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Annual Report 2011



40th Anniversary
New Jersey Lottery
Give Your Dreams A Chance



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VIP Club

The New Jersey Lottery Celebrating

40 Years

Innovation. Growth. Contributions.



Chris Christie
Governor

The New Jersey Lottery celebrated the 40th Anniversary of the first game draw and the legacy it represents in Fiscal Year 2011. Over the forty years since that first ticket was sold to Governor William T. Cahill on Dec. 16,



Kim Guadagno
Lt. Governor

1970, the Lottery's innovative approach to its gaming system processes, retailer infrastructure and creative marketing has effected substantive change in the Lottery both as a business and a revenue producer for



Andrew P. Sidamon-Eristoff
State Treasurer

the state. These innovations have helped the Lottery evolve into the fourth largest revenue generator for the State of New Jersey and one of the most cost-efficient lotteries in the world.

The Lottery contributed \$930 million to state-run programs and institutions in FY 2011, bringing the historical total to more than \$20 billion. It produced record-breaking sales while introducing remarkable technological advancements including a complete conversion of its lottery gaming system, customer facing technological advancements and creative game products and marketing initiatives, laying the groundwork for a bright and dynamic future.

The Lottery contributed \$930 million to state-run programs and institutions in FY 2011, bringing the historical total to more than \$20 billion

Record-breaking Sales, Reduced Operating Costs, Increased Statewide Contributions

The Lottery's record-breaking sales of over \$2.6 billion in FY 2011 represents an increase of \$31.5 million from FY 2010. This marked the fourth consecutive year that Lottery sales have crossed the \$2.5 billion mark. The accomplishment was even more notable because it came at a time when the country was still struggling to recover from a severe economic recession. Strong, focused leadership, creative game product development, and an efficient, lean operating organization all helped

deliver these remarkable accomplishments.

The increased sales translated into increased contributions for state aid to education and state institutions. The Lottery contributed \$930 million to organizations including: county college capital improvement initiatives; school nutrition efforts; the Marie Katzenbach School for the Deaf; the operation of centers for the developmentally disabled, state psychiatric hospitals and homes for veterans; higher education tuition and grants; and aid to colleges and universities. All of these are vital programs that serve the needs of our state's residents.

Nov. 1969
— Voters Approve Lottery

Dec. 16, 1970
— First Lottery Ticket Sold



Mar. 1971
— First Millionaire Drawing Held



Nov. 1972
— The First 5 Digit Daily Game is Introduced

May 1975
— Pick-It, The Nation's First Online Game is Introduced



June 1975
— First Instant Game Introduced



Jan. 1977
— First Televised NJ Lottery Drawing



May 1980
— Pick-6 Lotto is Introduced

May 1981
— First Pick-6 Lotto Millionaire

Oct. 1982
— Pick-6 Lotto annuity prize began

Commissioners



Andrew P. Sidamon-Eristoff, State Treasurer, Carole Hedinger, Executive Director, Bob Hurley, Basketball Coach at St. Anthony's High School in Jersey City attended the 40th Anniversary Event at the War Memorial Building in Trenton on April 26, 2011.



Frank V. Ragazzo
Chairman



Dr. Munir Kazmir
Vice Chairman



Al Alvarez, Esq.
Commissioner



Robert J. D'Anton
Commissioner



Robert Slater
Commissioner



Thomas Tucci Jr.
Commissioner

Our Chairman

Dear Friends,

The New Jersey Lottery provides the residents of our State the multi-pronged benefit of exciting entertainment along with funding for essential programs including: school nutrition, academic tuition and grants, veterans services, operating centers for the developmentally disabled, State psychiatric hospitals and the Marie Katzenbach School for the Deaf. On behalf of the Lottery Commission, we are honored to

serve this organization as Commissioners to help fulfill the needs and dreams of so many of our residents. Once again, the Lottery has broken its own record during Fiscal Year 2011 with its \$930 million contribution to the New Jersey Treasury. That contribution is the largest in Lottery history and is certainly a significant achievement during a year in which our nation and its people faced economic uncertainty. It has been an honor and a

pleasure to work side by side with the distinguished Lottery commission members and the management team of the Lottery. I am confident that we will achieve continued success in the upcoming year.

Frank Ragazzo
Chairman

Our Executive Director



Carole Hedinger
Executive Director

To our Customers, Retail Partners and Residents of New Jersey,

Our Priorities: Innovation. Growth. Contributions.

My most satisfying moments at the Lottery are when I have the opportunity to meet our winning players, shake their hands, some times receive a grateful hug, and discuss how the win will affect their lives. This past year those meetings often included sighs of immense relief and tears of joy knowing that their winnings have just allowed them to turn a page on some difficult economic times. In the Clover Room, our winners' greeting room, Fiscal Year 2011 has proven to be a place where *our players' dreams really do come true* and I am proud to be heading the organization that provides those life changing experiences.

Providing exciting entertainment opportunities to our players would not be possible without the heart and soul of the New Jersey Lottery, our 150 employees and nearly 6,200 retailers that work to make those dreams come true. I want to thank the Lottery staff for managing the details of the day to day operation of the Lottery. Their level of expertise keeps the organization highly

productive and efficient and allows us room to grow our customer offerings, increase productivity for our business partners, and ultimately provide significant contributions to the State and its residents. Our employees took on the challenges of FY 2011 by instituting the first Million Dollar Replay program, a second-chance offering for customers, organizing and executing major technological infrastructure changes for our retailers and nurturing the newly introduced multi-state Powerball game and so much more. Each progressive change was managed with calm, steady determination and decisive action resulting in remarkable execution and record-breaking sales within a repressed economic environment.

Our retail partners, the customer facing representatives of the Lottery, are also evolving with us. FY 2011 was marked by incorporating state-of-the-art gaming equipment across the retail fleet to provide broader customer experiences through increased efficiency, heightened security and creative marketing messages at every touch point. I want to extend my special thanks to the exceptional service provided by so many of our retailers who make the customer

experience with the Lottery one of excitement and camaraderie. These are the traits that build strong businesses and long lasting customer relationships.

Lastly, I want to thank the Lottery Commissioners who dedicate their time and service to providing guidance and oversight to the organization. We are grateful for their service.

To all our partners, the ultimate goal of the Lottery is delivering upon our promise of funding many essential educational services and meeting the needs of our veterans. I am incredibly proud to have been able to fulfill that promise in FY 2011 by providing \$930 million to the State Treasury to fund those programs. That is a pride that should be shared equally by the partners of the Lottery. I am confident that our strength and business acumen will continue to prevail in FY 2012 when we can provide even more funding towards the greater good of our State and its residents.

Sincerely,

Carole Hedinger, CPA
Executive Director

May 1983
— New Jersey Lottery Names 100th Millionaire

June 1984
— Pick-6 Lotto Game Expands Numbers; Bonus Drawing Rises to \$1 Million

June 1986
— \$1 Billion in Yearly Sales Reached



Feb. 1987
— Pick-It Name Changed to Pick-3

April 1987
— Yearly Sales Surpass \$1 Billion



Sept. 1992
— Jersey Cash 5 is Introduced

Aug. 1993
— "Lucky 372" Share \$8.6 Million Pick-6 Jackpot

May 1995
— Pick-6 Lotto Exceeds \$5 Billion in Sales Since Inception



Jan. 1996
— Lottery Introduces First "Win for Life" Instant Game

May 1997
— Lottery Announces Cash Option and Advanced Play for Pick-6 Lotto



Mar. 1998
— Lottery Introduces "LOTZEE"

Lottery as an Economic Stimulus

The public plays the Lottery to win jackpots. These range in size from \$1 to life-changing millions and everything in between. This year the Lottery awarded over \$1.543 billion in prizes, an increase of \$31 million over FY 2010. Every prize paid out delivers a stimulus for the overall economy and inspires more customers to return for more entertainment opportunities and chances to win.

The Lottery also continues to provide significant business opportunities around the State. It affords small, mid-size and large businesses a revenue generation source and additional marketing opportunities that non-lottery retailers do not have. By generating record-breaking sales, the nearly 6,200 strong Lottery retailer network also received record-breaking profits. These Lottery partners received \$147 million in revenue from earned lottery commissions during this challenging economy, up \$2 million from the prior year.

Gaming System Advancements

Higher retailer productivity, improved retail space management and heightened player experience are just a few of the outcomes from the Lottery gaming system improvements in FY 2011. Remarkable technological upgrades were made in all retail locations. The new equipment included a customer centric Ticket Checker, an upgraded Retailer Gaming

Terminal, a Multi-Media customer facing Monitor, along with a Printer and Jackpot sign. Each upgrade enhanced productivity at the retail location and made playing the Lottery even easier for the customer.

The newly installed equipment is faster, more user-friendly and more versatile.



Customers can use the newly installed Ticket Checker with barcode reader to check their own tickets. This allows them to engage in the gaming process and provides a heightened sense of security by verifying their winning amounts. It's small in size and mountable, allowing it to be placed anywhere within 50 feet of the Lottery terminal.



The new Altura Retailer Gaming Terminal has an easy-to-use, fully height adjustable, touch screen for all terminal operations. The top-mounted reader scans bet slips faster than ever and has a shelf that holds up to 30 at a time. These are essential tools on high-volume customer play days.



The 17-inch Color Multi-Media Monitor is easy for players to read, and instantly displays brand consistent promotional materials to support the current gaming offerings. Jackpot amounts for all games

are regularly shown on the monitor, to inform customers of the exciting opportunities.



Printing the game tickets also became more efficient and secure by showing the customer their transaction information and providing current updates on jackpot games like Jersey Cash 5, Pick 6, Mega Millions, and Powerball. The quick, quiet thermal printer means clear, crisp printing every time and eliminates the cost and time associated with the old ribbon ink delivery system. The new printer is also compact, allowing the retailer to conveniently place it close at hand.



New, automatically updated jackpot signs were also a part of the technological upgrades for retailers. These eliminate the manual updates of the old flip signs and the human error associated with that task.

The gaming system advancements brought the New Jersey Lottery retailers into the 21st Century with tools, systems and processes that increase productivity, heighten customer experiences and streamline internal processes.

Technological Advancements

New Design for Lottery Website and Social Media



FY 2011 began a new era in technological advancements for the New Jersey Lottery. On June 30, 2011 the NJN television network, after 40 years of producing television broadcasts for New Jersey residents, went dark. Along with the station went the venue the Lottery had used to broadcast its live game draws. Faced with the loss of its television broadcast the Lottery executive management team determined that the optimal solution was to bring the draw production in-house to lottery headquarters and stream it live on the Internet for public viewing. Changes and upgrades needed to be made to all customer facing Lottery technology including the website, Facebook and YouTube Channel. The social media tools would become the Lottery's new broadcast venue.

The media team researched, sourced and purchased state-of-the-art camera and post-production gear to prepare for the transition.

Creative and technology teams were formed to design and build an in-house studio within Lottery headquarters. The media team researched, sourced and purchased state-of-the-art camera and post-production gear to prepare for the transition. Extensive staff training occurred to ensure the daily draw would be handled efficiently. The planning and execution was challenging and time-sensitive with the fate of the Lottery draw at stake. The efforts were successful and the outcome during FY 2012 was that the New Jersey Lottery became the first Lottery in the nation to live-stream its game draws over the Internet.



The newly redesigned Lottery website was launched on June 30, 2011 offering lottery fans daily game draws and historical game information. The Lottery home page features the latest promotions and advertising campaigns.



The New Jersey Lottery Facebook Page was launched in January 2011. The social media site enabled strangers with a common bond, the NJ Lottery, to build a thriving community. The site allows the Lottery to interact with its customers, and conversely, it provides a platform where the customers can provide direct feedback to the Lottery.



Lottery fans can register for the VIP Club, Bonus Zone special programs and the Million Dollar Replay directly from the updated NJLottery.net website. Membership in the VIP Club provides increased opportunities to win cash prizes and special event experiences.



May 1999

— New Jersey Lottery joins Multi-state Lottery, "Big Game"

May 2000

— Big Game Jackpot reaches \$363 Million

Feb. 2001

— Largest Pick-6 Lotto Jackpot in New Jersey History \$48.9 million

Aug. 2001

— Largest BIG GAME Jackpot Paid in New Jersey \$118 million

Oct. 2001

— Jersey Cash 5 Drawings Increased to Seven Days a Week

Nov. 2001

— Introduction of Midday Drawings

Jan. 2002

— Introduction of Big Money Spectacular Instant Game

April 2002

— Largest New Jersey Big Game Jackpot Won Monmouth County Couple wins one-third share of \$331 million

May 2002

— Mega Millions Replaces Big Game

June 2002

— Lottery Sales Surpass \$2 Billion for First Time in History



Aug. 2003

— The End of LOTZEE

Feb. 2004

— Introduction of Cyber Slingo, the First Internet Lottery Game



Where the Money Goes



Recognized as one of the most cost-efficient lotteries in the United States, the New Jersey Lottery spends less than one percent of its revenue to operate its business. As the State's fourth-largest revenue producer, the Lottery grossed over \$2.6 billion in sales for FY 2011 and contributed more than \$930 million to the State, or nearly 35 percent of sales. The New Jersey Lottery contributions help fund education and institutions making everyone in the Garden State a winner.

Since its inception more than forty years ago, the Lottery has dedicated more than \$20 billion to programs that benefit millions of New Jersey residents. Community Colleges, the Department of Human Services, the Department of Military and Veterans Affairs, the School Nutrition Program and the Marie Katzenbach School for the Deaf are just a few of the organizations and programs whose constituencies benefit from Lottery proceeds.

The Lottery also plays a key role in supporting small businesses throughout the State. Nearly 6,200 businesses serve as Lottery retailers and act as a direct link between the Lottery and its players. Retailers earn five percent of their lottery ticket sales in the form of commissions and other bonuses. In FY 2011, the Lottery returned nearly \$147 million in commissions and bonuses to support chain stores, supermarkets, pharmacies, convenience stores and other establishments throughout the state.

The Lottery grossed over \$2.6 billion in sales for FY 2011 and contributed more than \$930 million to the State, or nearly 35 percent of sales

| Department of Agriculture | |
|--|-------------------|
| School Nutrition Program | \$ 2,675 |
| Department of Education | |
| Marie Katzenbach School for the Deaf | 1,762 |
| Non-Public School Aid | 41,851 |
| Statewide Assessment Program (Grades 4, 8, 11) | 8,803 |
| School Construction and Renovations | 53,385 |
| Total Department of Education | 105,801 |
| Higher Educational Services | |
| Senior Public Institutions - Operating Aid | 340,403 |
| Tuition Aid Grants | 133,876 |
| Higher Education Capital Improvement Plan - Debt Service | 13,406 |
| Aid to County Colleges for Operational Costs | 57,334 |
| Coordinated Garden State Scholarship Program | 2,410 |
| Higher Education Facilities Trust Fund - Debt Service | 9,996 |
| Student Tuition Assistance Reward Scholarships (NJSTARS) | 6,231 |
| Opportunity Program Grants | 12,164 |
| Supplementary Education Program Grants | 6,102 |
| Veterinary Medicine Education | 58 |
| Total Higher Educational Services | 581,980 |
| Department of Human Services | |
| Operation of Centers for the Developmentally Disabled | 46,992 |
| Operation of State Psychiatric Hospitals | 156,264 |
| Total Department of Human Services | 203,256 |
| Department of Military and Veterans' Affairs | |
| Operation of Homes for Disabled Soldiers | 36,288 |
| Total Revenue Realized - GAAP Basis | \$ 930,000 |

The amount of State Lottery funding in the programs designated above may only represent a portion of their total State funding. Any balance of the appropriation for the program would be funded by the General Fund.



VIP Club

The Lottery's VIP Club is one of the largest online lottery membership clubs in the country. It has more than 189,000 active members, with 18,237 registered in FY 2011 alone. The club is a free-of-charge membership program that offers participants various benefits including the opportunity to partake in special drawings such as the newly introduced Million Dollar Replay second-chance program. VIP Club members are also eligible for other special drawings for prizes such as tickets to concerts, sporting events, and family entertainment along with receiving daily drawing results emailed to them, and more.

The Lottery's VIP Club is also home to the Lottery Bonus Zone Second Chance Drawing games, where even non-winning tickets can win a diverse array of prizes. Second-chance drawings on popular branded games like Minute to Win It and Cruise for Cash offered players the opportunity to win unique prizes and trips, providing continued interest and excitement in playing the Lottery instant game line of products.

Million Dollar Replay

The Million Dollar Replay, a second-chance bonus drawing program, was introduced in FY 2011 on April 4. The Million Dollar Replay program provides lottery players with the opportunity to enter non-winning instant game tickets into a free, second-chance drawing. Participants enter \$10 worth of non-winning, eligible instant game scratch-off tickets for a chance to become a semi-finalist in a Grand Prize Drawing. Four semi-finalist drawings are held to generate the list of grand prize drawing finalists. With each quarterly drawing, 100 finalist names and 25 alternate names are randomly selected to create a finalist list of 400 participants for the Grand Prize Drawing. The Grand Prize Drawing includes fifteen prizes ranging from \$10,000 up to \$1 million. Semi-finalists from all four quarterly drawings who do not win a top prize receive a \$250 consolation prize.

Creating the Million Dollar Replay program was an exciting way to offer customers additional incentives to play instant games by providing them a second opportunity to win cash prizes.

Responsible Play

As part of its continuing efforts to increase public awareness and the understanding of playing responsibly, the Lottery distributes brochures to the public outlining responsible play guidelines when playing the lottery and other gaming activities. In FY 2011, the brochure was distributed through the nearly 6,200 lottery retailers throughout the state. It encourages the public to call the 1-800-GAMBLER hotline if they think they or someone they know may have a gambling problem. The staff at the hotline can direct them to assistance. Further reinforcing its commitment to combating underage gambling, the Lottery partners with the Council on Compulsive Gambling of New Jersey to share the message. In an ongoing campaign "Not 18 Yet? No Bet" the Council and the Lottery work toward increasing public awareness of the age restriction on lottery play in New Jersey. The campaign conveys to retailers and citizens the importance of not selling or giving lottery tickets to minors.

The 1-800-GAMBLER hotline number is featured on all of the Lottery's product line and as a tagline in its advertising.



Sept. 16, 2005
– Largest Single Ticket Win in NJ Lottery History \$258 million



Mar. 6, 2007
– Cape May County Couple Wins Record Setting Mega Millions Jackpot \$390 million

May 15, 2009
– Lottery Stops Televising Midday Drawings On NJN; Puts Video Of Drawings Online

Jan. 31, 2010
– New Jersey Lottery Begins Selling Powerball Tickets

Mar. 13, 2010
– Morris County resident becomes New Jersey's First Powerball Jackpot Winner \$211 million

Oct. 3, 2010
– Gaming System Conversion



Jan. 2011
– 40th Anniversary of the first game draw

Jan. 18, 2011
– Mega Millions Megaplier introduced

April 4, 2011
– Million Dollar Replay program begins

June 30, 2011
– New Jersey Lottery contributes over \$20 billion to fund State education, institutions and programs during its 40 years

June 30, 2011
– NJN television station ceases to air

NEW JERSEY LOTTERY GAMES

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Pick 3 (originally dubbed Pick-It) has been operating since May 22, 1975 and is now one of Lottery's longest-running games. It delivers excitement every day, twice a day with its midday and evening draws. Pick 3 offers customers the added excitement of the Instant Match Option. For an additional \$1 bet, players have the opportunity to win up to \$500 instantly by matching their selected Pick 3 game numbers with randomly generated terminal numbers for an immediate win. The customer knows if they are a winner before leaving the retailer adding excitement at the store level.

Pick 3 also offers special promotions that increase chances for players to win such as the Green Ball promotion. The promotions keep regular players coming back for more and inspire new people to join in the fun. The Green Ball Double Draw ran from February to March FY 2011.

The Pick 3 game contributed \$435 million to revenues in FY 2011. Over its 36 year history, the game has generated over \$14 billion in sales.



Two years after the foundation laid by the success of the Pick 3 game, Lottery officials introduced the Pick 4 game. 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. Pick 4, like the Pick 3, also has the Instant Match Option. The Pick 4 has remained a steady favorite among players, amassing more than \$7 billion since its introduction. In FY 2011, this cornerstone game generated over \$258 million in revenues.



Enhancing favorite lottery games with new features keeps players excited and playing. On April 3, 2011, the Jersey Cash 5 game received the Instant Match Option that provides players an additional opportunity to win by matching their Jersey Cash 5 numbers with a computer generated set of numbers. If the player's numbers match the generated set, in any order, they are winners, automatically. If duplicate numbers are matched, both bets will be winners. Up to \$500 can be won with Instant Match, and all prizes are paid out instantly.

Jersey Cash 5 represented 5.6 percent of game sales in FY 2011. Drawn once daily, in the evening, Jersey Cash 5 costs \$1 per game and resulted in 191 jackpot winners in FY 2011. The average top-prize was approximately \$201,759 and players won over \$73 million. Sales for the game were over \$146.3 million.



Since its first drawing back on May 9, 1980, the Pick 6 Lotto has created more New Jersey millionaires than any other game. It continues to be a strong component in the lottery line-up. In FY 2011, it generated \$68.5 million in revenues. Players received payouts of \$34.4 million. Nine New Jersey winners became millionaires this year thanks to the game. The original New Jersey Lottery lotto style jackpot game gives players the best odds to become a millionaire for only \$1 per play. Jackpots start at \$2 million and grow from there and players can win cash prizes for matching only three numbers.



New Jersey's instant game product line continues to be the most popular and productive game genre with lottery players. Instant game sales represented 51.8 percent of sales in FY 2011. The New Jersey Lottery offers dozens of instant games, ranging in price from \$1 to \$10 with prizes ranging up to \$1 million or more. Topping the popularity chart for individual game issues is the \$100,000,000 Spectacular game that provided players with an opportunity to win more than 15 annuity prizes of \$1 million. With its 75 percent prize payout, this is one of the most robust prize offerings in Lottery history. The \$100,000,000 Spectacular game sales were nearly \$117 million with its first issue. The instant lottery game offers better than one in four overall odds for the \$10 ticket price.

The Crossword brand of games has been a long time favorite of lottery players. New games are consistently being released under this brand and in FY 2011 the Crossword brand of games collectively produced revenues of \$279.8 million. Overall, instant tickets generated over \$367.8 million for State education and institutions. Additionally, a record \$904 million was paid out in cash and prizes to our many instant ticket winners.



When New Jersey joined "The Big Game," now known as Mega Millions, on May 26, 1999, the starting jackpot was \$5 million. As starting jackpots rose over the years, the FY 2011 starting jackpot was \$12 million. Game jackpots also grew with the second largest Mega Millions jackpot in history occurring in FY 2011 at \$380 million on Jan. 4, 2011. That jackpot was split by two lucky players, one from Idaho and the other from the State of Washington. In addition, three lucky New Jersey Lottery players won the Mega Millions second prize of \$250,000.

FY 2011 created another new opportunity for players to increase their winnings with the addition of the Megaplier option on Jan. 18, 2011. For an extra \$1 per play, the Megaplier is a special feature that multiplies all prizes, other than the jackpot, by a terminal generated, randomly selected number of either two, three or four. Players who buy the Megaplier option and match five numbers without matching the Mega Ball automatically win \$1 million regardless of the Megaplier number. All other non-jackpot prizes are multiplied by the Megaplier number drawn. New Jersey Mega Millions sales for Fiscal Year 2011 were \$230.6 million representing 8.75 percent of overall ticket sales. New Jersey Lottery players received \$114.2 million in prizes from the game. The New Jersey economy was bolstered by Lottery retailers reaping \$11.78 million in commissions from the Mega Millions game. New Jersey residents also benefited from the game with contributions to the State at \$107.7 million. Overall, a win, win, win situation in Fiscal Year 2011.



The New Jersey Lottery kicked off the Powerball® game on Jan. 31, 2010 and sales hit their stride in FY 2011. The multi-state game's popularity is evidenced by FY 2011 ticket sales of nearly \$133 million. The Powerplay option accounted for more than \$15 million of that figure. Nearly 13 percent of lottery players chose the Powerplay option on their ticket purchase to boost their winnings potential. Lottery players benefited from the game by winning more than \$67 million in cash prize awards, representing more than 5 percent of total sales revenue in FY 2011.

Powerball® provides players with the added excitement of a multi-state, big jackpot opportunity. Powerball® jackpots start at a minimum of \$20 million, and give players nine ways to win, with overall odds of 1 in 35 at a cost of \$1 per bet. For an additional \$1, players can choose the PowerPlay® option, which can multiply winnings, other than the jackpot prizes, by 2 to 5 times with prizes up to \$1 million. The Power Play multiplier number is randomly drawn just before the Powerball® drawing.

Give Your Dreams a Chance®



INDEPENDENT AUDITORS' REPORT

State of New Jersey
Department of the Treasury
Division of State Lottery

We have audited the accompanying financial statements of the New Jersey Division of State Lottery (the "Division of State Lottery") as of and for the years ended June 30, 2011 and 2010. These financial statements are the responsibility of the Division of State Lottery'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division of State Lottery's internal control over financial reporting. Accordingly, we express no such opinion. 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the New Jersey Division of State Lottery at June 30, 2011 and 2010, 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.

In accordance with *Government Auditing Standards*, we have also issued our reports dated October 18, 2011 and October 20, 2010, on our consideration of Division of State Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were performed 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 methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Mercadien, P.C.
Certified Public Accountants

October 18, 2011

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MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

The following discussion and analysis provides an analytical overview of the financial position and activities of the State of New Jersey, Department of Treasury, Division of State Lottery, (the "Division of State Lottery") for the years June 30, 2011 and 2010. This statement was prepared by management and should be read in conjunction with the financial statements and notes hereto, which follow this section.

The Division of State Lottery was established in 1970 pursuant to the "State Lottery Law," N.J.S.A 5:9-1 et seq. The Division of State 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 Division of State Lottery licenses almost 6,200 agents 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 Division of State 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 online terminal network and the warehousing and distribution of instant tickets and promotional materials. GTECH is also responsible to provide communications between the sales terminals and the GTECH data centers.
- Pollard Bank Note, Scientific Games and GTECH Printing are contracted to print and support instant game products.

The Division of State Lottery offers various products for sale with prize awards ranging from \$1.00 to annuity prizes well 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 (including Jersey Cash 5 Instant Match)
- Pick 6 Lotto
- Mega Millions
- Powerball

FINANCIAL HIGHLIGHTS

The Division of State Lottery's financial position at June 30, 2011 and 2010, consisted of total assets of \$640 million and \$722 million, respectively, and total liabilities of \$629 million and \$712 million, respectively. A substantial portion of the asset and liability numbers is due to the Division of State Lottery's annuity investment in prize awards. The total amounts invested and due to Division of State Lottery winners as future installment payments at June 30, 2011 and 2010, were \$446 million and \$527 million, respectively. Net assets increased from \$10 million in fiscal year 2010 to \$11 million for fiscal year 2011.

FINANCIAL STATEMENTS

The Division of State Lottery's financial statements include statements of net assets as of June 30, 2011 and 2010, statements of revenues, expenses and changes in net assets for the years ended June 30, 2011 and 2010, and statements of cash flows for the years ended June 30, 2011 and 2010. The financial statements are prepared in accordance with the accounting principles established by the Governmental Accounting Standards Board.

Statements of Net Assets

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

| | June 30, | |
|-------------------------|--------------|--------------|
| | 2011 | 2010 |
| Current Assets | \$ 304 | \$ 319 |
| Deposit Fund Contracts | 336 | 403 |
| Total Assets | 640 | 722 |
| Current Liabilities | 293 | 308 |
| Non-Current Liabilities | 336 | 404 |
| Total Liabilities | 629 | 712 |
| Restricted Net Assets | 7 | 6 |
| Unrestricted Net Assets | 4 | 4 |
| Total Net Assets | \$ 11 | \$ 10 |

Current assets consist of cash and investment in the State of New Jersey Cash Management Fund (the "NJCMF"), accounts receivable, current year annuity investments and prepaid expenses. The investment in the NJCMF totaled \$152 million and \$154 million at June 30, 2011 and 2010, respectively. The Division of State Lottery also holds Prudential stock with a market value of \$3 million at June 30, 2011.

The Division of State Lottery funds long-term installment prizes with insurance company annuities and United States Treasury securities. The total value of these investments was \$446 million and \$527 million as of June 30, 2011 and 2010, respectively. The Division of State Lottery has annuity investments with ten (10) insurance companies. The total market value of the United States Treasury securities was \$40 million and \$41 million at June 30, 2011 and 2010, respectively. The annuity prizes due beyond fiscal year 2012 total \$335 million and represents the non-current assets reported on the Division of State Lottery's statements 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 \$69 million and \$71 million as of June 30, 2011 and 2010, respectively. Also, \$110 million was due to annuity winners as of June 30, 2011.

Non-current liabilities represent annuity prize awards due beyond 2012 and also include the total due for unused vacation and sick leave. Net assets represent the excess of the Division of State Lottery's assets over its liabilities and are summarized as follows (in millions):

| | June 30, | |
|---------------------------------------|--------------|--------------|
| | 2011 | 2010 |
| Restricted (Unclaimed Prize Reserves) | \$ 7 | \$ 6 |
| Unrestricted | 4 | 4 |
| Total Net Assets | \$ 11 | \$ 10 |

Expired prizes, or unclaimed prize reserves, are restricted to fund either future prizes or state contributions.

Statements of Revenues, Expenses and Changes in Net Assets

The results of the Division of State Lottery's operations are presented in the statements of revenues, expenses and changes in net assets, which is summarized (in millions) as follows:

| | Year Ended June 30, | |
|---|---------------------|--------------|
| | 2011 | 2010 |
| Operating revenues | | |
| Ticket sales | \$ 2,637 | \$ 2,605 |
| Forfeited prizes | 38 | 42 |
| Miscellaneous income | 2 | 1 |
| Total operating revenue | 2,677 | 2,648 |
| Operating expenses | | |
| Prize expenses | 1,544 | 1,512 |
| Bad debt expense | 1 | - |
| Administration expense | 22 | 18 |
| Retailer commissions | 147 | 145 |
| Vendor fees | 33 | 43 |
| Networking fees | (1) | 4 |
| Drawing broadcast fees | 1 | 1 |
| Total operating expenses | 1,747 | 1,723 |
| Operating income | 930 | 925 |
| Investment income | - | 1 |
| Income before transfers | 930 | 926 |
| Operating transfers - state contributions | 930 | 924 |
| Increase/(decrease) in net assets | \$ - | \$ 2 |

The Division of State Lottery awarded over \$1.543 billion in prize awards in fiscal year 2011 and over \$1.512 billion in fiscal year 2010. Almost 110 million winning tickets were validated and paid in fiscal year 2011 and over 111 million were validated and paid in fiscal year 2010.

The Division of State Lottery's vendors provided critical services to the Division of State Lottery, including the production, warehousing, distribution and accounting for all lottery tickets. The total compensation paid for the Division of State Lottery's vendors and network fees was \$32 million in fiscal year 2011 and \$48 million in fiscal year 2010. Drawing broadcast fees were approximately \$1 million for both years ended June 30, 2011 and 2010, respectively.

The Division of State Lottery's administrative expenses for the fiscal years 2011 and 2010 totaled \$22 million and \$18 million, respectively. These administrative expenses include salaries, advertising, auditing services, rent, security, data processing services, office supplies and attorney general fees.

The Division of State Lottery is required by State of New Jersey law to contribute at least 30% of gross revenues from ticket sales 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 Division of State Lottery contributed \$930 million, 35% of total revenues, in fiscal year 2011 and \$924 million, 35% of total revenues, in fiscal year 2010.

Statements of Cash Flows

The statements of cash flows are summarized (in millions) as follows:

| | Year Ended June 30, | |
|---|---------------------|--------|
| | 2011 | 2010 |
| Cash flows provided by operating activities | \$ 921 | \$ 932 |
| Cash flows used in non-capital financing activities | (923) | (935) |
| Cash flows used in investing activities | 2 | 4 |
| Net increase (decrease) in cash | \$ - | \$ 1 |

The Division of State 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.

The management of Division of State Lottery 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:

- Pick 3 "Green Ball" Double Draw
- Pick 4 "Red Ball" Double Up
- Various Instant Games, including new feature game \$100 million Dollar Spectacular
- Implemented new game feature for Mega Millions - Megaplier, started January 2011
- The addition of Jersey Cash 5 Instant Match started April 2011
- Various promotions of VIP Club to increase membership
- Started Million Dollar Replay second chance program for non-winning instant tickets, first drawing held June 2011
- Established social media presence on Facebook, Twitter and YouTube
- First U.S. Lottery to live stream mid-day and evening drawings on lottery website and Facebook.

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.

CONTACTING THE DIVISION'S FINANCIAL MANAGEMENT

This financial report is designed to provide citizens, investors and creditors with a general overview of the Division's finances. If you have any questions about this report or need additional financial information, contact the Division's Deputy Director of Finance at One Lawrence Park Complex, 1333 Brunswick Avenue, PO Box 041, Lawrenceville, New Jersey 08625-0041.

STATEMENTS OF NET ASSETS

| | Year ended June 30, | |
|---|-----------------------|-----------------------|
| | 2011 | 2010 |
| ASSETS | | |
| Current Assets | | |
| Cash | \$ 601,305 | \$ 617,648 |
| Accounts receivable, net of allowance for doubtful accounts of \$2,515,960 and \$2,450,000 in 2011 and 2010, respectively | 28,096,451 | 25,475,922 |
| Deferred Expenses | 10,007,940 | 15,399,765 |
| Investments | | |
| Deposit Fund Contracts | 110,302,504 | 124,019,004 |
| Tradable Stock | 3,203,283 | - |
| State of New Jersey Cash Management Fund | 152,215,577 | 153,563,268 |
| Total current assets | 304,427,060 | 319,075,607 |
| Non-Current Assets | | |
| Investments - deposit fund contracts | 335,430,609 | 402,824,222 |
| Total non-current assets | 335,430,609 | 402,824,222 |
| Total assets | <u>\$ 639,857,669</u> | <u>\$ 721,899,829</u> |
| LIABILITIES | | |
| Current Liabilities | | |
| Accounts payable and accrued expenses | \$ 13,731,178 | \$ 20,290,847 |
| Obligation for unpaid prize awards | 68,505,050 | 70,535,872 |
| Installment prize awards | 110,302,504 | 124,019,004 |
| Due to State of New Jersey - education and state institutions | 100,000,111 | 93,009,031 |
| Total current liabilities | 292,538,843 | 307,854,754 |
| Non-Current Liabilities | | |
| Compensated absences | 1,024,519 | 989,444 |
| Installment prize awards | 335,430,609 | 402,824,222 |
| Total non-current liabilities | 336,455,128 | 403,813,666 |
| Total liabilities | <u>628,993,971</u> | <u>711,668,420</u> |
| NET ASSETS | | |
| Restricted for prize awards or contributions for aid to education and state institutions | 6,706,490 | 6,074,201 |
| Unrestricted | 4,157,208 | 4,157,208 |
| Total net assets | <u>\$ 10,863,698</u> | <u>\$ 10,231,409</u> |

See accompanying notes to financial statements

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

| | Year ended June 30, | |
|---|----------------------|----------------------|
| | 2011 | 2010 |
| Operating Revenues | | |
| Ticket Sales | | |
| Pick 3 | \$ 435,314,038 | \$ 435,271,947 |
| Pick 4 | 258,279,303 | 264,132,894 |
| Jersey Cash 5 | 146,364,005 | 143,977,454 |
| Pick 6 Lotto | 68,530,737 | 81,916,339 |
| Mega Millions | 230,633,522 | 307,096,483 |
| Powerball | 132,782,891 | 71,215,958 |
| Raffle sales | - | - |
| Instant games | 1,364,543,070 | 1,301,493,067 |
| Total ticket sales | 2,636,447,566 | 2,605,104,142 |
| Other revenues | | |
| Forfeited prizes | 38,453,261 | 42,223,139 |
| Miscellaneous | 1,981,067 | 1,000,343 |
| Total operating revenues | <u>2,676,881,894</u> | <u>2,648,327,624</u> |
| Operating expenses | | |
| Prize expenses | 1,543,672,565 | 1,511,914,428 |
| Amortization expense | 51,660 | 51,660 |
| Bad debt expense | 650,000 | - |
| Administrative expenses | 22,322,459 | 18,052,156 |
| Retailer commissions | 146,973,605 | 144,890,988 |
| Online vendor fees | 17,901,509 | 25,447,918 |
| Instant vendor fees | 14,793,052 | 17,362,734 |
| Multi-state fees | 31,219 | 21,140 |
| Online network fees | (855,684) | 4,402,944 |
| Drawing broadcast fees | 1,074,418 | 1,074,677 |
| Total operating expenses | <u>1,746,614,803</u> | <u>1,723,218,645</u> |
| Operating income | 930,267,091 | 925,108,979 |
| Non-operating revenue | | |
| Interest | 365,309 | 575,470 |
| Income before transfers out | 930,632,400 | 925,684,449 |
| Transfers out - contributions for state aid to education and state institutions | 930,000,111 | 924,009,031 |
| Change in net assets | 632,289 | 1,675,418 |
| Net assets, beginning of year | 10,231,409 | 8,555,991 |
| Net assets, end of year | <u>\$ 10,863,698</u> | <u>\$ 10,231,409</u> |

See accompanying notes to financial statements

STATEMENTS OF CASH FLOWS

| | Year ended June 30, | |
|--|-----------------------|-----------------------|
| | 2011 | 2010 |
| Cash Flows from Operating Activities | | |
| Sales to customers | \$ 1,296,367,920 | 1,323,081,283 |
| Payments for prize awards | (353,411,947) | (350,600,578) |
| Payments for vendor commissions and fees | (35,599,402) | (48,109,278) |
| Payments to suppliers | (18,934,459) | (21,177,037) |
| Other payments | (16,579) | (22,826) |
| Cash flows from annuity operations | | |
| Annuity receipts | 110,381,004 | 123,663,004 |
| Purchases of annuities | (2,463,693) | (2,745,087) |
| Payments of annuity prizes | (75,043,156) | (92,502,858) |
| Net cash provided by operating activities | <u>921,279,688</u> | <u>931,586,623</u> |
| Cash Flows used in Non-Capital Financing Activities | | |
| Contributions for aid to education and state institutions | (923,009,031) | (935,208,916) |
| Cash Flows from Investment Activities | | |
| Cash Management Fund proceeds | 1,118,113,000 | 1,340,635,000 |
| Cash Management Fund purchases | (1,116,400,000) | (1,336,800,000) |
| Net cash provided by (used in) investing activities | <u>1,713,000</u> | <u>3,835,000</u> |
| Net increase in cash | (16,343) | 212,708 |
| Cash, beginning of year | 617,648 | 404,940 |
| Cash, end of year | <u>\$ 601,305</u> | <u>\$ 617,648</u> |
| Reconciliation of operating income to net cash provided by operating activities | | |
| Operating Income | \$ 930,267,091 | \$ 925,108,979 |
| Changes in assets and liabilities | | |
| Accounts receivable | (2,620,529) | (3,342,594) |
| Investments - deposit fund contracts | 77,906,831 | 84,836,011 |
| Other assets | 5,391,824 | (3,914,218) |
| Accounts payable and accrued expenses | (6,559,669) | 4,007,298 |
| Obligation for unpaid prize awards | (83,140,935) | (74,954,538) |
| Compensating absences | 35,075 | (154,315) |
| Net cash provided by operating activities | <u>\$ 921,279,688</u> | <u>\$ 931,586,623</u> |

See accompanying notes to financial statements

NEW JERSEY DIVISION OF STATE LOTTERY

Notes to Financial Statements

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The New Jersey Division of State Lottery (the "Division of State Lottery") and the State Lottery Commission (the "Commission") were concurrently established in 1970, pursuant to the "State Lottery Law" (N.J.S.A. 5:9-1 et seq.). The Division of State Lottery operates within the Department of the Treasury of the State of New Jersey. The Commission consists of the State Treasurer and six public members and 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, and the apportionment of ticket revenues. The Division of State Lottery's financial statements are presented as those of an enterprise fund and include the operations for which the Division of State Lottery is financially accountable and exercises oversight responsibility.

Basis of Accounting

The Division of State Lottery prepares its financial statements using the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when incurred.

In its accounting and financial reporting, the Division follows the pronouncements of the Governmental Accounting Standards Board ("GASB") and other entities that promulgate accounting principles. Per GASB Statement 55, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments, priority is established as to which source of accounting principles to utilize in determining proper accounting treatment. The hierarchy is as follows: GASB Statements and Interpretations; GASB Technical Bulletins; American Institute of Certified Public Accountants ("AICPA") Industry Audit and Accounting Guides and AICPA Statements of Position, if applicable, and cleared by GASB; AICPA Practice Bulletins, if applicable, and cleared by GASB; Implementation Guides published by the GASB; AICPA pronouncements that are not specially applicable to state and governmental entities; Financial Accounting Standards Board ("FASB") Statements and Interpretations; and Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee of Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Governmental Accounting Standards Board ("GASB") Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, provides proprietary activities with a choice of authoritative guidance issued after November 30, 1989. The Division of State Lottery has elected to follow GASB pronouncements exclusively after that date.

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 and disclosures. Accordingly, actual results could differ from those estimates.

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.

Accounts Receivable

Accounts receivable is comprised primarily of amounts due from retailers. The allowance for uncollectible accounts is funded by a \$100 per year license renewal fee paid by the Division's retailers. Operating expense is charged with an allowance for estimated uncollectible accounts based on past experience and an analysis of current accounts receivable collectibility. Accounts deemed uncollectible are charged to the allowance in the year they are deemed uncollectible.

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 Division of State Lottery for prize disbursements. The Division of State Lottery purchases annuity contracts from insurance companies and U.S. government securities to fund its liability for installment prize awards. An annuity contract represents an obligation by an insurance company to provide a fixed series of payments over a specified period. Annuity contracts are subject to credit risk. The Division of State Lottery 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 having minimum acceptable ratings from at least two of three private rating companies. The rating companies and the minimal acceptable ratings are the following: Standard and Poor's financial strength rating of "AA," A.M. Best financial strength rating of "A," and Moody's financial strength rating of "Aa2." However, due to the long-term nature of these contracts, the credit quality of the issuer is subject to change. 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. These annuities are presented on the statement of net assets as deposit fund contracts, carried at contract value which approximates fair value.

Equipment

The Division 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. As of June 30, 2011 and 2010, leasehold improvements were \$357,474 and \$357,474, respectively. For the years ended June 30, 2011 and 2010, amortization expense was \$51,660.

Net Assets**Restricted**

Amounts restricted for prize awards or contributions for aid to education and state institutions consist of prizes that are not claimed within one year from the date of the drawing for machine games and within one year from the date of game's closing for instant games.

Unrestricted

The unrestricted net assets represent resources available for current operating expenses in compliance with legal and budgetary restrictions.

Revenue Recognition

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

- "Pick-3," "Pick-4," "Jersey Cash 5," "Pick-6 Lotto," "Mega Millions," "Powerball" and various raffle games 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.

Forfeited Prizes

The State Lottery Law requires that prizes not claimed within one year from the date of the drawing for machine games and within one year from the date of the game's closing for instant games be forfeited. Effective November 21, 1991, the Commission authorized that seventy percent of forfeited prizes are to be maintained restricted for prize awards and are available to augment future prize awards or, at the discretion of the executive director, to augment the Division of State Lottery's contribution for state aid for education and state institutions. The remaining 30% goes directly to contributions to aid education and institutions to be consistent with the 30% minimum contribution requirement of the State Lottery Law. Forfeited prizes are recognized as "Other Revenues" during the period forfeited. For the years ended June 30, 2011 and 2010, forfeited prizes were \$38,453,261 and \$42,223,139, respectively.

Contributions and Prize Awards

The State Lottery Law requires no less than 30% of total revenues accruing from ticket sales to be paid to the State Treasury for state aid for education and state institutions. Contributions for the years ended June 30, 2011 and 2010, aggregated \$930,000,111 and \$924,009,031, respectively, of which \$100,000,111 and \$93,009,031 was due to the State Treasury at June 30, 2011 and 2010, respectively.

For machine games, the Division of State Lottery 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.

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 online 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.

Vacation and Sick Leave

The Division 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 from the State of New Jersey's General Fund. Such 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.

Advertising

The Division of State Lottery uses advertising to promote the sale of lottery tickets. The costs of advertising are expensed as incurred. Advertising expense included in administrative expense amounted to \$9,957,379 and \$7,038,893 for the years ended June 30, 2011 and 2010, respectively.

CASH AND INVESTMENTS

The Division of State Lottery adopted GASB Statement No. 40, 'Deposits and Investment Risk Disclosures,' which requires uncollateralized deposits exposed to custodial credit risk to be disclosed. The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits that are in possession of an outside party. The following is a summary of the Division's cash deposits by financial institution and the amount exposed to custodial credit risk at June 30, 2011 and 2010. The Division's deposits with Wachovia are insured by the Federal Deposit Insurance Corporation up to \$250,000.

| | Year Ended June 30 | |
|---------------------------------|----------------------|----------------------|
| | 2011 | 2010 |
| Wachovia (Wells Fargo) | \$ 601,305 | \$ 617,648 |
| New Jersey Cash Management Fund | \$ 152,215,577 | 153,563,268 |
| Total Assets | \$152,816,882 | \$154,180,916 |

The New Jersey Cash Management Fund is a common trust fund administered by the Department of the Treasury, Division of Investments. Securities in the fund are insured, registered or held by the Division of Investment or its agents in the Division's name. Since the New Jersey Cash Management Fund is a pooled investment and the cash balance is guaranteed by the State of New Jersey, the Commission's cash and investments are not subject to custodial credit risk under GASB Statement No. 40.

Fair Value Measurements

The Division of State Lottery follows the Fair Value Measurements Topic of the FASB Accounting Standards Codification, which provides a framework for measuring fair value under accounting principles generally accepted in the United States of America.

As defined in the Fair Value Measurements Topic of the FASB Accounting Standards Codification, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Division of State Lottery uses the stock market index approach. Based on this approach, the Division of State Lottery often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Division of State Lottery utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques the Division of State Lottery required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury and federal agency securities and federal agency mortgage-backed securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or similar assets or liabilities.

Level 3 - Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

Investments

The fair value of investment securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use unobservable inputs due to the limited market activity of the instrument. Investments at June 30, 2011, consist of Prudential Financial common stock.

Fair Value on a Recurring Basis

The table below presents the balances of investments measured at fair value on the statement of net assets as of June 30, 2011:

| | Total | June 30, 2011 | | |
|-------------------------------|--------------|---------------|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Available for Sale Securities | \$ 3,203,283 | \$ 3,203,283 | \$ - | \$ - |
| Total | \$ 3,203,283 | \$ 3,203,283 | \$ - | \$ - |

FUTURE INSTALLMENT PRIZE AWARDS

The Division purchases annuity, or deposit fund contracts, from insurance companies and U.S. government securities to fund its liability for future installment prize awards. Generally, annuity contracts fund Win for Life instant game annuity prizes, and U.S. government securities fund annuity prizes for Pick 6, Mega Millions and Powerball. 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, 2011 and 2010, the Division held U.S. government securities totaling \$40,246,366 and \$41,081,902, respectively, which are included in investments - deposit fund contracts.

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 Division 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 having minimum acceptable ratings from at least two of three private rating companies. The rating companies and the minimal acceptable ratings are the following; Standard and Poors financial strength rating of "AA," A.M. Best financial strength rating of "A," and Moody's financial strength rating of "Aa2." However, due to the long-term nature of these contracts, the credit quality of the issuer is subject to change. As of June 30, 2011, eight companies with annuity contracts totaling approximately \$218,285,264 had ratings below those minimally acceptable for new purchases. At June 30, 2011 and 2010, the Division held insurance company annuity contracts totaling \$405,486,747 and \$485,761,324, respectively, issued through ten insurance companies, which are due in installments ranging from ten years to the lifetime of the recipient. The estimated fair value of annuity contracts approximates the carrying value reflected in the accompanying statements of net assets at June 30, 2011 and 2010.

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, as stated above, are the only category subject to concentration of credit risk disclosure.

A significant portion (in excess of 5% of total) of the Division's investment in annuity contracts at such date is invested with each of the following five companies:

- Ohio National Life
- New York Life Insurance Co.
- Protective Life
- Metropolitan Life
- Sun Life Assurance

LITIGATION

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

COMMITMENTS

Contractual Arrangements

The Division of State Lottery maintains a gaming network of almost 6,200 online locations where all games are sold. GTECH Corporation is responsible for operating the online games and providing courier services under a contract which expires October 2, 2017.

Operating Leases

The Division of State Lottery leases certain office facilities under non-cancelable operating lease agreements expiring through fiscal year 2017.

Future minimum lease payments are as follows:

| <u>Year Ending June 30</u> | Amount |
|----------------------------|---------------------|
| 2012 | \$ 802,871 |
| 2013 | 814,933 |
| 2014 | 429,904 |
| 2015 | 154,883 |
| 2016 | 154,883 |
| 2017 | 129,069 |
| | <u>\$ 2,486,543</u> |

SUBSEQUENT EVENTS

Management has evaluated subsequent events that occurred after the statement of net assets date but before October 18, 2011, the date the financial statements were available to be issued.

ROUNDING

Some schedules in the financial statements may have dollar differences due to rounding adjustments.

Rent expense for office facilities at June 30, 2011 and 2010, was \$1,134,182 and \$1,081,213, respectively.



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