

**STATE OF NEW JERSEY,
DEPARTMENT OF TREASURY,
DIVISION OF STATE LOTTERY**

Financial Statements
and Supplementary Information

June 30, 2015

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

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**STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

INTRODUCTION

The following discussion and analysis provides an analytical overview of the financial position and activities of the State of New Jersey, Department of the Treasury, Division of State Lottery (the "Division of State Lottery") for the years ended June 30, 2015 and 2014. This statement was prepared by management and should be read in conjunction with the financial statements and notes hereto, which follow this section.

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

As of June 30, 2015, the Division of State Lottery licensed more than 7,600 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, bonuses and various retailer incentive programs.

On June 20, 2013, a competitively bid 15 year (plus fiscal year 2014 stub year) contract was awarded to Northstar New Jersey, LLC (Northstar NJ) to provide sales and marketing services to the Division of State Lottery for the purpose of increasing lottery sales and net income (net proceeds for state aid for education and state institutions). If contracted net income targets for a given fiscal year are met or exceeded, Northstar NJ will earn incentive compensation. Conversely, if net income targets for a given fiscal year are not met it could result in reduced incentive or a contribution shortfall payment to the Division of State Lottery. In addition to compensation for its sales and marketing efforts, Northstar NJ is reimbursed for certain direct costs it incurs on behalf of the Division of State Lottery.

For the purposes of the incentive compensation calculation, the Division of State Lottery's net income is predicated on income targets contained in the Northstar contract (see Schedule of Northstar NJ Net Income Targets). The Division of Lottery's actual net income for a fiscal year is decreased when Northstar NJ earns an incentive payment and is increased if Northstar is obligated to pay a shortfall payment.

Northstar NJ's first operational year, the year ending June 30, 2014 was a stub year October 1, 2013 through June 30, 2014. The remaining fifteen years (Fiscal years 2015 – 2029) of the contract coincide with the Lottery's fiscal year, starting on July 1 and ending on June 30 through the year ending June 30, 2029. The year ending June 30, 2015 was the first full operational year of the contract.

Under the terms of the agreement, Northstar is responsible for subcontracting on behalf of the Lottery for service for which the Division of State Lottery previously contracted. Such services include the online terminal network for ticket sales, the warehousing and distribution of instant tickets, printing contracts for instant tickets, and marketing and advertising services.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

INTRODUCTION (CONTINUED)

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

- Instant Games
- FastPlay (launched in August 2015)
- Pick 3 (Including Pick 3 Instant Match)
- Pick 4 (Including Pick 4 Instant Match)
- Jersey Cash 5 (Including Jersey Cash 5 Instant Match)
- Pick 6 Xtra Lotto
- Mega Millions
- Powerball
- Cash 4 Life
- Monopoly Millionaires Club (game suspended December 2014)

FINANCIAL HIGHLIGHTS

The Division of State Lottery's financial position at June 30, 2015 and 2014 consisted of total assets of \$511 million and \$517 million, respectively, and total liabilities of \$509 million and \$516 million, respectively. A substantial portion of the asset and liability amounts is due to the Division of State Lottery's annuity investment in prize awards. The total amounts invested and due to Division of State Lottery winners as future installment payments at June 30, 2015 and 2014, were \$269 million and \$296 million, respectively. Net position increased from \$0.80 million in fiscal year 2014 to \$1.80 million for fiscal year 2015.

FINANCIAL STATEMENTS

The Division of State Lottery's financial statements include statement of net position as of June 30, 2015 and 2014, statement of revenues, expenses and changes in net position for years ended June 30, 2015 and 2014, and statement of cash flows for years ended June 30, 2015 and 2014. The financial statements are prepared in accordance with the accounting principles established by the Governmental Accounting Standards Board.

Statement of Net Position

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

	Years Ended June 30,		
	2015	2014	2013
Current Assets	\$ 283	\$ 272	\$ 321
Deposit Fund Contracts	228	245	268
Total Assets	<u>511</u>	<u>517</u>	<u>589</u>
Current Liabilities	280	270	311
Non-Current Liabilities	229	246	269
Total Liabilities	<u>509</u>	<u>516</u>	<u>580</u>
Restricted Net Position	1.5	.5	2
Unrestricted Net Position	.3	.3	7
Total Net Position	<u>\$ 1.8</u>	<u>\$.8</u>	<u>\$ 9</u>

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (CONTINUED)

FINANCIAL STATEMENTS (CONTINUED)

Statement of Net Position (Continued)

Current assets consist of cash and investment in the State of New Jersey Cash Management Fund (the NJCMF), accounts receivable, current year annuity investments and deferred expenses. The investment in the NJCMF totaled \$207 million and \$204 million at June 30, 2015 and 2014, respectively.

The Division of State Lottery funds long-term installment prizes with insurance company annuities and United States Treasury securities. The total value of these investments was \$269 million and \$296 million as of June 30, 2015 and 2014, respectively. The Division of State Lottery has annuity investments with ten (10) insurance companies. The total market value of the United States Treasury securities was \$45 million at June 30, 2015 and 2014. The annuities due beyond fiscal year 2016 total \$229 million and represent the non-current assets reported on the Division of State Lottery's statement of net position. Although categorized as an asset, annuities represent an obligation that the Division of State Lottery has to the annuitants to fund the monies due to them over a fixed period of time based on the amount of the annuitized jackpot at the time of the "win." The duration of an annuity varies from twenty years to life. Because of the true nature of these annuities, the Division of State Lottery has a fiduciary responsibility to continue to administer these instruments in a responsible and prudent manner. The current amounts due to annuity winners totaled \$40 million and \$51 million as of June 30, 2015 and 2014, respectively.

Non-current liabilities represent annuity prize awards due beyond 2016 and also include the total due for unused vacation and sick leave (compensated absences).

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

	Years Ended June 30,		
	2015	2014	2013
Restricted (Unclaimed Prize Reserves)	\$ 1.5	\$ 0.5	\$ 2.1
Unrestricted	.3	0.3	6.9
Total Net Position	<u>\$ 1.8</u>	<u>\$ 0.8</u>	<u>\$ 9.0</u>

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

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (CONTINUED)

FINANCIAL STATEMENTS (CONTINUED)

Statements of Revenues, Expenses and Changes in Net Assets

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

	Years Ended June 30,		
	2015	2014	2013
Operating revenues			
Ticket sales	\$ 3,001	\$ 2,901	\$ 2,821
Forfeited prizes	48	39	39
Miscellaneous income	1	2	1
Total operating revenue	3,050	2,942	2,861
Operating expenses			
Prize expenses	1,825	1,732	1,670
Retailer commissions	170	162	158
Northstar NJ fees & expenses	42	29	
Vendor fees	54	46	36
Administrative expense	10	16	35
Bad debt expense	1	1	-
Total operating expenses	2,102	1,986	1,899
Operating income	948	956	962
Non-Operating Revenue (expenses)	13	1	120 *
Income before transfers out	961	957	1,082
Operating transfers – state contributions	960	965	1,085
Increase (decrease) in net position	\$ 1	\$ (8)	\$ (3)

* As part of the contract terms, Northstar provided a \$120 million "accelerated guarantee payment" to the Division of State Lottery which was reflected in the FY 2013 financials as non-operating revenue. Of this amount, \$20 million is apportioned for use by Northstar to offset any Contribution Shortfall Payments required under the compensation terms of the contract.

The Division of State Lottery awarded approximately \$1.825 billion in prize awards in fiscal year 2015 and approximately \$1.732 billion in fiscal year 2014. Nearly 111 million winning tickets were validated and paid in fiscal year 2015. This amount replicates the 111 million winning tickets which were validated and paid in fiscal year 2014.

The Division of State Lottery's vendors provided critical services to the Division of State Lottery, including the production, warehousing, distribution and accounting for all lottery tickets. The total compensation paid for the Division of State Lottery's vendors and network fees was \$97 million in fiscal year 2015. Of this amount \$96 million was paid directly to Northstar for the services it provided or procured on behalf of the Division of State Lottery. Included in the \$96 million paid to Northstar NJ was \$23 for advertising and marketing costs, \$32 million for gaming system vendor fees, \$22 million for instant ticket printing vendor fees and \$19 million for services provided by Northstar NJ. In fiscal year 2014, a stub year of 9 months for Northstar operations, \$75 million was paid to all such vendors including \$16 million for advertising and marketing costs.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (CONTINUED)

FINANCIAL STATEMENTS (CONTINUED)

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

The Division of State Lottery's administrative expenses for the fiscal years 2015 and 2014 totaled \$10 million and \$16 million, respectively. These administrative expenses include salaries, auditing services, rent, security, data processing services, office supplies and attorney general fees. The decline from fiscal 2014 to fiscal 2015 is directly attributable to the Northstar NJ contract being operational for a full fiscal year (verses being operational for only nine months in fiscal 2014). The contract itself has shifted advertising and other expenses from the Division of State Lottery to Northstar NJ. Other contributing factors for the decline are reduced rent and salary expenses due to reduced staffing levels.

The Division of State Lottery is required by the State of New Jersey Lottery law to contribute a minimum of 30% of net revenues from ticket sales to the State of New Jersey, Department of Treasury for state aid for education and state institutions. As a result of various sales initiatives, game enhancements, and efficient operations, the Division of State Lottery contributed \$960 million, 32% of net sales, in fiscal year 2015 and \$965 million, 33% of net sales, in fiscal year 2014.

During the term of the contract, Northstar's incentive compensation is reduced in the event the annual contractual net income target is not met or increased in the event that the net income target is exceeded. Furthermore, in the event that actual net income is significantly below the contracted net income target, then the contribution shortfall payment provisions are invoked. Northstar's net income target for the fiscal year ending June 30, 2015 was \$1,047,000,000.

The operating income for fiscal year 2015 totaled \$948 million. In accordance with the Northstar NJ contract, a separate calculation is performed to determine the operating income for purposes of establishing the incentive/shortfall payment. The calculation deducts a portion of the unclaimed prizes for use of the Division of State Lottery, and also subtracts the cost of the Million Dollar Replay program. The calculation determined that the Northstar NJ's incentive/shortfall payment is based on operating income of \$940 million. The calculation is shown below.

Operating Income	\$ 948.0 million
Division of State Lottery Portion of Unclaimed Prizes	(6.7) million
Cost of Million Dollar Replay Program	1.3 million
Total Deduction	<u>\$ 940.0 million</u>

The contract contains two scenarios for calculating the contribution shortfall payment. In the first scenario, if net income for the contract year is less than the Net Income Target but greater than the Base Level Income, then Northstar NJ will issue to the Division of State Lottery a Contribution Shortfall Payment equal to 50% of the difference between the Net Income Target and the actual Net Income for that specific contract year. If Net Income is less than the Base Level Income, then Northstar NJ will issue to the Division of State Lottery a Contribution Shortfall Payment equal to the sum of 50% of the difference between the Base Level Income and the Net Income Target plus 100% of the difference between the Net Income and the Base Level Income.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (CONTINUED)

FINANCIAL STATEMENTS (CONTINUED)

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

The contract does establish bottom and top caps on Northstar NJ's compensation. In the event of a particularly lucrative contract year (Upper Income Levels are surpassed) total compensation to Northstar NJ cannot exceed 5% of Net Income for the entire contract year. Conversely, in a subpar contract year, the contribution shortfall payment cannot exceed 2% of net income.

In fiscal year 2015, the latter scenario was utilized to calculate the Contribution Shortfall Payment as outlined below.

Contribution Shortfall Payment, below Target, above Base	(\$40,000,000)
Contribution Shortfall Payment below Base	(\$25,660,633)
Net Contribution Shortfall Payment	(\$65,660,633)
Low Cap	(\$18,799,399)

The Northstar NJ contract provided for an allowance of \$20 million to offset any potential contribution shortfall payments over the life of the contract. The balance of this allowance as of June 30, 2014 was \$5,889,163. Subsequently, the Contribution Shortfall Payment of \$18,799,399 has been offset from this balance resulting in a net Shortfall Payment of \$12,910,236.

Statement of Cash Flows

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

	Years Ended June 30,		
	2015	2014	2013
Cash flows provided by operating activities	\$ 936	\$ 916	\$ 1,022
Cash flows used in non-capital financing activities	(943)	(950)	(1,081)
Cash flows (used in) provided by investing activities	10	34	57
Net increase (decrease) in cash	\$ 3	\$ -	\$ (2)

SUMMARY AND OUTLOOK

Division of State Lottery management has been working closely with Northstar NJ throughout fiscal year 2015, and looks forward to continuing this innovative partnership going into the second full year of the contract.

Prior to the end of fiscal 2014 the Division of State Lottery along with the New York State Lottery launched the new multi-state draw game, Cash4Life in which players can win \$1,000 a day for life, \$1,000 a week for life or seven other fixed prize levels. Through fiscal 2015 "Cash 4 Life" has exceeded expectations and has proved to be both very popular with players and attractive to other lottery jurisdictions with Virginia and Pennsylvania joining the game in the spring of 2015. Cash4Life is expected to expand to at least two more states for a total of six states in fiscal 2016.

**STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (CONTINUED)**

SUMMARY AND OUTLOOK (CONTINUED)

On October 19, 2014, another new multi-state draw game called "Monopoly Millionaires' Club" was launched. Monopoly Millionaires Club offered three different ways to win \$1 million or more on each ticket and was designed to create hundreds of millionaires. The game would also have its own national TV game show that premiered in March 2015. Unfortunately, as a draw game, Monopoly did not prove popular with players across the nation and the game was cancelled in December 2014. However, the TV game show has resonated with TV audiences and the Division of State Lottery along with its counterparts across the nation instituted a Monopoly instant game that provide players an opportunity to win a chance to appear on the TV game show and compete for cash prizes. In August 2015, the Division of State Lottery launched FastPlay, a new terminal game. Unlike traditional draw games, the FastPlay product line comprises a series of quick play style games generated through the lottery terminal that offer multiple price points and multiple themes. Similar to an instant game, players will know immediately if they have won rather than wait until later in the day or the week for a drawing to take place to learn the outcome. This new "easy to play and win" game category has proven successful with attracting new players in other lottery jurisdictions.

Looking forward, players and retailers can expect to see new promotions and incentive programs, expansion of the retailer base, other new games and other beneficial changes. With the assistance of Northstar NJ, the Division of State Lottery will continue to enhance its position as a major revenue source for the State of New Jersey. The revenue generated by the Division of State Lottery funds various educational and institutional programs throughout the State.

CONTACTING THE DIVISION'S FINANCIAL MANAGEMENT

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

INDEPENDENT AUDITORS' REPORT

State of New Jersey
Department of Treasury
Division of State Lottery

Report on the Financial Statements

We have audited the accompanying financial statements of the State of New Jersey, Department of Treasury, Division of State Lottery (the "Division of State Lottery") as of and for the years ended June 30, 2015 and 2014, and the related notes to financial statements, which collectively comprise the Division of State Lottery's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division of State Lottery's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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INDEPENDENT AUDITORS' REPORT (CONTINUED)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Division of State Lottery as of June 30, 2015 and 2014, and the respective changes in its financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages one through seven be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Division of State Lottery's basic financial statements. The accompanying schedules of revenues, expenses and changes in net position budget and actual, instant game revenues and administrative expenses are presented for the purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information except for the portion marked "unaudited," has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, except for the portion marked "unaudited," the schedules of revenues, expenses and changes in net position budget and actual, instant game revenues and administrative expenses are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The schedule of Northstar NJ net income targets as listed in the table of contents has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 19, 2015 and October 31, 2014, for the years ended June 30, 2015 and 2014, respectively, on our consideration of Division of State Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division of State Lottery's internal control over financial reporting and compliance.

Mercadien, P.C.

Certified Public Accountants

**MERCADIEN, P.C.
CERTIFIED PUBLIC ACCOUNTANTS**

November 19, 2015

**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**

State of New Jersey
Department of Treasury
Division of State Lottery

We have audited, in accordance with the 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, the financial statements of the Division of State Lottery as of and for the years ended June 30, 2015 and 2014, and the related notes to financial statements, which collectively comprise the Division of State Lottery's basic financial statements, and have issued our report thereon dated November 19, 2015.

Internal Control over Financial Reporting

In planning and performing our audits of the basic financial statements, we considered the Division of State Lottery's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Division of State Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Division of State Lottery's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Division of State Lottery's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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**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 the Division of State Lottery's financial statements are free from 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Mercadien, P.C.

Certified Public Accountants

**MERCADIEN, P.C.
CERTIFIED PUBLIC ACCOUNTANTS**

November 19, 2015

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

STATEMENT OF NET POSITION

	June 30,	
	2015	2014
ASSETS		
Current Assets		
Cash	\$ 3,301,670	\$ 407,418
Accounts receivable, net of allowance for doubtful accounts of \$2,724,000 in 2015 and \$2,433,000 in 2014	16,412,649	13,220,416
Northstar NJ shortfall receivable	12,910,236	-
Deferred Expenses	2,724,776	3,027,054
Investments:		
Deposit Fund Contracts	40,211,749	50,768,499
State of New Jersey Cash Management Fund	207,229,895	204,414,284
Total current assets	<u>282,790,974</u>	<u>271,837,671</u>
Non Current Assets		
Investments - deposit fund contracts	<u>228,525,068</u>	<u>245,502,273</u>
Total non-current assets	<u>228,525,068</u>	<u>245,502,273</u>
 Total assets	 <u>\$ 511,316,042</u>	 <u>\$ 517,339,944</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued expenses	\$ 30,956,803	\$ 13,772,464
Obligation for unpaid prize awards	76,100,675	89,780,528
Installment prize awards	40,211,749	50,768,499
Due To State Of New Jersey - education & state institutions	133,000,000	116,010,000
Total current liabilities	<u>280,269,226</u>	<u>270,331,491</u>
Non Current Liabilities		
Compensated absences	723,069	686,899
Installment prize awards	<u>228,525,068</u>	<u>245,502,273</u>
Total non current liabilities	<u>229,248,137</u>	<u>246,189,172</u>
Total Liabilities	<u>509,517,363</u>	<u>516,520,662</u>
NET POSITION		
Restricted for prize awards or contributions for aid to education and state institutions	1,479,397	499,998
Unrestricted	<u>319,282</u>	<u>319,284</u>
Total Net Position	<u>\$ 1,798,679</u>	<u>\$ 819,282</u>

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Years Ended June 30,	
	2015	2014*
Operating revenues		
Ticket sales		
Pick 3	\$ 437,774,537	\$ 436,742,690
Pick 4	271,765,815	268,396,396
Jersey Cash 5	148,424,382	148,226,709
Pick 6 Lotto	57,613,947	77,529,761
Cash4Life	71,417,890	4,727,306
Monopoly	3,265,580	-
Mega Millions	162,460,731	205,860,905
Powerball	165,435,126	233,653,931
Raffle Sales	-	1,227,770
Instant Games	1,709,143,246	1,531,771,568
Sales discounts/tickets provided as prizes	(26,772,618)	(6,491,474)
Total ticket sales	<u>3,000,528,636</u>	<u>2,901,645,562</u>
Other Revenues		
Forfeited prizes	48,069,961	38,866,559
Miscellaneous	1,391,732	1,705,289
Total operating revenues	<u>3,049,990,329</u>	<u>2,942,217,410</u>
Operating expenses		
Prize expenses	1,825,233,183	1,731,959,514
Retailer commissions	169,445,854	162,107,574
Instant ticket vendor printing fees	22,316,078	18,706,070
Gaming system vendor fees	31,786,934	27,220,623
Northstar NJ management fee	4,850,004	3,552,740
Northstar NJ manager expenses	14,186,014	9,383,269
Northstar NJ advertising & marketing expenses	23,320,008	16,331,995
Administration expenses	9,967,207	15,877,577
Multi-State fees	81,538	65,122
Drawing broadcast fees	334,957	5,980
Bad debt expense	625,000	400,000
Total operating expenses	<u>2,102,146,779</u>	<u>1,985,610,464</u>
Operating income	947,843,550	956,606,946
Non-operating revenue		
Interest	225,611	209,438
Income before transfers out	<u>948,069,161</u>	<u>956,816,384</u>
Northstar NJ shortfall (payment)	<u>12,910,236</u>	<u>-</u>
Income available for transfer	960,979,397	956,816,384
Contributions for state aid to education and state institutions	<u>960,000,000</u>	<u>965,010,000</u>
Change in net position	979,397	(8,193,616)
Net position, beginning of year	<u>819,282</u>	<u>9,012,898</u>
Net position, end of year	<u>\$ 1,798,679</u>	<u>\$ 819,282</u>

*Some amounts have been reclassified to conform with current year presentation.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
STATEMENT OF CASH FLOWS

	Years ended June 30,	
	2015	2014
Cash Flows from Operating Activities		
Sales to customers	\$ 1,400,922,317	\$ 1,428,992,039
Payments for prize awards	(376,612,147)	(423,866,990)
Payments for vendor commissions and fees	(95,987,279)	(67,742,494)
Payments to suppliers	(2,628,159)	(34,833,546)
Other Payments	(27,741)	(19,526)
Cash flows from annuity operations		
Annuity receipts	48,049,662	64,581,504
Purchases of annuities	(2,862,726)	(8,408,676)
Payments of annuity prizes	(35,297,300)	(42,729,559)
Net cash provided by operating activities	<u>\$ 935,556,627</u>	<u>\$ 915,972,752</u>
Cash Flows used in Non-Capital Financing Activities		
Contributions for aid to education and state institutions	<u>\$ (943,010,000)</u>	<u>\$ (950,009,581)</u>
Cash Flows from Investment Activities		
Cash Management Fund proceeds	\$ 1,251,147,625	\$ 1,281,510,000
Cash Management Fund purchases	(1,240,800,000)	(1,247,500,000)
Net cash (used) provided by investment activities	<u>\$ 10,347,625</u>	<u>\$ 34,010,000</u>
Net Increase (Decrease) in cash	\$ 2,894,252	\$ (26,830)
Cash, beginning of year	407,418	434,248
Cash, end of year	<u>\$ 3,301,670</u>	<u>\$ 407,418</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating Income	\$ 947,843,550	\$ 956,606,946
Changes in assets and liabilities		
Accounts receivable	(16,129,858)	(8,040,920)
Investments - deposit fund contracts & tradable stock	27,533,956	36,350,560
Other assets	302,278	9,796,161
Accounts payable and accrued expenses	17,184,339	(32,830,987)
Obligation for unpaid prize awards	(41,213,808)	(45,611,505)
Compensating absences	36,170	(297,504)
Net cash provided by operating activities	<u>\$ 935,556,627</u>	<u>\$ 915,972,752</u>

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

Basis of Accounting

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

In its accounting and financial reporting, the Division follows the pronouncements of the Governmental Accounting Standards Board ("GASB") and other entities that promulgate accounting principles. GASB Statement 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, establishes the order of priority of pronouncements and other sources of accounting and financial reporting guidance that a governmental entity should apply. Per the Statement, the sources of authoritative generally accepted accounting principles ("GAAP") are categorized in descending order of authority as follows: GASB Statements and Interpretations, GASB Technical Bulletins, GASB Implementation Guides, and literature of the American Institute of Certified Public Accountants ("AICPA") cleared by the GASB. Authoritative GAAP is incorporated periodically into the *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), and when presented in the Codification, it retains its authoritative status. If the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP described above, a governmental entity should first consider accounting principles for similar transactions or other events within a source of authoritative GAAP described above and then may consider nonauthoritative accounting literature from other sources. These include GASB Concepts Statements; pronouncements and other literature of the Financial Accounting Standards Board ("FASB"), Federal Accounting Standards Advisory Board, International Public Sector Accounting Standards Board, and International Accounting Standards Board, and AICPA literature not cleared by the GASB; practices that are widely recognized and prevalent in state and local government; literature of other professional associations or regulatory agencies; and accounting textbooks, handbooks, and articles.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

State of New Jersey Cash Management Fund

Investments in the State of New Jersey Cash Management Fund are valued at cost, which approximates fair value.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable

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

Installment Prize Awards and Prize Expenses

Installment prize awards are recorded based upon the present value of an annuity at terms to yield a series of future payments needed to meet the obligations of the Division of State Lottery for prize disbursements. The Division of State Lottery purchases annuity contracts from insurance companies and U.S. government securities to fund its liability for installment prize awards. An annuity contract represents an obligation by an insurance company to provide a fixed series of payments over a specified period. Annuity contracts are subject to credit risk. The Division of State Lottery seeks to control its exposure to such credit risk by purchasing annuity contracts only from insurance companies that meet certain minimum standards.

Due to the long-term nature of these contracts, the credit quality of the issuer is subject to change. Amounts recorded as prize expense reflect the cost of annuity contracts and U.S. government securities necessary to satisfy stated prize awards plus any single payment awards. These annuities are presented on the statements of net position as deposit fund contracts, carried at contract value which approximates fair value.

Equipment

The Division follows the state's threshold for capitalizing equipment as follows: machinery and equipment over \$20,000 and motor vehicles over \$30,000. Purchases that do not meet the threshold for capitalization are recognized as expenses in the statements of revenues, expenses and changes in net assets in the period during which they are acquired and are included in administrative expenses. As of June 30, 2015 and 2014, leasehold improvements included in deferred expenses were \$734,362. For the years ended June 30, 2015 and 2014, amortization expense was \$68,408 and \$52,668, respectively.

Net Position

Restricted

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

Unrestricted

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

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue Recognition

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

- "Pick-3," "Pick-4," "Jersey Cash 5," "Pick-6 Lotto," "Mega Millions," "Megaplier", "Powerball", "Power Play", "CASH4LIFE", "Monopoly", and various raffle games on the drawing date.
- Instant games are recognized daily, based upon the settlement of instant game inventory packs by selling retailers. Sales adjustments are recorded based upon final reconciliations prepared after the termination of a lottery instant game.
- Sales discounts are recorded for the sales value of tickets provided to retailers at no cost, to be used for promotional purposes. Tickets provided as prizes are recorded as sales at the face value of each ticket, then backed out as discounts and are not included in prize expense.

Forfeited Prizes

The State Lottery Law requires that prizes not claimed within one year from the date of the drawing for machine games and within one year from the date of the game's closing for instant games be forfeited. Effective November 21, 1991, the Commission authorized that 70% of forfeited prizes are to be maintained restricted for prize awards and are available to augment future prize awards or, at the discretion of the executive director, to augment the Division of State Lottery's contribution for state aid for education and state institutions. The remaining 30% goes directly to contributions to aid education and institutions to be consistent with the 30% minimum contribution requirement of the State Lottery Law. Forfeited prizes are recognized as "Other Revenues" during the period forfeited. For the years ended June 30, 2015 and 2014, forfeited prizes were \$48,069,961 and \$38,866,559, respectively.

Contributions and Prize Awards

The State Lottery Law requires no less than 30% of total revenues accruing from ticket sales to be paid to the State Treasury for state aid for education and state institutions. Contributions for the years ended June 30, 2015 and 2014, aggregated \$960,000,000 and \$965,010,000, respectively, of which \$133,000,000 and \$116,010,000 was due to the State Treasury at June 30, 2015 and 2014, respectively.

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

Commissions and Fees

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

Northstar NJ has had numerous retailer incentive programs for the purpose of boosting sales, these include temporary commission increases and bonuses. Both of these incentives are recorded as prize expense.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

NOTES TO FINANCIAL STATEMENTS

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Vacation and Sick Leave

The Division records vacation and sick time incurred during the period in "administrative expenses" in the accompanying statements of revenues, expenses and changes in net assets. Payments for accumulated sick leave balances are made to retiring employees upon regular retirement from the State of New Jersey's General Fund. Such payment is based on 50% of the employee's sick leave accumulation at the pay rate in effect at the time of retirement, up to a maximum of \$15,000. Employees separating from service prior to retirement are not entitled to payments for accumulated sick leave.

Advertising

The Division of State Lottery uses advertising to promote the sale of lottery tickets. Starting October 1, 2013, these services were transferred to Northstar NJ as part of the management contract. Prior to shifting to Northstar NJ, the costs of advertising were expensed as incurred by the Division of State Lottery. The Division of State Lottery incurred no advertising expenses for the year ended June 30, 2015 and \$5,204,308 for the year ended June 30, 2014.

B. CASH AND INVESTMENTS

The Division of State Lottery adopted GASB Statement No. 40, "Deposits and Investment Risk Disclosures," which requires uncollateralized deposits exposed to custodial credit risk to be disclosed. The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits that are in possession of an outside party. The following is a summary of the Division's cash deposits by financial institution and the amount exposed to custodial credit risk at June 30, 2015 and 2014. The Division's deposits with Wells Fargo are insured by the Federal Deposit Insurance Corporation up to \$250,000.

	June 30,	
	2015	2014
Wells Fargo	\$ 3,301,670	\$ 407,418
New Jersey Cash Management Fund	207,229,895	204,414,284
Total	<u>\$ 210,531,565</u>	<u>\$ 204,821,702</u>

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

Fair Value Measurements

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

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

NOTES TO FINANCIAL STATEMENTS

B. CASH AND INVESTMENTS (CONTINUED)

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

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

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

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

Fair Value on a Recurring Basis

The table below presents the balances of investments - deposit fund contracts measured at fair value on the statement of net position as of June 30, 2015 and 2014:

	June 30, 2015			
	Total	Level 1	Level 2	Level 3
Annuity Investment Deposit Fund Contracts	\$ 268,736,816	\$ 45,496,949	\$ 223,239,868	\$ -
Total	<u>\$ 268,736,816</u>	<u>\$ 45,496,949</u>	<u>\$ 223,239,868</u>	<u>\$ -</u>
	June 30, 2014			
Annuity Investment Deposit Fund Contracts	\$ 296,270,772	\$ 44,563,284	\$ 251,707,488	\$ -
Total	<u>\$ 296,270,772</u>	<u>\$ 44,563,284</u>	<u>\$ 251,707,488</u>	<u>\$ -</u>

C. FUTURE INSTALLMENT PRIZE AMOUNTS

The Division of State Lottery purchases annuity, or deposit fund contracts, from insurance companies and U.S. government securities to fund its liability for future installment prize awards. Generally, insurance company annuity contracts fund life annuities for games such as the Cash4Life draw game and Win for Life instant games. U.S. government securities fund term annuity prizes for games such as Pick 6 Xtra Lotto, Mega Millions, Powerball and instant games. An annuity contract represents an obligation by an insurance company to provide a fixed series of payments over a specified period.

Annuity contracts are carried at their current contract values, which are based upon their original purchase prices adjusted for credited interest and amounts already received. Annuity contracts are subject to credit risk. The Division of State Lottery seeks to control its exposure to such credit risk by purchasing annuity contracts only from insurance companies that meet certain minimum standards. Such standards include the following requirements:

1. Combined capital and surplus of at least \$1 billion;
2. Admitted assets of at least \$10 billion;
3. Risk based capital ratio of at least 300%; and
4. Must have ratings equal to or better than at least two of the three private rating agencies:
 - Standard & Poor's long term insurer financial strength rating of AA- or higher
 - AM Best financial strength rating of "A" or higher
 - Moody's long term insurance financial strength rating of "Aa3" or higher.

According to the Division of State Lottery's calculation, only one company does not meet the criteria, that of Delaware Life, formerly Sun Life Assurance; as of June 30, 2015 and 2014, Delaware Life had annuity contracts totaling approximately \$28,936,804 and \$36,773,973, respectively. However, due to the long-term nature of these contracts, the credit quality of the issuer is subject to change. At June 30, 2015 and 2014, the Division of State Lottery held insurance company annuity contracts totaling \$223,239,868 and \$251,707,488, respectively, issued through ten insurance companies, which are due in installments ranging from twenty-five years to the lifetime of the recipient. The estimated fair value of annuity contracts approximates the carrying value reflected in the accompanying statement of net position at June 30, 2015 and 2014.

U.S. government securities are carried at fair value. At June 30, 2015 and 2014, the Division of State Lottery had \$45,496,949 and \$44,563,284, respectively, in U.S. treasuries (see Note B).

Concentrations of Credit Risk

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

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

- Ohio National Life
- New York Life Insurance Co.
- Protective Life
- Metropolitan Life
- Delaware Life (formerly Sun Life Assurance)

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

NOTES TO FINANCIAL STATEMENTS

D. LITIGATION

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

E. COMMITMENTS

Contractual Arrangements

The Division of State Lottery maintains a gaming network of over 7,600 retailer locations where all games are sold. IGT Corporation, formerly GETCH Corporation is responsible for operating the network games and providing courier services under a contract that was assigned to Northstar NJ on October 1, 2013 and expires concurrent with Northstar NJ's contract.

On June 20, 2013, a competitively bid 15 year contract was awarded to Northstar New Jersey Lottery Group, LLC to provide sales and marketing services to the Division of State Lottery. Northstar New Jersey Lottery Group, LLC is owned directly by two members: (1) Scientific Games New Jersey, LLC, and (2) Northstar New Jersey Holding Company, LLC, and indirectly by three companies: (1) IGT Corporation and (2) OSI LTT NJ Holdings Inc., which are the Members of Northstar New Jersey Holding Company, LLC, and (3) Scientific Games International, Inc., which is the owner of Scientific Games New Jersey, LLC. The base services commenced on October 1, 2013. The contract required NSNJ to bid net income targets for each fiscal year of the 15 year contract. If NSNJ meets or exceeds the net income target for a given fiscal year, they can earn an incentive pay or alternatively, if they don't meet the net income target, they are assessed a penalty. The Northstar NJ contract provides for an allowance of \$20 million to offset any potential contribution shortfall payments over the life of the contract. For fiscal year 2014 (stub year), the calculated contribution shortfall amounted to \$14,110,837 which was deducted from the \$20 million contractual allowance for such purposes leaving a contribution shortfall allowance balance of \$5,889,163. For fiscal year 2015, the calculated contribution shortfall amounted to \$18,799,399 which was offset by the remaining allowance of \$5,889,163, resulting in a net shortfall payment of \$12,910,236.

Prior to the beginning of each fiscal year the Division of State Lottery and Northstar NJ agree to an annual business plan that includes the projected operating expenses of Northstar NJ for the fiscal year. Each month NSNJ may invoice the Division of State Lottery one twelfth (1/12) of the total operating expenses for the fiscal year. Each monthly invoice is accompanied by detailed backup data and information supporting expenses incurred. At the end of the fiscal year Northstar NJ operating expenses are aggregated and reconciled with any excess returned to the Division of State Lottery. The Northstar NJ expenses for services to the Division of State Lottery amounted to \$42,356,026 and \$29,268,004 for the years ended June 30, 2015 and 2014 (stub year), respectively.

In addition to the budgeted monthly expenditures, NSNJ receives a system provider vendor fee based on 1.05% of ticket sales and an instant ticket printing fee based on 1.216% of ticket sales as part of its subcontractor agreements. All other gaming contractors are paid fees based on the units of service provided.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

NOTES TO FINANCIAL STATEMENTS

E. COMMITMENTS (CONTINUED)

Operating Leases

The Division of State Lottery leases certain office facilities and equipment under non-cancelable operating lease agreements expiring through fiscal year 2024.

Future minimum lease payments for office facilities are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2016	\$ 793,433
2017	767,619
2018	638,550
2019	648,583
2020	655,750
2021-2024	<u>2,240,479</u>
	<u>\$ 5,744,414</u>

Rent expense for office facilities and equipment for the years ended June 30, 2015 and 2014, was \$1,130,524 and \$1,127,424, respectively.

F. GASB STATEMENT NUMBER 45 - ACCOUNTING AND FINANCIAL REPORTING BY EMPLOYERS FOR POST-RETIREMENT BENEFITS OTHER THAN PENSION

The Division of State Lottery is a member of the State of New Jersey's cost sharing multiple-employer plan for health and post-retirement medical benefits. Thus, the Division of State Lottery's portion of this liability and cost is included in the State of New Jersey's Comprehensive Annual Financial Report, as such, the Liability of Division of State Lottery's employees is covered under the State plan on an annual basis.

Please refer to State website www.state.nj.us for more information regarding the plan.

G. PENSION PLAN

The Division of State Lottery's employees which are part of the Department of Treasury, participate in the Public Employees Retirement System of New Jersey ("PERS"), a cost sharing multiple-employer defined benefit plan. The Division of State Lottery's contribution is determined by State statute and is based upon an actuarial computation performed by the PERS.

The Division of State Lottery's total and covered payroll for the years ended June 30, 2015, 2014 and 2013, was, \$6,306,627, \$6,421,066 and \$8,871,554, respectively. The State of New Jersey's (the "State") contribution is based on the employer contribution rate developed by the system's actuary. The rate is then applied against the pension eligible salary for all State employees. The State does not keep track of contributions made to PERS for each separate state agency. For fiscal year ended June 30, 2015 and 2014, the contribution rate was 3.06% and 3.06%, respectively. For fiscal year ended June 30, 2013, the contribution rate was 6.03%.

The State of New Jersey, Division of Pension and Benefits, issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the State of New Jersey, Division of Pension and Benefits, P.O. Box 295, Trenton, NJ 08625-0295 or by visiting their website at: www.state.nj.us/treasury/pensions.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

NOTES TO FINANCIAL STATEMENTS

H. ROUNDING

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

SUPPLEMENTARY INFORMATION

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION - BUDGET AND ACTUAL

Year ended June 30, 2015

	Budget (unaudited)	Actual	Variance (unfavorable) favorable
Operating revenues			
Ticket sales			
Pick 3	\$ 438,953,909	\$ 437,774,537	\$ (1,179,372)
Pick 4	270,576,974	271,765,815	1,188,841
Jersey Cash 5	169,852,183	148,424,382	(21,427,801)
Pick 6 Xtra Lotto	73,987,370	57,613,947	(16,373,423)
Cash 4 Life	73,250,581	71,417,890	(1,832,691)
New Instate Game	12,101,146	-	(12,101,146)
Monopoly	55,670,185	3,265,580	(52,404,605)
Monitor Games	36,039,372	-	(36,039,372)
Mega Millions	201,453,422	162,460,731	(38,992,691)
Powerball	279,094,964	165,435,126	(113,659,838)
Instant Games	1,696,416,876	1,709,143,246	12,726,370
Sales discounts/Tickets Provided as Prizes	(7,354,773)	(26,772,618)	(19,417,845)
	<u>3,300,042,209</u>	<u>3,000,528,636</u>	<u>(299,513,573)</u>
Other Revenues			
Forfeited prizes	31,860,000	48,069,961	16,209,961
Miscellaneous	1,000,000	1,391,732	391,732
Total operating revenues	<u>3,332,902,209</u>	<u>3,049,990,329</u>	<u>(282,911,880)</u>
Operating expenses			
Prize expenses	1,975,746,032	1,825,233,183	(150,512,849)
Retailer commissions	189,282,932	169,445,854	(19,837,078)
Instant ticket vendor printing fees	20,628,429	22,316,078	1,687,649
Gaming system vendor fees	34,727,668	31,786,934	(2,940,734)
Northstar NJ management fee	4,850,000	4,850,004	4
Northstar NJ manager expenses	23,461,000	14,186,014	(9,274,986)
Northstar NJ advertising & marketing expenses	23,320,000	23,320,008	8
Administration expenses	13,325,000	9,967,207	(3,357,793)
Multi-State fees	150,000	81,538	(68,462)
Drawing broadcast fees	-	334,957	334,957
Bad debt expense	600,000	625,000	25,000
Total operating expenses	<u>2,286,091,061</u>	<u>2,102,146,779</u>	<u>(183,944,282)</u>
Operating income	<u>1,046,811,148</u>	<u>947,843,550</u>	<u>(98,967,598)</u>
Non-operating revenue			
Interest	200,000	225,611	25,611
Income before transfers out	<u>1,047,011,148</u>	<u>948,069,161</u>	<u>(98,941,987)</u>
Northstar NJ shortfall (payment)	<u>(10,150,000) *</u>	<u>12,910,236 **</u>	<u>23,060,236</u>
Income available for transfer	<u>1,036,861,148</u>	<u>960,979,397</u>	<u>(75,881,751)</u>
Contributions for state aid to education and state institutions	<u>1,036,861,148</u>	<u>960,000,000</u>	<u>(76,861,148)</u>
Change in net position	-	979,397	979,397
Net position, beginning of year	<u>819,282</u>	<u>819,282</u>	-
Net position, end of year	<u>\$ 819,282</u>	<u>\$ 1,798,679</u>	<u>\$ 979,397</u>

* The Northstar NJ incentive payment of \$10,150,000 for meeting the net revenue target.

** Per Northstar NJ's contract, Northstar NJ was provided an allowance of \$20 million to offset any potential shortfall payments over the life of the contract. In FY14 \$14,110,837 of the allowance was deducted. For FY 2015 the calculated shortfall amount is \$18,799,399; taking into consideration the remaining shortfall allowance of \$5,889,163, the net shortfall payment is \$12,910,236. Going forward no shortfall allowance remains.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

SCHEDULE OF INSTANT GAME REVENUES

	Years Ending June 30,	
	2015	2014
\$5,000,000 CASH EXTRAVAGANZA	\$ 111,664,860	\$ -
\$150,000,000 CASH SPECTACULAR	84,301,080	54,849,140
\$2,000,000 MEGA CASH	75,166,162	41,340,340
50X MONEY	63,745,359	25,702,190
DIAMOND SPECTACULAR	43,949,560	11,109,970
CROSSWORD	42,095,609	-
CROSSWORD	41,271,814	-
BIG MONEY SPECTACULAR	35,447,550	-
BIG MONEY SPECTACULAR	34,999,477	-
\$10,000 PAYDAY	34,971,900	-
\$500 FRENZY	32,026,252	12,502,800
LOTERIA	31,949,855	-
\$250,000 CROSSWORD	31,552,930	4,800,880
WIN \$2,500 A WEEK FOR LIFE	31,396,525	39,918,620
\$20,000 PAY DAY	29,674,257	-
CROSSWORD	29,638,269	12,384,123
20X MONEY	28,588,614	15,732,665
BIG MONEY SPECTACULAR	28,156,743	7,171,054
SUPER CROSSWORD	27,831,472	-
WORLD SERIES OF POKER	27,613,765	-
SUPER CROSSWORD	27,543,845	-
DOUBLE DIAMOND SPECTACULAR	27,495,700	-
SUPER CROSSWORD	26,915,352	-
WIN \$1,000 A WEEK FOR LIFE	26,223,224	33,190,840
\$500 FRENZY	24,061,710	-
\$2,500 FRENZY	23,998,760	-
SUPER CASH SPECTACULAR	21,843,370	-
BINGO X10	20,817,258	-
HOLIDAY GOLD	20,544,504	-
TRIPLE WINNING 7s	19,523,701	-
WIN IT ALL	19,064,177	-
LUCKY LOOT	18,845,942	-
GEM 7s	17,701,631	5,448,210
10X MONEY	17,686,749	11,254,460
BIG MONEY SPECTACULAR	17,240,226	-
2015 CASH SPECTACULAR	15,259,462	-
HOLIDAY MAGIC	15,068,247	-
QUARTER MILLION CROSSWORD	14,989,860	5,544,717

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ending June 30,	
	2015	2014
HOLIDAY LUCKY TIMES 10	14,841,073	-
TRIPLE DIAMONDS	14,399,291	-
\$1,000,000 JACKPOT	14,252,860	-
CROSSWORD	14,166,273	-
MONOPOLY (\$5)	14,054,943	-
CASH BONUS BINGO	13,283,694	-
CANDY CANE CROSSWORD	13,207,510	-
WIN \$500 A WEEK FOR LIFE	13,039,320	17,682,341
MASSIVE MONEY BINGO	12,443,930	-
SUPER CROSSWORD	12,034,250	28,206,230
\$100 FRENZY	12,023,254	-
SUPER CROSSWORD	11,937,685	-
BINGO STAR TRIPLER	11,547,693	4,457,970
SUPER TIC TAC TOE	11,493,912	-
10X CASH	11,340,216	34,483,480
LOOSE CHANGE	11,271,259	1,086,945
SILVER GOLD PLATINUM 7'S	11,156,650	22,702,405
20X CASH	10,952,511	32,307,321
\$200,000 JACKPOT	10,905,280	-
BIG CASH SPECTACULAR	10,659,738	-
CLASSIC BINGO	10,251,880	-
BIRTHDAY BUCKS	10,124,266	-
MONOPOLY (\$2)	9,666,773	-
\$500,000 FORTUNE	9,253,540	-
MONEY MATCH	9,100,037	9,408,600
\$250,000 CROSSWORD	8,992,740	-
ELECTRIC 5s	8,932,939	5,611,372
CLASSIC BINGO	8,435,454	-
AMC THE WALKING DEAD	8,232,414	-
JOKER'S WILD	7,893,930	-
CHILLY BILLS	7,595,946	-
HOLIDAY CASH	7,566,051	-
LUCKY IN LOVE	7,546,006	-
GOLD BAR BINGO	7,311,098	-
NEW JERSEY HOLD 'EM POKER	6,843,511	14,801,703
ESCAPE TO MARGARITAVILLE	6,753,319	-
\$30,000 JACKPOT	6,422,274	-
MONOPOLY MILLIONAIRES' CLUB	6,285,180	-

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ending June 30,	
	2015	2014
FIRE & ICE	6,256,044	9,028,743
5X MONEY	6,195,684	3,673,748
\$50 FRENZY	5,770,157	-
CLASSIC BINGO	5,508,418	4,790,826
MONOPOLY (\$1)	5,222,539	-
HIGH ROLLER	4,572,536	10,410,505
MASSIVE MONEY BINGO	4,354,801	12,449,436
WIN FOR LIFE!	3,971,910	-
HOLD 'EM POKER	3,539,220	17,672,985
HOT DICE	3,414,591	1,103,890
BLOOMIN' BUCKS	3,139,139	-
\$5,000 JACKPOT	2,988,521	-
CASH EXPLOSION	2,775,210	-
HIT \$50s	2,484,296	9,581,298
DOUBLE BLACKJACK	1,752,110	3,450,112
BIG MONEY SPECTACULAR	1,735,454	33,667,616
DOUBLE YOUR LUCK	1,415,108	-
CROSSWORD	1,263,808	41,438,451
\$100,000,000 SPECTACULAR	1,243,840	119,030,930
POWER PLAY CROSSWORD	822,504	14,942,324
7/11/2021	748,393	3,664,748
ZUMA	581,593	6,902,577
SNOW ME THE MONEY	479,394	9,193,092
DIAMOND SPECTACULAR	453,900	55,965,330
3X CASH	271,887	4,356,268
LOVE TO WIN!	241,353	7,597,992
TRIPLE TRIPLER	238,224	5,283,462
5X CASH	208,185	17,594,135
CLASSIC BINGO	198,482	10,703,088
QUARTER MILLION CROSSWORD	166,974	17,743,150
SUPER CROSSWORD	86,775	27,926,195
BIG MONEY SPECTACULAR	55,134	34,205,894
SUNNY \$50'S	15,770	11,819,998
BINGO BOXES	13,170	10,368,000
WIN FOR LIFE	13,014	16,607,675
CLASSIC BINGO	12,900	-
GOLD BAR BINGO	11,935	19,790,568
GOLDEN NUGGET	10,700	14,398,809

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ending June 30,	
	2015	2014
SEASON'S GOLD	10,145	15,269,823
CROSSWORD	8,085	41,713,581
SUPER CROSSWORD	6,790	26,075,820
LUCKY 7'S DOUBLER	6,170	6,783,836
MERRY MILLIONAIRE	5,388	19,555,790
RUBY RED 7s	4,572	12,079,940
\$50,000 LUCKY STREAK	4,552	8,088,975
BIG MONEY SPECTACULAR	3,226	35,778,250
HOLIDAY LUCKY TIMES 10	1,452	12,738,092
SUPER CROSSWORD	(145)	196,820
DOUBLE DOLLARS	(186)	1,824,648
\$50 SHADES OF GREEN	(296)	718,704
GOLD RUSH	(300)	2,683,632
\$50 FALL CLEANUP	(300)	370,614
SUPER CROSSWORD	(300)	6,102,470
CLASSIC BINGO	(528)	83,520
TIC TAC SNOW	(562)	215,770
LUCKY HORSESHOE BINGO	(573)	1,618,569
CROSSWORD	(576)	12,806,112
GOLD MINE	(600)	257,748
BIG MONEY SPECTACULAR	(600)	19,628,970
BIG MONEY SPECTACULAR	(600)	35,174,900
BINGO TIMES 10	(625)	3,853,505
BIRTHDAY WISHES	(712)	847,888
RED HOT HEARTS	(894)	910,626
PACK MAN CASH	(1,024)	1,167,766
CASINO CASH	(1,195)	2,199,614
BULLSEYE BINGO	(1,287)	1,286,793
QUARTER MILLION CROSSWORD	(1,300)	8,427,670
STARRY NIGHT	(1,420)	1,066,326
PRIOR YEAR GAME	(1,500)	(12,008)
DIAMOND SPECTACULAR	(1,500)	3,033,740
SUPER CROSSWORD	(1,500)	25,810,495
LUCKY TIMES 20	(1,905)	10,448,192
FOOTBALL BLITZ	(1,918)	1,035,984
MONOPOLY MILLIONAIRE	(1,940)	4,853,490
CASH COW	(2,004)	1,326,184
LUCKY LINES	(2,199)	8,781,778

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY

SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ending June 30,	
	2015	2014
SKEE-BALL	(2,379)	654,966
\$500,000 LUCKY STREAK	(2,464)	9,322,137
WIN FOR LIFE	(2,472)	1,752,984
SUPER TIC TAC TOE	(2,529)	3,155,271
BLACKJACK TRIPLER	(2,555)	1,461,330
CASH LINES	(2,667)	16,144,536
MONEY MANIA	(2,690)	3,484,840
POKER SHOWDOWN	(2,880)	6,036,415
MASSIVE CASH	(2,910)	5,850,024
CROSSWORD	(3,276)	42,177,681
MARTI - MONEY	(3,754)	157,554
DINER DOUBLER	(4,078)	639,128
CHAMPIONSHIP POKER	(4,735)	14,985,320
SUPER 7'S SLINGO	(4,758)	6,602,711
CLASSIC BINGO	(5,114)	13,649,714
THE GOLDEN TICKET	(5,375)	4,123,240
ZODIAC MATCH	(5,546)	2,816,304
LUCKY DUCK DOUBLER	(5,957)	2,890,748
FANTASY BLACK JACK	(6,430)	3,633,032
\$1,000,000 LAS VEGAS GAME SHOW	(6,630)	3,387,622
SPRING DOUBLER	(7,244)	3,668,652
MOTHER'S DAY	(7,573)	1,384,974
TAKE ME OUT TO THE BALLGAME	(8,205)	4,686,936
PLANTS VS. ZOMBIES	(8,780)	5,418,223
FROGGER	(9,066)	2,552,991
CASINO MULTIPLIER	(9,100)	6,673,458
RED, WHITE & MOOLA	(10,742)	6,982,504
FATHER'S DAY	(13,007)	2,124,424
DUBBLE BUBBLE BINGO	(19,113)	4,902,208
HOLIDAY GREETINGS	(24,760)	5,970,196
DOUBLE IT (C)	-	(752)
CASH IN A FLASH	-	(300)
MONOPOLY (2011)	-	(45)
BIRTHDAY WISHES	-	(300)
\$1000 DOWNPOUR	-	(600)
\$300,000 DOUBLE DOWN	-	(435)
BLACK CHERRY TRIPLER	-	(78)
LUCKY 7S CASINO	-	(210)

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ending June 30,	
	2015	2014
SUPER 6'S	-	(715)
BEJEWELED MONEY MULTIPLIER	-	(327)
THE NEW ROYALS	-	(1,570)
WHEEL OF FORTUNE	-	(300)
\$500 FALL FRENZY	-	(324)
COSMIC MATCH	-	(3,420)
SUPER 7 SLOTS	-	(2,125)
ZOMBIE TRIPLER	-	(300)
GREAT BIG BINGO	-	(5)
LUCKY TWELVES	-	(308)
HOLIDAY COUNTDOWN	-	(159)
FREEZIN' \$50S	-	(300)
BETTY BOOP	-	(170)
DRAGON'S FORTUNE	-	(805)
TRIPLE WIN	-	(380)
KISSES & CAASH	-	(2,302)
HOLD'EM POKER	-	(300)
DOUBLE DIAMONDS	-	(672)
CASH SOUNDS	-	(306)
MASSIVE MONEY MATCH	-	(300)
LOTERIA	-	(1,356)
SHAMROCK 7S	-	(600)
SNAKE EYES	-	(1,686)
CASH FARMER	-	(981)
LUCKY TIMES 10	-	(1,906)
HOLD'EM POKER	-	(600)
\$100 HOMERS	-	(4,552)
10X CASH	-	(300)
\$100,000,000 SPECTACULAR	-	26,130
FATHER'S DAY	-	(5,206)
STRAWBERRY 7'S	-	(1,248)
RED LINE BINGO	-	(2,140)
BIG MONEY SPECTACULAR	-	300
CROSSWORD	-	300
WIN FOR LIFE	-	(1,365)
DOUBLE SIDED DOLLARS	-	483,470
MAD MONEY	-	(1,455)
LUCKY TIMES 20	-	85,525

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
 SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ending June 30,	
	2015	2014
10X CASH	-	(2,130)
CHAMPIONSHIP POKER	-	(2,685)
PLANTS V. ZOMBIES	-	(2,846)
HOLIDAY LUCKY TIMES 10	-	59,254
HOLIDAY CASH	-	64,664
STOCKING STUFFER	-	20,643
JINGLE BELL BINGO	-	432,291
WINNER WISHES	-	64,020
BIG MONEY SPECTACULAR	-	(378)
SUPER CROSSWORD	-	(435)
CROSSWORD	-	(1,749)
BIG MONEY SPECTACULAR	-	(1,390)
TRIPLING RED 7s	-	151,784
10X THE MONEY	-	77,290
SUPER CROSSWORD	-	22,200
BIG MONEY SPECTACULAR	-	38,974
CROSSWORD	-	254,418
DIAMOND SPECTACULAR	-	75,440
BIG MONEY SPECTACULAR	-	812,710
	<u>\$ 1,709,143,246</u>	<u>\$ 1,531,771,568</u>

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
SCHEDULE OF ADMINISTRATIVE EXPENSES

	Years Ended June 30,	
	2015	2014*
Salaries	\$ 6,306,627	\$ 6,421,066
Printing office supplies	66,921	66,262
Vehicular supplies	583	1,206
Household & clothing	2,032	604
Travel	36,783	61,352
Telephone	101,689	231,439
Postage	51,163	74,376
Data processing	547,382	748,275
Household & security	246,184	217,082
Professional services	347,519	535,887
Other professional services	237,168	5,204,308
Data processing-OIT	526,484	306,717
Maintenance-building grounds	11,063	12,931
Maintenance-office equipment	10,702	14,595
Rent-building and grounds	1,130,524	1,127,424
Central motor pool	93,376	92,285
Vehicular equipment	143,382	99,193
Other equipment	29,300	7,648
Info processing equipment	9,919	108,005
Amortization expense	68,408	52,668
Office of information technology fees	-	494,254
Total	\$ 9,967,207	\$ 15,877,577

*Some amounts have been reclassified to conform with current year presentation.

STATE OF NEW JERSEY, DEPARTMENT OF TREASURY, DIVISION OF STATE LOTTERY
 SCHEDULE OF NORTHSTAR NJ NET INCOME TARGETS (UNAUDITED)

Year	Fiscal Year	Net Income Target	
Year 1 (Stub Year)	2014	\$ 760,897,061	(Prorated)
Year 2	2015	1,047,000,000	
Year 3	2016	1,060,000,000	
Year 4	2017	1,070,000,000	
Year 5	2018	1,080,000,000	
Year 6	2019	1,090,300,000	
Year 7	2020	1,103,100,000	
Year 8	2021	1,115,400,000	
Year 9	2022	1,126,800,000	
Year 10	2023	1,137,500,000	
Year 11	2024	1,148,200,000	
Year 12	2025	1,159,600,000	
Year 13	2026	1,171,200,000	
Year 14	2027	1,182,900,000	
Year 15	2028	1,194,700,000	
Year 16	2029	1,206,600,000	