

Statement of Intent

for the financial years ending 30 June 2008 - 30 June 2010



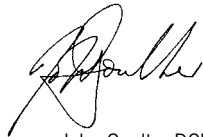
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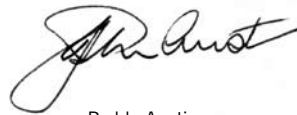
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This statement of intent for the New Zealand Lotteries Commission (NZ Lotteries) meets the requirements of section 139 of the Crown Entities Act 2004. It is for the financial years ending 30 June 2008, 2009 and 2010. The statement sets out the overall intentions and objectives of the New Zealand Lotteries Commission during this three-year period.

On behalf of the board of the New Zealand Lotteries Commission.



John Goulter DCNZM, JP
Presiding Member



Paddy Austin
Deputy Presiding Member

19 June 2007

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Term Information

Our Purpose

To provide safe gambling that allows New Zealanders to play and win while contributing money back to New Zealand communities.

Our Goal

Our primary goal is to continue to generate improved earnings so that we are able to maximise the contribution we make to numerous New Zealand communities. At the same time, the incidence of any problem gambling and underage gambling associated with our products will be minimised. We aim to achieve this by creating winning outcomes for all our stakeholders – our customers, our shareholder the Government, our retail network and other business partners, and our staff.

Our Background

The New Zealand Lotteries Commission (NZ Lotteries) was established in 1987 and operates as a Crown Entity under the Gambling Act 2003.

One of the largest Crown-owned trading enterprises, NZ Lotteries employs approximately 110 staff based in Auckland, Wellington and Christchurch, as well as territory representatives in some regions. We have a retail network of more than 950 lottery outlets that employ more than 4,000 people, the largest single retail network in New Zealand.

Lotto, our flagship game, has become a national icon. Alongside Lotto (which incorporates Winning Wheel), NZ Lotteries' other products are Lotto Powerball, Lotto Strike, Big Wednesday, Instant Kiwi and Keno.

NZ Lotteries' profits are transferred to the New Zealand Lottery Grants Board which administers funding allocations to arts, cultural, sporting, and community groups.

The integrity of our products, transparency of our systems and our commitment to growing our business without adverse social outcomes are the cornerstones of our business practices.

Our Statutory Functions

The activities of NZ Lotteries are specifically authorised and controlled through the Gambling Act 2003 and the Crown Entities Act 2004.

This legislative framework gives NZ Lotteries four main statutory functions which are:

- to promote, organise and conduct New Zealand lotteries (currently Lotto, Lotto Strike, Lotto Powerball, Big Wednesday, Instant Kiwi and Keno) for the purpose of generating profits for distribution by the New Zealand Lottery Grants Board, or for a community purpose for which a special purpose lottery is promoted under section 245 of the Gambling Act 2003;
- to maximise profits so generated, subject to ensuring that the risks of problem gambling and underage gambling are minimised;
- to make rules regulating the conduct and operation of New Zealand lotteries under section 243 of the Gambling Act 2003;
- to advise the Minister of Internal Affairs on matters relating to New Zealand lotteries.

NZ Lotteries is required to act within the Government's general policy in relation to New Zealand lotteries. We submit our annual budget to the Minister of Internal Affairs for approval and comply with any written direction given by the Minister and tabled in Parliament.

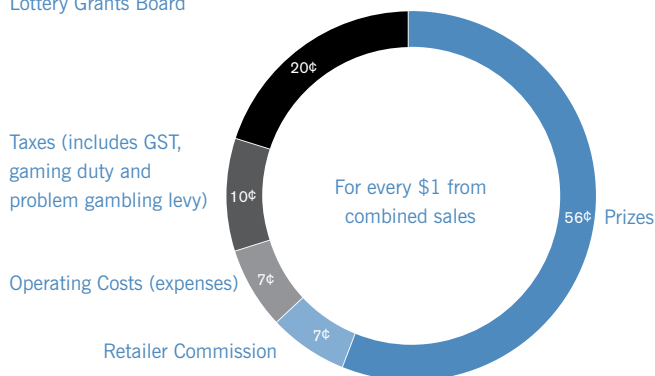
Supporting the Community

NZ Lotteries' earnings are passed to the New Zealand Lottery Grants Board and flow on to directly benefit the broader community.

Since its creation, NZ Lotteries has contributed more than \$2 billion to the Lottery Grants Board. About 76% of NZ Lotteries' sales go back to the community in the form of prizes and Lottery Grants - see *Figure 1*.

Figure 1: How NZ Lotteries Money is Spent*

Lottery Grants Board



* Based on forecast results for the year ended 30 June 2007

We are a major supplier of funding for Sport and Recreation New Zealand, Creative New Zealand and the New Zealand Film Commission. The activities of New Zealand's artists, film-makers and high-achieving sportspeople provide inspiration for us all. They act as a major catalyst in creating a positive sense of identity for New Zealanders.

The remainder of the Lottery Grants Board's funding supports well over 3,000 grass roots community activities and projects each year. This funding directly helps develop vibrant communities.

Allocations by the Lottery Grants Board for 2006/07

Total available for allocation 2006/07 **\$124,328,032**

Allocated to: **\$**

Regional Community Committees

Northland	1,254,882
Auckland	6,095,377
Waikato	2,301,989
Bay of Plenty/Gisborne	2,063,577
Hawke's Bay	1,151,701
Taranaki	751,770
Manawatu/Whanganui	1,347,642
Wellington/Wairarapa	1,960,076
West Coast/Nelson-Marlborough	1,247,233
Canterbury/Kaikoura	2,312,680
Otago/Southland	1,594,404

22,081,332

National Community Committee/Subcommittees

National Community Committee	11,880,000
Individuals with Disabilities	3,901,700
Pacific Provider Development Fund	350,000
	16,131,700

TOTAL Allocated to Community Committees **38,213,032**

Specialist Committees

Environment and Heritage	8,083,900
Health Research	2,816,000
Marae Heritage and Facilities	6,084,100
Minister's Fund	165,000
Outdoor Safety	7,315,000

TOTAL Allocated to Specialist Committees **24,464,000**

TOTAL to Lottery Distribution Committees **62,677,032**

Statutory Bodies

Creative New Zealand	21,310,000
Sport and Recreation NZ (SPARC)	30,890,000
NZ Film Commission	8,801,000
NZ Film Archive (via NZ Film Commission)	650,000

TOTAL Allocated to Statutory Bodies **61,651,000**

TOTAL ALLOCATION FOR 2006/07 **124,328,032**

Source: Lottery Grants Board and Department of Internal Affairs

Our Organisation

The NZ Lotteries Board has five members, all of whom are appointed by the Government. The board members are responsible for overall policy and direction.

Day-to-day running of NZ Lotteries is the responsibility of its chief executive and the other members of the senior executive team.

NZ Lotteries operates from offices in Auckland, Wellington and Christchurch. Commercial operations are conducted from Auckland. Some sales and training personnel, whose role is to support our network of retailers, are field based. Corporate support is in Wellington.

Parallel computer installations are retained at two sites for risk management and security purposes.

NZ Lotteries undertook a staff survey in late 2006 which found that staff felt they worked for a successful organisation, felt they were treated with respect, liked the people they worked with and had confidence in each other, and understood what was expected of them. This survey will continue to be undertaken on a regular basis.

Corporate Governance: External Relationships

Before the start of each financial year, NZ Lotteries submits a budget and business plan to the Minister of Internal Affairs (the Minister) for approval (including a budgeted profit transfer to the Lottery Grants Board).

Responsibility for advising the Minister on NZ Lotteries' activities sits with the Crown Company Monitoring Advisory Unit which receives quarterly updates on operating performance.

NZ Lotteries complies with section 139 of the Crown Entities Act 2004 by providing the Minister with an annual statement of intent. This document sets out NZ Lotteries' plans for the next three years. It also contains specific performance measures and financial targets for the coming financial year.

After the end of each financial year, NZ Lotteries delivers to the Minister an annual report of its proceedings and operations, together with a copy of its audited accounts and the report of Audit New Zealand on those accounts. This report is tabled in Parliament as required by Section 150 of the Crown Entities Act 2004. After its annual report is published, NZ Lotteries may be requested to appear before Parliament's Government Administration Committee to answer questions about NZ Lotteries' financial performance.

NZ Lotteries also produces a half-yearly report on its operations. Unlike the budget estimate, annual report and statement of intent, this half-yearly report is not a statutory requirement, but NZ Lotteries believes that all stakeholders, including the Minister, benefit from the provision of this information.

Corporate Governance: Within NZ Lotteries

The board meets at least ten times a year and additional meetings are held as required. The chief executive and chief financial officer attend all meetings.

Year-to-date financial information is provided for every board meeting. The board monitors any variances from its approved operating and capital expenditure budget.

The board has two committees: an Audit and Risk Committee and a Remuneration Committee.

The Audit and Risk Committee currently consists of three board members, including the Deputy Presiding Member who is the chair of the committee. It meets with officials from Audit New Zealand, NZ Lotteries' auditors. This committee, with the assistance of the executive, is responsible for matters of compliance and risk management. Final approval of NZ Lotteries' accounts is confirmed by the Audit and Risk Committee prior to endorsement by the full board.

The Remuneration Committee consists of two board members who are delegated to deal with strategic employment issues.

The executive is responsible for the Disputed Prize Claims Committee, which adjudicates on disputed prize claims up to \$25,000 from players, with management's decisions subsequently endorsed by the board. Disputed claims over this amount are dealt with directly by the board.

Public Perceptions of NZ Lotteries

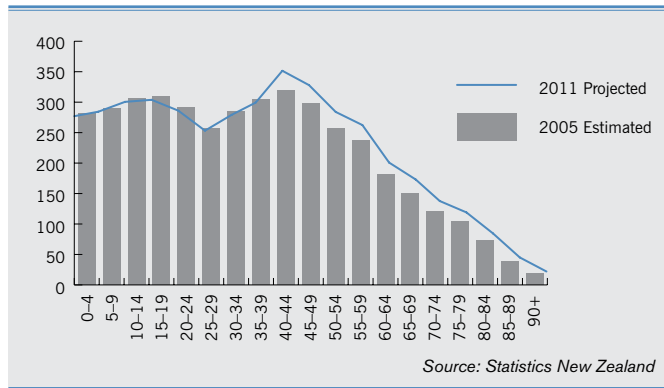
NZ Lotteries has a well established history and presence in New Zealand society. We are a New Zealand gambling operator with a pure community-benefit funding model. This model means that we are perceived differently from other gambling operators. After almost twenty years of operation the public view NZ Lotteries as part of the kiwi way of life.

We are known as a source of large-scale community funding. We are also perceived as a trusted organisation. As a Crown Entity we are subject to stringent government reporting and monitoring requirements.

Population and Lifestyles

NZ Lotteries operates only within New Zealand, a market that has a relatively slow growing and ageing population – see *Figure 2*. The resident population of New Zealand was estimated at 4.18 million at 31 March 2007 and population growth was estimated to be 43,100, or 1.0 percent, during the year to 31 March 2007. Natural increase contributed 31,000 to population growth and net migration contributed 12,100 during the same period. Half of New Zealand’s population was over 36 years of age at 31 March 2007 and about one in eight were aged 65 years and over.¹

Figure 2: New Zealand Population Demographic 2005 – 2011 (000's)



The ethnic diversity of New Zealand’s population has changed significantly since the beginning of Lotto in 1987. Population growth is now focused on Auckland which has much greater ethnic diversity than other cities. Only 59.6% of Auckland’s current population was born in New Zealand compared with a national average of 73.5%.²

¹ Department of Statistics, National Population Estimates, March 2007 quarter.

² Statistics New Zealand 2006 New Zealand Census of Population & Dwellings.

When Lotto first started, crowding around the TV on a Saturday night was the social engagement of the week. Twenty years later, New Zealanders live more mobile and social lives with a corresponding growth in movie theatre complexes, live entertainment and a thriving café and restaurant culture. Those at home on a Saturday night now have far greater choice between subscription and free-to-air television, along with electronic home entertainment options.

New Zealand Gambling Industry - Regulatory Environment

NZ Lotteries operates in a regulatory environment involving strict legislative boundaries, complex stakeholder relationships and a high level of scrutiny. Changing existing games, or introducing new ones, requires long lead times.

However, this environment means we are able to offer stakeholders transparency and a high level of integrity in terms of gambling processes and communication with the community.

The Gambling Act 2003

The Gambling Act (the Act) was enacted in September 2003, marking the beginning of a new era for New Zealand’s gambling industry after a lengthy period of uncertainty.

The Act introduced strict harm prevention and minimisation obligations and the Government allocated responsibility for funding problem gambling services, and developing a strategic plan for preventing and minimising gambling harm, to the Ministry of Health.

The Act established the Gambling Commission and disestablished the Casino Control Authority whose residual functions were integrated into the functions of the Department of Internal Affairs and the Gambling Commission. The Act provided that no new licences for casinos would be issued.

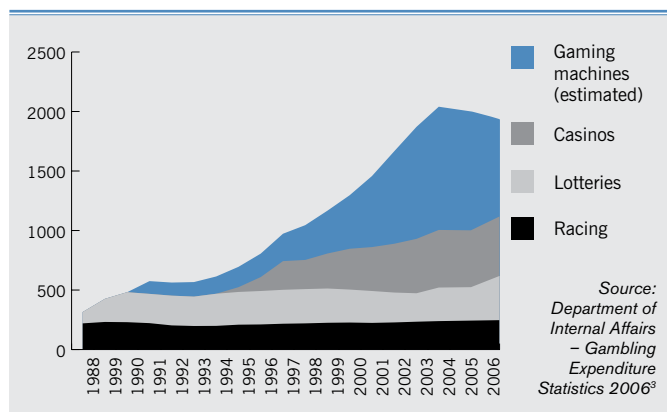
For NZ Lotteries, the Act raised the minimum age restriction on our Instant Kiwi product to 18 years and incorporated harm minimisation requirements into our statutory functions. The statutory responsibilities placed with the Ministry of Health make it appropriate for NZ Lotteries to consult with it and the Department of Internal Affairs on harm minimisation issues, particularly when changing existing games and developing new games.

Under the Act NZ Lotteries may conduct approved forms of remote interactive gambling.

Competition

Since Lotto was launched twenty years ago, the gambling market in New Zealand has grown rapidly and overall consumer participation has increased significantly. Until 2004, in the face of stiff competition from gaming and other competitors, expenditure on NZ Lotteries' products remained relatively static, and our share of the gaming market progressively declined as new entrants grew rapidly – see *Figure 3*.

Figure 3: New Zealand Gaming Market Expenditure 1988 – 2006 \$M



In 2004, expenditure on NZ Lotteries' products increased to 14% of total gambling expenditure, the first time it had increased since 1994. Expenditure in the New Zealand gaming market as a whole grew by 9% in that year.

In 2005, expenditure in the New Zealand gaming market fell for the first time since 1992 and continued to drop in 2006, with a drop in overall expenditure of \$12 million (0.6%) in 2005 and \$48 million (2.4%) in 2006, largely due to the smokefree legislation and tighter regulatory controls on gaming machines.

Expenditure on NZ Lotteries' products increased from 14% of overall expenditure in 2005 to 16% in 2006. However, gaming machines outside casinos still accounted for just under half the total gaming expenditure in New Zealand. NZ Lotteries' revenues have increased over the past three years. However, in real terms, revenue is below mid-1990's levels.

Direct competitors

NZ Lotteries' direct competitors within the gambling industry provide intense competition with their gambling products, typically offering rapid return reinvestment opportunities.

TAB / The New Zealand Racing Board

- Offers racing and sports betting through retail and web channels.
- Under the Gambling Act 2003, the New Zealand Racing Board and racing clubs are permitted to operate gaming machines in TABs and racing clubs, and the New Zealand Racing Board can sell its products online.

Non-casino gaming machines

- As at 31 March 2007, the Department of Internal Affairs estimated that there were 20,302 gaming machines in pubs and clubs with 444 societies operating them from 1,607 venues. This amounts to approximately one machine for every 146 New Zealanders aged 20 or over.
- Since the passing of the Gambling Act, there has been a decline in the number of machines each quarter.
- Jackpot devices linking gaming machines within one outlet have been operating for several years. However, operators are restricted from advertising jackpots or using jackpot branding except inside the venue.
- Operators of gaming machines in pubs and clubs are required to provide customers with information on problem gambling and loyalty programmes are prohibited.
- All gaming machines in New Zealand must be connected to an electronic monitoring system operated by the Department of Internal Affairs.

Casinos

- The Gambling Act now prohibits any further casino licences from being granted.
- In 2006, player expenditure in casinos was over 50% higher than that spent on NZ Lotteries products with casino expenditure increasing by 20% in the past four years.
- Operators of gaming machines at casino venues are required to provide customers with information on problem gambling and are restricted from advertising jackpots or using jackpot branding except inside the casino.

³ Gambling statistics derived from the Department of Internal Affairs website www.dia.govt.nz, which also has accompanying explanations on the data. 'Expenditure' means the gross amount wagered minus the amount paid out as prizes.

Interactive gambling

- A variety of overseas internet-based options are available to New Zealanders and these are increasing all the time, but advertising them in New Zealand is unlawful.
- Online poker and other games have shown great increases in popularity over recent years.
- This market is driven by brand, as opposed to regulation, and the traditional country/market barriers are blurring.

International lottery blocs

- Lottery operators from different states or countries form 'blocs' so that they are able to offer their customers the same game. The larger customer base they are able to draw on means that they can offer very large jackpot prizes at long odds.
- Lottery blocs already exist in the United States, Australia, Asia and Europe.
- The games offered by blocs can be played online in New Zealand today, but advertising them in New Zealand is unlawful.

Indirect competition

Indirect competition for New Zealanders' discretionary dollars continues to intensify:

Digital television

- Sky and TelstraClear have more than 700,000 subscribers paying an average of just over \$60 a month for their services.
- FreeView television was launched in New Zealand in April 2007. While there are no ongoing costs, set-up costs start at \$170 for a set top box alone and \$309 for a starter package including set top box and satellite dish.

Home entertainment

- Videos and DVDs are very common, offering choice and ease of use at an increasingly low cost. Several DVD hire websites have been launched, enabling customers to order DVDs online from the comfort of their own home.
- Sky introduced My Sky, a TiVo-style digital video recorder (DVR) device in late 2005. Based on international experience this is expected to further fragment consumers' media consumption.

Mobile phones

- There are more than 3.8 million mobile users in New Zealand representing 92% of the population.⁴
- Users are being offered high-speed data and content delivery, mobile commerce is emerging and there are interactive competitions which can reach a broad player base. Vodafone users with 3G phones can subscribe to watch selected Sky TV channels on their mobile phones.

The Internet

- More than 80% of New Zealanders have access to the Internet and it is growing in importance as a communications vehicle.⁵
- Computers and high-speed Internet access are becoming cheaper, interactive content is becoming mainstream, and e-mail is a popular communication and marketing tool. Broadband participation continues to grow, rising from 8.1% in December 2005 to 14.0% in December 2006.⁶

Other leisure and entertainment

- Consumers have multiple entertainment options for their discretionary dollars including music downloads, video and computer games, CDs, movies, magazines, travel and snack foods.
- Restaurants, cafes and bars are multiplying and diversifying, offering something for everyone's taste and wallet.

⁴ Vodafone NZ estimate as per their website May 2007.

⁵ Nielsen/NetRatings Market Intelligence April 2005.

⁶ OECD ranking on broadband penetration December 2006.

Economic Environment

The following is a report provided by Infometrics in May 2007 for the purpose of assisting NZ Lotteries in its planning for the three years ending 30 June 2010.

New Zealand's economic growth has slowed from 4.5% to 1.5% pa since the end of 2004. Consumer spending growth has slowed as households have taken a more cautious approach to spending, and private investment activity has remained weak (down 3.4% over the last year). The soft domestic sector has led to weak import growth, but the export sector continues to grapple with the high currency, meaning that New Zealand's current account deficit remains large, at 9% of GDP. Business margins continue to come under pressure from high labour costs, high transport costs, and high financing costs (interest rates). Firms exporting, or those competing with imports in New Zealand, have not been able to increase prices in response to these cost pressures.

The following is a list of other relevant assumptions about the economy:

- Economic growth hit a low point of 1.4% pa in the September 2006 quarter. However, any acceleration over the next 12 months is likely to be relatively muted, with GDP growth only recovering to 2.3% pa by June 2008 due to the current tightness of monetary policy.
- The unemployment rate has held below 4% over the last year, although total employment fell over the second half of 2006. Employment intentions have recently improved, but job losses in the manufacturing sector could push unemployment temporarily back above 4% over the next year.
- Aggregate growth in real disposable income held in the 3-4% pa range during 2006, implying that households increased their savings in response to more difficult economic conditions. That caution is likely to diminish this year, with aggregate income growth forecast to average over 3.5% pa over the next three years. Although wage growth is likely to slow in the short-term, weaker consumer price inflation implies that real income growth will hold steady.
- Inflation has eased from around 4% to 2.5% pa since June last year, primarily due to the drop in fuel prices since mid-2006. Underlying inflationary pressures remain strong, with domestic (non-tradable) inflation still running at 4.1% pa. The lack of spare capacity, the tight labour market, and the pressure on business margins over the last two years may combine to push overall inflation back up to 3% pa by early 2009.

- The Reserve Bank's official cash rate (OCR) is currently 7.75%*, with another 25-point increase likely in the current tightening cycle due to the medium-term inflationary pressures outlined above. The Bank is keen to lower inflation expectations, despite the negative effect of further interest rate increases on the export sector. Interest rate cuts are possible from mid-2008, but the OCR is unlikely to drop below 7%.
- The New Zealand dollar is at very high levels due to a combination of New Zealand's relatively high interest rates and global willingness to accept risk. The currency is likely to remain strong until late 2007, when increases in offshore interest rates start to reduce the interest rate differential and make New Zealand a little less attractive to foreign investors. The trade weighted index is forecast to be 68 in mid-2008 and 63 in mid-2009 (currently 71).
 - * At time of printing the Reserve Bank's official cash rate had increased to 8.0%

International Benchmarking

Comparing lotteries is a complex business and any comparisons are no more than a guide to overall performance. Lotteries vary in their regulatory frameworks, social and cultural environments, physical terrain for providing services, the potential numbers and relative economic wealth of their players, degree of state control, cost structures and amount of competition within their markets. The degree of variation is so great that no simple, overall comparison can ever be strictly valid.

In its April 2007 issue, the *International Gaming and Wagering Business* assesses all 43 US state lotteries on a series of effectiveness and efficiency measures. Instead of the usual per-capita comparisons, *International Gaming and Wagering Business* uses aggregated personal-income figures for each US state to calculate the percentage of personal income spent on lottery sales.

The *International Gaming and Wagering Business* approach gives an effectiveness or market-penetration measure that is not distorted by some lottery markets having more citizens with higher levels of disposable income. NZ Lotteries has adopted this methodology and applied it to its own performance as a means of international benchmarking.

NZ Lotteries ranked as follows for the 2005/2006 financial year:

1. Effectiveness and market-penetration measure:

Fiscal 2005/2006 sales as a per cent of US state personal income.

**NZ Lotteries' comparative ranking is 9th at 0.65%.
(11th in 2004/2005)**

2. Fiscal effectiveness measure:

Fiscal 2005/2006 government revenue as a per cent of US state personal income.

**NZ Lotteries' comparative ranking is 11th at 0.19%.
(11th in 2004/2005)**

3. Efficiency measure:

Ranked by cents spent to generate one sales dollar in fiscal 2005/2006*.

**NZ Lotteries' comparative ranking is 30th at 15.0 cents.
(24th in 2004/2005)**

* Economies of scale, population density, the percentage of rural and urban outlets, the amount of competition, commission fees, as well as telecommunications, advertising, and office accommodation costs all affect the relative cost structures of different lotteries.

4. Fiscal efficiency measure:

Fiscal 2005/2006 revenue generated for community and government as a per cent of gross revenue (sales minus prizes)*.

**NZ Lotteries' comparative ranking is 28th at 66.7%.
(22nd in 2004/2005)**

* This measure uses gross revenue figures, and so evens out the effect of lower prize payouts between lotteries.

Technical notes to this particular international benchmarking comparison:

- US state personal income figures were for the calendar year 2006.
- US state lotteries revenue and expense results were predominantly for the year to 30 June 2006.
- New Zealand personal income figures are consistent with the definition used for US personal income figures. They were derived from Statistics New Zealand's Household Income and Outlay Account for the year to 31 March 2006.
- NZ Lotteries' revenue and expenses were for the year to 30 June 2006. GST has been treated as being fully paid to the Government. However, NZ Lotteries receives credits of approximately \$10 million because of the GST it pays on services from its suppliers. These credits have been treated as being ultimately paid to the Government by those suppliers.

NZ LOTTERIES' STRATEGIC PRIORITIES

Our Business Goals

Since 2003, NZ Lotteries has undergone a significant transformation both in terms of its revenue generation and also in its underlying business infrastructure.

Consequently, the business has achieved strong growth in its top line revenues and net surplus, culminating in a record \$138.6 million contribution to the Lottery Grants Board in 2005/2006.

The next four years will be characterised by NZ Lotteries adopting an approach of widespread, incremental improvement. Our key business goals to achieve by 2010/2011 are:

- to have 1.5 million customers playing our games every week;
- to offer an interactive sales channel;
- to deliver \$175 million back to the community each year.

The unpredictable nature of jackpots can have a major influence on year-to-year revenue for NZ Lotteries. However, we aim to achieve these goals by growing our net surplus by around 6% on average each year.

Our Mission

NZ Lotteries sells a unique product set. Our products are intangible in nature and rely on the establishment of a strong emotional connection with our customers. Our underlying mission, and the link between our goals and our business strategies, is therefore:

To fire people's imagination to play and win

Our Growth Strategies

Games

We aim to connect more New Zealanders with games they love to play each week. This includes:

- revitalising our existing games;
- rejuvenating communications: re-engaging customers with our brands;
- introducing innovative new games.

Retail

We will continue to build a network that can reach, engage and excite players every week and in doing so move from a quantity to a quality focus. This includes:

- optimising our network reach;
- developing our retailer relationships;
- creating a great experience at the point of purchase and bringing the brand to life in-store.

Interactive

We look to develop a leading online interactive business. This includes:

- working with stakeholders to develop a sound interactive framework that minimises the risk of problem of underage gambling;
- making the interactive experience easy and straight-forward so players can register and play quickly and securely;
- personalising customers' experience and learning from their behaviour;
- developing beyond pure convenience and into entertainment.

Our Support Strategies

The growth strategies will be underpinned by three business support strategies.

Knowledge

We intend to develop a knowledge-based business which uses facts to drive decisions and actions. This includes:

- developing knowledge within the business by extracting better intelligence from the millions of transactions recorded each month;
- building the right infrastructure and tools to develop a more intimate understanding of our customers and support strategic priorities;
- actively using information and seeking insights to facilitate decisions based on fact and learning.

Culture

We plan to further develop a high performance culture within NZ Lotteries and our sales channels. This includes:

- becoming a values-based organisation, where our values are explicit and have been developed by our own employees;
- fostering strong leadership and coaching skills within the business;
- better employee and channel partner engagement.

Responsible Gambling

We look to continue our leadership role in the promotion of responsible gambling. This includes:

- using new technologies where possible to enhance safeguards against problem gambling behaviours;
- adopting the World Lottery Association's Responsible Gaming Framework and benchmarking practices.

Operating Intentions

Games

Lotto family sales were not significantly affected by the launch of Big Wednesday in October 2005. However, there is a need to revitalise the Lotto family of products which, aside from fluctuations driven by Powerball jackpots and promotions, have not had growth in sales since changes were made to Lotto in 2004.

A reinvigoration of Lotto is planned to coincide with Lotto's 20th birthday in August 2007. Key initiatives include revitalising the Saturday draw, placing more emphasis on the Winning Wheel and real winners, exciting new advertising and an associated fresh new promotional strategy. The Powerball product also requires more advertising differentiation from Big Wednesday, and promotional work will focus on reminding irregular players to play earlier in the jackpot cycle.

Since its launch, Big Wednesday has performed well above expectations, and it quickly established a strong position in the market. We are aware of the need to keep the game fresh and exciting, and, as with Powerball, will aim to bring irregular players into the jackpot cycle earlier.

Instant Kiwi acquired the tagline "The Little Thriller" in late 2006, and has shown an increase in sales. Continued growth will come from new designs and game structures for key Instant Kiwi streams, better stock management, and more effective promotional strategies.

Retail

The past three years have seen a significant increase in the size of our retail network from 640 to more than 950 retail stores. We have also moved from the traditional 27m² store format to a more flexible in-store design which enabled many more stores to join the network, extending our reach to communities which previously did not have convenient access to a lottery outlet.

The growth of the retail network has been an important contributor to the increases in sales performance of recent years and we will continue working to optimise our network to meet our long-term aim of having 90% of the population living within easy access of a lottery outlet.

Looking forward, NZ Lotteries is moving from an emphasis on rapid expansion of the network to focussing on the quality of the retail network and using it to engage more closely with our customers.

We will develop our relationship with our retailers, identifying their needs and drivers in order to better understand and communicate with them. A recognition and reward programme has already begun and will be further developed to give retailers an incentive to further commit themselves to increasing sales and providing customers with a great in-store experience.

Supporting our retailers' efforts, NZ Lotteries will also work on improving the in-store experience for customers by making it more consistent with our brand and making the point of purchase straightforward and convenient.

Interactive

In recent years, we have implemented a new gaming system, lottery terminals, management information system, corporate system and IP Wide Area Network. NZ Lotteries will work to continually improve and, where necessary, upgrade this infrastructure to ensure it remains capable of meeting the business' requirements.

The new IT infrastructure also provides functionality for the introduction of an online interactive sales channel. As outlined earlier, the Gambling Act 2003 makes provision for NZ Lotteries to offer online products. As broadband penetration continues to grow in New Zealand and the number of people who shop over the Internet increases, the influence of the Internet will only expand further. Recent research showed that 1.25 million New Zealanders shopped online during the twelve months to September 2006⁷ spending an estimated \$1.6 billion.

There is strong consumer demand for online products and many government agencies have introduced online access to their range of services. It is essential that NZ Lotteries also responds to this change in consumer buying preferences. We are therefore working with the Department of Internal Affairs and the Ministry of Health to develop a commercially sound interactive framework that minimises the risks of problem and underage gambling.

The first stage of the interactive strategy will give New Zealanders the ability to purchase the majority of our current products online. In subsequent stages, we envisage that customers will be able to choose from new products that are specially tailored to the online channel.

⁷ Nielsen Media Research Panorama report 11 December 2006.

In developing our interactive strategy, NZ Lotteries will consider the experiences of other international lottery organisations that have successfully been operating in the online environment for many years. Lotteries in Australia, Canada, the United Kingdom, and Scandinavia make their products available for purchase over the Internet. Rigorously regulated, and generally government-owned, lottery operators are seen as being able to offer interactive products reliably and safely when compared with unregulated competitors.

Responsible Play

One of NZ Lotteries' statutory functions under the Gambling Act 2003 is to maximise profits, subject to ensuring that any risks of problem gambling and underage gambling associated with our products are minimised.

We have now incorporated this commitment to minimise these risks as one of NZ Lotteries' core business support strategies. This is a significant step for NZ Lotteries, and recognises the serious impact that problem gambling behaviour has on individuals, families and communities. NZ Lotteries and its retail network are committed to conducting all aspects of lottery business in a professional and responsible manner. All efforts are made to provide a safe, friendly and responsible play environment that adheres to legislative and regulatory requirements.

Unlike other forms of gambling, lottery games are based on the principle of a large pool of players entering a draw for a low entry price. For most players, lottery games are fun and rewarding entertainment and lotteries provide a clear net community benefit. There are, however, a very small number of people for whom playing our games can create gambling problems.

NZ Lotteries estimates that about two million adults, approximately 75% of New Zealand's adult population, play our games each year. Problem gambling figures for the 2005 year show that 37, or 2.1%, of the 1,798 gamblers who received face-to-face counselling for the first time cited our products as their primary mode of gambling, compared to 0.6%, or 13, of the 2,219 gamblers in 2004.⁸ While the overall percentage remains relatively small, NZ Lotteries is concerned by the reported increase in presentations in 2005, and has requested a further analysis of the data by the Ministry of Health to gain a better understanding of what factors contributed to this increase. This will enable NZ Lotteries to further develop and improve our measures for minimising problem gambling in the future.

NZ Lotteries supports programmes that help protect people most at risk through funds raised from the Problem Gambling Levy.

Initiatives to ensure NZ Lotteries' harm prevention and minimisation responsibilities under the Act are met include:

- adoption of the World Lottery Association's Responsible Gaming Framework;
- ongoing consultation with the Ministry of Health and the Department of Internal Affairs on issues around preventing and minimising harm, particularly for new games;
- the continuation of a harm minimisation framework used to review all Instant Kiwi tickets during the ticket design process;
- attendance at World Lottery Association seminars on responsible gaming;
- periodic reviews of our Code of Practice for Responsible Play and its companion brochure that are carried in all lottery outlets, on our website and integrated into retail network training programmes;
- continued vigilance to ensure compliance with the age restriction for playing Instant Kiwi supported by in-store communications and training;
- continue to display a Responsible Play mark on our website, corporate collateral and at point of sale;
- continued representation on the Ministry of Health and Department of Internal Affairs' joint Expert Advisory Group on problem gambling.

⁸ Ministry of Health 2005 primary mode data for Problem Gambling Intervention Services in New Zealand.

Corporate Citizen and Integrity Performance Measures

NZ Lotteries aims to conduct all aspects of the lottery business in a professional and responsible manner. All efforts are made to provide a safe, friendly and responsible play environment that adheres to legislative and regulatory requirements.

NZ Lotteries' corporate citizen initiatives and integrity performance measures are to:

- conduct all draws on time for Lotto (including Lotto Powerball), Keno, Big Wednesday and any new draw games introduced during the year;
- comply with all provisions of the Gambling, Fair Trading, Commerce, and Consumer Guarantees Acts;
- ensure that all of our advertising complies with the standards set by the Advertising Standards Authority;
- monitor problem gambling counselling national statistics with the aim of ensuring that less than 100 of the problem gamblers who seek counselling for the first time cite NZ Lotteries products as their primary mode of gambling in any one year;
- ensure there are no convictions for the sale of Instant Kiwi to persons aged under 18 years.

NZ Lotteries' Organisational Health & Capability

NZ Lotteries is committed to being a good employer with a high performance culture. To continue to build a winning team, NZ Lotteries must invest in the development and retention of our staff. We aim to provide a professional and supportive work environment with a good work/life balance.

The development of explicit organisational values will be driven by staff and is key to developing an open, expressive and positive culture. We are also focussing on fostering strong leadership and coaching skills so that each employee has the support they require to succeed in their role.

Initiatives to ensure NZ Lotteries is meeting its obligations to manage organisational health and capability include:

- the introduction of organisational values;
- the adoption of a Gallup framework to measure employee engagement;
- the establishment of a more open and inclusive culture;
- clearer career paths for all people;
- training and professional development for all staff;
- objective reviews of leadership styles;
- annual staff conferences;
- a focus on improved communications.

NZ LOTTERIES' PERFORMANCE MEASURES

<i>Financial Performance Targets</i>	Actual 2005/2006	Estimate* 2006/2007	Budget 2007/2008	Projection 2008/2009	Projection 2009/2010
Total sales (\$m) (GST inclusive)	719.2	735.0	750.0	800.0	850.0
Net profit (\$m)	145.0	147.1	147.5	157.0	167.0
Paid to NZ Lottery Grants Board (\$m)	138.6	147.1	147.5	157.0	167.0

* The 2006/2007 estimate is based on 10 months' unaudited actual results and an estimate for May and June 2007.

Notes:

1. All financial information is GST exclusive unless described otherwise.
2. NZ Lotteries' financial statements will be prepared under New Zealand Equivalents to International Accounting Standards (NZ IFRS) with effect from the year ending 30 June 2008. The adoption of NZ IFRS is not expected to have a material impact on the basis on which sales and net profit are measured.

<i>Other targets</i>	Actual 2005/2006	Estimate* 2006/2007	Budget 2007/2008	Projection 2008/2009	Projection 2009/2010
Achievement level for World Lottery Association's Responsible Gaming Framework	n/a	2	3	3	4
Weekly population penetration**	n/a	25%	28%	30%	32%

** Population penetration = proportion of the total population who have purchased NZ Lotteries' products in the last week, taking into account multiple purchases

<i>Capital expenditure</i>	Actual 2005/2006	Estimate* 2006/2007	Budget 2007/2008	Projection 2008/2009	Projection 2009/2010
Capital expenditure (\$m)	30.0	6.5	9.8	5.0	5.0

Annual Information

PERFORMANCE TARGETS FOR THE 2007/2008 FINANCIAL YEAR

The functions of NZ Lotteries under the Gambling Act 2003 are as follows:

- to promote, organise, and conduct New Zealand lotteries for the purpose of generating profits for distribution by the New Zealand Lottery Grants Board, or for a community purpose for which a special purpose lottery is promoted under section 245 of the Act;
- to maximise profits so generated, subject to ensuring that the risks of problem gambling and underage gambling are minimised;
- to make rules regulating the conduct and operation of New Zealand lotteries in accordance with section 243 of the Act;
- to advise the Minister of Internal Affairs on matters relating to New Zealand lotteries.

The primary measures by which the performance of the first two statutory functions may be assessed are set out in the statement on the following page.

A 'special purpose lottery' under section 245 of the Act can only take place at the instruction of the Minister of Internal Affairs. There have been no special purpose lotteries since NZ Lotteries' inception in 1987.

In respect of NZ Lotteries' third statutory function, the objective is to ensure that any proposed rules for new games, or amendments to rules for existing games, are approved by the Minister of Internal Affairs.

NZ Lotteries will aim to fulfil its fourth statutory function by ensuring that any advice that the Minister seeks regarding New Zealand lotteries is rendered in a professional and timely manner.

Statement of Forecast Service Performance

For the year ending 30 June 2008

	Forecast 2007/2008	Forecast 2006/2007	Actual 2005/2006
Financial			
Total sales (\$ million)	750.0	735.0	719.2
Net surplus (\$ million)	147.5	147.1	145.0
Distribution to the Lottery Grants Board (\$ million)	147.5	147.1	138.6
Operating expenses as a percentage of sales	7.6%	7.3%	7.3%
Operational			
Estimated average number of customers per week (million)	1.17	1.05	*
Number of retail stores at year end	1030	970	878
Retail stores with "new look" (percentage of total stores)	100%	89%	65%
Customers satisfied with purchase experience**	>60%	>50%	*
Selling system up-time	99.9%	99.9%	99.9%
Registered players on interactive site (thousand)	20	n/a	n/a
Total weekly visits to interactive site (thousand)	90	65	n/a
Problem gamblers seeking face-to-face counselling for the first time citing NZ Lotteries products as their primary gambling mode	<100	<100	37
Convictions for the sale of Instant Kiwi games to persons under 18 years	Nil	Nil	Nil
Draws held on time for Lotto, Big Wednesday, Keno and any new games introduced during the year	All	All	All
Comply with all provisions of the Gambling, Fair Trading, Commerce, and Consumer Guarantees Acts	Full	Full	Full
Complaints upheld by the Advertising Standards Authority	Nil	Nil	Nil

* New measure starting 2006/2007.

** Customer satisfaction sourced via exit interviews at retail outlets.

FINANCIAL TARGETS FOR THE 2007/2008 FINANCIAL YEAR

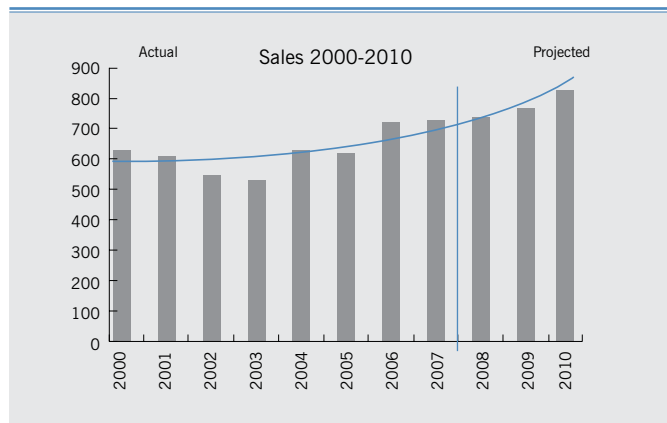
Key Financial Objectives

Our budget for 2007/2008 is based on realistic objectives given the unpredictability of Powerball and Big Wednesday's jackpotting cycles. Large prize offers create sizeable increases in sales and earnings.

NZ Lotteries' key financial objectives for the 2007/2008 financial year are:

- to achieve gross sales of \$750 million;
- to achieve a net surplus of \$147.5 million;
- to transfer \$147.5 million to the New Zealand Lottery Grants Board.

Sales



Big Wednesday was successfully launched in October 2005, which contributed to the record sales result for 2005/2006 of \$719.2 million. The strong sales performance has been maintained in 2006/2007, though without as much help from Powerball jackpots as the previous year. We expect sales to be in the vicinity of \$735 million, an increase of 2.2% on 2005/2006.

These efforts were supported by advertising and in-store promotions, an increase in the number of retail outlets to over 950, and the continuation of the national network refurbishment programme which is due for completion at the end of 2007.

We are budgeting an increase in sales to \$750 million for 2007/2008. The actual outcome could well turn out to be better, but much will depend on the state of the domestic economy, Powerball and Big Wednesday's jackpotting behaviour, and the implementation of our online sales channel.

Whereas the last three years have seen the business grow by delivering a small number of critical projects, growth in 2007/2008 will come from NZ Lotteries adopting an approach of widespread, incremental improvement.

Much opportunity still exists to increase play frequency and attract new players, as was demonstrated by the introduction of Big Wednesday. August 2007 marks Lotto's 20th birthday, which we see as an opportune time to refresh our relationship with our present and past customers and also attract irregular players back to our revitalised games.

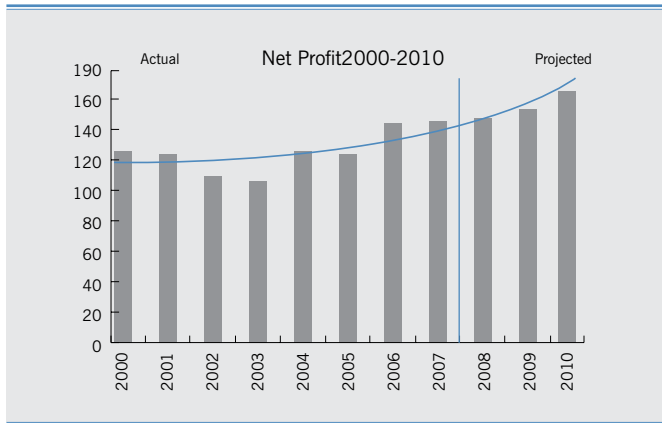
Part of our business strategy is to introduce innovative new games, and we aim to launch the first of these in 2008. Strengthening our game portfolio will allow us to spread our revenue risk across the week and address the difference in product spread between us and the other Australasian lotteries.

Major growth of our retail network, to offer our customers throughout New Zealand better accessibility and convenience when buying our products, has been achieved over the past three years. While we will continue with a controlled expansion of the retail network, this expansion will be at a slower pace than previously. Our focus will now be on the quality of the retail experience and will introduce higher levels of customisation based on unique store needs.

The introduction of our online sales channel is a key focus for 2007/2008. We expect our retail network to remain the dominant sales channel. However, this additional channel will provide a valuable new revenue stream to help generate future growth.

These initiatives are key to achieving our objective of maximising our contribution to the New Zealand community. At the same time, we will continue to promote policies and practices, such as our Responsible Play Code of Practice and in-store training, that ensure we meet the Gambling Act's requirement to minimise the risk of problem and underage gambling.

Earnings



Decreasing sales over several years led to an associated fall in profitability. However, in 2003/2004 buoyant sales, assisted by three big Powerball jackpots, gave a large boost to profits. Earnings in the 2004/2005 year, which received much less help from Powerball jackpots, were of a similar level, while those of 2005/2006 benefitted from the introduction of Big Wednesday and other initiatives which helped drive net profit to an increase of nearly \$15 million on the previous year.

Earnings in 2006/2007 are projected to be up by about \$2 million (1.5%) on the previous year.

Consistent with the relatively small increase that we are budgeting for in sales, we expect earnings in 2007/2008 to be around the same level as the projected out-turn for 2006/07.

PROSPECTIVE FINANCIAL INFORMATION

The prospective financial statements reflect NZ Lotteries' budget for the year ending 30 June 2008 and the forecast results and financial position for the year ending 30 June 2007. They have been prepared in accordance with the requirement under section 142 (1) (a) of the Crown Entities Act 2004.

The budget and forecast have been prepared on the basis of assumptions as to future events that NZ Lotteries' board reasonably expects to occur associated with the actions the board reasonably expects to take as at 1 June 2007. The board is responsible for the prospective financial statements presented, including the appropriateness of the assumptions underlying the prospective financial statements and all other disclosures.

The forecasts in respect of the year ending 30 June 2007 incorporate the actual financial results for the ten months to 30 April 2007.

Actual results are likely to vary from the forecasts and variations may be material.

It is not intended that the forecasts will be updated subsequent to the issue of this statement of intent.

Prospective Income Statement

For the year ending 30 June 2008

	2008 Budget \$ ' 000	% of sales	2007 Projection \$ ' 000	% of sales	2006 Actual \$ ' 000	% of sales
Sales including GST	750,000	100.0	735,000	100.0	719,206	100.0
Less GST	37,011	4.9	36,207	4.9	35,531	4.9
Sales net of GST	712,989	95.1	698,793	95.1	683,675	95.1
Less cost of sales (Note 6)	516,243	68.8	506,466	68.9	493,565	68.6
Gross profit	196,746	26.3	192,327	26.2	190,110	26.5
Other revenue	7,560	1.0	8,046	1.1	10,002	1.4
Operating expenses						
Advertising, draws, other promotions and retail support	29,658		28,563		28,087	
Personnel expenses	10,235		10,293		11,245	
Depreciation	6,525		4,862		3,146	
Amortisation of intangibles (computer software)	737		748		513	
Other	9,649		8,788		9,416	
Total operating expenses	56,804	7.6	53,254	7.3	52,407	7.3
Net surplus after operating expenses	147,502	19.7	147,119	20.0	147,705	20.6
Revaluation of land and building	-	-	-	-	-2,749	0.4
Net surplus	147,502	19.7	147,119	20.0	144,956	20.2
Distribution to the New Zealand Lottery Grants Board	147,502	19.7	147,119	20.0	138,589	19.3
Net surplus after distribution to the New Zealand Lottery Grants Board	-	-	-	-	6,367	0.9

The accompanying notes form part of this statement and should be read in conjunction with it.

Statement of Prospective Movements in Equity

For the year ending 30 June 2008

	2008 Budget \$ ' 000	2007 Projection \$ ' 000	2006 Actual \$ ' 000
Equity at the beginning of the year	36,317	36,277	29,910
Adoption of NZ IFRS (Note 3)	-	40	-
Net surplus for the year	-	-	6,367
Equity at the end of the year	36,317	36,317	36,277

The accompanying notes form part of this statement and should be read in conjunction with it.

Prospective Balance Sheet

At 30 June 2008

	2008 Budget \$ ' 000	2007 Projection \$ ' 000	2006 Actual \$ ' 000
ASSETS EMPLOYED			
Cash and cash equivalents	57,153	71,877	98,086
Retailer and other receivables	8,650	7,650	7,361
Inventories	2,500	2,500	2,044
Property, plant and equipment	36,213	33,126	33,323
Intangible assets (computer software)	472	959	1,831
Total assets employed	104,988	116,112	142,645
FUNDS EMPLOYED			
Unpaid prizes and other payables	46,460	54,397	74,715
Prize reserve account	15,211	18,322	23,709
Provisions	-	576	2,685
Financial liabilities	7,000	6,500	5,259
Equity	36,317	36,317	36,277
Total funds employed	104,988	116,112	142,645

The accompanying notes form part of this statement and should be read in conjunction with it.

Statement of Prospective Cash Flows

For the year ending 30 June 2008

	2008 Budget \$ ' 000	2007 Projection \$ ' 000
OPERATING ACTIVITIES		
Cash provided from:		
Sale of game tickets	711,989	697,702
Interest received	6,500	7,150
Other receipts	5,560	4,988
Cash applied to:		
Prize payments	419,510	421,574
Lottery duty	41,858	40,822
Retailers' commission	49,839	48,839
Personnel payments	10,188	10,239
Other payments	51,101	43,300
Net cash inflow from operating activities	150,553	145,066
INVESTING ACTIVITIES		
Cash provided from:		
Sale of property, plant and equipment	100	112
Cash applied to:		
Purchase of property, plant and equipment	9,896	9,880
Purchase of intangible assets	66	60
Net cash outflow from investing activities	-9,862	-9,828
FINANCING ACTIVITIES		
Cash provided from:		
Increase in financial liabilities	1,165	1,846
Cash applied to:		
Repayment of financial liabilities	665	605
Net cash inflow from financing activities	500	1,241
OTHER ACTIVITIES		
Payments to the New Zealand Lottery Grants Board	-156,015	-163,196
Net GST refunded	100	508
Net decrease in cash held	-14,724	-26,209
Cash and cash equivalents at beginning of year	71,877	98,086
Cash and cash equivalents at end of year	57,153	71,877

The accompanying notes form part of this statement and should be read in conjunction with it.

NOTES TO THE FORECAST FINANCIAL STATEMENTS

1. Accounting Policies

Reporting entity

These are the New Zealand Lotteries Commission's (NZ Lotteries) financial statements. They are prepared subject to the provisions of the Crown Entities Act 2004 and the Gambling Act 2003. NZ Lotteries is a Crown Entity as specified in the Gambling Act 2003.

Accounting compliance

The financial statements are prepared in accordance with New Zealand generally accepted accounting practice. They comply with New Zealand equivalents to International Accounting Standards (NZ IFRS) and other applicable financial reporting standards, as appropriate to NZ Lotteries.

The Gambling Act 2003 specifies multiple objectives for NZ Lotteries. However, NZ Lotteries has determined that it is a profit-oriented entity for the purpose of complying with New Zealand generally accepted accounting practice and NZ IFRS.

The financial statements for the year ending 30 June 2008 will be the first complying with NZ IFRS. An explanation of how the transition to NZ IFRS is likely to affect the reported financial position, financial performance, and cash flows of the Commission is provided in note 3.

Accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements and in preparing an opening NZ IFRS balance sheet as at 1 July 2006 for the purposes of the transition to NZ IFRS.

The measurement base applied is historical cost modified by the revaluation of certain assets and liabilities as identified in this statement of accounting policies.

The accrual basis of accounting has been used unless otherwise stated. These financial statements are presented in New Zealand dollars rounded to the nearest thousand.

Changes in accounting policies

Accounting policies are changed only if the change is required by a standard or interpretation or otherwise provides more reliable and more relevant information. There have been no changes in accounting policies. All policies have been applied on a basis consistent with the previous year.

Comparatives

When presentation or classification of items in the financial statements is amended or accounting policies are changed voluntarily, comparative figures are restated to ensure consistency with the current period unless it is impracticable to do so.

Employee entitlements

Obligations for contributions to the defined contribution retirement plan are recognised in the income statement as they fall due.

Employee entitlement to salaries and wages, annual leave, long service leave and other similar benefits are recognised in the income statement when they accrue to employees. Employee entitlements to be settled within 12 months are reported at the amount expected to be paid. The liability for long-term employee entitlements is reported as the present value of the estimated future cash outflows.

Termination benefits are recognised in the income statement only when there is a demonstrable commitment to either terminate employment prior to normal retirement date or to provide such benefits as a result of an offer to encourage voluntary redundancy. Termination benefits settled within 12 months are reported at the amount expected to be paid, otherwise they are reported as the present value of the estimated future cash outflows.

Financial instruments

Financial assets

Cash and cash equivalents include cash on hand, bank accounts and investments with a maturity of not more than 12 months, from date of acquisition. It is NZ Lotteries' policy to restrict all its investments to instruments issued or guaranteed by either the New Zealand Government or registered New Zealand banks. Although investments are normally held to maturity, they are readily marketable and therefore may be regarded as liquid assets. The value of investments held fluctuates as changes in market interest rates occur. However the extent of such fluctuations in value is limited for such investments of under 12 months term.

Cash and cash equivalents (including investments of under 12 months term from date of acquisition) are recorded at cost, adjusted in the case of government stock by the amortisation of any premium or discount included in the purchase price.

Investments with a maturity of greater than 12 months from date of acquisition are measured at fair value with any changes in value recorded through the income statement.

Receivables are non-derivative financial assets with fixed payments of a duration less than 12 months. These assets are recognised at their nominal value.

Financial liabilities

Other financial liabilities represents the amounts payable to Lotto, Winning Wheel, Instant Kiwi and Big Wednesday winners where the actual payments made are spread over a period of greater than 12 months from the date of claiming of the prizes. These liabilities are designated and measured at fair value with any changes in value recorded through the income statement. This is because this accounting treatment results in more relevant information due to these liabilities being managed and evaluated on a fair value basis.

Goods and Services Tax (GST)

All items in the financial statements are exclusive of GST, with the exception of amounts due from retailers for current games, trade receivables, moneys received for games not drawn at balance date, and trade creditors.

Intangible assets

These assets comprise computer software which is not integral to the hardware on which it operates. The software has a finite life and is recorded at purchase cost less any amortisation and impairment losses. Amortisation is charged to the income statement on a straight line basis over the software's useful life.

The useful lives of the intangible assets are reviewed at least annually to determine if there is any indication of impairment. Where any software's recoverable amount is less than its carrying amount, it is reported at its recoverable amount and an impairment loss will be recognised in the income statement.

Inventories

Inventories are recorded at the lower of cost (calculated using the first in, first out (FIFO) method) and net realisable value.

Interest

Interest income is accrued using the effective interest rate method. The effective interest rate method exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. The method applies this rate to the principal outstanding to determine interest income for each period.

Interest on cash and cash equivalents and investments relating to unpaid prizes and the prize reserve account is credited direct to the prize reserve account. Interest on other cash and cash equivalents and other investments is credited as sundry income in the income statement.

Judgements and estimations

The preparation of financial statements in conformity with NZ IFRS requires judgements, estimates and assumptions that affect the application of policies and reported amounts of asset and liabilities, income and expenses. Where material, information on major assumptions is provided in the relevant accounting policy or in the relevant note. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

No judgements have been entered into during the reporting period which have a significant effect on the financial statements and estimates and which have a significant risk of material adjustment in the next year.

Leases

Operating leases, where the lessor substantially retains the risks and rewards of ownership, are recognised in a systematic manner over the term of the lease. Leasehold improvements are capitalised and the cost is amortised over the unexpired period of the lease or the estimated useful life of the improvements, whichever is shorter. Lease incentives received are recognised evenly over the term of the lease as a reduction in rental expense.

Prize reserve account

This account is established in accordance with the requirements of the Rules governing the conduct and operation of NZ Lotteries' games. Transfers into this account comprise amounts set aside from the prize pools for games, together with prizes unclaimed after 12 months from the date of the relevant draw or game closure. Funds accumulated in this account are used exclusively for the purposes of augmenting the prize pools for various draws and games.

Property, plant and equipment

Items of property, plant and equipment are initially recorded at cost. Cost may include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment.

The net current fair value of the land and building is assessed by an independent valuer every three years in accordance with standards issued by the New Zealand Property Institute. The book values are then adjusted accordingly.

Depreciation of property, plant and equipment, other than freehold land which is not depreciated, is calculated on a straight line basis so as to allocate the cost of the assets, or the revalued amount, over their estimated useful lives as follows:

Gaming computers and associated equipment	7 years
Other computer hardware	3 years
Leasehold improvements	1-5 years
Draw equipment	5 years
Furniture and fittings	10 years
Motor vehicles	4 years
Office equipment	5 years
Building - structure	50 years
- services	15 years
- fit out	10 years

The useful lives of the items of property, plant and equipment are reviewed at least annually to determine if there is any indication of impairment. Where any item's recoverable amount is less than its carrying amount, it is reported at its recoverable amount and any impairment loss is recognised in the income statement.

Provisions

Provisions are recorded at the best estimate of the expenditure required to settle the obligation. Provisions to be settled beyond 12 months are recorded at their present value.

Revenue and expense recognition

Revenues and corresponding direct expenses for Lotto (including Lotto Strike and Powerball), Keno and Big Wednesday are recognised when each lottery is drawn. Instant Kiwi revenue and corresponding direct expenses are recognised when retailers activate ticket stock prior to sale to players, making those tickets part of a game.

Statement of cash flows

Cash and cash equivalents means cash on hand, bank accounts and investments with a maturity of not more than 12 months from date of acquisition.

Cash flows from operating activities include cash received from all income sources of NZ Lotteries, and cash payments made for the supply of goods and services.

Investing activities are those activities relating to the acquisition and disposal of non-current assets.

Financing activities are those activities related to the acknowledgement of prize liabilities incurred and repayments made, where the actual payment of prizes is spread over a period of greater than 12 months from the date of claiming the prizes.

Taxation

NZ Lotteries is exempt from income tax by virtue of Section 264 of the Gambling Act 2003.

The following taxes are paid by NZ Lotteries:

- lottery duty of 5.5 cents in the dollar on GST-inclusive sales;
- problem gaming levy of 0.20 cents (0.14 cents to 30 June 2008) in the dollar on GST-inclusive sales less prizes payable;
- goods and services tax charged on lottery sales less related prizes payable;
- fringe benefit tax.

2. Explanation of transition to NZ IFRS

NZ Lotteries' financial statements for the year ended 30 June 2008 will be the first financial statements to comply with NZ IFRS. NZ Lotteries has applied NZ IFRS 1 in preparing these prospective financial statements. The transition date was 1 July 2006 and NZ Lotteries has prepared its opening NZ IFRS balance sheet at that date. Therefore, although the reporting date of these prospective financial statements is 30 June 2008, NZ Lotteries' adoption date was 1 July 2006. In preparing the prospective financial statements in accordance with NZ IFRS 1, NZ Lotteries has applied the mandatory exceptions and not the optional exemptions from full retrospective application of NZ IFRS.

3. Financial effect of transition to NZ IFRS

There was only one financial effect of the transition to NZ IFRS on 1 July 2006. This related to the provision of \$2,684,000 for the refurbishment of retailer premises as at 30 June 2006. NZ IAS 37 (Provisions, Contingent Liabilities and Contingent Assets) requires that where the effect of the time value of money is material, the amount of the provision shall be the present value of the expenditures expected to be required to settle the obligation. In accordance with NZ IFRS 37, the present value of the provision was re-stated on 1 July 2006 as \$2,644,000. This adjustment resulted in an increase in equity of \$40,000 as at 1 July 2006.

4. Compliance with Financial Reporting Standard No. 42

These prospective financial statements comply with FRS42 (Prospective Financial Statements) which was approved in December 2005 by the Accounting Standards Review Board under the Financial Reporting Act 1993.

5. Principle assumptions

The principles assumptions made in arriving at the forecasts for the remainder of 2006/2007 and for 2007/2008 are as follows:

- Total retail sales in New Zealand as measured by Statistics New Zealand's Retail Trade Survey will increase by between 2% and 5% in actual terms in 2007/2008.
- There will be no major outages affecting our lottery systems.
- There will be no statistically abnormal series of jackpot runs for Powerball or Big Wednesday.
- The number of lottery outlets will have increased to 1030 outlets by 30 June 2008.
- There will be no major global lotteries initiative over the internet during 2007/2008.
- There will be no changes in GST, lottery duty or the problem gambling levy. Taxation will continue to be levied on NZ Lotteries on the same basis as at June 2007.

6. Cost of sales

	2008	2007	2006
	Budget	Projected	Actual
	\$'000	\$'000	\$'000
Lottery duty	41,251	40,425	39,557
Problem gambling levy	666	456	464
Retailers' commission	52,500	51,450	50,345
Prizes paid and payable	400,444	383,715	376,226
Prize reserve fund	16,455	25,420	21,930
Ticket costs	4,927	5,000	5,043
Total	516,243	506,466	493,565

DIRECTORY

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Board Members:

John Goulter DCNZM, JP

Presiding Member

Paddy Austin PhD

Deputy Presiding Member

Guy Herbert LLB (Hons) Dip TP

Laura Humphreys

John Wright

Senior Management:

Todd McLeay

Chief Executive

Auckland

Karen Jones

Head of Communications and Government Relations

Wellington

Evan Lawrey

General Manager Interactive

Auckland

Chris Lyman

General Manager Retail Sales

Auckland

Wayne Pickup

Chief Technology Officer

Auckland

Wendy Rayner

Head of Marketing

Auckland

Warren Salisbury

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