

2005

ANNUAL REPORT

Giving more than dreams a chance.



Giving our children a chance.

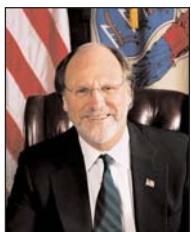


Giving education a chance.



Giving our veterans a chance.

LETTER FROM THE GOVERNOR



Dear Friends,

I am proud to be the Governor of New Jersey, a State that can boast about the New Jersey Lottery, a nationally recognized business model for other similar organizations. This past year, the New Jersey Lottery again displayed its commitment to New Jersey and its sound financial acumen by operating at a one percent administrative budget.

Winners of New Jersey Lottery instant tickets and online games such as Pick-3, Pick-4, Jersey Cash 5, the Pick-6 Lotto, and our multistate game, Mega Millions, received nearly \$1.3 billion in cash and prizes. However, the Lottery's impact on the Garden State does not stop with the 94 million winners of our games.

The Lottery's impressive sales figures—and multitude of winners—translated into more than \$812 million in support of important State education programs and institutions. As it has since its founding 35 years ago, the Lottery continues to make a difference in countless lives through the funding of such entities as our State's Homes for Disabled Veterans, the Higher Education Student Assistance Authority, and our School Nutrition Program.

I applaud your efforts and, on behalf of all New Jerseyans, I offer my sincere thanks to the New Jersey Lottery family.



With all good wishes,

A handwritten signature in black ink, which appears to read "Jon Corzine". The signature is fluid and stylized, with a large loop at the end.

Jon S. Corzine
Governor

2005



LETTER FROM THE EXECUTIVE DIRECTOR



Dear Friends,

Three and one-half decades ago, the New Jersey Lottery was only the third Lottery of its kind in the United States. What had its beginnings in the work of Governor William T. Cahill's State Lottery Planning Commission in the early months of 1970, has grown and evolved into an entity that has returned billions of dollars to education and institutions, and continues to record milestones in sales and support.

As the State's fourth largest revenue producer, the Lottery has returned nearly \$15 billion over the past 35 years, including \$812 million in fiscal year 2005, to various State institutions and educational programs.

The increasing popularity of the Lottery's instant games translated into a record-shattering \$1 billion in sales in fiscal year 2005. As an added result of this landmark sales year, the Lottery's network of 6,100 retailers—the majority of whom are small business owners—earned commissions of over \$126 million.

And our customers? Well, in fiscal year 2005, our playing public boasted more than 94 million winners who were awarded a total of nearly \$1.3 billion in prizes.

The Lottery's continued success is a direct reflection of our hard-working and creative staff and diverse network of retailers. We are proud of the significant achievements of the Lottery and are grateful for the role we play in improving the quality of life for so many of our fellow residents.



Sincerely,

Michellene Davis, Esq.
Executive Director

LETTER FROM THE TREASURER



Dear Friends,

In the early months of my tenure as New Jersey's Treasurer, I was immediately impressed by the significant contribution the New Jersey Lottery has made, and continues to make, to the citizenry of our State.

Over the past 35 years, the New Jersey Lottery has been a tremendous source of funding for educational programs and State institutions. For the fourth consecutive year, this important State agency achieved over \$2 billion in sales, further securing a place among the most successful and efficient state lotteries in North America.

But in addition to the numbers—the strong sales figures, the dollars returned to local economies through the commissions earned by Lottery retailers and, of course, prizes won by our winners—the New Jersey Lottery is truly living its “Give Your Dreams A Chance” motto. Support from the Lottery has made a difference in the lives of students at our State universities and independent colleges, as well as some of our State's most vulnerable citizens.

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

Congratulations on a tremendous year.

Sincerely,



Bradley I. Abelow
State Treasurer



LETTER FROM THE CHAIRMAN



Dear Friends,

On behalf of the New Jersey Lottery Commission, I am proud to report that as the Lottery marks its 35th Anniversary, it continues to evolve. Our numbers tell the story of an organization whose offerings are resonating in the marketplace; winners, Lottery retailers, the many beneficiary organizations the Lottery's revenue helps support—all have benefited in the past fiscal year.

Sound financial management and technological improvements to better serve our customers and retailers have contributed greatly to our growth. Lottery sales returned more than \$812 million in fiscal year 2005 to our State's educational programs and institutions, an increase of approximately \$17 million over fiscal year 2004.

My fellow commissioners and I are grateful to serve on a board that contributes so much to our State and affects the lives of so many. The membership and leadership of the New Jersey Lottery Commission looks forward to another prosperous and exciting year ahead.



Sincerely,

Robert James D'Anton
Chairman

WHERE THE MONEY GOES

The Lottery is so much more than jackpots and making millionaires. It's about helping to feed a nutritious meal to a young student, or providing scholarships to a high school student. It's about improving the quality of life for disabled veterans and developmentally disabled individuals.

As one of the most cost-efficient lotteries in the United States, the New Jersey Lottery spends approximately one percent of its revenues to operate and promote its business. As the State's fourth largest revenue producer, the Lottery raised over \$2.2 billion in sales

for fiscal year 2005, and was able to contribute more than \$812 million to the State to help fund education and institutions, making everyone in the Garden State a winner.

Since its inception 35 years ago, the Lottery has dedicated nearly \$15 billion to programs that benefit millions of New Jersey residents. Educational opportunity programs, the Department of Human Services, the Governor's School Program, the Department of Military and Veterans Affairs, our 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 New Jersey Lottery also plays a key role in supporting small businesses throughout the State. Over 6,100 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. Last fiscal year, the Lottery returned over \$126 million in commissions to support chain stores, supermarkets, pharmacies, convenience stores and small businesses throughout the State.

STATE OF NEW JERSEY PROGRAMS SUPPORTED BY STATE LOTTERY RESOURCES FOR THE YEAR ENDED JUNE 30, 2005 (Amounts expressed in thousands)	
	Amount Expended and/or Encumbered (a)
DEPARTMENT OF AGRICULTURE	
SCHOOL NUTRITION	\$ 3,910
DEPARTMENT OF EDUCATION	
GOVERNOR'S SCHOOL	729
MARIE KATZENBACH SCHOOL FOR THE DEAF	1,095
NON-PUBLIC SCHOOL AID	40,492
STATEWIDE ASSESSMENT PROGRAM (GRADES 4,8,11)	4,432
SCHOOL CONSTRUCTION AND RENOVATIONS	48,747
TOTAL DEPARTMENT OF EDUCATION	95,495
HIGHER EDUCATIONAL SERVICES	
SENIOR PUBLIC INSTITUTIONS-OPERATING AID	332,868
TUITION AID GRANTS	70,517
HIGHER EDUCATION CAPITAL IMPROVEMENT PLAN-DEBT SERVICE	8,129
OUTSTANDING SCHOLAR RECRUITMENT PROGRAM	4,979
AID TO COUNTY COLLEGES FOR OPERATIONAL COSTS	58,423
AID TO INDEPENDENT COLLEGES AND UNIVERSITIES	9,057
COORDINATED GARDEN STATE SCHOLARSHIP PROGRAM	2,735
HIGHER EDUCATION FACILITIES TRUST FUND - DEBT SERVICE	7,944
HIGHER EDUCATION FOR SPECIAL NEEDS STUDENTS	396
OPPORTUNITY PROGRAM GRANTS	8,849
SUPPLEMENTARY EDUCATION PROGRAM GRANTS	4,870
VETERINARY MEDICINE EDUCATION	529
TOTAL HIGHER EDUCATIONAL SERVICES	509,296
DEPARTMENT OF HUMAN SERVICES	
OPERATION OF CENTERS FOR DEVELOPMENTALLY DISABLED	76,520
OPERATION OF STATE PSYCHIATRIC HOSPITALS	104,759
TOTAL DEPARTMENT OF HUMAN SERVICES	181,279
DEPARTMENT OF MILITARY AND VETERANS' AFFAIRS	
OPERATION OF HOMES FOR DISABLED SOLDIERS	22,067
TOTAL REVENUE REALIZED - GAAP BASIS	\$ 812,047

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



HOMES FOR DISABLED VETERANS

In fiscal year 2005, the New Jersey Lottery contributed \$22,067,000 to The Department of Military and Veterans Affairs, which operates three modern long-term care nursing homes in Vineland, Menlo Park and Paramus that provide quality care for the State's more than 600,000 veterans. Comprehensive services and a deep concern for the residents go hand-in-hand at these facilities.

Around-the-clock medical and nursing care is provided by a full-time staff of physicians and nurses. Rehabilitative services, such as occupational and physical therapies, speech therapy, and recreational activities are provided under the direct supervision of licensed therapists. A wide range of other medical services is also offered. These include dental, psychiatric, and dermatological care. Resident accommodations are assigned based on care required and availability, and are either private or semi-private rooms, each equipped with a nurse-call system for immediate nursing care. In spacious dining rooms, residents are provided with wholesome meals prepared under the supervision of licensed dietitians.

For the convenience and comfort of the residents, the homes feature fully-equipped beauty and barber shops, lounges for socializing, outdoor patios and recreation areas, picnic grounds, and chapels for religious services for all faiths.

Recreational activities available include gardening, ceramics and other arts and crafts, cooking, music, art and pet therapy programs, movies, fishing excursions, billiards, and trips to sporting events, shopping malls and other off-site activities.

Our State's three veterans' facilities are home to many New Jerseyans who have given selflessly of themselves and their lives to ensure and protect the freedom of this State and our nation. The Lottery is proud to play a part in improving the quality of care to these veterans, to whom we all owe so much.



THE SCHOOL NUTRITION PROGRAMS

Nearly \$11.7 million in proceeds from the New Jersey Lottery provided over 602,000 school lunches and 140,000 school breakfasts for students across the State in fiscal year 2005. The NJ Department of Agriculture, Division of School Nutrition, operates the following programs:

- National School Lunch Program
- School Breakfast Program

These programs are available to eligible public and non-profit private schools and child care institutions on request. By participating in these programs, each school or institution that serves a lunch or milk in compliance with the requirements can receive financial assistance.

The objective of the National School Lunch Program and the School Breakfast Program is to provide a nutritious, well-balanced lunch and breakfast for children in order to promote sound eating habits, to foster good health and academic achievement and to reinforce the nutrition education taught in the classroom. A school lunch will provide one-third of the Recommended Dietary Allowances for lunch and be consistent with the Dietary Guidelines for Americans. A school breakfast must provide one-quarter of the daily dietary allowance.



NEW AND IMPROVED WEBSITE



The Lottery's website, www.njlottery.net, receives an average of 40,000 visitors each day and close to 1.5 million visitors each month, making it the most visited site among all State agencies in New Jersey and one of the most popular state lottery websites in the country. In fiscal year 2005, enhancements were made to the site, including an overall layout redesign, a new color scheme and a more straightforward navigation system.

Many of the website's more popular features now can be accessed without leaving the main homepage. The addition of flash drop-down menus, rollover images and jackpot amounts aligned at the top of the website add an interactive twist. Thanks to alterations such as these, visitors to the website can view winning numbers and jackpot amounts for each game with only a click of their mouse.



THE GUANGDONG PROVINCE OF CHINA SPORTS LOTTERY VISITS NEW JERSEY



The New Jersey Lottery's outstanding international reputation as one of the most efficient and cost-effective lotteries in the United States earned a visit from representatives of the Guangdong Sports Lottery in China. The 10 member delegation met with Executive Director Michellene Davis and members of the Lottery's senior staff to discuss the New Jersey Lottery's highly touted reputation for efficiency.

Among the topics discussed were marketing product performance, security, licensing and sales. The visit was arranged by the Vincent International Culture Exchange, a Los Angeles-based company dedicated to the promotion of the culture and economic exchange between China and the United States. The New Jersey Lottery was the only Lottery the delegation visited in the United States.

THE VIP CLUB

The Lottery's VIP Club has over 113,000 members – the most of any Lottery in the country. The VIP Club is free of charge and members enjoy such privileges as having the daily results directly e-mailed to them; the ability to participate in special drawings for tickets to concerts, sporting events and family entertainment; and a newsletter that details games and promotions that are on the horizon. Members sign up by logging onto the Lottery's website, www.njlottery.net.



RESPONSIBLE PLAY



As part of its continuing efforts to increase public awareness and understanding of playing responsibly, the Lottery designed a brochure for distribution to the public that provided guidelines to use when playing the Lottery and other gaming activities.

The brochure, entitled "It's Only a Game", was distributed to the Lottery's 6,100 retailers throughout the State. The free brochure 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. In conjunction with the brochure, the Lottery also distributes "Not 18 Yet? No Bet" decals to remind retailers that it's against the law to sell Lottery products to minors.

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

PICK-3, PICK-4 AND JERSEY CASH 5



Pick-3 (originally dubbed Pick-It) was introduced on May 22, 1975 and astonished Lottery officials with its instant success among players. The game was originally slated for a six-month trial period, but in just five months, officials were very pleasantly surprised when the fledgling game recorded sales of nearly \$18 million. Thirty years later, the game has generated \$11.5 billion in sales over those three decades, with \$456.6 million generated in this past fiscal year.

Two years later, with the foundation laid by the success of the Pick-3 game, Lottery officials introduced the Pick-4. The weekly Pick-4 game was designed to produce larger prizes with higher odds of winning in comparison to the daily Pick-3.

Although payouts have evolved over the years, the characteristics of the Pick-4 game remain the same. The game is still only \$.50 per bet, and the straight and combination features still remain. The Pick-4 has remained a steady favorite among players, amassing \$2.36 billion since its introduction. In fiscal year 2005, this cornerstone game earned \$265 million in sales and returned \$114 million to the State to support education and institutions.



In fiscal year 2004, the Lottery made several enhancements to the State's more popular games designed to give players the chance to win higher jackpots more often.

The results of these changes were very apparent in fiscal year 2005. With more people winning higher jackpots throughout the year, Jersey Cash 5 became one of the more popular games the Lottery has to offer. Jersey Cash 5 is drawn seven days per week and costs \$1.00 per game.



The average top-prize in 2005 was \$145,000 and 1,029,459 players won \$61.2 million. There were also 197 jackpot winners over the course of the year. Sales for the game reached an all-time high of \$123.3 million in fiscal year 2005 as well.

Players also had the chance to win a 4 x 4 Jeep Laredo through a special promotion done in conjunction with Jersey Cash 5. This unique promotion marked the first time a bonus drawing had been added to the Jersey Cash 5 game, and it was a resounding success.



PICK-6 LOTTO, MEGA MILLIONS AND INSTANT GAMES



Since its inception, the Pick-6 Lotto has generated \$7.3 billion in sales, paid out \$3.65 billion to winners and returned more than \$3.10 billion to State education and institutions.

Pick-6 Lotto, which made its first millionaire in 1981, turned out 13 millionaires in fiscal year 2005. With fiscal year 2005 sales totaling \$110 million, and returns to the State equaling \$48 million, the Pick-6 Lotto once again established itself as one of the Lottery's flagship games. In addition to continuing to turn ordinary citizens into overnight millionaires, Pick-6 Lotto was further enhanced by offering players the chance to win one of several all-expense paid trips in conjunction with playing Pick-6.

As one of the first six-digit games in the industry, New Jersey's Pick-6 Lotto has continually produced a high level of return and evolved to maintain player interest. In the months and years ahead, while the essence of this singular game remains intact, expect to see new and exciting enhancements added on for the benefit of our playing public.



With California becoming the 12th state to join Mega Millions, jackpots increased at a greater rate. The addition of the country's most populous state also meant a change in the initial amount of the jackpot from \$10 million to \$12 million. The second prize also increased from \$175,000 to \$250,000.

Sales from Mega Millions reached \$253,408,054 in New Jersey and featured a \$24 million winner from Passaic County. In fiscal year 2005, there were seven jackpots that exceeded \$100 million, including two that topped the \$200 million mark.



For the first time in the New Jersey Lottery's history, sales from instant games topped the \$1 billion mark. In fiscal year 2005, 53 new instant games, ranging in prices from \$1 to \$10, were introduced. Among the most popular were *Wheel of Fortune*, *Crossword* and *Win For Life*.

Second chance drawings on games like *Who's On First* and *Betty Boop* offered players the opportunity to win lucrative prizes and trips.

Instant tickets were responsible for contributing \$286 million to State education and institutions. Additionally, a record \$687 million was paid out in cash and prizes to instant winners. New Jersey's instant game product line continues to be one of the most popular in the nation.

MANAGEMENTS DISCUSSION AND ANALYSIS

Fiscal Years 2005 and 2004

INTRODUCTION:

The following discussion and analysis provides an analytical overview of the financial position and activities of the New Jersey State Lottery Commission (the "Lottery") for the years ended June 30, 2005 and 2004. This statement was prepared by management and should be read in conjunction with the financial statements and notes hereto, which follow this section.

The Lottery was established in 1970 pursuant to the "State Lottery Law," N.J.S.A. 5:9-1 et seq. The Lottery operates within the Department of Treasury of the State of New Jersey. The New Jersey Lottery Commission is a seven-member board, appointed by the Governor, authorized and empowered to promulgate rules and regulations in the operation of the Lottery. The "State Lottery Law" also mandates that a minimum of 30% of gross revenues from ticket sales be allocated for contributions to state aid for education and state institutions (N.J.S.A. 5:9-7a (11)).

The Lottery licenses over 6,100 retailers throughout the State of New Jersey to act as retailers in the sale of New Jersey Lottery tickets. Lottery retailers receive compensation in the form of commissions on each ticket sold or validated. The Lottery also contracts with various ticket vendors in the production, distribution and management of lottery products.

- Gtech Corporation is contracted to provide ticket sales through the on-line terminal network and the warehousing and distribution of instant tickets and promotional materials.
- Creative Games, Pollard Bank Note, Scientific Games and Oberthur Gaming Technologies are contracted to print and support instant game products.
- Verizon Communications is contracted to provide digital communication between the Lottery's 6,100 sales terminals and the Gtech data center.

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

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

FINANCIAL HIGHLIGHTS:

The Lottery's financial position at June 30, 2005 and 2004, consisted of total assets of \$1.071 billion and \$1.174 billion, respectively, and total liabilities of \$1.058 billion and \$1.153 billion, respectively. A substantial portion of the asset and liability numbers is due to the Lottery's annuity investment in prize awards. The total amounts invested and due to Lottery winners as future

installment payments at June 30, 2005 and 2004, were \$904 million and \$972 million, respectively. Net assets decreased \$7.6 million in fiscal year 2005 as a result of a decrease in unclaimed prize reserves and a decrease in the amount of accrued expenses. Net assets increased \$3 million in fiscal year 2004 as a result primarily of an increase in forfeited prizes.

FINANCIAL STATEMENTS:

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

Statement of Net Assets:

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

	June 30,	
	<u>2005</u>	<u>2004</u>
Current Assets	\$ 327	\$ 353
Long Term Annuity Investments	<u>744</u>	<u>821</u>
Total Assets	<u>1,071</u>	<u>1,174</u>
Current Liabilities	313	331
Non-Current Liabilities	<u>745</u>	<u>822</u>
Total Liabilities	<u>1,058</u>	<u>1,153</u>
Restricted Net Assets	10	18
Unrestricted Net Assets	<u>3</u>	<u>3</u>
Total Net Assets	<u>\$ 13</u>	<u>\$ 21</u>

Current assets consist of cash and investment in the State of New Jersey Cash Management Fund, accounts receivable, current year annuity investments and prepaid expenses. The investment in the State Cash Management Fund totaled \$125 million and \$148 million at June 30, 2005 and 2004, respectively.

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



MANAGEMENTS DISCUSSION AND ANALYSIS

Fiscal Years 2005 and 2004

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

Non-current liabilities represent annuity prize awards due in fiscal years beyond 2006 and the total due for unused vacation and sick leave.

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

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

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

Statement of Revenues, Expenses and Changes in Net Assets:

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

	Year Ended June 30,	
	<u>2005</u>	<u>2004</u>
Operating Revenues:		
Ticket Sales	\$ 2,274	\$ 2,187
Forfeited Prizes	31	43
Miscellaneous Income	<u>1</u>	<u>1</u>
Total Operating Revenue	<u>2,306</u>	<u>2,231</u>
Operating Expenses:		
Prize Expenses	1,297	1,240
Administrative Expenses	28	21
Retailer Commissions	126	121
Vendor Fees	44	43
Network Fees	8	8
Drawing Broadcast Fees	<u>1</u>	<u>1</u>
Total Operating Expenses	<u>1,504</u>	<u>1,434</u>
Operating Income	802	797
Investment Income	<u>2</u>	<u>1</u>
Income Before Transfers	<u>804</u>	<u>798</u>
Operating Transfers-State Contributions	<u>812</u>	<u>795</u>
(Decrease) Increase in Net Assets	\$ (8)	\$ 3

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

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

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

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

Statement of Cash Flows:

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

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

SUMMARY AND OUTLOOK:

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

Lottery management will continue to monitor its product mix to maintain player interest. To this end, the following programs and products have proven to be successful in maintaining this interest:

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

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

INDEPENDENT AUDITORS' REPORT

Commissioners of the NEW JERSEY STATE LOTTERY COMMISSION

We have audited the accompanying statement of net assets of the NEW JERSEY STATE LOTTERY COMMISSION (the "Commission") as of June 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the NEW JERSEY STATE LOTTERY COMMISSION at June 30, 2005 and 2004, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

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

MERCADIEN, P.C., CPAs

October 21, 2005





STATEMENTS OF NET ASSETS

June 30, 2005 and 2004

	Fiscal Year 2005	Fiscal Year 2004
ASSETS		
Current Assets:		
Cash	\$521,666	\$616,215
Accounts Receivable, Net of allowance for doubtful accounts of \$150,000 in 2004 and 2003	\$27,346,355	\$39,149,762
Deferred Expenses	\$14,889,807	\$14,203,750
Investments:		
Deposit Fund Contracts - Current Portion (See Note 2)	\$160,286,504	\$150,691,304
State of New Jersey Cash Management Fund	\$124,740,315	\$148,134,843
Total Current Assets	\$327,784,647	\$352,795,874
Non Current Assets:		
Investments:		
Deposit Fund Contracts (See Note 2)	\$743,996,848	\$821,629,480
Total Non Current Assets	\$1,071,781,495	\$821,629,480
Total Assets	\$1,071,781,495	\$1,174,425,354
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities	\$22,821,118	\$20,512,711
Obligation for Unpaid Prize Awards	\$50,783,599	\$70,689,336
Current Year Installment Prize Awards	\$160,286,504	\$150,691,304
Due To State Of New Jersey - Education & State Institutions	\$79,546,973	\$88,971,914
Total Current Liabilities	\$313,438,194	\$330,865,265
Non Current Liabilities:		
Unused Sick & Vacation Leave	\$876,398	\$828,951
Installment Prize Obligations	\$743,996,848	\$821,629,480
Total Non Current Liabilities	\$744,873,246	\$822,458,431
Total Liabilities	\$1,058,311,440	\$1,153,323,696
NET ASSETS		
Retained Earnings	\$13,470,055	\$21,101,658
Total Net Assets	\$13,470,055	\$21,101,658

See Accompanying Notes to Financial Statements

COMPARATIVE STATEMENTS

Statements of Revenues, Expenses and Changes in Net Assets

	Cumulative 390 Months Ended June 30, 2003 *	12 Months Ended June 30, 2004	12 Months Ended June 30, 2005	Cumulative 414 Months Ended June 30, 2005 *	%
REVENUES:					
GROSS SALES	32,072,153,240	\$ 2,186,669,795	\$ 2,273,806,117	36,532,629,152	98.69%
FORFEITED PRIZES	395,724,373	42,984,774	30,662,853	469,372,000	1.27%
MISCELLANEOUS INCOME	13,214,842	1,382,932	1,247,318	15,845,092	0.04%
TOTAL OPERATING REVENUE	32,481,092,455	2,231,037,501	2,305,716,288	37,017,846,244	100.00%
EXPENDITURES:					
PRIZE EXPENSE	16,618,340,968	1,239,739,587	1,296,810,791	19,154,891,346	51.75%
COMMISSION TO RETAILERS	1,753,534,359	120,998,201	126,248,659	2,000,781,219	5.40%
ADMINISTRATIVE EXPENSES	440,553,474	21,083,924	27,492,371	489,129,769	1.32%
VENDOR FEES	541,406,039	42,761,283	44,264,877	628,432,199	1.70%
COURIER COLLECTION FEE	12,235,328	-	-	12,235,328	0.03%
ON LINE NETWORK FEES	62,195,923	8,053,690	7,759,214	78,008,827	0.21%
DRAWING BROADCAST FEES	-	1,141,555	1,141,540	2,283,095	0.01%
START UP COSTS	686,137	-	-	686,137	0.00%
MULTI STATE FEES	112,394	24,083	16,852	153,329	0.00%
AMORTIZATION EXPENSE	-	-	2,086	2,086	0.00%
PROVISION FOR DOUBTFUL ACCOUNTS	299,896	-	-	299,896	0.00%
TOTAL EXPENSES	19,429,364,518	1,433,802,323	1,503,736,390	22,366,903,231	60.42%
OPERATING INCOME	13,051,727,937	797,235,178	801,979,898	14,650,943,013	39.58%
NON OPERATING REVENUE					
INTEREST INCOME	84,761,406	1,126,443	2,435,472	88,323,321	0.24%
TOTAL	84,761,406	1,126,443	2,435,472	88,323,321	0.24%
INCOME BEFORE TRANSFERS	13,136,489,343	798,361,621	804,415,370	14,739,266,334	39.82%
OPERATING TRANSFERS OUT					
CONTRIBUTIONS FOR AID TO EDUCATION AND STATE INSTITUTIONS	13,118,777,392	794,971,914	812,046,973	14,725,796,279	39.78%
CHANGE TO NET ASSETS	17,711,951	3,389,707	(7,631,603)	13,470,055	0.04%
NET ASSETS, BEGINNING OF PERIOD		17,711,951	21,101,658		
NET ASSETS, END OF PERIOD	17,711,951	\$ 21,101,658	\$ 13,470,055	13,470,055	0.04%

See accompanying notes to financial statements.

*Figures not covered by independent auditor's report.



STATEMENTS OF CASH FLOWS
For Fiscal Years Ended June 30, 2005 and 2004

	Fiscal Year 2005	Fiscal Year 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash Flows from Current Operations:		
Sales to Customers	\$ 1,174,590,351	\$ 1,134,667,315
Payments for Prize Awards	(326,209,724)	(289,215,390)
Payments for Vendor Commissions and Fees	(50,052,629)	(53,828,028)
Payments for Bond Insurance	-	(597)
Payments for Administrative Expenses (Suppliers)	(20,614,419)	(22,097,230)
Other Payments	(341,701)	(7,139)
Annuity Operations:		
Annuity Award Receipts	164,104,704	166,328,612
Annuity Award Purchases	(26,503,851)	(17,434,881)
Annuity Prize Payments	(119,425,366)	(122,709,485)
Net cash provided by operations	795,547,365	795,703,177
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
State Transfers	(821,471,914)	(790,401,159)
Net cash used by noncapital financing activities	(821,471,914)	(790,401,159)
CASH FLOWS FROM INVESTMENT ACTIVITIES:		
Cash Management Fund Sales	1,106,480,000	1,049,055,000
Cash Management Fund Purchases	(1,080,650,000)	(1,055,750,000)
Net cash provided by investment activities	25,830,000	(6,695,000)
Net Decrease in Cash	(94,549)	(1,392,982)
Cash July 1	616,215	2,009,197
Cash June 30	\$ 521,666	\$ 616,215
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating Income	\$ 801,979,898	\$ 797,235,178
Net Changes in Assets and Liabilities:		
Accounts Receivable	11,803,407	(18,583,611)
Investments: deposit fund contracts	68,037,432	66,708,327
Other Assets	(686,057)	(2,342,651)
Accounts Payable and Accrued Expenses	2,308,407	1,079,990
Unpaid Prize Awards	(87,943,169)	(48,425,960)
Compensated Absences	47,447	31,904
Net cash provided by operations	\$ 795,547,365	\$ 795,703,177

See accompanying notes to financial statements.

NEW JERSEY STATE LOTTERY COMMISSION

Notes to Financial Statements June 30, 2005 and 2004

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 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, and the apportionment of ticket revenues.

Basis of Accounting

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

Contributions and Prize Awards

The State Lottery Law requires at least 30% of gross revenues from ticket sales to be paid to the State Treasury for aid to education and State institutions. Pursuant to this law, the Commission has also designated all unallocated revenues for aid to education and State institutions. Contributions for the years ended June 30, 2005 and 2004 aggregated \$812,046,973 and \$794,971,914, respectively, of which \$79,546,973 and \$88,971,914 was due to the State Treasury at June 30, 2005 and 2004, respectively.

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

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 Lottery's contribution for aid to education and State institutions. For the year ended June 30, 2005 and 2004 unclaimed prizes were \$30,662,853 and \$42,984,774, respectively.

Revenue Recognition

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

- "Pick-3", "Pick-4", "Pick-6 Lotto", "Jersey Cash 5", and "Mega Millions" are recognized on the drawing date.
- Instant games are recognized daily, based upon the settlement of instant game inventory packs by selling retailers. Sales adjustments are recorded based upon final reconciliation's 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

Lottery 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 \$150,000 and a designated net assets cash reserve of \$500,000.

Equipment

The Commission follows the State's threshold for capitalizing equipment as follows; machinery and equipment over \$20,000; and motor vehicles over \$30,000. Purchases that do not meet the threshold for capitalization are recognized as expenses in the statements of revenues, expenses, and changes in net assets in the period in which they are acquired and are included in administrative expenses. During 2004, there were no capitalized equipment purchases. In June 2005, the Commission recorded leasehold improvements to other assets in the amount of \$202,344. The amortization expense for the month of June 2005 was \$2,086.

Installment Prize Awards and Prize Expenses

Installment prize awards are recorded based upon the present value of an annuity at terms to yield a series of future payments needed to meet the obligations of the Commission for prize disbursements. The Commission purchases annuity contracts from insurance companies and U.S. Government securities to fund its liability for installment prize awards. Amounts recorded as "prize expense" reflect the cost of annuity contracts and U.S. Government securities necessary to satisfy stated prize awards plus any single payment awards.

Vacation and Sick Leave

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

Use of Estimates

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



NEW JERSEY STATE LOTTERY COMMISSION

Notes to Financial Statements June 30, 2005 and 2004

B. Cash and Investments

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

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

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

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

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

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

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

Custodial Credit Risk

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

C. Future Installment Prize Awards

The Commission purchases annuity contracts from insurance companies and U.S. Government securities to fund its liability for future installment prize awards. Generally, annuity contracts fund instant product annuity prizes and U.S. Government securities fund annuity prizes for Pick 6 and Mega Millions. An annuity contract represents an obligation by an insurance company to provide a fixed series of payments over a specified period.

U.S. Government securities are carried at fair value. At June 30, 2005 and 2004, the Commission held U.S. securities totaling \$34,387,398 and \$31,238,581, respectively.

Annuity contracts are carried at their current contract values, which are based upon their original purchase price adjusted for credited interest and amounts already received. Annuity contracts are subject to credit risk. The Commission seeks to control its exposure to such credit risk by purchasing annuity contracts only from insurance companies, which meet certain minimum standards. Such standards include a minimum required claims payment rating from Standard and Poors Corporation, a private rating agency, of at least "AA". However, due to the long term nature of these contracts, the credit quality of the issuer is subject to change. At June 30, 2005 three companies had ratings under "AA". At June 30, 2005 and 2004, the Commission held insurance company annuity contracts totaling \$904,283,352 and \$972,320,784, respectively, issued through thirteen

insurance companies, which are due in installments ranging from ten years to the lifetime of the recipient. A significant portion of the Commission's investment in annuity contracts at such date is concentrated among eight companies as follows:

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

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

Concentrations of Credit Risk

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

D. Litigation

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

E. Commitments

Contractual Arrangements

The Commission maintains a gaming network of over 6,100 on line locations where all games are sold. GTECH Corporation is responsible for operating the on line games and providing courier services under a contract expiring June 20, 2006.

Operating Leases

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

Future minimum lease payments are as follows:

<u>Year ending</u> <u>June 30</u>	<u>Amount</u>
2006	\$697,438
2007	\$697,438
2008	\$638,550
2009	\$638,550
2010	\$638,550
2011	\$638,550
2012	\$638,550
2013	\$638,550

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



A BENEFICIARY STORY...

In fiscal year 2005, the Lottery contributed \$812 million to various State educational programs and institutions. One of these worthy beneficiaries is the Governor's School Program.

The Governor's School began in 1983 and has provided thousands of students a head start in such areas as: public administration, the performing and creative arts, environmental studies and the physical sciences. The four-week summer session, made possible by Lottery proceeds, includes tuition, room and board and expenses. The New Jersey Lottery is proud of its part in providing an opportunity for many students to attend the Governor's School Program and become better prepared to meet their academic and professional goals.

The artwork featured here was created by Christopher MacFarlane of Oradell, a 2005 student of the Governor's School Program.



Jon S. Corzine, Governor
Bradley I. Abelow, State Treasurer

Michellene Davis, Esq., Executive Director
Robert J. D'Anton, Chairman

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