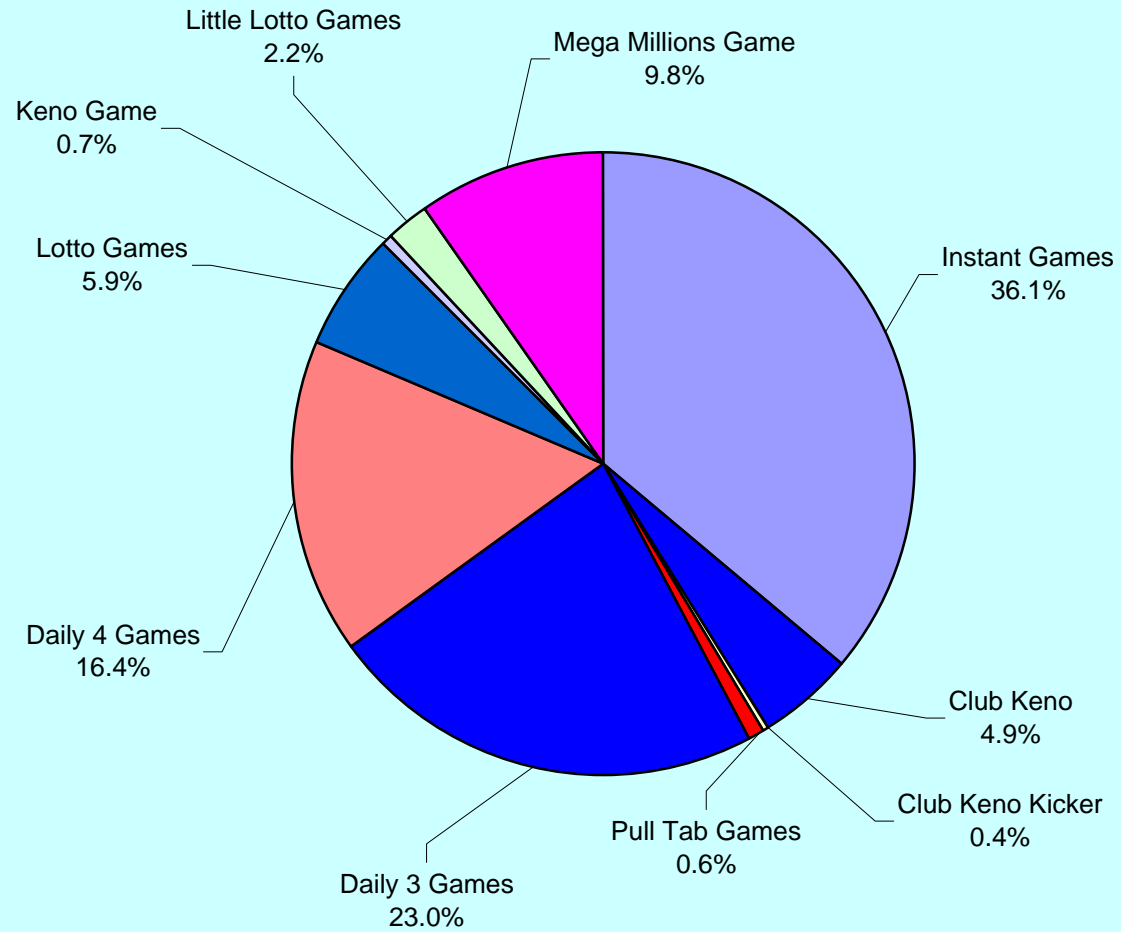
Bureau of State Lottery, State of Michigan
Revenue Capacity
Revenues from Ticket Sales
Fiscal Years Ending September 30, 1997 through September 30, 2006
(In Millions)

TICKET SALES	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
<i>Instant Games</i>										
Instant Tickets	\$ 563.8	\$ 605.9	\$ 629.9	\$ 643.3	\$ 626.7	\$ 655.4	\$ 682.7	\$ 690.2	\$ 662.5	\$ 710.8
<i>Club Games</i>										
Club Keno								204.5	332.3	343.8
Club Keno Kicker										80.3
Pull Tab Games								25.1	39.1	41.6
Total Club Games								229.6	371.4	465.7
<i>Online Games</i>										
Daily 3, Extra 3, Double 3	400.8	410.1	424.5	416.8	404.2	418.3	423.3	423.2	402.9	385.7
Daily 4, Extra 4, Double 4	262.2	280.5	293.9	284.7	280.6	289.2	297.2	310.2	309.7	323.0
Michigan Lotto, Michigan Millions, Winfall, Classic Lotto 47	202.3	167.3	161.5	106.2	100.0	71.7	79.3	66.6	55.7	50.7
Keno	14.0	12.6	11.6	10.7	10.1	10.3	13.5	14.9	13.5	14.6
Little Lotto: Cash Five, Michigan Rolldown, Fantasy 5 and Change Play	36.2	32.1	28.5	44.4	41.1	37.2	38.0	32.6	49.9	45.5
Mega Millions	120.0	129.1	181.0	188.6	152.0	206.0	147.5	206.6	203.9	216.4
Total On-line	1,035.5	1,031.7	1,101.0	1,051.4	988.0	1,032.7	998.8	1,054.1	1,035.6	1,035.9
TOTAL TICKET SALES	\$ 1,599.3	\$ 1,637.6	\$ 1,730.9	\$ 1,694.7	\$ 1,614.7	\$ 1,688.1	\$ 1,681.5	\$ 1,973.9	\$ 2,069.5	\$ 2,212.4
PRICE PER TICKET:										
Instant Games:										
Club Games:										
Online Games:										
Club Keno										
Pull-Tabs										
Daily 3										
Change Play										
All other online games										

Note: Principal revenue payers are the general public. Please see Demographic and Economic Information on page 54 for statistics.

Source: Bureau of State Lottery, State of Michigan

Bureau of State Lottery, State of Michigan
Revenue Capacity
Ticket Sales 1997 through 2006



Source: Bureau of State Lottery, State of Michigan





Bureau of State Lottery, State of Michigan
Debt Capacity
Ratio of Installment Prize Awards Liability
Fiscal Years Ending September 30, 1997 through September 30, 2006
(In Millions)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
<u>INSTALLMENT PRIZE AWARDS LIABILITY</u>										
Current - at face amount	\$ 130.9	\$ 132.8	\$ 133.2	\$ 110.4	\$ 110.1	\$ 109.8	\$ 109.6	\$ 103.4	\$ 94.7	\$ 86.5
Long-term - at face amount	<u>1,570.6</u>	<u>1,490.4</u>	<u>1,373.4</u>	<u>1,039.7</u>	<u>929.8</u>	<u>820.0</u>	<u>713.9</u>	<u>617.3</u>	<u>527.3</u>	<u>443.3</u>
Total installment prize award ^s	<u>\$ 1,701.5</u>	<u>\$ 1,623.2</u>	<u>\$ 1,506.6</u>	<u>\$ 1,150.1</u>	<u>\$ 1,039.9</u>	<u>\$ 929.8</u>	<u>\$ 823.5</u>	<u>\$ 720.7</u>	<u>\$ 622.0</u>	<u>\$ 529.8</u>
<u>INVESTMENTS</u>										
<u>United States Treasury zero coupon bonds: purchased to provide for the payment of future installment payments to prize winners</u>										
Face amount	<u>\$ 1,689.0</u>	<u>\$ 1,600.2</u>	<u>\$ 1,467.6</u>	<u>\$ 1,148.9</u>	<u>\$ 1,038.4</u>	<u>\$ 928.3</u>	<u>\$ 818.3</u>	<u>\$ 709.4</u>	<u>\$ 626.7</u>	<u>\$ 535.2</u>
Installment prize awards payable as a percentage of investments:	100.74%	101.44%	102.66%	100.10%	100.14%	100.16%	100.64%	101.59%	99.25%	98.99%

Note: Details regarding the Bureau's prize awards and investments can be found in the notes to the financial statements.



Bureau of State Lottery, State of Michigan
Demographic and Economic Information
Fiscal Years Ending September 30, 1997 through September 30, 2006

These are the results of the Lottery's demographic general tracking study prepared biennially of Lottery Player profiles.

	1997	1999	2001	2003	2005
Gender					
Male	40%	40%	39%	50%	50%
Female	60%	60%	61%	50%	50%
Education					
Some high school	8%	5%	9%	7%	9%
Completed high school	39%	35%	41%	44%	36%
Some college	25%	26%	22%	18%	23%
Completed college	23%	29%	24%	26%	29%
Technical or vocation school	4%	4%	3%	3%	2%
Refused	1%	1%	1%	2%	1%
Age					
18 - 24 Yrs	9%	10%	5%	5%	5%
25 - 34 Yrs	21%	20%	13%	8%	8%
35 - 44 Yrs	23%	20%	21%	21%	14%
45 - 54 Yrs	23%	18%	21%	20%	19%
55 - 64 Yrs	13%	14%	18%	21%	22%
65 Yrs & over	11%	17%	20%	22%	31%
Refused	0%	1%	2%	3%	1%
Marital Status					
Married	57%	60%	53%	56%	59%
Single	43%	40%	47%	44%	41%
Income					
Under \$25,000	20%	17%	18%	21%	22%
\$25,000 - \$50,000	31%	29%	26%	25%	22%
\$50,000 - \$100,000	17%	24%	20%	25%	21%
\$100,000 or more	3%	6%	5%	4%	6%
Refused	29%	24%	31%	25%	29%
Ethnicity					
White	80%	81%	71%	73%	83%
Black/African-American	13%	11%	24%	17%	9%
Hispanic/Latino	1%	1%	1%	3%	1%
Other	2%	7%	3%	3%	1%
Refused	4%	3%	1%	4%	6%

Source: Bureau of State Lottery
General Tracking Study



Bureau of State Lottery, State of Michigan
Operating Information
Fiscal Years Ending September 30, 1997 through September 30, 2006

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Number of Employees	175	189	189	184	175	175	159	161	166	173
Number of Retailers										
Instant only	3,006	2,827	2,891	2,630	2,141	1,869	1,760	1,600	1,497	816
Club Games	-	-	-	-	-	-	-	1,829	2,077	2,216
Online	6,151	6,410	6,415	6,641	7,076	7,291	7,288	7,377	7,502	7,848
Total Retailers	9,157	9,237	9,306	9,271	9,217	9,160	9,048	10,806	11,076	10,880
Prize Payout Percentage	54.18%	54.51%	54.57%	54.33%	54.09%	54.39%	54.67%	57.29%	57.00%	58.69%
Percentage of Lottery Ticket										
Sales transferred to the State School Aid Fund	36.75%	37.62%	35.88%	36.50%	36.35%	36.35%	34.85%	32.67%	32.26%	31.10%
Number of Millionaire										
Prize Winners	25	28	15	22	18	16	11	20	21	17
Number of Prize Winners										
Greater than \$600	33,885	37,060	36,147	32,563	27,777	25,921	44,162	44,962	44,692	52,124

Source: Bureau of State Lottery, State of Michigan

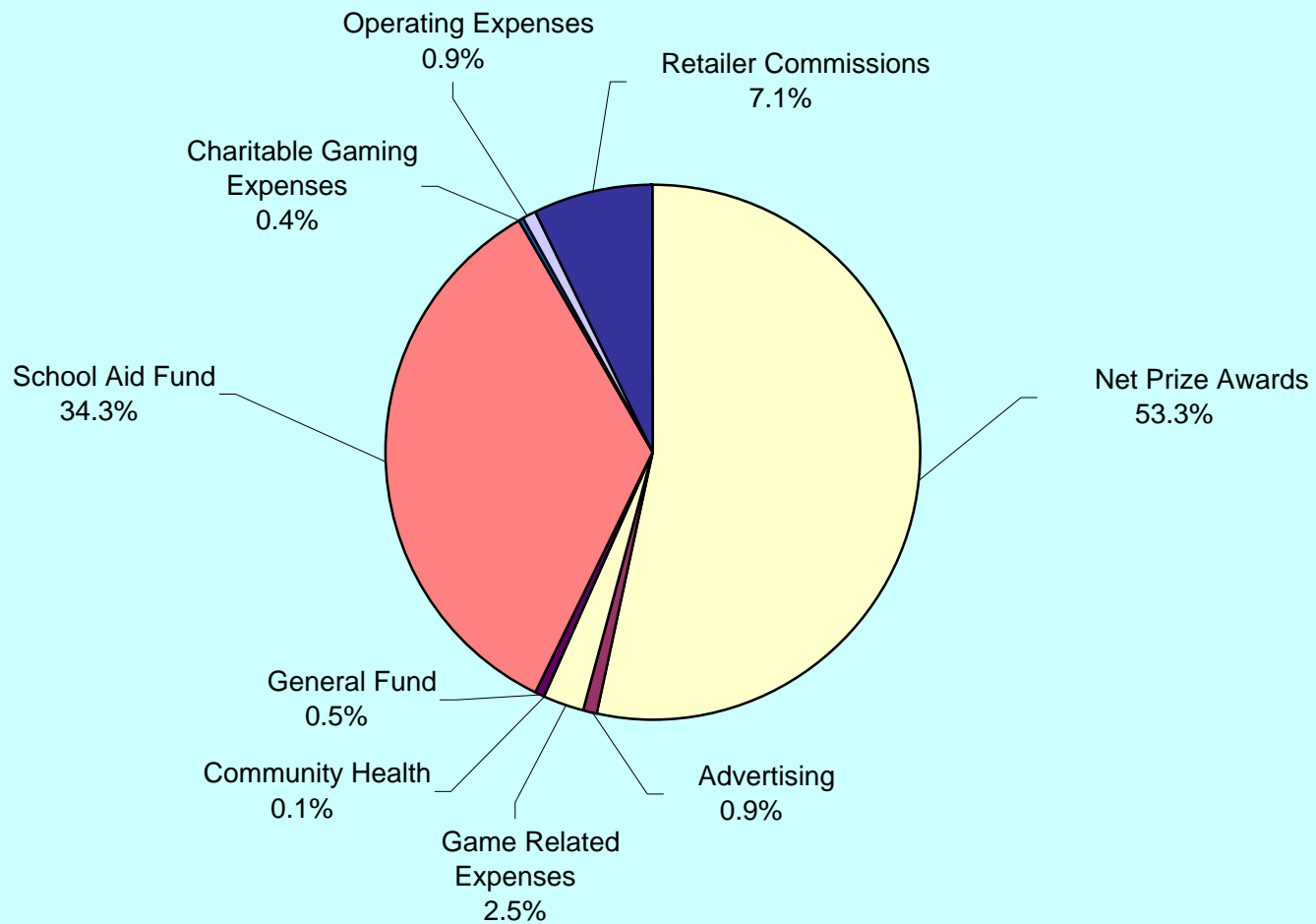


Bureau of State Lottery, State of Michigan
Operating Information
Expenses and Transfers to the State's School Aid Fund, General Fund, and Community Health
Fiscal Years Ending September 30, 1997 through September 30, 2006
(In Millions)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
EXPENSES										
Prize Awards	\$ 866.5	\$ 892.6	\$ 944.5	\$ 920.8	\$ 873.3	\$ 918.1	\$ 919.2	\$ 1,130.8	\$ 1,179.6	\$ 1,298.5
Unclaimed Prizes	<u>(14.5)</u>	<u>(42.0)</u>	<u>(20.3)</u>	<u>(26.5)</u>	<u>(23.3)</u>	<u>(44.4)</u>	<u>(19.6)</u>	<u>(31.1)</u>	<u>(17.6)</u>	<u>(30.3)</u>
	852.0	850.6	924.2	894.3	850.0	873.7	899.6	1,099.7	1,162.0	1,268.2
Net Prize Awards	15.6	16.7	15.0	17.3	16.9	17.1	17.1	17.5	17.6	17.5
Advertising	26.1	32.3	44.3	43.0	41.8	44.1	45.2	54.1	56.8	60.0
Game Related Expenses	111.9	114.6	120.8	120.4	114.9	120.7	121.8	145.4	152.7	165.3
Retailer Commissions	15.9	16.0	16.0	14.5	14.7	15.3	15.3	15.9	17.9	19.7
Operating Expenses	<u>5.5</u>	<u>6.7</u>	<u>6.5</u>	<u>6.6</u>	<u>7.4</u>	<u>7.6</u>	<u>7.9</u>	<u>7.8</u>	<u>7.9</u>	<u>8.1</u>
Charitable Gaming Expenses										
TOTAL EXPENSES	<u>\$ 1,027.0</u>	<u>\$ 1,036.9</u>	<u>\$ 1,126.8</u>	<u>\$ 1,096.1</u>	<u>\$ 1,045.7</u>	<u>\$ 1,078.5</u>	<u>\$ 1,106.9</u>	<u>\$ 1,340.4</u>	<u>\$ 1,414.9</u>	<u>\$ 1,538.8</u>
TRANSFERS TO THE STATE										
School Aid Fund	587.7	616.1	621.1	618.5	587.0	613.5	586.0	644.9	667.6	688.0
General Fund	7.4	7.0	7.3	7.0	9.4	12.1	11.2	12.2	11.7	10.5
Community Health	<u></u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>	<u>1.0</u>
TOTAL TRANSFERS	<u>\$ 595.1</u>	<u>\$ 624.1</u>	<u>\$ 629.4</u>	<u>\$ 626.5</u>	<u>\$ 597.4</u>	<u>\$ 626.6</u>	<u>\$ 598.2</u>	<u>\$ 658.1</u>	<u>\$ 680.3</u>	<u>\$ 699.5</u>

Transfers to Community Health began in fiscal year 1998.

**Bureau of State Lottery, State of Michigan
Operating Information
Expenses and Transfers 1997 through 2006**



Source: Bureau of State Lottery, State of Michigan

**Bureau of State Lottery, State of Michigan
Industry Comparative Information**

Fiscal Year 2005 U.S. Lottery Sales, Profit and Expense Analysis

Lottery	Pop (Mil)	Millions of Dollars							As Percentage of Revenues				PC Sales	PC Net Income
		Ticket Sales	Other Income	Total Revenue	Prizes	Retailer Comm.	Expense	Net Income	Prizes	Retailer Comm.	Expense	Income		
Arizona	5.94	397.56	0.96	\$ 398.52	\$ 200.30	\$ 26.51	\$ 54.69	\$ 117.03	50.4%	6.7%	13.8%	29.4%	\$ 67	\$ 20
California	36.13	3,333.62	28.99	\$ 3,362.61	\$ 1,795.25	\$ 233.45	\$ 166.99	\$ 1,166.92	53.9%	7.0%	5.0%	35.0%	\$ 92	\$ 32
Colorado	4.67	416.97	1.70	\$ 418.67	\$ 249.50	\$ 31.67	\$ 32.43	\$ 105.06	59.8%	7.6%	7.8%	25.2%	\$ 89	\$ 22
Connecticut	3.51	932.93	0.87	\$ 933.80	\$ 573.00	\$ 51.69	\$ 40.57	\$ 268.54	61.4%	5.5%	4.3%	28.8%	\$ 266	\$ 77
Delaware	0.84	114.31	(0.26)	\$ 114.06	\$ 59.83	\$ 7.06	\$ 13.31	\$ 33.85	52.3%	6.2%	11.6%	29.6%	\$ 136	\$ 40
D.C.	0.55	234.93	0.65	\$ 235.58	\$ 120.53	\$ 14.44	\$ 29.10	\$ 71.52	51.3%	6.1%	12.4%	30.4%	\$ 427	\$ 130
Florida	17.79	3,470.73	19.38	\$ 3,490.11	\$ 2,044.25	\$ 197.78	\$ 142.61	\$ 1,105.46	58.9%	5.7%	4.1%	31.9%	\$ 195	\$ 62
Georgia	9.07	2,734.35	12.17	\$ 2,746.52	\$ 1,633.28	\$ 192.48	\$ 111.89	\$ 808.87	59.7%	7.0%	4.1%	29.6%	\$ 301	\$ 89
Idaho	1.43	113.50	0.12	\$ 113.61	\$ 69.59	\$ 6.72	\$ 13.11	\$ 24.19	61.3%	5.9%	11.6%	21.3%	\$ 79	\$ 17
Illinois	12.76	1,814.35	42.42	\$ 1,856.77	\$ 1,042.89	\$ 91.88	\$ 99.79	\$ 622.21	57.5%	5.1%	5.5%	34.3%	\$ 142	\$ 49
Indiana	6.27	739.63	3.29	\$ 742.92	\$ 455.33	\$ 51.40	\$ 47.14	\$ 189.04	61.6%	6.9%	6.4%	25.6%	\$ 118	\$ 30
Iowa	2.97	210.67	0.74	\$ 211.40	\$ 113.46	\$ 17.34	\$ 28.57	\$ 52.03	53.9%	8.2%	13.6%	24.7%	\$ 71	\$ 18
Kansas	2.74	206.72	1.05	\$ 207.77	\$ 112.56	\$ 12.09	\$ 20.86	\$ 62.27	54.5%	5.8%	10.1%	30.1%	\$ 75	\$ 23
Kentucky	4.17	707.26	1.23	\$ 708.49	\$ 457.69	\$ 45.13	\$ 47.40	\$ 158.27	64.7%	6.4%	6.7%	22.4%	\$ 170	\$ 38
Louisiana	4.52	307.01	1.47	\$ 308.48	\$ 153.26	\$ 16.86	\$ 29.44	\$ 108.92	49.9%	5.5%	9.6%	35.5%	\$ 68	\$ 24
Maine	1.32	209.30	2.38	\$ 211.68	\$ 127.02	\$ 14.86	\$ 19.47	\$ 50.33	60.7%	7.1%	9.3%	24.0%	\$ 159	\$ 38
Maryland	5.60	1,485.73	(2.15)	\$ 1,483.59	\$ 856.23	\$ 97.59	\$ 51.36	\$ 478.40	57.6%	6.6%	3.5%	32.2%	\$ 265	\$ 85
Massachusetts	6.40	4,465.72	17.19	\$ 4,482.91	\$ 3,211.54	\$ 253.73	\$ 81.50	\$ 936.13	71.9%	5.7%	1.8%	21.0%	\$ 698	\$ 146
Michigan	10.12	2,069.48	1.08	\$ 2,070.56	\$ 1,162.01	\$ 152.63	\$ 100.28	\$ 655.63	56.1%	7.4%	4.8%	31.7%	\$ 204	\$ 65
Minnesota	5.13	408.00	0.73	\$ 408.73	\$ 241.30	\$ 24.97	\$ 36.31	\$ 106.16	59.1%	6.1%	8.9%	26.0%	\$ 80	\$ 21
Missouri	5.80	785.60	9.74	\$ 795.34	\$ 487.93	\$ 48.80	\$ 38.97	\$ 219.64	62.1%	6.2%	5.0%	28.0%	\$ 135	\$ 38
Montana	0.94	33.81	0.09	\$ 33.90	\$ 17.80	\$ 1.97	\$ 7.91	\$ 6.22	52.6%	5.8%	23.4%	18.4%	\$ 36	\$ 7
Nebraska	1.76	100.66	0.33	\$ 100.99	\$ 58.35	\$ 6.43	\$ 12.34	\$ 23.86	58.0%	6.4%	12.3%	23.7%	\$ 57	\$ 14
New Hampshire	1.31	227.98	1.49	\$ 229.47	\$ 132.69	\$ 12.34	\$ 15.09	\$ 69.35	58.2%	5.4%	6.6%	30.4%	\$ 174	\$ 53
New Jersey	8.72	2,274.36	33.79	\$ 2,308.15	\$ 1,296.81	\$ 126.25	\$ 80.68	\$ 804.42	57.0%	5.6%	3.5%	35.4%	\$ 261	\$ 92
New Mexico	1.93	139.24	(4.50)	\$ 134.74	\$ 76.17	\$ 8.94	\$ 17.40	\$ 32.23	54.7%	6.4%	12.5%	23.1%	\$ 72	\$ 17
New York	19.25	6,038.77	(75.85)	\$ 6,194.64	\$ 3,523.53	\$ 429.18	\$ 254.30	\$ 1,987.64	58.3%	7.1%	4.2%	32.9%	\$ 314	\$ 103
North Dakota	0.64	19.13	0.16	\$ 19.28	\$ 9.09	\$ 0.96	\$ 2.78	\$ 6.46	47.5%	5.0%	14.5%	33.8%	\$ 30	\$ 10
Ohio	11.46	2,159.13	26.90	\$ 2,186.03	\$ 1,280.79	\$ 133.84	\$ 97.69	\$ 673.71	59.3%	6.2%	4.5%	31.2%	\$ 188	\$ 59
Oregon	3.64	360.17	14.41	\$ 374.58	\$ 245.13	\$ 31.86	\$ 26.69	\$ 70.91	68.1%	8.8%	7.4%	19.7%	\$ 99	\$ 19
Pennsylvania	12.43	2,644.86	17.85	\$ 2,662.70	\$ 1,529.44	\$ 137.83	\$ 143.63	\$ 851.80	57.8%	5.2%	5.4%	32.2%	\$ 213	\$ 69
Rhode Island	1.08	241.88	1.83	\$ 243.72	\$ 143.56	\$ 29.68	\$ 8.17	\$ 62.31	59.4%	12.3%	3.4%	25.8%	\$ 224	\$ 58
South Carolina	4.26	956.95	3.56	\$ 960.51	\$ 573.60	\$ 67.53	\$ 41.88	\$ 277.50	59.9%	7.1%	4.4%	29.0%	\$ 225	\$ 65
South Dakota	0.78	32.50	0.25	\$ 32.75	\$ 18.35	\$ 1.77	\$ 5.75	\$ 6.88	56.5%	5.4%	17.7%	21.2%	\$ 42	\$ 9
Tennessee	5.96	783.70	4.30	\$ 788.00	\$ 444.24	\$ 54.88	\$ 49.78	\$ 239.10	56.7%	7.0%	6.4%	30.5%	\$ 131	\$ 40
Texas	22.86	3,662.46	(11.91)	\$ 3,650.55	\$ 2,228.00	\$ 187.46	\$ 178.78	\$ 1,056.31	60.8%	5.1%	4.9%	28.8%	\$ 160	\$ 46
Vermont	0.62	92.59	0.02	\$ 92.61	\$ 57.90	\$ 5.42	\$ 8.41	\$ 20.88	62.5%	5.9%	9.1%	22.6%	\$ 149	\$ 34
Virginia	7.57	1,333.95	5.77	\$ 1,339.71	\$ 774.56	\$ 75.63	\$ 66.01	\$ 423.52	58.1%	5.7%	4.9%	31.7%	\$ 176	\$ 56
Washington	6.29	458.13	12.01	\$ 470.14	\$ 280.86	\$ 28.75	\$ 33.89	\$ 126.64	61.3%	6.3%	7.4%	27.6%	\$ 73	\$ 20
West Virginia	1.82	194.19	18.29	\$ 212.48	\$ 117.13	\$ 13.60	\$ 17.91	\$ 63.85	60.3%	7.0%	9.2%	32.9%	\$ 107	\$ 35
Wisconsin	5.54	451.87	3.03	\$ 454.90	\$ 262.18	\$ 31.36	\$ 28.54	\$ 132.82	58.0%	6.9%	6.3%	29.4%	\$ 82	\$ 24
Total	266.59	47,364.70	195.57	\$ 47,791.97	\$ 28,236.93	\$ 2,974.76	\$ 2,303.42	\$ 14,276.88	Average Percentages:				\$ 178	\$ 54
									59.6%	6.3%	4.9%	30.1%		

Notes to Table: Fiscal year 2005 is latest data available. Fiscal year ends June 30 for most states except New York (March 31), Texas (August 31), D.C. and Michigan (September 30).

*Data represents only revenue from traditional lottery games and not video lottery terminal operations.

Source: LaFleur's 2006 World Lottery Almanac

**Bureau of State Lottery, State of Michigan
Industry Comparative Information**

Fiscal Year 2005 U.S. Lottery Sales by Game*

(in \$millions)				Online Games									Total Sales	VLT (net) ¹	Gov't Transfer
Lottery	Pop (M)	Instant	Pulltab	3-digit	4-digit	Lotto	Cash Lotto	Mega Millions	Power Ball	Hot Lotto	Keno	Other			
Arizona	5.94	219.65		7.18		54.82	9.43		106.48				397.56		116.39
California	36.13	1,736.79		136.16		1,098.89	160.76	11.04			174.30	15.68	3,333.62		1,148.78
Colorado	4.67	282.74				38.27	15.05		80.91				416.97		103.74
Connecticut	3.51	592.27		106.44	78.27	35.61	40.78		79.56				932.93		268.54
Delaware ¹	0.84	28.70		27.56	16.83	4.29	11.51		25.43				114.31	575.23	
D.C.	0.55	36.11		68.60	74.14		8.47		31.54	2.20	11.87	2.01	234.93		71.45
Florida	17.79	1,844.62		345.60	206.98	689.82	252.47					131.25	3,470.73		1,103.63
Georgia	9.07	1,653.13		551.50	174.16	67.44	75.85	170.44			41.83		2,734.35		802.24
Idaho	1.43	77.75	1.33	1.19		3.19			30.04				113.50		26.00
Illinois	12.76	878.83		307.24	168.35	131.54	131.78	192.60				4.01	1,814.35		619.50
Indiana	6.27	470.41	19.32	29.56	29.98	60.86	8.00		120.32			1.16	739.63		188.93
Iowa	2.97	103.26	23.62	6.20	2.04		4.43		54.24	10.44		6.43	210.67		51.09
Kansas	2.74	93.28	4.39	5.17		2.17	19.31		44.53		37.11	0.77	206.72		65.41
Kentucky	4.17	385.13	24.22	130.35	35.66	17.55	16.81		90.46			7.10	707.26		158.19
Louisiana	4.52	104.10		47.79	25.57	32.83	5.36		91.36				307.01		110.39
Maine	1.32	151.88		5.84	4.43	18.36	2.53		26.25				209.30		50.33
Maryland	5.60	390.97		296.10	225.45	34.10	21.92	99.74			416.51	0.94	1,485.73		477.10
Massachusetts	6.40	3,135.42	1.81		352.45	51.29	85.68	97.07			742.01		4,465.72		
Michigan	10.12	662.53	39.07	401.07	308.85	55.64	49.89	203.90			345.86	2.66	2,069.48		667.58
Minnesota	5.13	253.40		13.10			23.90		92.50	16.30		8.80	408.00		106.17
Missouri	5.80	467.33	20.73	60.56	21.34	30.31	23.06		114.49		47.62	0.17	785.60		218.64
Montana	0.94	10.54				2.30	3.83		13.89	2.82		0.44	33.81		6.22
Nebraska	1.76	56.51		0.53		2.53	10.57		30.51				100.66		26.37
New Hampshire	1.31	161.36		10.65		10.25	3.14		39.10	3.48			227.98		69.35
New Jersey	8.72	1,066.13		456.58	265.00	109.98	123.25	253.41					2,274.36		812.05
New Mexico	1.93	90.84		2.06	0.89		9.18		36.26				139.24		32.23
New York	19.25	3,005.59		790.47	624.20	305.86	348.18	446.21			507.36	10.91	6,038.77	231.72	2,062.70
North Dakota	0.64					2.02			13.21	3.90			19.13		6.10
Ohio	11.46	1,217.20		387.66	170.09	113.06	74.82	176.39				19.91	2,159.13		645.14
Oregon ¹	3.64	133.24	2.19		1.39	48.28			35.00		122.20	17.87	360.17	579.65	
Pennsylvania	12.43	1,301.81		425.36	271.55	151.01	201.26		293.86				2,644.86		
Rhode Island ¹	1.08	75.60		28.58			3.74		41.97		90.55	1.44	241.88	399.19	
South Carolina	4.26	578.84		118.85	51.32		29.00		178.94				956.95		279.74
South Dakota ¹	0.78	16.15				1.81	1.80		11.14	1.59			32.50	216.76	119.32
Tennessee	5.96	538.35		69.19	6.09	23.40			146.67				783.70		234.30
Texas	22.86	2,705.41		284.95		306.66	102.66	217.71				45.07	3,662.46		1,070.30
Vermont	0.62	71.21		1.55	1.27	5.64	1.18		11.75				92.59		20.47
Virginia	7.57	679.56		253.22	169.18	66.69	28.11	137.18					1,333.95		423.50
Washington	6.29	294.67		17.24		58.61	21.63	50.24			6.44	9.30	458.13		115.63
West Virginia ¹	1.82	111.86		9.29	4.42		6.11		49.21	3.34	9.96		194.19	1,199.35	
Wisconsin	5.54	263.04	6.87	24.50	10.37	18.09	49.71		79.30				451.87		143.40
Total	266.59	25,946.21	143.55	5,427.89	3,300.27	3,653.17	1,985.16	2,055.93	1,968.92	44.07	2,553.62	285.92	47,364.70	3,201.90	12,420.92
% of total		54.8%	0.3%	11.5%	7.0%	7.6%	4.2%	4.3%	4.2%	0.1%	5.4%	0.6%	100.0%		

¹ Denotes VLT net machine income. *Fiscal year ends June 30 for most states except New York (March 31), Texas (August 31), D.C. and Michigan (September 30).

Source: LaFleur's 2006 World Lottery Almanac

**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***

Mr. Gary C. Peters, Commissioner
Bureau of State Lottery, State of Michigan
and
Mr. Thomas H. McTavish, Auditor General
State of Michigan

We have audited the financial statements of the Bureau of State Lottery, State of Michigan (the "Lottery") a proprietary fund of the State of Michigan, as of and for the six month period and year ended September 30, 2006, and have issued our report thereon dated November 17, 2006. 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 Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery'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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Commissioners, management and the Office of Auditor General, State of Michigan and is not intended to be and should not be used by anyone other than these specified parties.

Yeo & Yeo, P.C.

Lansing, Michigan
November 17, 2006





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