

DELAWARE STATE LOTTERY

Basic Financial Statements

June 30, 2018 and 2017

(With Independent Auditors' Reports Thereon)

DELAWARE STATE LOTTERY

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Independent Auditor's Report

Vernon Kirk, Director of the Delaware State Lottery, and
Richard Geisenberger, 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, 2018 and 2017, 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, 2018 and 2017, 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, 2018 and 2017, 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 as respect to this matter.

As discussed in Note 1 (d) to the financial statements, in Fiscal Year 2018, the Lottery adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*. This Statement modifies the Lottery's recognition of its other postemployment benefits and requires a restatement of some June 30, 2017 balances. Our opinion is not modified as 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 30, schedule of Lottery's pension contributions on page 30, schedule of Lottery's proportional share of net OPEB liability on page 31, and schedule of Lottery's OPEB contributions on page 31 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 November 30, 2018 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.

Gunnip & Company LLP

November 30, 2018

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2018 and 2017

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, 2018 and 2017, 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 operation and nonoperation 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, 2018 and 2017

Condensed Net Position

Table 1
(In millions)

Assets	June 30		
	2018	2017	2016
Cash and investments	\$ 5.9	3.8	5.9
Accounts receivable, net of allowance of \$0.8, \$0.8, and \$0.8, respectively	10.8	7.9	6.2
Investments	-	-	0.1
Due from State of Delaware	12.7	12.4	4.7
Deposit with Multi-State Lottery	2.5	2.3	2.3
Total assets	<u>31.9</u>	<u>26.4</u>	<u>19.2</u>
Deferred outflows	<u>1.1</u>	<u>1.3</u>	<u>0.2</u>
Liabilities and Net Position			
Liabilities:			
Prizes liability	6.7	5.1	4.9
Accounts payable and accrued liabilities	6.6	4.7	4.7
Due to the State of Delaware	2.4	0.9	1.5
Pension and OPEB liability	12.1	13.6	4.7
Multi-State Lottery reserve	2.5	2.3	2.3
Total liabilities	<u>30.3</u>	<u>26.6</u>	<u>18.1</u>
Deferred inflows	<u>1.7</u>	<u>0.1</u>	<u>0.3</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 four days in 2016, and five days in 2017 and six days in 2018.

Table 1 above shows that the one extra day of sales in fiscal year 2018 and 2017 allows for an increase in accounts receivable collected over fiscal years 2017 and 2016, respectfully.

Prizes liability as shown in Table 1 has increased in fiscal year 2018 over fiscal year 2017 by \$1.5 million. At least a quarter of the increase is due to the sports lottery expansion, increasing the number of tickets sold increases the amount of winnings.

With the implementation of the Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, the Pension and OPEB liability and the amount due from the State of Delaware increased for fiscal years 2018 and 2017 from fiscal year 2016 to cover such obligations. 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.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
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Revenue

Table 2
Revenue
(In millions)

	Year ended June 30		
	2018	2017	2016
Play 3	\$ 27.0	27.5	27.7
Play 4	22.8	22.7	22.6
Multi Win Lotto	4.6	4.3	4.6
Powerball	24.6	22.8	30.5
Hot Lotto	1.3	2.7	2.4
Mega Millions	12.1	8.9	9.5
Lotto America	2.1	-	-
Keno	8.7	8.2	8.0
Lucky for Life	3.0	3.4	4.0
Instant games	70.6	69.3	65.7
Traditional games revenue	176.8	169.8	175.0
Video lottery, net	353.8	352.8	360.8
I-Gaming	2.2	2.7	2.6
Video lottery expired jackpots and credit slips	0.4	0.3	0.3
Casino license fees	3.2	3.2	3.2
Sports lottery	54.7	46.1	39.4
Table games, net	54.6	53.1	54.0
Total revenue	\$ 645.7	628.0	635.3

Table 2 above compares revenue for each lottery game category. There is an increase in revenue in fiscal year 2018 of \$17.7 million or 2.8% over fiscal year 2017. Lottery revenue for fiscal year 2017 showed a decrease over fiscal year 2016 by \$7.3 million or 1.1%.

Powerball and Mega Millions sales are typically driven by the size of the jackpot. Mega Millions had a large jackpot in fiscal year 2018 explaining the increase in sales of \$3.2 million or 36% over fiscal year 2017. The lack of higher jackpots in fiscal year 2017 is the cause for the decrease in sales on these games from fiscal year 2016.

An increase of \$1.3 million or 1.9% in fiscal year 2018 over fiscal year 2017 was again a record for the instant product. The increase of \$3.6 million or 5.5% in fiscal year 2017 over fiscal year 2016 was mainly contributed to an increase in the production of \$25 and \$20 scratch tickets.

Sports Lottery expanded at the end of fiscal year 2018 to allow betting on all sports along with single game bets. This expansion led to a significant jump in sales for sports lottery over fiscal year 2017 with an increase of \$8.6 million or 18.7%. Sports lottery had an increase in revenue for fiscal year 2017 over fiscal year 2016 of \$6.7 million or 17.0%. Payouts for sports was at an all-time high, having players re-invest their winnings into more sports tickets.

Table games revenue increased \$1.5 million or 2.8% in fiscal year 2018 over fiscal year 2017. This increase shared the same trends as all lottery product increases for the current fiscal year. Table games revenue showed a slight decline in fiscal year 2017 over fiscal year 2016 of \$0.9 million or 1.7%.

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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. Due to a Supreme Court ruling in fiscal year 2018, the Lottery expanded sports lottery to selling tickets from just profession football to all sports and added betting on single games.

Cost of Games

Table 3

Cost of Games

(In millions and as a percentage of all revenue)

	Year ended June 30					
	2018		2017		2016	
Commission expense	\$ 199.9	31.0%	196.7	31.3%	202.4	32.0%
Gaming vendor fees and costs	43.0	6.7%	39.8	6.3%	41.8	6.6%
Prize expense	136.5	21.1%	135.0	21.5%	126.5	20.0%
Total cost of games	<u>\$ 379.4</u>		<u>371.5</u>		<u>370.7</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. Delaware law allows for the net of sports (sports sales minus sports win) to be used in the calculations for commissions and vendors fees. Commission expense for fiscal year 2018 increase slightly from fiscal year 2017 by \$3.2 million or 1.6%. This increase grew the same percentage as the sales for traditional games. A decrease in commission expense from fiscal year 2016 to fiscal year 2017 of \$5.7 million or 2.8% was mostly due to the large win amounts on sports lottery. 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 for fiscal year 2018 increased over fiscal year 2017 by \$3.2 million or 8.0%. The increase in vendor fees was due to the fact of the increase in sales and the increase in net revenue of sports lottery. Gaming vendor fees decreased in fiscal year 2017 over fiscal year 2016 of \$2.0 million or 4.8%. This decrease can also be contributed to the increase in sports winners for fiscal year 2017.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
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Prize Expense, Net of Reversions

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

	Year ended June 30		
	2018	2017	2016
Play 3	\$ 13.1	12.8	14.8
Play 4	11.0	10.3	10.3
Multi Win Lotto	2.8	2.6	2.8
Powerball	12.0	10.7	14.9
Hot Lotto	0.5	1.3	1.2
Mega Millions	6.1	4.6	4.5
Keno	5.2	4.8	4.9
Lucky for Life	1.8	1.6	2.4
Lotto America	1.1	—	—
Sports lottery	36.2	40.2	28.2
Instant games	46.7	46.1	42.5
Total prize expense	\$ 136.5	135.0	126.5

Table 4 above compares prize expense for each lottery game category for the past three years. Prize expense includes the costs for winning tickets for traditional and sports lottery. 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. Sports lottery winners vary from year to year due to the unpredictability of the outcome of professional sports. During any given sports event the liability of the game could exceed the sales for that event.

The prize expense for fiscal year 2018 increased slightly over fiscal year 2017 by \$1.5 million or 1.1%. Sport lottery prize cost were unusually low for the NFL season and with the expansion into other professional and college sports the liability is predicted to be much more constant over the course of the events. Prize expense for fiscal year 2017 compared to fiscal year 2016 increases \$8.5 million or 6.7%. Sports lottery accounted for the majority of the increase.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2018 and 2017

Operating Expenses

Table 5
Operating Expenses
(In millions)

	Year ended June 30		
	2018	2017	2016
Operating expenses	\$ 10.4	10.7	10.7

Operating expenses remained relatively unchanged from fiscal year 2016 through fiscal year 2018 with a slight decrease in fiscal year 2018 from spending less in travel, supplies, and capital purchases.

Nonoperating Expenses

Table 6
Nonoperating Expenses
(In millions)

	Year ended June 30		
	2018	2017	2016
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	36.9	35.7	36.8
Department of Health & Social Services	1.6	1.6	1.6
State of Delaware - General Fund	213.3	204.4	211.5
Total nonoperating expenses	\$ 255.8	245.7	253.9

The portion of nonoperating expenses increased in fiscal year 2018 over fiscal year 2017 by \$10.1 million or 4.1%. This increase was in correlation of the increase in sales for the year and the decrease in sports expense. Overall decrease in revenue for fiscal year 2017 vs fiscal year 2016 is the direct correlation for the decrease in nonoperating expenses and contribution to the general fund.

DELAWARE STATE LOTTERY
Basic Statements of Net Position
June 30, 2018 and 2017

Assets	2018	2017
Current assets:		(restated)
Cash and investments	\$ 5,903,324	3,791,602
Accounts receivable, net of allowance of \$833,018 and \$791,748, respectively	10,836,366	7,920,400
Investments – restricted for payment of prize liabilities	-	19,679
Due from the State of Delaware	12,657,006	12,446,099
Total current assets	<u>29,396,696</u>	<u>24,177,780</u>
Noncurrent assets:		
Deposit Multi-State Lottery	2,467,039	2,265,380
Total noncurrent assets	<u>2,467,039</u>	<u>2,265,380</u>
Total assets	<u>31,863,735</u>	<u>26,443,160</u>
Deferred outflows	<u>1,127,219</u>	<u>1,339,348</u>
Liabilities and Net Position		
Current liabilities:		
Prizes liability	6,662,632	5,065,864
Accounts payable and accrued liabilities	6,615,524	4,721,166
Due to the State of Delaware	2,461,534	944,651
Total current liabilities	<u>15,739,690</u>	<u>10,731,681</u>
Noncurrent liabilities:		
Multi-State Lottery reserve	2,467,039	2,265,380
Pension and OPEB liability	12,095,841	13,680,945
Total noncurrent liabilities	<u>14,562,880</u>	<u>15,946,325</u>
Total liabilities	<u>30,302,570</u>	<u>26,678,006</u>
Deferred inflows	<u>1,688,384</u>	<u>104,502</u>
Net position:		
Unrestricted	\$ <u>1,000,000</u>	<u>1,000,000</u>

See accompanying notes to basic financial statements.

DELAWARE STATE LOTTERY

Basic Statements of Revenue, Expenses, and Changes in Net Position Years ended June 30, 2018 and 2017

	2018	2017
Revenue:		
Video lottery, net	\$ 353,776,920	352,834,117
Video lottery expired jackpots and credit slips	379,558	320,466
Casino license fees	3,221,800	3,172,411
I-Gaming	2,178,023	2,701,931
Sports lottery	54,747,779	46,114,509
Table games, net	54,629,995	53,117,143
Draw games	106,188,593	100,438,292
Instant games	70,599,375	69,284,712
Total revenue	645,722,043	627,983,581
Cost of games:		
Video lottery commissions	149,150,781	148,997,809
Prize costs, net of reversions	136,506,526	134,955,648
Gaming vendor fees and costs	43,009,044	39,826,424
Instant and draw games commissions	10,764,400	10,503,135
Sports lottery commissions	3,913,713	2,153,872
Table games commissions	36,110,427	35,110,431
Total cost of games	379,454,891	371,547,319
Gross margin	266,267,152	256,436,262
Operating expenses:		
Advertising and promotions	3,147,412	3,287,302
Payroll and related benefits	5,506,623	5,758,648
Other general and administrative	1,791,987	1,676,294
Total operating expenses	10,446,022	10,722,244
Operating income	255,821,130	245,714,018
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	251,821,130	241,714,018
Total nonoperating expenses	255,821,130	245,714,018
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, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Receipts from customers	\$ 642,806,077	626,241,119
Payments to vendors for goods and services	(47,712,684)	(45,246,004)
Payments to employees for services	(5,524,150)	(5,736,121)
Payments for prizes	(134,890,079)	(134,833,338)
Payments for commissions	(198,263,195)	(196,314,719)
Net cash provided by operating activities	256,415,969	244,110,937
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	(250,304,247)	(242,271,080)
Net cash used in noncapital financing activities	(254,304,247)	(246,271,080)
Cash flows from investing activity:		
Proceeds from maturity of investments		30,224
Net cash provided by investing activity	—	30,224
Net increase (decrease) in cash and investments	2,111,722	(2,129,919)
Cash and investments at beginning of year	3,791,602	5,921,521
Cash and investments at end of year	\$ 5,903,324	3,791,602
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 255,821,130	245,714,018
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Accounts receivable, net	(2,915,966)	(1,742,462)
Prizes liability	1,616,447	122,310
Accounts payable and accrued liabilities	1,894,358	17,071
Net cash provided by operating activities	\$ 256,415,969	244,110,937

See accompanying notes to basic financial statements.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2018 and 2017

(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 non-video 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) Implementation of GASB Statement

During the fiscal year ending June 30, 2018, the Lottery implemented the requirements for GASB Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other than Pensions." GASB Statement No. 75 establishes accounting and financial reporting standards that improve governmental postemployment for benefits other than pensions (OPEB) and requires the recognition of the actuarially determined net postemployment other than pension liability for the entity's proportional share of multi-employer cost sharing plans. See further information on the implementation in footnote 11(b).

(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, 2018 and 2017

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.

A deferred outflow of resources is reported for employer pension and OPEB contributions made subsequent to the measurement date of the Lottery's net pension and net OPEB liabilities and before the end of the Lottery's current reporting period. These contributions will be recognized as a reduction to the net pension liability and net OPEB liability in the following fiscal year. The other deferred outflows of resources and the deferred inflows of resources will be amortized over either a five or six year period and recognized as a component of pension and OPEB expense.

(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 non-prize 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.

	2018	2017
Receivables:		
Accounts	\$ 11,669,384	8,712,148
Total receivables	11,669,384	8,712,148
Allowance for doubtful accounts	(833,018)	(791,748)
Total receivables, net	\$ 10,836,366	7,920,400
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 the Lottery had on hand have matured.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2018 and 2017

(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, 2018, the Lottery had no new purchases of capital assets and had properly disposed of all old capital assets.

(j) Revenue Recognition

Revenue from drawing games and sports lottery 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. All revenue that the Lottery reports is considered operating revenue.

(k) Prize Obligations

Prize obligations for the traditional draw games and sports lottery are determined and recognized after each drawing or sports game 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, Lotto America, 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.

(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, 2018. 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

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June 30, 2018 and 2017, the Lottery had liabilities of \$229,406 and \$242,713 for accrued vacation and \$221,760 and \$238,033 for accrued sick leave, respectively.

(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	
	2018	2017
On hand and in bank	\$ 3,461,584	2,047,753
Pooled cash and investments	2,441,740	1,743,849
Total cash balances	\$ 5,903,324	3,791,602

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:

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

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, 2018 and June 20, 2017, the total bank balance of cash in all bank accounts was \$3,461,584 and \$2,047,753 respectively.

(3) Investments

All previous investments reported on the statement of net position have reached maturity.

(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.

(4) Capital Assets

During the year ending June 30, 2018 the Lottery did not have any new purchases of capital assets. Currently, there are no capital assets or corresponding depreciation expense.

(5) Prize Obligations

The following is a reconciliation of changes in the prizes liability account, which includes the present value of prize installment obligations, for the fiscal years ended June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Prize obligations, beginning of year	\$ 5,065,864	4,943,554
Prize payments	(134,909,758)	(134,833,338)
Prize costs, net of reversions	136,506,526	134,955,648
Prize obligations, end of year	<u>\$ 6,662,632</u>	<u>5,065,864</u>

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(6) Participation in the Multi-State Lottery

The Lottery is a member of the Multi-State Lottery (the MUSL), which operates traditional draw 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 since fiscal year 2008 and the Mega Millions game since 2010. They recently added Lotto America in 2018. 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, 2018 and 2017, equaled \$2,467,039 and \$2,265,380 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.

(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.

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(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, 2018 and 2017, the Lottery made the following contributions to the State.

	June 30	
	2018	2017
Amounts transferred and to be transferred to the State for the fiscal year:		
General Fund	\$ 213,325,651	204,389,911
Department of Health and Social Services	1,584,083	1,570,598
Department of Agriculture	36,911,396	35,753,509
	\$ 251,821,130	241,714,018

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(9) Revenue and Expenses by Game

The following revenue was recognized:

	Year ended June 30	
	2018	2017
Draw games:		
Play 3 Day	\$ 10,491,733	10,737,859
Play 3 Night	16,530,817	16,798,003
Play 4 Day	8,564,019	8,590,011
Play 4 Night	14,217,965	14,162,692
Multi Win Lotto	4,559,172	4,268,594
Powerball	24,577,701	22,774,734
Hot Lotto	1,300,792	2,655,062
Lotto America	2,129,759	-
Mega Millions	12,072,786	8,877,979
Delaware Cash 5	-	-
Keno	8,721,480	8,168,946
Lucky for Life	3,022,369	3,404,412
Total draw games	<u>106,188,593</u>	<u>100,438,292</u>
Instant games	<u>70,599,375</u>	<u>69,284,712</u>
Total traditional lottery	176,787,968	169,723,004
Video lottery, net	353,776,920	352,834,117
I-Gaming video lottery, net	2,178,023	2,701,931
Video lottery expired jackpots and credit slips	379,558	320,466
Casino license fees	3,221,800	3,172,411
Sports lottery	54,747,779	46,114,509
Table games, net	<u>54,629,995</u>	<u>53,117,143</u>
Total revenue	<u>\$ 645,722,043</u>	<u>627,983,581</u>

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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, 2018:							
Revenue	\$ 353,776,920	2,178,023	54,747,779	54,629,995	106,188,593	70,599,375	642,120,685
Other income	3,601,358	—	—	—	—	—	3,601,358
Prize costs, net of reversions	—	—	36,199,716	—	53,621,285	46,685,525	136,506,526
	357,378,278	2,178,023	18,548,063	54,629,995	52,567,308	23,913,850	509,215,517
Commissions expense	149,150,781	—	3,913,713	36,110,427	6,546,770	4,217,630	199,939,321
Contribution margin per game	208,227,497	2,178,023	14,634,350	18,519,568	46,020,538	19,696,220	309,276,196
Game vendor fees	27,253,703	1,782,125	3,842,631	—	6,155,206	3,975,379	43,009,044
Gross margin	\$ 180,973,794	395,898	10,791,719	18,519,568	39,865,332	15,720,841	266,267,152
Year ended June 30, 2017:							
Revenue	\$ 352,834,117	2,701,931	46,114,509	53,117,143	100,438,292	69,284,712	624,490,704
Other income	3,492,877	—	—	—	—	—	3,492,877
Prize costs, net of reversions	—	—	40,180,913	—	48,688,872	46,085,863	134,955,648
	356,326,994	2,701,931	5,933,596	53,117,143	51,749,420	23,198,849	493,027,933
Commissions expense	148,997,809	—	2,153,872	35,110,431	5,962,305	4,540,830	196,765,247
Contribution margin per game	207,329,185	2,701,931	3,779,724	18,006,712	45,787,115	18,658,019	296,262,686
Game vendor fees	27,132,325	1,805,691	1,223,740	—	5,783,694	3,880,974	39,826,424
Gross margin	\$ 180,196,860	896,240	2,555,984	18,006,712	40,003,421	14,777,045	256,436,262

(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 2018 and fiscal year 2017, the Lottery incurred \$5,506,623 and \$5,758,648 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.

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(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 State of Delaware is responsible for setting benefits and amending plan provisions. The Plan prepares separate financial statements and is administered by the Delaware Public Employees' Retirement System (DPERS). 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, 2017 and 2016, the rate of the employer contribution was 9.56 percent of covered payroll. The Lottery's employer contributions for the years ended June 30, 2017 and 2016 was \$236,800 and \$242,448, respectively. The Lottery's required contributions equaled actual contributions made for the years ended June 30, 2017 and 2016.

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Net Pension Liability and Expense

At June 30, 2018 and 2017, the Lottery reported a net pension liability of \$1,860,152 and \$1,999,680, respectively, for its proportionate share of the net pension liability of the State of Delaware. The net pension liability was measured as of June 30, 2017, 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, 2016 to June 30, 2017. At June 30, 2017, the Lottery's proportion was 0.1269 percent, which was a decrease of 0.0058 percent from its proportion measured as of June 30, 2016. For the years ended June 30, 2018 and 2017, the Lottery recognized a pension expense of \$359,712 and \$291,012.

Deferred Outflows and Inflows of Resources

At June 30, 2018 and 2017, the Lottery reported deferred outflows of resources of \$253,999 and \$236,800, respectively, 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, 2018 and 2017, the Lottery reported deferred outflows of resources related to pensions from the following sources:

	<u>2018</u>	<u>2017</u>
Net difference between projected and actual investment earnings	\$ 217,458	\$ 623,256
Difference between actual and expected experience	21,474	-
Changes in assumptions	365,495	185,175
Contributions subsequent to the date of measurement	253,999	236,800
	<u>\$ 858,426</u>	<u>\$ 1,045,231</u>

At June 30, 2018 and 2017, the Lottery reported deferred inflows of resources related to pensions from the following sources:

	<u>2018</u>	<u>2017</u>
Difference between actual and expected experience	\$ 32,796	\$ 43,863
Changes in proportions	91,693	60,639
	<u>\$ 124,489</u>	<u>\$ 104,502</u>

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

Year Ending June 30	
2019	\$ 43,613
2020	249,416
2021	166,590
2022	(18,724)
2023	39,043
	<u>\$ 479,938</u>

Actuarial Assumptions

The total pension liability as of June 30, 2017 and June 30, 2016 measurement dates was determined by an actuarial valuation as of June 30, 2016 and June 30, 2015, with update procedures used to roll forward the total pension liability to June 30, 2017 and June 30, 2016, respectively. These actuarial valuations used the following actuarial assumptions for both years:

Investment Return -7.0%, includes inflation at 2.5%
Salary Increases – 2.5% + Merit, includes inflation at 2.5%

Mortality rates were based on the Sex distinct RP-2014 tables with gender adjustments for healthy annuitants and disabled retirees and an adjusted version on MP-2015 mortality improvement scale on a fully generational basis.

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 recommendation of the actuary and adopted by the State Board of Pension Trustees based on the most recent review of the Plan’s experience completed in 2016. Key assumption changes included a reduction in the inflation assumption for 3.0% to 2.5% and a change to use updated mortality tables. 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 are summarized in the following table:

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<u>Asset class</u>	Long-term expected real rate of return	Asset allocation
Domestic equity	5.7%	33.5%
International equity	5.7%	13.7%
Fixed income	2.0%	26.6%
Alternative investments	7.8%	22.7%
Cash and equivalents	-	3.5%

Discount Rate

The discount rate used to measure the total pension liability as of June 30, 2017 was 7.0%. The change in the discount rate assumption from 7.2% as of June 30, 2016 was due to an adoption by the Board of Trustees in fiscal year 2017. 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, 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 as of June 30, 2017, calculated using the discount rate of 7.0%, as well as what the net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate:

	1% decrease <u>6.0%</u>	Current discount rate <u>7.0%</u>	1% increase <u>8.0%</u>
Lottery's proportionate share of the net pension liability	<u>\$ 3,349,116</u>	<u>\$1,860,152</u>	<u>\$ 598,279</u>

The following presents the net pension liability as of June 30, 2016, calculated using the discount rate of 7.2%, as well as what the net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate:

	1% decrease <u>6.2%</u>	Current discount rate <u>7.2%</u>	1% increase <u>8.2%</u>
Lottery's proportionate share of the net pension liability	<u>\$ 3,475,692</u>	<u>\$1,999,680</u>	<u>\$ 758,749</u>

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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 in fiscal year 2015, 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 (OPEB)

The Lottery contributes to the State Employees' Other Postemployment Benefits Fund Trust (OPEB Trust) established by the State to provide benefits for state employees. The OPEB Trust is a cost-sharing multiple employer defined benefit plan established in the Delaware Code. Policy for and management of the OPEB Trust benefits provided to retirees are the responsibility of the State. Beginning in FY 18, the OPEB Trust prepares separate financial statements and is administered by the Delaware Public Employees' Retirement System (DPERS). All details of the OPEB Trust 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 OPEB Trust provides medical coverage to eligible pensioners and their eligible dependents through the same healthcare plans that are available to active employees. The participant's cost and vesting provisions of OPEB benefits is variable based on years of service. Pensioners who retire after July 1, 2012 and who become eligible for Medicare will pay an additional five percent of the Medicare Supplement offered by the State. Surviving spouses are eligible for coverage after a retiree's death.

Contributions

Participating employers fund the OPEB Trust for current retirees on a pay-as-you-go basis along with funding for future benefits at a rate that is approved in the annual budget, but not actuarially determined. By State Statute Chapter 52, Title 29 of the Delaware Code, contribution requirements of plan members and the government are established and may not be amended by the State Legislature.

For the year ended June 30, 2018, the rate of the employer contribution was 11.7 percent of covered payroll. The Lottery's employer contributions for the years ended June 30, 2018 and 2017 was \$268,793 and \$294,117, respectively. The Lottery's required contributions equaled actual contributions made for the years ended June 30, 2018 and 2017.

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Net OPEB Liability and Expense

At June 30, 2018 and 2017, the Lottery reported a net Other Postemployment Benefits (OPEB) liability of \$10,235,689 and \$11,681,265, respectively, for its proportionate share of the net OPEB liability of the State of Delaware. The net OPEB liability was measured as of June 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by rolling forward the Plan's total OPEB liability as of June 30, 2016 to June 30, 2017. At June 30, 2017, the Lottery's proportion is based on the percentage of actual employer contributions during the period ending June 30, 2017 and 2016, respectively. The Lottery's proportion was 0.1240 percent, which was a decrease of 0.0046 percent from its proportion measured as of June 30, 2016. For the year ended June 30, 2018, the Lottery recognized an OPEB expense of \$412,436.

Deferred Outflows and Inflows of Resources

At June 30, 2018 and 2017, the Lottery reported deferred outflows of resources of \$268,793 and \$294,117, respectively, for its contributions subsequent to the measurement date, which will be recognized as a reduction of the net OPEB liability in the following year.

At June 30, 2018 and 2017, the Lottery reported deferred outflows of resources related to OPEB from the following sources:

	<u>2018</u>	<u>2017</u>
Contributions subsequent to the date of measurement	<u>\$ 268,793</u>	<u>\$ 294,117</u>

At June 30, 2018 and 2017, the Lottery reported deferred inflows of resources related to OPEB from the following sources:

	<u>2018</u>	<u>2017</u>
Net difference between projected and actual investment earnings	\$ 20,267	\$ -
Changes in assumptions	1,194,939	
Changes in proportions	<u>348,689</u>	<u>-</u>
	<u>\$ 1,563,895</u>	<u>\$ -</u>

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

Year Ending June 30	
2019	\$ (313,792)
2020	(313,792)
2021	(313,792)
2022	(313,792)
2023	<u>(308,727)</u>
	<u>\$ (1,563,895)</u>

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Actuarial Assumptions

The total OPEB liability for the June 30, 2017 measurement date was determined by an actuarial valuation as of June 30, 2016, with update procedures used to roll forward the total OPEB liability to June 30, 2017. The total OPEB liability for the June 30, 2016 measurement date was determined by an actuarial valuation as of June 30, 2015, with update procedures used to roll forward the total OPEB liability to June 30, 2016. These actuarial valuations used the following actuarial assumptions.

<u>Actuarial assumptions:</u>	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Discount Rate	3.58%	2.85%
Projected Salary increases	3.25% + Merit	3.25% + Merit
Healthcare cost trends rates	7.00%	Not Available*

**Rate not available for the years prior to the GASB No. 75 measurement date. The rate was 7.0%, decreasing 0.2% per year to an ultimate rate of 4.0% for 2032 and later years.*

Mortality rates were based on the sex-distinct RP-2014 Total Dataset Healthy Annuitant Mortality Table, including adjustment for healthy annuitant and disabled annuitant factors for each covered pension plan. Future mortality improvements are projected to 2020.

The total OPEB liabilities are measured based on assumptions pertaining to the interest rates, inflation rates, health costs, and employee demographics behavior in future years. The assumptions used were based on the results of an actuarial experience study conducted in 2016. It is likely that future experiences will not exactly conform to these assumptions. To that extent liabilities may be higher or lower than anticipated. The more the 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 arithmetic real rates of return for each major asset class included in the expected asset allocation are summarized in the following table:

<u>Asset class</u>	<u>Long-term expected real rate of return</u>	<u>Asset allocation</u>
Domestic equity	3.75%	36.7%
International equity	3.75%	19.2%
Fixed income	3.75%	38.1%
Cash and equivalents	0.00%	6.0%

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June 30, 2018 and 2017

Discount Rate

The discount rate used to measure the total OPEB liability was 2.85% at the beginning of the current measurement period and 3.58% at the end of the current measurement period, based on the Bond Buyer GO 20-Bond Municipal Bond Index, an index satisfying the GASB requirements of an index rate for 20-year, tax exempt general obligation municipal bonds with an average rating of AA/Aa or higher. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and the employer contributions to the OPEB will continue to follow the pay-as-you-go contribution policy. Based on the assumptions of a pay-as-you-go plan, the discount rates used for June 30, 2017, and 2016 measurement dates are equal to the applicable rate of the 20-year, tax exempt general obligation municipal bonds with an average rating of AA/Aa or higher, and satisfying GASB requirements.

Sensitivity of the Net OPEB Liability to Changes in the Discount Rate:

	1 % Decrease <u>2.58%</u>	Discount Rate <u>3.58%</u>	1% Increase <u>4.58%</u>
Lottery's proportionate share of the OPEB liability	\$12,272,624	\$10,235,689	\$8,647,782

Sensitivity of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rates:

	1 % Decrease <u>6.0%</u>	Discount Rate <u>7.0%</u>	1% Increase <u>8.0%</u>
Lottery's proportionate share of the OPEB liability	\$8,666,222	\$10,235,689	\$12,157,385

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.

Restatement and Net Position – OPEB

With the implementation of GASB Statement No 75 in fiscal year 2018, the Lottery restated the June 30, 2017 balances for deferred outflows and the net pension liability to retroactively reflect the implementation at the earliest date presented in the financial statements. Accordingly, the June 30, 2017 balances have been restated for deferred outflow and the net OPEB liability by \$294,117, and \$11,681,265 respectively. 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.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2018 and 2017

(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 5.371% of draw game sales, 4.18% of PHD sales, 9.95% of Keno sales, 5.6% of instant sales, 1% of video net gaming revenue, and 25% of net win for charitable gaming video machines to its central system provider through October 2022. 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 12.5% 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 Schedule of Contributions

Proportionate Share of Net Pension Liability

Measurement date	6/30/2017	6/30/2016	6/30/2015	6/30/2014	6/30/2013
Lottery's proportion of the net pension liability	0.1269%	0.1327%	0.1327%	0.1370%	0.1407%
Lottery's proportion of the net pension liability - dollar value	\$ 1,860,152	\$ 1,999,680	\$ 1,999,680	\$ 911,588	\$ 518,009
Lottery's covered employee payroll	\$ 2,472,103	\$ 2,530,772	\$ 2,530,772	\$ 2,555,038	\$ 2,589,613
Lottery's proportionate share of the net pension liability as a percentage of its covered employee payroll	75.2%	79.0%	79.0%	35.7%	20.0%
Plan fiduciary net position as a percentage of the total pension liability	85.4%	84.1%	84.1%	92.7%	95.8%

Contributions

Contractually required contributions	\$ 236,800	\$ 242,448	\$ 242,448	\$ 244,307	\$ 245,999
Contributions in relation to the contractually required contributions	\$ 236,800	\$ 242,448	\$ 242,448	\$ 244,307	\$ 245,999
Contribution excess (deficit)	\$ -	\$ -	\$ -	\$ -	\$ -
Lottery's covered employee payroll	\$ 2,472,103	\$ 2,530,772	\$ 2,530,772	\$ 2,555,038	\$ 2,589,613
Contribution as a percentage of covered employee payroll	9.56%	9.56%	9.56%	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.

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

Proportionate Share of Net Pension Liability

Measurement date	<u>6/30/2017</u>	<u>6/30/2016</u>
Lottery's proportion of the net OPEB liability	0.1240%	0.1286%
Lottery's proportion of the net OPEB liability - dollar value	\$ 10,235,689	\$ 11,681,265
Lottery's covered employee payroll	\$ 2,472,103	\$ 2,530,772
Lottery's proportionate share of the net OPEB liability as a percentage of its covered employee payroll	414.0%	461.6%
Plan fiduciary net position as a percentage of the total OPEB liability	4.13%	3.30%

Contributions

Contractually required contributions	\$ 294,117	\$ 279,887
Contributions in relation to the contractually required contributions	\$ 294,117	\$ 279,887
Contribution excess (deficit)	<u>\$ -</u>	<u>\$ -</u>
Lottery's covered employee payroll	\$ 2,472,103	\$ 2,530,772
Contribution as a percentage of covered employee payroll	11.90%	11.06%

In accordance with GASB Statement No. 75, 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.

Notes to Schedule:

Benefit Changes. There were no changes in benefits during the year.

Changes in Assumptions The discount rate uses to measure the OPEB liability as of June 30, 2016 was 2.85%. The discount rate used to measure the OPEB liability as of June 30, 2017 was 3.58%. In developing the projection of cash flows to determine the discount rate, it was assumed the employer contributions will continue to follow the pay-as-you-go contribution policy.

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
Richard Geisenberger, 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, 2018, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated November 30, 2018.

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 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 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.

Gunnip & Company LLP

November 30, 2018