

Exhibit E

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

Financial Statements
and Supplementary Information

June 30, 2017

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

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

INTRODUCTION

The following discussion and analysis provides an analytical overview of the financial position and activities of the State of New Jersey, Department of the Treasury, Division of State Lottery (the "Division of State Lottery") for the years ended June 30, 2017 and 2016. 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, 2017, 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 State 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.

Northstar NJ's first operational year was a stub year; October 1, 2013 through June 30, 2014. The remaining fifteen years (fiscal years 2015 – 2029) of the contract coincide with the Lottery's fiscal year, starting on July 1 and ending on June 30 through the year ending June 30, 2029. The year ended June 30, 2017, was the third 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 service for which the Division of State Lottery previously contracted. Such services include the online terminal network for ticket sales, the warehousing and distribution of instant tickets, printing contracts for instant tickets, and marketing and advertising services.

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, 2017 and 2016, consisted of total assets of \$516 million and \$553 million, respectively, and total liabilities of \$514 million and \$541 million, respectively. A substantial portion of the asset and liability amounts for the year ending June 30, 2016, 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, 2017 and 2016, were \$254 million and \$253 million, respectively. Net position decreased from \$11.4 million in fiscal year 2016 to \$1.6 million for fiscal year 2017.

FINANCIAL STATEMENTS

The Division of State Lottery's financial statements include statements of net position as of June 30, 2017 and 2016, statements of revenues, expenses and changes in net position for years ended June 30, 2017 and 2016, and statements of cash flows for years ended June 30, 2017 and 2016. 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:

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

FINANCIAL STATEMENTS (CONTINUED)

Statement of Net Position (Continued)

	June 30,		
	2017	2016	2015
Current Assets	\$ 287	\$ 326	\$ 283
Deposit Fund Contracts	228	227	228
Total Assets	515	553	511
Current Liabilities	285	314	280
Non-Current Liabilities	228	228	229
Total Liabilities	513	542	509
Restricted Net Position	0.8	3.9	1.5
Unrestricted Net Position	0.8	7.5	.3
Total Net Position	\$ 1.6	\$ 11.4	\$ 1.8

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 \$244 million and \$251 million at June 30, 2017 and 2016, 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 \$254 million and \$253 million as of June 30, 2017 and 2016, respectively. The Division of State Lottery has annuity investments with ten (10) insurance companies. The total market value of the United States Treasury securities was \$40 million and \$45 million at June 30, 2017 and 2016, respectively. The annuities due beyond fiscal years 2017 and 2016 total \$228 million and \$227 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 pay the annuitants to fund the monies due to them over a fixed period of time based on the amount of the annuitized jackpot at the time of the "win." The duration of an annuity varies from twenty years to life. Because of the true nature of these annuities, the Division of State Lottery has a fiduciary responsibility to continue to administer these instruments in a responsible and prudent manner. The current amounts due to annuity winners totaled \$26 million and \$25 million as of June 30, 2017 and 2016, respectively.

Non-current liabilities represent annuity prize awards due beyond 2018 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):

	June 30,		
	2017	2016	2015
Restricted (Unclaimed Prize Reserves)	\$ 0.8	\$ 3.9	\$ 1.5
Unrestricted	0.8	7.5	0.3
Total Net Position	\$ 1.6	\$ 11.4	\$ 1.8

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 Position

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,		
	2017	2016	2015
Operating revenues			
Ticket sales	\$ 3,187	\$ 3,290	\$ 3,001
Forfeited prizes	45	34	48
Miscellaneous income	1	2	1
Total operating revenue	3,233	3,326	3,050
Operating expenses			
Prize expenses	1,927	2,002	1,825
Retailer commissions	182	186	170
Northstar NJ fees & expenses	43	44	42
Vendor fees	60	60	54
Administrative expense	9	10	10
Bad debt expense	1	0	1
Total operating expenses	2,222	2,302	2,102
Operating income	1,011	1,024	948
Non-Operating (expenses) revenue	(27)	(28)	13
Income before transfers out	984	997	961
Operating transfers – State contributions	994	987	960
(Decrease) increase in net position	\$ (10)	\$ 10	\$ 1

The Division of State Lottery awarded approximately \$1.927 billion in prize awards in fiscal year 2017 and approximately \$2.002 billion in fiscal year 2016. Over 101 million winning tickets were validated and paid in fiscal year 2017. This amount is a decrease from the 113 million winning tickets which were validated and paid in fiscal year 2016.

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 to the Division of State Lottery's vendors and network fees was \$103 million in fiscal year 2017. 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 \$103 million paid to Northstar NJ was \$25 million for advertising and marketing costs, \$34 million for gaming system vendor fees, and \$25 million for instant ticket vendor printing fees. In fiscal year 2016, the total compensation paid for the Division of State Lottery's vendors and network fees was \$104 million. Of this amount \$104 million was paid to Northstar NJ including \$25 million for advertising and marketing costs, \$35 million for gaming system vendor fees, and \$24 million for instant ticket vendor printing fees.

**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 Position (Continued)

The Division of State Lottery's administrative expenses for the fiscal years 2017 and 2016 were \$9 million and \$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 \$994 million, 31% of net revenues, in fiscal year 2017 and \$987 million, 30% of net revenues, in fiscal year 2016.

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, 2017, was \$990,513,343.

The income before transfers operating income for fiscal year 2017 totaled \$1,013 million. In accordance with the amended Northstar contract, a separate calculation is performed to determine the income for the purposes of establishing the incentive/shortfall payment. Northstar NJ's incentive/shortfall payment based on income before transfers of \$1,013 million resulted in an incentive payment of \$29 million.

The total income for fiscal year 2017 totaled \$1,013 million. In accordance with the amended Northstar NJ contract, a separate calculation is performed to determine the income for the purposes of establishing the incentive/shortfall payment. This calculation is outlined in the table below.

INCENTIVE PAYMENTS BANDS	FY 2017
Above Base Level, Below Middle Level	5.0%
Above Middle Level, Below Upper Level	20.0%
Operating Income Levels	
Base Level Income	\$ 821,490,000
Middle Level Income	883,950,000
Lottery Management Agreement NET INCOME	1,013,141,933
Incentive Payments	
Above Base, Below Middle	3,123,000
Above Middle, Below Upper	25,838,387
Total Incentive Payments	<u>\$ 28,961,387</u>

**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 Position (Continued)

The amended contract does establish bottom and top caps on Northstar NJ's compensation. In the event that Upper Income Levels are surpassed total compensation to Northstar NJ cannot exceed 3% of operating income for the entire contract year. Conversely, in the event Base Income Levels are not achieved, the contribution shortfall payment cannot exceed 2% of net income. In fiscal year 2017, neither the bottom nor the top cap had to be utilized in the incentive payment calculation.

Statements of Cash Flows

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

	Years Ended June 30,		
	2017	2016	2015
Cash flows provided by operating activities	\$ 993	\$ 1,042	\$ 936
Cash flows used in non-capital financing activities	(964)	(1,017)	(943)
Cash flows (used in) provided by investing activities	(22)	(28)	10
Net increase (decrease) in cash	\$ 7	\$ (3)	\$ 3

SUMMARY

Division of State Lottery management has been working closely with Northstar NJ throughout fiscal year 2017, and looks forward to continuing this innovative partnership going into the fourth full year of the contract.

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 fifty-two 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 are drawn from a draw machine. 5 Card Cash contains the attributes of both an instant and a draw game.

In early Fiscal 2018, the Division of State Lottery will launch Quick Draw, a keno style game where winning numbers are electronically drawn and then displayed on a television screen installed at retail locations. Quick Draw is a social space game. It will be available predominantly in public venues such as bars and restaurants. Players can purchase a Quick Draw play for a \$1.00 minimum up to a \$10.00 maximum. Prizes range from \$1.00 up to \$1,000,000.00 depending on the purchase amount. Quick Draw is unique from other lottery games in the sense that many people can participate and engage with the game simultaneously via the large television screen enhancing interaction in social spaces. The game also provides an opportunity to a new set of businesses which do not currently offer traditional lottery games. At launch in July, four hundred such new retailers were added to the Division of State Lottery's retailer network.

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

SUMMARY (CONTINUED)

In conjunction with the Fiscal 2018 Appropriations Act, Governor Christie signed the Lottery Transfer Act (Chapter 98 of the Public Law of 2017) into law. The Lottery Transfer Act and the subsequent Memorandum of Lottery Contribution (MOLC) entered into between the State Treasurer and the Division of Investment, effectively transfers the operations of the Lottery and its resulting net revenues to the newly established Pension Fund L for the purposes of providing funding to select units of New Jersey's major public employee pension systems.

Both the legislation and the MOLC require that retained assets and liabilities of the Lottery existing prior to the transfer date (July 1, 2017), not be transferred to Pension Fund L for a thirty-year term. This requirement compels the Division of State Lottery, specifically its Finance Department, to maintain two general ledgers. The pre-existing (or residual) State Lottery Fund ledger will now only account for all activity associated with those pre-existing assets and liabilities and a new general ledger will account for all the obligations and assets resulting from lottery sales and games emanating on and after the July 1, 2017, transfer date.

The MOLC outlines a six month transition period for the Lottery to re-organize its accounting operation in a manner consistent with the spirit and intent of Chapter 98 of the Public Law of 2017. Although the Lottery Transfer Act has no direct impact on the Division of State Lottery's financial statements for the year ended June 30, 2017, it is a significant event that will impact the agency's financials statements for years to come.

Other recently passed legislation impacting the Division of State Lottery is the Lottery Courier Law (Chapter 11 of the Public Laws of 2017). This legislation, which went into effect in November 2017, requires the Lottery to promulgate extensive rules and regulations governing the activity of the lottery couriers.

Prior to the passage of this law, services provided by a lottery courier were not regulated anywhere in the United States although a few states were permitting such couriers to operate.

In accordance with the Courier Law, and the subsequently enacted regulations, couriers will be required to maintain certain cyber security and technology standards. The Division of State Lottery will be regularly auditing registered couriers to ensure that they are in compliance with the provisions of the law.

Similar to the Lottery Transfer Act, the Courier Law has no direct impact on the Division of State Lottery's financial statements for the year ended June 30, 2017.

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

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, 2017 and 2016, and the related notes to financial statements, which 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, 2017 and 2016, and the respective changes in its financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Other Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that 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 19, 2017, 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.

Mercadieu, P.C.

Certified Public Accountants

December 19, 2017

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

	June 30,	
	2017	2016
ASSETS		
Current Assets		
Cash	\$ 7,204,746	\$ 84,665
Accounts receivable, net of allowance for doubtful accounts of \$3,109,635 and \$2,224,000 in 2017 and 2016, respectively	8,596,404	46,188,335
Deferred Expenses	1,703,996	2,690,563
Investments:		
Deposit Fund Contracts	25,983,704	25,352,704
State of New Jersey Cash Management Fund	243,886,611	251,134,998
Total current assets	<u>287,375,461</u>	<u>325,451,266</u>
Non-Current Assets		
Investments - deposit fund contracts	<u>228,216,100</u>	<u>227,170,016</u>
Total non-current assets	<u>228,216,100</u>	<u>227,170,016</u>
 Total Assets	 <u>\$ 515,591,561</u>	 <u>\$ 552,621,282</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued expenses	\$ 53,558,867	\$ 64,235,894
Obligation for unpaid prize awards	72,533,872	120,682,044
Installment prize awards	25,983,704	25,352,704
Due to State of New Jersey - education & state institutions	133,000,000	103,000,000
Total current liabilities	<u>285,076,443</u>	<u>313,270,643</u>
Non-Current Liabilities		
Compensated absences	671,479	733,631
Installment prize awards	<u>228,216,100</u>	<u>227,170,016</u>
Total non-current liabilities	<u>228,887,579</u>	<u>227,903,647</u>
Total Liabilities	<u>513,964,022</u>	<u>541,174,289</u>
NET POSITION		
Restricted for prize awards or contributions for aid to education and state institutions	826,559	3,881,442
Unrestricted	800,980	7,565,551
Total Net Position	<u>\$ 1,627,539</u>	<u>\$ 11,446,993</u>

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,	
	2017	2016
Operating revenues		
Ticket sales		
Pick 3	\$ 429,556,948	\$ 439,627,708
Pick 4	273,452,759	275,200,494
Jersey Cash 5	165,040,813	151,636,143
Pick 6 Lotto	52,446,644	54,632,415
Cash 4 Life	40,950,780	45,760,158
Mega Millions	135,511,285	144,424,092
Powerball	213,478,557	286,003,472
Fastplay	26,904,333	48,388,770
Niche Games (5 Card Cash)	10,512,394	3,064,919
Bonus Draw	35,824	-
Instant Games	1,887,940,043	1,872,915,471
Sales discounts/tickets provided as prizes	(48,920,486)	(31,806,927)
Total ticket sales	<u>3,186,909,893</u>	<u>3,289,846,714</u>
Other revenues		
Forfeited Prizes	45,230,927	33,931,475
Miscellaneous	1,041,713	1,983,565
Total operating revenues	<u>3,233,182,532</u>	<u>3,325,761,753</u>
Operating expenses		
Prize expenses	1,927,302,259	2,001,693,206
Retailer commissions	181,905,365	185,980,265
Instant ticket vendor printing fees	24,876,907	24,467,215
Gaming system vendor fees	34,195,452	35,080,631
Northstar NJ management fee	5,056,829	4,952,335
Northstar NJ manager expenses	13,372,927	13,979,117
Northstar NJ advertising & marketing expenses	24,793,452	24,779,320
Administration expenses	9,418,452	10,134,156
Multi-State fees	42,024	61,239
Drawing broadcast fees	530,291	407,093
Bad debt expense	634,000	110,000
Total operating expenses	<u>2,222,127,958</u>	<u>2,301,644,578</u>
Operating income	<u>1,011,054,574</u>	<u>1,024,117,175</u>
Non-operating revenue	2,087,359	3,155,103
Income before transfers	<u>1,013,141,933</u>	<u>1,027,272,279</u>
Northstar NJ incentive payment	28,961,387	30,623,965
Income available for transfer	<u>984,180,546</u>	<u>996,648,314</u>
Transfers out - contributions for state aid to education and state institutions	<u>994,000,000</u>	<u>987,000,000</u>
Change in net position	(9,819,454)	9,648,314
Net position, beginning of year	11,446,993	1,798,680
Net position, end of year	<u>\$ 1,627,539</u>	<u>\$ 11,446,993</u>

See notes to financial statements.

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

STATEMENTS OF CASH FLOWS

	Years ended June 30,	
	2017	2016*
Cash Flows from Operating Activities		
Sales to customers	\$ 1,497,304,267	\$ 1,523,781,082
Payments for prize awards	(389,661,085)	(383,423,271)
Payments for vendor commissions and fees	(113,830,053)	(96,561,724)
Payments to suppliers	(10,048,217)	(10,002,023)
Other Payments	(21,584)	-
Cash flows from annuity operations		
Annuity receipts	26,759,204	36,079,204
Purchases of annuities	-	(2,307,648)
Payments of annuity prizes	(17,358,486)	(25,942,860)
Net cash provided by operating activities	<u>993,144,046</u>	<u>1,041,622,759</u>
Cash Flows used in Non-Capital Financing Activities		
Contributions for aid to education and state institutions	<u>(964,000,000)</u>	<u>(1,017,000,000)</u>
Cash Flows from Investment Activities		
Cash Management Fund proceeds	1,194,200,000	1,299,200,000
Cash Management Fund purchases	(1,185,600,000)	(1,342,450,000)
Proceeds (to)/from Northstar NJ	(30,623,965)	15,410,236
Net cash used by investment activities	<u>(22,023,965)</u>	<u>(27,839,764)</u>
Net Increase (Decrease) in cash	7,120,081	(3,217,005)
Cash, beginning of year	84,665	3,301,670
Cash, end of year	<u>\$ 7,204,746</u>	<u>\$ 84,665</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating Income	\$ 1,011,054,574	\$ 1,024,117,175
Bad Debt Expense	634,000	110,000
Changes in assets and liabilities		
Accounts receivable	37,693,678	(29,885,686)
Investments - deposit fund contracts	(1,677,084)	16,214,097
Other assets	986,567	34,213
Accounts payable and accrued expenses	(9,014,449)	2,655,126
Obligation for unpaid prize awards	(46,471,088)	28,367,272
Compensated absences	(62,152)	10,562
Net cash provided by operating activities	<u>\$ 993,144,046</u>	<u>\$ 1,041,622,759</u>

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

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 of State Lottery 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 of State Lottery'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 of State Lottery 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 position in the period during which they are acquired and are included in administrative expenses.

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.

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.

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.

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

NOTES TO FINANCIAL STATEMENTS

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Commissions and Fees (Continued)

Northstar New Jersey Lottery Group, LLC ("Northstar NJ or NSNJ") 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 records vacation and sick time incurred during the period in "administrative expenses" in the accompanying statements of revenues, expenses and changes in net position. 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 of State Lottery's cash deposits by financial institution and the amount exposed to custodial credit risk at June 30, 2017 and 2016. The Division of State Lottery's deposits with Wells Fargo are insured by the Federal Deposit Insurance Corporation up to \$250,000.

	June 30,	
	2017	2016
Wells Fargo	\$ 7,204,746	\$ 84,665
New Jersey Cash Management Fund	243,886,611	251,134,998
Total	<u>\$ 251,091,357</u>	<u>\$ 251,219,664</u>

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.

Fair Value Measurements

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

The Division of State Lottery categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs.

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

NOTES TO FINANCIAL STATEMENTS

B. CASH AND INVESTMENTS (CONTINUED)

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, 2017 and 2016:

	June 30, 2017			
	Total	Level 1	Level 2	Level 3
Annuity Investment Deposit				
Fund Contracts	\$ 254,199,804	\$ 40,328,240	\$ -	\$ 213,871,564
Total	<u>\$ 254,199,804</u>	<u>\$ 40,328,240</u>	<u>\$ -</u>	<u>\$ 213,871,564</u>
	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	<u>\$ 252,522,720</u>	<u>\$ 45,382,269</u>	<u>\$ -</u>	<u>\$ 207,140,451</u>

C. FUTURE INSTALLMENT PRIZE AMOUNTS

The Division of State Lottery purchases annuity, or deposit fund contracts, from insurance companies and U.S. government securities to fund its liability for future installment prize awards. Generally, insurance company annuity contracts fund life annuities for games such as the CASH4LIFE draw game and Win for Life instant games. U.S. government securities fund term annuity prizes for games such as Pick 6 Xtra Lotto, Mega Millions, Powerball and instant games. An annuity contract represents an obligation by an insurance company to provide a fixed series of payments over a specified period.

Annuity contracts are carried at their current contract values, which are based upon their original purchase prices adjusted for credited interest and amounts already received by the Division of State 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, 2017 and 2016, Delaware Life had annuity contracts totaling approximately \$22,091,348 and \$24,657,743, 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, 2017 and 2016, the Division of State Lottery held insurance company annuity contracts totaling \$213,871,564 and \$207,140,451, 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, 2017 and 2016.

U.S. government securities are carried at fair value. At June 30, 2017 and 2016, the Division of State Lottery had \$40,328,240 and \$45,382,268, respectively, in U.S. treasuries included in guaranteed annuity contracts (see financial statement footnote 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 June 30, 2017 and 2016, 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 (“NSNJ”) 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 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. This allowance was exhausted in fiscal years 2014 and 2015. For Fiscal Years 2016 and 2017, NSNJ met its amended contractual net income target resulting in an incentive contribution due to NSNJ of \$28,961,387 and \$30,623,965, respectively.

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 \$43,223,208 and \$43,710,772 for the years ended June 30, 2017 and 2016, 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:

<u>Years Ending June 30,</u>	<u>Amount</u>
2018	\$ 638,550
2019	648,583
2020	655,750
2021	655,750
2022	655,750
2023-2024	<u>929,979</u>
	<u>\$ 4,184,362</u>

Rent expense for office facilities and equipment for the years ended June 30, 2017 and 2016, was \$1,080,369 and \$1,261,056, 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/treasury/pensions/annrpts.shtml for more information regarding the plan.

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

NOTES TO FINANCIAL STATEMENTS

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 covered payroll for the years ended June 30, 2017, 2016 and 2015, was \$5,749,046, \$5,910,857 and \$5,861,734, 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, 2017, the contribution rate was 3.06%.

The State of New Jersey, Division of Pensions 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 Pensions 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.

I. SUBSEQUENT EVENTS

Effective July 1, 2017, with the passage of Chapter 98 of the Public Law of 2017, the Lottery Transfer Act and the subsequent Memorandum of Lottery Contribution ("MOLC") entered into between the State Treasurer and the Division of Investment, the operations of the Division of State Lottery and its resulting net revenues were transferred to Pension Fund L for a period of thirty years. While there is no impact from an accounting and auditing perspective for the fiscal year ended June 30, 2017, it is nonetheless a significant event that will have an impact on the financial statements of the Division of State Lottery for the next few decades. Both the legislation and the MOLC require that retained assets and liabilities of the Division of State Lottery existing prior to the transfer date (July 1, 2017), not be transferred to Pension Fund L. This requirement compels the Division of State Lottery, specifically its Finance Department, to maintain two general ledgers. The pre-existing (or residual) State Lottery fund ledger will now only account for all activity associated with those pre-existing assets and liabilities and a new general ledger will account for all the obligations and assets resulting from lottery sales and games emanating on and after the July 1, 2017, transfer date.

The MOLC outlines a six-month transition period for the Division of State Lottery to re-organize its accounting operation in a manner consistent with the spirit and intent of Chapter 98 of the Public Law of 2017. This is necessary to ensure that all the financial reporting, accounting operations, collections activity and accounts receivable functions of the Division of State Lottery are being properly recorded and posted. At the conclusion of this transition period, it is critical that all lottery funds (\$3.3 billion annually) have been allocated to the appropriate ledger. Moving forward, all accounting activity will be posted to the proper ledger.

I. SUBSEQUENT EVENTS (CONTINUED)

Other recently passed legislation impacting the Division of State Lottery is the Lottery Courier Law (Chapter 11 of the Public Laws of 2017). This legislation, which went into effect in November 2017, requires the Division of State Lottery to promulgate extensive rules and regulations governing the activity of the lottery couriers.

Prior to the passage of this law, services provided by a lottery courier were not regulated anywhere in the United States although a few states were permitting such couriers to operate.

In accordance with the Courier Law, and the subsequently enacted regulation, couriers will be required to maintain certain cyber security and technology standards. The Division of State Lottery will be regularly auditing registered couriers to ensure that they are in compliance with the provisions of the law.

Similar to the Lottery Transfer Act, the Courier Law has no direct impact on the Division of State Lottery's financial statements for the year ended June 30, 2017.

SUPPLEMENTARY INFORMATION

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

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

Year ended June 30, 2017

	Budget (unaudited)	Actual	Variance (unfavorable) favorable
Operating revenues			
Ticket sales			
Pick 3	\$ 448,000,000	\$ 429,556,948	\$ (18,443,052)
Pick 4	279,000,000	273,452,759	(5,547,241)
Jersey Cash 5	156,450,000	165,040,813	8,590,813
Pick 6 Lotto	60,210,000	52,446,644	(7,763,356)
Cash 4 Life	37,024,000	40,950,780	3,926,780
Mega Millions	154,863,000	135,511,285	(19,351,715)
Powerball	185,657,000	213,478,557	27,821,557
Fastplay	41,652,000	26,904,333	(14,747,667)
Niche Games (5 Card Cash)	32,396,000	10,512,394	(21,883,606)
Monopoly Millionaires' Club	-	35,824	35,824
Instant Games	1,858,088,300	1,887,940,043	29,851,743
Sales discounts/tickets provided as prizes	(36,673,700)	(48,920,486)	(12,246,786)
	<u>3,216,666,600</u>	<u>3,186,909,893</u>	<u>(29,756,707)</u>
Other revenues			
Forfeited prizes	37,601,250	45,230,927	7,629,677
Miscellaneous	1,041,713	1,041,713	-
Total operating revenues	<u>3,255,309,563</u>	<u>3,233,182,532</u>	<u>(22,127,031)</u>
Operating expenses			
Prize expenses	1,965,549,301	1,927,302,259	38,247,042
Retailer commissions	181,211,055	181,905,365	(694,310)
Instant ticket vendor printing fees	22,594,354	24,876,907	(2,282,553)
Gaming system vendor fees	34,160,073	34,195,452	(35,379)
Northstar NJ management fee	5,056,000	5,056,829	(829)
Northstar NJ manager expenses	18,048,000	13,372,927	4,675,073
Northstar NJ advertising & marketing expenses	26,157,000	24,793,452	1,363,548
Administration expenses	13,271,000	9,418,452	3,852,548
Multi-State fees	150,000	42,024	107,976
Drawing broadcast fees	250,000	530,291	(280,291)
Bad debt expense	600,000	634,000	(34,000)
Instant ticket enhancement/license fees	2,000,000	-	2,000,000
Total operating expenses	<u>2,269,046,783</u>	<u>2,222,127,958</u>	<u>46,918,825</u>
Operating income	<u>986,262,780</u>	<u>1,011,054,574</u>	<u>24,791,794</u>
Non-operating revenue	200,000	2,087,359	1,887,359
Income before transfer	<u>986,462,780</u>	<u>1,013,141,933</u>	<u>26,679,153</u>
Northstar NJ incentive payment	21,921,075	28,961,387	(7,040,312)
Income available for transfer	<u>964,541,705</u>	<u>984,180,546</u>	<u>19,638,841</u>
Transfers out - contributions for state aid to education an state institutions	<u>964,541,705</u>	<u>994,000,000</u>	<u>(29,458,295)</u>
Change in net position	-	(9,819,454)	(9,819,454)
Net position, beginning of year	11,446,993	11,446,993	-
Net position, end of year	<u>\$ 11,446,993</u>	<u>\$ 1,627,539</u>	<u>\$ (9,819,454)</u>

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

SCHEDULE OF INSTANT GAME REVENUES

	Years Ended June 30,	
	2017	2016
\$5,000,000 CASH EXTRAVAGANZA	\$ 189,157,000	\$ 71,975,730
PLATINUM DIAMOND SPECTACULAR	93,082,660	-
\$5,000,000 FORTUNE	80,869,230	-
\$1,000,000 MAYHEM	68,917,862	-
100X THE CASH	54,415,780	80,048,840
ALL CASH MILLIONS	50,534,860	45,125,300
CROSSWORD	41,677,093	-
MEGA CROSSWORD	38,469,740	-
CROSSWORD	36,735,401	5,061,708
\$500 MAYHEM	35,912,855	-
CASH IN A FLASH	34,956,771	-
LUCKY 7s MULTIPLIER	31,410,590	-
WIN FOR LIFE	31,365,809	3,116,103
50X THE CASH	29,845,935	37,808,775
CROSSWORD	29,390,772	-
SUPER CROSSWORD	27,122,955	-
SUPER CROSSWORD	27,025,065	-
SUPER CROSSWORD	26,582,715	-
POKER SHOWDOWN	26,406,566	-
EXTRA PLAY	25,718,957	-
100 X THE BUCKS	25,608,020	-
BIG MONEY SPECTACULAR	25,164,972	-
\$10K BLOWOUT	25,075,403	-
BIG MONEY SPECTACULAR	24,812,292	-
BIG MONEY SPECTACULAR	24,032,276	1,101,600
LUCKY 7s TRIPLER	22,337,100	-
WHEEL OF FORTUNE	21,958,671	-
BINGO BONUS SQUARE	21,548,871	-
MULTIPLIER MANIA	20,750,360	-
20X THE CASH	19,972,875	22,894,545
\$250,000 CROSSWORD	17,862,670	-
\$150,000 GOLD RUSH	17,849,686	5,112,310
\$250,000 CROSSWORD	17,784,588	-
\$250,000 CROSSWORD	17,465,674	-
JINGLE BILLS	17,134,945	-
\$250,000 CROSSWORD	17,023,390	-
HOT STREAK	16,774,880	-
LOTERIA	16,231,077	-
BANKROLL BINGO	16,169,550	-
LOTERIA	15,028,059	-
\$500 MONEY MADNESS	14,301,525	-
BLACK AND GOLD	14,283,885	-
\$2,000,000 MEGA CASH	14,115,690	62,387,140
SUPER CROSSWORD	13,909,685	-

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

SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ended June 30,	
	2017	2016
\$150,000,000 CASH SPECTACULAR	13,897,289	61,839,520
\$100 MAYHEM	13,746,625	-
BIG MONEY SPECTACULAR	13,083,776	-
\$10K BLOWOUT	12,664,775	17,695,390
\$500,000 WINFALL	12,604,930	24,504,144
LUCKY 7s DOUBLE	12,588,906	-
ALL CASH CLUB	12,096,703	-
SHIMMERING 7'S	11,875,202	15,129,670
HOLIDAY LUCKY TIMES 10	11,630,623	-
INSTANT BINGO	11,588,826	-
LADY LUCK	10,876,405	-
CASINO ROYALE	10,408,330	13,883,807
SUPER CROSSWORD	10,251,045	16,846,035
CASH BLAST	9,842,859	13,170,700
LUCKY DAY	9,553,583	-
BINGO MULTIPLIER	9,546,579	11,428,880
SUPER CASH SPECTACULAR	9,130,181	23,837,274
\$100,000 WINNING STREAK	8,663,230	6,666,320
10X THE CASH	8,562,270	13,313,526
\$250,000 CROSSWORD	8,265,400	-
MONEY VAULT	8,197,877	-
WILD CASH BONANZA	7,989,216	32,524,720
LUCKY CASH	7,942,475	19,894,503
MONEY BAGS	7,716,802	-
\$250,000 CROSSWORD	7,657,940	10,231,780
KISSES & CASH	7,547,433	-
SUPER 7'S SLINGO	7,491,987	8,923,659
\$2,500 FRENZY	7,429,834	21,065,274
INSTANT BINGO	7,165,182	-
CASH FLURRIES	7,162,684	-
\$20,000 HOLLYWOOD CASH FANTASY	7,055,499	-
LIFE IS GOOD	6,812,443	1,835,610
HOLIDAY LUCK	6,336,169	-
WORLD SERIES OF POKER	6,323,160	21,298,446
\$20,000 PAY DAY	6,030,960	22,262,729
BOARDWALK BUCKS	5,875,174	-
CASH IN A FLASH	5,721,330	-
WILD CASH	5,678,125	27,092,498
RED WHITE & BLUE DOUBLER	5,351,848	631,096
QUICK \$50S	5,334,449	6,053,603
\$1,000,000 JACKPOT	5,186,570	19,110,052
SPRING \$50s	5,078,583	-
\$25 MAYHEM	5,024,385	-
BIRTHDAY SURPRISE	4,943,154	-

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

SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ended June 30,	
	2017	2016
POCKET CHANGE	4,604,323	-
LUCKY 7s	4,424,443	-
\$10,000 PAY DAY	4,234,950	29,926,883
INSTANT BINGO	4,170,386	6,663,503
DOUBLE DOLLARS	4,146,838	-
WIN FOR LIFE	3,878,868	-
POCKET CHANGE	3,797,420	-
LUCKY CATCH	3,349,520	-
BIG MONEY SPECTACULAR	3,255,146	21,980,104
BIRTHDAY BUCKS	3,232,610	3,692,622
\$200,000 JACKPOT	3,103,890	14,405,823
ALL CASH CLUB	2,987,560	-
BIG CASH SPECTACULAR	2,234,902	14,688,037
TIC TAC TOE	2,209,180	1,855,195
POCKET CHANGE	2,109,184	-
5X THE CASH	2,086,735	4,226,564
CROSSWORD	1,817,145	40,177,386
SUPER SLOTS	1,801,285	16,505,895
LIBERTY BILLS	1,704,910	-
SPRING FLING TRIPLER	1,471,350	7,283,685
DOUBLE DOUBLER	1,419,343	4,806,377
HOT SPOT BINGO	1,385,695	-
MONOPOLY MILLIONAIRES' CLUB	1,269,681	7,567,270
JOKER'S WILD	1,204,610	12,331,203
LOTERIA (D)	1,133,025	-
WIN FOR LIFE!	702,005	30,770,214
WILD CHERRY BINGO DOUBLER	668,529	17,243,956
\$100 FRENZY	648,186	11,145,432
DOUBLE \$\$	587,458	-
\$5,000,000 CASH EXTRAVAGANZA	547,350	152,973,829
RAPID REFUND	537,370	3,481,195
LOTERIA	437,064	28,053,779
\$250,000 CROSSWORD	378,350	17,587,300
FROSTY FUN	370,195	10,473,178
SUPER CROSSWORD	330,000	26,962,537
MEGA CROSSWORD	184,800	-
\$500 FRENZY	126,180	27,313,609
WIN \$2,500 A WEEK FOR LIFE	124,895	17,845,565
WILD 10s	116,662	17,840,691
BIG MONEY SPECTACULAR	83,012	25,167,376
\$50 FRENZY	76,338	3,724,657
WIN \$500 A WEEK FOR LIFE	65,051	5,933,853
CLASSIC BINGO	58,852	17,277,570
\$250,000 CROSSWORD	31,100	17,896,440

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

SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ended June 30,	
	2017	2016
20X MONEY	15,839	15,369,604
QUICK CHANGE	15,335	5,238,141
WIN IT ALL	15,230	7,215,581
SEASON'S GOLD	13,570	22,448,258
CROSSWORD	11,859	41,816,993
10X MONEY	11,512	6,289,054
\$500,000 FORTUNE	11,160	27,869,818
MONOPOLY (\$2)	10,474	1,517,951
SUPER CROSSWORD	10,065	27,669,390
DOUBLE DIAMOND SPECTACULAR	8,220	33,748,760
GOLD BAR BINGO	8,165	13,542,234
LUCKY LOOT	6,875	4,148,780
WILD DOUBLER	6,008	4,439,251
\$30,000 JACKPOT	4,638	7,300,855
MONOPOLY (\$1)	4,490	717,605
AMC THE WALKING DEAD	4,374	1,140,714
LOOSE CHANGE	3,394	3,063,382
BIG MONEY SPECTACULAR	3,366	34,369,344
SUPER TIC TAC TOE	2,988	11,236,165
GEM 7s	2,695	1,849,902
\$250,000 CROSSWORD	2,560	18,004,242
HOLIDAY LUCKY TIMES 10	2,336	11,851,996
BIRTHDAY BUCKS	1,098	4,113,192
HOLIDAY SPARKLE	350	16,730,190
DIAMOND SPECTACULAR	300	1,519,218
\$100,000,000 SPECTACULAR	-	(600)
10X CASH	-	8,830
HOLD 'EM POKER	-	(295)
20X CASH	-	(3,140)
CLASSIC BINGO	-	(110)
3X CASH	-	(35)
NEW JERSEY HOLD 'EM POKER	-	7,115
MASSIVE MONEY BINGO	-	(2,260)
ZUMA	-	(177)
SUPER CROSSWORD	-	(300)
CROSSWORD	-	(606)
HIT \$50s	-	(694)
HIGH ROLLER	-	9,960
QUARTER MILLION CROSSWORD	-	127,470
7/11/2021	-	(1,761)
SILVER GOLD PLATINUM 7'S	-	19,395
DOUBLE BLACKJACK	-	(6,700)
FIRE & ICE	-	10,936
POWER PLAY CROSSWORD	-	(789)
CLASSIC BINGO	-	(2,294)

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

SCHEDULE OF INSTANT GAME REVENUES (CONTINUED)

	Years Ended June 30,	
	2017	2016
HOT DICE	-	(10,858)
ELECTRIC 5s	-	13,148
BINGO STAR TRIPLER	-	14,481
MONEY MATCH	-	418,600
CROSSWORD	-	(663)
BIG MONEY SPECTACULAR	-	(1,096)
TRIPLE DIAMONDS	-	484,350
BIG MONEY SPECTACULAR	-	1,692
SUPER CROSSWORD	-	(1,280)
MONOPOLY (\$5)	-	116,176
BIG MONEY SPECTACULAR	-	175,769
CLASSIC BINGO	-	15,262
CROSSWORD	-	7,515
HOLIDAY LUCKY TIMES 10	-	345,048
HOLIDAY GOLD	-	311,330
SUPER CROSSWORD	-	12,690
SUPER CROSSWORD	-	755,315
WIN \$1,000 A WEEK FOR LIFE	(2)	3,101,703
2015 CASH SPECTACULAR	(2)	102,467
CHILLY BILLS	(46)	73,226
HOLIDAY MAGIC	(115)	182,194
BIG MONEY SPECTACULAR	(192)	17,956,053
\$250,000 CROSSWORD	(300)	119,650
CROSSWORD	(300)	671,278
CANDY CANE CROSSWORD	(300)	311,807
LUCKY IN LOVE	(300)	394,218
\$500 FRENZY	(315)	354,815
WORLD SERIES OF POKER	(315)	2,957,075
BINGO X10	(335)	73,010
MASSIVE MONEY BINGO	(340)	5,747,990
\$10,000 PAYDAY	(460)	1,159,276
CLASSIC BINGO	(548)	2,231,212
HOLIDAY CASH	(654)	70,698

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

	Years Ended June 30,	
	2017	2016
SUPER CROSSWORD	(1,020)	27,763,089
50X MONEY	(1,060)	13,001,259
\$250,000 CROSSWORD	(1,310)	8,809,530
SUPER CROSSWORD	(1,380)	15,715,815
BIG CASH SPECTACULAR	(2,238)	5,664,402
DOUBLE MATCH	(2,710)	10,466,746
CASH BONUS BINGO	(2,874)	4,297,296
CROSSWORD	(3,081)	27,672,013
\$5,000 JACKPOT	(3,224)	2,115,907
5X MONEY	(3,244)	894,387
ESCAPE TO MARGARITAVILLE	(4,316)	2,126,790
CASH EXPLOSION	(4,366)	7,707,106
DOUBLE YOUR LUCK	(5,755)	2,791,141
BLOOMIN' BUCKS	(6,188)	3,944,436
TRIPLE WINNING 7s	(6,465)	10,371,492
PRIOR YEAR GAME	(6,820)	-
HOLIDAY CHEER	(8,255)	6,362,331
TOTALS	<u>\$ 1,887,940,043</u>	<u>\$ 1,872,915,471</u>

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

	Years Ended June 30,	
	2017	2016
Salaries	\$ 6,101,591	\$ 6,315,443
Printing & Office Supplies	92,020	65,801
Vehicular Supplies	1,020	489
Household & Clothing	5,648	2,898
Travel	40,851	40,177
Telephone	112,838	112,820
Postage	50,559	50,512
Data Processing	690,392	790,147
Household & Security	208,119	238,456
Professional Services	332,452	352,000
Other Professional Services	244,640	300,245
Data Processing-OIT	234,715	192,813
Maintenance - Building & Grounds	6,567	2,199
Maintenance - Office Equipment	6,880	6,150
Rent - Building & Grounds	1,080,369	1,261,056
Central Motor Pool	81,246	85,606
Vehicular Equipment	1,103	32,202
Other Equipment	39,473	178,709
Information Processing Equipment	20,509	31,056
Amortization	67,461	75,378
Totals	<u>\$ 9,418,452</u>	<u>\$ 10,134,156</u>

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

<u>Year</u>	<u>Fiscal Year</u>	<u>Net Income Target</u>	
Year 1 (Stub Year)	2014	\$ 760,897,061	(Prorated)
Year 2	2015	1,047,000,000	
Year 3	2016	963,478,103	
Year 4	2017	990,513,343	
Year 5	2018	1,009,871,643	
Year 6	2019	1,023,544,636	
Year 7	2020	1,036,114,600	
Year 8	2021	1,045,300,757	
Year 9	2022	1,054,562,917	
Year 10	2023	1,063,906,791	
Year 11	2024	1,073,794,937	
Year 12	2025	1,083,757,077	
Year 13	2026	1,093,797,230	
Year 14	2027	1,103,903,546	
Year 15	2028	1,114,089,100	
Year 16	2029	1,124,348,918	

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, 2017 and 2016, and the related notes to financial statements, which comprise the Division of State Lottery's basic financial statements, and have issued our report thereon dated December 19, 2017.

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.

Mercadieu, P.C.
Certified Public Accountants

December 19, 2017