GEORGIA LOTTERY

2005 ANNUAL REPORT

Table of Contents

GEORGIA LOTTERY CORPORATION

Message from the President

Fiscal Year 2005 was another banner year for the Georgia Lottery Corporation (GLC). Sales for the year reached $2.92 billion and resulted in more dollars returned to the educational programs funded with lottery proceeds than in any previous year.

The numbers are staggering. To date, the Georgia Lottery Corporation has raised more than $7.6 Billion for Georgia students. More than 850,000 students have attended college on a lottery-funded HOPE Scholarship and 635,000 four-year-olds have received a jump start on their education by attending Georgia's lottery-funded, high quality, Pre-K Program. This year alone, the GLC raised more than $2 million per day for HOPE and Pre-K!

We debuted fun, new games with exciting promotional campaigns throughout fiscal year 2005 - led by the popular $100 Million Cash Spectacular Instant Game. Mega Millions continued to deliver on the promise of producing mega jackpots – capped off by a record-breaking $290 million jackpot in July. And, we relaunched our Fantasy 5 game in April – with 11 times better odds of winning!

Your continued support of the Georgia Lottery Corporation has made success possible. Thank you for partnering with us in our commitment to responsibly raise revenues for education.

Margaret R. DeFrancisco

This year alone the GLC raised more than $2 million a day for HOPE and Pre-K.

Meet the Board of Directors

(photos left to right):
Celeste Osborn;
Jim Ivey;
Tony Campbell;
Rayna Casey;
David C. Garrett III;
Barbara M. Dooley, Chair.

What a year! Georgia Lottery sales for fiscal year 2005 surpassed last year's record mark by more than $211 million. My thanks to our Board of Directors, GLC President & CEO Margaret DeFrancisco and the entire lottery staff for their hard work and commitment to raising more dollars than ever for Georgia students.

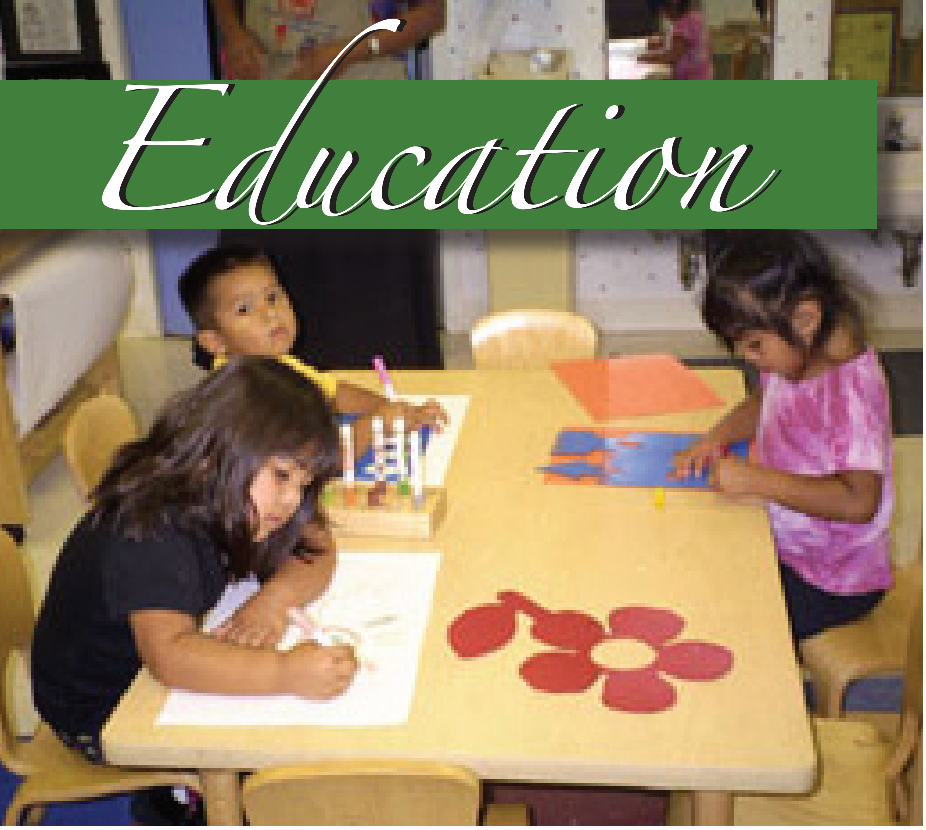
Just as important as breaking sales and profit records is how you got there. Our business is guided by basic principles found in most successful corporations - we operate efficiently and with the utmost integrity. These core values dictate every business decision made at the GLC.

As a Georgian, a parent and current Chair of the Georgia Lottery Corporation's (GLC) Board of Directors I take pride in the accomplishments our lottery has achieved. Together we are making a difference.

Barbara M Dooley

The GLC provides educational opportunities for a growing number of Georgians.

Education



Working hard to accomplish our mission of maximizing revenues for the Lottery for Education Account, the GLC raised more than

$802 million

for the HOPE Scholarship and Pre-K Programs in fiscal year 2005. This is the highest transfer amount in our 12-year history.

More than 72,000 Georgia families enrolled their four-year-olds in Georgia Pre-K programs throughout the state. Enrollment has consistently grown since its first year with approximately 4,000 additional students than the previous year. Lottery proceeds totaling $276 million funded the program for the 2004-2005 school year.

Participation in the high-quality Pre-K program helps children develop social and pre-academic skills that will help them succeed in kindergarten and throughout their educational experiences. Since inception of the Lottery, over 635,000 four-year-olds have benefited from this remarkable program.

72,000 Pre-K students got an early start to their education with Georgia's lottery-funded high quality Pre-K Program.

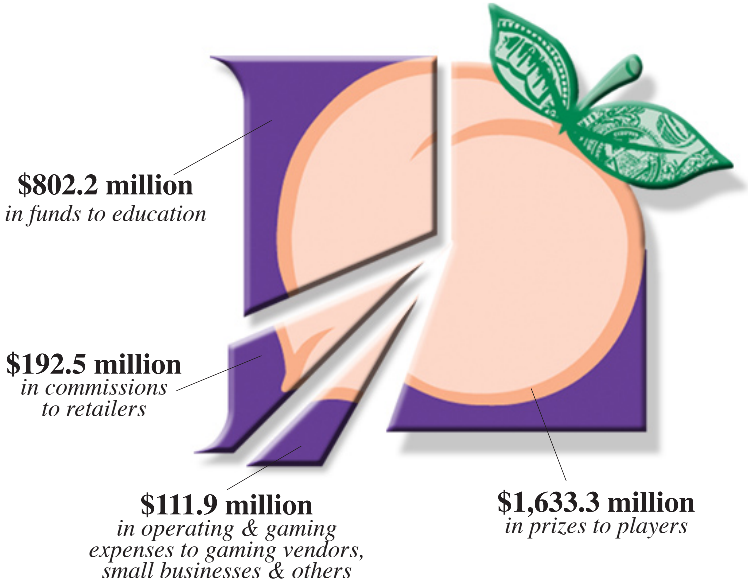
More than 220,000 college students earned lottery-funded HOPE Scholarships in fiscal year 2005.

Lottery proceeds exceeding $425 million funded the nationally acclaimed HOPE Program for college and technical college students last year. To date, 850,000 students have benefited from HOPE at over 100 accredited higher education institutions throughout the state of Georgia.

The HOPE Scholarship Program has created the opportunity for all of Georgia's students to attend college. Since the Lottery's inception, more than $7.6 billion in proceeds have been raised for educational programs in Georgia. These funds directly impact thousands of families in the state of the Georgia.

Where The Money Goes!

The Georgia Lottery Corporation is committed to providing opportunities to all Georgians. Every dollar spent on Georgia Lottery tickets is reinvested into Georgia's economy. Lottery funds go towards educating Georgia's students and future workforce. Businesses across the state have benefitted from a successful partnership with the GLC and players won more than $1.6 billion in prizes last year alone.



$425 million in lottery proceeds funded the popular HOPE Scholarship Program for 220,000 college students this year.

Games

With fiscal year 2005 boasting record ticket sales of over $2.92 billion, on-line and instant games were a winning combination. Georgia Lottery games provided fun and entertainment throughout the year with innovative debuts and longtime favorites.

Instant games remained extremely popular among players, contributing more than $1.84 billion to sales for fiscal year 2005. Led by the instant game $100 Million Cash Spectacular, sales for the week ending February 19, 2005 were the highest in Georgia Lottery history at $79,024,822. This milestone surpassed the previous record, set just a week earlier, of $77.5 million.

$100 Million Cash Spectacular was introduced on February 1, 2005. The instant game featured 10 $1 million top prizes and over $118 million in total cash prizes.

Georgia Lottery President and CEO Margaret DeFrancisco unveiled $100 Million Cash Spectacular during a press conference at Philips Arena. Atlanta business leaders Michael Gearon and Rutherford Seydel, who are part of the ownership of Atlanta Spirit, LLC – the Atlanta Hawks, Atlanta Thrashers and Philips Arena – were on hand, along with former Hawks great Dominique Wilkins, to show their support.

The GLC partnered with Atlanta Spirit, LLC, AirTran Airways and Crowne Plaza Hotels & Resorts for exciting promotions.

In conjunction with $100 Million Cash Spectacular, the Georgia Lottery conducted its biggest statewide promotion ever – Million-Dollar Hoopla. Players could enter a second chance drawing for a chance to win $1 million. From the second chance drawing, contestants were chosen to participate in regional free throw basketball events at a location in each Georgia Lottery district. From the regional events, 10 lucky finalists traveled to Atlanta for a chance to win $1 million at the Grand Prize Million-Dollar Hoopla Event during a Hawks basketball game.

$100 Million Cash Spectacular was so overwhelmingly successful that the game was reprinted in March 2005 with the exact same number of winners and the exact same odds.

On-line games continued to perform well in fiscal year 2005 with over $1.08 billion in sales. The figures were solid for CA$H 3, CA$H 4, Fantasy 5, Lotto South, Mega Millions and Quick Cash Keno.

With the launch of the new Fantasy 5 on April 10, 2005, players have 11 times better odds of winning. Players can win a prize by matching two of five numbers, valid for a free Fantasy 5 Quik Pik ticket. With more chances to win, the overall odds of winning a prize in Fantasy 5 have been enhanced from 1 in 100 to 1 in 8.77.

During a press conference at the AirTran Airways hangar, the Georgia Lottery unveiled the Fantasy 5 Getaway promotion in conjunction with the relaunch of Fantasy 5. The Georgia Lottery, in partnership with AirTran and Crowne Plaza Hotels & Resorts, gave away five fantasy vacations for five consecutive weeks.

Mega Millions started the fiscal year off on a roll when the jackpot for the July 2, 2004 drawing reached $294 million. It was the largest Mega Millions jackpot ever and the third highest jackpot in Georgia Lottery history.

Mega Millions continued to generate excitement as California joined the multi-state game. The matrix and prize structure of Mega Millions was changed, resulting in bigger jackpots faster. The minimum Mega Millions jackpot increased from $10 million to $12 million. The second prize increased to $250,000 while the third prize increased to $10,000.

The Georgia Lottery continues to provide fresh, fun and exciting games. As a result, fiscal year 2005 was another record-breaking success.

Winners

Fiscal year 2005 was full of fun, excitement and winning for Georgia Lottery players. Lucky players won big with instant games, on-line games and exciting promotions. Georgia Lottery players were awarded a record-breaking $1.63 billion in prizes during fiscal year 2005. They also enjoyed mega getaways, fantasy vacations, and a whole lot of hoopla.

In conjunction with $100 Million Cash Spectacular, the Georgia Lottery conducted its biggest statewide promotion ever – Million-Dollar Hoopla. The promotional events culminated with the Grand Prize Million-Dollar Hoopla Event during an Atlanta Hawks game on April 1, 2005. Jerry Brinkley of Dearing missed in his attempt to sink the million-dollar shot, but he still scored a $5,000 prize.

With the instant game $100 Million Cash Spectacular, 20 lucky players won $1 million each with a total of over $277.6 million in additional cash prizes awarded. Parker Stephens, a HOPE Scholarship recipient from Statesboro, was the game's first millionaire.

Lucky players won big this fiscal year - a record-breaking $1.63 billion in prizes!

Mega Millions players won over $85 million during fiscal year 2005. Margaret Jones and her husband James became the second largest winners in Georgia Lottery history when they won a $130 million Mega Millions jackpot on January 18, 2005. The couple selected the cash option, which amounted to approximately $77.7 million before taxes.

During fiscal year 2005, Lotto South players won more than $33.7 million. When James Terrell Turner of Americus won a $9 million jackpot on June 18, 2005, the Georgia Lottery traveled to his hometown to celebrate with his family and friends. Mr. Turner selected the cash option and received his big check for $4.9 million just days before the fiscal year came to a close.

Fantasy 5 players enjoyed over $37 million in winnings. With the Fantasy 5 Getaway promotion, 25 lucky players enjoyed fantasy vacations to locations that included: Los Angeles, California; West Palm Beach, Florida; New Orleans, Louisiana; New York, New York; and Hilton Head, South Carolina.

Georgia Lottery players also won big with Cash 3, Cash 4 and Quick Cash Keno. More than $278.5 million was awarded to Cash 3 players, while Cash 4 players won more than $87.9 million. Quick Cash Keno players received over $23.4 million.

With the Mega Road Trip promotion that welcomed California to Mega Millions, 11 lucky players won trips for two to the West Coast to watch the Atlanta Braves play the San Francisco Giants.

In addition to cash prizes, GLC winners enjoyed mega getaways, fantasy vacations and a lot of hoopla this year!

Retailers

The Georgia Lottery and its retailers are a winning combination with retailers earning over

$192 million in commissions.

All across the state of Georgia, retailers are the ambassadors of the Georgia Lottery. This fiscal year, more than 7,800 retail partners sold games, interacted with players and posed with retailer checks, earning over $192 million in commissions, bonuses and incentives. The Georgia Lottery looks forward to strengthening this partnership and continuing to provide excellent customer service to all players.

The hard work of over 7,800 retailers statewide enabled the GLC to raise more dollars for HOPE & Pre-K than ever before.

Senior Staff

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

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

The Sales and Marketing Division coordinates and oversees all sales and retailer activities, including corporate account management and retailer sales.

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

The Finance and Administration Division provides services related to financial accounting and reporting, cash management, budget, collections, procurement, and maintains state-of-the-art computer systems, technology and telecommunications systems. The Administration Division incorporates facilities management, prize validation and retailer administration.

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

(photos left to right):

Rear row:
Daniel Johnson, Vice President of Systems Development;
Gerald Mecca, Senior Vice President of Finance and Administration;
Kurt Freedlund, Senior Vice President and General Counsel;
Larry Sipes, Vice President of Information Technology;
James Hutchinson, Vice President of Marketing;
Connie Laverty, Chief Operating Officer;
Doug Parker, Interim Vice President of Human Resources;
Rosemarie Morse, Vice President of Legal Affairs.

Middle row:
Jack Dimling, Vice President of Sales;
Teri Rosa, Vice President of Customer Operations;
Sam Hammett, Vice President of Sales;
Joan Schoubert, Senior Vice President of Strategic Planning and Development.

Front row:
Sharman Lomax, Vice President of Financial Management;
Margaret R. DeFrancisco, President and CEO;
J.B. Landroche, Vice President of Corporate Affairs.
Not pictured: Mar-D Greer, Vice President of Security.

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

Independent Auditors' Report

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To the Board of Directors of the Georgia Lottery Corporation:

We have audited the accompanying statements of net assets of the Georgia Lottery Corporation (the "GLC"), a blended component unit of the State of Georgia, as of June 30, 2005 and 2004, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the GLC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the GLC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the GLC as of June 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This information is the responsibility of the GLC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of supplementary information. However, we did not audit such information, and we do not express an opinion on it.

Deloitte & Touche LLP

October 25, 2005

Management's Discussion and Analysis

As management of the Georgia Lottery Corporation (the "GLC"), we offer readers of the GLC's financial statements this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with the financial statements, which begin on page 8.

Financial Highlights

The GLC had another record-breaking year in fiscal year 2005. Gross ticket sales surpassed $2.9 billion, representing the highest sales total in the GLC's twelve-year history. The net proceeds transferred to the Lottery for Education Account were $802.2 million, also setting a GLC record. The net proceeds transferred represent a growth of $19.5 million over last year. Other significant financial highlights include the following:

- Gross ticket sales increased by $211.9 million, more than an 8% increase over the previous fiscal year.
- Prize expense increased $153.0 million. This expense increases or decreases in direct proportion to ticket sales and represented approximately 56% of gross ticket sales in 2005 and 55% in 2004.
- Direct gaming expenses, which include retailer commissions and bonuses, contractor fees, advertising, and retailer merchandising and marketing, increased $12.9 million. These expenses fluctuate in proportion to ticket sales and represented approximately 10% of gross ticket sales in 2005 and in 2004.
- Operating expenses, which include salaries and benefits, rent, utilities and maintenance, professional fees, depreciation, and other expenses increased $27,000 over the previous fiscal year.
- Nonoperating revenues, net of expenses, increased $23.0 million or approximately 148% in 2005 as compared to 2004. This increase is attributable to the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments and the increase of interest revenue over the prior fiscal year.

Overview of the Financial Statements

The GLC is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the GLC's basic financial statements, along with the notes to the financial statements. The statements of net assets on page 20, the statements of revenues, expenses, and changes in net assets on page 21, and the statements of cash flows on pages 22 and 23 report the GLC's net assets and changes therein. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements begin on page 24 of this report.

The GLC transfers its net proceeds each fiscal year to the general fund of the state treasury for credit to the Lottery for Education Account. As a result, the GLC's net assets consist of funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds as required by the Georgia Lottery for Education Act and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. The GLC expects to hold these investments to maturity to meet our future grand prize winner obligations and, therefore, would not realize any gains or losses related to these investments for distribution as net proceeds. The reader of these financial statements should review the assets and liabilities in the statements of net assets and the operating revenues and expenses and the transfer to education in the statements of revenues, expenses, and changes in net assets to assess the GLC's financial position as of June 30, 2005 and 2004, and the results of its operations for the years then ended.

Financial Analysis

Assets

Total assets at the end of fiscal year 2005 were $481.3 million compared to $465.8 million at the end of fiscal year 2004, representing an increase of $15.6 million.

Current assets increased from $250.8 million in 2004 to $260.7 million in 2005, representing an increase of $9.9 million. This increase is primarily due to a $6.8 million decrease in cash and cash equivalents and a $16.5 million increase in retailer accounts receivable due to the timing of collections from our customers.

Grand prize investments increased from $213.2 million in 2004 to $218.4 million in 2005, an increase of $5.3 million. The increase resulted from net purchases of $11.5 million, payments to grand prize winners totaling $22.9 million, interest earned on current-year maturities of $11.5 million, and a $5.1 million increase in the fair value of the investments. Capital assets increased from $1.8 million in 2004 to $2.2 million in 2005, an increase of $0.4 million. The increase resulted from capital asset purchases of $1.3 million less depreciation expense of $0.9 million.

Liabilities

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

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

Long-term liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. Grand prizes payable increased $0.3 million in 2005. The increase is primarily attributable to two factors. Grand prize payables of $11.4 million became due and payable in fiscal year 2005 as an annual payment obligation to our grand prize winners, thus reducing the long-term liabilities. The GLC increased its grand prizes payable by $11.5 million as the result of new annual payment obligations for grand prize winners for two instant games, Win for Life and $100 Million Cash Spectacular. The GLC purchased U.S. Treasury securities to fund these future payment obligations. During fiscal year 2005, all eligible grand prize winners in our online games elected to receive their prizes in a single cash payment.

Net Assets and Changes in Net Assets

Net assets increased to $15.6 million in fiscal year 2005 from $9.0 million in fiscal year 2004, representing a $6.6 million increase. This increase primarily resulted from a $5.1 million unrealized gain in the fair value of grand prize investments held by the GLC for funding of future grand prize payments and the $1.3 million increase in funds invested in capital assets resulting from inclusion of these capital costs in the determination of net proceeds as required by the Georgia Lottery for Education Act. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value, and the change in the fair value is recorded as nonoperating revenue (expense) annually. The GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations.

Sales

Total lottery ticket sales for fiscal year 2005 were $2.922 billion, as compared to $2.710 billion in 2004. This represents an increase of over $211.9 million. This represents average weekly gross ticket sales for fiscal year 2005 of $56.2 million versus $52.1 million in 2004.

Gross instant ticket sales increased significantly, up $284.3 million over one year ago, from $1.557 billion in 2004 to $1.841 billion in 2005. The increase is attributable to several factors, including the GLC's administration of a sound marketing strategy, ongoing development and introduction of new instant ticket games, and effective management of the instant product mix, offering players the opportunity to choose among a variety of games at different price points; $1, $2, $3, $5, and $10. During fiscal year 2005, the GLC introduced a new $10 game, $100 Million Cash Spectacular providing players with the highest ever prize payout for any of our instant games. GLC players continued demonstrating loyalty to their favorite instant games, including our most popular core games such as Jumbo Bucks Classic, Mega Bucks, Junior Jumbo Bucks, and Jumbo Jumbo Bucks. In 2005, the GLC expanded a core game, Lucky 7's, by introducing a new instant game at the $5 price point, Triple Lucky 7's, in addition to offering Lucky 7's and Double Lucky 7's, at the $1 and $2 price points, respectively.

Cash 3 sales decreased $45.4 million in 2005 to $551.5 million compared to $596.9 million in 2004. Cash 3 is a twice-daily game whereby the player chooses a three-digit number and wins a specified amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners and the prize amount. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales will occur. The actual prize payout experienced for fiscal years 2005 and 2004 was 49% and 47%, respectively. Consequently, lower than expected actual prize payouts in fiscal year 2005 resulted in a continued decline in Cash 3 sales.

Mega Millions sales decreased $15.6 million in 2005 to $170.4 million compared to $186.0 million in 2004. Mega Millions is a multistate lottery game operated with eleven other states—California, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Texas, Virginia, and Washington. Drawings are held weekly on Tuesdays and Fridays. During June of fiscal year 2005, Mega Millions added the California Lottery, which significantly increased the potential player base. Furthermore, changes were made to the game matrix. The matrix change resulted in an improvement in the overall odds for winning, an increase of the prize amounts for two of eight fixed prize levels, and raising the starting minimum jackpots from $10 million to $12 million. With these changes, and the larger player base, the GLC anticipates larger jackpots and faster jackpot growth. Mega Millions produced two jackpots over $200 million in fiscal year 2005, including a record-setting $294 million winning jackpot in July 2004 and a $208 million jackpot in April 2005. In comparison, the second largest Mega Millions jackpot since the game's inception, $239 million was generated during the previous fiscal year in February 2004.

Cash 4 sales increased $2.3 million, from $171.9 million in 2004 to $174.2 million in 2005. Actual prize payouts in fiscal years 2005 and 2004 were 51% and 58%, respectively, exceeding the industry average of 50%. Historically, as the prize amounts won for this game increase above the industry average, a corresponding increase in sales will occur. In fiscal year 2005, actual prize payouts continued to exceed the industry average. Consequently, the higher than expected actual prize payouts in fiscal year 2005 resulted in a continued increase in Cash 4 sales.

Lotto South sales decreased $8.7 million in 2005 to $67.4 million compared to $76.1 million in 2004. Lotto South is a multistate pari-mutuel lottery game operated with two other states—Kentucky and Virginia. Drawings are held weekly on Wednesdays and Saturdays. Lotto South produced only one jackpot over $20 million in both fiscal years 2004 and 2005. During fiscal year 2005, Lotto South had fourteen winning jackpots as compared to ten winning jackpots in fiscal year 2004. The increased frequency of winning jackpots in fiscal year 2005 resulted in an average jackpot of $9 million versus an average jackpot of $13 million in 2004. Historically, lower advertised jackpots generate an incremental decrease in draw sales.

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

Sales for our Quick Cash Keno game were $47.2 million and $41.8 million in fiscal year 2004 and 2005, respectively. No specific factors have occurred supporting the $5.3 million decrease in sales during 2005. For the fiscal year 2006, management has developed and plans to implement marketing initiatives to increase the number and type of retailer locations offering Quick Cash Keno.

Other Operating Revenue

Other operating revenue includes online fees and other miscellaneous revenue. For both fiscal years 2005 and 2004, other operating revenue was $4.7 million.

Prize Expense

Gross prize expense for instant games increased to $1,124 million in fiscal year 2005 from $934.3 million in 2004, an increase of $190.0 million. Instant games prize expense is managed through the number of tickets printed for each game and value of prizes as determined prior to ticket production. Prize expense is recognized based on an established prize structure and related percentage of sales for each game introduced and is recognized when products are made available for sale to the public.

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

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

Total online prize expense decreased $37.5 million in 2005 to $546.0 million compared to $583.5 million in 2004. The net decrease is comprised of the following increases and decreases by game as follows:

- Prize expense for Cash 3 decreased $22.9 million in fiscal year 2005 as compared to 2004.
- Prize expense for Mega Millions decreased $7.8 million in 2005 versus 2004.
- Prize expense for Cash 4 increased $1.2 million over 2004.
- Prize expense for Lotto South decreased $4.3 million in 2005 as compared to 2004.
- Prize expense for Fantasy 5 decreased $0.2 million in 2005 versus 2004.
- Prize expense for Quick Cash Keno decreased $3.0 million in 2005 as compared to 2004.
- Prize expense for The Change Game decreased $0.4 million in 2005.

Direct Gaming and Operating Expenses

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

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

- A set commission percentage for selling tickets
- A ticket cashing bonus for validating and paying winning prizes up to $599
- Winning jackpot ticket incentives

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

Advertising expense decreased $0.4 million to $19.5 million in 2005 from $19.9 million in 2004.

Retailer merchandising and marketing expenses increased to $9.2 million in 2005 from $5.9 million in 2004. This increase is primarily the result of new game development expenses associated with new instant games and several marketing initiatives to increase player awareness about our lottery games. During fiscal year 2005, the GLC distributed promotional coupons for a free lottery ticket with an instant or online ticket purchase and offered several second-chance drawings, special promotional events, contests, and giveaways, including the Million Dollar Hoopla promotional event and the Fantasy 5 Getaway and Mega Road Trips.

Operating expenses increased to $24.6 million in 2005 from $24.5 million in 2004.

Nonoperating Revenues (Net of Expenses)

Nonoperating revenues, net of expenses, consist primarily of interest revenue and the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. Nonoperating revenues, net of expenses, increased $23.0 million from $15.5 million in nonoperating expenses in 2004 to $7.5 million in nonoperating revenues in 2005. This increase is attributable primarily to the $21.9 million change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. The increases or decreases in the fair value of grand prize investments are impacted by market fluctuations. The $21.9 million change resulted from a $5.1 million increase in the fair value of grand prize investments as of June 30, 2005, compared to a $16.8 million decrease in fair value of grand prize investments as of June 30, 2004.

Interest income increased $1.0 million due to higher earnings realized from funds held in a pooled short-term investment fund managed by the State of Georgia Office of Treasury and Fiscal Services. This fund is a combined state general fund and local government investment pool and is used by the GLC for funds not needed in the short-term for operating purposes. These funds generally represent net proceeds held, pending quarterly transfer to the education account.

Significant Factors Impacting Next Year

The multistate Mega Millions consortium expanded with the addition of the California Lottery in June 2005. The addition of California should result in a broader player base for the game when larger jackpots occur and will also expose the game to a more nationwide audience. This increased the number of states participating in the multistate game to twelve. A reliable estimate of the impact of an additional state joining the game cannot be made at this time.

North Carolina's Lottery could begin ticket sales during fiscal year 2006, which may potentially affect the GLC's sales, especially along the Georgia and North Carolina border.

The rising cost of vehicle fuel and energy commodities in general over the past several months raises significant concerns regarding disposable income available for lottery ticket purchases. Recent experience indicated a decline in customer purchases but this has since improved as of this writing.

Contacting the GLC's Financial Management

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

GEORGIA LOTTERY CORPORATION

STATEMENTS OF NET ASSETS
AS OF JUNE 30, 2005 AND 2004

	2005	2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$158,037,000	$164,865,000
Restricted fidelity fund cash	440,000	120,000
Retailer accounts receivable—net	101,057,000	84,573,000
Prepaid expenses and other assets	1,152,000	1,216,000
Total current assets	260,686,000	250,774,000
GRAND PRIZE INVESTMENTS	218,424,000	213,168,000
CAPITAL ASSETS—Net	2,205,000	1,821,000
TOTAL	$481,315,000	$465,763,000
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Due to Lottery for Education Account	$202,726,000	$193,600,000
Prizes payable	42,945,000	47,643,000
Accounts payable and accrued liabilities	12,235,000	8,745,000
Restricted fidelity fund	440,000	120,000
Total current liabilities	258,346,000	250,108,000
LONG-TERM LIABILITIES:		
Grand prizes payable	205,264,000	204,960,000
Noncurrent portion of other long-term liabilities	2,105,000	1,722,000
Total liabilities	465,715,000	456,790,000
NET ASSETS:		
Invested in capital assets	2,205,000	1,821,000
Unrestricted	13,395,000	7,152,000
Total net assets	15,600,000	8,973,000
TOTAL	$481,315,000	$465,763,000

See notes to financial statements.

GEORGIA LOTTERY CORPORATION

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
OPERATING REVENUES:		
Ticket sales	$2,922,332,000	$2,710,459,000
Less instant tickets provided as prizes	(187,985,000)	(160,922,000)
Net ticket sales	2,734,347,000	2,549,537,000
Online fees	4,557,000	4,591,000
Other	145,000	133,000
Net operating revenues	2,739,049,000	2,554,261,000
OPERATING EXPENSES:		
Prizes	1,633,277,000	1,480,303,000
Retailer commissions and bonuses	192,482,000	177,990,000
Contractor fees	58,585,000	63,109,000
Advertising	19,500,000	19,860,000
Salaries and benefits	18,911,000	18,193,000
Retailer merchandising and marketing	9,187,000	5,967,000
Rent, utilities, and maintenance	3,313,000	3,271,000
Depreciation	930,000	1,134,000
Professional fees	983,000	795,000
Other	484,000	1,201,000
Total operating expenses	1,937,652,000	1,771,823,000
Operating income	801,397,000	782,438,000
NONOPERATING REVENUES (EXPENSES):		
Interest revenue and other	2,357,000	1,305,000
Net increase (decrease) in fair value of grand prize investments	5,113,000	(16,811,000)
Total nonoperating revenues (expenses)	7,470,000	(15,506,000)
Income before transfers	808,867,000	766,932,000
TRANSFERS—Transfers to and due to Lottery for Education Account	(802,240,000)	(782,724,000)
Change in net assets	6,627,000	(15,792,000)
NET ASSETS—Beginning of year	8,973,000	24,765,000
NET ASSETS—End of year	$ 15,600,000	$ 8,973,000

See notes to financial statements.

GEORGIA LOTTERY CORPORATION

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
OPERATING ACTIVITIES:		
Cash received from customers	$ 2,717,895,000	$ 2,564,808,000
Other operational cash received	4,702,000	4,724,000
Cash paid to prize winners	(1,648,975,000)	(1,468,531,000)
Cash paid to retailers	(102,988,000)	(177,990,000)
Cash paid to contractors and employees	(192,482,000)	(104,449,000)
Other operating payments	(3,631,000)	(8,837,000)
Net cash provided by operating activities	774,521,000	809,725,000
NONCAPITAL FINANCING ACTIVITIES:		
Payments to Lottery for Education Account	(793,114,000)	(805,028,000)
Payments to Department of Human Resources	(200,000)	(200,000)
Net cash used in noncapital financing activities	(793,314,000)	(805,228,000)
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchases of property and equipment	(1,314,000)	(819,000)
Proceeds from disposals of property and equipment	37,000	29,000
Net cash used in capital and related financing activities	(1,277,000)	(790,000)
INVESTING ACTIVITIES:		
Interest received	2,200,000	926,000
Purchases of grand prize investments	(11,500,000)	(106,319,000)
Investments sold		87,285,000
Maturities of grand prize investments	22,862,000	21,677,000
Net cash provided by investing activities	13,562,000	3,569,000
NET (DECREASE) INCREASE IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	(6,508,000)	7,276,000
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—Beginning of year	164,985,000	157,709,000
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—End of year	$ 158,477,000	$ 164,985,000

(Continued)

GEORGIA LOTTERY CORPORATION

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$801,397,000	$782,438,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	930,000	1,134,000
Provision for doubtful retailer accounts	(418,000)	213,000
Gains on disposals of property and equipment	(37,000)	(29,000)
Changes in assets and liabilities:		
Retailer accounts receivable	(16,066,000)	15,059,000
Prepaid expenses and other assets	221,000	3,609,000
Accounts payable and accrued liabilities	3,490,000	(4,418,000)
Prizes payable	(4,498,000)	14,246,000
Grand prizes payable	(11,200,000)	(2,477,000)
Restricted fidelity fund	320,000	104,000
Other liabilities	382,000	(154,000)
Net cash provided by operating activities	$774,521,000	$809,725,000
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES:		
Increase (decrease) in fair value of investments	$ 5,113,000	$(16,811,000)
Accretion of grand prizes payable	11,505,000	12,005,000
Increase in unrealized gain on other assets	157,000	
Common stock received		379,000
	$ 16,775,000	$ (4,427,000)

See notes to financial statements.

(Concluded)

GEORGIA LOTTERY CORPORATION

NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

1. REPORTING ENTITY

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

The GLC's ticket sales include instant ticket sales and online ticket sales for Cash 3, Cash 4, Lotto South, Fantasy 5, Quick Cash Keno, and Mega Millions. On June 30, 2004, the GLC ended The Change Game.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Basis of Accounting—The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). Under this method, revenues are recognized when earned and expenses are recognized when incurred. In accordance with Statement of Governmental Accounting Standards ("SGAS") No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* the GLC is required to follow all applicable Governmental Accounting Standards Board ("GASB") pronouncements.

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

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

Commissions and Bonuses—Retailers receive a commission of 5% on ticket sales, except for Cash 3 sales, on which retailers receive a commission of 7%, and a 2% cashing bonus on all ticket validations at their location. In addition, retailers receive bonuses for selling winning jackpot tickets for Lotto South, Fantasy 5, Mega Millions, and certain instant ticket games. During 2005 and 2004, at least four instant ticket games were introduced with a retailer sales commission of 10%.

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

The GLC entered into a seven-year vendor contract effective September 7, 2003, with GTECH Corporation ("GTECH") for the operation of the gaming network that consists of over 7,700 instant and online retailer ticket terminals and associated software. Under the contract, GTECH receives a fee of 1.28% of net ticket revenue. Under the previous amended contract, GTECH received a fee of 2.315% of net ticket revenue.

The GLC entered into a seven-year vendor contract effective September 7, 2003, with Scientific Games, Inc. for the printing and distribution of instant game tickets. Scientific Games, Inc. receives a fee of 1.2875% of net instant game tickets distributed to retailers. Under the previous contract, Scientific Games received a fee of 2.4375% of net instant ticket revenue.

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

Mega Millions and Lotto South are multistate lottery games operated by member lotteries. The Mega Millions and Lotto South prizes are shared based on contributions to the prize pools by the member lotteries. Grand prize investments for jackpot winners who purchased tickets in Georgia are held by the GLC.

The Powerball grand prize is a shared prize from contributions to the prize pool by all member lotteries of the Multi-State Lottery Association ("MUSL"). All Powerball grand prizes won by players who purchased tickets in Georgia are funded by investments purchased by MUSL. The investments are held by MUSL in trust for the GLC and are paid in 20 annual installments. Investments of $10,026,000 and $10,567,000 included in the GLC's grand prize investments in the statements of net assets at June 30, 2005 and 2004, respectively, were held by MUSL in trust. The GLC withdrew from MUSL on August 31, 1996.

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

Net Assets—Net assets represent cumulative revenues less expenses in excess of net proceeds transferred to the Lottery for Education Account, as defined under the Act (see Note 7). Net assets include funds invested in capital assets and unrestricted net assets. Unrestricted net assets normally result from the inclusion of capital costs in the determination of net proceeds as required by the Act and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. Grand prize investments are purchased to finance future payments to Lotto South, Mega Millions, and certain instant game grand prize winners. Any increases or decreases in the fair value of these investments are determined to be unrealized and will not affect (i) the future ability to hold these investments or (ii) the amount of funds available for distribution to the Lottery for Education Account. Unrealized gains on grand prize investments at June 30, 2005 and 2004, were $13,066,000 and $7,954,000, respectively.

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

Retailer Accounts Receivable—Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions, cashing bonuses, and prizes paid by the retailers. Lottery proceeds are collected weekly from retailer bank accounts held in trust for the GLC. An allowance for doubtful accounts is established based on management's estimate of retailer receivables that will not be collected. At June 30, 2005 and 2004, the allowance for uncollectible retailer receivables was $1,939,000 and $1,896,000, respectively.

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

Fidelity Fund—In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a GLC retailer. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers. At the end of each year, any amount in the fund in excess of $500,000 is treated as net proceeds from the GLC subject to transfer to the Lottery for Education Account. There were no fidelity funds available for transfer as net proceeds for the years ended June 30, 2005 and 2004. The fidelity fund proceeds are held in a separate account and is presented in the statements of net assets as restricted fidelity fund cash and in liabilities as restricted fidelity funds.

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

Budget—Georgia Statute requires the GLC to submit to the Office of Planning and Budget ("OPB") and the State Auditor, annually by June 30, a proposed operating budget for the next fiscal year. Additionally, the GLC is required to submit to the OPB annually, on September 1, a proposed operating budget for the GLC and an estimate of net proceeds for the succeeding fiscal year. The GLC complied with these requirements in 2005 and 2004.

New Accounting Pronouncements—In November 2003, GASB issued SGAS No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries,* and establishes accounting and financial reporting standards for impairment of capital assets. In accordance with this statement, a capital asset will be considered impaired when its service utility has declined significantly and unexpectedly and such impairment will be required to be reported in the financial statements when such impairment has occurred and not as part of ongoing depreciation or upon disposal of the capital asset. This statement also enhances comparability of financial statements between governments by requiring all governmental entities to account for insurance recoveries in the same manner. SGAS No. 42 provisions are effective for financial statements for periods beginning after December 15, 2004. GLC management has not yet determined the impact that implementation of SGAS No. 42 will have on the GLC's financial statements.

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

In December 2004, GASB issued SGAS No. 46, *Net Assets Restricted by Enabling Legislation: an amendment of GASB Statement No. 34*. This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. This Statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this Statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation. The provisions of this Statement are effective for periods beginning after June 15, 2005. GLC management has not yet determined the impact that implementation of SGAS No. 46 will have on the GLC's financial statements.

In April 2005, GASB issued GASB Statement No. 47, *Accounting for Termination Benefits*. This Statement provides accounting and reporting guidance for state and local governments that offer benefits such as early retirement incentives or severance to employees that are involuntarily terminated. The Statement requires that similar forms of termination benefits be accounted for in the same manner and is intended to enhance both the consistency of reporting for termination benefits and the comparability of financial statements. The provisions of this Statement are effective for periods beginning after June 15, 2005. GLC management has not yet determined the impact that implementation of SGAS No. 47 will have on the GLC's financial statements.

3. CASH, CASH EQUIVALENTS, AND GRAND PRIZE INVESTMENTS

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

Cash—Cash is held in demand deposits at various financial institutions. The bank balance of these deposits of approximately $5,840,000 and $2,444,000 at June 30, 2005 and 2004, respectively, were insured by either the state's collateral for public deposits in accordance with Georgia Statutes, Chapter 280.04, or federal depository insurance. These deposits are collateralized with U.S. government securities held in a custody account at the Federal Reserve Bank for the benefit of the GLC. The fair value of the underlying securities must be at least equal to the amount of funds held by the financial institution on behalf of the GLC. All collateralized deposits are considered insured.

Cash Equivalents—Cash equivalents represent surplus cash invested in Georgia Fund 1 administered by the State of Georgia's Office of Treasury and Fiscal Services. The voluntary fund is a short-term investment vehicle that is available for use by state entities and local governments. Georgia Fund 1 invests its assets in U.S. Treasury bills, U.S. Treasury notes, securities issued by federal agencies and instrumentalities, banker's acceptances, and repurchase agreements. As of June 30, 2005 and 2004, the Georgia Fund 1 net assets totaled $6,958,596,000 and $6,292,865,000, respectively. No allocation will be made as to the GLC's share of the types of investments, and assets and liabilities will not be carried on the statements of net assets since the Georgia Fund 1 is operated on a pooled basis. To included such informaion may give the misleading impression that the GLC has some controlling authority over the investment vehicles.

The Georgia Fund 1 is an AAA rated investment pool by Standard & Poor's, and the portfolio's weighted average maturity is twenty-four days. Under SGAS No. 40, since these funds represent an externally managed pooled it is not exposed to custodial credit risk, and therefore, no custodial credit risk disclosures are required. The GLC's investment in Georgia Fund 1 was approximately $155,876,000 and $164,134,000 at June 30, 2005 and 2004, respectively. Interest earned on the GLC's investments was approximately $2,200,000 and $926,000 for the years ended June 30, 2005 and 2004, respectively.

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

Grand prize investments at June 30, 2005 and 2004, consist of the following:

	Fair Value	
	2005	2004
U.S. Treasury securities	$208,496,000	$203,000,000
Government agencies	9,928,000	10,168,000
	$218,424,000	$213,168,000

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

Changes in grand prize investments for the years ended June 30, 2005 and 2004, consisted of the following:

Fair value—June 30, 2003	$220,617,000
Purchases	106,319,000
Payments to grand prize winners	(21,677,000)
Investments sold	(87,285,000)
Interest earned on current-year maturities	12,005,000
Change in fair value	(16,811,000)
Fair value—June 30, 2004	213,168,000
Purchases	11,500,000
Payments to grand prize winners	(22,862,000)
Investments sold	
Interest earned on current-year maturities	11,505,000
Change in fair value	5,113,000
Fair value—June 30, 2005	$218,424,000

Deposits—The majority of the GLC's cash deposits not in Georgia Fund 1 are held in a master operating account with Bank of America. All of these cash deposits are insured by government securities pledged as collateral by Bank of America. At June 30, 2005, the GLC's Master Operating Account had a book balance of $5,687,000 and a bank balance of $5,708,000, which was insured by collateralized securities with a fair value of $10,118,000 pledged by Bank of America. The GLC also has a Fidelity Fund account with Carver State Bank consisting of cash deposits collected from retailer application fees that are used to offset uncollectible retailer receivable balances. Any balances exceeding $500,000 in this account are transferred as net proceeds to the state of Georgia at year-end. As of June 30, 2005, the GLC's Fidelity Fund account had a bank balance of $420,000, which was collateralized by a Federal Home Loan Bank Bond in the amount of $500,000.

Investments—The GLC's investments consist of U.S. Treasury Strips (principal and interest) that are held to maturity to fund grand prize winners for Lotto Georgia, The Big Game, Lotto South, and various Instant Games with annuity prizes such as Win For Life. In addition, MUSL (Multistate Lottery Association) holds U.S. government agency securities on behalf of the GLC that are held to maturity to fund Georgia's two Powerball grand prize winners. At June 30, 2005, the GLC's investment balances consisted of U.S Treasury Strips with a fair value of $208,496,000 and U.S government agency securities with a fair value of $9,928,000. U.S Treasury Strips held by the GLC are AAA-rated and current holdings mature quarterly beginning August 2005 through August 2029. U.S. government agency securities held for the GLC by MUSL are AAA-rated with maturities each year in September and May through the year 2015.

Interest Rate Risk—The GLC's deposits in the master operating account with Bank of America are subject to fluctuations in short-term interest rates. This is the only exposure that the GLC has in regards to interest rate sensitivity since there is no investment related impact on the GLC resulting from the effect of interest rate changes on grand prize investments.

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

Custodial Credit Risk—For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the GLC will not be able to recover the value of its investments in the possession of an outside party. The GLC's investments in U.S. Treasury Strips include strips with a fair value of $69,430,000 that were purchased from Bank of America and are also held by Bank of America in a safekeeping account on the behalf of the GLC.

4. CAPITAL ASSETS

Capital assets at June 30, 2005 and 2004, consisted of the following:

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

	Balance at June 30, 2003	Increases	Decreases	Balance at June 30, 2004
Capital assets:				
Furniture and fixtures	$ 2,486,000	$ 1,000	$ -	$ 2,487,000
Computer and communications equipment	7,870,000	358,000	(952,000)	7,276,000
Vehicles	2,211,000	211,000	(227,000)	2,195,000
Leasehold improvements	2,135,000	230,000		2,365,000
Software	429,000	13,000	(50,000)	392,000
Other assets	1,362,000	6,000		1,368,000
Total capital assets at historical cost	16,493,000	819,000	(1,229,000)	16,083,000
Less accumulated depreciation	(14,357,000)	(1,134,000)	1,229,000	(14,262,000)
Capital assets—net	$ 2,136,000	$ (315,000)	$ -	$ 1,821,000

5. GRAND PRIZES PAYABLE

Grand prizes payable is recorded at the net present value of the U.S. Treasury securities purchased for each jackpot winner. Grand prizes payable was accreted by approximately $11,505,000 and $12,005,000 for the years ended June 30, 2005 and 2004, respectively. Grand prizes payable are not presented as current liabilities, as they are not part of the GLC's current operations.

Future payments of grand prizes payable at June 30, 2005, are scheduled as follows:

2006	$ 23,514,000
2007	23,493,000
2008	23,444,000
2009	23,443,000
2010	23,444,000
2011–2015	107,074,000
2016–2020	26,145,000
2021–2025	13,895,000
2026–2030	13,517,000
2031–2035	6,607,000
2036–2040	820,000
	285,396,000
Less imputed interest	(80,132,000)
Net present value of grand prizes payable	$205,264,000

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

Claimants of qualified prizes, as defined in the GLC Rules and Regulations, on or after the date of enactment of the Omnibus Act, can make an irrevocable election to receive a lump-sum cash payment equivalent of the annuitized prize within 60 days of the claim date. Grand prizes payable at June 30, 2005, consist of no qualified prizes under this provision of the Special Rule.

6. OPERATING LEASES

The GLC has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the GLC. Future minimum rental payments on noncancelable leases with original terms of one year or more are scheduled as follows:

Year Ending June 30	Operating Leases
2006	$ 1,948,000
2007	1,948,000
2008	2,231,000
2009	2,231,000
2010	2,231,000
2011–2014	8,923,000
	19,512,000
Less sublease revenues	(2,210,000)
Total	$17,302,000

Rental expense under all operating leases totaled approximately $2,072,000 and $2,103,000 for the years ended June 30, 2005 and 2004, respectively.

7. DUE TO LOTTERY FOR EDUCATION ACCOUNT

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

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

Net proceeds and operating expenses for the years ended June 30, 2005 and 2004, are summarized as follows:

	2005	2004
Operating revenues:		
Ticket sales	$2,922,332,000	$2,710,459,000
Less instant tickets provided as prizes	(187,953,000)	(160,922,000)
Less sales return allowance	(32,000)	
Net ticket sales	2,734,347,000	2,549,537,000
Online fees and other revenues	4,702,000	4,724,000
Interest revenue and other	2,357,000	1,305,000
GLC proceeds	2,741,406,000	2,555,566,000
Operating expenses—as defined:		
Gaming	1,913,031,000	1,747,229,000
Operating	24,621,000	24,594,000
Other	1,514,000	1,019,000
Total operating expenses—as defined	1,939,166,000	1,772,842,000
Net proceeds subject to transfer	$ 802,240,000	$ 782,724,000
Amount due to Lottery for Education Account for year	$ 802,240,000	$ 782,724,000
Amount paid during year	(599,514,000)	(589,124,000)
Amount due to Lottery for Education Account—		
End of year	$ 202,726,000	$ 193,600,000

Subsequent to June 30, 2005, all amounts due at the end of fiscal year 2005 were transferred to the Lottery for Education Account.

8. EMPLOYEE BENEFITS

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

There were 194 GLC employees participating in the 401(k) plan at June 30, 2005. For the years ended June 30, 2005 and 2004, GLC contributed $331,000 and $812,000, respectively, to the plan. During the year ended June 30, 2005, the GLC did not have to pay any employer contributions from December 2004 to June 2005 due to an employer contribution holiday being granted by the state of Georgia as the payments for those months were funded from plan forfeitures. Total employer contributions funded from plan forfeitures for the year ended June 30, 2005 was $485,000. Contributions by plan participants during fiscal years ended June 30, 2005 and 2004, were $533,000 and $516,000, respectively. For the years ended June 30, 2005 and 2004, the GLC paid $3,000 of plan administrative fees, on behalf of GLC employees.

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

Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Service Code to provide that all assets and income under a Section 457(b) plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. Nationwide Retirement Solutions is the custodian of the plan's assets. As of June 30, 2005 and 2004, the fair value of the plan's assets was $1,397,000 and $1,259,000, respectively. Contributions by participants during the years ended June 30, 2005 and 2004, were $124,000 and $141,000, respectively.

Compensated Absences—At June 30, 2005 and 2004, the balance for compensated absences was $1,833,000 and $1,705,000, respectively. The year-end balances are comprised of earned and unused vacation and sick leave hours. At separation, employees are compensated for all earned vacation and any remaining sick leave hours accrued prior to March 1, 2005. Increases to the compensated absences balance represent vacation and sick leave hours earned by employees and decreases represent their usage of leave. During the year ended June 30, 2005, employees earned and used leave totaling $1,037,000 and $909,000, respectively. The current portion of the compensated absence liability, expected to be due within one year of the statement date, June 30, 2004, is estimated using historical trends. At June 30, 2005 and 2004, the estimated current portion of the compensated absences liability was $222,000 and $230,000, respectively.

9. CONTINGENCIES

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

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