

DELAWARE STATE LOTTERY

Basic Financial Statements

June 30, 2019 and 2018

(With Independent Auditors' Reports Thereon)

DELAWARE STATE LOTTERY

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INDEPENDENT AUDITORS' REPORT

Vernon Kirk, Director of Delaware State Lottery, and
Richard Geisenberger, Secretary of Finance, State of Delaware
Dover, Delaware

Report on the Financial Statements

We have audited the accompanying financial statements of the Delaware State Lottery (the Lottery), an enterprise fund of the State of Delaware, as of and for the year ended June 30, 2019, 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.

Auditors' Responsibility

Our responsibility is to express opinions 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery, an enterprise fund of the State of Delaware as of June 30, 2019, and the changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Vernon Kirk, Director of Delaware State Lottery, and
Richard Geisenberger, Secretary of Finance, State of Delaware

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Lottery and do not purport to, and do not present fairly the financial position of the State of Delaware as of June 30, 2019 and 2018, the changes in financial position, or, where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 8, and the required supplementary information on pages 28 and 29 as listed in the table of contents, 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 1, 2019, 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Lottery's 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.

Prior Year Financial Statements

The 2018 financial statements of the Delaware State Lottery were audited by other auditors whose report dated November 30, 2018 expressed an unmodified opinion on those statements.



CliftonLarsonAllen LLP

Baltimore, Maryland
November 1, 2019

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2019 and 2018

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, 2019 and 2018, 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, 2019 and 2018

Condensed Net Position

Table 1
(In millions)

Assets	June 30		
	2019	2018	2017
Cash and investments	\$ 4.7	5.9	3.8
Accounts receivable	12.4	10.8	7.9
Due from State of Delaware	12.6	12.7	12.4
Deposit with Multi-State Lottery	2.8	2.5	2.3
Total assets	32.5	31.9	26.4
Deferred outflows	1.0	1.1	1.3
Liabilities and Net Position			
Liabilities:			
Prizes liability	8.5	6.7	5.1
Accounts payable and accrued liabilities	6.9	6.6	4.7
Due to the State of Delaware	0.7	2.4	0.9
Pension and OPEB liability	11.4	12.1	13.6
Multi-State Lottery reserve	2.8	2.5	2.3
Total liabilities	30.3	30.3	26.6
Deferred inflows	2.2	1.7	0.1
Net position:			
Unrestricted	\$ 1.0	1.0	1.0

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 five days in 2017, six days in 2018 and seven days in 2019.

Table 1 above shows that the one extra day of sales in fiscal year 2019 over 2018 and one day from 2018 over 2017 allows for an increase in accounts receivable.

Prizes liability as shown in Table 1 has increased in fiscal year 2019 over fiscal year 2018 by \$1.8 million mainly due to the addition of sports wagering all year on all sports compared to just football in 2018. The liability had increased in fiscal year 2018 over fiscal year 2017 by \$1.6 million.

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 2019 and 2018 from fiscal year 2017 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
June 30, 2019 and 2018

Revenue

Table 2
Revenue
(In millions)

	Year ended June 30		
	2019	2018	2017
Play 3	\$ 27.5	27.0	27.5
Play 4	23.7	22.8	22.7
Multi Win Lotto	4.5	4.6	4.3
Powerball	25.2	24.6	22.8
Hot Lotto	-	1.3	2.7
Mega Millions	20.7	12.1	8.9
Lotto America	3.4	2.1	-
Keno	8.6	8.7	8.2
Lucky for Life	2.9	3.0	3.4
Instant games	79.8	70.6	69.3
Traditional games revenue	196.3	176.8	169.8
Video lottery, net	367.4	353.8	352.8
I-Gaming	3.2	2.2	2.7
Video lottery expired jackpots and credit slips	0.4	0.4	0.3
Casino license fees	0.2	3.2	3.2
Sports lottery	158.6	54.7	46.1
Table games, net	56.6	54.6	53.1
Total revenue	\$ 782.7	645.7	628.0

Table 2 above compares revenue for each lottery game category. Fiscal year 2019 saw a record year in instant sales, a record jackpot for Mega Millions and the addition of sports wagering to include all sports all year-round increased sales \$137 million or 21.2% over fiscal year 2018. There is an increase in revenue in fiscal year 2018 of \$17.7 million or 2.8% over fiscal year 2017. The increase is primarily due to the increase in popularity of sports lottery.

Powerball, Mega Millions and Lotto America sales are typically driven by the size of the jackpot. Mega Millions had a record billion-dollar jackpot in fiscal year 2019 providing the increase in sales of \$8.6 million or 71% over fiscal year 2018. 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.

Sports Lottery expanded at the end of fiscal year 2018 to allow betting on all sports along with single game bets. This expansion for the last three weeks of the fiscal year led to a significant jump in sales for sports lottery over fiscal year 2017 with an increase of \$8.6 million or 18.7%. With the expansion of Sports Lottery to include all sports for the entire fiscal year, sales increased dramatically \$103.9 million for fiscal year 2019 over fiscal year 2018.

Video lottery and table games revenue increased 3.8% and 3.6% respectively from fiscal year 2019 over fiscal year 2018 following industry wide trends. Other contributing factors include the increase of capital and marketing expenditures required by new legislative changes for fiscal year 2019. Video lottery only had a slight increase of \$1 million for fiscal year 2018 over fiscal year 2017. Table games revenue increased \$1.5 million or 2.8% in fiscal year 2018 over fiscal year 2017. These increases shared the same trends as all lottery product increases for the current fiscal year.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2019 and 2018

Cost of Games

Table 3

Cost of Games

(In millions and as a percentage of all revenue)

	Year ended June 30					
	2019		2018		2017	
Commission expense	\$ 220.5	28.2%	\$ 199.9	31.0%	\$ 196.7	31.3%
Gaming vendor fees and costs	47.4	6.1%	43.0	6.7%	39.8	6.3%
Prize expense	244.4	31.2%	136.5	21.1%	135.0	21.5%
Total cost of games	\$ 512.3		\$ 379.4		\$ 371.5	

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 2019 increased over fiscal year 2018 by \$20.6 million or 10.3%. Fiscal year 2018 increased slightly from fiscal year 2017 by \$3.2 million or 1.6%. Both increases have grown the same percentage as the sales.

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 2019 increased over fiscal year 2018 by \$4.4 million or 10.2%. The increase in sales was a contributing factor to the increase in vendor fees. 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.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2019 and 2018

Prize Expense, Net of Reversions

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

	Year ended June 30		
	2019	2018	2017
Play 3	\$ 13.3	13.1	12.8
Play 4	11.7	11.0	10.3
Multi Win Lotto	2.6	2.8	2.6
Powerball	12.2	12.0	10.7
Hot Lotto	—	0.5	1.3
Mega Millions	10.5	6.1	4.6
Keno	5.0	5.2	4.8
Lucky for Life	1.7	1.8	1.6
Lotto America	1.7	1.1	—
Sports lottery	132.5	36.2	40.2
Instant games	53.1	46.7	46.1
Total prize expense	\$ 244.3	136.5	135.0

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 2019 increased \$107.8 million or 78.97% over fiscal year 2018. The increase for mega million and instant prize expense is due to the increase in the sales for those games. Most of the increase for FY19 prize expense over FY18 is in sports. Sports prize expense increased \$96.3 million also because of the increase in sports sales. The prize expense for fiscal year 2018 increased slightly over fiscal year 2017 by \$1.5 million or 1.1%. Sport lottery prize costs were unusually low for the 2018 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. Sports lottery accounted for much of the increase in FY18 as well.

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2019 and 2018

Operating Expenses

Table 5
Operating Expenses
(In millions)

	Year ended June 30		
	2019	2018	2017
Operating expenses	\$ 10.7	10.4	10.7

Operating expenses remained relatively unchanged from fiscal year 2017 through fiscal year 2019 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		
	2019	2018	2017
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	40.2	36.9	35.7
Department of Health & Social Services	1.7	1.6	1.6
State of Delaware - General Fund	213.8	213.3	204.4
Total nonoperating expenses	\$ 259.7	255.8	245.7

Table 6 shows the expenses incurred to other state agencies as dictated by Delaware Law. The increase in contributions to nonoperating expenses in fiscal year 2019 over fiscal year 2018 of \$3.9 million or 1.5% is due to the increase in total revenue and the increase in the percentage of revenue to purses for video due to legislative changes. 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.

DELAWARE STATE LOTTERY
Basic Statements of Net Position
June 30, 2019 and 2018

Assets	2019	2018
Current assets:		
Cash and investments	\$ 4,748,553	\$ 5,903,324
Accounts receivable	12,369,828	10,836,366
Due from the State of Delaware	12,607,234	12,657,006
Total current assets	29,725,615	29,396,696
Noncurrent assets:		
Deposit Multi-State Lottery	2,845,122	2,467,039
Total assets	32,570,737	31,863,735
Deferred outflows	967,386	1,127,219
Liabilities and Net Position		
Current liabilities:		
Prizes liability	8,545,304	6,662,632
Accounts payable and accrued liabilities	6,872,002	6,615,524
Due to the State of Delaware	701,075	2,461,534
Total current liabilities	16,118,381	15,739,690
Noncurrent liabilities:		
Multi-State Lottery reserve	2,845,122	2,467,039
Pension and OPEB liability	11,410,101	12,095,841
Total noncurrent liabilities	14,255,223	14,562,880
Total liabilities	30,373,604	30,302,570
Deferred inflows	2,164,519	1,688,384
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, 2019 and 2018

	2019	2018
Revenue:		
Video lottery, net	\$ 367,399,349	\$ 353,776,920
Video lottery expired jackpots and credit slips	381,685	379,558
Casino license fees	211,300	3,221,800
I-Gaming	3,166,045	2,178,023
Sports lottery	158,630,194	54,747,779
Table games, net	56,611,092	54,629,995
Draw games	116,507,746	106,188,593
Instant games	79,809,999	70,599,375
Total revenue	782,717,410	645,722,043
Cost of games:		
Video lottery commissions	156,338,344	149,150,781
Prize costs, net of reversions	244,362,133	136,506,526
Gaming vendor fees and costs	47,448,710	43,009,044
Instant and draw games commissions	12,178,982	10,764,400
Sports lottery commissions	6,699,434	3,913,713
Table games commissions	45,288,873	36,110,427
Total cost of games	512,316,476	379,454,891
Gross margin	270,400,934	266,267,152
Operating expenses:		
Advertising and promotions	3,251,410	3,147,412
Payroll and related benefits	5,754,456	5,506,623
Other general and administrative	1,703,148	1,791,987
Total operating expenses	10,709,014	10,446,022
Operating income	259,691,920	255,821,130
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	255,691,920	251,821,130
Total nonoperating expenses	259,691,920	255,821,130
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, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
Receipts from customers	\$ 781,183,948	\$ 642,806,077
Payments to vendors for goods and services	(52,437,817)	(47,712,684)
Payments to employees for services	(5,750,054)	(5,524,150)
Payments for prizes	(242,479,461)	(134,890,079)
Payments for commissions	(220,219,008)	(198,263,195)
Net cash provided by operating activities	260,297,608	256,415,969
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	(257,452,379)	(250,304,247)
Net cash used in noncapital financing activities	(261,452,379)	(254,304,247)
Net change cash and investments	(1,154,771)	2,111,722
Cash and investments at beginning of year	5,903,324	3,791,602
Cash and investments at end of year	\$ 4,748,553	\$ 5,903,324
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 259,691,920	\$ 255,821,130
Adjustments to reconcile operating income to net cash provided by operating activities:		
Effect of changes in operating assets and liabilities:		
Accounts receivable, net	(1,533,462)	(2,915,966)
Prizes liability	1,882,672	1,616,447
Accounts payable and accrued liabilities	256,478	1,894,358
Net cash provided by operating activities	\$ 260,297,608	\$ 256,415,969

See accompanying notes to basic financial statements.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2019 and 2018

(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) 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.

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.

(e) 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.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2019 and 2018

(f) 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. Accounts receivable are stated at the carrying amount net of allowance for uncollectible accounts. An allowance for uncollectible accounts receivable is established when specific customer collection issues are identified. Uncollectible accounts are written off when management has determined that the balance will not be collected.

	2019	2018
Receivables:		
Accounts	\$ 12,369,828	\$ 11,669,384
Total receivables	12,369,828	11,669,384
Allowance for doubtful accounts	—	(833,018)
Total receivables, net	\$ 12,369,828	\$ 10,836,366
Amounts not scheduled for collection during the subsequent year	\$ —	\$ —

(g) 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.

(h) 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 years ending June 30, 2019, and June 30, 2018, the Lottery had no new purchases of capital assets and had properly disposed of all old capital assets.

(i) 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

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2019 and 2018

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.

(j) 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.

(k) 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, 2019. 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, 2019, and 2018, the Lottery had liabilities of \$234,915 and \$229,406 for accrued vacation and \$231,990 and \$221,760 for accrued sick leave, respectively.

(l) 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.

(m) Net Pension Liability

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Delaware Public Employees Retirement System (DPERS) and additions to/deductions from DPERS' fiduciary net position have been determined on the same basis as they are reported by DPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2019 and 2018

(n) Net Pension OPEB Liability

For purposes of measuring the net Other Postemployment Benefits (OPEB) liability, deferred outflows of resources and deferred inflows of resources related to OPEB and OPEB expenses, information about the fiduciary net position of OPEB Trust and additions to/deductions from OPEB Trust's fiduciary net position have been determined on the same basis as they are reported by the OPEB Trust. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported a fair value.

(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 consist of cash equivalents, commercial paper, certificates of deposit, short-term (12 to 18 months) and long-term investments, which comprise corporate, municipal and U.S. government obligations, held and managed by the State Treasurer.

Cash and investment balances consisted of the following:

	June 30	
	2019	2018
On hand and in bank	\$ 2,771,742	\$ 3,461,584
Pooled cash and investments	<u>1,976,811</u>	<u>2,441,740</u>
Total cash and investment balances	<u>\$ 4,748,553</u>	<u>\$ 5,903,324</u>

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

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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, 2019, and June 30, 2018, the total bank balance of cash in all bank accounts was \$2,881,693 and \$3,598,928 respectively.

Pooled cash and investments maintained by the State Treasurer is not deemed to have custodial credit risk with regard to the Lottery.

(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 years ending June 30, 2019, and 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, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Prize obligations, beginning of year	\$ 6,662,632	\$ 5,065,864
Prize payments	(242,479,461)	(134,909,758)
Prize costs, net of reversions	<u>244,362,133</u>	<u>136,506,526</u>
Prize obligations, end of year	<u>\$ 8,545,304</u>	<u>\$ 6,662,632</u>

(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

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MUSL member pays lesser prizes directly to the winners. The MUSL has operated the Powerball game since fiscal year 2008, Mega Millions game since 2010, and Lotto America since 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, 2019 and 2018, equaled \$2,845,122 and \$2,467,039 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 Standardbred Breeder's Program for the purpose of promoting the Delaware harness racing industry. This legislation, amended in 2004, and 2008 requires the Lottery to withhold \$3,000,000 of funds annually (\$750,000 from the State General Fund, \$1,500,000 from Purses, and \$750,000 from Video commissions) and remit to the Delaware Standardbred 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. This legislation, amended in 2008, requires the Lottery to withhold \$1,000,000 of funds annually (\$250,000 from the State General Fund, \$500,000 from Purses, and \$250,000 from Video Commissions) and remit these funds to the Delaware Certified Thoroughbred Program.

(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, 2019 and 2018, the Lottery made the following contributions to the State.

	June 30	
	2019	2018
Amounts transferred and to be transferred to the State for the fiscal year:		
General Fund	\$ 213,826,875	\$ 213,325,651
Department of Health and Social Services	1,728,607	1,584,083
Department of Agriculture	40,136,438	36,911,396
	<u>\$ 255,691,920</u>	<u>\$ 251,821,130</u>

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(9) Revenue and Expenses by Game

The following revenue was recognized:

	<u>Year ended June 30</u>	
	<u>2019</u>	<u>2018</u>
Draw games:		
Play 3 Day	\$ 10,739,010	\$ 10,491,733
Play 3 Night	16,721,484	16,530,817
Play 4 Day	8,985,908	8,564,019
Play 4 Night	14,737,567	14,217,965
Multi Win Lotto	4,514,384	4,559,172
Powerball	25,229,105	24,577,701
Hot Lotto	-	1,300,792
Lotto America	3,367,629	2,129,759
Mega Millions	20,707,521	12,072,786
Keno	8,594,476	8,721,480
Lucky for Life	2,910,662	3,022,369
Total draw games	<u>116,507,746</u>	<u>106,188,593</u>
Instant games	<u>79,809,999</u>	<u>70,599,375</u>
Total traditional lottery	196,317,745	176,787,968
Video lottery, net	367,399,349	353,776,920
I-Gaming video lottery, net	3,166,045	2,178,023
Video lottery expired jackpots and credit slips	381,685	379,558
Casino license fees	211,300	3,221,800
Sports lottery	158,630,194	54,747,779
Table games, net	56,611,092	54,629,995
Total revenue	<u>\$ 782,717,410</u>	<u>\$ 645,722,043</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, 2019:							
Revenue	\$ 367,399,348	3,166,045	158,630,194	56,611,092	116,507,746	79,808,944	782,123,370
Other income	381,685			211,300		1,055	594,040
Prize costs, net of reversions			132,473,496		58,773,996	53,114,641	244,362,133
	367,781,033	3,166,045	26,156,699	56,822,392	57,733,750	26,695,358	538,355,277
Commissions expense	156,338,344	—	6,699,434	45,288,873	7,296,461	4,882,522	220,505,634
Contribution margin per game	\$ 211,442,689	3,166,045	19,457,265	11,533,519	50,437,289	21,812,836	317,849,643
Game vendor fees	29,205,706	2,101,162	4,639,631	—	6,578,755	4,923,456	47,448,710
Gross margin	182,236,983	1,064,883	14,817,634	11,533,519	43,858,534	16,889,380	270,400,933
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

(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 2019 and fiscal year 2018, the Lottery incurred \$5,754,456 and \$5,506,623 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, 2019 and 2018, the rate of the employer contribution was 11.8% and 10.4% percent of covered payroll respectively. The Lottery's employer contributions for the years ended June 30, 2019 and 2018 was \$304,759 and \$253,999 respectively.

Net Pension Liability and Expense

At June 30, 2019 and 2018, the Lottery reported a net pension liability of \$1,585,580 and \$1,860,152, respectively, for its proportionate share of the net pension liability of the State of Delaware. The net pension liability at June 30, 2019, was measured as of June 30, 2018, 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, 2017 to June 30, 2018. As of the measurement date, June 30, 2018, the lottery's proportion was 0.1228 percent, a

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decrease of 0.0041 percent from June 30, 2017. As of the measurement date 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, 2019 and 2018, the Lottery recognized a pension expense of \$306,987 and \$359,712.

Deferred Outflows and Inflows of Resources

At June 30, 2019 and 2018, the Lottery reported deferred outflows of resources of \$304,759 and \$253,999, respectively, for its contributions after the measurement date, which will be recognized as a reduction of the net pension liability in the following year.

At June 30, 2019 and 2018, the Lottery reported deferred outflows of resources related to pensions from the following sources:

	<u>2019</u>	<u>2018</u>
Net difference between projected and actual investment earnings	\$ -	\$ 217,458
Difference between actual and expected experience	82,865	21,474
Changes in assumptions	276,068	365,495
Contributions subsequent to the date of measurement	304,759	253,999
	<u>\$ 663,692</u>	<u>\$ 858,426</u>

At June 30, 2019 and 2018, the Lottery reported deferred inflows of resources related to pensions from the following sources:

	<u>2019</u>	<u>2018</u>
Net difference between projected and actual investment earnings	\$ 67,212	\$ -
Difference between actual and expected experience	22,884	32,796
Changes in proportions	103,445	91,693
	<u>\$ 193,541</u>	<u>\$ 124,489</u>

Amounts reported as deferred inflows of resources at June 30, 2019, related to pensions will be recognized as part of pension expense in future periods as follows:

Year Ending June 30	
2020	\$ (183,912)
2021	(101,089)
2022	84,226
2023	26,458
2024	8,925
	<u>\$ (165,392)</u>

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Actuarial Assumptions

The collective total pension liability for the June 30, 2018 measurement date was determined by an actuarial valuation as of June 30, 2017, with update procedures used to roll forward the total pension liability to June 30, 2018. This actuarial valuation used the following actuarial assumptions:

Investment Return includes inflation at 2.5%

Salary Increases – 2.5% + Merit, includes inflation at 2.5%

The total pension liabilities are measured based on assumptions pertaining to the interest rates inflation rates, and employee demographic behavior in future years. 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 experience deviates the larger the impact on future financial statements.

Mortality assumptions are 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.

Projected benefit payments do not include the effects of projected ad hoc cost-of-living adjustments (ad hoc COLAs) as they are not substantively automatic. The primary considerations relevant to making this determination include the historical pattern of granting the changes and the consistency in the amounts of the changes.

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 weighting 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:

<u>Asset class</u>	Long-term expected real rate of return	Asset allocation
Domestic equity	5.7%	30.7%
International equity	5.7%	13.9%
Fixed income	2.0%	23.3%
Alternative investments	7.8%	24.4%
Cash and equivalents	-	7.7%

Discount Rate

The discount rate used to measure the total pension liability was 7.0%. 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

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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 7.0%, as well as what the collective 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>
2019 Lottery's proportionate share of the net pension liability	<u>\$ 3,076,897</u>	<u>\$1,585,580</u>	<u>\$ 333,305</u>
2018 Lottery's proportionate share of the net pension liability	<u>\$ 3,349,116</u>	<u>\$1,860,152</u>	<u>\$ 598,279</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 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 2018, 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.

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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, 2019, the rate of the employer contribution was 12.1 percent of covered payroll. The Lottery's employer contribution for the years ended June 30, 2019 and 2018 was \$303,694 and \$268,793, respectively. The Lottery's required contributions equaled actual contributions made for the years ended June 30, 2019 and 2018.

Net OPEB Liability and Expense

At June 30, 2019 and 2018, the Lottery reported a net Other Postemployment Benefits (OPEB) liability of \$9,824,521 and \$10,235,689, 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, 2018, 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, 2017 to June 30, 2018. 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.

As of the measurement date, June 30, 2018, the Lottery's proportion is based on the percentage of actual employer contributions during the period ending June 30, 2018. The Lottery's 2018 and 2017 proportion was 0.1197 percent and 0.1240 percent, respectively. The 2018 portion showed a decrease of 0.0004 percent from its proportion measured as of June 20, 2017. The 2017 portion showed a decrease of 0.0046 percent from its proportion measured as of June 30, 2016. For the year ended June 30, 2019 and 2018, the Lottery recognized an OPEB expense of \$264,708 and \$412,436, respectively.

Deferred Outflows and Inflows of Resources

At June 30, 2019 and 2018, the Lottery reported deferred outflows of resources related to OPEB from the following sources:

	<u>2019</u>	<u>2018</u>
Contributions subsequent to the date of measurement	<u>\$ 303,694</u>	<u>\$ 268,793</u>

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At June 30, 2019 and 2018, the Lottery reported deferred inflows of resources related to OPEB from the following sources:

	<u>2019</u>	<u>2018</u>
Net difference between projected and actual investment earnings	\$ 24,685	\$ 20,267
Changes in assumptions	1,334,798	1,194,939
Changes in proportions	<u>611,495</u>	<u>348,689</u>
	<u>\$ 1,970,978</u>	<u>\$ 1,563,895</u>

The cumulative amounts of collective net deferred outflows of resources and deferred inflows of resources will be recognized in OPEB expense as follows:

Year Ending June 30	
2020	\$ (458,442)
2021	(458,442)
2022	(458,442)
2023	(453,375)
2024	<u>(142,277)</u>
	<u>\$ (1,970,978)</u>

Actuarial Assumptions

The total OPEB liability for the June 30, 2018 measurement date was determined by an actuarial valuation as of June 30, 2017, with update procedures used to roll forward the total OPEB liability to June 30, 2018. These actuarial valuations used the following actuarial assumptions.

<u>Actuarial assumptions:</u>	<u>June 30, 2018</u>	<u>June 30, 2017</u>
Discount Rate	3.87%	3.58%
Projected Salary increases	3.25% + Merit	3.25% + Merit
Healthcare cost trends rates	6.80%	7.00%

Mortality rates were based on the sex-distinct employee, healthy annuitant, and disabled annuitant mortality tables derived from the RP-2014 Total Dataset Employee Mortality Table, including adjustment factors. Future mortality improvements are reflected by applying a custom projection scale on a generational basis to adjusted base tables from the base year.

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.

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The long-term expected rate of return on the Trust's investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of 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 weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class as of June 30, 2018 are summarized in the following table:

<u>Asset class</u>	<u>Asset Allocation Range</u>		<u>Long-term expected real rate of return</u>	<u>Asset allocation</u>
	<u>Min</u>	<u>Max</u>		
Equity	20%	80%		
Domestic equity			5.7%	38.7%
International equity			5.7%	19.0%
Fixed income	20%	80%		
Domestic Fixed Income			2.0%	39.3%
Cash and Cash Equivalents			0.0%	

Discount Rate

The discount rate used to measure the total OPEB liability was 3.58% at the beginning of the current measurement period and 3.87% at the end of the current measurement period, based on the Bond Buyer GO 20-Bond Municipal Bond Index. 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, 2018 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.

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

	1 % Decrease <u>2.87%</u>	Discount Rate <u>3.87%</u>	1% Increase <u>4.87%</u>
2019 Lottery's proportionate share of Collective Net OPEB liability	<u>\$11,690,918</u>	<u>\$9,824,521</u>	<u>\$8,356,972</u>
	1 % Decrease <u>2.58%</u>	Discount Rate <u>3.58%</u>	1% Increase <u>4.58%</u>
2018 Lottery's proportionate share of Collective Net OPEB liability	<u>\$12,272,674</u>	<u>\$10,235,689</u>	<u>\$8,647,782</u>

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

	1 % Decrease <u>5.8%</u>	Health Care Trend <u>6.8%</u>	1% Increase <u>7.8%</u>
2019 Lottery's proportionate share of Collective Net OPEB liability	<u>\$8,364,989</u>	<u>\$9,824,521</u>	<u>\$11,601,859</u>
	1 % Decrease <u>6.0%</u>	Health Care Trend <u>7.0%</u>	1% Increase <u>8.0%</u>
2018 Lottery's proportionate share of Collective Net OPEB liability	<u>\$8,666,222</u>	<u>\$10,235,689</u>	<u>\$12,157,385</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.

(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, 12.5% of track sports net revenue and 25% of retailer sports net revenue, 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 6.5% to 7.0% to video lottery vendors through October 28, 2020. 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.

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

Proportionate Share of Net Pension Liability

Measurement date	<u>6/30/2018</u>	<u>6/30/2017</u>	<u>6/30/2016</u>	<u>6/30/2015</u>	<u>6/30/2014</u>
Lottery's proportion of the net pension liability	0.1228%	0.1269%	0.1327%	0.1370%	0.1407%
Lottery's proportion of the net pension liability - dollar value	\$ 1,585,580	\$ 1,860,152	\$ 1,999,680	\$ 911,588	\$ 518,009
Lottery's covered payroll	\$ 2,438,127	\$ 2,472,103	\$ 2,530,813	\$ 2,555,038	\$ 2,589,613
Lottery's proportionate share of the net pension liability as a percentage of its covered payroll	65.0%	75.2%	79.0%	35.7%	20.0%
Plan fiduciary net position as a percentage of the total pension liability	87.5%	85.4%	84.1%	92.7%	95.8%
<u>Contributions</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contributions	\$ 304,759	\$ 253,999	\$ 236,800	\$ 242,448	\$ 244,307
Contributions in relation to the contractually required contributions	304,759	253,999	236,800	242,448	244,307
Contribution excess (deficit)	<u>\$ -</u>				
Lottery's covered payroll	\$ 2,577,989	\$ 2,438,127	\$ 2,472,103	\$ 2,530,813	\$ 2,555,038
Contribution as a percentage of covered payroll	11.83%	10.42%	9.58%	9.58%	9.56%

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 OPEB Liability

	<u>6/30/2018</u>	<u>6/30/2017</u>	<u>6/30/2016</u>
Measurement date			
Lottery's proportion of the net OPEB liability	0.1197%	0.1240%	0.1286%
Lottery's proportion of the net OPEB liability - dollar value	\$ 9,824,521	\$ 10,235,689	\$ 11,681,265
Lottery's covered payroll	\$ 2,455,646	\$ 2,472,103	\$ 2,530,772
Lottery's proportionate share of the net OPEB liability as a percentage of its covered payroll	400.1%	414.0%	461.6%
Plan fiduciary net position as a percentage of the total OPEB liability	4.4%	4.1%	3.3%

Contributions

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Contractually required contributions	\$ 303,694	\$ 268,793	\$ 294,117
Contributions in relation to the contractually required contributions	\$ 303,694	\$ 268,793	\$ 294,117
Contribution excess (deficit)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Lottery's covered payroll	\$ 2,577,989	\$ 2,455,646	\$ 2,472,103
Contribution as a percentage of covered payroll	11.78%	10.95%	11.90%

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.



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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Vernon Kirk, Director of Delaware State Lottery, and
Richard Geisenberger, Secretary of Finance,
State of Delaware
Dover, 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), an enterprise fund of the State of Delaware as of and for the year ended June 30, 2019, 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 1, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, 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 opinions 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free from 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

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

A handwritten signature in cursive script that reads "CliftonLarsonAllen LLP".

CliftonLarsonAllen LLP

Baltimore, Maryland
November 1, 2019