

2016 ANNUAL REPORT

Benefiting Education and Institutions Since 1970



GOVERNMENT LEADERSHIP in Fiscal Year 2016



Chris Christie
Governor



Kim Guadagno
Lieutenant Governor



Andrew P. Sidamon-Eristoff
State Treasurer
Served: Feb. 2010-Nov. 2015



Ford M. Scudder
State Treasurer
Served: Nov. 2015-Present

LOTTERY COMMISSIONERS



Thomas Tucci, Jr.
Chairman



Frank V. Ragazzo
Vice Chairman



Al Alvarez, Esq.
Commissioner



Robert J. D'Anton
Commissioner



Patrick P. Toscano, Esq.
Commissioner



Robert Slater
Commissioner



NEW JERSEY LOTTERY MISSION STATEMENT

The mission of the New Jersey State Lottery is to raise revenue for **maximum contribution** to State education and institutions benefiting the citizens of New Jersey through the responsible sale of lottery products. This is accomplished by providing entertaining products through a dynamic public business enterprise built upon honesty, integrity, customer satisfaction, teamwork, and public/private partnerships.

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EXECUTIVE DIRECTOR'S LETTER

Fiscal Year 2016 was another highly successful year for the New Jersey Lottery. It continues to hold its position as one of the top ten revenue producing lotteries in the country. Lottery sales topped \$3.3 billion making 2016 the seventh consecutive year of increased revenue. The Lottery State contribution was \$987 million making it the largest conventional contribution in New Jersey Lottery history.

These achievements were accomplished by incorporating the diverse perspectives of Lottery staff and shaping them into actionable tasks for today and plans for the future. Their insights define department goals, set priorities and implement change. The outcome of which has enabled us to expand products and services, increase efficiency, heighten productivity, and become an industry trend-setting lottery.

The Lottery expanded its product line with the addition of two new game styles, Fast Play and 5 Card Cash. To support the 5 Card Cash game a new in-house game drawing studio was built. Maintaining drawings in-house is operationally cost efficient and keeps Lottery staff integral to the process. The 5 Card Cash drawing room complements the two professional television studios also housed at Headquarters and managed by Lottery staff.

Customer services were expanded for our players in various ways. One high technology addition was the upgrade of the Lottery mobile application. The enhancement enables players to scan their Lottery ticket to determine whether it is a winning ticket.

The retailer services team heightened their productivity when sales force automation software was implemented to improve retailer sales discussions and to show retailers how to increase lottery sales efficiency.

The Validations Unit of Lottery, which receives claims by mail and in person at the Lottery headquarters, processed more than 66,000 winner claims in FY 2016. That was a year-over-year increase from over 56,000 claims, highlighting the operational management goal of increasing staff productivity and ensuring no job is left undone.

Additionally, retailer instant ticket accounting challenges were eased by leveraging International Gaming Technology (IGT) instant ticket inventory tracking software, Smart Count, at an increased number of retail locations.

Retailer Advisory meetings were conducted to obtain valuable feedback from retailers that resulted in the development of a new terminal report and changes to point-of-sale materials.



Carole Hedinger, CPA
Executive Director



Carole Hedinger was awarded the Major Peter J. O'Connell Lottery Industry Lifetime Achievement Award by the Public Gaming Research Institute in 2016 for her dedication, contribution and great success in Government Lotteries.

Northstar New Jersey Lottery Group (NSNJ) has provided Lottery with an additional team that is developing and executing many of these efficiencies. The relationship between Lottery and NSNJ has increased the structural integrity of the organization with the benefit of advanced technology, highly trained sales staff and strong creative efforts. The rate at which we can implement improvements has been exponentially increased due to the growth management services agreement with NSNJ.

Additionally, we ensured that the New Jersey Lottery will be able to maintain its essential functions by creating a fully functional Back-up Continuity Site (BCS). The BCS is an alternate location from headquarters at which the Lottery can operate completely, including performing daily draws, if the headquarters is rendered non-functional. This monumental project required the combined efforts of the Lottery Information Technology, Finance, Facilities, and vendor, IGT,

staffs for its successful completion. The Lottery is the first in the nation to have achieved this level of preparedness.

Current Lottery revenue has increased by more than \$1 billion since Fiscal Year 2003. With only modest population growth in the state during that time period, the success is attributable to an expansion of our customer base and increased product popularity.

The Annual Report highlights many of the Lottery's accomplishments. It also features the Lottery Organizational Structure by noting each Section, its assigned function and the leadership who has nurtured ideas, making them actionable tasks with measurable outcomes. It is with great pride that I share with you the New Jersey Lottery 2016 Annual Report.

Very truly yours,
Carole Hedinger, CPA

LOTTERY LEADERSHIP SENIOR STAFF

I-r - seated: Carole Hedinger, Executive Director; R. John Custodio, Deputy Executive Director. **I-r - standing:** Richard Pagnani, IMS Manager; Duane Daniels, Deputy Director, Security; Margaret Square, Deputy Director, Operations; Michael DeCheser, Director, Media and Broadcast; Judith Drucker, Chief Communications Officer; Megan Mazzoni, Deputy Director, Administration and Compliance; John White, Deputy Director, Finance.



NEW JERSEY LOTTERY GIVING BACK

NEW JERSEY LOTTERY BENEFITS EDUCATION AND INSTITUTIONS

The New Jersey Lottery reported the seventh consecutive year of increased ticket sales with Fiscal Year 2016 revenue of \$3.29 billion. Increased sales resulted in a record-breaking contribution of \$987 million to the State on behalf of Lottery beneficiaries, up from \$960 million in Fiscal Year 2015. New Jersey Lottery contributions provide vital funding to education and institutions making everyone in the Garden State a winner. The Lottery is the State's fourth largest revenue producer.

Our **REAL WINNERS** don't need tickets.

Since its inception in 1970, the Lottery has dedicated more than \$24.9 billion to programs and institutions that benefit millions of New Jersey residents. The Departments of Agriculture, Education, Human Services, Military and Veterans Affairs and Higher Education Services receive support from Lottery-generated revenue. Some of the programs and institutions that receive Lottery funding include the: School Nutrition Program, Tuition Aid Grants, Student Tuition Assistance Reward Scholarship (NJ Stars), Marie Katzenbach School for the Deaf, centers for developmentally disabled, state psychiatric hospitals and homes for New Jersey's disabled soldiers.

New Jersey Lottery players also had a record-winning year with \$2.0 billion paid in prizes up from \$1.8 billion in Fiscal Year 2015. Nearly 113 million winning tickets were validated and paid in Fiscal Year 2016, which was an increase from the 111 million in Fiscal Year 2015.

The Lottery plays a key role in supporting businesses, large and small, throughout the State. At the end of Fiscal Year 2016 there were more than 7,600 Lottery retailer licenses issued. Retailers are vital to the success and growth of the Lottery. As the public face of the lottery brand they provide customer service and product support. In return, retailers earn five percent commission on their lottery ticket sales in addition to ticket cashing and special product promotion bonuses. In Fiscal Year 2016, retailers received \$186 million, up from \$170 million, in commissions and bonuses.

STATE OF NEW JERSEY PROGRAMS SUPPORTED BY STATE LOTTERY RESOURCES FOR THE YEAR ENDED JUNE 30, 2016

(Amounts expressed in thousands)

Amount Expended and/or Encumbered (a)

DEPARTMENT OF AGRICULTURE

School Nutrition	\$	3,410
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DEPARTMENT OF EDUCATION

Marie Katzenbach School for the Deaf		4,431
Non-Public School Aid		47,024
Statewide Assessment Program (Grades 4, 8, 11)		15,806

TOTAL DEPARTMENT OF EDUCATION		67,261
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HIGHER EDUCATIONAL SERVICES

Senior Public Institutions-Operating Aid		385,845
Tuition Aid Grants		222,511
Higher Education Capital Improvement Plan-Debt Service		21,619
Opportunity Program Grants		14,405
Higher Education Facilities Trust Fund		10,904
Supplementary Education Program Grants		7,088
Student Tuition Assistance Reward Scholarships (NJStars)		3,824
Aid to Independent Colleges and Universities		554
Governor's Urban Scholarship Program		523

TOTAL HIGHER EDUCATIONAL SERVICES		667,273
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DEPARTMENT OF HUMAN SERVICES

Operation of Centers for Developmentally Disabled		70,075
Operation of State Psychiatric Hospitals		163,325

TOTAL DEPARTMENT OF HUMAN SERVICES		233,400
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DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

Operation of Homes for Disabled Soldiers		15,656
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TOTAL REVENUE REALIZED-GAAP BASIS	\$	987,000
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(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.

Ford M. Scudder, State Treasurer

RESPONSIBLE PLAY



An essential element of the Lottery mission is to provide the public with entertaining lottery products in a responsible manner. To accomplish that task, the Lottery has established a comprehensive Responsible Play Program. Elements of that program include being a long-standing member of the Council on Compulsive Gambling of New Jersey (CCGNJ). Also, a Lottery staff member holds a position on the Council's Board of Directors.

The Lottery includes a responsible play message and the 1-800-GAMBLER® phone number on every Lottery product, in advertising and marketing messaging, and through other public outreach opportunities.

The Lottery consistently reminds the public of the need for responsible play. Last year, on August 4, 2015, back-to-school season, a press conference was held to reinforce the message that lottery play is exclusively for those 18 years of age or older. The yearly "Not 18 Yet? No Bet." awareness messaging was shared with the media and public. Later in the fiscal year, the "Not 18 Yet? No Bet." logo was refreshed and reissued in retail locations.

Through sponsorship and staff attendance, the Lottery participated in the 33rd Annual Statewide Conference on Compulsive Gambling held on Sept. 18, 2015, joining with advocates, professionals and other members of the gaming community, who came together to address aspects of problem gambling and gambling from a multicultural perspective.

Also in September 2015, the Lottery Commission approved a revision to the mission statement to include the word "responsible" to the phrase "sale of Lottery products" as an affirmation of the organization's commitment to responsible play. Additionally, all Lottery staff received responsible play messaging on the backs of their business cards, which included the 1-800-GAMBLER helpline phone number. This messaging was also added to employee email signatures.

During the gift-giving holiday season, CCGNJ and Lottery officials came together at a press conference on December 1, 2015 to launch the Lottery's 2015 Holiday Awareness Campaign. In efforts to build public awareness, both organizations

continued to stress the message throughout the season that lottery tickets are not an appropriate gift for minors.

Governor Christie proclaimed March 2016 as Problem Gambling Awareness Month in New Jersey. To support his initiative, the Lottery joined with the CCGNJ at a press conference on March 2, 2016, to kick-off the Lottery's annual campaign efforts to educate the public about the warning signs of gambling addiction. The event raised awareness about help that is available for those who experience problem gambling behavior.

In an effort to keep employees aware of the Lottery's commitment to responsible gaming, it created a quarterly Responsible Gaming eNewsletter to inform them of the current Responsible Gaming initiatives.

In coordination with the contract management company, Northstar New Jersey Lottery (NSNJ), the Lottery continued to make strides toward achieving its goal of reaching the highest level of Responsible Gaming Framework Certificate of Accreditation from the World Lottery Association (WLA). The WLA is an industry leader in responsible gaming best practices. The Lottery achieved WLA Level 2 and 3 certifications by March 2015. In Fiscal Year 2016, extensive work was in progress to receive the Level 4 certification, the highest level of recognition awarded by the Association.

Efforts are ongoing to continually strengthen relationships with responsible gaming stakeholders. Throughout Fiscal Year 2016, the Lottery was an active member of the Responsible Gaming for the Future Working Group, hosting and participating in quarterly meetings of representatives from the gaming, regulatory, academic, and public health communities. The meetings provided an opportunity to exchange ideas and to work together to promote public awareness of responsible gaming and to raise awareness of treatment options available for individuals who engage in addictive behavior.

**As of this writing, the Lottery achieved its WLA Level 4 certification in November 2016 during Fiscal Year 2017. The New Jersey Lottery is only the third US lottery to achieve this distinction, certifying that it applies responsible gaming principles in day-to-day operations.*

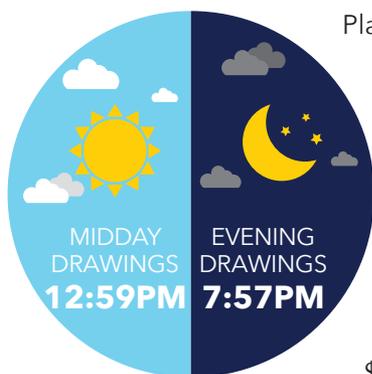


PICK-3 IS NEW JERSEY LOTTERY'S TOP-SELLING DRAW GAME

Playing is as easy as 1-2-3. Players select three numbers between 0 and 9 to play Pick-3, or opt for a Quick Pick. They may also choose from one of six bet types. Close Enough is the newest bet type that was offered to players beginning on November, 22, 2015.

Close Enough affords players with a win even if any of their selected numbers are off by one, either higher or lower, than the Lottery drawn numbers.

STRAIGHT • BOX • STRAIGHT/BOX • WHEEL • CLOSE ENOUGH • PAIR BETS



Players win cash prizes beginning with a 50-cent wager.

For an additional dollar per wager, players can instantly become winners with Instant Match. Instant Match is an immediate play option that provides players with an additional opportunity to win up to \$500 prior to the draw. Instant Match was introduced in 2002.

2016 TOTAL SALES
\$439.62
Million

NJ PLAYERS WON
\$219.76
Million

INSTANT MATCH

CONTRIBUTED
\$3.50 Million
TO TOTAL SALES



RETAILERS EARNED
\$24.67
Million
IN COMMISSIONS

BENEFICIARIES RECEIVED
\$184.64
Million

**INSTANT
MATCH**

CONTRIBUTED
\$4.16 Million
TO TOTAL SALES

2016 TOTAL SALES
**\$275.20
Million**

NJ PLAYERS WON
**\$138.73
Million**



RETAILERS EARNED
**\$14.80
Million**
IN COMMISSIONS

BENEFICIARIES
RECEIVED
**\$115.58
Million**



PICK-4 IS THE SECOND HIGHEST REVENUE-PRODUCING DRAW GAME

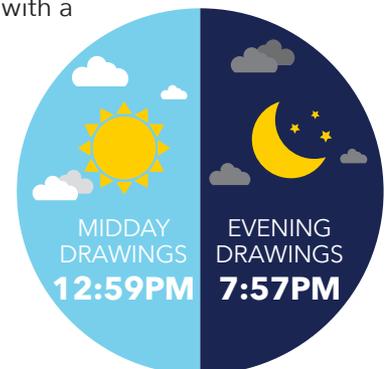
Playing is as easy as 1-2-3-4. Players select four numbers between 0 and 9 to play Pick-4, or opt for a Quick Pick. They may also choose from one of six bet types. Close Enough is the newest bet type that was offered to players beginning on November 22, 2015.

Close Enough affords players with a win even if any of their selected numbers are off by one, either higher or lower, than the Lottery drawn numbers.

STRAIGHT • BOX • STRAIGHT/BOX • WHEEL • CLOSE ENOUGH • PAIR BETS

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JERSEY CASH 5 TOP JACKPOT SPLIT BETWEEN TWO WINNERS

Jersey Cash 5 jackpots start at \$75,000 and grow with each drawing. This year's top jackpot reached \$1,330,193 by the November 7, 2015, drawing. That prize was split by two winning tickets sold in Bergen and Middlesex counties.

There were 159 jackpot winning tickets sold during the year. In total, there were 1.1 million winning tickets sold in the year with those ticketholders claiming more than \$75.79 million in cash prizes.



NJ PLAYERS WON
\$75.79
Million

2016 TOTAL SALES
\$151.63
Million

INSTANT MATCH

CONTRIBUTED
\$3.11 Million
MILLION TO TOTAL SALES

RETAILERS EARNED
\$7.90
Million
IN COMMISSIONS

BENEFICIARIES
RECEIVED
\$63.60
Million

EVENING DRAWING
7 NIGHTS A WEEK
7:57PM



CONTRIBUTED
\$4.76 Million
TO TOTAL SALES

2016 TOTAL SALES
**\$54.63
Million**

NJ PLAYERS WON
**\$28.26
Million**

BENEFICIARIES
RECEIVED
**\$21.85
Million**

RETAILERS EARNED
**\$2.81
Million**
IN COMMISSIONS

MONDAY AND THURSDAY
EVENING DRAWING
7:57PM



PICK 6 XTRA TOP JACKPOT WON ON SEPTEMBER 3, 2015

Pick-6, now with XTRA, celebrated its 36th year of providing exciting opportunities for players to win millions of dollars with drawings twice a week, on Monday and Thursday evenings. Nearly 1.64 million winning tickets were validated this year with ticketholders claiming more than \$28.26 million in cash prizes.

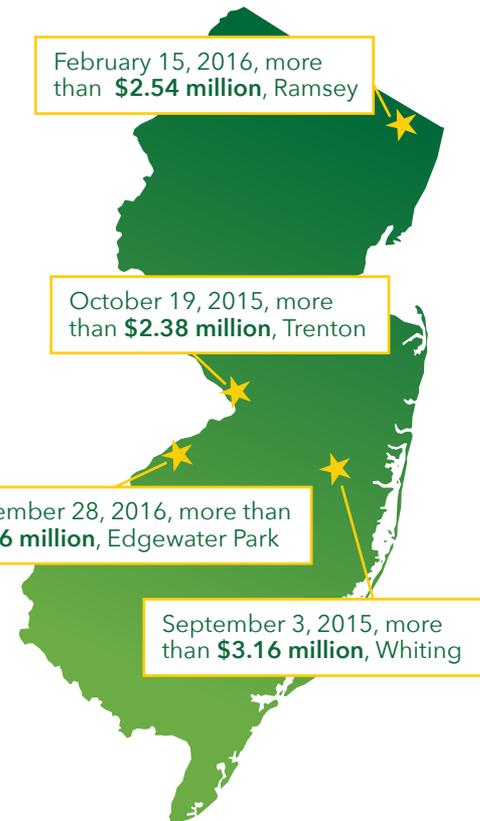
Four jackpot winning tickets were sold this year. The draw dates, jackpot amounts and towns in which the ticket holders reside are:

February 15, 2016, more than **\$2.54 million**, Ramsey

October 19, 2015, more than **\$2.38 million**, Trenton

December 28, 2016, more than **\$3.16 million**, Edgewater Park

September 3, 2015, more than **\$3.16 million**, Whiting



NJ PLAYERS WON
**\$38.49
 Million**
 IN THE
 MULTI-STATE GAME

RETAILERS EARNED
**\$2.43
 Million**
 IN COMMISSIONS

2016 TOTAL SALES
**\$45.76
 Million**

BENEFICIARIES
 RECEIVED
**\$16.61
 Million**



CASH4LIFE was launched as a New York Lottery and New Jersey Lottery exclusive game on June 16, 2014, at the New Jersey

Lottery studio in Lawrenceville. Other states began joining the game due to its unique prize proposition of two top prizes - \$1,000 a day for life and \$1,000 a week for life. By the end of this fiscal year, Maryland, Pennsylvania, Tennessee and Virginia had joined the founding states in offering the games to their state's residents.

There were three New Jersey \$1,000-a-day and four \$1,000-a-week for life prizewinners this fiscal year. In addition, more than 2.9 million winning tickets were validated this year, claiming nearly \$28.26 million in cash prizes.



During Fiscal Year 2016, there were 13 New Jersey Lottery Mega Millions tickets sold that won the second-tier \$1 million prize. The jackpot remained elusive in

the Garden State, yet, in total, more than 9.25 million winning Mega Millions tickets were claimed.

The largest jackpot during the year reached \$390 million in July 2016 but continued to climb into Fiscal Year 2017. It reached \$536 million before it was claimed by a sole winning ticket purchased in Indiana. Each time the jackpot is hit, it resets to the \$15 million baseline.

2016 TOTAL SALES
**\$144.42
 Million**

MEGAPLIER
 CONTRIBUTED
\$9.16 Million
 TO TOTAL SALES

NJ PLAYERS WON
**\$31.45
 Million**
 IN THE
 MULTI-STATE GAME

BENEFICIARIES
 RECEIVED
**\$60.66
 Million**

RETAILERS EARNED
**\$7.42
 Million**
 IN COMMISSIONS



5 Card Cash is a new poker-themed Draw Game launched on May 16, 2016. The game gives players two chances to win with every \$2 purchase of a ticket (hand). Every hand has an instant win component, "Win Now," with immediately redeemable prizes, as well as a nightly drawing, "Win Tonight."

The **5 Card Cash** game "deals" players a hand with five cards that are Quick Pick only. Players can check their ticket immediately after purchase to determine if their hand is a "Win Now" winner based on traditional poker hands. Prizes range from \$2 for the Pair of Jacks or Better to \$5,000 for the Royal Flush hands.

For an additional \$1 per hand, an **ALL IN** option is available to increase the top five "Win Now" tiers. It also affords players the opportunity to win **all** or a **portion** of a progressive jackpot.

A second opportunity to win is offered with the "Win Tonight" drawing held each evening. The lotto-style drawing takes place at the New Jersey Lottery studio and is played as a traditional match game. The drawing produces five winning cards. Players simply need to match the cards printed on their ticket with the cards drawn. Prizes range from \$2 to \$100,000.

The drawing is broadcast to the NJ Lottery Livestream site with computer-generated graphics. The graphics puts players in a seat at the poker table for a live experience. The drawing is also available to be viewed on-demand.





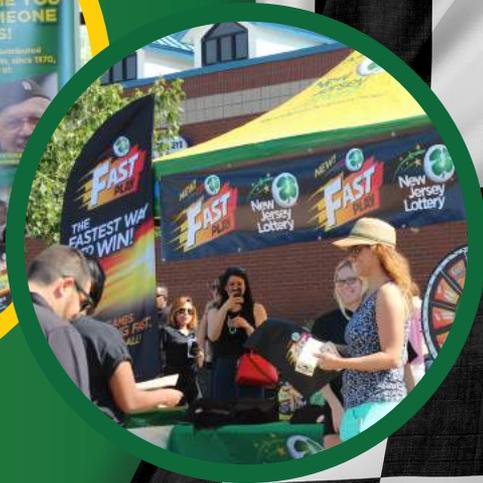
Fast Play was another new game innovation, introduced in Fiscal Year 2016, with sales beginning on August 2, 2015. **Fast Play** is a new game category for the Lottery. There are no numbers to pick, no drawings to wait for, and no tickets to scratch. Each **Fast Play** game contains randomly predetermined winning tickets with everything needed to play a game printed on the ticket, on-demand, at the retail location.

There were four game themes to choose from at launch. Each theme had a unique game board, set of symbols, features and prize structure. Each ticket is printed with the winning numbers to match along with individualized game instructions. The game rules are simple and clear but offer an element of excitement to keep players engaged. The prize pools instantly replenish after every purchase so each ticket sold has the same great odds of winning any prize. There are lots of cash prizes packed into each game.

Fast Play's game style warranted a novel introduction to the market. So, on Aug. 14, 2015, a kick-off event and press conference, entitled **Fast Pass for Fast Play Friday**, were held at the Frank S. Farley Plaza Rest Stop off the Atlantic City Expressway. Director Hedinger introduced the media and patrons to the new game with an explanation, signage and brochures. Then, with the wave of a checkered flag, the Lottery began an hour-long free toll pass for motorists at the Egg Harbor Eastbound Toll Plaza. The Lottery promotions team was on hand to celebrate with giveaways and interactive games.

New games were regularly introduced to the market to keep the product fresh and fun. There were 22 Fast Play games launched in Fiscal Year 2016.

2016 TOTAL SALES
\$48.39
Million



NJ PLAYERS WON
\$32.10
Million

BENEFICIARIES
RECEIVED
\$16.14
Million

RETAILERS EARNED
\$2.78
Million
IN COMMISSIONS

New Jersey Lottery



2016 TOTAL SALES
**\$286.00
Million**

Powerball shook the lottery playing world in Fiscal Year 2016 when game sales generated a new world record for any lottery jackpot game. The news media highlighted the frenzy with widespread coverage as the jackpot grew. After 20 game draws, the jackpot climbed to \$1.586 billion with a cash value of \$983.5 million.

The run ended on January 13, 2016, when three winning tickets were sold in California, Florida and Tennessee. Each ticket had an annuity value of \$528.8 million and a cash value of \$327.8 million. Nationwide, total sales for the 20 draw roll were \$1,343,334,683 which includes \$73,128,409 in Power Play sales. According to IGT, the lottery service provider, there were so many tickets sold that retailers used 234,000 rolls of paper, which is enough ticket stock to go around the world 1½ times.

As monumental as the billion dollar jackpot was to the game, there was a New Jersey Lottery win that inspired millions of people and resonated worldwide. On May 7, 2016, the New Jersey Lottery sold the sole winning Powerball ticket with an annuity value of \$429.6 million and a cash value of \$284 million. It was the sixth largest annuity jackpot in Powerball history.

The ticket was sold by a 7-Eleven, located in the state's capitol city of Trenton, in Mercer County. This win affirmed New Jersey's status as a "very lucky State" as it was the fourth New Jersey jackpot, out of the top eleven largest, in Powerball's game history. To exemplify the magnitude of this

win with the public and media across the country, Powerball ticket sales soared to \$919.99 million nationwide during this particular game run.

BENEFICIARIES
RECEIVED
**\$120.12
Million**

Public anticipation heightened when a press conference was held at the retail store from which the ticket was purchased. It highlighted the store owner's small-business story and shared the experience of the clerk who sold the ticket. The 'who-won-it' theme kept interest piqued until May 13 when the winner was revealed. The winners were introduced to the public at a standing-room only press conference held at Lottery Headquarters. The jackpot was claimed by a Trenton family with seven adult siblings and their mother. The group became known as The Smith Family Lottery Group. The family spokesperson, Valerie Marie Arthur said, "Divine intervention provided the winning numbers to my mother in a dream...Friday the 13th is now a blessed day."

The win was an international news story that resonated with players and media generating thousands of broadcast newscasts, radio air play, print and online articles reaching more than 850 million people around the world. It was a day that became famous in Lottery history.

NJ PLAYERS WON
**\$335.43
Million**
IN THE
MULTI-STATE GAME

RETAILERS EARNED
**\$14.59
Million**
IN COMMISSIONS

POWER PLAY
CONTRIBUTED
\$9.16 Million
TO TOTAL SALES



2016 TOTAL SALES
**\$1.87
 Billion**

The instant games category contributed more than 56 percent to total ticket sales in Fiscal Year 2016, once again establishing the category as players' favorite Lottery product. The stellar performance resulted in nearly all of the top 10 highest-ever weekly sales occurring during the fiscal year. The highest ranking sales week was achieved during the week-ending May 11, 2016, when sales topped \$40.85 million.

Contributing to the success of the instant games category was the reinvigoration of the Lottery Bonus Zone and Second Chance promotions. These promotions provided players with additional opportunities to win cash or other prizes by entering their non-winning instant games tickets into the programs.



One such opportunity was available through the World Series of Poker instant game. The second-chance promotional prize included a trip to Las Vegas and a seat at the World Series of Poker® Main Event table.

L-R John Custodio, NJ Lottery Deputy Executive Director, Amy and John Hammerstone, Kaitlyn Cuning, Lottery Drawing Hostess

L-R, Carole Hedinger, NJ Lottery Executive Director, Shatan McRae Thompson, \$25,000 Million Dollar Replay winner, Laura Palumbo, \$25,000 Million Dollar Replay winner, John Custodio, NJ Lottery Deputy Executive Director



The **Million Dollar Replay** program provides a year-long opportunity for instant games players to win one of 15 cash prizes ranging from \$10,000 up to \$1 million dollars in the final Grand Prize Drawing. Each entry into the Million Dollar Replay program requires \$10 in non-winning, eligible instant game tickets. Entries are received online through the New Jersey Lottery VIP Club portal. Four quarterly drawings are held each program year when 100 entrants are chosen as semi-finalists for the grand prize drawing. Each semi-finalist receives a \$250 prize.



The Grand Prize distribution for the Million Dollar Replay program is as follows: one \$1 million winner, two \$100,000 winners, three \$50,000 winners, four \$25,000 winners, and five \$10,000 winners. The Million Dollar Replay program is an exceptionally popular program with instant ticket players. Millions of entries are received each quarter. The program is funded with a portion of the unclaimed prize fund. This year, the event was held inside the George Washington Ballroom in the War Memorial in Trenton.

PLAYERS' PRIZE
PAYOUT
**\$1.26
Billion**

BENEFICIARIES
RECEIVED
**\$386.07
Million**

RETAILERS EARNED
**\$108.36
Million**
IN COMMISSIONS

RETAIL MERCHANDISING

Instant games **retail merchandising** also may have contributed to the games increased customer appeal. The Lottery Sales Team completed updating retail stores with new display units that were designed to provide customers with a full view of the colorful instant games graphics. Allowing customers a clear view of the distinct graphics and game styles provides a rich visual retail experience.

GAME FAMILIES

Keeping players engaged with the product line was achieved by launching new game families, beginning with the "Wild" Family of instant games in September, 2015. During the first month of sales, the game contributed over \$12 million. The "Multiplier" family was relaunched in February, 2016 and contributed more than \$23 million in the first month of sales.

HOLIDAY SEASON

The holiday season is always a robust time for instant games sales and this year was exceptional. The category achieved a sales growth of seven percent year-over-year. In November 2015, custom-branded Lottery Card Standees and Lottery-branded holiday cards were produced for the campaign.

The holiday efforts resulted in the weeks ending Dec. 23, 2015 and Dec. 30, 2015, as being the second and fourth highest sales weeks on record with sales of more than \$40.6 million and \$39.8 million respectively.

The New Year began with the introduction of the "All Cash Millions" instant game which creates "instant millionaires" with a top prize of \$1 million cash. The \$5,000,000 Cash Extravaganza, which costs \$30 to purchase, was relaunched in March 2016 and continued to be a consistent top-selling game since its initial launch in January 2015. To date, these games have paid out over \$242 million in prizes collectively.

The instant games category remains a robust product category achieving high customer satisfaction as evidenced by ticket sales.



NORTHSTAR NEW JERSEY LOTTERY GROUP

Retail Network Operations, Advertising, Marketing and Promotion in Fiscal Year 2016

It has been nearly three years since the Northstar New Jersey Lottery Group (NSNJ) began executing its plan to provide growth management services on behalf of the Lottery, beginning on Oct. 1, 2013. The 15-year contract focused on: product innovation, marketing optimization, reinvigorated advertising and branding, sales force and retailer expansion. Exceptional progress was achieved this year resulting in record-breaking ticket sales and revenue to the State on behalf of its beneficiaries.

NSNJ ended the year with a total of 130 employees, of which 93 were in sales, 20 in marketing and 17 in administration. The organizational structure exemplifies the focus of the staff, which emphasizes day-to-day performance, productivity and achieving results.

RETAIL NETWORK

Lottery Sales Representatives (LSRs) are in the market daily, working with retailers to maximize marketing potential, assisting in managing Lottery product inventory and responding to individual retailer needs. Merchandising standards continued to evolve and improve with store makeovers throughout the retailer network. LSR's completed a refresh of the retail network's instant ticket dispensers enhancing consumer visibility of instant games at retail.

Lottery has a robust marketing program with many tools provided for the retail space. LSRs instructed retailers on how to maximize the benefits of the creative assets provided to them by Lottery. LSRs were also on hand to explain new promotions, games and to respond to other questions.

To assist retailers in managing their businesses, sales force automation software was implemented to improve sales discussions and show retailers how to increase Lottery sales efficiently. Also, instant ticket accounting challenges were eased by leveraging IGT's instant ticket inventory tracking software, Smart Count, at an increased number of retail locations.

Maintaining strong relationships with our retailers is essential. Retailer Advisory meetings were conducted to obtain valuable feedback from them. The responses conveyed during those sessions sparked the impetus for new reporting developments and modified merchandising efforts.

ADVERTISING AND MARKETING

The advertising and marketing teams continued to maintain a strong brand presence in the marketplace. Retailers received a rich array of point-of-sale assets throughout the year. These items were game-specific and announced promotions, new game enhancements and winner awareness news. The eye-catching creative campaigns were refreshed regularly to keep players informed and engaged in the brand and its products. Some of those assets included: counter mats, counter displays, window clings and terminal toppers.

Television, radio and social media advertising continued to be a component in sharing the Lottery brand. Exemplifying the quality of the team's work, the Lottery was honored with an industry advertising excellence award, the Fleury, for its spot featuring iconic New Jersey residents. The television advertisement underscores the "Anything Can Happen in Jersey™" Lottery slogan.

Jackpot awareness billboards were redesigned to accommodate the growing billion dollar jackpot amounts. And adding to traditional media, new media was incorporated into the advertising mix. This expanded brand awareness into new demographic markets. Select bloggers were tasked with promoting the games through their personal playing experiences.





During the holiday season, bloggers shared with their followers DIY projects using Lottery tickets in their crafts. They posted photos and how-to instructions on their blog sites.

For the first time, internet radio also was added to the advertising plan.

This year marked the launch of a new game category, Fast Play. A grand publicity event kicked-off the games with an innovative launch on Aug. 14, 2015. The Fast Pass for Fast Play event made news throughout the Tri-State Area. The event was accompanied by a full advertising and marketing campaign to introduce the product to market. In addition, a teaser campaign was used in movie theaters to promote the new games.

Holiday is consistently a strong Instant Game selling season. To keep the New Jersey Lottery products top-of-mind for consumers in a crowded market, card standees and Lottery-branded holiday cards were produced for select corporate accounts. The standee and holiday cards made gifting a very simple choice for consumers.

PROMOTIONS

Integrating the Lottery brand at public events is an integral component of the promotions strategy. The team held 306 promotional events during the year. A large majority were held at malls and retail locations across the state. Those visits included the display of the holiday standee. Large promotional events included the Atlantic City Concert Series, Haskell Invitational at Monmouth Park and the QuickChek Balloon Festival.

The Lottery also had a presence in professional sports venues with Jets, Giants and Devils sponsorships. The sponsorships included on-field promotions and new this year, video vignettes featuring

Lottery Ambassador Erica Young, and Giants' alumni. The videos captured surprised people in various New Jersey locations as they received prizes from the Lottery and Giants' alumni. The experiences created memorable moments for all.

Erica Young was also featured in specialty themed videos such as 'spreading acts of kindness,' DIY, how to play and Powerball jackpot awareness.

TECHNOLOGY

The NSNJ technology team, along with IGT, is the behind-the-scenes staff that implements the technology required to launch new products, promotions and game enhancements throughout the retailer network. This year, they worked to streamline the Million Dollar Replay entry process. They created a mobile application for personal devices providing players with the ability to scan Lottery tickets to determine if they are winners. At the retail level, they fashioned the ability to produce promotional coupons at terminals. Additionally, they implemented the launch of the Fast Play and 5 Card Cash games into the Lottery system.



NSNJ has provided a broad array of services and benefits to the Lottery and enhanced the integrated working relationship between the two organizations and their staffs.

Future plans are regularly vetted and developed, ensuring continued growth and progress for the Lottery and the State.



NEW JERSEY LOTTERY 2016 PROMOTIONAL EVENT PARTICIPATION

New Jersey Lottery players visit our promotions booth rain or shine!



Red Bulls game attendees that were selected for a special on-field New Jersey Lottery promotion.



Customers line up to win prizes and buy Lottery tickets at the NJ Seafood Festival in Belmar held each May.



Left: New Jersey Lottery Ambassador, Erica Young, with players at the Harrah's After Dark event in Atlantic City. Below: Winner of iPad Mini at the Harrah's After Dark event in Atlantic City.

Large event at the Haskell Invitational at Monmouth Park





Right and below:
New Jersey Lottery
promotions team at
the Live Nation beach
concert in Atlantic City.
The headliner was
Maroon 5.



Left and above: Players
tailgated with the New
Jersey Lottery promotions
team at the Jets football
game.



The new Fast Play game
was promoted during
the Harrah's After Dark
events in Atlantic City.



Lottery Sales
Representatives and
the New Jersey Lottery
promotions team
visited retailer locations
throughout the State,
supporting new products.



Since its inception in 1970, the New Jersey Lottery has contributed nearly **\$25 billion** to the State in support of education and institutions. Among its beneficiaries are: **veterans homes, colleges and universities, school nutrition programs, homes for the developmentally disabled, psychiatric hospitals, higher education scholarship programs** and the **Marie Katzenbach School for the Deaf.**



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

Financial Statements

June 30, 2016

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June 30, 2016

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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, 2016 and 2015. 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 the 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, 2016, 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 amended Northstar NJ 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 NJ is obligated to pay a shortfall payment.

During Fiscal 2015 Northstar NJ, in accordance with the terms of the contract, filed an adverse action due to the State of New Jersey's refusal to allow monitor games at retailers. The Division of State Lottery agreed that the refusal was an adverse action and provided relief to Northstar in the form of amended (reduced) net income targets. The amended contract provided for an allowance of \$2.5 million from Northstar NJ to the Division of State Lottery as an additional consideration for the terms contained therein.

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 15 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 ended June 30, 2016 was the second full operational year of the contract.

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

INTRODUCTION (Continued)

Under the terms of the agreement, Northstar NJ is responsible for subcontracting on behalf of the Lottery for services 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.

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)
- 5 Card Cash (launched in May 2016)
- 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
- CASH4LIFE

FINANCIAL HIGHLIGHTS

The Division of State Lottery's financial position at June 30, 2016 and 2015, consisted of total assets of \$553 million and \$511 million, respectively, and total liabilities of \$542 million and \$509 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, 2016 and 2015, were \$253 million and \$269 million, respectively. Net position increased from \$1.80 million in Fiscal Year 2015 to \$11.4 million for Fiscal Year 2016.

FINANCIAL STATEMENTS

The Division of State Lottery's financial statements include statement of net position as of June 30, 2016 and 2015, statement of revenues, expenses and changes in net position for years ended June 30, 2016 and 2015, and statement of cash flows for years ended June 30, 2016 and 2015. 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,		
	2016	2015	2014
Current Assets	\$ 326	\$ 283	\$ 272
Deposit Fund Contracts	227	228	245
Total Assets	553	511	517
Current Liabilities	314	280	270
Non-Current Liabilities	228	229	246
Total Liabilities	542	509	516
Restricted Net Position	3.9	1.5	.5
Unrestricted Net Position	7.5	.3	.3
Total Net Position	\$ 11.4	\$ 1.8	\$.8

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 \$251 million and \$207 million at June 30, 2016 and 2015, 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 \$253 million and \$269 million as of June 30, 2016 and 2015, 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, 2016 and 2015, respectively. The annuities due beyond Fiscal Year 2017 and Fiscal Year 2016 total \$228 million and \$229 million, respectively. These represent the non-current assets reported on the Division of State Lottery's statements 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 20 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 \$25 million and \$40 million as of June 30, 2016 and 2015, respectively.

Non-current liabilities represent annuity prize awards due beyond 2017 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,		
	2016	2015	2014
Restricted (Unclaimed Prize Reserves)	\$ 3.9	\$ 1.5	\$ 0.5
Unrestricted	7.5	0.3	0.3
Total Net Position	\$ 11.4	\$ 1.8	\$ 0.8

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

**STATE OF NEW JERSEY, DEPARTMENT OF THE 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 statements of revenues, expenses and changes in net position, which are summarized (in millions) as follows:

	Years Ended June 30,		
	2016	2015	2014
Operating revenues			
Ticket sales	\$ 3,290	\$ 3,001	\$ 2,901
Forfeited prizes	34	48	39
Miscellaneous income	2	1	2
Total operating revenues	3,326	3,050	2,942
Operating expenses			
Prize expenses	2,002	1,825	1,732
Retailer commissions	186	170	162
Northstar NJ fees and expenses	44	42	29
Vendor fees	60	54	46
Administrative expense	10	10	16
Bad debt expense	0	1	1
Total operating expenses	2,302	2,102	1,986
Operating income	1,024	948	956
Non-Operating Revenue (expenses)	(28)	13	1
Income before transfers out	997	961	957
Operating transfers – State contributions	987	960	965
Increase (decrease) in net position	\$ 10	\$ 1	\$ (8)

The Division of State Lottery awarded approximately \$2.002 billion in prize awards in Fiscal Year 2016 and approximately \$1.825 billion in Fiscal Year 2015. Nearly 113 million winning tickets were validated and paid in Fiscal Year 2016. This amount is a slight increase above the 111 million winning tickets which were validated and paid in Fiscal Year 2015.

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 \$104 million in Fiscal Year 2016. This amount was paid directly to Northstar NJ for the services it provided or procured on behalf of the Division of State Lottery. Included in the \$104 million paid to Northstar NJ was \$25 million for advertising and marketing costs, \$35 million for gaming system vendor fees, and \$24 million for instant ticket printing vendor fees. In Fiscal Year 2015, the total compensation paid for the Division of Lottery's vendors and network fees was \$97 million. Of this amount \$96 million was paid to Northstar NJ including \$23 million for advertising and marketing costs, \$32 million for gaming system vendor fees, and \$22 million for instant ticket printing vendor fees.

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 2016 and 2015 were \$10 million, respectively for each year. These administrative expenses include salaries, auditing services, rent, security, data processing services, office supplies and attorney general fees. The management services contract has shifted advertising and other expenses from the Division of State Lottery to Northstar NJ.

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 the 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 \$987 million, 30% of net revenues, in Fiscal Year 2016 and \$960 million, 32% of net revenues, in Fiscal Year 2015.

During the term of the contract, Northstar NJ's incentive compensation is reduced in the event the annual contractual net income target is not met or if the 30% minimum contribution threshold is not achieved. Conversely, incentive compensation is 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 (amended) net income target for the Fiscal Year ended June 30, 2016, was \$963,478,103.

The operating income for Fiscal Year 2016 totaled \$1,024.7 million. In accordance with the amended Northstar contract, a separate calculation is performed to determine the operating income for the 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 Northstar NJ's incentive/shortfall payment is based on operating income of \$1,024.7 million. The calculation is shown below.

Operating Income	\$ 1,024.7 million
Division of State Lottery Portion of Unclaimed Prizes	(2.6) million
Cost of Million Dollar Replay Program	(1.4) million
Total Deduction	\$ 1,020.8 million

The amended 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 3% of Operating 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 2016, the former scenario was utilized to calculate the Incentive Compensation Payment as outlined below.

**STATE OF NEW JERSEY, DEPARTMENT OF THE 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)

Net Income Target	\$ 963.5 million
Fiscal Year 2016 Operating Income (adjusted)	1,020.8 million
3% Calculation for Incentive Compensation	30.6 million
Less Penalty for Failure to Achieve 30% Contribution Mandate	0.0 million
Total Incentive Compensation for Fiscal Year 2016	\$ 30.6 million

Statement of Cash Flows

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

	Years Ended June 30,		
	2016	2015	2014
Cash flows provided by operating activities	\$ 1,042	\$ 936	\$ 916
Cash flows used in non-capital financing activities	(1,017)	(943)	(950)
Cash flows (used in) provided by investing activities	(28)	10	34
Net increase (decrease) in cash	\$ (3)	\$ 3	\$ -

SUMMARY

Division of State Lottery management has been working closely with Northstar NJ throughout Fiscal Year 2016, and looks forward to continuing this innovative partnership going into the third full year of the contract.

Prior to the end of Fiscal Year 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 Year 2015 "CASH4LIFE" exceeded expectations and 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. In Fiscal Year 2016, CASH4LIFE expanded to a total of six states with Tennessee and Maryland joining. In Fiscal Year 2017, CASH4LIFE is expected to increase to a total of nine states with Georgia joining in August, Indiana joining in September, and Florida joining later in the year.

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. During Fiscal Year 2016, the game generated nearly \$48 million in net revenues. By attracting additional players to the entire New Jersey Lottery gaming portfolio, the game proved to be a key building block in the Division of State Lottery's efforts to obtain record sales during the year.

SUMMARY (CONTINUED)

Before the close of Fiscal 2016, the Division of State Lottery launched 5 Card Cash, a new daily terminal game which is based on the rules of poker. The player receives a ticket containing the images of five playing cards from a traditional 52 card deck. If any combination of those five cards contains a winning hand, the player instantly wins a prize ranging in size from \$2.00 to \$5,000.00. For an additional wager, the player may opt to participate in the game's "All In" feature and have a chance to win the progressive jackpot that pays a minimum of \$10,000.00. Every player also has a chance to win at the evening draw when the images of five playing cards will be drawn from a draw machine. Similar to FastPlay, 5 Card Cash contains the attributes of both an instant and a draw game.

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 The 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 The Treasury, Division of State Lottery (the "Division of State Lottery") as of and for the years ended June 30, 2016 and 2015, 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.

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, 2016 and 2015, 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 thirty-one through thirty-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 report dated December 1, 2016, 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 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

December 1, 2016

STATE OF NEW JERSEY, DEPARTMENT OF THE TREASURY, DIVISION OF STATE LOTTERY
STATEMENTS OF NET POSITION

	June 30,	
	2016	2015
ASSETS		
Current Assets		
Cash	\$ 84,665	\$ 3,301,670
Accounts receivable, net of allowance for doubtful accounts of \$2,224,000 in 2016 and \$2,724,000 in 2015	46,188,335	16,412,649
Northstar NJ shortfall receivable	–	12,910,236
Deferred Expenses	2,690,563	2,724,776
Investments:		
Deposit Fund Contracts	25,352,704	40,211,749
State of New Jersey Cash Management Fund	251,134,998	207,229,895
Total current assets	325,451,266	282,790,974
Non-Current Assets		
Investments - deposit fund contracts	227,170,016	228,525,068
Total non-current assets	227,170,016	228,525,068
Total Assets	\$ 552,621,282	\$ 511,316,042
LIABILITIES		
Current Liabilities		
Accounts payable and accrued expenses	\$ 64,235,894	\$ 30,956,803
Obligation for unpaid prize awards	120,682,044	76,100,675
Installment prize awards	25,352,704	40,211,749
Due to State Of New Jersey - education and State institutions	103,000,000	133,000,000
Total Current Liabilities	313,270,643	280,269,226
Non-Current Liabilities		
Compensated absences	733,631	723,069
Installment prize awards	227,170,016	228,525,068
Total non-current liabilities	227,903,647	229,248,137
Total Liabilities	541,174,289	509,517,363
NET POSITION		
Restricted for prize awards or contributions for aid to education and State institutions	3,881,442	1,479,398
Unrestricted	7,565,551	319,282
Total Net Position	\$ 11,446,993	\$ 1,798,680

See accompanying notes to financial statements.

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

	Years Ended June 30,	
	2016	2015
Operating Revenues		
Ticket Sales		
Pick-3	\$ 439,627,708	\$ 437,774,537
Pick-4	275,200,494	271,765,815
Jersey Cash 5	151,636,143	148,424,382
Pick-6 Lotto	54,632,415	57,613,947
CASH4LIFE	45,760,158	71,417,890
Mega Millions	144,424,092	162,460,731
Powerball	286,003,472	165,435,126
Fastplay	48,388,770	-
Niche Games (5 Card Cash)	3,064,919	-
Monopoly Millionaires' Club	-	3,265,580
Instant games	1,872,915,471	1,709,143,246
Sales discounts/tickets provided as prizes	(31,806,927)	(26,772,618)
Total Ticket Sales	3,289,846,714	3,000,528,636
Other revenues		
Forfeited Prizes	33,931,475	48,069,961
Miscellaneous	1,983,565	1,391,732
Total operating revenues	3,325,761,753	3,049,990,329
Operating expenses		
Prize expenses	2,001,693,206	1,825,233,183
Retailer commissions	185,980,265	169,445,854
Instant ticket vendor printing fees	24,467,215	22,316,078
Gaming system vendor fees	35,080,631	31,786,934
Northstar NJ management fee	4,952,335	4,850,004
Northstar NJ manager expenses	13,979,117	14,186,014
Northstar NJ advertising & marketing expenses	24,779,320	23,320,008
Administration expenses	10,134,156	9,967,207
Multi-State fees	61,239	81,538
Drawing broadcast fees	407,093	334,957
Bad debt expense	110,000	625,000
Total operating expenses	2,301,644,578	2,102,146,779
Operating income	1,024,117,175	947,843,550
Non-operating revenue		
Northstar NJ	2,500,000	-
Interest	655,103	225,611
Total operating income	1,027,272,279	948,069,161
Northstar NJ incentive/(shortfall) payment	30,623,965	(12,910,236)
Income available for transfer	996,648,314	960,979,397
Contributions for State aid to education and State institutions	987,000,000	960,000,000
Change in net position	9,648,314	979,397
Net position, beginning of year	1,798,679	819,282
Net position - end of year	\$ 11,446,993	\$ 1,798,679

See accompanying notes to financial statements.

STATE OF NEW JERSEY, DEPARTMENT OF THE TREASURY, DIVISION OF STATE LOTTERY
STATEMENTS OF CASH FLOWS

	Years Ended June 30,	
	2016	2015
Cash Flows from Operating Activities		
Sales to customers	\$ 1,523,781,082	\$ 1,400,922,317
Payments for prize awards	(383,423,271)	(376,612,147)
Payments for vendor commissions and fees	(96,561,724)	(95,987,279)
Administrative payments	(10,002,023)	(2,628,159)
Other payments	-	(27,741)
Cash flows from annuity operations		
Annuity receipts	36,079,204	48,049,662
Purchases of annuities	(2,307,648)	(2,862,726)
Payments of annuity prizes	(25,942,860)	(35,297,300)
Net cash provided by operating activities	1,041,622,759	935,556,627
Cash Flows used in Non-Capital Financing Activities		
Contributions for aid to education and state institutions	(1,017,000,000)	(943,010,000)
Cash Flows from Investment Activities		
Cash Management Fund proceeds	1,299,200,000	1,251,147,625
Cash Management Fund purchases	(1,342,450,000)	(1,240,800,000)
Proceeds from Northstar NJ	15,410,236	-
Net cash (used) provided by investment activities	(27,839,764)	10,347,625
Net (Decrease) Increase in cash	(3,217,005)	2,894,252
Cash, beginning of year	3,301,670	407,418
Cash, end of year	\$ 84,665	\$ 3,301,670
Reconciliation of operating income to net cash provided by operating activities		
Operating Income	\$ 1,024,117,175	\$ 947,843,550
Changes in assets and liabilities		
Accounts receivable	(29,775,686)	(16,129,858)
Investments - deposit fund contracts	16,214,097	27,533,956
Other assets	34,213	302,278
Accounts payable and accrued expenses	2,655,126	17,184,339
Obligation for unpaid prize awards	28,367,272	(41,213,808)
Compensating absences	10,562	36,170
Net cash provided by operating activities	\$ 1,041,622,759	\$ 935,556,627

See accompanying notes to financial statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The State of New Jersey, Department of the 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 the Treasury of the State of New Jersey. The Commission consists of the State Treasurer and six public members and is authorized and empowered to promulgate rules and regulations regarding the conduct of lottery games, including the price or prices of tickets, the number and size of prizes on winning tickets, the licensing of retailers, and the apportionment of ticket revenues. The Division of State Lottery's financial statements are presented as those of an enterprise fund and include the operations for which the Division of State Lottery is financially accountable and exercises oversight responsibility.

Basis of Accounting

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

In its accounting and financial reporting, the Division follows the pronouncements of the Governmental Accounting Standards Board ("GASB") and other entities that promulgate accounting principles. 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. For each lottery winner that chooses to receive their prize in installments, 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, 2016 and 2015, leasehold improvements included in deferred expenses were \$734,362. For the years ended June 30, 2016 and 2015, amortization expense was \$75,378 and \$68,408, 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", and "5 Card Cash" 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.
- Fastplay games upon the sale of each ticket.
- 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, 2016 and 2015, forfeited prizes were \$33,931,475 and \$48,069,961, 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, 2016 and 2015, aggregated \$987,000,000 and \$960,000,000, respectively, of which \$103,000,000 and \$133,000,000 was due to the State Treasury at June 30, 2016 and 2015, 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.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Commissions and Fees (Continued)

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.

Administrative Expenses

The Division of State Lottery follows the state's threshold for capitalizing equipment, which is 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 statement of revenues, expenses and changes in net position during the period in which they are acquired and are included in administrative expenses.

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.

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, 2016 and 2015. The Division's deposits with Wells Fargo are insured by the Federal Deposit Insurance Corporation up to \$250,000.

	June 30,	
	2015	2015
Wells Fargo	\$ 84,416	\$ 3,301,420
New Jersey Cash Management Fund	251,134,998	207,229,895
Total	\$ 251,219,414	\$ 210,531,565

The New Jersey Cash Management Fund ("NJCMF") is a common trust fund administered by the Department of the Treasury, Division of Investment. NJCMF is considered to be an investment trust fund as defined in Governmental Accounting Standards Board (GASB) Statement No. 31. NJCMF funds are not subject to custodial credit risk due to the fact that the funds are held by and in the name of the NJCMF in a segregated trust account with the third party custodian rather than in the possession of the third party custodian. Additionally, though the underlying assets and investments of the NJCMF pool are subject to credit risk, the risk is limited by the mix of the credit quality ratings of the assets in the portfolio maintained by NJCMF.

STATE OF NEW JERSEY, DEPARTMENT OF THE TREASURY, DIVISION OF STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS

B. CASH AND INVESTMENTS (Continued)

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.

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, 2016 and 2015:

	June 30, 2016			
	Total	Level 1	Level 2	Level 3
Annuity Investment Deposit Fund Contracts	\$ 252,522,720	\$ 45,382,269	\$ 207,140,451	\$ -
Total	\$ 252,522,720	\$ 45,382,269	\$ 207,140,451	\$ -
	June 30, 2015			
Annuity Investment Deposit Fund Contracts	\$ 268,736,817	\$ 45,496,949	\$ 223,239,868	\$ -
Total	\$ 268,736,817	\$ 45,496,949	\$ 223,239,868	\$ -

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 by Lottery and disbursed to annuitants. 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, 2016 and 2015, Delaware Life had annuity contracts totaling approximately \$24,657,743 and \$28,936,804, respectively. However, due to the long-term nature of these contracts, the credit quality of the issuer is subject to change.

C. FUTURE INSTALLMENT PRIZE AMOUNTS (Continued)

At June 30, 2016 and 2015, the Division of State Lottery held insurance company annuity contracts totaling \$207,140,451 and \$223,239,868, 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, 2016 and 2015.

U.S. government securities are carried at fair value. At June 30, 2016 and 2015, the Division of State Lottery had \$45,382,268 and \$45,496,949, 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)

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 GTECH 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. An amendment signed on December 31, 2015, revised the income level and targets downward for contract years 3 through 15. The amended contract provided for an allowance of \$2.5 million from Northstar NJ to the Division of State Lottery (PTO) as an additional consideration for the terms contained therein. 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.

E. COMMITMENTS (CONTINUED)**Contractual Arrangements (Continued)**

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 2015, the calculated contribution shortfall amounted to \$18,799,399 which was offset by \$5,889,163 remaining of the \$20 million shortfall allowance, resulting in a net shortfall payment of \$12,910,236. For Fiscal Year 2016, NSNJ met its amended contractual net income target resulting in an incentive contribution due to NSNJ of \$30,623,965.

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 \$43,710,772 and \$42,356,026 for the years ended June 30, 2016 and 2015, 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.

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:

Year Ended June 30,	Amount
2017	\$ 767,619
2018	638,550
2019	648,583
2020	655,750
2021	655,750
2022-2024	1,584,729
	<u>\$ 4,950,982</u>

Rent expense for office facilities and equipment for the years ended June 30, 2016 and 2015, was \$1,261,056 and \$1,130,524, 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 the 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, 2016, 2015 and 2014, was, \$6,315,443, \$6,306,627 and \$6,421,066, 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, 2016 and 2015, the contribution rate was 3.06%. For Fiscal Year ended June 30, 2014, the contribution rate was 3.06%.

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.

H. ROUNDING

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

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 the 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 (the "Division of State Lottery") as of and for the year ended June 30, 2016 and 2015, 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 December 1, 2016.

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.

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

December 1, 2016







Must be 18 or older to buy a lottery ticket. Please play responsibly. If you or someone you know has a gambling problem, call 1-800-GAMBLER®.