

DELAWARE STATE LOTTERY

Basic Financial Statements

June 30, 2017 and 2016

(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
Tom Cook, Secretary of Finance,
State of Delaware

Report on the Financial Statements

We have audited the accompanying financial statements of the Delaware State Lottery (the Lottery) of the State of Delaware, as of and for the years ended June 30, 2017 and 2016, 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, 2017 and 2016, and the changes in financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1 to the financial statements, in Fiscal Year 2017, the Lottery adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 82, *Pension Issues – An Amendment to GASB Statements No. 67, No. 68, No. 73*.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 8, schedule of Lottery's proportional share of net pension liability on page 27 and schedule of contributions on page 27 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 3, 2017 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 3, 2017

DELAWARE STATE LOTTERY
Management's Discussion and Analysis
June 30, 2017 and 2016

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, 2017 and 2016, 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.

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Condensed Net Position

Table 1
(In millions)

Assets	June 30		
	2017	2016	2015
Cash and investments	\$ 3.8	5.9	3.1
Accounts receivable, net of allowance of \$0.8, \$0.8, and \$0.8, respectively	7.9	6.2	13.3
Investments	-	0.1	0.1
Due from State of Delaware	5.4	4.7	4.5
Deposit with Multi-State Lottery	2.3	2.3	2.5
Total assets	<u>19.4</u>	<u>19.2</u>	<u>23.5</u>
Deferred outflows	<u>1.0</u>	<u>0.2</u>	<u>0.2</u>
Liabilities and Net Position			
Liabilities:			
Prizes liability, including \$0, \$0.1, and \$0.1, respectively, of prize installment obligation	5.1	4.9	6.8
Accounts payable and accrued liabilities	4.7	4.7	7.1
Due to the State of Delaware	0.9	1.5	1.6
Pension and OPEB liability	6.3	4.7	3.9
Multi-State Lottery reserve	2.3	2.3	2.5
Total liabilities	<u>19.3</u>	<u>18.1</u>	<u>21.9</u>
Deferred inflows	<u>0.1</u>	<u>0.3</u>	<u>0.8</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 nine days in 2015, only four days in 2016, and five days in 2017. Table 1 above shows one extra day of sales in fiscal year 2017, which allows for an increase in accounts receivable collected after year end. Fewer days of money not collected in fiscal year 2016 reflects the decrease in accounts receivable over fiscal year 2015.

With the last full week in June ending on the 25th, it allowed five days before year end to make payments to vendors, therefore decreasing the liability from fiscal year 2015 to fiscal year 2016. One extra day from fiscal year 2016 to fiscal year 2017 showed very little change in accounts payable.

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Management's Discussion and Analysis
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Revenue

Table 2
Revenue
(In millions)

	Year ended June 30		
	2017	2016	2015
Play 3	\$ 27.5	27.7	25.6
Play 4	22.7	22.6	21.1
Multi Win Lotto	4.3	4.6	4.2
Powerball	22.8	30.5	20.9
Hot Lotto	2.7	2.4	3.2
Mega Millions	8.9	9.5	10.8
Delaware Cash 5	-	-	0.5
Keno	8.2	8.0	6.7
Lucky for Life	3.4	4.0	2.3
Instant games	69.3	65.7	54.4
Traditional games revenue	169.8	175.0	149.7
Video lottery, net	352.8	360.8	357.5
I-Gaming	2.7	2.6	1.8
Video lottery expired jackpots and credit slips	0.3	0.3	0.3
Casino license fees	3.2	3.2	3.2
Sports lottery	46.1	39.4	37.9
Table games, net	53.1	54.0	51.5
Total revenue	\$ 628.0	635.3	601.9

Table 2 above compares revenue for each lottery game category. Lottery revenue for fiscal year 2017 showed a decrease over fiscal year 2016 by \$7.3 million or 1.1%. Total lottery revenue for fiscal year 2016 showed an increase over fiscal year 2015 by \$33.4 million or 5.5%.

Powerball and Mega Millions sales are typically driven by the size of the jackpot. The lack of higher jackpots in fiscal year 2017 is the cause for the decrease in sales on these games. Changes to the Powerball game in fiscal year 2016 provided a few larger jackpots, which allowed for a significant increase in Powerball sales.

Instant products continue to reach record sales again this fiscal year. The increase of \$3.6 million or 5.5% in fiscal year 2017 over fiscal year 2016 was mainly contributed by an increase in the production of \$25 and \$20 scratch tickets. The increase in sales for fiscal year 2016 over fiscal year 2015 of \$11.3 million or 20.8% is due to the introduction of the \$25 instant scratch ticket.

Sports lottery had a large increase in revenue for fiscal year 2017 over fiscal year 2016 of \$6.7 million or 17.0%. Sports lottery has become increasingly popular in the last year. More sports retailers were added and twenty retailers were given permission to cash higher non-taxable tickets. Payouts for sports was at an all-time high, with players re-investing their winnings into more sports tickets. Sports lottery showed an increase in revenue in fiscal year 2016 over fiscal year 2015 of \$1.5 million or 4.0%. Continued expansion of these products throughout our retail network during fiscal year 2016 and fiscal year 2015 has led to more awareness to the players of these products and a boost to the sales.

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Table games revenue showed a slight decline in fiscal year 2017 over fiscal year 2016 of \$0.9 million or 1.7%. Additional competition in the surrounding states had a slight increase as well. Table games revenue had an increase of \$2.5 million, or 4.9% in fiscal year 2016 over fiscal year 2015. The tracks added more promotions and poker tournaments throughout the state which offered more play in fiscal year 2016.

Since the Delaware Legislature passed the Administration's *Delaware Gaming Competitiveness Act of 2012* which allowed for the expansion of sports lottery into retail locations, implementation of Keno, and authorizing Delaware to conduct internet gaming for both traditional and casino style online wagering, sales from these products have continued to grow. In fiscal year 2017, the Lottery continued to expand sports lottery into retail locations, add additional Keno retailers, and expand internet gaming on mobile devices and added a new I-Gaming vendor.

Cost of Games

Table 3

Cost of Games

(In millions and as a percentage of all revenue)

	Year ended June 30					
	2017		2016		2015	
Commission expense	\$ 196.7	31.3%	\$ 202.4	32.0%	\$ 198.0	32.9%
Gaming vendor fees and costs	39.8	6.3%	41.8	6.6%	40.3	6.7%
Prize expense	135.0	21.5%	126.5	20.0%	109.0	18.1%
Total cost of games	\$ <u>371.5</u>		\$ <u>370.7</u>		\$ <u>347.3</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 vendor fees. A decrease in commission expense of \$5.7 million or 2.8% was mostly due to the large win amounts on sports lottery. An increase in commissions in fiscal year 2016 over fiscal year 2015 of \$4.4 million, or 2.2% is due to an overall increase in revenue over last year. 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 also decreased in fiscal year 2017 over fiscal year 2016 of \$2.0 million or 4.8%. This decrease can also be contributed by the increase in sports winners for fiscal year 2017. Gaming vendor fees increased \$1.5 million, or 3.7% in fiscal year 2016 over fiscal year 2015 primarily due to the increased revenue.

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Prize Expense, Net of Reversions

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

	Year ended June 30		
	2017	2016	2015
Play 3	\$ 12.8	14.8	13.1
Play 4	10.3	10.3	11.4
Multi Win Lotto	2.6	2.8	2.6
Powerball	10.7	14.9	10.0
Hot Lotto	1.3	1.2	1.6
Mega Millions	4.6	4.5	5.3
Delaware Cash 5	—	—	0.2
Keno	4.8	4.9	4.2
Lucky for Life	1.6	2.4	1.5
Sports lottery	40.2	28.2	23.7
Instant games	46.1	42.5	35.4
Total prize expense	\$ 135.0	126.5	109.0

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

Prize expense includes the costs for winning tickets for traditional and sports lottery. Prize expense for fiscal year 2017 compared to fiscal year 2016 increased \$8.5 million or 6.7%. Sports lottery accounted for the majority of the increase. Prize expense for fiscal year 2016 versus fiscal year 2015 increased \$17.5 million or 16.1%. Fiscal year 2016 produced a higher prize expense for instant due to adding more higher-price tickets with a higher payout percentage. Sports lottery winners vary from year to year due to the unpredictability of the outcome of professional football. The payout percentage increased over 9% resulting in a higher prize expense for fiscal year 2016 over fiscal year 2015.

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Operating Expenses

Table 5
Operating Expenses
(In millions)

	Year ended June 30		
	2017	2016	2015
Operating expenses	\$ 10.7	10.7	10.6

Operating expenses remained relatively unchanged from fiscal year 2015 through fiscal year 2017.

Non-operating Expenses

Table 6
Nonoperating Expenses
(In millions)

	Year ended June 30		
	2017	2016	2015
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	35.7	36.8	36.6
Department of Health & Social Services	1.6	1.6	1.7
State of Delaware - General Fund	204.4	211.5	201.7
Total nonoperating expenses	\$ 245.7	253.9	244.0

Overall decrease in revenue for fiscal year 2017 vs fiscal year 2016 is the direct correlation for the decrease in non-operating expenses and contribution to the general fund. Fiscal year 2016 showed an overall increase over fiscal year 2015 in non-operating expenses, which is relative to the increase in revenue.

DELAWARE STATE LOTTERY
Basic Statements of Net Position
June 30, 2017 and 2016

Assets	2017	2016
Current assets:		
Cash and investments	\$ 3,791,602	5,921,521
Accounts receivable, net of allowance of \$791,748 and \$791,748, respectively	7,920,400	6,177,938
Investments – restricted for payment of prize liabilities	19,679	30,000
Due from the State of Delaware	5,386,177	4,762,963
Total current assets	17,117,858	16,892,422
Noncurrent assets:		
Investments – restricted for payment of prize liabilities	-	19,903
Deposit Multi-State Lottery	2,265,380	2,316,299
Total non-current assets	2,265,380	2,336,202
Total assets	\$ 19,383,238	19,228,624
Deferred outflows	\$ 1,045,231	242,448
Liabilities and Net Position		
Current liabilities:		
Prizes liability, including \$19,679 and \$30,000 of prize installment obligations, respectively	\$ 5,065,864	4,923,651
Accounts payable and accrued liabilities	4,721,166	4,704,095
Due to the State of Delaware	944,651	1,501,713
Total current liabilities	10,731,681	11,129,459
Noncurrent liabilities:		
Multi-State Lottery reserve	2,265,380	2,316,299
Prize installment obligations, noncurrent	-	19,903
Pension and OPEB liability	6,326,906	4,669,812
Total noncurrent liabilities	8,592,286	7,006,014
Total liabilities	\$ 19,323,967	18,135,473
Deferred inflows	\$ 104,502	335,599
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, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Revenue:		
Video lottery, net	\$ 352,834,117	360,771,884
Video lottery expired jackpots and credit slips	320,466	309,340
Casino license fees	3,172,411	3,199,100
I-Gaming	2,701,931	2,559,090
Sports lottery	46,114,509	39,398,130
Table games, net	53,117,143	54,010,328
Draw games	100,438,292	109,381,171
Instant games	69,284,712	65,659,766
Total revenue	<u>627,983,581</u>	<u>635,288,809</u>
Cost of games:		
Video lottery commissions	148,997,809	152,478,747
Prize costs, net of reversions	134,955,648	126,503,755
Gaming vendor fees and costs	39,826,424	41,815,118
Instant and draw games commissions	10,503,135	11,399,240
Sports lottery commissions	2,153,872	2,792,770
Table games commissions	35,110,431	35,700,827
Total cost of games	<u>371,547,319</u>	<u>370,690,457</u>
Gross margin	<u>256,436,262</u>	<u>264,598,352</u>
Operating expenses:		
Advertising and promotions	3,287,302	3,193,949
Payroll and related benefits	5,758,648	5,905,596
Other general and administrative	1,676,294	1,634,148
Total operating expenses	<u>10,722,244</u>	<u>10,733,693</u>
Operating income	245,714,018	253,864,659
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	241,714,018	249,864,659
Total nonoperating expenses	<u>245,714,018</u>	<u>253,864,659</u>
Change in net position	-	-
Net position at beginning of year	<u>1,000,000</u>	<u>1,000,000</u>
Net position at end of year	<u>\$ 1,000,000</u>	<u>1,000,000</u>

See accompanying notes to basic financial statements.

DELAWARE STATE LOTTERY
Basic Statements of Cash Flows
Years ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Receipts from customers	\$ 626,241,119	642,405,983
Payments to vendors for goods and services	(45,246,004)	(46,348,273)
Payments to employees for services	(5,736,121)	(5,842,743)
Payments for prizes	(134,833,338)	(128,382,725)
Payments for commissions	(196,314,719)	(205,101,583)
Net cash provided by operating activities	244,110,937	256,730,659
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	(242,271,080)	(249,972,944)
Net cash used in noncapital financing activities	(246,271,080)	(253,972,944)
Cash flows from investing activity:		
Proceeds from maturity of investments	30,224	29,878
Net cash provided by investing activity	30,224	29,878
Net (decrease) increase cash and investments	(2,129,919)	2,787,593
Cash and investments at beginning of year	5,921,521	3,133,928
Cash and investments at end of year	\$ 3,791,602	5,921,521
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 245,714,018	253,864,659
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,742,462)	7,117,174
Prizes liability	122,310	(1,878,970)
Accounts payable and accrued liabilities	17,071	(2,372,204)
Net cash provided by operating activities	\$ 244,110,937	256,730,659

See accompanying notes to basic financial statements.

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2017 and 2016

(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) Use of Estimates in the Preparation of Financial Statements

The preparation of basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

(e) New Accounting Pronouncements

During the year ended June 30, 2017, the School implemented GASB Statement No. 82, "Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73." Statement No. 82 addresses the presentation of payroll-related measures in the Required Supplementary Information, the selection of assumptions used in determining the total pension liability and related measures, and the classification of employer –paid member contributions.

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Notes to Basic Financial Statements
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(f) 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.

(g) 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.

(h) 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.

	<u>2017</u>	<u>2016</u>
Receivables:		
Accounts	\$ 8,712,148	6,969,686
Total receivables	8,712,148	6,969,686
Allowance for doubtful accounts	(791,748)	(791,748)
Total receivables, net	<u>\$ 7,920,400</u>	<u>6,177,938</u>
Amounts not scheduled for collection during the subsequent year	\$ —	—

(i) Investments

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

(j) 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

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Notes to Basic Financial Statements
June 30, 2017 and 2016

reflected in operations in the period of disposal. During the fiscal year ending June 30, 2017 the Lottery had no new purchases of capital assets and had properly disposed of all old capital assets. As of June 30, 2016, the Lottery did not have any capital assets.

(k) Revenue Recognition

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

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

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

All revenue that the Lottery reports is considered operating revenue.

(l) Prize Obligations

Prize obligations for the traditional draw games and sports lottery are determined and recognized after each drawing or profession football 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, Hot Lotto, and Mega Millions, 50% of the revenues are allocated to the prize pool.

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

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

(m) 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, 2017. 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, 2017 and 2016, the Lottery had liabilities of \$242,713 and \$235,398 for accrued vacation and \$238,033 and \$226,769 for accrued sick leave, respectively.

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(n) Operating and Nonoperation 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 nonoperation expenses.

(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	
	2017	2016
On hand and in bank	\$ 2,047,753	4,346,952
Pooled cash and investments	1,743,849	1,574,569
Total cash balances	\$ 3,791,602	5,921,521

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 fair 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, 2017 and June 20, 2016, the total bank balance of cash in all bank accounts was \$2,047,753 and \$4,346,952, respectively.

(3) Investments

Until April 1998, annuity contracts were purchased from insurance companies to fund prizes of \$150,000 or more, payable on an installment basis. All investments reported on the statement of net position represent such annuities, and are carried on the statement of net position at amortized cost. The Lottery intends to hold the investments until maturity. The Lottery remains liable for future periodic payments of deferred prize obligations (approximately \$20,000 as of June 30, 2017) in the event that annuity issuers default on their obligations. Lottery investments as of June 30, 2017 are not subject to custodial credit risk since their existence is not evidenced by securities that exist in physical or book entry form.

(a) Interest Rate Risk

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

(b) Credit Risk and Concentration of Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. While the Lottery no longer utilizes the purchase of annuity contracts to fulfill prize obligations, the Lottery places no limit on the amount it may invest in any one issuer. As of June 30, 2017, the insurance companies with which the Lottery's investments in annuity contracts to pay future prize obligations are held were rated by A.M. Best Company and concentrated as follows:

<u>Insurance company</u>	<u>Total annuity contract values</u>	<u>Concentration</u>	<u>A.M. Best rating</u>
New York Life Insurance Company	\$ 19,679	100.00	AAA

(4) Capital Assets

During the year ending June 30, 2017 the Lottery did not have any new purchases of capital assets and properly disposed of all old capital assets in fiscal year 2015. There is currently no depreciation expense.

DELAWARE STATE LOTTERY
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(5) Prize Obligations

The following is a reconciliation of changes in the prize liability account, which includes the present value of prize installment obligations, for the fiscal years ended June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Prize obligations, beginning of year	\$ 4,943,554	6,822,524
Prize payments	(134,833,338)	(128,382,725)
Prize costs, net of reversions	134,955,648	126,503,755
Prize obligations, end of year	<u>\$ 5,065,864</u>	<u>4,943,554</u>

The Lottery pays the winners of certain jackpots in annual installments over periods that vary generally from 14 to 20 years. The future prize installment obligations payable as of June 30, 2017, during the last year is as follows:

Total payments for unpaid prize installment obligations	\$ 20,000
Less imputed interest rate (1.6%)	<u>(321)</u>
Present value of prize installment obligations	<u>\$ 19,679</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 MUSL member pays lesser prizes directly to the winners. The MUSL operates the Powerball game and the Hot Lotto game since fiscal year 2008 and the Mega Millions game since 2010. Participating lotteries are required to maintain deposits with MUSL for contingency reserves to protect MUSL from unforeseen prize liabilities. The money in this reserve fund is refundable to MUSL members if the MUSL disbands or if a member leaves the MUSL Board. The MUSL has an agreement that grants MUSL the nonexclusive right to offer the multi-jurisdictional lottery game known as the "Mega Millions Game," to be conducted by the MUSL member lotteries.

The amount the Lottery had on deposit with the MUSL, as of June 30, 2017 and 2016, equaled \$2,265,380 and \$2,316,299, 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.

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

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

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

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

(8) Contributions to the State of Delaware

As required, under the Legislation, net position of the Lottery may not exceed \$1,000,000; therefore, the Lottery periodically transfers surplus funds to the State in accordance with the Legislation. For the years ended June 30, 2017 and 2016, the Lottery made the following contributions to the State.

	June 30	
	2017	2016
Amounts transferred and to be transferred to the State for the fiscal year:		
General Fund	\$ 204,389,911	211,461,338
Department of Health and Social Services	1,570,598	1,600,897
Department of Agriculture	35,753,509	36,802,424
	\$ 241,714,018	249,864,659

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
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(9) Revenue and Expenses by Game

The following revenue was recognized:

	<u>Year ended June 30</u>	
	<u>2017</u>	<u>2016</u>
Draw games:		
Play 3 Day	\$ 10,737,859	10,732,472
Play 3 Night	16,798,003	16,970,205
Play 4 Day	8,590,011	8,493,811
Play 4 Night	14,162,692	14,131,074
Multi Win Lotto	4,268,594	4,634,945
Powerball	22,774,734	30,445,066
Hot Lotto	2,655,062	2,365,068
Mega Millions	8,877,979	9,536,437
Keno	8,168,946	8,038,051
Lucky for Life	3,404,412	4,034,042
Total draw games	<u>100,438,292</u>	<u>109,381,171</u>
Instant games	<u>69,284,712</u>	<u>65,659,766</u>
Total traditional lottery	169,723,004	175,040,937
Video lottery, net	352,834,117	360,771,884
I-Gaming video lottery, net	2,701,931	2,559,090
Video lottery expired jackpots and credit slips	320,466	309,340
Casino license fees	3,172,411	3,199,100
Sports lottery	46,114,509	39,398,130
Table games, net	<u>53,117,143</u>	<u>54,010,328</u>
Total revenue	<u>\$ 627,983,581</u>	<u>635,288,809</u>

DELAWARE STATE LOTTERY
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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, 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
Year ended June 30, 2016:							
Revenue	\$ 360,771,884	2,559,090	39,398,130	54,010,328	109,381,171	65,659,766	631,780,369
Other income	3,508,440	—	—	—	—	—	3,508,440
Prize costs, net of reversions	—	—	28,186,445	—	55,831,551	42,485,759	126,503,755
	364,280,324	2,559,090	11,211,685	54,010,328	53,549,620	23,174,007	508,785,054
Commissions expense	152,478,747	—	2,792,770	35,700,827	6,836,328	4,562,912	202,371,584
Contribution margin per game	211,801,577	2,559,090	8,418,915	18,309,501	46,713,292	18,611,095	306,413,470
Game vendor fees	27,593,315	1,956,837	2,309,647	—	6,277,183	3,678,136	41,815,118
Gross margin	\$ 184,208,262	602,253	6,109,268	18,309,501	40,436,109	14,932,959	264,598,352

(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 2017 and fiscal year 2016, the Lottery incurred \$5,758,648 and \$5,905,596 respectively, of payroll and benefit costs, including pension, health insurance, and other employee benefit costs, paid to various state agencies responsible for the administration of benefit programs.

DELAWARE STATE LOTTERY
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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 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 State Board of Pension Trustees. For the year ended June 30, 2017, the rate of the employer contribution was 9.6 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, 2016 and 2015.

DELAWARE STATE LOTTERY
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Net Pension Liability and Expense

At June 30, 2017, the Lottery reported a net pension liability of \$1,999,680 for its proportionate share of the net pension liability of the State of Delaware. The net pension liability was measured as of June 30, 2016, 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, 2015 to June 30, 2016. At June 30, 2016, the Lottery's proportion was 0.1327 percent, which was a decrease of 0.004 percent from its proportion measured as of June 30, 2015. For the year ended June 30, 2017, the Lottery recognized a pension expense of \$291,012.

Deferred Outflows and Inflows of Resources

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

Deferred Inflows & Outflows of Resources:	Measure- ment Period ending June 30	Amorti- zation Period	Beginning of Year Balance	Additions	Deductions	End of Year Balance
Changes of assumption	2017	6 years	\$ -	222,210	(37,035)	185,175
Net Difference between projected and actual earnings on pension plan investment.	2017	5 years	-	976,060	(195,212)	780,848
	2016	5 years	338,683	-	(84,671)	254,012
	2015	5 years	(617,407)	-	205,803	(411,604)
Total Deferred Outflows:			<u>(278,724)</u>	<u>976,060</u>	<u>(74,080)</u>	<u>623,256</u>
			(278,724)	1,198,270	(111,115)	808,431
Change in Proportion	2017	6 years	-	(38,240)	6,373	(31,867)
	2016	6 years	(29,044)	-	5,809	(23,235)
	2015	6 years	(7,383)	-	1,846	(5,537)
			<u>(36,427)</u>	<u>(38,240)</u>	<u>14,028</u>	<u>(60,639)</u>
Net Difference between expected and actual experience.	2017	6 years	-	(33,006)	5,501	(27,505)
	2016	6 years	(20,448)	-	4,090	(16,358)
			<u>(20,448)</u>	<u>(33,006)</u>	<u>9,591</u>	<u>(43,863)</u>
Total Deferred Inflows:			<u>(56,875)</u>	<u>(71,246)</u>	<u>23,619</u>	<u>(104,502)</u>
Total Deferred Inflows & Outflows			<u>\$ (335,599)</u>	<u>1,127,024</u>	<u>(87,496)</u>	<u>703,929</u>

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

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2017 and 2016

Year Ending June 30		
2018	\$	87,497
2019		87,497
2020		293,300
2021		210,475
2022		25,160
	\$	703,929

Actuarial Assumptions

The total pension liability as of 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 pension liability to June 30, 2016. These actuarial valuations used the following actuarial assumptions:

Investment Return -7.2%, 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 include a reduction in the inflation assumption from 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 Plan’s current and expected asset allocation is summarized in the following table:

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

Discount Rate

The discount rate used to measure the total pension liability was 7.20%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rates and that contributions from employers will be made at rates determined by the State 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, calculated using the discount rate of 7.20%, as well as what the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.20%) or one percentage point higher (8.20%) than the current rate:

	1% decrease <u>6.20%</u>	Current discount rate <u>7.20%</u>	1% increase <u>8.20%</u>
Lottery's proportionate share of the net pension liability	<u>\$ 3,475,692</u>	<u>1,999,680</u>	<u>758,749</u>

Pension Plan Fiduciary Net Position

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

Net Position – Pension

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

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2017 and 2016

(b) Other Postemployment Benefits (OPEB)

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

The OPEB Trust is a single-employer defined-benefit plan and provides retirement medical coverage to pensioners and their eligible dependents through the same healthcare plans that are available to active employees. Retirees' contributions depend on date of hire and years of service and range from 0% to 100% of the cost. The OPEB liability continued to increase each year because the Lottery is not funding the Annual Required Contribution, but is only paying retiree healthcare on a pay-as-you-go basis. There are currently 33,127 active eligible plan members. The Lottery has 61 active eligible plan members, which is the basis on which plan costs are allocated.

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

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

	State total	Lottery allocation
	(In millions)	(In thousands)
Net OPEB obligation as of June 30, 2016	\$ 2,390.8	3,758.2
Annual required contribution	542.5	999.0
Interest on net OPEB Obligation	89.7	165.2
Adjustment to required contribution	(85.8)	(157.9)
Net OPEB obligation before contributions	2,937.2	4,764.5
Employer contributions	237.4	437.1
Net OPEB obligation as of June 30, 2017	\$ 2,699.8	4,327.4

DELAWARE STATE LOTTERY
Notes to Basic Financial Statements
June 30, 2017 and 2016

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

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

<u>Fiscal year ended</u>	<u>Annual OPEB cost</u>	<u>of annual OPEB cost contributed</u>	<u>Net OPEB obligation</u>
6/30/2015	\$ 790,200	54.9%	\$ 3,356,630
6/30/2016	\$ 806,000	50.2%	\$ 3,758,244
6/30/2017	\$ 1,006,000	43.4%	\$ 4,327,226

(12) Risk Management

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

(13) Commitments

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

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

Proportionate Share of Net Pension Liability

	<u>6/30/2016</u>	<u>6/30/2015</u>	<u>6/30/2014</u>
Actuarial valuation date			
Lottery's proportion of the net pension liability	0.1327%	0.1370%	0.1407%
Lottery's proportion of the net pension liability - dollar value	\$ 1,999,680	911,588	518,009
Lottery's covered employee payroll	\$ 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	79.0%	35.7%	20.0%
Plan fiduciary net position as a percentage of the total pension liability	84.1%	92.7%	95.8%

Contributions

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

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States the financial statements of the Delaware State Lottery (the Lottery) of the State of Delaware, as of and for the year ended June 30, 2017, 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 3, 2017.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a misstatement of the Lottery's financial statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our considerations of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that were not identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Gunnip & Company LLP

November 3, 2017