



LETTER FROM THE EXECUTIVE DIRECTOR

Dear Friends,

For the second straight year the New Jersey Lottery topped \$2 billion in sales. As the state's fourth largest revenue producer, the Lottery has returned more than \$13.1 billion over the past 33 years, including \$765 million in fiscal year 2003, to various institutions and programs.

The Lottery's primary objective is to generate revenues for the state. By balancing prize payouts and operating expenses we have sustained a high level of operating efficiency, thus maximizing the money we return to support programs such as community colleges, school nutrition programs, developmentally disabled individuals and veterans' homes.

In fiscal year 2003, more than 79 million winners were awarded \$1.17 billion in prizes, including Sundel "Sonny" Judson, who claimed the largest jackpot prize ever in New Jersey - \$165 million in Mega Millions. Pick 6 Lotto proved to again be popular with our players and turned out 16 millionaires. Moreover, the increasing popularity of the Lottery's instant games translated into a record-shattering \$901 million in sales.

As an added result of its record-breaking sales year, the Lottery's network of 6,000 retailers, the majority of whom are small business owners, earned commissions of \$114 million.

We are proud of the significant achievements of the Lottery and are grateful for the role we play in improving the quality of life for so many of our fellow residents.



Sincerely,

Virginia S. Bauer
Executive Director

\$13 BILLION AND GROWING TO BENEFIT

LETTER FROM THE GOVERNOR



Dear Friends,

Thank you for your support of the New Jersey Lottery, which has helped us achieve another record-breaking year. With sales of more than \$2 billion, the Lottery solidified its position as one of the largest revenue producing agencies for the state.

Most importantly, these milestone sales figures made it possible for New Jersey to provide more than \$765 million for education programs, as well as for state institutions which serve veterans, the developmentally disabled, the hearing-impaired and many others throughout New Jersey.

As always, the Lottery also provided several inspiring winner stories in 2003 while continuing to support small businesses in New Jersey through its extensive network of retailers.

Congratulations to all our Lottery winners and retailers, and special thanks to Lottery Executive Director Virginia S. Bauer and her professional staff for ensuring the success of the Lottery and its operation. We're looking forward to another great year in 2004.



With all good wishes,

A handwritten signature in black ink, reading "James E. McGreevey".

James E. McGreevey
Governor



LETTER FROM THE TREASURER

Dear Friends,

Over the past 33 years, the New Jersey Lottery has been a tremendous source of funding for educational programs and state institutions. For the second consecutive year, this important state agency achieved over \$2 billion in sales, further securing a place among the most successful and efficient state lotteries in North America.

With 36 cents out of every dollar earned directly benefiting those programs that derive funding from the Lottery, the Lottery contributed more than \$765 million to the State Treasury. New Jersey Lottery has the highest rate of return to the state of any lottery in the nation and is the fourth largest revenue producer in New Jersey.

It is my pleasure to join in presenting this Annual Report to the people of New Jersey. Once again, the Lottery has helped make our state a better place to live, work and play.

Congratulations on a tremendous year.



Sincerely,

John E. McCormac, CPA
State Treasurer

\$13 BILLION AND GROWING TO BENEFIT

WHERE THE MONEY GOES

**STATE OF NEW JERSEY
PROGRAMS SUPPORTED BY STATE LOTTERY RESOURCES
FOR THE FISCAL YEAR ENDED JUNE 30, 2003
(Amounts expressed in thousands)**

| | Amount Expended and or Encumbered (a) |
|--|--|
| DEPARTMENT OF AGRICULTURE | |
| SCHOOL NUTRITION | \$ 5,142 |
| DEPARTMENT OF EDUCATION | |
| GOVERNOR'S SCHOOL | 1,008 |
| MARIE KATZENBACH SCHOOL FOR THE DEAF | 2,653 |
| NON-PUBLIC SCHOOL AID | 56,654 |
| STATEWIDE ASSESSMENT PROGRAM (GRADES 4,8,11) | 8,423 |
| TOTAL DEPARTMENT OF EDUCATION | <u>68,738</u> |
| HIGHER EDUCATIONAL SERVICES | |
| SENIOR PUBLIC INSTITUTIONS-OPERATING AID | 156,968 |
| TUITION AND GRANTS | 95,893 |
| EXCELLENCE IN HIGH TECHNOLOGY WORKFORCE | 8,396 |
| HIGHER EDUCATION CAPITAL IMPROVEMENT PLAN-DEBT SERVICE | 7,091 |
| AID TO COUNTY COUNTY COLLEGES FOR OPERATIONAL COSTS | 76,953 |
| AID TO INDEPENDENT COLLEGES AND UNIVERSITIES | 13,488 |
| COORDINATED GARDEN STATE SCHOLARSHIP PROGRAM | 4,105 |
| HIGHER EDUCATION FACILITIES TRUST FUND - DEBT SERVICE | 12,082 |
| HIGHER EDUCATION FOR SPECIAL NEEDS STUDENTS | 601 |
| OPPORTUNITY PROGRAM GRANTS | 12,594 |
| SUPPLEMENTARY EDUCATION PROGRAM GRANTS | 7,119 |
| VETERINARY MEDICINE EDUCATION | 745 |
| TOTAL HIGHER EDUCATIONAL SERVICES | <u>396,035</u> |
| DEPARTMENT OF HUMAN SERVICES | |
| OPERATION OF CENTERS FOR DEVELOPMENTALLY DISABLED | 115,759 |
| OPERATION OF STATE PSYCHIATRIC HOSPITALS | 149,888 |
| TOTAL DEPARTMENT OF HUMAN SERVICES | <u>265,647</u> |
| DEPARTMENT OF MILITARY AND VETERANS AFFAIRS | |
| OPERATION OF HOMES FOR DISABLED SOLDIERS | <u>29,839</u> |
| TOTAL REVENUE REALIZED - GAAP BASIS | <u>\$ 765,401</u> |

(a) portion of its total state funding. Any Balance of the appropriation would be funded by the General Fund.

John E. McCormac, CPA
State Treasurer

Every day, New Jersey residents benefit from New Jersey Lottery proceeds. Each time a ticket is purchased, players are providing support to underprivileged children, scholarships for college students, homes for disabled veterans and developmentally disabled individuals, and treatment programs for troubled youth in New Jersey.

As one of the most cost-efficient lotteries in the United States, the New Jersey Lottery spends less than 1% of its revenues to operate and promote its business. The Lottery produced nearly \$2.07 billion in sales for FY '03. Of that amount, \$22 million was used for operating expenditures, allowing the Lottery to contribute over \$765 million to the State to help fund education and institutions making everyone in the Garden State a winner.

Out of every sales dollar, the Lottery returned 56 cents to players in prizes. In FY' 03 players received \$1.17 billion, compared to \$1.14 billion the previous year.

Since its inception in 1970, the Lottery has dedicated more than \$13.1 billion to programs that benefit millions of New Jersey residents such as: Community Colleges, Department of Human

Services, Governor's School Program, Department of Military and Veterans Affairs, School Nutrition and the Marie Katzenbach School for the Deaf.

NEW JERSEY STATE LOTTERY COMMISSION



Daniel F. Becht, Esq.
Commissioner



Robert James D'Anton
Chairman



Robert Slater
Commissioner



John E. McCormac, CPA
Treasurer



Virginia S. Bauer
Executive Director



Dr. Munnr Kazmir
Commissioner



Dr. Stephen T. Boswell
Vice-Chairman



Dr. Anthony R. Caputo
Commissioner

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LETTER FROM THE CHAIRMAN



Dear Friends,

On behalf of the New Jersey Lottery Commission I am proud to report that after 33 years the New Jersey Lottery continues to flourish. The Lottery continues to grow more and more winners, support more and more retailers and impact more and more lives through its beneficiaries.

The Lottery's success represents the perfect balance between production and efficiency. This past year the Lottery was once again among the largest revenue producers for the Garden State. New levels in player prizes and commissions paid to retailers were achieved. All this, while maintaining its distinction as one of the most efficient lottery programs in the nation.

My fellow commissioners and I are grateful to serve on a board that contributes significantly to our state and look forward to another prosperous and exciting year ahead.



Sincerely,

A handwritten signature in black ink that reads "Robert J. D'Anton".

Robert James D'Anton
Chairman

SONNY JUDSON WINS MEGA MILLIONS

In May 2002, the New Jersey Lottery joined eight other states in introducing the country's largest, most exciting multi-state, mega-jackpot game, MEGA MILLIONS. The game exceeded its predecessor, the BIG GAME, in many ways, offering players higher jackpots while producing record-breaking commissions for retailers and most importantly generating millions of dollars for important state programs.



In New Jersey the game officially stepped out of the shadows of the BIG GAME when Sundel "Sonny" Judson of Cliffside Park came forward with the lone winning ticket for the \$165 million jackpot for the July 16th drawing. Before a packed audience at Union County Community College, one of the lottery's beneficiaries, Judson, alongside Governor McGreevey, staked his claim to the largest single-ticket win in New Jersey Lottery's history.

The Lottery's news conference received statewide coverage, with several television stations carrying the event live as part of their noon broadcast. In addition, numerous national media outlets including CNN, Associated Press and the New York Times covered the story giving Sonny's winning experience national reach.

Judson vowed not to move since his big winnings. In fact, at 73, he planned to not make many changes in his life. His grown children, grandchildren, and wife, would benefit from his winnings, but Sundel expressed his satisfaction for his lifestyle at that time, with no desire to change it.



"I have been quite fortunate in my life," said Sundel Judson that day. "I only graduated high school, but I had a job that I love doing. I have a wonderful wife and family and my health. I've been very lucky."

"I have no desire to change," said Judson. "I wake up at 7:15, I take my vitamins, I pick up a cup of coffee and a roll, and I go into the city a couple days a week," said Judson. "I do some work on the computer, sit down with some customers, and at 11:30 I go home and have lunch. I smile, I go to sleep, I watch TV, I go where I wanna go, when I wanna go. I had all that before, and I still have that now. I've always been lucky."

\$13 BILLION AND GROWING TO BENEFIT

SUPPORTING SMALL BUSINESS



The New Jersey Lottery also plays a key role in supporting small businesses throughout the state. In fact, over 6,000 businesses serve as Lottery retailers and act as a direct link between the Lottery and its players.

Their unique marketing strategies and customer relations skills play an important part in driving sales and keeping customers informed of Lottery activities. Through the hard work, professionalism and dedication of these unsung heroes, the New Jersey Lottery continues to play a key role in sustaining economic prosperity in the Garden State.

Retailers earn five percent of their lottery ticket sales in the form of commissions. These commissions, as well as additional bonuses for selling top prize winning tickets, have enabled many retailers to put their children through college, buy new homes or take long-awaited vacations.

Last fiscal year, the Lottery returned more than \$114 million in commissions to support chain stores, supermarkets, pharmacies, convenience stores and other establishments throughout the state.



RESPONSIBLE PLAY AT THE NEW JERSEY LOTTERY



Playing the lottery is a recreational activity, something that is fun and entertaining and for New Jersey, benefits education and state institutions. As with other recreational and entertainment activities, it is the player's responsibility to exercise caution and, in the case of gaming activities, maintain control of his or her spending.

The New Jersey Lottery is concerned with the health and well-being of its players and has a long history of advocating responsible play.

The Council on Compulsive Gambling of New Jersey's gambling hotline -- 1-800-gambler -- has been printed on every lottery ticket, brochure and signage for over a decade and Lottery's website directs visitors to the Council's site -- www.800gambler.org the site provides people with free information/ help for compulsive gambling. The

Lottery designated a staff position to work with the Council and other entities within the Lottery to broaden the responsible play program and enforce underage gambling rules. For the past four years, Lottery has a seat on the Council's Board of Directors and has had significant input into policy directions regarding the education of the public.

The New Jersey Lottery continues to design and launch initiatives aimed at promoting responsible play and enforce underage gambling prohibitions, including development of a free brochure that was provided to retailers and players with tips for setting guidelines on playing responsibly. This brochure is available in each of the 6,000 registered lottery retailer locations throughout New Jersey, at lottery exhibits and fairs, legislative offices, as well as through the Lottery website <http://www.njlottery.net>. Also, Lottery runs public service announcements during high jackpots, has responsible play messaging on Lottery Terminal Displays at retailer locations, and has a section on its website devoted to Responsible Play.

Over the next year, Lottery will roll-out other components, including an expanded program to enforce underage gambling prohibitions, Speaker Bureau to promote responsible play and Where The Money Goes and e-mail subscriber service messaging and website announcements promoting responsible play.

Good business is also about good corporate citizenship and social responsibility. Through a commitment to sound and socially conscious business practices, the New Jersey Lottery has maintained its integrity while protecting the value of its revenue source.

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LOTTERY ASSISTS HOME FOR NJ VETERANS

In fiscal year 2003, the New Jersey Lottery contributed \$29.8 million to the Department of Military and Veterans' Affairs to help operate three modern long-term care nursing homes located in Paramus, Menlo Park, and Vineland. These homes are inspected and licensed annually by the New Jersey Department of Health and Senior Services, and the U.S. Department of Veterans Affairs and offer around-the-clock medical and nursing care provided by a full-time medical staff.

Last year, the Lottery arranged for "Beetle Bailey" and its creator Mort Walker, to visit the Menlo Park facility and present a check for \$6,000 to the Veterans Memorial Home. The donation was part of a unique licensing agreement with Oberthur Gaming Technologies (OBT) for the Lottery's *Beetle Bailey Instant* game and included a special presentation by Jack McGreevey, a former United States Marine Corps drill instructor and father of Governor James E. McGreevey.



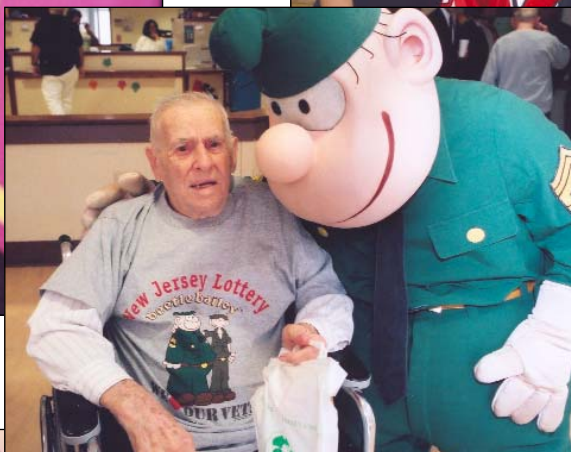
A YEAR IN PHOTOS



NJ Lottery Hostess Renai Ellison speaking at the nightly drawing.



NJ Lottery Hostess Carmen Delia Torres, NJ Devils mascot and NJ Devils WABC Radio Announcer Randy Velischek with representatives of Glenwood Confectionery in Bloomfield at a NJ Lottery Retailer Night.



Howard Fitch, Deputy Director of Chain Stores and Offsite Lottery Retail Locations presents Joe DiFigalia, owner of the 7-11 in Budd Lake, Morris County, a bonus check for \$2,000. Mr. DiFigalia's store sold the only winning Pick 6 Lotto ticket for the August 5, 2002 drawing.



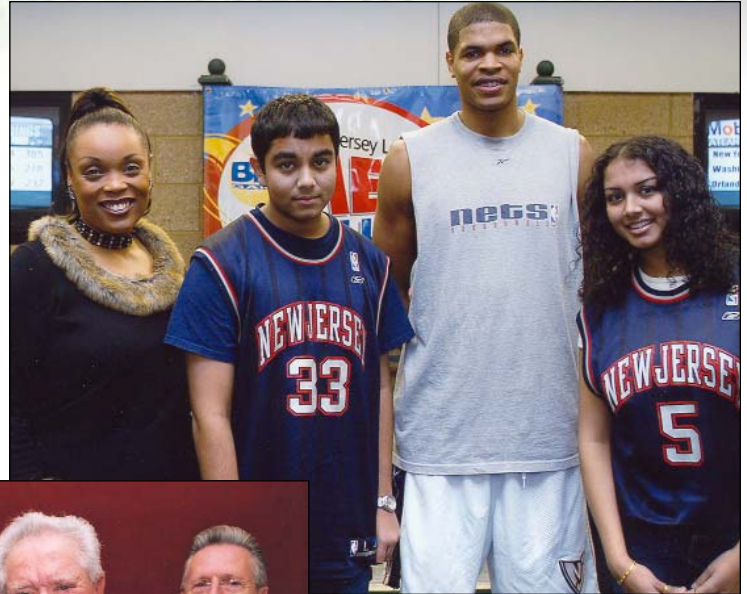
Governor James E. McGreevey speaking at "A Garden State Salute" featuring Ray Charles on November 7, 2002.

\$13 BILLION AND GROWING TO BENEFIT

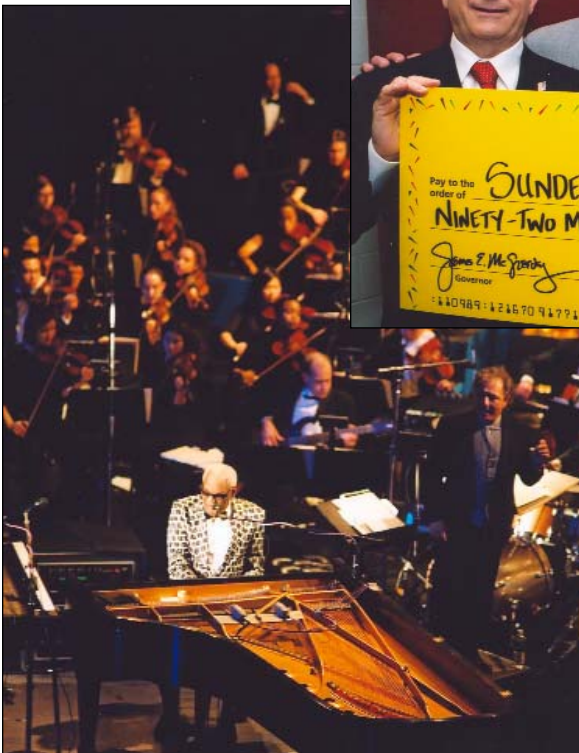
A YEAR IN PHOTOS



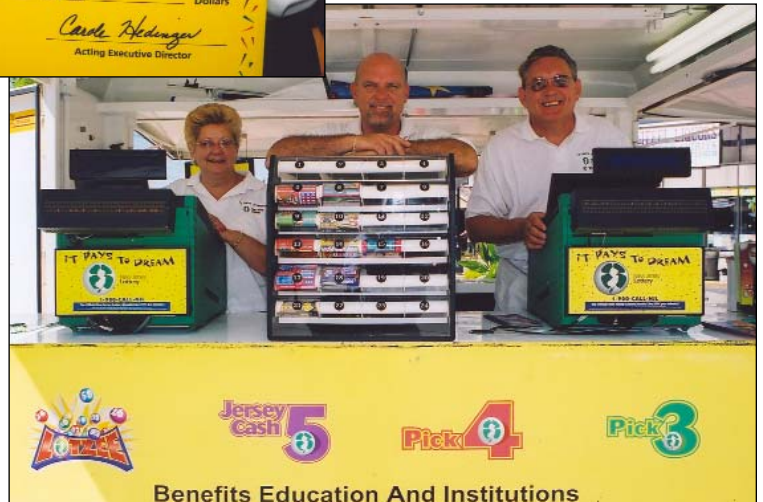
Mort Walker, the creator of Beetle Bailey and Sarge visit the Menlo Park Veteran's Home.



NJ Lottery Hostess Renai Ellison and NJ Nets player Tamar Slay with representatives of House of Liquors in Parlin at a NJ Lottery Retailer Night.



Ray Charles plays alongside the Rutgers Symphony Orchestra and the Rutgers Jazz Ensemble at "A Garden State Salute".



XXXXX, Bob Ptaszenski and Ken Inman working behind the Lottery trailer at a Lionel Trains Instant Ticket Promotion in Red Bank, NJ.

THE PEOPLE OF THE GARDEN STATE.

PICK 3, PICK 4 AND JERSEY CASH 5



Pick 3 (originally dubbed Pick-It) was first introduced on May 22, 1975 and astonished Lottery officials with its instant success among players. The game was originally slated for a six-month trial period, but in just five months, recorded sales of nearly \$18 million. Almost three decades later, the game has generated \$10.6 billion in sales, with \$467.6 million this past fiscal year.

With the foundation laid by the success of the Pick 3 game, Lottery officials introduced the Pick 4 on June 9, 1977. The weekly Pick 4 game was designed to produce larger prizes with higher odds of winning in comparison to the daily Pick 3. Although payouts have evolved over the years, the characteristics of the Pick 4 game remain the same. The game is still only \$.50 per bet, and the straight and combination features still remain. The Pick 4 has remained a steady favorite among players, amassing \$266.1 million in sales and returning \$111.8 million to the state in FY '03, and \$2.1 billion since its introduction.

The games were enhanced by a "Bonus Match" feature where players were given the chance to win up to \$250 instantly by selecting an extra set of potentially winning numbers. The game feature enabled combined sales of over \$733 million for Pick 3 and Pick 4. This represented a dual increase of 3%.



The New Jersey Lottery introduced Jersey Cash 5 on September 30, 1992, the game featured cash prizes in an easy to play five-digit numbers game, which allowed players to choose five numbers from a field of 38. With a field of 38 numbers, the Jersey Cash 5 offered lottery players a greater chance at winning than similar five digit games in neighboring states.

Previously drawn every weekday, Jersey Cash 5 players can now win the big money every day. Sales from Jersey Cash 5 exceeded projections and amounted to \$68.2 million in FY '03, but more importantly, since its inception Jersey Cash 5 has contributed more than \$403.5 million to state programs. The game was aided by a doubling of prize values every weekend in November. During the promotion, the Jersey Cash 5 Saturday and Sunday draw sales increased more than 70%, and the average weekly sales increased almost 20% during the month of November. Average weekday draw sales also increased by more than three-percent. Overall, the promotion resulted in JC5 players winning \$2.0 million (double payout) and retailers earning over \$116,000 in additional JC5 commissions.

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LOTZEE, PICK 6 AND INSTANTS



Since its inception, the Pick 6 Lotto has generated \$7.06 billion in sales, paid out \$3.53 billion to winners and returned more than \$2.96 billion to state education and institutions.

Pick 6 Lotto, which made its first millionaire in 1981, turned out 16 millionaires in fiscal year '03. With sales totaling \$127.2 million, and returns to the state equaling \$53.4 million, the Pick 6 Lotto once again established itself as one of the Lottery's premier games.

As one of the first six digit games in the industry, New Jersey's Pick 6 Lotto has continually produced a high level of return and evolved to maintain player interest. Plans are underway to continue to make the game attractive to our players.



In 1998, at a time when instant games were becoming more popular, New Jersey Lottery officials sought to design a new "Green Machine" game that played just like an instant. The result was Lotzee, a game that offered players 63 ways to win on each \$2.00 ticket and served as the first game of its kind in the industry.

Lotzee's top prize tier offered players a chance at \$500,000 for correctly matching all four numbers within that prize tier. Players also could win by matching all four numbers in other tiers worth \$100,000 or \$50,000. Smaller prizes also were offered to players who matched three or two numbers in any set.



New Jersey's instant games once again proved to be one of the most popular lottery products in the country. Total sales from instant tickets were a record \$901 million. The 16.5% increase over the previous year was well above the national average of 11.7% among lotteries with instant games.

New Jersey's instant tickets were responsible for contributing \$241.5 million to state education and institutions. Additionally, a record \$581 million was paid out in cash and prizes to instant winners.

In fiscal year 2003, 53 new instant games, ranging in prices from \$1 to \$10, were introduced. Among the most often purchased were: *I Love Lucy*, *Wheel of Fortune*, *Crossword* and *Win For Life*. In addition, a version of the popular Internet game *Slingo* was introduced as an instant game in the spring and proved to be very popular. At the same time, second chance drawings on games like *Wheel of Fortune* and *Harley Davidson* offered players the opportunity to win lucrative prizes and trips.

MANAGEMENTS DISCUSSION AND ANALYSIS

FISCAL YEARS 2003 AND 2002

INTRODUCTION:

The following discussion and analysis provides an analytical overview of the financial position and activities of the New Jersey State Lottery (The Lottery) for the years ended June 30, 2003 and 2002. This statement was prepared by management and should be read in conjunction with the financial statements and notes here to, which follow this section.

The Lottery was established in 1970 pursuant to the "State Lottery Law," N.J.S.A. 5:9-1, et seq. The Lottery operates within the Department of Treasury of the State of New Jersey. The New Jersey Lottery Commission is a seven member board, appointed by the Governor, authorized and empowered to promulgate rules and regulations in the operation of the Lottery. The "State Lottery Law" also mandates that a minimum of 30% of gross revenues from ticket sales be allocated for Contributions to Education and State Institutions.

The Lottery licenses over 6,000 retailers throughout the State of New Jersey to act as agents in the sale of New Jersey Lottery tickets. Lottery retailers receive compensation in the form of commissions on each ticket sold or validated. The Lottery also contracts with various ticket vendors in the production, distribution and management of lottery products.

- Gtech Corporation is contracted to provide ticket sales through the on-line terminal network and the warehousing and distribution of instant tickets and promotional materials.
- Creative Games, Pollard Bank Note and Scientific Games, are contracted to print and support instant game products.
- Verizon Communications is contracted to provide digital communication between the Lottery's 6,000 sales terminals and the Gtech data center.

The Lottery offers various products for sale with prize awards ranging from \$2.00 to Annuity prizes in excess of \$100 million. The various products sold are:

- Instant Games
- Pick 3
- Pick 4
- Jersey Cash 5
- Pick 6 Lotto
- Lotzee
- Mega Millions (formerly The Big Game)

FINANCIAL HIGHLIGHTS:

The Lottery's financial position at June 30, 2003 and 2002 consisted of total assets of \$1.214 billion and \$1.242 billion, respectively, and total liabilities of \$1.196 billion and \$1.213 billion, respectively. A substantial portion of the asset and liability numbers is due to the Lottery's annuity investment in prize awards. The total amount invested and due to Lottery winners as future installment payments at June 30, 2003 and 2002 was \$1.039 billion and \$1.111 billion, respectively. Net assets decreased \$11 million in fiscal year 2003 and increased \$21 million in fiscal year 2002 as a result of its operating and nonoperating activities, which are summarized as follows (in millions):

| | <u>FY '03</u> | <u>FY '02</u> | <u>FY '01</u> |
|---|----------------|---------------|---------------|
| Total Operating Revenues | \$2,113 | \$2,098 | \$1,838 |
| Total Operating Expenses | <u>1,361</u> | <u>1,326</u> | <u>1,150</u> |
| Operating Income | 752 | 772 | 688 |
| Nonoperating Revenues | <u>2</u> | <u>3</u> | <u>6</u> |
| Income Before Contributions | 754 | 775 | 694 |
| Operating Transfers-State contributions | <u>765</u> | <u>754</u> | <u>697</u> |
| Change in net assets | <u>\$ (11)</u> | <u>\$ 21</u> | <u>\$ (3)</u> |

The \$11 million decrease in net assets in fiscal year 2003 is a result of the transfer of unclaimed prize awards, which are restricted to fund either future prizes or state contributions. The \$21 million increase in net assets in fiscal year 2002 was a result of an increase in forfeited prizes.

FINANCIAL STATEMENTS:

The Lottery's financial statements include Statements of Net Assets as of June 30, 2003 and 2002, Statements of Revenues, Expenses, and Changes in Net Assets for the years ended June 30, 2003 and 2002, and Statements of Cash Flows for the years ended June 30, 2003 and 2002. The financial statements are prepared in accordance with the accounting principles established by the Governmental Accounting Standards Board (GASB).

Statement of Net Assets:

The statement of net assets presents the Lottery's financial position as of the last day of the fiscal year. The Lottery's assets, liabilities and net assets are summarized as follows (in millions):

| | <u>FY '03</u> | <u>FY '02</u> | <u>FY '01</u> |
|-------------------------------|---------------|---------------|---------------|
| Current Assets | \$ 340 | \$ 297 | \$ 321 |
| Long Term Annuity Investments | <u>874</u> | <u>945</u> | <u>1,005</u> |
| Total Assets | <u>1,214</u> | <u>1,242</u> | <u>1,326</u> |
| Current Liabilities | 321 | 267 | 312 |
| Noncurrent Liabilities | <u>875</u> | <u>946</u> | <u>1,006</u> |
| Total Liabilities | <u>1,196</u> | <u>1,213</u> | <u>1,318</u> |
| Restricted Net Assets | 15 | 26 | 8 |
| Unrestricted Net Assets | <u>3</u> | <u>3</u> | <u>-</u> |
| Total Net Assets | <u>\$ 18</u> | <u>\$ 29</u> | <u>\$ 8</u> |

Current assets consist of cash, investment in the State of New Jersey Cash Management Fund, accounts receivable, current year annuity investments and prepaid expenses. The investment in the State Cash Management Fund

\$ 13 BILLION AND GROWING TO BENEFIT

MANAGEMENTS DISCUSSION AND ANALYSIS

FISCAL YEARS 2003 AND 2002

totaled \$140 million and \$99 million as of June 30, 2003 and 2002, respectively.

The Lottery funds long term installment prizes with insurance company annuities and United States Treasury securities. The total value of these investments was \$1.04 and \$1.11 billion as of June 30, 2003 and 2002, respectively. The Lottery has annuity investments with thirteen (13) insurance companies. The total market value of the United States Treasury securities was \$25.7 million and \$25.6 million as of June 30, 2003 and 2002, respectively. The annuity prizes due in fiscal years 2005 and beyond totaled \$874 million and represented the noncurrent assets reported on the Lottery's Statement of Net Assets.

Current liabilities consist of unpaid prizes awards, accounts payable and outstanding contribution due to the State of New Jersey General Fund. The total unpaid prizes due and payable totaled \$52 million and \$59 million as of June 30, 2003 and 2002, respectively. There is also \$165 million due to annuity winners in the fiscal year 2004.

Noncurrent liabilities represent annuity prizes due in fiscal years 2005 and beyond and the total due for unused vacation and sick leave.

Net assets represent the excess of the Lottery's assets over its liabilities and are summarized as follows (in millions):

| | <u>FY '03</u> | <u>FY '02</u> | <u>FY '01</u> |
|-----------------------------------|---------------|---------------|---------------|
| Restricted (Expired Prize Awards) | \$ 15 | \$ 26 | \$ 8 |
| Unrestricted | <u>3</u> | <u>3</u> | <u>-</u> |
| Total Net Assets | <u>\$ 18</u> | <u>\$ 29</u> | <u>\$ 8</u> |

Expired prizes are restricted to fund either future prizes or state contributions.

Statement of Revenues, Expenses and Changes in Net Assets:

The results of the Lottery's operations are presented in the Statement of Revenues, Expenses and Changes in Net Assets, which is summarized (in millions) as follows for the years ended June 30:

| | <u>FY '03</u> | <u>FY '02</u> | <u>FY '01</u> |
|--------------------------|---------------|---------------|---------------|
| Ticket Sales | \$2,074 | \$2,068 | \$1,807 |
| Forfeited Prizes | 38 | 29 | 29 |
| Miscellaneous Income | <u>1</u> | <u>1</u> | <u>2</u> |
| Total Operating Revenues | <u>2,113</u> | <u>2,098</u> | <u>1,838</u> |
| Prize Awards | 1,171 | 1,145 | 995 |
| Administrative Expenses | 22 | 23 | 18 |
| Agent Commissions | 115 | 113 | 99 |
| Vendor Fees | 40 | 38 | 31 |
| Network Fees | <u>13</u> | <u>7</u> | <u>7</u> |
| Total Operating Expenses | <u>1,361</u> | <u>1,326</u> | <u>1,150</u> |

| | <u>FY '03</u> | <u>FY '02</u> | <u>FY '01</u> |
|--|----------------|---------------|---------------|
| Operating Income | 752 | 772 | 688 |
| Investment Income | <u>2</u> | <u>3</u> | <u>6</u> |
| Income Before Contributions | 754 | 775 | 694 |
| Operating Transfers - State Contributions | <u>765</u> | <u>754</u> | <u>697</u> |
| Change in Net Assets | <u>\$ (11)</u> | <u>\$ 21</u> | <u>\$ (3)</u> |

The Lottery awarded over \$1.171 billion in prize awards in fiscal year 2003 and over \$1.144 billion in fiscal year 2002. Over 88 million winning tickets were validated and paid in fiscal year 2003 while over 79 million winning tickets were validated and paid in fiscal year 2002.

Lottery vendors provide critical services to the Lottery including the production, warehousing, distribution and accounting for all lottery tickets. The total compensation paid for lottery vendors and network fees was \$52.5 million in fiscal year 2003 and \$44.9 million in fiscal year 2002.

The Lottery's administrative expenses for fiscal years 2003 and 2002 totaled \$22.3 million and \$22.7 million, respectively. These administrative expenses include salaries, advertising, auditing services, rent, security, data processing services, office supplies and attorney general fees.

The Lottery is required by State of New Jersey law to contribute at least 30% of total revenue to the State of New Jersey for Education and State Institutions. As a result of various sales initiatives, game enhancements and efficient operations, the Lottery contributed over \$765 million, 36.2% of total revenue in fiscal year 2003 and over \$755 million, 36% of total revenue in fiscal year 2002.

SUMMARY AND OUTLOOK:

The Lottery continues its position as a major revenue source for the State of New Jersey. Lottery revenue funds various educational and institutional programs throughout the state.

Lottery management will continue to monitor its product mix to maintain player interest. Various programs such as "double draw", "double payout" and "free play coupons" have proven to be successful in maintaining this interest. Management will also monitor prize payout percentages and drawing odds in order to achieve an effective mix, which will be both beneficial to players and state contributions.

INDEPENDENT AUDITORS' REPORT



Princeton Pike Corporate Center
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Commissioners of the New Jersey State Lottery Commission:

We have audited the accompanying statements of net assets of the New Jersey State Lottery Commission (the Commission), as of June 30, 2003 and 2002 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 Commission'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Commission and do not purport to, and do not, present fairly the financial position of the State of New Jersey as of June 30, 2003 and 2002, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the New Jersey State Lottery Commission as of June 30, 2003 and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The combined statements of revenues, expenses, and changes in net assets for the cumulative 366 months ended June 30, 2001, and the cumulative 390 months ended June 30, 2003, were not audited by us and accordingly, we do not express an opinion on them.

KPMG LLP

September 19, 2003

\$13 BILLION AND GROWING TO BENEFIT

STATEMENTS OF NET ASSETS

JUNE 30, 2003 AND 2002

| | Fiscal Year 2003 | Fiscal Year 2002 |
|--|-------------------------|-------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash | \$ 2,009,197 | \$ 513,748 |
| Accounts Receivable, net of allowance for doubtful accounts of \$150,000 in 2003 and 2002 | 20,566,151 | 19,519,004 |
| Other Assets | 11,861,099 | 12,412,233 |
| Investments: | | |
| Deposit Fund Contracts - current portion (note 2) | 164,801,704 | 165,708,704 |
| State Of New Jersey Cash Management Fund | 140,313,400 | 99,284,467 |
| Total Current Assets | 339,551,551 | 297,438,156 |
| Non Current Assets: | | |
| Investments: | | |
| Deposit Fund Contracts (note 2) | 874,227,407 | 944,904,514 |
| Total Non Current Assets | 874,227,407 | 944,904,514 |
| Total Assets | \$ 1,213,778,958 | \$ 1,242,342,670 |
| LIABILITIES | | |
| Current Liabilities: | | |
| Accounts Payable and Accrued Expenses | \$ 19,432,721 | \$ 26,819,156 |
| Obligation for Unpaid Prize Awards | 52,406,969 | 59,359,092 |
| Current Year Installment Prize Awards | 164,801,704 | 165,708,704 |
| Due To State Of New Jersey - Education & Institutions | 84,401,159 | 15,549,833 |
| Total Current Liabilities | 321,042,553 | 267,436,785 |
| Non Current Liabilities: | | |
| Compensated Absences | 797,047 | 872,089 |
| Installment Prize Awards | 874,227,407 | 944,904,514 |
| Total Non Current Liabilities | 875,024,454 | 945,776,603 |
| Total Liabilities | \$ 1,196,067,007 | \$ 1,213,213,388 |
| NET ASSETS | | |
| Unrestricted | \$ 2,771,534 | \$ 2,771,534 |
| Restricted | 14,940,417 | 26,357,748 |
| Total Net Assets | \$ 17,711,951 | \$ 29,129,282 |

See accompanying notes to financial statements

COMPARATIVE STATEMENTS

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

| | Cumulative 366 Months *Ended June 30, 2001 | 12 Months Ended June 30, 2002 | 12 Months Ended June 30, 2003 | Cumulative 390 Months *Ended June 30, 2003 | % |
|--|---|-------------------------------------|-------------------------------------|---|----------------|
| OPERATING REVENUES: | | | | | |
| GROSS SALES | \$ 27,929,822,024 | \$ 2,068,506,868 | \$ 2,073,824,348 | \$ 32,072,153,240 | 98.74% |
| FORFEITED PRIZES | 328,364,270 | 28,842,236 | 38,517,867 | 395,724,373 | 1.22% |
| MISCELLANEOUS INCOME | 11,649,232 | 904,236 | 661,374 | 13,214,842 | 0.04% |
| TOTAL OPERATING REVENUES | 28,269,835,526 | 2,098,253,340 | 2,113,003,589 | 32,481,092,455 | 100.00% |
| OPERATING EXPENSES: | | | | | |
| PRIZE EXPENSE | 14,302,147,447 | 1,144,736,660 | 1,171,456,861 | 16,618,340,968 | 51.16% |
| COMMISSION TO AGENTS & BANKS | 1,525,273,657 | 113,440,214 | 114,820,488 | 1,753,534,359 | 5.40% |
| ADMINISTRATIVE EXPENSES | 395,505,549 | 22,742,189 | 22,305,736 | 440,553,474 | 1.36% |
| VENDOR FEES | 463,784,434 | 37,703,888 | 39,917,717 | 541,406,039 | 1.67% |
| COURIER COLLECTION FEE | 12,235,328 | - | - | 12,235,328 | 0.04% |
| ON LINE NETWORK FEES | 42,392,942 | 7,247,920 | 12,555,061 | 62,195,923 | 0.19% |
| START UP COSTS | 686,137 | - | - | 686,137 | 0.00% |
| MULTI STATE FEES | 44,145 | 51,418 | 16,831 | 112,394 | 0.00% |
| PROVISION FOR DOUBTFUL ACCOUNTS | 299,896 | - | - | 299,896 | 0.00% |
| TOTAL OPERATING EXPENSES | 16,742,369,535 | 1,325,922,289 | 1,361,072,694 | 19,429,364,518 | 59.82% |
| OPERATING INCOME | 11,527,465,991 | 772,331,051 | 751,930,895 | 13,051,727,937 | 40.18% |
| NON OPERATING REVENUE | | | | | |
| INVESTMENT INCOME | 79,508,323 | 3,200,150 | 2,052,933 | 84,761,406 | 0.26% |
| TOTAL | 79,508,323 | 3,200,150 | 2,052,933 | 84,761,406 | 0.26% |
| INCOME BEFORE CONTRIBUTIONS | 11,606,974,314 | 775,531,201 | 753,983,828 | 13,136,489,343 | 40.44% |
| CONTRIBUTIONS FOR AID TO EDUCATION AND STATE INSTITUTIONS | 11,598,826,400 | 754,549,833 | 765,401,159 | 13,118,777,392 | 40.97% |
| CHANGE IN NET ASSETS | 8,147,914 | 20,981,368 | (11,417,331) | 17,711,951 | 0.05% |
| NET ASSETS, BEGINNING OF PERIOD | - | 8,147,914 | 29,129,282 | - | - |
| NET ASSETS, END OF PERIOD | \$ 8,147,914 | \$ 29,129,282 | \$ 17,711,951 | \$ 17,711,951 | 0.05% |

See accompanying notes to financial statements.

*Figures not covered by independent auditor's report.

\$13 BILLION AND GROWING TO BENEFIT

STATEMENTS OF CASH FLOWS

FOR FISCAL YEARS ENDED JUNE 30, 2003 AND 2002

| | FISCAL YEAR 2003 | FISCAL YEAR 2002 |
|---|---------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Current Operations: | | |
| Sales to Customers | \$ 1,079,567,156 | \$ 1,155,641,151 |
| Payments for Prize Awards | (295,827,721) | (330,377,661) |
| Payments for Commissions and Vendor Fees | (52,809,080) | (47,509,563) |
| Payments for Bond Insurance | (452,921) | (483,360) |
| Payments to Suppliers | (26,541,810) | (15,119,193) |
| Other Payments | (43,604) | (43,634) |
| Annuity Operations: | | |
| Annuity Award Receipts | 168,452,204 | 169,908,079 |
| Annuity Award Purchases | (13,276,579) | (25,397,712) |
| Annuity Prize Payments | (122,046,363) | (122,556,316) |
| Net cash provided by operations | 737,021,282 | 784,061,791 |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES | | |
| Contributions for aid to Education and State Institutions | (696,549,833) | (816,397,293) |
| Net cash used by noncapital financing activities | (696,549,833) | (816,397,293) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Cash Management Fund Sales | 998,049,000 | 1,118,893,000 |
| Cash Management Fund Purchases | (1,037,025,000) | (1,087,455,000) |
| Net cash provided by (used in) investing activities | (38,976,000) | 31,438,000 |
| Net Increase (Decrease) in Cash | 1,495,449 | (897,502) |
| Cash July 1 | 513,748 | 1,411,250 |
| Cash June 30 | \$ 2,009,197 | \$ 513,748 |
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | |
| Operating Income | \$ 751,930,895 | \$ 772,331,051 |
| Net Changes in Assets and Liabilities: | | |
| Accounts Receivable | (1,047,147) | (3,820,541) |
| Investments: deposit fund contracts | 71,584,107 | 61,040,922 |
| Other Assets | 551,134 | (2,469,322) |
| Accounts Payable and Accrued Expenses | (7,386,435) | 5,860,565 |
| Obligation for Unpaid Prize Awards | (78,536,230) | (48,934,022) |
| Compensated Absences | (75,042) | 53,138 |
| Net cash provided by operating activities | \$ 737,021,282 | \$ 784,061,791 |

See accompanying notes to financial statements.

NEW JERSEY STATE LOTTERY COMMISSION

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003 AND 2002

(1) Summary of Significant Accounting Policies

Reporting Entity

The New Jersey State Lottery Commission (the Commission) was established in 1970 pursuant to the "State Lottery Law," N.J.S.A. 5:9 1, et seq. The Commission operates within the Department of Treasury of the State of New Jersey. The Commission's financial statements are presented as an enterprise fund and include the operations for which the Commission is financially accountable and exercises oversight responsibility. The Commission is authorized and empowered to promulgate rules and regulations regarding the conduct of lottery games, including the price or prices of tickets, the number and size of prizes on winning tickets, the licensing of agents, and the apportionment of ticket revenues.

Basis of Accounting

The Commission prepares its financial statements using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Government Entities that Uses Proprietary Funds*, provides proprietary activities with a choice of authoritative guidance issued after November 30, 1989. The Commission has elected to follow GASB pronouncements exclusively after that date. The following is a summary of other significant accounting policies of the Commission.

Contributions and Prize Awards

The State Lottery Law requires at least 30% of gross revenues from ticket sales to be paid to the State Treasury for aid to education and State institutions. Pursuant to this law, the Commission has also designated all unallocated revenues for aid to education and State institutions. Contributions for the years ended June 30, 2003 and 2002 aggregated \$765,401,159 and \$754,549,833, respectively, of which \$84,401,159 and \$15,549,833 was due to the State Treasury at June 30, 2003 and 2002, respectively.

For online games, the Commission has designated that a minimum of 45% of gross revenues be allocated for prize awards, including agent bonuses. A prize expense is recorded when the winning ticket number is selected for the respective lottery game based on eligible winning tickets sold. For instant games, the percentage of gross revenues to be allocated for prize expense varies by game.

Forfeited Prizes

New Jersey Law requires that prizes not claimed within one year from the date of the drawing are forfeited. 70% of forfeited prizes are to be maintained in a reserve for prize awards and are available to augment future prize awards or, at the discretion of the Executive Director, to augment the Commission's contribution for aid to education and State institutions. The remaining 30% is unrestricted. For the years ended June 30, 2003 and 2002

unclaimed prizes were \$38,517,867 and \$28,842,236, respectively, and are included in other revenues.

Revenue Recognition

Revenues from the sale of lottery tickets are recognized as follows:

- "Pick 3", "Pick 4", "Pick 6 Lotto", "Jersey Cash 5", "Lotzee", and "Mega Millions" (formerly The Big Game) on the drawing date.
- Instant games, daily based upon the settlement of instant game inventory packs by selling agents. Sales adjustments are recorded based upon final reconciliations prepared after the termination of a lottery instant game.
- Sales discounts are recorded for the sales value of tickets provided to agents at no cost for promotional purposes

Commissions and Fees

Agents receive a commission of 5% based on the total tickets sold and a commission of 1.25% of terminal validations. The on line game contractor receives a fee equal to a contractual percentage of the revenue generated through the respective network maintained by the contractor. All other gaming contractors are paid fees based on the units of service provided.

State of New Jersey Cash Management Fund

Investments in the State of New Jersey Cash Management Fund are valued at cost, which approximates fair value. The State of New Jersey Cash Management Fund is a common trust fund administered by the State Department of the Treasury, Division of Investment. Securities in the fund are insured, registered or held by the Division of Investment or its agent in the Commission's name.

Accounts Receivable

Accounts receivable is comprised primarily of amounts due from agents.

Equipment and Inventory

The Commission follows the State's threshold for capitalizing equipment and inventory as follows; machinery and equipment \$20,000; and motor vehicles \$30,000. Purchases that do not meet the threshold for capitalization are recognized as expenses in the statements of revenues, expenses, and changes in net assets in the period in which they are acquired. During 2003 and 2002, there were no capitalized equipment or inventory purchases.

Installment Prize Awards and Prize Expenses

Installment prize awards are recorded based upon the present value of an annuity at terms to yield a series of future payments needed to meet the obligations of the Commission for prize disbursements. The Commission purchases annuity contracts from insurance companies and U.S.

\$ 13 BILLION AND GROWING TO BENEFIT

NEW JERSEY STATE LOTTERY COMMISSION

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2003 AND 2002

Government securities to fund its liability for installment prize awards. Amounts recorded as prize expense reflect the amortization of the present value cost of annuity contracts and U.S. Government securities necessary to satisfy stated prize awards plus any single payment awards.

Vacation and Sick Leave

The Commission records vacation and sick time incurred during the period in administrative expenses in the accompanying statements of revenues, expenses, and changes in net assets.

Payments for accumulated sick leave balances are made to retiring employees upon regular retirement. The payment is based on 50% of the employee's sick leave accumulation, at the pay rate in effect at the time of retirement up to a maximum of \$15,000. Employees separating from service prior to retirement are not entitled to payments for accumulated sick leave.

Use of Estimates

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

(2) Future Installment Prize Awards

The Commission purchases annuity contracts from insurance companies and U.S. Government securities to fund its liability for future installment prize awards. An annuity contract represents an obligation by an insurance company to provide a fixed series of payments over a specified period. U.S. Government securities are carried at fair value. Annuity contracts are carried at their current contract values, which are based upon their original purchase price adjusted for credited interest and amounts already received. Annuity contracts are subject to credit risk. The Commission seeks to control its exposure to such credit risk by purchasing annuity contracts only from insurance companies, which meet certain minimum standards. Such standards include a minimum required claims payment rating from Standard and Poors Corporation, a private rating agency, of at least "AA". However, due to the long term nature of these contracts, the credit quality of the issuer is subject to change. At June 30, 2003 and 2002, the Commission held annuity contracts totaling \$1,013,311,919 and \$1,110,613,218, respectively, issued through thirteen insurance companies, which are due in installments ranging from ten years to the lifetime of the recipient. A significant portion of the Commission's investment in annuity contracts at such date is concentrated among five companies as follows:

- Ohio National Life
- New York Life Insurance Co.
- Mutual of America

- Alexander Hamilton Life Insurance Co.
- Great West Life Assurance Co.

The estimated fair value of annuity contracts approximates the carrying value reflected in the accompanying statements of net assets at June 30, 2003 and 2002. Fair value has been estimated by discounting future cash flows using the current rates of annuity contracts with similar credit ratings and maturities.

(3) Litigation

The Commission is a party to a number of legal actions arising out of the conduct of its business. While the ultimate results of the lawsuits or other proceedings against the Commission cannot be predicted with certainty, management of the Commission does not expect that these matters will have a material adverse effect on the financial position or changes in financial position of the Commission.

(4) Commitments

Contractual Arrangements

The Commission maintains a gaming network of over 6,000 on line locations where all games are sold. GTECH Corporation is responsible for operating the on line games and providing courier services under a contract expiring November 23, 2006.

Operating Leases

The Commission leases certain office facilities under noncancelable operating lease agreements expiring through fiscal year 2005.

Future minimum lease payments are as follows:

| Year ending | Amount |
|------------------------|---------------|
| <u>June 30,</u> | |
| 2004 | \$ 668,650 |
| 2005 | 278,604 |

Rent expense for office facilities in 2003 and 2002 was \$874,337 and \$839,649, respectively.