

NEW JERSEY STATE LOTTERY COMMISSION

Financial Statements
and Supplementary Information

Years Ended June 30, 2006 and 2005

NEW JERSEY STATE LOTTERY COMMISSION

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INDEPENDENT AUDITORS' REPORT

To the Commissioners of
NEW JERSEY STATE LOTTERY COMMISSION

We have audited the accompanying statements of net assets of the **NEW JERSEY STATE LOTTERY COMMISSION** (the "Commission") as of June 30, 2006 and 2005, 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, 2006 and 2005, 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 30, 2006 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 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.

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INDEPENDENT AUDITORS' REPORT (CONTINUED)

Our audit was 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 presentation of management's discussion and analysis. However, we did not audit the information and express no opinion on it.

Mercedino, P.C.
Certified Public Accountant

October 30, 2006

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, 2006 and 2005. 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, 2006 and 2005 consisted of total assets of \$977 million and \$1.071 billion, respectively, and total liabilities of \$964 million and \$1.058 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, 2006 and 2005 were \$799 million and \$904 million, respectively. Net assets remained relatively stable at \$13 million in fiscal year 2006.

FINANCIAL STATEMENTS

The Lottery's financial statements include Statements of Net Assets as of June 30, 2006 and 2005, Statements of Revenues, Expenses and Changes in Net Assets for fiscal years ended June 30, 2006 and 2005, and Statements of Cash Flows for fiscal years ended June 30, 2006 and 2005. 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,	
	2006	2005
Current Assets	\$ 332	\$ 327
Deposit Fund Contracts	645	744
Total Assets	977	1,071
Current Liabilities	318	313
Non-Current Liabilities	646	745
Total Liabilities	964	1,058
Restricted Net Assets	10	10
Unrestricted Net Assets	3	3
Total Net Assets	\$ 13	\$ 13

Management's Discussion and Analysis (Continued)

FINANCIAL STATEMENTS (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 \$145 million and \$125 million at June 30, 2006 and 2005, respectively.

The Lottery funds long-term installment prizes with insurance company annuities and United States Treasury securities. The total value of these investments was \$799 million and \$904 million as of June 30, 2006 and 2005, respectively. The Lottery has annuity investments with thirteen (13) insurance companies. The total market value of the United States Treasury securities was \$31.4 million and \$34.4 million at June 30, 2006 and 2005, respectively. The annuity prizes due in fiscal years 2008 and beyond totaled \$645 million and represent the non-current assets reported on the 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 \$64 million and \$51 million as of June 30, 2006 and 2005, respectively. There is also \$154 million due to annuity winners in fiscal year 2007.

Non-current liabilities represent annuity prize awards due in fiscal years beyond 2007 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,	
	2006	2005
Restricted (Expired Prize Awards)	\$ 10	\$ 10
Unrestricted	3	3
Total Net Assets	<u>\$ 13</u>	<u>\$ 13</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:

Management's Discussion and Analysis (Continued)

FINANCIAL STATEMENTS (CONTINUED)

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

	Year Ended June 30,	
	2006	2005
Operating revenues		
Ticket sales	\$ 2,406	\$ 2,274
Forfeited prizes	35	31
Miscellaneous income	1	1
Total operating revenue	<u>2,442</u>	<u>2,306</u>
Operating expenses		
Prize expenses	1,380	1,297
Administrative expenses	30	28
Retailer commissions	134	126
Vendor fees	48	44
Network fees	9	8
Drawing broadcast fees	1	1
Bad debt and amortization expenses	1	-
Total operating expenses	<u>1,603</u>	<u>1,504</u>
Operating income	839	802
Investment income	5	2
Income before transfers	<u>844</u>	<u>804</u>
Operating transfers - state contributions	<u>844</u>	<u>812</u>
Decrease in net assets	<u>\$ -</u>	<u>\$ (8)</u>

The Lottery awarded over \$1.380 billion in prize awards in fiscal year 2006 and approximately \$1.297 billion in fiscal year 2005. Over 102 million winning tickets were validated and paid in fiscal year 2006, while approximately 95 million winning tickets were validated and paid in fiscal year 2005.

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 \$57.5 million in fiscal year 2006 and \$52.0 million in fiscal year 2005. Drawing broadcast fees were \$1,141,548 in fiscal year 2006 and \$1,141,540 in fiscal year 2005.

Management's Discussion and Analysis (Continued)

FINANCIAL STATEMENTS (CONTINUED)

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

The Lottery's administrative expenses for the fiscal years 2006 and 2005 totalled \$29.6 million and \$27.5 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 2006 was for advertising.

The 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 Lottery contributed \$844 million, 34.6% of total revenues, in fiscal year 2006 and \$812 million, 35.2% of total revenues, in fiscal year 2005.

Statements of Cash Flows:

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

	Year Ended June 30,	
	2006	2005
Cash flows from operating activities	\$ 866	\$ 796
Cash flows used in non-capital financing activities	(847)	(822)
Cash flows (used in) provided by investing activities	(16)	26
Net increase in cash	\$ 3	\$ -

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,	
	2006	2005
ASSETS		
Current Assets		
Cash	\$ 3,228,501	\$ 521,666
Accounts receivable, net of allowance for doubtful accounts of \$650,000 in 2006 and \$150,000 in 2005	13,740,316	27,346,355
Investments		
Deposit fund contracts	153,857,004	160,286,504
State of New Jersey Cash Management Fund	145,453,450	124,740,315
Other assets	15,270,368	14,889,807
Total current assets	331,549,639	327,784,647
Non-Current Assets		
Investments - deposit fund contracts	644,974,326	743,996,848
Total assets	976,523,965	1,071,781,495
LIABILITIES		
Current Liabilities		
Accounts payable and accrued expenses	23,619,358	22,821,118
Obligation for unpaid prize awards	64,216,529	50,783,599
Installment prize awards	153,857,004	160,286,504
Due to State of New Jersey - education and state institutions	76,155,935	79,546,973
Total current liabilities	317,848,826	313,438,194
Non-Current Liabilities		
Compensated absences	998,542	876,398
Installment prize awards	644,974,326	743,996,848
Total non-current liabilities	645,972,868	744,873,246
Total liabilities	963,821,694	1,058,311,440
NET ASSETS		
Restricted for prize awards or contributions for aid to education and state institutions	9,875,921	10,698,521
Unrestricted	2,826,350	2,771,534
Total net assets	\$ 12,702,271	\$ 13,470,055

NEW JERSEY STATE LOTTERY COMMISSION

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended June 30,	
	2006	2005
Operating revenues		
Ticket Sales		
Pick 3	\$ 458,716,926	\$ 456,582,545
Pick 4	260,267,470	265,003,920
Jersey Cash 5	125,903,092	123,253,335
Pick 6 Lotto	102,732,860	109,983,537
Mega Millions	317,207,674	253,408,054
Instant games	1,141,676,642	1,066,130,914
Sales discounts	(587,835)	(556,188)
Total ticket sales	<u>2,405,916,829</u>	<u>2,273,806,117</u>
Other revenues		
Forfeited prizes	34,737,378	30,662,853
Miscellaneous	852,043	1,247,318
Total operating revenues	<u>2,441,506,250</u>	<u>2,305,716,288</u>
Operating expenses		
Prize expenses	1,380,414,193	1,296,810,791
Administrative expenses	29,564,516	27,492,371
Retailer commissions	133,595,624	126,248,659
On-line vendor fees	31,461,000	29,924,546
Instant vendor fees	16,633,464	14,340,331
Multi-state fees	19,313	16,852
On-line network fees	9,394,721	7,759,214
Drawing broadcast fees	1,141,548	1,141,540
Bad debt expense	500,000	-
Amortization expense	26,854	2,086
Total operating expenses	<u>1,602,751,233</u>	<u>1,503,736,390</u>
Operating income	838,755,017	801,979,898
Non-operating revenue		
Interest	<u>4,633,134</u>	<u>2,435,472</u>
Income before transfers out	843,388,151	804,415,370
Transfers out - contributions for state aid to education and state institutions	<u>844,155,935</u>	<u>812,046,973</u>
Change in net assets	(767,784)	(7,631,603)
Net assets, beginning of year	<u>13,470,055</u>	<u>21,101,658</u>
Net assets, end of year	<u>\$ 12,702,271</u>	<u>\$ 13,470,055</u>

NEW JERSEY STATE LOTTERY COMMISSION

STATEMENTS OF CASH FLOWS

	Year Ended June 30,	
	2006	2005
Cash flows from operating activities		
Sales to customers	\$ 1,257,696,195	\$ 1,174,590,351
Payments for prize awards	(323,000,738)	(326,209,724)
Payments for vendor commissions and fees	(57,422,846)	(50,052,629)
Payments to suppliers	(33,930,650)	(20,614,419)
Other payments	(1,560)	(341,701)
Cash flows from annuity operations:		
Annuity receipts	154,726,746	164,104,704
Purchases of annuities	(11,942,462)	(26,503,851)
Payments of annuity prizes	(119,790,876)	(119,425,366)
Net cash provided by operations	<u>866,333,809</u>	<u>795,547,365</u>
Cash flows used in non-capital financing activities		
Contributions for aid to education and state institutions	<u>(847,546,974)</u>	<u>(821,471,914)</u>
Cash flows from investing activities		
Cash Management Fund proceeds	1,204,545,000	1,106,480,000
Cash Management Fund purchases	<u>(1,220,625,000)</u>	<u>(1,080,650,000)</u>
Net cash (used in) provided by investment activities	<u>(16,080,000)</u>	<u>25,830,000</u>
Net increase (decrease) in cash	2,706,835	(94,549)
Cash, beginning of year	521,666	616,215
Cash, end of year	<u>\$ 3,228,501</u>	<u>\$ 521,666</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating Income	\$ 838,755,017	\$ 801,979,898
Changes in assets and liabilities		
Accounts receivable	13,606,039	11,803,407
Investments - deposit fund contracts	105,452,022	68,037,432
Other assets	(380,561)	(686,057)
Accounts payable and accrued expenses	798,240	2,308,407
Obligation for unpaid prize awards	(92,019,092)	(87,943,169)
Compensating absences	122,144	47,447
Net cash provided by operating activities	<u>\$ 866,333,809</u>	<u>\$ 795,547,365</u>

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, 2006 and 2005, aggregated \$844,155,935 and \$812,046,973, respectively, of which \$76,155,935 and \$79,546,973 was due to the State Treasury at June 30, 2006 and 2005, 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.

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, 2006 and 2005, forfeited prizes were \$34,737,378 and \$30,662,853, respectively.

NEW JERSEY STATE LOTTERY COMMISSION

NOTES TO FINANCIAL STATEMENTS

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 \$650,000 and \$150,000 for the years ended June 30, 2006 and 2005, respectively. The Commission also maintains 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. For the years ended June 30, 2006 and 2005, leasehold improvements included in other assets were \$257,160 and \$202,344, respectively. For the years ended June 30, 2006 and 2005, amortization expense was \$26,854 and \$2,086, respectively.

NEW JERSEY STATE LOTTERY COMMISSION

NOTES TO FINANCIAL STATEMENTS

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 expenses" 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.

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 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.

NEW JERSEY STATE LOTTERY COMMISSION

NOTES TO FINANCIAL STATEMENTS

B. CASH AND INVESTMENTS (CONTINUED)

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.

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, 2006 and 2005, the Commission held U.S. government securities totaling \$31,456,233 and \$34,387,398, 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, 2006, only one of the companies had a rating under "AA," as compared to three at June 30, 2005. At June 30, 2006 and 2005, the Commission held insurance company annuity contracts totaling \$798,831,330 and \$904,283,352, 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 the following eight companies:

- | | |
|-------------------------------|---|
| • Ohio National Life | • Metropolitan Life |
| • New York Life Insurance Co. | • Keyport Life/Sun Life |
| • Mutual of America | • Alexander Hamilton Life Insurance Co. (Jefferson Pilot) |
| • Protective Life | • 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, 2006 and 2005.

NEW JERSEY STATE LOTTERY COMMISSION

NOTES TO FINANCIAL STATEMENTS

C. FUTURE INSTALLMENT PRIZE AWARDS (CONTINUED)

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.

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 December 20, 2007.

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
2007	\$ 697,438	2011	\$ 638,550
2008	638,550	2012	638,550
2009	638,550	2013	638,550
2010	638,550		

Rent expense for office facilities in 2006 and 2005 was \$1,041,127 and \$750,100, respectively.

SUPPLEMENTARY INFORMATION

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS BUDGET AND ACTUAL

Year Ended June 30, 2006

	Budget (unaudited)	Actual	Variance favorable (unfavorable)
Operating revenues			
Ticket Sales			
Pick 3	\$ 448,564,250	\$ 458,716,926	\$ 10,152,676
Pick 4	266,564,250	260,267,470	(6,296,780)
Jersey Cash 5	122,112,900	125,903,092	3,790,192
Pick 6 Lotto	120,016,000	102,732,860	(17,283,140)
Mega Millions	288,080,000	317,207,674	29,127,674
Instant games	1,119,090,000	1,141,676,642	22,586,642
Sales discounts	(2,000,000)	(587,835)	1,412,165
Total ticket sales	<u>2,362,427,400</u>	<u>2,405,916,829</u>	<u>43,489,429</u>
Other income			
Forfeited prizes	29,473,000	34,737,378	5,264,378
Miscellaneous	1,000,000	852,043	(147,957)
Total operating revenues	<u>2,392,900,400</u>	<u>2,441,506,250</u>	<u>48,605,850</u>
Operating expenses			
Prize expenses	1,347,062,300	1,380,414,193	(33,351,893)
Administrative expenses	29,000,000	29,564,516	(564,516)
Retailer commissions	130,043,507	133,595,624	(3,552,117)
On-line vendor fees	30,960,376	31,461,000	(500,624)
Instant vendor fees	15,779,169	16,633,464	(854,295)
Multi-state fees	50,000	19,313	30,687
On-line network fees	9,000,000	9,394,721	(394,721)
Drawing broadcast fees	1,140,000	1,141,548	(1,548)
Bad debt expense	-	500,000	(500,000)
Amortization expense	-	26,854	(26,854)
Total operating expenses	<u>1,563,035,352</u>	<u>1,602,751,233</u>	<u>(39,715,881)</u>
Operating income	829,865,048	838,755,017	8,889,969
Non-operating revenue			
Interest income	<u>1,800,000</u>	<u>4,633,134</u>	<u>2,833,134</u>
Income before transfers out	831,665,048	843,388,151	11,723,103
Contributions for state aid to education and state institutions	<u>832,000,000</u>	<u>844,155,935</u>	<u>(12,155,935)</u>
Change in net assets	(334,952)	(767,784)	(432,832)
Net assets, beginning of year	<u>13,470,055</u>	<u>13,470,055</u>	<u>-</u>
Net assets, end of year	<u>\$ 13,135,103</u>	<u>\$ 12,702,271</u>	<u>\$ (432,832)</u>

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAME REVENUES

	Year Ended June 30,	
	2006	2005
CROSSWORD (X)	\$ 99,600	\$ 42,917,994
CROSSWORD U	2,448	42,695,466
CROSSWORD V	6,009	42,307,662
CROSSWORD (W)	6,024	41,678,283
CROSSWORD (Y)	1,326,828	39,194,799
LIFETIME RICHES	181,365	30,124,270
BIG MONEY SPECTACULAR (H)	68,658	23,153,014
BIG MONEY SPECTACULAR	5,386	21,831,886
VINTAGE BINGO	334,292	21,336,054
BIG MONEY SPECTACULAR (I)	2,752,460	19,388,656
BINGO EXTRA	24,687	18,029,628
SUPER BLACKJACK DOUBLE PLAY	1,363,680	17,908,295
HOLD'EM POKER	3,549,275	17,475,285
WIN FOR LIFE AB	19,431	16,786,233
SPECTACULAR 7'S	233,730	16,784,390
\$1,000,000 JACKPOT	2,862,420	16,453,690
SUPER TIC TAC TOE	1,841,169	16,309,950
PINBALL WIZARD	13,150	15,837,715
GOLDEN RICHES	1,279,449	14,536,196
VINTAGE BINGO	(1,178)	14,506,900
WIN FOR LIFE AC	1,591,026	14,386,620
HOT SLOTS	6,028,425	14,143,070
CROSSWORD (Z)	29,288,646	13,974,018
POKER NIGHT	41,910	13,943,885
DOUBLE UP SLINGO	84,600	12,827,295
SUPER SIZE CASH	29,430	12,681,340
FISTFUL OF \$50's	3,360	12,469,318
MULTI MONEY	8,850	12,397,558
DOUBLE DOUBLER	201,206	12,144,922
HOLIDAY LUCKY TIMES 10	36,822	12,046,946
DOUBLE YOUR LUCK	149,677	11,907,816
LUCKY STARS DOUBLE PLAY	5,101,890	11,645,990
LUCKY 7	5,734,445	11,244,320
LUCKY HEARTS	391,520	10,848,478
PAC-MAN MANIA	481,324	10,471,208
STOCKING STUFFER	44,905	10,441,056
SIZZLING HOT CASH	378,016	10,409,450
SHAMROCK TRIPLER	1,684,118	10,265,754
BIG BANG BUCKS	6,396	10,059,092
BIG MONEY SPECTACULAR F	7,200	9,883,200

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAME REVENUES (CONTINUED)

	Year Ended June 30,	
	2006	2005
FOOTBALL FEVER	387,960	9,671,446
SNOW MAGIC	776,430	9,525,680
MAGIC LINE BINGO	8,707,752	9,413,874
HARVEST CASH	828,954	9,204,830
KING SIZE CASH	7,386,630	9,127,100
ACES HIGH	783,502	8,890,602
LIFETIME RICHES	26,892,250	8,554,285
DOUBLE YOUR LUCK	3,659,062	8,548,935
CONGRATULATIONS	3,365,892	8,535,400
PROGRESSIVE BLACKJACK	3,185,790	8,295,850
QUICK SILVER	21,744	8,182,763
SPRING CASH	2,459,800	8,172,736
HOLIDAY COUNTDOWN	735,987	8,113,923
CARIBBEAN STUD POKER	3,257,228	7,583,660
CAESARS PALACE	(2,425)	7,286,420
NJ ROAD TRIP	72,516	7,101,380
PLATINUM BINGO	(879)	6,879,501
10 TIMES LUCKY (D)	5,532,310	6,862,750
TEXAS HOLD'EM POKER	13,695,625	6,845,275
BREEDERS' CUP GOLD	71,000	6,573,550
VINTAGE BINGO	14,902,876	6,535,050
MATRIMONEY	4,195,630	6,298,772
WIN FOR LIFE A1	(300)	6,279,978
WILD BILL	10,993	6,181,735
DEEP SEA DOUBLER	1,750	6,174,713
YOUNG & RESTLESS	506,780	5,962,270
PROGRESSIVE POKER	137,490	5,603,510
HOLLYWOOD STARS	708,302	5,553,992
BIG CASH DOUBLEPLAY	(1,800)	5,271,465
MOTHER'S DAY BONUS	801,967	5,110,457
TRIPLE TRIPLER	-	5,079,544
10 TIMES LUCKY	3,000	5,071,074
XTREME SIGHTS & SOUNDS	162,830	4,877,050
JACKS OR BETTER D	27,395	4,825,895
MATRI-MONEY	(780)	4,567,432
ROLL 6 POKER	19,668	4,447,590
WHO'S ON FIRST	2,567,788	4,270,152
CROSSWORD T	-	4,086,420
BACK 9	6,099,129	3,897,531
MILLION DOLLAR MANIA	14,654,590	3,691,710

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAME REVENUES (CONTINUED)

	Year Ended June 30,	
	2006	2005
CYBER SLINGO 5 PACK	383,627	3,637,034
POOL PARTY CASH	6,086,820	3,463,212
SPRING BREEZE	(1,200)	3,432,946
SLINGO	(516)	3,400,467
BIRTHDAY SURPRISE	(1,312)	3,330,706
FATHER'S DAY DOUBLER	(900)	3,319,201
WINNING LEGENDS	120,750	3,315,622
PHARAOHS GOLD	(300)	3,279,909
BIG CASH CASINO	(910)	3,222,310
ORANGE COUNTY CHOPPERS	3,110,514	3,164,643
FATHER'S DAY BONUS	2,619,046	3,040,653
CARIBBEAN CASH	(848)	2,709,470
BURST CASH	(580)	2,566,300
SINGLE, DOUBLE, TRIPLE PLAY BINGO	14,445,810	2,457,280
LUCKY 4 LEAF CASH	(900)	2,273,882
TETRIS	159,015	2,272,683
FIRECRACKER CASH DOUBLER	8,778,360	1,874,098
LUCKY 8'S BINGO	(600)	1,725,177
CYBER SLINGO	88,496	1,720,848
DOMINOES	13,647,246	1,684,800
ARCTIC CASH	4,500	1,571,304
HUNT FOR CASH	(600)	1,365,765
MOTHERS DAY DOUBLER	(300)	1,331,056
NHL	(1,228)	1,247,620
HOLIDAY MAGIC	4,200	1,151,235
THE HONEYMOONERS	(1,500)	1,125,680
FALL FEST	(600)	1,004,010
WILD 7'S SLINGO	-	896,541
CASH CROP	(600)	562,602
WIN FOR LIFE (AD)	15,579,858	543,900
SUPER DIAMOND	(600)	496,880
FAST CASH CORVETTE	-	468,118
AMAZING ADVENTURE	(690)	448,056
DIAMOND DOLLAR BINGO	(300)	338,211
BIG MONEY SPECTACULAR (J)	22,726,560	319,200
LIVIN' LUCKY	(600)	306,985
BETTY BOOP	9,903,770	265,200
HOLLY JOLLY JACKPOT	-	177,667
VINTAGE BINGO	-	175,120
\$25,000 HEARTS	(300)	166,292

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAME REVENUES (CONTINUED)

	Year Ended June 30,	
	2006	2005
CROSSWORD S	-	158,508
WINNER WEATHER	-	150,443
COUNT DE MONEY	-	148,596
RED HOT DOUBLER D	-	144,502
THE NUMBERS GAME	7,831,938	135,000
BIG MONEY SPECTACULAR	300	134,936
JOKER'S WILD	(234)	123,326
TAIL GATOR	(300)	104,874
WIN FOR LIFE Z	-	87,147
DOUBLE DOUBLER	(592)	87,038
TRIPLE TRIPLER C	-	68,054
AMAZIN 8	(836)	64,082
BONUS BASEBALL	-	55,687
HOLIDAY LUCKY TIMES	(844)	38,284
MONEY MAKER DBL PLAY	(300)	31,080
CROSSWORD R	-	24,885
MAGIC NUMBERS	-	24,402
HAPPY FATHER'S DAY	-	21,995
MAGIC CHARM BINGO	-	20,040
POKER ROYALE	-	18,465
MORE LUCKY LINES	(597)	14,688
INSTANT PICK 4	-	9,820
ALL THE MARBLES	-	9,295
PINBALL PAYOFF	(135)	8,180
MONOPOLY	-	5,990
BARRELS OF BUCKS	-	5,626
BIG MONEY SPECTACULAR C	-	4,800
SWEET WINNINGS	(300)	2,996
JINGLE BELL BINGO	-	2,991
MARRY MONEY	(300)	2,486
CROSSWORD P	-	2,310
WILD 7'S CYBER SLINGO	653,830	-
DOUBLE YOUR LUCK (C)	12,687,895	-
24K GOLD	10,627,164	-
SPICY HOT CASH	10,963,536	-
RAISE THE STAKES	19,781,620	-
CONGRATULATIONS (B)	9,670,080	-
RUBY RED 7'S	11,819,404	-
BIRTHDAY WISHES	11,032,428	-
RUN THE TABLE	16,268,560	-

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAME REVENUES (CONTINUED)

	Year Ended June 30,	
	2006	2005
AUTUMN DOLLARS	8,658,594	-
OFF ROAD DOUGH	5,462,638	-
COSMIC BINGO	16,961,613	-
ULTIMATE SPORTS GETAWAY	4,770,098	-
CROSSWORD (AA)	42,314,637	-
SUPER CROSSWORD	19,193,750	-
LUCKY DOLLARS	11,977,227	-
ROULETTE MULTIPLIER	10,969,026	-
WILD CRAZY 8'S	10,688,120	-
INSTANT BINGO	11,158,206	-
INSTANT BINGO	20,262,525	-
CROSSWORD (AB)	42,037,710	-
DOUBLE YOUR LUCK D	4,676,013	-
BIG MONEY SPECTACULAR K	23,882,932	-
COUNT CASHULA	5,453,766	-
WHEEL OF FORTUNE (2005)	9,880,050	-
STOCKING STUFFER	11,494,809	-
HOLIDAY LUCKY TIMES 10	12,187,362	-
HOLIDAY WISHES	7,019,757	-
BONUS MILLIONS	14,165,870	-
COOL HAND LOOT	8,789,998	-
TREASURE CODE	8,884,197	-
CASH BONANZA	14,071,070	-
ICASH	5,177,928	-
STRIKE IT RICH	7,288,946	-
BIG SMOOCH	7,809,476	-
SLOTS OF CASH	7,506,707	-
CARNIVAL CASH	9,765,285	-
WIN FOR LIFE (AE) ORANGE	14,723,247	-
MAX-A-MILLION	13,489,250	-
SUPER TIC TAC TOE (B)	10,358,088	-
CROSSWORD (AC) ORANGE	42,375,294	-
BIG MONEY SPECTACULAR (L)	24,048,810	-
BIRTHDAY WISHES (B)	1,008,156	-
MATRIMONEY (B)	2,001,232	-
4 LEAF LUCK	9,165,518	-
PINK PANTHER	6,664,358	-
FLOWERING 50'S	8,617,660	-
ROULETTE DOUBLER	6,050,312	-
ZODIAC	4,758,510	-

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAME REVENUES (CONTINUED)

	Year Ended June 30,	
	2006	2005
GOLDEN 7'S	10,720,888	-
LUCKY DICE MULTIPLIER	6,268,101	-
SUPER CROSSWORD	20,584,940	-
MOTHER'S DAY RICHES	4,544,868	-
CROSSWORD (AD) LIME GREEN	41,257,743	-
LUCKY TIMES 20	13,829,225	-
GO FOR THE GREEN	2,739,522	-
INSTANT BINGO (B) RED	10,631,470	-
SUPER CROSSWORD (C)	20,516,435	-
WIN FOR LIFE (AE)	509,400	-
CROSSWORD (AE) RED	32,837,907	-
INSTANT BINGO (C)	9,028,360	-
BIG MONEY SPECTACULAR (M) YELLOW	19,745,094	-
CASH CATCHER	4,171,270	-
DOUBLING RED BINGO	5,091,024	-
TREASURE HUNT	2,844,782	-
SUPER RED MILLIONS	5,175,700	-
FATHER'S DAY	3,229,328	-
LIBERTY BILLS	1,949,556	-
SHORE EXCITEMENT	1,552,408	-
PRICE IS RIGHT	1,069,200	-
LUCKY LINES	1,631,940	-
PLAYERS CLUB RICHES	532,800	-
COSMIC BINGO	7,817,643	-
INSTANT BINGO (D) TEAL BLUE	1,474,200	-
SUPER CROSSWORD (D) PURPLE	2,937,000	-
BIG MONEY SPECTACULAR (N) GREEN	66,600	-
CROSSWORD (AF)	11,400	-
RED HOT TRIPLER	335,100	-
BIG MONEY SPECTAC	-	(74)
STRUCK BY LUCK	-	(90)
HIGH TIDES	-	(300)
BEETLE BAILEY	-	(300)
SPOOKY LOOT	-	(300)
FROSTY FUN DOUBLER	-	(300)
TRIPLE TRIPLER B	-	(300)
CASH BONUS	-	(300)
LUCKY CLOVER	-	(300)
CROSSWORD O	-	(300)
LIONEL CASH EXPRESS	-	(518)

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF INSTANT GAME REVENUES (CONTINUED)

	Year Ended June 30,	
	2006	2005
QUEEN FOR A DAY	-	(600)
CLASSIC BINGO	-	(600)
HAPPY HOLIDAYS	-	(600)
JACKS OR BETTER	-	(600)
MONEY BAGS	-	(600)
FUN IN THE SUN	-	(650)
4TH & GOAL	-	(888)
WILD ARUBA STUD	-	(900)
BIRTHDAY CHEER	-	(1,200)
HOLIDAY CHEER	-	(1,200)
FLOWER POWER	-	(1,200)
10 TIMES LUCKY	-	(1,200)
INSTANT PICK 3	-	(1,201)
HARLEY DAVIDSON	-	(1,378)
I LOVE LUCY	-	(1,554)
HAPPY MOTHER'S DAY	-	(1,708)
BUSHEL OF CLAMS	-	(2,100)
WHEEL OF FORTUNE	-	(2,172)
WIN FOR LIFE Y	-	(2,307)
YANKEE DOODLE DOLLARS	-	(2,659)
PROGRESSIVE BLACKJACK	-	(3,080)
PRIOR YEAR GAME	(48,597)	(4,818)
	<u>\$ 1,141,676,642</u>	<u>\$ 1,066,130,914</u>

NEW JERSEY STATE LOTTERY COMMISSION

SCHEDULES OF ADMINISTRATIVE EXPENSES

	Year Ended June 30,	
	2006	2005
Salaries	\$ 8,503,384	\$ 8,023,643
Printing and office supplies	273,302	483,100
Vehicular supplies	-	1,063
Household and clothing	3,565	4,878
Other supplies	422	646
Travel	217,830	240,577
Telephone	97,578	97,181
Postage	90,019	90,000
Data processing	301,810	318,188
Household and security	208,598	217,812
Professional services	426,136	357,501
Advertising	18,196,020	16,679,739
Maintenance - building and grounds	5,321	9,502
Maintenance - office equipment	19,449	21,977
Maintenance - vehicles	578	-
Rent - building and grounds	1,041,127	750,100
Rent - central motor pool	80,762	75,489
Rent - other	6,547	6,402
Vehicular equipment	84,931	74,961
Information processing equipment	626	8,155
Other equipment	6,511	31,457
Total administrative expenses	<u>\$ 29,564,516</u>	<u>\$ 27,492,371</u>

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

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* PRIVATE COMPANIES PRACTICE SECTION

* CENTER FOR PUBLIC COMPANY AUDIT FIRMS

* REGISTERED WITH THE PCAOB

* AN INDEPENDENTLY OWNED MEMBER OF THE

RSM MCGladREY NETWORK

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") as of and for the year ended June 30, 2006, and have issued our report thereon dated October 30, 2006. 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.

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 under 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 caused by error or fraud 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 30, 2006.

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

Compliance and Other Matters

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, and contracts, noncompliance with which could have a direct and 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*.

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

Mercaderes, P.C.
Certified Public Accountant

October 30, 2006