

**NEW JERSEY STATE LOTTERY COMMISSION**

Financial Statements  
and Supplementary Information

Years Ended June 30, 2005 and 2004

**NEW JERSEY STATE LOTTERY COMMISSION**

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Years Ended June 30, 2005 and 2004

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## INDEPENDENT AUDITORS' REPORT

Commissioners of  
**NEW JERSEY STATE LOTTERY COMMISSION**

We have audited the accompanying statement of net assets of the **NEW JERSEY STATE LOTTERY COMMISSION** (the "Commission") as of June 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the 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, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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** at June 30, 2005 and 2004, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2005 on our consideration of New Jersey State Lottery Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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## INDEPENDENT AUDITORS' REPORT (CONTINUED)

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules included in the supplementary information are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such information, except for the portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

*Mercadier, P.C.*  
*Certified Public Accountants*

October 21, 2005

## Management's Discussion and Analysis

### INTRODUCTION:

The following discussion and analysis provides an analytical overview of the financial position and activities of the New Jersey State Lottery Commission (the "Lottery") for the years ended June 30, 2005 and 2004. This statement was prepared by management and should be read in conjunction with the financial statements and notes hereto, 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 state aid for education and state institutions (N.J.S.A. 5:9-7a (11)).

The Lottery licenses over 6,100 retailers throughout the State of New Jersey to act as retailers 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, Scientific Games and Oberthur Gaming Technologies are contracted to print and support instant game products.
- Verizon Communications is contracted to provide digital communication between the Lottery's 6,100 sales terminals and the Gtech data center.

The Lottery offers various products for sale with prize awards ranging from \$1.00 to annuity prizes in excess of \$100 million. The various products sold are:

- Instant Games
- Pick 3 (Including Pick 3 Instant Match)
- Pick 4 (Including Pick 4 Instant Match)
- Jersey Cash 5
- Pick 6 Lotto
- Mega Millions

## Management's Discussion and Analysis (Continued)

### FINANCIAL HIGHLIGHTS:

The Lottery's financial position at June 30, 2005 and 2004, consisted of total assets of \$1.071 billion and \$1.174 billion, respectively, and total liabilities of \$1.058 billion and \$1.153 billion, respectively. A substantial portion of the asset and liability numbers is due to the Lottery's annuity investment in prize awards. The total amounts invested and due to Lottery winners as future installment payments at June 30, 2005 and 2004, were \$904 million and \$972 million, respectively. Net assets decreased \$7.6 million in fiscal year 2005 as a result of a decrease in unclaimed prize reserves and a decrease in the amount of accrued expenses. Net assets increased \$3 million in fiscal year 2004 as a result primarily of an increase in forfeited prizes.

### FINANCIAL STATEMENTS:

The Lottery's financial statements include Statements of Net Assets as of June 30, 2005 and 2004, Statements of Revenues, Expenses and Changes in Net Assets for fiscal years ended June 30, 2005 and 2004, and Statements of Cash Flows for fiscal years ended June 30, 2005 and 2004. The financial statements are prepared in accordance with the accounting principles established by the Governmental Accounting Standards Board ("GASB").

### Statements of Net Assets:

The statements of net assets present 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):

	June 30,	
	2005	2004
Current Assets	\$ 327	\$ 353
Deposit Fund Contracts	744	821
Total Assets	1,071	1,174
Current Liabilities	313	331
Non-Current Liabilities	745	822
Total Liabilities	1,058	1,153
Restricted Net Assets	10	18
Unrestricted Net Assets	3	3
Total Net Assets	\$ 13	\$ 21

## Management's Discussion and Analysis (Continued)

### Statements of Net Assets: (Continued)

Current assets consist of cash and 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 totaled \$125 million and \$148 million at June 30, 2005 and 2004, respectively.

The Lottery funds long-term installment prizes with insurance company annuities and United States Treasury securities. The total value of these investments was \$904 million and \$972 million as of June 30, 2005 and 2004, respectively. The Lottery has annuity investments with thirteen (13) insurance companies. The total market value of the United States Treasury securities was \$34.4 million and \$31.2 million at June 30, 2005 and 2004, respectively. The annuity prizes due in fiscal years 2007 and beyond totaled \$744 million and represents the non-current assets reported on the Lottery's Statement of Net Assets.

Current liabilities consist of unpaid prize awards, accounts payable and outstanding contributions due to the State of New Jersey General Fund. The total unpaid prizes due and payable totaled \$51 million and \$71 million as of June 30, 2005 and 2004, respectively. There is also \$160 million due to annuity winners in fiscal year 2006.

Non-current liabilities represent annuity prize awards due in fiscal years beyond 2006 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):

	June 30,	
	2005	2004
Restricted (Expired Prize Awards)	\$ 10	\$ 18
Unrestricted	3	3
Total Net Assets	<u>\$ 13</u>	<u>\$ 21</u>

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

### Statements of Revenues, Expenses and Changes in Net Assets:

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

## Management's Discussion and Analysis (Continued)

### Statements of Revenues, Expenses, and Changes in Net Assets: (Continued)

	Year Ended June 30,	
	2005	2004
Operating revenues:		
Ticket sales	\$ 2,274	\$ 2,187
Forfeited prizes	31	43
Miscellaneous income	1	1
Total operating revenue	2,306	2,231
Operating expenses:		
Prize expenses	1,297	1,240
Administrative expenses	28	21
Retailer commissions	126	121
Vendor fees	44	43
Network fees	8	8
Drawing broadcast fees	1	1
Total operating expenses	1,504	1,434
Operating income	802	797
Investment income	2	1
Income before transfers	804	798
Operating transfers - state contributions	812	795
(Decrease) increase in net assets	\$ (8)	\$ 3

The Lottery awarded over \$1.296 billion in prize awards in fiscal year 2005 and approximately \$1.240 in fiscal year 2004. Approximately 95 million winning tickets were validated and paid in fiscal year 2005, while over 91 million winning tickets were validated and paid in fiscal year 2004.

The Lottery's vendors provided critical services to the Lottery, including the production, warehousing, distribution and accounting for all lottery tickets. The total compensation paid for the Lottery's vendors and network fees was \$52.0 million in fiscal year 2005 and \$50.8 million in fiscal year 2004. Drawing broadcast fees were \$1,141,540 in fiscal year 2005 and \$1,141,555 in fiscal year 2004.

The Lottery's administrative expenses for the fiscal years 2005 and 2004 totalled \$27.5 million and \$21.1 million, respectively. These administrative expenses include salaries, advertising, auditing services, rent, security, data processing services, office supplies and attorney general fees. The majority of the increase in administrative expenses for fiscal year 2005 was for advertising.

## Management's Discussion and Analysis (Continued)

### Statements of Revenues, Expenses, and Changes in Net Assets: (Continued)

The Lottery is required by State of New Jersey law to contribute at least 30% of gross revenues from ticket sales to be paid to the State of New Jersey Treasury for state aid for education and state institutions. As a result of various sales initiatives, game enhancements and efficient operations, the Lottery contributed \$812 million, 35.2% of total revenues, in fiscal year 2005 and \$795 million, 35.6% of total revenues, in fiscal year 2004.

### Statements of Cash Flows:

Below are the statements of cash flows, which are summarized (in millions) as follows:

	Year Ended June 30,	
	2005	2004
Cash flows from operating activities	\$ 796	\$ 796
Cash flows used in non-capital financing activities	(822)	(790)
Cash flows provided by (used in) investing activities	26	(7)
Net decrease in cash	\$ -	\$ (1)

### 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. To this end, the following programs and products have proven to be successful in maintaining this interest:

- Free play coupons
- Pick 3 "Green Ball"
- Free raffle tickets with purchase of various games

Management will also monitor prize payout percentages and drawing odds in order to achieve an effective mix, which will be beneficial both to players and to the State contributions.

**NEW JERSEY STATE LOTTERY COMMISSION**

**STATEMENTS OF NET ASSETS**

	June 30,	
	<u>2005</u>	<u>2004</u>
<b>ASSETS</b>		
Current Assets:		
Cash	\$ 521,666	\$ 616,215
Accounts receivable, net of allowance for doubtful accounts of \$150,000 in 2005 and 2004	27,346,355	39,149,762
Investments:		
Deposit fund contracts	160,286,504	150,691,304
State of New Jersey Cash Management Fund	124,740,315	148,134,843
Other assets	14,889,807	14,203,750
Total current assets	<u>327,784,647</u>	<u>352,795,874</u>
Non-current assets:		
Investments - deposit fund contracts	<u>743,996,848</u>	<u>821,629,480</u>
Total assets	<u>1,071,781,495</u>	<u>1,174,425,354</u>
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts payable and accrued expenses	22,821,118	20,512,711
Obligation for unpaid prize awards	50,783,599	70,689,336
Installment prize awards	160,286,504	150,691,304
Due to State of New Jersey - education and state institutions	79,546,973	88,971,914
Total current liabilities	<u>313,438,194</u>	<u>330,865,265</u>
Non-current liabilities:		
Compensated absences	876,398	828,951
Installment prize awards	743,996,848	821,629,480
Total non-current liabilities	<u>744,873,246</u>	<u>822,458,431</u>
Total liabilities	<u>1,058,311,440</u>	<u>1,153,323,696</u>
<b>NET ASSETS</b>		
Restricted for prize awards or contributions for aid to education and state institutions	10,698,521	18,330,124
Unrestricted	2,771,534	2,771,534
Total net assets	<u>\$ 13,470,055</u>	<u>\$ 21,101,658</u>

## NEW JERSEY STATE LOTTERY COMMISSION

### STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended June 30,	
	2005	2004
Operating revenues:		
Ticket Sales		
Pick 3	\$ 456,582,545	\$ 452,462,474
Pick 4	265,003,920	261,852,496
Jersey Cash 5	123,253,335	115,426,263
Pick 6 Lotto	109,983,537	130,774,560
Lotzee	-	2,951,240
Mega Millions	253,408,054	251,295,751
Instant games	1,066,130,914	973,632,996
Sales discounts	(556,188)	(1,725,985)
Total ticket sales	2,273,806,117	2,186,669,795
Other revenues:		
Forfeited prizes	30,662,853	42,984,774
Miscellaneous	1,247,318	1,382,932
Total operating revenues	2,305,716,288	2,231,037,501
Operating expenses:		
Prize expenses	1,296,810,791	1,239,739,587
Administrative expenses	27,492,371	21,083,924
Retailer commissions	126,248,659	120,998,201
On-line vendor fees	29,924,546	28,657,699
Instant vendor fees	14,340,331	14,103,584
Multi-state fees	16,852	24,083
On-line network fees	7,759,214	8,053,690
Drawing broadcast fees	1,141,540	1,141,555
Amortization expense	2,086	-
Total operating expenses	1,503,736,390	1,433,802,323
Operating income	801,979,898	797,235,178
Non-operating revenue:		
Interest	2,435,472	1,126,443
Income before transfers out	804,415,370	798,361,621
Transfers out - contributions for state aid to education and state institutions	812,046,973	794,971,914
Change in net assets	(7,631,603)	3,389,707
Net assets, beginning of year	21,101,658	17,711,951
Net assets, end of year	\$ 13,470,055	\$ 21,101,658

See accompanying notes to financial statements

**NEW JERSEY STATE LOTTERY COMMISSION**

**STATEMENTS OF CASH FLOWS**

	Year Ended June 30,	
	2005	2004
Cash flows from operating activities:		
Sales to customers	\$ 1,174,590,351	\$ 1,134,667,315
Payments for prize awards	(326,209,724)	(289,215,390)
Payments for vendor commissions and fees	(50,052,629)	(53,828,028)
Payments for bond issuance	-	(597)
Payments to suppliers	(20,614,419)	(22,097,230)
Other payments	(341,701)	(7,139)
Cash flows from annuity operations:		
Annuity receipts	164,104,704	166,328,612
Purchases of annuities	(26,503,851)	(17,434,881)
Payments of annuity prizes	(119,425,366)	(122,709,485)
Net cash provided by operations	795,547,365	795,703,177
Cash flows used in non-capital financing activities:		
Contributions for aid to education and state institutions	(821,471,914)	(790,401,159)
Cash flows from investing activities:		
Cash Management Fund Proceeds	1,106,480,000	1,049,055,000
Cash Management Fund Purchases	(1,080,650,000)	(1,055,750,000)
Net cash provided by (used in) investment activities	25,830,000	(6,695,000)
Net decrease in cash	(94,549)	(1,392,982)
Cash, beginning of year	616,215	2,009,197
Cash, end of year	\$ 521,666	\$ 616,215
Reconciliation of operating income to net cash provided by operating activities:		
Operating Income	\$ 801,979,898	\$ 797,235,178
Changes in assets and liabilities:		
Accounts receivable	11,803,407	(18,583,611)
Investments - deposit fund contracts	68,037,432	66,708,327
Other assets	(686,057)	(2,342,651)
Accounts payable and accrued expenses	2,308,407	1,079,990
Obligation for unpaid prize awards	(87,943,169)	(48,425,960)
Compensating absences	47,447	31,904
Net cash provided by operating activities	\$ 795,547,365	\$ 795,703,177

# NEW JERSEY STATE LOTTERY COMMISSION

## NOTES TO FINANCIAL STATEMENTS

### A. 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 those of 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 retailers (vendors), 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 Use 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.

#### **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 state aid for 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, 2005 and 2004, aggregated \$812,046,973 and \$794,971,914, respectively, of which \$79,546,973 and \$88,971,914 was due to the State Treasury at June 30, 2005 and 2004, respectively.

The Commission has designated that a minimum of 45% of gross revenues be allocated for prize awards, including retailer bonuses. 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 awards varies by game.

## NEW JERSEY STATE LOTTERY COMMISSION

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

#### A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### **Forfeited Prizes**

The State Lottery Law requires that prizes not claimed within one year from the date of the drawing be forfeited and be included in other revenues during the period forfeited. Effective November 21, 1991, the Commission authorized that 70% of forfeited prizes are to be maintained in a reserve for prize awards. Such funds 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. For the years ended June 30, 2005 and 2004, unclaimed prizes were \$30,662,853 and \$42,984,774, respectively.

##### **Revenue Recognition**

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

- "Pick-3", "Pick-4," "Pick-6 Lotto," "Jersey Cash 5," and "Mega Millions" are recognized on the drawing date.
- Instant games are recognized daily, based upon the settlement of instant game inventory packs by selling retailers. 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 retailers at no cost to be used for promotional purposes.

##### **Commissions and Fees**

Retailers 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.

##### **Cash**

For the purpose of the statements of cash flows, cash includes unrestricted time deposits and highly liquid debt instruments with original maturities of three months or less.

##### **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.

## NEW JERSEY STATE LOTTERY COMMISSION

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

#### A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### **Accounts Receivable**

Accounts receivable is comprised primarily of amounts due from retailers. The reserve for uncollectible accounts is funded by a \$100 per year bonding fee paid by the Commission's retailers. The reserve also comprises an allowance for uncollectible accounts of \$150,000 and a designated net assets cash reserve of \$500,000.

##### **Equipment**

The Commission follows the State's threshold for capitalizing equipment as follows: machinery and equipment over \$20,000 and motor vehicles over \$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 during which they are acquired and are included in administrative expenses. During 2004, there were no capitalized equipment purchases. In June 2005, the Commission recorded leasehold improvements to other assets in the amount of \$202,344. The amortization expense for the month of June 2005 was \$2,086.

##### **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. government securities to fund its liability for installment prize awards. Amounts recorded as "prize expense" reflect the 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.

##### **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 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.

## NEW JERSEY STATE LOTTERY COMMISSION

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

#### B. CASH AND INVESTMENTS

Deposits are with contracted depository banks in interest-bearing accounts which are insured under the Government Unit Deposit Protection Act ("GUDPA") of the State of New Jersey. All such deposits are held in the Commission's name.

GUDPA permits the deposit of public funds into the State of New Jersey Cash Management Fund or into institutions located in New Jersey which are insured by the Federal Deposit Insurance Corporation ("FDIC"), or by any other agencies of the United States that insure deposits.

GUDPA requires public depositories to maintain collateral for deposits of public funds that exceed insurance limits as follows:

The market value of the collateral must equal 5% of the average daily balance of public funds; or, if the public funds deposited exceed 75% of the capital funds of the depository, the depository must provide collateral having a market value equal to 100% of the amount exceeding 75%.

All collateral must be deposited with the Federal Reserve Bank, the Federal Home Loan Bank Board, or a banking institution that is a member of the Federal Reserve System and has capital funds of not less than \$25,000,000.

Uninsured and uncollateralized deposits are covered under the unit certificate of eligibility, as required by GUDPA.

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.

#### **Custodial Credit Risk**

Custodial credit risk is the risk that, in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. Since the New Jersey Cash Management Fund balance is a pooled investment and the cash balance is covered under GUDPA, the Commission's cash and investments are not subject to custodial credit risk under GASB Statement No. 40.

## NEW JERSEY STATE LOTTERY COMMISSION

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

#### C. 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. Generally, annuity contracts fund instant product annuity prizes, and U.S. government securities fund annuity prizes for Pick 6 and Mega Millions. 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. At June 30, 2005 and 2004, the Commission held U.S. government securities totaling \$34,387,398 and \$31,238,581, respectively.

Annuity contracts are carried at their current contract values, which are based upon their original purchase prices 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 that 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. As of June 30, 2005 three companies had ratings under "AA". At June 30, 2005 and 2004, the Commission held insurance company annuity contracts totaling \$904,283,352 and \$972,320,784, 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 eight companies as follows:

- Ohio National Life
- New York Life Insurance Co.
- Mutual of America
- Protective Life
- Metropolitan Life
- Keyport Life / Sun Life
- Alexander Hamilton Life Insurance Co. (Jefferson Pilot)
- Great West Life

The estimated fair value of annuity contracts approximates the carrying value reflected in the accompanying statements of net assets at June 30, 2005 and 2004.

#### **Concentrations of Credit Risk**

"Concentration of Credit Risk" is the risk that relates to the amount of investment at any one entity. The disclosure requirement of this risk factor is limited to investments in excess of 5% of the total. Guaranteed annuity contracts are the only category subject to concentration of credit risk disclosure.

NEW JERSEY STATE LOTTERY COMMISSION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

**D. 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 results of operations of the Commission.

**E. COMMITMENTS**

**Contractual Arrangements**

The Commission maintains a gaming network of over 6,100 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 June 20, 2006.

**Operating Leases**

The Commission leases certain office facilities under non-cancelable operating lease agreements expiring through fiscal year 2013.

Future minimum lease payments are as follows:

Year Ending June 30,	Amount	Year Ending June 30,	Amount
2006	\$ 697,438	2010	\$ 638,550
2007	697,438	2011	638,550
2008	638,550	2012	638,550
2009	638,550	2013	638,550

Rent expense for office facilities in 2005 and 2004 was \$750,100 and \$762,564, respectively.

## **SUPPLEMENTARY INFORMATION**

**NEW JERSEY STATE LOTTERY COMMISSION**

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
BUDGET AND ACTUAL**

Year Ended June 30, 2005

	<u>Budget</u> <u>(unaudited)</u>	<u>Actual</u>	Variance favorable <u>(unfavorable)</u>
Operating revenues:			
Ticket Sales			
Pick 3	\$ 449,784,775	\$ 456,582,545	\$ 6,797,770
Pick 4	265,596,125	265,003,920	(592,205)
Jersey Cash 5	136,500,000	123,253,335	(13,246,665)
Pick 6 Lotto	167,648,000	109,983,537	(57,664,463)
Mega Millions	230,152,000	253,408,054	23,256,054
Instant games	1,095,000,000	1,066,130,914	(28,869,086)
Sales discounts	<u>(2,000,000)</u>	<u>(556,188)</u>	<u>1,443,812</u>
Total ticket sales	<u>2,342,680,900</u>	<u>2,273,806,117</u>	<u>(68,874,783)</u>
Other income:			
Forfeited prizes	28,187,025	30,662,853	2,475,828
Miscellaneous	<u>1,000,000</u>	<u>1,247,318</u>	<u>247,318</u>
Total operating revenues	<u>2,371,867,925</u>	<u>2,305,716,288</u>	<u>(66,151,637)</u>
Operating expenses:			
Prize expenses	1,332,457,336	1,296,810,791	35,646,545
Administrative expenses	30,300,000	27,492,371	2,807,629
Retailer commissions	128,957,450	126,248,659	2,708,791
On-line vendor fees	30,676,108	29,924,546	751,562
Instant vendor fees	15,439,500	14,340,331	1,099,169
Multi-state fees	50,000	16,852	33,148
On-line network fees	9,000,000	7,759,214	1,240,786
Drawing broadcast fees	1,140,000	1,141,540	(1,540)
Amortization expense	<u>-</u>	<u>2,086</u>	<u>(2,086)</u>
Total operating expenses	<u>1,548,020,394</u>	<u>1,503,736,390</u>	<u>44,284,004</u>
Operating income	823,847,531	801,979,898	(21,867,633)
Non-operating revenue:			
Interest income	<u>1,800,000</u>	<u>2,435,472</u>	<u>635,472</u>
Income before transfers out	825,647,531	804,415,370	(21,232,161)
Contributions for aid to education and state institutions	<u>825,000,000</u>	<u>812,046,973</u>	<u>12,953,027</u>
Change in net assets	647,531	(7,631,603)	(8,279,134)
Net assets, beginning of year	<u>21,101,658</u>	<u>21,101,658</u>	<u>-</u>
Net assets, end of year	<u>\$ 21,749,189</u>	<u>\$ 13,470,055</u>	<u>\$ (8,279,134)</u>

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAMES REVENUES

	Year Ended June 30,	
	2005	2004
CROSSWORD P	\$ 2,310	\$ 43,452,460
CROSSWORD S	158,508	43,227,048
CROSSWORD R	24,885	42,033,111
CROSSWORD T	4,086,420	38,554,962
BIG MONEY SPECTACULAR C	4,800	22,742,882
BIG MONEY SPECTACULAR	134,936	22,368,784
VINTAGE BINGO	175,120	21,873,978
CROSSWORD P	-	21,497,173
BIG CASH CASINO	3,222,310	20,992,890
MONEY MAKER DBL PLAY	31,080	20,014,715
LIVIN' LUCKY	306,985	19,704,900
DIAMOND DOLLAR BINGO	338,211	16,815,263
ALL THE MARBLES	9,295	16,120,040
WIN FOR LIFE Z	87,147	15,940,278
WILD 7'S SLINGO	896,541	15,555,375
SUPER DIAMOND	496,880	15,468,070
WIN FOR LIFE Y	(2,307)	15,388,146
BIG CASH DOUBLEPLAY	5,271,465	14,612,530
SLINGO	3,400,467	13,584,522
PHARAOHS GOLD	3,279,909	13,424,156
MORE LUCKY LINES	14,688	12,997,419
POKER ROYALE	18,465	12,920,960
MONOPOLY	5,990	12,777,868
JACKS OR BETTER D	4,825,895	12,460,040
HOLIDAY LUCKY TIMES	38,284	12,384,520
DOUBLE DOUBLER	87,038	12,345,994
\$25,000 HEARTS	166,292	12,305,556
AMAZIN 8	64,082	12,280,078
TRIPLE TRIPLER C	68,054	12,043,379
RED HOT DOUBLER D	144,502	11,953,705
BIG MONEY SPECTACULAR F	9,883,200	11,807,520
WIN FOR LIFE A1	6,279,978	11,613,123
BARRELS OF BUCKS	5,626	10,788,130
HOLIDAY MAGIC	1,151,235	10,378,044
LUCKY 4 LEAF CASH	2,273,882	10,120,156
ROLL 6 POKER	4,447,590	9,879,690
CAESARS PALACE	7,286,420	9,722,440
CASH CROP	562,602	9,689,450
FAST CASH CORVETTE	468,118	9,627,554
MAGIC NUMBERS	24,402	9,619,212
HOLLY JOLLY JACKPOT	177,667	9,591,800

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAMES REVENUES (CONTINUED)

	Year Ended June 30,	
	2005	2004
FALL FEST	1,004,010	9,510,477
SPRING BREEZE	3,432,946	8,806,368
BURST CASH	2,566,300	8,688,466
ARCTIC CASH	1,571,304	8,316,296
CLASSIC BINGO	(600)	8,117,710
VINTAGE BINGO	14,506,900	7,931,140
THE HONEYMOONERS	1,125,680	7,807,636
CARIBBEAN CASH	2,709,470	7,704,608
BIRTHDAY SURPRISE	3,330,706	7,653,502
PLATINUM BINGO	6,879,501	7,609,563
PROGRESSIVE POKER	5,603,510	7,450,070
INSTANT PICK 4	9,820	7,365,594
AMAZING ADVENTURE	448,056	7,337,685
TRIPLE TRIPLER	5,079,544	6,909,488
WHEEL OF FORTUNE	(2,172)	6,868,485
MAGIC CHARM BINGO	20,040	6,643,665
10 TIMES LUCKY	5,071,074	6,400,854
PROGRESSIVE BLACKJACK	(3,080)	6,394,280
NHL	1,247,620	6,184,332
MATRI-MONEY	4,567,432	5,872,244
BUSHEL OF CLAMS	(2,100)	5,840,652
JOKER'S WILD	123,326	5,724,474
TAIL GATOR	104,874	5,683,311
10 TIMES LUCKY	(1,200)	5,575,528
HUNT FOR CASH	1,365,765	5,504,910
POKER NIGHT	13,943,885	5,398,735
CYBER SLINGO	1,720,848	5,250,628
WINNER WEATHER	150,443	5,250,608
WINNING LEGENDS	3,315,622	5,247,728
COUNT DE MONEY	148,596	5,219,860
MOTHERS DAY DOUBLER	1,331,056	4,680,339
SUPER SIZE CASH	12,681,340	4,365,040
CYBER SLINGO 5 PACK	3,637,034	3,944,936
I LOVE LUCY	(1,554)	3,935,384
YANKEE DOODLE DOLLARS	(2,659)	3,924,420
XTREME SIGHTS & SOUNDS	4,877,050	3,815,282
FLOWER POWER	(1,200)	3,579,282
BONUS BASEBALL	55,687	3,529,487
DOUBLE UP SLINGO	12,827,295	3,344,292
BIG MONEY SPECTAC	(74)	2,837,792
JACKS OR BETTER	(600)	2,702,745

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAMES REVENUES (CONTINUED)

	Year Ended June 30,	
	2005	2004
NJ ROAD TRIP	7,101,380	2,685,600
HAPPY FATHER'S DAY	21,995	2,685,245
RED HOT DOUBLER C	-	2,680,523
FATHER'S DAY DOUBLER	3,319,201	2,612,754
LUCKY 8'S BINGO	1,725,177	2,498,784
HARLEY DAVIDSON	(1,378)	2,477,114
SWEET WINNINGS	2,996	2,199,904
WIN FOR LIFE X	-	1,966,148
COLD HARD CASH	-	1,817,482
BIG BANG BUCKS	10,059,092	1,699,200
SIZZLING HOT CASH	10,409,450	1,294,500
JINGLE BELL BINGO	2,991	1,158,105
CASH BONUS	(300)	1,114,455
CROSSWORD U	42,695,466	1,067,400
WILD ARUBA STUD	(900)	1,006,156
TRIPLE TRIPLER B	(300)	942,974
HAPPY MOTHER'S DAY	(1,708)	941,002
HARVEST GOLD	-	899,020
BEETLE BAILEY	(300)	836,026
STRUCK BY LUCK	(90)	824,128
INSTANT PICK 3	(1,201)	590,637
LUCKY CLOVER	(300)	424,513
FUN IN THE SUN	(650)	409,054
NBA	-	398,034
CROSSWORD O	(300)	387,141
LIONEL CASH EXPRESS	(518)	297,840
PINBALL WIZARD	15,837,715	288,300
PINBALL PAYOFF	8,180	285,600
DOLLAR SIGNS	-	270,788
HIGH TIDES	(300)	220,626
HAPPY HOLIDAYS	(600)	157,047
BIRTHDAY CHEER	(1,200)	135,768
GOLDEN RICHES	14,536,196	118,800
FROSTY FUN DOUBLER	(300)	109,177
QUEEN FOR A DAY	(600)	86,380
HOLIDAY CHEER	(1,200)	74,210
MARRY MONEY	2,486	61,500
LUCKY LINES	-	55,824
SPOOKY LOOT	(300)	55,247
MONEY BAGS	(600)	34,948
DOUBLE DOUBLER	-	32,040

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAMES REVENUES (CONTINUED)

	Year Ended June 30,	
	2005	2004
4TH & GOAL	(888)	25,975
CLASSIC BINGO B	-	18,932
INSTANT LOTZEE	-	17,066
TABASCO HOT CASH	-	15,590
CROSSWORD N	-	13,935
STAR SPANGLE DOLL	-	12,346
WIN FOR LIFE W	-	10,395
LOTS O SPOTS BINGO	-	7,536
SUPER BLACKJACK DBL	-	7,480
RED HOT DOUBLER B	-	6,600
CASH IN A FLASH	-	4,500
SUNKEN TREASURE	-	3,900
STUD POKER	-	3,600
CROSSWORD M	-	3,540
CLUB CASINO	-	3,000
WINNING COMBINATION	-	2,874
BIG MONEY SPECTACULAR	-	2,400
LUCKY TIMES 10	-	2,014
SUPER 7'S F	-	1,908
CRAB DOUBLER	-	1,661
CROSSWORD L	-	600
MAUI MONEY	-	300
CYBER SLINGO	-	75
WIN FOR LIFE AB	16,786,233	-
DEEP SEA DOUBLER	6,174,713	-
MULTI MONEY	12,397,558	-
FISTFUL OF \$50's	12,469,318	-
SUPER BLACKJACK DOUBLE PLAY	17,908,295	-
BINGO EXTRA	18,029,628	-
BREEDERS' CUP GOLD	6,573,550	-
FOOTBALL FEVER	9,671,446	-
HARVEST CASH	9,204,830	-
TETRIS	2,272,683	-
YOUNG & RESTLESS	5,962,270	-
VINTAGE BINGO	21,336,054	-
LIFETIME RICHES	30,124,270	-
WILD BILL	6,181,735	-
BIG MONEY SPECTACULAR	21,831,886	-
HOLD'EM POKER	17,475,285	-
HOLLYWOOD STARS	5,553,992	-
SNOW MAGIC	9,525,680	-

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAMES REVENUES (CONTINUED)

	Year Ended June 30,	
	2005	2004
WIN FOR LIFE AC	14,386,620	-
CROSSWORD (W)	41,678,283	-
DOUBLE DOUBLER	12,144,922	-
HOLIDAY LUCKY TIMES 10	12,046,946	-
STOCKING STUFFER	10,441,056	-
HOLIDAY COUNTDOWN	8,113,923	-
\$1,000,000 JACKPOT	16,453,690	-
CROSSWORD V	42,307,662	-
QUICK SILVER	8,182,763	-
SPECTACULAR 7'S	16,784,390	-
PROGRESSIVE BLACKJACK	8,295,850	-
DOUBLE YOUR LUCK	11,907,816	-
LUCKY STARS DOUBLE PLAY	11,645,990	-
PAC-MAN MANIA	10,471,208	-
LUCKY HEARTS	10,848,478	-
CARIBBEAN STUD POKER	7,583,660	-
BIG MONEY SPECTACULAR (H)	23,153,014	-
HOT SLOTS	14,143,070	-
SUPER TIC TAC TOE	16,309,950	-
SHAMROCK TRIPLER	10,265,754	-
ACES HIGH	8,890,602	-
SPRING CASH	8,172,736	-
CROSSWORD (X)	42,917,994	-
KING SIZE CASH	9,127,100	-
MATRIMONEY	6,298,772	-
CONGRATULATIONS	8,535,400	-
WHO'S ON FIRST	4,270,152	-
MAGIC LINE BINGO	9,413,874	-
BIG MONEY SPECTACULAR (I)	19,388,656	-
DOUBLE YOUR LUCK	8,548,935	-
LIFETIME RICHES	8,554,285	-
CROSSWORD (Y)	39,194,799	-
VINTAGE BINGO	6,535,050	-
ORANGE COUNTY CHOPPERS	3,164,643	-
LUCKY 7	11,244,320	-
MOTHER'S DAY BONUS	5,110,457	-
BACK 9	3,897,531	-
FATHER'S DAY BONUS	3,040,653	-
10 TIMES LUCKY (D)	6,862,750	-
TEXAS HOLD'EM POKER	6,845,275	-
POOL PARTY CASH	3,463,212	-

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAMES REVENUES (CONTINUED)

	Year Ended June 30,	
	2005	2004
SINGLE, DOUBLE, TRIPLE PLAY BINGO	2,457,280	-
MILLION DOLLAR MANIA	3,691,710	-
FIRECRACKER CASH DOUBLER	1,874,098	-
DOMINOES	1,684,800	-
BETTY BOOP	265,200	-
THE NUMBERS GAME	135,000	-
CROSSWORD (Z)	13,974,018	-
WIN FOR LIFE (AD)	543,900	-
BIG MONEY SPECTACULAR (J)	319,200	-
HAPPY BIRTHDAY	-	(240)
RAKE IT IN	-	(300)
HOLLYWOOD SQUARES	-	(300)
DOUBLE BINGO	-	(300)
SUPER BUCKS	-	(300)
WIN FOR LIFE U	-	(300)
CLASSIC BINGO	-	(300)
RED HOT DOUBLER	-	(300)
2001:A CASH ODYSSEY	-	(600)
BEACH BLANKET BINGO	-	(600)
SHORE THING	-	(600)
WINTER GREEN	-	(600)
GARDEN STATE GREEN	-	(600)
ME & MY MONEY	-	(600)
VIVA LAS VEGAS	-	(900)
10 TIMES LUCKY	-	(900)
GRAND SLAM	-	(900)
2002 & BEYOND	-	(960)
SOLITAIRE	-	(1,185)
HOLIDAY MAGIC	-	(1,200)
WIN FOR LIFE V	-	(1,200)
VALENTINE KISSES	-	(1,296)
CASINO FORTUNE	-	(1,500)
MASQUERADE PARTY	-	(1,800)
DAD'S DAY DOUBLER	-	(1,850)
SPRING FEVER	-	(1,910)
YOU STRUCK GOLD	-	(1,920)
CMT COUNTRY MUSIC	-	(2,234)
HEROES OF SPACE	-	(3,206)
PRIOR YEAR GAME	(4,818)	(10,141)
	<u>\$1,066,130,914</u>	<u>\$ 973,632,996</u>

**NEW JERSEY STATE LOTTERY COMMISSION**

**SCHEDULES OF ADMINISTRATIVE EXPENSES**

	Year Ended June 30,	
	2005	2004
Salaries	\$ 8,023,643	\$ 7,282,454
Printing and office supplies	483,100	345,394
Vehicular supplies	1,063	701
Household and clothing	4,878	3,546
Other supplies	646	1,625
Travel	240,577	177,542
Telephone	97,181	96,724
Postage	90,000	90,000
Data processing	318,188	254,503
Household and security	217,812	229,387
Professional services	357,501	495,502
Advertising	16,679,739	11,121,491
Maintenance - building and grounds	9,502	4,740
Maintenance - office equipment	21,977	22,589
Maintenance - vehicles	-	4,145
Rent - building and grounds	750,100	762,564
Rent - central motor pool	75,489	60,206
Rent - other	6,402	4,020
Vehicular equipment	74,961	85,775
Information processing equipment	8,155	5,854
Other equipment	31,457	35,162
Total administrative expenses	<u>\$ 27,492,371</u>	<u>\$ 21,083,924</u>

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON  
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Commissioners of  
New Jersey State Lottery Commission

We have audited the accompanying statements of net assets, revenues, expenses, and changes in net assets of New Jersey State Lottery Commission (the "Commission") for the year ended June 30, 2005, and have issued our report thereon dated October 21, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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RICHARD S. WILLINGER, CPA

Compliance

As part of obtaining reasonable assurance about whether New Jersey State Lottery Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting, which we have reported to management and the audit committee of the Commission in a separate letter dated October 21, 2005.

This report is intended solely for the information and use of the New Jersey State Lottery Commissioners, management and others within the Commission and should not be used by anyone other than these specified parties.

*Mercadien, P.C.*  
*Certified Public Accountants*

October 21, 2005

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