

DELAWARE STATE LOTTERY

Basic Financial Statements

June 30, 2016 and 2015

(With Independent Auditors' Reports Thereon)

Issuance Date: October 24, 2016

DELAWARE STATE LOTTERY

Table of Contents

	Page
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Basic Financial Statements:	
Basic Statements of Net Position	9
Basic Statements of Revenue, Expenses, and Changes in Net Position	10
Basic Statements of Cash Flows	11
Notes to Basic Financial Statements	12
Required Supplementary Schedule	27
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 <i>Government Auditing Standards</i>	28

Independent Auditors' Report

Vernon Kirk, Director of the Delaware State Lottery, and
Tom Cook, Secretary of Finance, State of Delaware

Report on the Financial Statements

We have audited the accompanying financial statements of the Delaware State Lottery (the Lottery) of the State of Delaware, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 auditor's 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 entity'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.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2016 and 2015, and the changes in financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1 (b) to the financial statements, the financial statements present only the Lottery enterprise fund and do not purport to, and do not, present fairly the financial position of the State of Delaware as of June 30, 2016 and 2015, and the changes in its financial position, or its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 8, schedule of Lottery's proportional share of net pension liability on page 27 and schedule of contributions on page 27 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 12, 2016 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements 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 Lottery's internal control over financial reporting and compliance.

October 12, 2016

Gunnip & Company LLP

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2016 and 2015

The management of the Delaware State Lottery (the Lottery) offers this narrative overview and analysis of the Lottery's financial activities for the years ended June 30, 2016 and 2015, which should be read in conjunction with the Lottery's basic financial statements.

Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the Lottery's basic financial statements. Since the Lottery is an enterprise fund of the State of Delaware, these financial statements are presented in a manner similar to a private-sector business. As required by accounting principles generally accepted in the United States of America (GAAP), current year's revenues are recorded when earned and expenses are recorded as they are incurred, regardless of when the cash is received or disbursed.

The Statement of Net Position presents information on all of the Lottery's assets, liabilities, deferred outflows, and deferred inflows with the residual of all elements reported as the net position. Pursuant to Delaware law, the Lottery's net position should remain relatively unchanged, since all excess monies are to be sent directly to the State's General Fund, allowing the Lottery to maintain a net position of \$1,000,000.

The Statement of Revenue, Expenses, and Changes in Net Position show the result of the Lottery's total operations and reflect both operating and nonoperating activities. Changes in net position (increases or decreases) reflect the current fiscal year's operating impact upon the overall financial position of the Lottery.

The Statement of Cash Flows provides a detailed analysis of all sources and uses of cash. The direct method of cash flows is presented, ending with a reconciliation of operating income to net cash provided by operating activities. The Statement of Cash Flows is divided into three sections – operating, noncapital financing, and investing.

Notes to the basic financial statements contain additional information, and often offer explanations to the basic financial statements. The notes are intended to assist the reader in understanding the Lottery's basic financial statements.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2016 and 2015

Condensed Net Position

Table 1
(In millions)

Assets	June 30		
	2016	2015	2014
Cash and investments	\$ 5.9	3.1	3.1
Accounts receivable, net of allowance of \$0.8, \$0.8, and \$0.8, respectively	6.2	13.3	12.4
Investments	0.1	0.1	0.1
Due from State of Delaware	4.7	4.5	2.6
Deposit with Multi-State Lottery	2.3	2.5	2.6
Total assets	<u>19.2</u>	<u>23.5</u>	<u>20.8</u>
Deferred outflows	<u>0.2</u>	<u>0.2</u>	<u>-</u>
Liabilities and Net Position			
Liabilities:			
Prizes liability, including \$0.1, \$0.1, and \$0.1, respectively, of prize installment obligation	4.9	6.8	4.8
Accounts payable and accrued liabilities	4.7	7.1	7.8
Due to the State of Delaware	1.5	1.6	1.6
Pension and OPEB liability	4.7	3.9	3.0
Multi-State Lottery reserve	2.3	2.5	2.6
Total liabilities	<u>18.1</u>	<u>21.9</u>	<u>19.8</u>
Deferred inflows	<u>0.3</u>	<u>0.8</u>	<u>-</u>
Net position:			
Unrestricted	<u>\$ 1.0</u>	<u>1.0</u>	<u>1.0</u>

The Lottery's accounting periods are predicated on a 4-4-5 week cycle except at year-end when the closing date includes additional days up to and including June 30. These extra days amounted to eight in 2014, nine in 2015, and only four in 2016. Fewer days of money not collected in fiscal year 2016 reflects the decrease in accounts receivable over fiscal year 2015. The additional day in fiscal year 2015 is reflected as additional accounts receivable over fiscal year 2014.

With the last full week in June ending on the 26th, it allowed four days before year end to make payments to vendors, therefore decreasing the liability from fiscal year 2015 to fiscal year 2016. There was a slight increase in liability from fiscal year 2014 to fiscal year 2015 mainly due to the pension liability calculation conforming to GASB Statement No. 68, *Accounting and Financial Reporting of Pension*. Since the Lottery is required to send all surplus funds to the State General Fund, any monies required to pay these liabilities would come from the State's General Fund. Respectively, the Due to the State of Delaware represents current year excess surplus funds due to the State's General Fund and due to other state agencies, including the Department of Health and Social Services and Department of Agriculture.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2016 and 2015

Revenue

Table 2
Revenue
(In millions)

	Year ended June 30		
	2016	2015	2014
Play 3	\$ 27.7	25.6	24.8
Play 4	22.6	21.1	19.9
Multi Win Lotto	4.6	4.2	4.2
Powerball	30.5	20.9	26.9
Hot Lotto	2.4	3.2	3.1
Mega Millions	9.5	10.8	12.6
Delaware Cash 5	-	0.5	0.9
Keno	8.0	6.7	5.2
Lucky for Life	4.0	2.3	-
Instant games	65.7	54.4	50.7
Traditional games revenue	175.0	149.7	148.3
Video lottery, net	360.8	357.5	363.4
I-Gaming	2.6	1.8	1.4
Video lottery expired jackpots and credit slips	0.3	0.3	0.4
Casino license fees	3.2	3.2	3.3
Sports lottery	39.4	37.9	31.5
Table games, net	54.0	51.5	52.5
Total revenue	\$ 635.3	601.9	600.8

Table 2 above compares revenue for each lottery game category. Total lottery revenue for fiscal year 2016 showed an increase over fiscal year 2015 by \$33.4 million or 5.5%. Fiscal year 2015 saw a slight increase over fiscal year 2014 by \$1.1 million or less than 1%.

Powerball and Mega Millions sales are typically driven by the size of the jackpot. Changes to the Powerball game in fiscal year 2016 provided larger jackpots, which allowed for a significant increase in Powerball sales. Powerball sales decreased in 2015 due to the limited number of higher jackpots during fiscal year 2014.

Instant game sales continue to increase, reporting another record sales year in this category. The Lottery offered a new \$25 higher price point ticket, proving the survey data that higher price points with higher prize levels were more attractive to the playing public.

Video lottery, net proceeds, for fiscal year 2016 showed a \$3.3 million, or 1%, increase over fiscal year 2015. Fiscal year 2015 saw a decrease in net proceeds over fiscal year 2014.

Sports lottery and Keno showed an increase in revenue in fiscal year 2016 over fiscal year 2015 of \$2.8 million or 6.2%. Continued expansion of these products throughout our retail network during fiscal year 2016 and fiscal year 2015 has led to more awareness to the players of these products and a boost to the sales.

Table games revenue had an increase of \$2.5 million, or 4.9% in fiscal year 2016 over fiscal year 2015. The tracks added more promotions and poker tournaments throughout the state which offered more play in fiscal year 2016. Table games showed a decline in fiscal year 2015 over fiscal year 2014 of \$1.0 million. Added competition in 2015 from surrounding states accounted for the slight decline in table games revenue.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2016 and 2015

Since the Delaware Legislature passed the Administration's *Delaware Gaming Competitiveness Act of 2012* which allowed for the expansion of sports lottery into retail locations, implementation of Keno, and authorizing Delaware to conduct internet gaming for both traditional and casino style online wagering, sales from these products have continued to grow. In fiscal year 2016, the Lottery expanded the sports retail locations from 85 to 102 retailers, added additional Keno retailers, and expanded internet gaming on mobile devices.

Cost of Games

Table 3
Cost of Games
(In millions and as a percentage of revenue)

	Year ended June 30					
	2016		2015		2014	
Commission expense	\$ 202.4	32.0%	\$ 198.0	32.9%	\$ 192.4	32.0%
Gaming vendor fees and costs	41.8	6.6%	40.3	6.7%	38.1	6.3%
Prize expense	126.5	20.0%	109.0	18.1%	102.0	17.1%
Total cost of games	<u>\$ 370.7</u>		<u>\$ 347.3</u>		<u>\$ 332.5</u>	

Table 3 above compares the cost of games for the last three years. Commission expense includes payments to lottery retailers for selling and cashing traditional and sports lottery tickets, and commissions to casinos for the operation of video lottery, internet gaming, sports lottery, and table games. An increase in commissions in fiscal year 2016 over fiscal year 2015 of \$4.4 million, or 2.2% is due to an overall increase in revenue over last year. An increase in commissions from fiscal year 2014 to fiscal 2015 of \$5.6 million, or 2.9%, is due to the increase in revenue from sports retailers and the instant games.

Gaming vendor fees and costs include the cost of the central system used to monitor and collect pertinent data for the traditional draw games and the video lottery system, the instant games supplier fees, the cost of leasing video lottery terminals and franchise video games, and the cost incurred by internet gaming for fees and website maintenance. Gaming vendor fees increased \$1.5 million, or 3.7% in fiscal year 2016 over fiscal year 2015 primarily due to the increased revenue. Gaming vendor fees increased \$2.2 million, or 5.8%, in fiscal year 2015 over fiscal year 2014 due to an increase in instant and sports sales and the addition of new video vendor contract fees that took affect half way through fiscal year 2014.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2016 and 2015

Prize Expense, Net of Reversions

Table 4
Prize Expense, Net of Reversions
(In millions)

	Year ended June 30		
	2016	2015	2014
Play 3	\$ 14.8	13.1	11.8
Play 4	10.3	11.4	10.4
Multi Win Lotto	2.8	2.6	2.7
Powerball	14.9	10.0	13.0
Hot Lotto	1.2	1.6	1.5
Mega Millions	4.5	5.3	6.3
Delaware Cash 5	—	0.2	0.5
Keno	4.9	4.2	3.2
Lucky for Life	2.4	1.5	—
Sports lottery	28.2	23.7	20.1
Instant games	42.5	35.4	32.5
Total prize expense	\$ 126.5	109.0	102.0

Table 4 above compares prize expense for each lottery game category for the past three years. In general, prize expense by game will increase or decrease from year to year in proportion to the increase or decrease in sales for a particular game. However, the prize expenses for the Play 3 and Play 4 games are impacted by the luck of the draw, and actual prize payment is determined by lottery players' luck in matching the particular set of numbers randomly selected in each drawing for each game. Overall prize expense for the instant game product category is controllable for the most part, by printing a predetermined number and value of winning tickets for each instant game.

Prize expense includes the costs for winning tickets for traditional and sports lottery. Prize expense for fiscal year 2016 versus fiscal year 2015 increased \$17.5 million or 16%. Fiscal year 2016 produced a higher prize expense for instant due to adding more higher-price tickets with a higher payout percentage. Sports lottery winners vary from year to year due to the unpredictability of the outcome of professional football. The payout percentage increased over 9% resulting in a higher prize expense for fiscal year 2016 over fiscal year 2015. Fiscal year 2015 showed an increase in prize expense over fiscal year 2014 of \$7.0 million. Sports and Instant games accounted for \$6.5 million of this increase. The sales increase in sports lottery and instant games resulted in an increase in winners.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2016 and 2015

Operating Expenses

Table 5
Operating Expenses
(In millions)

	Year ended June 30		
	2016	2015	2014
Operating expenses	\$ 10.7	10.6	10.9

Operating expenses remained relatively unchanged from fiscal year 2014 through fiscal year 2016. The decrease in operating expenses fiscal year 2014 to fiscal year 2016 was due to the efforts of the Lottery office to reduce spending.

Nonoperating Expenses

Table 6
Nonoperating Expenses
(In millions)

	Year ended June 30		
	2016	2015	2014
Contributions to the State of Delaware:			
Standardbred Breeder's Program	\$ 3.0	3.0	3.0
Certified Thoroughbred Program	1.0	1.0	1.0
Department of Agriculture Purses	36.8	36.6	37.1
Department of Health & Social Services	1.6	1.7	1.7
State of Delaware - General Fund	211.5	201.7	214.6
Total nonoperating expenses	\$ 253.9	244.0	257.4

Fiscal year 2016 showed an overall increase over fiscal year 2015 in nonoperating expenses, which is relative to the increase in revenue. Decreases in contributions to the State of Delaware in fiscal year 2015 over fiscal year 2014 were attributed to the change in the law for the State's share of video lottery proceeds. The State's share of video proceeds is taken after deducting 75% of the vendor costs. Previously, the State's share was based solely on the video net proceeds. This change resulted in a \$9.9 million reduction of contributions to the State of Delaware General Fund for fiscal year 2015.

DELAWARE STATE LOTTERY
Basic Statements of Net Position
June 30, 2016 and 2015

Assets	2016	2015
Current assets:		
Cash and investments	\$ 5,921,521	3,133,928
Accounts receivable, net of allowance of \$791,748 and \$791,748, respectively	6,177,938	13,295,112
Investments – restricted for payment of prize liabilities	30,000	30,000
Due from the State of Delaware	4,762,963	4,462,770
Total current assets	16,892,422	20,921,810
Noncurrent assets:		
Investments – restricted for payment of prize liabilities	19,903	49,781
Deposit Multi-State Lottery	2,316,299	2,515,559
Total non-current assets	2,336,202	2,565,340
Total assets	19,228,624	23,487,150
Deferred outflows	242,448	244,307
Liabilities and Net Position		
Current liabilities:		
Prizes liability, including \$30,000 for both years, of prize installment obligations	4,923,651	6,772,743
Accounts payable and accrued liabilities	4,704,095	7,076,299
Due to the State of Delaware	1,501,713	1,609,998
Total current liabilities	11,129,459	15,459,040
Noncurrent liabilities:		
Multi-State Lottery reserve	2,316,299	2,515,559
Prize installment obligations, noncurrent	19,903	49,781
Pension and OPEB liability	4,669,812	3,874,639
Total noncurrent liabilities	7,006,014	6,439,979
Total liabilities	18,135,473	21,899,019
Deferred inflows	335,599	832,438
Net position:		
Unrestricted	\$ 1,000,000	1,000,000

See accompanying notes to basic financial statements.

DELAWARE STATE LOTTERY

Basic Statements of Revenue, Expenses, and Changes in Net Position Years ended June 30, 2016 and 2015

	2016	2015
Revenue:		
Video lottery, net	\$ 360,771,884	357,492,447
Video lottery expired jackpots and credit slips	309,340	252,068
Casino license fees	3,199,100	3,220,300
I-Gaming Video	2,559,090	1,773,149
Sports lottery	39,398,130	37,857,048
Table games, net	54,010,328	51,455,977
Draw games	109,381,171	95,395,052
Instant games	65,659,766	54,422,554
Total revenue	635,288,809	601,868,595
Cost of games:		
Video lottery commissions	152,478,747	150,989,347
Prize costs, net of reversions	126,503,755	108,964,095
Gaming vendor fees and costs	41,815,118	40,301,237
Instant and draw games commissions	11,399,240	9,675,383
Sports lottery commissions	2,792,770	3,324,221
Table games commissions	35,700,827	34,012,401
Total cost of games	370,690,457	347,266,684
Gross margin	264,598,352	254,601,911
Operating expenses:		
Advertising and promotions	3,193,949	3,057,702
Payroll and related benefits	5,905,596	5,877,778
Other general and administrative	1,634,149	1,704,982
Total operating expenses	10,733,694	10,640,462
Operating income	253,864,658	243,961,449
Nonoperating expenses:		
Delaware Standardbred Breeder's Program	3,000,000	3,000,000
Delaware Certified Thoroughbred Program	1,000,000	1,000,000
State of Delaware	249,864,659	239,961,449
Total nonoperating expenses	253,864,659	243,961,449
Change in net position	-	-
Net position at beginning of year	1,000,000	1,000,000
Net position at end of year	\$ 1,000,000	1,000,000

See accompanying notes to basic financial statements.

DELAWARE STATE LOTTERY
Basic Statements of Cash Flows
Years ended June 30, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Receipts from customers	\$ 642,405,983	600,991,396
Payments to vendors for goods and services	(46,348,273)	(45,354,466)
Payments to employees for services	(5,842,743)	(5,945,984)
Payments for prizes	(128,382,725)	(106,964,131)
Payments for commissions	(205,101,583)	(198,249,368)
Net cash provided by operating activities	256,730,659	244,477,447
Cash flows from noncapital financing activities:		
Transfers to the Delaware Standardbred Breeder's Program	(3,000,000)	(3,000,000)
Transfers to the Delaware Certified Thoroughbred Program	(1,000,000)	(1,000,000)
Transfers to the State of Delaware	(249,972,944)	(240,497,006)
Net cash used in noncapital financing activities	(253,972,944)	(244,497,006)
Cash flows from investing activity:		
Proceeds from maturity of investments	29,878	34,257
Net cash provided by investing activity	29,878	34,257
Net increase cash and investments	2,787,593	14,698
Cash and investments at beginning of year	3,133,928	3,119,230
Cash and investments at end of year	\$ 5,921,521	3,133,928
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 253,864,659	243,961,449
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Accounts receivable, net	7,117,174	(877,199)
Prizes liability	(1,878,970)	1,999,964
Accounts payable and accrued liabilities	(2,372,204)	(606,767)
Net cash provided by operating activities	\$ 256,730,659	244,477,447

See accompanying notes to basic financial statements.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

(1) Summary of Significant Accounting Policies

(a) Legislative Enactment

The Delaware State Lottery (the Lottery) was established by Enabling Legislation (the Legislation) passed on May 31, 1974, by the General Assembly of the State of Delaware (the General Assembly) under the authority of the Governor's Office and under the supervision of a Director. In July 1976, the Lottery was transferred to the Office of the Secretary of Finance. The Director has the power and duty to establish rules for conducting games, including the type and number of games, the price of tickets, the number and amounts of winning tickets, the manner of selecting winning tickets, the manner of prize payment, frequency of drawings, locations and methods for the sale of tickets, procedures for licensing of retailers, and all other functions related to the operation of the Lottery.

The Legislation provides that, for the nonvideo lottery games, at least 45% of total revenue shall be used to pay prizes, operating expenses shall not exceed 20% of total revenue, and the Lottery shall undertake to provide into the General Fund of the State of Delaware a payment of earnings of 30%. Enabling legislation for video lottery was enacted on July 16, 1994 and provides that, for the video lottery games, at least 87%, but not more than 95% (unless approved by the Director), of total proceeds on an average annual basis shall be used to pay prizes.

(b) Reporting Entity

The Delaware State Lottery (reporting entity) is an enterprise fund of the State of Delaware.

(c) Basis of Presentation

In accordance with accounting principles generally accepted in the United States of America, the financial statements are prepared on the accrual basis of accounting, which requires recognition of revenues when earned and expenses when incurred.

(d) New Accounting Pronouncements

In February of 2015, the Government Accounting Standards Board (GASB) issued Statement No. 72 *Fair Value Measurement and Application*. The objective of this Statement is to improve financial reporting by clarifying the definition of fair value for financial reporting purposes. The adoption of Statement No. 72 had no impact on the Lottery's financial statements.

In June of 2015, the GASB issued Statement No. 76 *The Hierarchy of Generally Accepted Accounting Principles for State and Local Government*. This Statement redefines the hierarchy of generally accepted accounting principles (GAAP). The adoption of Statement No. 76 had no impact on the Lottery's financial statements.

(e) Deferred Outflows and Inflows of Resources

In addition to assets, the Statement of Net Position includes a separate section for deferred outflows of resources. The deferred outflows of resources represent a consumption of net position that applies to future periods.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

In addition to liabilities, the Statement of Net Position includes a separate section for deferred inflows of resources. This separate section represents a source of net position that will be amortized to future periods.

(f) Cash and Investments

Cash and investments consist of deposits held in bank accounts and highly liquid overnight investment accounts, as well as deposits held by the State to fund future nonprize costs during the next month.

(g) Accounts Receivable

Accounts receivable consist primarily of unsettled balances due to the Lottery from the racetracks for video lottery and table games, and from retailers, which principally include grocery and convenience stores serving as the primary distribution channel for traditional lottery sales (drawing and instant games) to the general public.

	2016	2015
Receivables:		
Accounts	\$ 6,969,686	14,086,860
Total receivables	6,969,686	14,086,860
Allowance for doubtful accounts	(791,748)	(791,748)
Total receivables, net	\$ 6,177,938	13,295,112
Amounts not scheduled for collection during the subsequent year	\$ —	—

(h) Investments

Investments consist of annuity contracts purchased from insurance companies to fund future prize payments, and are carried at amortized cost as nonparticipating investment contracts. The practice of purchasing and holding annuity contracts to fund future prize obligations is no longer employed by the Lottery, as investment amounts reported represent annuity contracts whose most recent purchase was during 1998. It is the Lottery's policy to hold all investments of this nature that were purchased to fund prize obligations until maturity. All investments will mature as of February 16, 2018.

(i) Capital Assets

All purchases of capital assets, mostly computer equipment and furniture and fixtures, in excess of \$25,000 are capitalized and carried at cost. Depreciation is computed by using the straight-line method over the estimated useful life of 10 years. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations in the period of disposal. During the fiscal year ending June 30, 2015 the Lottery had no new purchases of capital assets and had properly disposed of all old capital assets. As of June 30, 2016, the Lottery does not have any capital assets.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

(j) Revenue Recognition

Revenue from drawing games is recognized on the day of purchase. Revenue from the sale of instant tickets is recognized when the book has been activated and when one of the following occurs:

- 85% of the related prizes of an activated book is paid
- 90 days from the date of activation
- When the next pack of the same game is activated

Revenue from video lottery and table game sales is recognized, net of prizes paid, at the time the public plays the game. Revenue from sports lottery is also recognized at the time the public plays the game.

All revenue that the Lottery reports is considered operating revenue.

(k) Prize Obligations

Prize obligations for the online games are determined and recognized after each drawing is held. For the numbers games, winners are paid a certain amount depending upon the number of, or order of, winning numbers. Of every Multi Win Lotto sales dollar, a fixed payment goes to fund the nine lower prize levels with the balance going into the jackpot. If there are no jackpot winners in the Lotto game, the amount is carried forward until there is a winner. For the Powerball, Hot Lotto, and Mega Millions, 50% of the revenues are allocated to the prize pool.

Prize obligations related to instant games are recognized by taking the greater of prize cash disbursements or the historical estimates of claimed prizes. Disbursements for prizes, including installment prize awards, are charged against the obligations for unpaid prize awards. Prizes unclaimed after one year revert back to the Lottery and reduce the prize costs for the year. Such unclaimed monies are then remitted to the State.

Prize obligations for the sports lottery are determined and recognized after the completion of National Football League games. All wagers must be parlays consisting of three or more individual games.

(l) Compensated Absences

The Lottery has accrued a liability included in accounts payable and accrued liabilities for employee future absences, recognizing the obligation relating to services already rendered. This liability represents benefits accrued to Lottery employees for vacation earned as of year-end and sick leave estimated to be paid out at retirement for services rendered as of June 30, 2016. Employees earn from 9.5 to 13.25 hours of vacation leave per month depending on years of service. The employee or his or her estate is paid for unused vacation upon termination of employment. Employees earn 9.5 hours of sick leave per month. The Lottery's obligation for sick leave credit is a maximum of 337.5 hours. As of June 30, 2016 and 2015, the Lottery had liabilities of \$235,398 and \$219,756 for accrued vacation and \$226,769 and \$209,957 for accrued sick leave, respectively.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

(m) Operating and Nonoperating Expenses

Operating expenses generally result from providing services and producing and delivering goods in connection with the Lottery's principal ongoing operations. Operating expenses of the Lottery include personnel costs, travel costs, contracted services, and supplies. All expenses not meeting this definition are reported as nonoperating expenses.

(n) Reclassifications

Certain amounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year's financial statements.

(2) Cash and Investments

Cash and investments reported reflect three types of account balances: the Lottery deposit account, the Lottery prize accounts, and pooled cash and investments held by the State Treasurer's Office. Cash receipts and all cash transfers to other state agencies are made in and out of the Lottery deposit account. Prize disbursements are made out of the Lottery prize accounts. Pooled cash and investments are comprised of cash and cash equivalents and short and long-term investments that are managed by the State Treasurer's Office.

Cash and investment balances consisted of the following:

	June 30	
	2016	2015
On hand and in bank	\$ 4,346,952	387,451
Pooled cash and investments	1,574,569	2,746,477
Total cash balances	\$ 5,921,521	3,133,928

Custodial Credit Risk

For deposits, custodial credit risk is the risk that, in the event of the failure of a depository financial institution, the deposits or collateral securities may not be recovered from an outside party.

All deposits are required by state law to be collateralized by direct obligations of, or obligations guaranteed by, the U.S. government or other suitable obligations as determined by the State's Cash Management Policy Board (the Board), unless the Board shall find such collateralization not in the best interest of the State. Additionally, the Board has determined that deposits need not be collateralized provided they are held in a bank that for the previous two years has had a return on total average assets of 0.5% or greater and has had an average capital ratio (total equity to total assets) of at least 5.0%. If the bank does not meet the aforementioned criteria, collateral must consist of one or more of the following:

- U.S. government securities;
- U.S. government agency securities;
- Federal Home Loan Board letters of credit;

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

- State securities; or
- Securities of a political subdivision of the State with a Moody's Investors service rating of "A" or better.

In addition, the bank must ensure that those securities pledged as collateral have a market value equal to or greater than 102% of the ledger balance(s) in the account(s) each day and ensure that securities pledged are identified as held in the State's name and are segregated on the bank's records.

At June 30, 2016 and 2015, the bank balance of deposits was not subject to custodial credit risk as all amounts were either fully insured and/or collateralized. As of June 30, 2016 and 2015, the total bank balance of cash in all bank accounts was \$4,346,952 and \$387,451, respectively.

(3) Investments

Until April 1998, annuity contracts were purchased from insurance companies to fund prizes of \$150,000 or more, payable on an installment basis. All investments reported on the statement of net position represent such annuities, and are carried on the statement of net position at amortized cost. The Lottery intends to hold the investments until maturity. The Lottery remains liable for future periodic payments of deferred prize obligations (approximately \$0.1 million as of June 30, 2016) in the event that annuity issuers default on their obligations. Lottery investments as of June 30, 2016 and 2015 are not subject to custodial credit risk since their existence is not evidenced by securities that exist in physical or book entry form.

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the value of an investment. Investments reported on the balance sheet are not subject to interest rate risk.

(b) Credit Risk and Concentration of Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. While the Lottery no longer utilizes the purchase of annuity contracts to fulfill prize obligations, the Lottery places no limit on the amount it may invest in any one issuer. As of June 30, 2016, the insurance companies with which the Lottery's investments in annuity contracts to pay future prize obligations are held were rated by A.M. Best Company and concentrated as follows:

<u>Insurance company</u>	<u>Total annuity contract values</u>	<u>Concentration</u>	<u>A.M. Best rating</u>
New York Life Insurance Company	\$ 49,903	100.00	AAA

(4) Capital Assets

During the year ending June 30, 2016 the Lottery did not have any new purchases of capital assets and properly disposed of all old capital assets in fiscal year 2015. There is currently no depreciation expense.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

(5) Prize Obligations

The following is a reconciliation of changes in the prize liability account, which includes the present value of prize installment obligations, for the fiscal years ended June 30, 2016 and 2015:

	2016	2015
Prize obligations, beginning of year	\$ 6,822,524	4,822,560
Prize payments	(128,382,725)	(106,964,131)
Prize costs, net of reversions	126,503,755	108,964,095
Prize obligations, end of year	\$ 4,943,554	6,822,524

The Lottery pays the winners of certain jackpots in annual installments over periods that vary generally from 14 to 20 years. The future prize installment obligations payable as of June 30, 2016, during the next two years, are as follows:

2017		\$ 30,000
2018		20,000
	Total payments for unpaid prize installment obligations	50,000
	Less imputed interest rate (0.2%)	(97)
	Present value of prize installment obligations	\$ 49,903

(6) Participation in the Multi-State Lottery

The Lottery is a member of the Multi-State Lottery (the MUSL), which operates online games on behalf of participating state lotteries. Each MUSL member sells game tickets through its agents and makes weekly wire transfers to the MUSL in an amount equivalent to the member's share of the estimated grand prize liability. Each MUSL member pays lesser prizes directly to the winners. The MUSL operates the Powerball game and the Hot Lotto game since fiscal year 2008 and the Mega Millions game since 2010. Participating lotteries are required to maintain deposits with MUSL for contingency reserves to protect MUSL from unforeseen prize liabilities. The money in this reserve fund is refundable to MUSL members if the MUSL disbands or if a member leaves the MUSL Board. The MUSL has an agreement that grants MUSL the nonexclusive right to offer the multi-jurisdictional lottery game known as the "Mega Millions Game," to be conducted by the MUSL member lotteries.

The amount the Lottery had on deposit with the MUSL, as of June 30, 2016 and 2015, equaled \$2,316,299 and \$2,515,559, respectively. These amounts are also reported as a liability on the Lottery's balance sheet because they represent the amount to be paid to the State's General Fund upon separation from the MUSL, if the MUSL is not required to use any portion of the Lottery's reserves held by the MUSL.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

(7) Delaware Standard Breeder’s Program and Delaware Certified Thoroughbred Program

In March 1998, an amendment to the Legislation was passed by the General Assembly that established the Delaware Standard Breeder’s Program (the Breeder’s Program) for the purpose of promoting the Delaware harness racing industry. Under this amendment, the Lottery was initially required to withhold \$2,000,000 of funds annually (\$1,000,000 from the General Fund of the State and \$1,000,000 from the Purse Increase Funds of the State Department of Agriculture) and remit these fees to the Breeder’s Program. Under an amendment signed in April 2004, the Lottery is required to withhold \$3,000,000 of funds annually (\$1,500,000 from the General Fund of the State and \$1,500,000 from the Purse Increase Funds of the State Department of Agriculture) and remit these fees to the Breeder’s Program.

In the epilogue language of the fiscal year 2006 Bond Bill, an amendment was passed by the General Assembly that established the Delaware Certified Thoroughbred Program for the purpose of enhancing the quantity of thoroughbred foals and/or yearlings stabled within Delaware. Under this amendment, effective July 1, 2006, the Lottery is required to withhold \$1,000,000 of funds annually (\$500,000 from the General Fund of the State and \$500,000 from the Purse Increase Funds of the State Department of Agriculture) and remit these funds to the Delaware Certified Thoroughbred Program.

During fiscal year 2008, the General Assembly approved House Bill #514, which reduces the State’s annual contribution to the Delaware Standardbred Breeder’s Program and the Certified Thoroughbred Program by \$750,000 and \$250,000, respectively. The State’s video lottery agents will pick up the reduction of the State’s contribution. The amounts paid by the agents are recorded as a reduction to video lottery commissions and/or accounts payable and is then transferred by the Lottery to the respective programs.

(8) Contributions to the State of Delaware

As required, under the Legislation, net position of the Lottery may not exceed \$1,000,000; therefore, the Lottery periodically transfers surplus funds to the State in accordance with the Legislation. For the years ended June 30, 2016 and 2015, the Lottery made the following contributions to the State.

	June 30	
	2016	2015
Amounts transferred and to be transferred to the State for the fiscal year:		
General Fund	\$ 211,461,338	201,715,829
Department of Health and Social Services	1,600,897	1,623,208
Department of Agriculture	36,802,424	36,622,412
	\$ 249,864,659	239,961,449

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

(9) Revenue and Expenses by Game

The following revenue was recognized:

	<u>Year ended June 30</u>	
	<u>2016</u>	<u>2015</u>
Draw games:		
Play 3 Day	\$ 10,732,472	9,796,329
Play 3 Night	16,970,205	15,749,004
Play 4 Day	8,493,811	7,818,263
Play 4 Night	14,131,074	13,282,140
Multi Win Lotto	4,634,945	4,196,545
Powerball	30,445,066	20,946,673
Hot Lotto	2,365,068	3,233,827
Mega Millions	9,536,437	10,821,285
Delaware Cash 5	-	547,120
Keno	8,038,051	6,665,168
Lucky for Life	4,034,042	2,338,698
Total draw games	<u>109,381,171</u>	<u>95,395,052</u>
Instant games	<u>65,659,766</u>	<u>54,422,554</u>
Total traditional lottery	175,040,937	149,817,606
Video lottery, net	360,771,884	357,492,447
I-Gaming video lottery, net	2,559,090	1,773,149
Video lottery expired jackpots and credit slips	309,340	252,068
Casino license fees	3,199,100	3,220,300
Sports lottery	39,398,130	37,857,048
Table games, net	<u>54,010,328</u>	<u>51,455,977</u>
Total revenue	<u>\$ 635,288,809</u>	<u>601,868,595</u>

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

The revenue, prize costs, and commission expense, by game type, are listed below:

	Video lottery net	Igaming video, net	Sports lottery	Table games, net	Draw games	Instant	Total
Year ended June 30, 2016:							
Revenue	\$ 360,771,884	2,559,090	39,398,130	54,010,328	109,381,171	65,659,766	631,780,369
Other income	3,508,440	—	—	—	—	—	3,508,440
Prize costs, net of reversions	—	—	28,186,445	—	55,831,551	42,485,759	126,503,755
	364,280,324	2,559,090	11,211,685	54,010,328	53,549,620	23,174,007	508,785,054
Commissions expense	152,478,747	—	2,792,770	35,700,827	6,836,328	4,562,912	202,371,584
Contribution margin per game	\$ 211,801,577	2,559,090	8,418,915	18,309,501	46,713,292	18,611,095	306,413,470
Game vendor fees	27,593,315	1,956,837	2,309,647	—	6,277,183	3,678,136	41,815,118
Gross margin	184,208,262	602,253	6,109,268	18,309,501	40,436,109	14,932,959	264,598,352
Year ended June 30, 2015:							
Revenue	\$ 357,492,447	1,773,149	37,857,048	51,455,977	95,395,052	54,422,554	598,396,227
Other income	3,472,368	—	—	—	—	—	3,472,368
Prize costs, net of reversions	—	4,177	23,742,870	—	49,836,876	35,380,172	108,964,095
	360,964,815	1,768,972	14,114,178	51,455,977	45,558,176	19,042,382	492,904,500
Commissions expense	150,989,347	—	3,324,221	34,012,401	5,781,410	3,893,973	198,001,352
Contribution margin per game	\$ 209,975,468	1,768,972	10,789,957	17,443,576	39,776,766	15,148,409	294,903,148
Game vendor fees	27,108,795	1,813,139	2,847,451	—	5,472,284	3,059,568	40,301,237
Gross margin	182,866,673	(44,167)	7,942,506	17,443,576	34,304,482	12,088,841	254,601,911

(10) Payroll-Related and Other Benefits

All Lottery personnel are employees of the State of Delaware and are covered by pension, health insurance, and other employee benefit programs administered by agencies of the State. During fiscal year 2016 and fiscal year 2015, the Lottery incurred \$5,905,596 and \$5,877,778, respectively, of payroll and benefit costs, including pension, health insurance, and other employee benefit costs, paid to various state agencies responsible for the administration of benefit programs.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

(11) Pension and Other Postemployment Benefits

(a) Pension

The Lottery contributes to the State Employees' Pension Plan (the Plan) established by the State to provide benefits for state employees. The Plan is a cost-sharing multiple employer defined benefit pension plan established in the Delaware Code. The Plan prepares separate financial statements. All details of the Plan can be obtained by writing to the State Board of Pension Trustees and Office of Pensions, McArdle Building, Suite #1, 860 Silver Lake Boulevard, Dover, Delaware 19904-2402.

Benefits Provided

The Plan provides retirement, disability and death benefits. Pre-2012 members are eligible for monthly retirement benefits upon reaching (a) age 62 with at least five years of credit service; (b) age 60 with 15 years of credit service; or (c) 30 or more years of service regardless of age. Post-2011 members are eligible for monthly retirement benefits upon reaching (a) age 65 with at least ten years of credited service; (b) age 60 with 20 years of credit service; or (c) 30 or more years of service regardless of age.

Pre-2012 participants are eligible for disability benefits after five years of credited service. In lieu of disability pension benefits, over 90% of the members in this plan opted into a Disability Insurance Program offered by the State effective January 1, 2006. Post-2011 participants are not offered disability pension benefits and are in the Disability Insurance Program.

Death benefits are payable upon the death of an active member who has reached age 62 with at least five years of credit service. Such benefits are paid at 75% of the benefit the employee would have received at age 62. If an employee is currently receiving a pension, the eligible survivor receives 50% of the pension benefit (or 75% with 3% reduction of benefit). Burial benefits of \$7,000 per member are also provided.

Employee Contributions

Pre-2012 members contribute at 3% of earnings in excess of \$6,000.

Post-2011 members contribute at 5% of earnings in excess of \$6,000.

Employer Contributions

Employer contributions are determined by the Board of Pension Trustees. For the year ended June 30, 2016, the rate of the employer contribution was 9.49 percent of covered payroll. The Lottery's employer contributions for the years ended June 30, 2016 and 2015 was \$242,448 and \$244,307, respectively. The Lottery's required contributions equaled actual contributions made for the years ended June 30, 2016 and 2015.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

Net Pension Liability and Expense

At June 30, 2016, the Lottery reported a net pension liability of \$911,588 for its proportionate share of the net pension liability of the State of Delaware. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by rolling forward the Plan's total pension liability as of June 30, 2014 to June 30, 2015. At June 30, 2015, the Lottery's proportion was 0.1370 percent, which was a decrease of 0.004 percent from its proportion measured as of June 30, 2014. For the year ended June 30, 2016, the Lottery recognized a pension expense of \$185,791.

Deferred Outflows and Inflows of Resources

At June 30, 2016, the Lottery reported deferred outflows of resources of \$242,448 for its contributions subsequent to the measurement date, which will be recognized as a reduction of the net pension liability in the following year.

At June 30, 2016, the Lottery reported deferred inflows of resources related to pensions from the following sources:

	Measurement Period ending June 30	Amorti- zation Period	Beginning of Year Balance	Additions	Deduction s	End of Year Balance
Difference between expected and actual experience.	2016	6 years	\$ 0	(24,538)	4,090	(20,448)
Change in Proportion	2015	6 years	(9,228)	0	2,307	(6,921)
	2016	6 years	<u>(9,228)</u>	<u>(36,883)</u>	<u>7,377</u>	<u>(29,506)</u>
			(9,228)	(36,883)	9,684	(36,427)
Net Difference between projected and actual earnings on pension plan investment.	2015	5 years	(823,210)	0	(205,803)	(617,407)
	2016	5 years	<u>(823,210)</u>	<u>423,354</u>	<u>84,671</u>	<u>338,683</u>
			<u>(823,210)</u>	<u>423,354</u>	<u>(121,132)</u>	<u>(278,724)</u>
			<u>\$ (832,438)</u>	<u>361,933</u>	<u>(107,358)</u>	<u>(335,599)</u>

Amounts reported as deferred inflows of resources related to pensions will be recognized as part of pension expense in future periods as follows:

Year Ending June 30	
2017	\$ 134,905
2018	134,905
2019	134,904
2020	(73,205)
2021	<u>4,090</u>
	<u>\$ 335,599</u>

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

Actuarial Assumptions

The total pension liability as of June 30, 2015 measurement date was determined by an actuarial valuation as of June 30, 2014, with update procedures used to roll forward the total pension liability to June 30, 2015. These actuarial valuations used the following actuarial assumptions:

Investment Return -7.2%, includes inflation at 3.0%

Salary Increases - 3.5% to 11.5%, includes inflation at 3.0%

Mortality rates were based on the Sex distinct RP-2000 Combined Mortality Table projected to 2015 using scale AA for males or females, as appropriate, for mortality improvement.

The total pension liabilities are measured based on assumptions pertaining to the interest rates, inflation rates, and employee demographic behavior in future years. The assumptions used were based on the results of an actuarial experience study conducted in 2011. It is likely that future experience will not exactly conform to these assumptions. To the extent that actual experience deviates from these assumptions, the emerging liabilities may be higher or lower than anticipated. The more the actual experience deviates, the larger the impact on future financial statements.

The long-term expected rate of return on plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by an asset allocation percentage, which is based on the nature and mix of current and expected plan investments, and by adding expected inflation. Best estimates of geometric real rates of return for each major asset class included in the System's current and expected asset allocation is summarized in the following table:

<u>Asset class</u>	<u>Long-term expected rate of return</u>
Domestic equity	5.7%
International equity	5.7%
Fixed income	2.0%
Alternative investments	7.8%
Cash and equivalents	-

Discount Rate

The discount rate used to measure the total pension liability was 7.20%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rates and that contributions from employers will be made at rates determined by the Board of Pension Trustees, actuarially determined. Based on those assumptions,

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on

pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Lottery's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability, calculated using the discount rate of 7.20%, as well as what the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.20%) or one percentage point higher (8.20%) than the current rate:

	1% decrease <u>6.20%</u>	Current discount rate <u>7.20%</u>	1% increase <u>8.20%</u>
Lottery's proportionate share of the net pension liability (asset)	<u>\$ 2,059,192</u>	<u>\$ 911,588</u>	<u>\$ (433,858)</u>

Pension Plan Fiduciary Net Position

Detailed information about the Delaware Public Employees' Retirement System (DPERS) fiduciary net position is available in the DPERS Comprehensive Annual Financial Report which can be obtained from the pension office at McArdle Building, Suite 1; 860 Silver Lake Blvd; Dover, DE, 19904.

Net Position – Pension

By implementing the requirements of GASB Statement No. 68 and GASB Statement No. 71 as of July 1, 2014, the Lottery recognized deferred outflows, net pension liability, and deferred inflows, which affects the Lottery's net position. Legislation dictates that the Lottery can only maintain a net position of \$1,000,000; therefore any such changes are reflected as an amount Due from the State.

(b) Other Postemployment Benefits

The Lottery accounts for and reports the value of its future obligation to pay OPEB, which is principally healthcare to employees as the related benefits are earned. The resulting liability has been recorded on the statement of net position as OPEB liability and the year-over-year change in the obligation has been expensed in the statement of revenues, expenses, and changes in net position in the current fiscal year. The Lottery also shows the OPEB due from the State since by design in the Delaware Code the Lottery is not to keep more than one million dollars on hand. All other proceeds are sent to the General Fund to be kept on the State of Delaware's net position. All full-time Lottery employees are covered under the State of Delaware OPEB Trust, which was established pursuant to Section 115 of the Internal Revenue Code and administered by the Delaware Public Employees' Retirement System. No stand-alone financial report is issued for the OPEB Trust, but the Trust is included in the statewide Comprehensive Annual Financial Report, which will be available from the Division of Accounting.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

The OPEB Trust is a single-employer defined-benefit plan and provides retirement medical coverage to pensioners and their eligible dependents through the same healthcare plans that are available to active employees. Retirees' contributions depend on date of hire and years of service and range from

0% to 100% of the cost. The OPEB liability continued to increase each year because the Lottery is not funding the Annual Required Contribution, but is only paying retiree healthcare on a pay-as-you-go basis. There are currently 32,854 active eligible plan members. The Lottery has 61 active eligible plan members, which is the basis on which plan costs are allocated.

By State statute Title 29 of the Delaware Code c.52, contribution requirements of plan members and the government are established and may be amended by the State Legislature. The contribution rates for the employer and retiree are established annually by the budgeting process of the State of Delaware, but are not actuarially determined.

The State's annual OPEB cost is calculated based on the actuarially determined annual required contribution (ARC) of the employer. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize the unfunded actuarial liabilities over a period of 30 years. Amounts "required" but not actually set aside to pay for these benefits are accumulated as part of the net OPEB obligation. The following tables show the components of the annual OPEB cost for the year, the amount actually contributed to the plan, and the net OPEB obligation, as well as the amounts allocated to the Lottery:

	State total	Lottery allocation
	(In millions)	(In thousands)
Net OPEB obligation as of June 30, 2015	\$ 2,174.5	3,356.6
Annual required contribution	425.6	790.2
Interest on net OPEB Obligation	92.4	171.6
Adjustment to required contribution	<u>(83.9)</u>	<u>(155.8)</u>
Net OPEB obligation before contributions	2,608.6	4,162.6
Employer contributions	<u>217.8</u>	<u>404.4</u>
Net OPEB obligation as of June 30, 2016	<u>\$ 2,390.8</u>	<u>3,758.2</u>

	State total	Lottery allocation
	(In millions)	(In thousands)
Net OPEB obligation as of June 30, 2014	\$ 1,988.6	3,000.2
Annual required contribution	404.4	775.3
Interest on net OPEB Obligation	84.5	161.9
Adjustment to required contribution	<u>(76.7)</u>	<u>(147.0)</u>
Net OPEB obligation before contributions	2,400.8	3,790.4
Employer contributions	<u>226.3</u>	<u>433.8</u>
Net OPEB obligation as of June 30, 2015	<u>\$ 2,174.5</u>	<u>3,356.6</u>

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2016 and 2015

The Lottery's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation are as follows:

<u>Fiscal year ended</u>	<u>Annual OPEB cost</u>	<u>Percentage of annual OPEB cost contributed</u>	<u>Net OPEB obligation</u>
6/30/2014	\$789,100	48.9%	\$3,000,272
6/30/2015	790,200	54.9%	3,356,630
6/30/2016	806,000	50.2%	3,758,244

(12) Risk Management

The Lottery stipulates in its vendor contracts that the vendors carry various insurance coverage such as property (video gaming machines and online terminals, etc.), general liability, errors and omissions, automotive, and crimes. The Lottery's risks of losses related to workers' compensation, employee healthcare, automobile, and a portion of property and casualty claims are insured internally by the State.

(13) Commitments

The Lottery has entered into various contracts for services to be rendered relating principally to the operation of the Lottery's games. Under the gaming systems contract the Lottery is committed to 5.4371% of draw game sales, 9.95% of Keno sales, 1% of video net gaming revenue, and 25% of net win for charitable gaming video machines to its central system provider through February 2018. For the instant sales and services contract, the Lottery is committed to 5.6% of instant sales through January 2018. For video lottery terminals, the lottery is committed to a range of 5.5% to 7.0% to video lottery vendors through October 28, 2018. For video lottery terminals classified as electronic table games (ETG), the Lottery is committed to a range of 7% to 20% through March 15, 2021. For sports lottery, the Lottery is committed to 15.625% of track venue net revenue and 25% of retailer net revenue through the 2018-2019 sports season.

Delaware State Lottery
Required Supplementary Information
Schedule of Proportionate Share of the Net Pension Liability and Contributions

Proportionate Share of Net Pension Liability

Actuarial valuation date	<u>6/30/2015</u>	<u>6/30/2014</u>
Lottery's proportion of the net pension liability	0.1370%	0.1407%
Lottery's proportion of the net pension liability - dollar value	\$ 911,588	\$ 518,009
Lottery's covered employee payroll	\$ 2,555,038	\$ 2,589,613
Lottery's proportionate share of the net pension liability as a percentage of its covered employee payroll	35.7%	20.0%
Plan fiduciary net position as a percentage of the total pension liability	92.7%	95.8%

Contributions

Contractually required contributions	\$ 244,307	\$ 245,999
Contributions in relation to the contractually required contributions	\$ 244,307	\$ 245,999
Contribution excess (deficit)	<u>\$ -</u>	<u>\$ -</u>
Lottery's covered employee payroll	\$ 2,555,038	\$ 2,589,613
Contribution as a percentage of covered employee payroll	9.56%	9.50%

In accordance with GASB Statement No. 68, this schedule has been prepared prospectively as the above information for the preceding years is not readily available.

This schedule will accumulate each year until sufficient information to present a ten year trend is available.

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

Vernon Kirk, Director of the Delaware State Lottery, and
Tom Cook, Secretary of Finance,
State of Delaware

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 Delaware State Lottery (the Lottery) of the State of Delaware, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated October 12, 2016.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the 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 Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund'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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a misstatement of the 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 considerations of internal control over financial reporting 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 and therefore material weaknesses or significant deficiencies may exist that were not identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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

This report is intended 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 the 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.



October 12, 2016