



COLORADO LOTTERY
FINANCIAL AND COMPLIANCE AUDIT
June 30, 2019 and 2018

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Members of the Legislative Audit Committee:

We have completed the financial statement audit of the Colorado Lottery as of and for the years ended June 30, 2019 and 2018. Our audit was conducted 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.

We were engaged to conduct our audit pursuant to Section 44-40-112, C.R.S., which requires the State Auditor to annually audit the Lottery Fund. The reports we have issued as a result of this engagement are set forth in the table of contents which follows.

Eide Bailly LLP

Fort Collins, Colorado
October 16, 2019

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COLORADO LOTTERY
Report Summary
Years Ended June 30, 2019 and 2018

Purposes and Scope of Audit

Authority, Purpose and Scope

The Office of the State Auditor, State of Colorado, engaged Eide Bailly LLP to conduct the financial audit of the Colorado Lottery for the Fiscal Year ended June 30, 2019. The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 44-40-112 C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery. The purpose of the audit was to express opinions on the financial statements of the Lottery for the years ended June 30, 2019 and 2018.

Eide Bailly LLP conducted the audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States of America.

The purposes and scope of this audit were:

- To express opinions on the financial statements of the Lottery as of and for the years ended June 30, 2019 and 2018, including consideration of the related systems of internal controls as required by auditing standards generally accepted in the United States of America.
- To test the Lottery's compliance with certain rules and regulations governing the expenditure of State funds for the year ended June 30, 2019.
- To evaluate progress in implementing the prior audit recommendations, if any.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

There were no prior year audit recommendations outstanding.

There were no new recommendations as a result of the current year audit.

Audit Opinions and Reports

The independent auditor's reports included herein, state that the financial statements of the Lottery are fairly stated, in all material respects, in accordance with accounting principles generally accepted in the United States of America, and that no material weaknesses in internal controls were identified during the course of the audit.

Auditor's Communication to Legislative Audit Committee

The auditor's communication to the Legislative Audit Committee describes the auditor's responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. This communication is located on page 80.

COLORADO LOTTERY
Background
Years Ended June 30, 2019 and 2018

In 1980, Colorado voters passed a referendum that added Article XVIII, Section 2(1) to the Colorado Constitution, allowing the establishment of a state-supervised lottery. Senate Bill 82-119 created the Lottery as a division within the Department of Revenue. The Lottery began operations on July 1, 1982 and sold its first lottery ticket on January 24, 1983.

During Fiscal Year 2019, the Lottery employed 114 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

The Lottery games are governed by rules and regulations established by a Commission of five members appointed by the Governor and approved by the Senate. By statute, Lottery Commission members must include an attorney, a certified public accountant and a law enforcement officer. Members may serve up to two 4-year terms.

Colorado Revised Statutes (C.R.S.) Section 44-40-111(9), requires that no less than 50% of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. Article XXVII of the Colorado Constitution states that “net lottery proceeds” (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund within the Department of Local Affairs, the Division of Parks and Wildlife within the Department of Natural Resources, and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap, which was calculated to be \$68.5 million for the year ended June 30, 2019.

Prior to 2002, amounts exceeding the GOCO cap (the spillover) were distributed to the State General Fund. For Fiscal Years 2002 through 2007, the spillover funds were distributed to the State Public School Fund Contingency Reserve. For Fiscal Year 2008, the spillover funds were transferred to the Lottery Proceeds Contingency Reserve Fund. For Fiscal Years 2009 through 2019, the spillover funds were required to be transferred to the Public School Capital Construction Assistance Fund pursuant to Section 22-43.7-104, C.R.S.



CPAs & BUSINESS ADVISORS

Independent Auditor's Report

To the Members of the Legislative Audit Committee and Lottery Commission
State of Colorado, Department of Revenue, Lottery Division
Denver, Colorado

Report on the Financial Statements

We have audited the accompanying financial statements of the Colorado Lottery, an enterprise fund of the State of Colorado, as of and for the years ended June 30, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the Colorado 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Colorado Lottery as of June 30, 2019 and 2018, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Relationship with the State of Colorado

As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position and cash flows for only that portion of the financial reporting entity, the State of Colorado, which is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2019 and 2018, and the changes in its financial position, or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Restatement

As discussed in Note 13, management reevaluated the classification of pension and other postemployment benefit expense and determined it was appropriate to reclassify the amount from a nonoperating activity to an operating activity. The 2018 financial statements have been restated for this reclassification. 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 6 through 22, the schedule of the Colorado Lottery's proportionate share of the net pension liability, the schedule of the Colorado Lottery's contributions for the Colorado Lottery's defined benefit pension plan on pages 70 and 71, as well as the schedule of the Colorado Lottery's proportionate share of the net OPEB liability and the schedule of Colorado Lottery's contributions for the Lottery's OPEB through the Health Care Trust Fund on pages 72 and 73 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.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Colorado Lottery's basic financial statements. The Schedule of Revenues and Costs for Scratch and Jackpot Games, Schedule of Percent of Prize Expense to Gross Ticket Sales and Budgetary Comparison (Supplementary Information) are presented for the purposes of additional analysis and are not a required part of the basic financial statements.

The Supplementary Information is the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Supplemental Information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 16, 2019 on our consideration of the Colorado 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 Colorado 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 Colorado Lottery's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Eide Sully LLP".

Fort Collins, Colorado
October 16, 2019

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

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the Fiscal Years ended June 30, 2019 and 2018. Please read it in conjunction with the Lottery's financial statements, which begin on page 23. These financial statements reflect only activities of the Colorado Lottery.

Games Offered by the Colorado Lottery

The Lottery offers a variety of ways to play with two different game types: scratch games and jackpot (draw) games. Scratch games consist of pre-printed tickets that may be purchased at various price points (\$1, \$2, \$3, \$5, \$10, \$20 and \$50) with multiple play styles at any Lottery retailer. When scratched, they provide instant knowledge if the ticket is a winner and can be cashed immediately at the retailer if the amount of the winnings is \$599 or less. Prizes over \$599 must be redeemed at the Lottery offices. On the other hand, jackpot or draw games which include Powerball, Lotto, Cash 5, Mega Millions, Pick 3, and Lucky For Life require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or possibly more playing boards for one draw or up to thirteen weeks of draws. Each board consists of a set of numbers, with the combination of numbers required for play varying by game. The winning numbers for each game are posted after their respective draw, with drawings held every day of the week. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer if the amounts of the total winnings by ticket are \$599 or less. Tickets with prizes over \$599 must be redeemed at the Lottery offices. Also offered by Colorado Lottery, the add-on game Cash 5 EZ Match gives players the opportunity to pay an extra \$1 per Cash 5 ticket for the chance to win a randomly assigned instant prize (a jackpot ticket purchase with the instant winning experience of a scratch ticket). With no draw involved and with prizes ranging from \$2 to \$500, winning tickets may be cashed instantly at the retailer.

Financial Highlights

- The Colorado Lottery's overall ticket sales for Fiscal Year 2019 reached nearly \$680 million, highlighting another record setting year. Surpassing the previous sales record set in Fiscal Year 2018 of \$612.0 million by \$67.8 million or 11.1 percent; the Fiscal Year 2019 sales mark of \$679.8 million moved into the top spot in the Lottery's thirty-seven year history. Fiscal Year 2016 with total sales of \$594.4 million moved down to the third highest sales year. Both scratch and jackpot sales also set new record highs in the current fiscal year. Leading the way in Fiscal Year 2019, scratch ticket sales ended at \$443.4 million or 8.8 percent higher than the previous fiscal year's scratch sales record of \$407.5 million. Increased scratch sales at the \$2, \$50 and especially the \$10 price points were the reason for the strong showing. October 2018 saw the highest Mega Millions jackpot ever reach \$1.5 billion, helping bring total jackpot sales in Fiscal Year 2019 to \$236.4 million, an increase over the previous fiscal year of nearly \$31.9 million or 15.6 percent and another record.

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

- Funds distributed or available for distribution from Fiscal Year 2019 sales were nearly \$166.5 million, shattering the previous highest record in the Lottery's history of \$143.6 million reached in Fiscal Year 2016 and the prior fiscal year mark of \$140.7 million. With an 18.3 percent increase in distributions from Fiscal Year 2018 to Fiscal Year 2019, distributions included a spill-over of funds to the Public School Capital Construction Assistance Fund of over \$14.7 million. This spill-over occurred when the Great Outdoors Colorado (GOCO) proceeds cap of nearly \$68.5 million in the current fiscal year was reached in April 2019, one of the earliest points in any fiscal year. The cap for GOCO is the 1992 base year amount of \$35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. This was the eighteenth year in a row the Lottery successfully reached the GOCO cap, ranging from \$46.5 million in Fiscal Year 2002 to the nearly \$68.5 million in the current fiscal year. Since Fiscal Year 2009, distributions to the Public School Capital Construction Assistance Fund have totaled over \$55.4 million, helping fund Building Excellent Schools Today (BEST), a capital construction grant program established in 2008 and administered by the Colorado Department of Education Division of Public School Assistance.
- Fiscal Year 2019 gross profit (Lottery product sales minus costs tied directly to those sales) as a percentage of sales increased by 1.2 percent from the previous fiscal year (from nearly 27.7 percent to 28.9 percent). Costs tied directly to sales include prize expense, retailer commissions and bonuses, scratch ticket costs and vendor fees charged for the use of the jackpot gaming systems provided by the third party vendor International Game Technology (IGT). A decrease of 1.3 percent in prize expense as a percentage of sales was the chief reason for the overall 1.2 percent increase in the gross profit percentage. This was combined with a slight decrease as a percentage of sales of commissions paid to retailers and of the costs for printing and license property fees of scratch tickets sold from Fiscal Year 2018 to Fiscal Year 2019. A combined increase in retailer bonus expense and vendor fees of 0.1 percent as a percentage of sales slightly offset the gross profit percentage increase.
- Total prize expense as a percentage of sales for all Lottery products decreased from 62.7 percent to 61.3 percent in Fiscal Years 2018 and 2019, respectively. Scratch prize expense as a percentage of sales decreased from 68.9 percent to 67.5 percent, along with a decrease from 50.3 percent to 49.8 percent for combined jackpot games. The decrease in prize expense as a percentage of sales seen in Fiscal Year 2019 from Fiscal Year 2018 for both scratch and jackpot games was mainly due to the increase in unclaimed prizes recognized in the current fiscal year. The write off of prizes that expire and are no longer available to be claimed by Lottery players ultimately lowers the prize expense as a percentage of sales. Unclaimed prizes in the current fiscal year increased by a total of \$3.7 million, with a \$2.9 million increase in scratch unclaimed prizes and a nearly \$0.8 million increase in jackpot unclaimed prizes. Scratch game unclaimed prizes showed a significant increase of \$2.9 million in the current fiscal year due to an increase in the number of scratch games for which the expired prizes are written off, along with a higher average write-off amount per game. The \$0.8 million increase of jackpot unclaimed prizes in the current fiscal year was chiefly made up of a \$1.0 million increase in Mega Millions unclaimed prizes directly tied to mostly smaller prizes going unclaimed from the \$1.5 billion jackpot draw and the two draws leading up to it, offset by a decrease of \$0.2 million in Powerball and Cash 5 unclaimed prizes from the prior fiscal year.

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

- Retailer commissions as a percentage of sales decreased slightly from Fiscal Year 2018 to Fiscal Year 2019 due to the higher percentage of jackpot products sold compared to scratch products in Fiscal Year 2019. Jackpot product sales carry a lesser commission rate than the sales of scratch products. Retailer bonuses as a percentage of sales increased mainly due to the substantial increase of scratch product sales in the current fiscal year over the previous fiscal year on which the sales bonuses were based. Combined retailer commission and bonus costs as a percentage of sales in Fiscal Years 2019 and 2018 were 7.6 percent and 7.5 percent, respectively. Cost of tickets sold in Fiscal Year 2019 as a percentage of sales was nearly the same as from the previous fiscal year. Vendor fees as a percentage of sales increased slightly in Fiscal Year 2019 mainly due to the increase in vendor fees paid for the use of signs displaying jackpot amounts provided by the gaming vendor. The continued increase in the use by Lottery players of the self-serving Gemini terminals to purchase their lottery tickets that carries a slightly higher vendor fee rate also contributed to the increase in vendor fees as a percentage of sales.

Using this Annual Report

This annual report consists of a series of financial statements. The Statements of Net Position provide information about the Lottery's assets, liabilities and deferred inflows and outflows and reflect the Lottery's financial position as of June 30, 2019 and 2018. The Statements of Revenues, Expenses and Changes in Net Position report the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2019 and 2018. Finally, the Statements of Cash Flows outline the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2019 and 2018.

Statements of Net Position

The Statements of Net Position present a financial snapshot of the Lottery at June 30, 2019 and 2018. It presents the fiscal resources (assets), of the Lottery the consumption of net assets that is applicable to a future reporting period (deferred outflows), the claims against those resources (liabilities), the acquisition of net assets that is applicable to a future reporting period (deferred inflows) and the residual available for future operations (net position). Assets and liabilities are classified by liquidity as either current or noncurrent.

Deferred outflows are reported in a separate section following assets, with deferred inflows reported in a separate section following liabilities. Net position is classified by the ways in which these assets may be used for future operations.

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

Condensed Statements of Net Position
June 30, 2019, 2018, and 2017

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Assets			
Current assets	\$ 77,974,884	\$ 68,768,925	\$ 67,863,202
Restricted assets	8,435,637	7,012,424	6,516,413
Capital assets	<u>422,552</u>	<u>284,956</u>	<u>285,567</u>
 Total assets	 <u>\$ 86,833,073</u>	 <u>\$ 76,066,305</u>	 <u>\$ 74,665,182</u>
Deferred Outflows			
Pensions	\$ 4,283,041	\$ 9,748,300	\$ 12,888,492
Other postemployment benefits	<u>78,450</u>	<u>64,281</u>	<u>-</u>
 Total deferred outflows	 <u>\$ 4,361,491</u>	 <u>\$ 9,812,581</u>	 <u>\$ 12,888,492</u>
Liabilities			
Current liabilities	\$ 82,858,225	\$ 73,250,713	\$ 71,502,770
Long-term liabilities	798,751	810,865	780,887
Net pension liability	25,422,465	45,852,060	41,110,831
Net other postemployment benefits liability	<u>1,075,746</u>	<u>1,066,928</u>	<u>-</u>
 Total liabilities	 <u>\$ 110,155,187</u>	 <u>\$ 120,980,566</u>	 <u>\$ 113,394,488</u>
Deferred Inflows			
Pensions	\$ 13,761,517	\$ 2,165,329	\$ 1,427,150
Other postemployment benefits	<u>34,881</u>	<u>17,849</u>	<u>-</u>
 Total deferred inflows	 <u>\$ 13,796,398</u>	 <u>\$ 2,183,178</u>	 <u>\$ 1,427,150</u>
Net Position			
Investment in Capital Assets	\$ 422,552	\$ 284,956	\$ 285,567
Restricted – Licensed Agent Recovery Reserve	688,356	593,286	516,720
Restricted – Operating Reserve	1,800,000	1,700,000	1,600,000
Unrestricted - Unrealized Gain/Loss on Investments	265,189	(573,515)	(20,762)
Unrestricted - Unfunded Pension Liability	(35,921,437)	(38,269,089)	(29,649,489)
Unrestricted - Unfunded Other Postemployment Benefits Liability	<u>(11,681)</u>	<u>(1,020,496)</u>	<u>-</u>
 Total net position	 <u>\$ (32,757,021)</u>	 <u>\$ (37,284,858)</u>	 <u>\$ (27,267,964)</u>

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

The Lottery's total assets at June 30, 2019 were \$86.8 million. Assets consisted primarily of cash and investments of \$54.7 million, including restricted balances of \$2.5 million, receivables from Lottery retailers for the sales of Lottery products of \$24.0 million, prepaid prize expense with Multi-State Lottery Association (MUSL) of over \$5.9 million, scratch ticket inventory of \$1.6 million and a net investment in fixed assets of \$0.4 million.

Comparable figures at June 30, 2018 were nearly \$76.1 million in total assets, principally including cash and investments of \$47.0 million, including restricted balances of \$2.3 million, receivables from retailers of \$22.1 million, prepaid prize expense with MUSL of \$4.7 million, scratch ticket inventory of nearly \$1.9 million and a net investment in fixed assets of nearly \$0.3 million.

Comparable figures at June 30, 2017 were \$74.7 million in total assets, principally including cash and investments of \$47.4 million, including restricted balances of \$2.1 million, receivables from retailers of \$21.0 million, prepaid prize expense with MUSL of over \$4.4 million, scratch ticket inventory of over \$1.4 million and a net investment in fixed assets of nearly \$0.3 million.

The Lottery's total assets increased by over \$10.7 million from Fiscal Year 2018 to Fiscal Year 2019. The increase in total assets was primarily made up of the increases in cash and investments of nearly \$7.7 million, in receivables from retailers of nearly \$2.0 million, and in prepaid prize expense with MUSL of \$1.2 million, offset by a decrease in scratch ticket inventory of nearly \$0.3 million. The increase in cash and investments of nearly \$7.7 million can be chiefly attributed to the \$5.6 million of net cash provided by operating activities over the distribution of proceeds paid in Fiscal Year 2019, combined with \$1.5 million in interest income and \$0.8 million gain in fair market value of investments offset by \$0.3 million used in the acquisition of capital assets. The Lottery's total assets increased by \$1.4 million from Fiscal Year 2017 to Fiscal Year 2018. This increase was primarily made up of increases in receivables from retailers of nearly \$1.1 million, in scratch ticket inventory of \$0.4 million, and in prepaid prize expense with MUSL of \$0.3 million, offset by a decrease in cash and investments of \$0.4 million.

The Lottery's total liabilities at June 30, 2019 totaled over \$110.1 million, which consisted primarily of prize liability on all Lottery products of \$36.6 million, proceeds distributions due to recipients of nearly \$36.5 million, net pension liability of over \$25.4 million recorded in accordance with Governmental Accounting Standards Board (GASB) Statement No. 68, nearly \$4.0 million due to Lottery vendors, over \$3.5 million due to retailers for bonuses, over \$1.1 million due to MUSL, wages and benefits due to Lottery employees of nearly \$1.1 million and net other postemployment benefits (OPEB) liability of nearly \$1.1 million recorded in accordance with GASB Statement No. 75.

The Lottery's total liabilities at June 30, 2018 totaled nearly \$121.0 million, which consisted primarily of net pension liability of nearly \$45.9 million, prize liability on all Lottery products of nearly \$37.1 million, proceeds distributions due to recipients of nearly \$30.5 million, over \$2.6 million due to retailers for bonuses, \$1.4 million due to MUSL, net OPEB liability of nearly \$1.1 million, and wages and benefits due to Lottery employees of \$0.9 million each.

The Lottery's total liabilities at June 30, 2017 totaled \$113.4 million, which consisted primarily of net pension liability of \$41.1 million, prize liability on all Lottery products of nearly \$35.4 million, proceeds distributions due to recipients of \$32.7 million, over \$1.2 million due to retailers for bonuses, and MUSL payments due and wages and benefits due to Lottery employees of \$0.8 million each.

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

The Lottery's total liabilities of over \$110.1 million at June 30, 2019 decreased by over \$10.8 million from the previous fiscal year chiefly due to the over \$20.4 million decrease in the net pension liability, the nearly \$0.5 million decrease in prize liability, and the \$0.2 million decrease in the amount due to MUSL offset by the \$6.0 million increase in funds available for proceeds distribution, the \$3.3 million increase in the amount due to Lottery vendors, and the nearly \$0.9 million increase in retailer bonus liability.. Remaining liability categories showed much smaller changes from June 30, 2018 to June 30, 2019.

The Lottery's total liabilities of nearly \$121.0 million at June 30, 2018 increased by \$7.6 million over the previous fiscal year chiefly due to the over \$4.7 million increase in the net pension liability, the over \$1.7 million increase in prize liability, the \$1.4 million increase in retailer bonus liability, the nearly \$0.6 million increase in the amount due to MUSL, and the nearly \$0.2 million increase in vendor liability, plus the addition of the \$1.1 million in net OPEB liability, offset by a decrease of \$2.3 million in funds available for proceeds distribution. Remaining liability categories showed much smaller changes from June 30, 2017 to June 30, 2018.

Components of the Lottery's net position are: 1) an amount to represent the Lottery's investment in capital assets as required by the reporting model under GASB Statement No. 34, (see "Total Capital Assets" on the Statements of Net Position); 2) a Licensed Agent Recovery Reserve (bonding reserve) funded by retailers in accordance with Section 44-40-121, C.R.S. to cover any uncollectible receivable accounts; 3) an amount representing the funds held by the Lottery in an operating reserve to ensure the operation of the Lottery for the ensuing year in accordance with Section 44-40-111 (5)(a), C.R.S. (see "Cash and Investments – Operating Reserve") on the Statements of Net Position; 4) unrestricted, unrealized gain/loss on investments, which represents an adjustment made by the Lottery to reflect its share of unrealized gains or losses on investments held by the State Treasurer, 5) unrestricted, unfunded pension liability, which represents the Lottery's share of the State's unfunded net pension liability as calculated by PERA and 6) unrestricted, unfunded OPEB liability, which represents the Lottery's share of the State's unfunded net liability for the Health Care Trust Fund as calculated by PERA.

The Lottery's total net position increased \$4.5 million from June 30, 2018 to June 30, 2019. This included 1) an increase in investment in capital assets of over \$137 thousand due to current year additions of capital assets of \$279 thousand offset by depreciation expense of \$142 thousand recognized in Fiscal Year 2019 2) an increase in the Licensed Agent Recovery Reserve (also known as bonding reserve) from \$593 thousand to \$688 thousand; 3) a net increase in operating reserve of \$100 thousand from \$1.7 million to \$1.8 million; 4) an unrealized gain on investments of nearly \$839 thousand resulting from a net increase in the adjustments on State Treasury investments; 5) a net decrease in unfunded net pension liability and related deferrals of over \$2.3 million; and 6) a net decrease in unfunded net OPEB liability and related deferrals of \$1.0 million.

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

Following is a schedule of net position for Fiscal Years 2019 and 2018:

	2019	2018	Change
Investment in Capital Assets	\$ 422,552	\$ 284,956	\$ 137,596
Restricted - Licensed Agent			
Recovery Reserve	688,356	593,286	95,070
Restricted - Operating Reserve	1,800,000	1,700,000	100,000
Unrestricted - Unrealized Gain or			
Loss on Investments	265,189	(573,515)	838,704
Unrestricted - Unfunded Pension			
Liability	(35,921,437)	(38,269,089)	2,347,652
Unrestricted - Unfunded Other			
Postemployment Benefits Liability	(11,681)	(1,020,496)	1,008,815
Total net position	<u>\$ (32,757,021)</u>	<u>\$ (37,284,858)</u>	<u>\$ 4,527,837</u>

The change in net position from June 30, 2017 to June 30, 2018 consisted of a minimal decrease in investment in capital assets due to the depreciation expense of \$176 thousand recognized in Fiscal Year 2018, totally offset by current year additions of capital assets of \$176 thousand, an increase in the bonding reserve from \$517 thousand to \$593 thousand, a net increase in operating reserve of \$100 thousand from \$1.6 million to \$1.7 million, an unrealized loss on investments of \$553 thousand resulting from a net decrease in the adjustments on State Treasury investments, a net increase in unfunded pension liability and related deferrals of \$8.6 million, and a net increase in unfunded net OPEB liability and related deferrals of \$1.0 million for a total net decrease in net position of \$9.0 million after the restatement of net position at July 1, 2017.

Following is a schedule of net position for Fiscal Years 2018 and 2017:

	2018	2017	Change
Investment in Capital Assets	\$ 284,956	\$ 285,567	\$ (611)
Restricted - Licensed Agent			
Recovery Reserve	593,286	516,720	76,566
Restricted - Operating Reserve	1,700,000	1,600,000	100,000
Unrestricted - Unrealized Gain or			
Loss on Investments	(573,515)	(20,762)	(552,753)
Unrestricted - Unfunded Pension			
Liability	(38,269,089)	(29,649,489)	(8,619,600)
Unrestricted - Unfunded Other			
Postemployment Benefits Liability	(1,020,496)	-	(1,020,496)
Total net position	<u>\$ (37,284,858)</u>	<u>\$ (27,267,964)</u>	<u>\$ (10,016,894)</u>

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Following is a schedule of net position excluding the effects of the reporting requirements of GASB 68 and GASB 75.

	2019	2018	2017
Total Net Position	\$ (32,757,021)	\$ (37,284,858)	\$ (27,267,964)
Add back Unrestricted - Unfunded Pension Liability	35,921,437	38,269,089	29,649,489
Add back Unrestricted - Unfunded Other Postemployment Benefits Liability	11,681	1,020,496	-
Net position excluding pension and OPEB effect	<u>\$ 3,176,097</u>	<u>\$ 2,004,727</u>	<u>\$ 2,381,525</u>

The Lottery's net position excluding the effects of GASB 68 and GASB 75 increased by nearly \$1.2 million from June 30, 2018 to June 30, 2019 and decreased by \$377 thousand from June 30, 2017 to June 30, 2018. The increase from June 30, 2018 to June 30, 2019 was mainly due to the unrealized gain on investments resulting from the net increase in the adjustment on State Treasury investments and the decrease from June 30, 2017 to June 30, 2018 was tied chiefly to the unrealized loss on investments resulting from the net decrease in the adjustments on State Treasury investments. The other three components of the Lottery's net position, as explained above, combine for a positive and relatively unchanged net position of \$2.9, \$2.6 million, and \$2.4 million at June 30, 2019, June 30, 2018, and June 30, 2017, respectively.

Statements of Revenues, Expenses and Changes in Net Position

The statements of revenues, expenses and changes in net position present the financial activity of the Lottery over the fiscal year. The focus is on operating revenues and expenses that have a significant effect on the distributions paid to the proceeds recipients. As discussed in Note 13 below, the Lottery reevaluated the classification and presentation of pension and other postemployment benefit expense and determined it would be appropriate to reclassify the amounts from a nonoperating activity to an operating activity. These amounts are now included in the Wages and benefits line. As such the 2018 and 2017 financial statements have been restated.

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**Condensed Statements of Revenues, Expenses and
Changes in Net Position**
For the Fiscal Years Ended June 30, 2019, 2018, and 2017

	2019	2018 (Restated)	2017 (Restated)
Operating Revenues	\$ 679,779,611	\$ 611,993,333	\$ 555,333,490
Direct Operating Expenses	483,410,571	442,729,142	394,451,245
Gross Profit on Sale of Tickets	196,369,040	169,264,191	160,882,245
Other Operating Expenses			
Marketing and communications	14,883,619	13,597,868	13,634,184
Wages and benefits	7,195,223	18,741,540	15,602,556
Other operating expenses	5,980,644	5,750,192	5,168,772
Total Other Operating Expenses	28,059,486	38,089,600	34,405,512
Other Operating Revenue	185,141	163,651	177,409
Total Operating Income	168,494,695	131,338,242	126,654,142
Nonoperating Revenues			
Investment income	2,318,941	382,486	314,792
Transfer in - pension direct distribution	175,361	-	-
Total Nonoperating Revenues	2,494,302	382,486	314,792
Proceeds distributions	(166,461,160)	(140,736,802)	(133,474,981)
Total Nonoperating Expenses	(166,461,160)	(140,736,802)	(133,474,981)
Net Income/(Loss)	4,527,837	(9,016,074)	(6,506,047)

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**Condensed Statements of Revenues, Expenses and
Changes in Net Position (Continued)**
For the Fiscal Years Ended June 30, 2019, 2018, and 2017

	2019	2018 (Restated)	2017 (Restated)
Net Position, Beginning of Year	\$ (37,284,858)	\$ (28,268,784)	\$ (20,761,917)
Net Change in Net Position	4,527,837	(9,016,074)	(6,506,047)
Net Position, End of Year	\$ (32,757,021)	\$ (37,284,858)	\$ (27,267,964)

Sales Activities

With the continuing record-setting pace of scratch sales from the prior fiscal year and with a total of six jackpots reaching over \$435 million throughout the fiscal year on the jackpot product side, including the record setting Mega Millions jackpot of \$1.5 billion, Fiscal Year 2019 revenues from the sales of Lottery products ended at an all-time high of \$679.8 million. Sales revenues for the current fiscal year were up from the previous fiscal year and previous record holder by over \$67.8 million, representing an 11.1 percent increase in overall sales. Fiscal Year 2018 sales revenues of \$612.0 million were up from the previous fiscal year of 2017 by nearly \$56.7 million, representing a 10.2 percent increase.

Fiscal Year 2019 scratch sales of \$443.4 million represented a \$35.9 million or 8.8 percent increase from Fiscal Year 2018 scratch sales of \$407.5 million. The increase in scratch ticket sales in Fiscal Year 2019 can be attributed to a \$28.6 million or 31.6 percent increase in sales of \$10 priced tickets, a \$9.2 million or 29.3 percent increase in sales of \$50 priced tickets, and a \$2.6 million or 11.6 percent increase in sales of \$2 priced tickets over the previous fiscal year. A strong showing in the crossword play style, from the \$500,000 Spotlight games and from the second Willy Wonka Golden Ticket explained the increase in the \$10 priced scratch category. The total of increased sales was offset by a decrease in sales of \$2.0 million or 9.6 percent in sales of \$1 priced tickets, nearly \$1.3 million or 1.3 percent in sales of \$20 priced tickets, and a combined decrease in sales of \$1.2 million or 1.4 percent in sales of \$5 and \$3 priced tickets

Fiscal Year 2018 scratch sales of \$407.5 million represented a nearly \$27.3 million or 7.2 percent increase from the prior fiscal year scratch sales of \$380.2 million. Starting in the month of November 2017 and continuing through the end of the fiscal year, scratch sales were up when compared to the prior fiscal year month over month. The introduction of the second \$50 scratch game in Lottery history in December 2017 resulted in a \$9.1 million or 41.2 percent increase in ticket sales at that price level over the sales of the remaining inventory of the first \$50 priced ticket seen in Fiscal Year 2017. Sales of the \$3, \$5, \$10 and \$20 priced tickets, led by a jump in the \$20 priced tickets of \$8.0 million, combined for a \$21.6 million increase in scratch sales compared to Fiscal Year 2017, offset by a decline in sales of the lower \$1 and \$2 priced tickets of \$3.5 million. The introduction of three new \$20 priced scratch games, including ones with \$1 million and \$750 thousand top prizes, resulted in the nearly 11.0 percent increase in sales at that price point.

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Combined jackpot game sales also reached record setting levels in Fiscal Year 2019. Jackpot sales for the current fiscal year ended at \$236.4 million, a \$31.9 million or 15.6 percent increase over the previous fiscal year record. The increase in jackpot game sales can be attributed to the higher sales associated with four Mega Millions and two Powerball jackpots that reached the \$435 million level or higher throughout the current fiscal year, with the October 2018 Mega Millions jackpot of \$1.5 billion, mentioned earlier, the highest. The Mega Millions game changed from a \$1 to \$2 priced game during Fiscal Year 2018, making Fiscal Year 2019 the first full year with Mega Millions jackpot sales at the higher price and the resulting higher jackpots. Fiscal Year 2019 Mega Millions sales jumped \$34.3 million or 89.4 percent over Fiscal Year 2018, mainly associated with the buying frenzy that came with the second highest-ever national jackpot. Powerball game sales of \$86.1 million in Fiscal Year 2019 represented the highest of any of the jackpot games, however, was slightly down by \$2.0 million or 2.3 percent from the previous fiscal year. Combined sales of \$77.5 million from all other jackpot products (Lotto, Cash 5 with Cash 5 EZ Match, Pick 3 and Lucky For Life) were also slightly down by just \$0.4 million from sales of the same products in the previous fiscal year.

Fiscal Year 2018 jackpot game sales saw a \$29.4 million or 16.8 percent increase over Fiscal Year 2017 jackpot sales. This was due to the nearly \$15.2 million increase of Powerball sales, the \$12.6 million increase of Mega Millions sales, and the net total increase of \$1.7 million sales of all other jackpot games for Fiscal Year 2018 over the previous fiscal year.

The following tables compare Lottery product sales between fiscal years.

Product Sales	2019	2018	Difference	Change
Scratch	\$ 443,409,967	\$ 407,489,335	\$ 35,920,632	8.8 %
Powerball	86,147,274	88,156,321	(2,009,047)	(2.3)
Lotto	28,034,842	28,462,945	(428,103)	(1.5)
Mega Millions	72,719,920	38,401,894	34,318,026	89.4
Cash 5	16,571,656	17,666,933	(1,095,277)	(6.2)
Cash 5 EZ Match	3,041,876	3,881,956	(840,080)	(21.6)
Pick 3	12,902,998	12,247,661	655,337	5.4
Lucky For Life	16,951,078	15,686,288	1,264,790	8.1
Total	<u>\$ 679,779,611</u>	<u>\$ 611,993,333</u>	<u>\$ 67,786,278</u>	11.1

Product Sales	2018	2017	Difference	Change
Scratch	\$ 407,489,335	\$ 380,249,492	\$ 27,239,843	7.2 %
Powerball	88,156,321	73,002,056	15,154,265	20.8
Lotto	28,462,945	30,609,106	(2,146,161)	(7.0)
Mega Millions	38,401,894	25,789,410	12,612,484	48.9
Cash 5	17,666,933	17,632,114	34,819	0.2
Cash 5 EZ Match	3,881,956	1,060,341	2,821,615	266.1
Pick 3	12,247,661	10,995,867	1,251,794	11.4
Lucky For Life	15,686,288	15,995,104	(308,816)	(1.9)
Total	<u>\$ 611,993,333</u>	<u>\$ 555,333,490</u>	<u>\$ 56,659,843</u>	10.2

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Other Operating Revenues

Other operating revenues for both the Fiscal Years ended June 30, 2019 and June 30, 2018 totaled nearly \$0.2 million with a slight increase in the current fiscal year of \$21 thousand. Other operating revenues mainly represent the net change in the bonding reserve mentioned earlier, amounts collected from Lottery retailers for annual licensing fees, liquidated damages charged to the jackpot gaming vendor for failure to satisfy or perform the duties and obligations as outlined in their contract between them and the Lottery, and fees the Lottery is allowed to charge retailers for failure to clear their weekly sweep of amounts owed.

Nonoperating Revenues

Nonoperating revenues for the years ended June 30, 2019 and June 30, 2018 totaled over \$2.5 million and \$0.4 million, respectively. The major reason for the nearly \$2.1 million increase was due to the \$1.4 million increase in the Lottery's share of the unrealized gains on investments held by the Treasury tied to the GASB Statement No. 31 adjustment recording, the \$.5 million net increase in nonoperating interest revenue earned on investments held by the Treasury and by the MUSL group mainly due to the increases in the average cash balances held and in the interest rate paid on investments throughout the current fiscal year, and the nearly \$0.2 million transfer-in from the Treasury for the pension direct distribution made to Colorado PERA mentioned in the note section below. The GASB Statement No. 31 adjustment resulted in an increase in revenue of \$1.4 million due to the change from a net loss of \$553 thousand recorded in Fiscal Year 2018 to a net gain of \$839 thousand recorded in Fiscal Year 2019.

Total Revenues

Total revenues were \$682.4 million and \$612.5 million for the years ended June 30, 2019 and June 30, 2018, respectively. The major contributing factor to the increase in total revenues of \$69.9 million was primarily due to the overall 11.1 percent increase in jackpot and scratch game sales for a total increase of over \$67.8 million in game sales in the current fiscal year. In addition, other operating revenue, investment income, and the pension transfer-in combined for a \$2.1 million increase as outlined above.

Major Expenses

The Lottery incurred \$483.4 million or 93.9 percent of its total expenses of nearly \$511.5 million for Fiscal Year ended June 30, 2019 in direct support of the Lottery games. These expenses include prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the jackpot gaming system. Of the \$483.4 million spent in Fiscal Year 2019 for the direct support of the Lottery games; \$416.9 million was for prize expense associated with those games.

In comparison, over \$442.7 million or 93.8 percent of the Lottery's total expenses of \$480.8 million for the Fiscal Year ended June 30, 2018 were game-related expenses. Of the over \$442.7 million spent in Fiscal Year 2018 for direct support of the Lottery games, \$383.5 million was spent for prize expense associated with those games.

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Total prize expense in Fiscal Year 2019 increased nearly \$33.5 million from Fiscal Year 2018 primarily due to the overall increase in sales experienced in Fiscal Year 2019; however, the prize expense as a percentage of sales decreased from 62.7 percent to 61.3 percent for Fiscal Year 2018 and Fiscal Year 2019, respectively. The decrease of prize expense as a percentage of sales was primarily due to an increase in unclaimed prizes as mentioned earlier, including the \$2.9 million increase in scratch unclaimed prizes and the \$1.0 million increase in Mega Millions unclaimed prizes. Total unclaimed prizes increased from \$10.1 million or nearly 1.7 percent of sales in Fiscal Year 2018 to nearly \$13.8 million or 2.0 percent of sales in Fiscal Year 2019 for a total decrease to prize expense of \$3.7 million, resulting in a 0.5 percent drop in prize expense as a percentage of sales in the current fiscal year. The remaining drop in prize expense as a percentage of sales in Fiscal Year 2019 can be attributed to several factors including the nearly 1.4 percent product shift from scratch sales (from 66.6 percent of total sales to 65.2 percent) to jackpot sales (from 33.4 percent of total sales to 34.8 percent) due to the fact that jackpot sales carry a lower prize expense percentage and the initial booking of the \$3 million second change prize for the \$50 scratch game at the start of the game in Fiscal Year 2018 with the majority of sales occurring in Fiscal Year 2019.

Total prize expense in Fiscal Year 2018 increased nearly \$42.0 million from Fiscal Year 2017 due to the increase in overall sales; however, the prize expense as a percentage of sales increased from 61.5 percent to 62.7 percent for Fiscal Year 2017 and Fiscal Year 2018, respectively. The increase in prize expense as a percentage of sales can be primarily attributed to the drop in unclaimed prizes written off in Fiscal Year 2018, to the booking of the second-chance drawing for the \$50 scratch game mentioned directly above, and to a lesser degree to the change in sales product mix and the associated prize expense percentage tied to the games played.

As a percentage of sales, the overall other game-related expenses other than prize expense increased from 9.7 percent in Fiscal Year 2018 to 9.8 percent in Fiscal Year 2019. Increases in retailer bonuses and vendor fees cost percentages were offset by decreases in retailer commissions and cost of tickets percentages.

Following are tables comparing the game-related expenses between Fiscal Years 2019 and 2018:

Game-Related Expenses	2019	% of Sales	2018	% of Sales	Difference	Change in % of Sales
Prize Expense						
Scratch	\$ 299,240,160	65.2 %	\$ 280,699,778	68.9 %	\$ 18,540,382	(3.7) %
Powerball	40,950,837	47.5	41,966,627	47.6	(1,015,790)	(0.1)
Lotto	14,529,352	51.8	15,298,252	53.7	(768,900)	(1.9)
Mega Millions	34,900,730	48.0	18,667,694	48.6	16,233,036	(0.6)
Cash 5	9,159,621	55.3	9,550,117	54.1	(390,496)	1.2
Cash 5 EZ Match	1,777,359	58.4	2,293,935	59.1	(516,576)	(0.7)
Pick 3	6,209,327	48.1	5,923,621	48.4	285,706	(0.3)
Lucky For Life	10,171,758	60.0	9,087,701	57.9	1,084,057	2.1
Total prize expense	416,939,144	61.3	383,487,725	62.7	33,451,419	(1.4)
Retailer compensation						
Commissions	45,128,159	6.6	40,701,692	6.7	4,426,467	(0.1)
Bonuses	6,446,362	1.0	5,424,871	0.9	1,021,491	0.1
Ticket costs	2,898,566	0.4	2,624,629	0.4	273,937	-
Vendor fees	11,998,340	1.8	10,490,225	1.7	1,508,115	0.1
Total direct op. exp.	<u>\$ 483,410,571</u>	71.1 %	<u>\$ 442,729,142</u>	72.4 %	<u>\$ 40,681,429</u>	(1.3) %

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Following are tables comparing the game-related expenses between Fiscal Years 2018 and 2017:

Game-Related Expenses	2018	% of Sales	2017	% of Sales	Difference	Change in % of Sales
Prize Expense						
Scratch	\$ 280,699,778	68.9 %	\$ 256,841,122	67.5 %	\$ 23,858,656	1.4 %
Powerball	41,966,627	47.6	33,189,585	45.5	8,777,042	2.1
Lotto	15,298,252	53.7	14,569,038	47.6	729,214	6.1
Mega Millions	18,667,694	48.6	11,408,993	44.2	7,258,701	4.4
Cash 5	9,550,117	54.1	9,294,847	52.7	255,270	1.4
Cash 5 EZ Match	2,293,935	59.1	648,493	61.2	1,645,442	(2.1)
Pick 3	5,923,621	48.4	5,509,525	50.1	414,096	(1.7)
Lucky For Life	9,087,701	57.9	10,056,946	62.9	(969,245)	(5.0)
Total prize expense	383,487,725	62.7	341,518,549	61.5	41,969,176	1.2
Retailer compensation						
Commissions	40,701,692	6.7	37,031,098	6.7	3,670,594	-
Bonuses	5,424,871	0.9	3,694,336	0.6	1,730,535	0.3
Ticket costs	2,624,629	0.4	2,950,426	0.5	(325,797)	(0.1)
Vendor fees	10,490,225	1.7	9,256,836	1.7	1,233,389	-
Total direct op. exp.	<u>\$ 442,729,142</u>	72.4 %	<u>\$ 394,451,245</u>	71.1 %	<u>\$ 48,277,897</u>	1.3 %

Non game-related expenses totaled nearly \$28.1 million in Fiscal Year 2019 compared to \$38.1 million in Fiscal Year 2018, a \$10.0 million or 2.6 percent decrease. Of the nearly \$28.1 million non game-related expenses in Fiscal Year 2019, \$14.9 million was for marketing agency fees, promotions, and institutional and product advertising compared to \$13.6 million in Fiscal Year 2018. Increases in specific product advertising, sponsorships, and research costs were partially offset by decreases in corporate/proceeds advertising, special events, point of sale materials and website management costs. Other significant non game-related expenses in Fiscal Year 2019 included wages and benefits expense of \$7.2 million including a nearly \$3.4 million adjustment decrease of pension and OPEB expenses tied to the requirements of GASB Statement No. 68, GASB Statement No. 71, and GASB Statement No. 75, \$1.7 million for payments made to other state agencies including indirect cost allocations paid to the Department of Revenue and the Office of Information Technology (OIT) and audit costs paid to the Office of the State Auditor and \$1.0 million for delivery of scratch games. Increases in non game-related expenses for marketing-related costs of \$1.3 million, wages and benefits of \$0.3 million and professional services costs of \$0.3 million, were offset by the decrease in the pension and OPEB expense adjustment of \$12.0 million and much smaller decreases in equipment, annual and sick leave, depreciation, and telephone costs of \$0.2 million.

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Non game-related expenses totaled \$38.1 million in Fiscal Year 2018 compared to \$34.4 million in Fiscal Year 2017, a \$3.7 million or nearly 10.7 percent increase. Of the \$29.4 million non game-related expenses in Fiscal Year 2018, \$13.6 million was for marketing agency fees, promotions and institutional and product advertising. The marketing and communication expenses stayed about the same from Fiscal Year 2018 compared to Fiscal Year 2017. Other significant non game-related expenses in Fiscal Year 2018 included \$18.7 million for wages and benefits, including an \$8.7 million adjustment increase of pension and OPEB expenses tied to the requirements of GASB Statement No. 68, GASB Statement No. 71, and GASB Statement No. 75, \$1.7 million for payments made to other state agencies including indirect cost allocations paid to the Department of Revenue and to the Office of Information Technology, and \$1.0 million for delivery of scratch games. Increases in non game-related expenses of the pension and OPEB expense adjustment (\$2.4 million), wages and benefits (nearly \$0.7 million), auditing costs (\$0.3 million), and combined increase of delivery, space rental, and equipment costs (\$0.2 million) were offset by smaller decreases in telephone, marketing depreciation and travel expenses (\$0.1 million).

Distributions to the Proceeds Recipients

The Lottery's proceeds distribution for Fiscal Year 2019 totaled nearly \$166.5 million, becoming the highest fiscal-year proceeds amount in the Lottery's history. This represented an increase of \$25.7 million or 18.3 percent over the Fiscal Year 2018 proceeds amount of \$140.7 million. Fiscal Year 2016, with proceeds distribution totaling \$143.6 million, became the fiscal year with the second highest proceeds amount, trailing Fiscal Year 2019 by \$22.9 million. As a percentage of total revenue, the Lottery returned 24.4 percent in Fiscal Year 2019, an increase of 1.4 percent from the 23.0 percent in Fiscal Year 2018. Of these total proceeds, nearly \$68.5 million, the cap amount, was allocated to the Great Outdoors Colorado Trust Fund, \$66.6 million to the Conservation Trust Fund and over \$16.6 million to the Division of Parks and Outdoor Recreation per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 44-40-111. Due to the fact that the maximum distribution to Great Outdoors Colorado of nearly \$68.5 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, over \$14.7 million spilled over into the Public School Capital Construction Assistance Fund pursuant to C.R.S. 22-43.7-104 (2)(b)(III).

Capital Assets

The Lottery's investment in net capital assets at June 30, 2019, 2018, and 2017 amounted to \$0.4 million, \$0.3 million, and \$0.3 million, respectively. The investment in capital assets as of June 30, 2019, 2018, and 2017 included computer equipment, servers, back office computer system, drawing equipment, modular furniture, cameras, recorders and leasehold improvements net of accumulated depreciation. The asset values of equipment increased by \$279,523 from Fiscal Year 2018 to Fiscal Year 2019.

The over \$279 thousand net increase in equipment from Fiscal Year 2018 to Fiscal Year 2019 was due to the over \$250 thousand purchase and capitalization of a new security camera system and the \$29 thousand for Cisco software. The \$74 thousand increase in equipment from Fiscal Year 2017 to Fiscal Year 2018 was due to the nearly \$174 thousand purchase and capitalization of computer equipment and software and upgrades to the video conferencing and phone systems netted against the write off of fully-depreciated miscellaneous computer and security equipment of \$100 thousand. Capital assets are shown on the Statement of Net Position at the cost on the day of acquisition.

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Analysis of changes in capital assets is as follows (Note 3):

Capital Assets as of
June 30, 2019, 2018, and 2017

Capital Assets	<u>2019</u>	<u>2018</u>	<u>2017</u>
Equipment	\$ 6,278,097	\$ 5,998,573	\$ 5,924,273
Leasehold Improvements	64,711	64,711	64,711
Less: Accumulated Depreciation	<u>(5,920,256)</u>	<u>(5,778,328)</u>	<u>(5,703,417)</u>
Net capital assets	<u>\$ 422,552</u>	<u>\$ 284,956</u>	<u>\$ 285,567</u>

Budgetary Highlights

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (the Long Bill), which determines budgets for every agency within the State. Many of the appropriation lines in the Long Bill are at the Department of Revenue (department) level, and the department has the discretion to allocate them among each agency within the department. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. Department level re-allocations were approved in variable vehicle, leased space and vehicle lease payments. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in Fiscal Year 2019.

The approved Lottery budget at the beginning of Fiscal Year 2019 was \$530.9 million. Department level reallocations approved throughout the fiscal year increased the overall budget slightly by \$30,000 to an amended total of nearly \$531.0 million. Total expenditures and roll-forwards for Fiscal Year 2019 on a budget basis came to nearly \$515.7 million, resulting in excess appropriations (or savings) of \$15.2 million.

Economic Outlook

According to the Colorado Economic and Fiscal Outlook for June 2019 published by the Governor's Office of State Planning and Budgeting, Colorado's strong economic growth experienced in recent years is expected to moderate in the future. The strong employment and growing wages seen in Colorado, however, continues to encourage consumer spending. With this in mind, the Colorado Lottery is optimistic to continue to grow its sales and the resulting proceeds paid to its recipients, including the expectation to exceed the statutory capped amount that is distributed to Great Outdoors Colorado with a spillover to the BEST program. With new management in place, the Colorado Lottery is projecting sales of \$750 million for Fiscal Year 2020, a bold but obtainable goal.

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In Colorado's largest revenue-generating area, the scratch game family will be undergoing several changes to align with industry best practices. Currently the Lottery offers twenty-four games at one time. In the immediate future twenty-eight games will be stocked at retail outlets across the state, with the goal to have forty to forty-five games available for order by the retailers by the end of the fiscal year. This will provide a greater variety of game options for players. Scheduled game launches are also being implemented. Other states have found that retailers prefer to receive new game shipments on a regular schedule and core players like to know when new games are going to be available for purchase.

The entire lottery industry in the United States has been experiencing strong growth in its higher priced scratch games, which in Colorado are the \$10, \$20 and \$50 price points. Research is being done to determine what is motivating players to gradually move up the price points and what changes the Colorado Lottery can make to optimize sales and proceeds as players make their scratch game purchases.

In the jackpot area, for the first time since the game was introduced 30 years ago, Colorado's own Lotto jackpot game is being restructured. Since the introduction of Powerball, Lotto sales have shown a continual decline in sales. In an effort to generate new excitement around Colorado's oldest jackpot game, the Lottery has decided to change the original Lotto game to the new *Colorado Lotto+* game. Changes in the price from the current \$1 to a \$2 ticket and the option to purchase, for an additional \$1, another chance in a second drawing provides players more ways to win. Including the addition of the second drawing, the new game offers a built-in prize multiplier for both draws, faster growing jackpots and improved odds of winning. Based on other states' success with this game structure, the Lottery is estimating the new game will grow sales by almost \$17 million in Fiscal Year 2020. Launching in late September 2019, changes like this to Colorado-only games will provide a stabilizing factor to future sales. Looking for new ways to play within the jackpot area, the Lottery is also researching monitor-type games, including not only rapid-draw Keno but also predetermined result monitor games such as horse racing and mixed martial art matches.

Although the Lottery has a goal of decreasing its dependence on the national Powerball and Mega Millions games, maintaining and growing the gross sales of these games remains a high priority. One of the ways to address this is to advertise the large multi-million jackpot amounts to ensure that all players, regular and potential, are aware of the amount that can be won.

The Lottery knows that innovation and modernization are necessary in all areas of the Lottery business to continue to deliver record proceeds amounts to beneficiaries for conservation, recreation and schools in Colorado.

Contacting the Lottery's Financial Management

This management discussion and analysis report is designed to provide Colorado citizens, Colorado government officials, our players, retailers and other interested parties with a general overview of the Lottery's financial activity for Fiscal Year 2018 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact Nancy Bartosz, the Colorado Lottery's Controller, 225 North Main Street, Pueblo, CO 81003.

COLORADO LOTTERY
Statements of Net Position
June 30, 2019 and 2018

	2019	2018
ASSETS		
Current Assets:		
Cash and Investments	\$ 52,227,733	\$ 44,741,997
Accounts Receivable, net of the allowance for doubtful accounts of \$116,665 in 2019 and \$122,970 in 2018	24,015,933	22,062,655
Consignment Inventory, at Cost	99,627	100,948
Warehouse Inventory, at Cost	1,509,864	1,769,127
Prepaid Expenses	121,727	94,198
Total Current Assets	77,974,884	68,768,925
Reserved and Restricted Assets:		
Cash and Investments-Operating Reserve	1,800,000	1,700,000
Cash and Investments-Licensed Agent Recovery Reserve Receipts	688,356	593,286
Prepaid Prize Expense with MUSL	5,947,281	4,719,138
Total Reserved and Restricted Assets	8,435,637	7,012,424
Capital Assets:		
Equipment	6,278,097	5,998,573
Leasehold Improvements	64,711	64,711
Less Accumulated Depreciation and Amortization	(5,920,256)	(5,778,328)
Total Capital Assets	422,552	284,956
TOTAL ASSETS	86,833,073	76,066,305
DEFERRED OUTFLOWS		
Pensions	4,283,041	9,748,300
Other Postemployment Benefits	78,450	64,281
TOTAL DEFERRED OUTFLOWS	4,361,491	9,812,581
TOTAL ASSETS AND DEFERRED OUTFLOWS	\$ 91,194,564	\$ 85,878,886

COLORADO LOTTERY
Statements of Net Position
June 30, 2019 and 2018

	2019	2018
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 3,987,046	\$ 707,663
Prize Liability	36,623,032	37,101,507
Payable to MUSL	1,149,410	1,387,224
Accrued Annual and Sick Leave	43,897	3,448
Wages and Benefits	1,076,709	927,389
Retailer Bonus Liability	3,519,872	2,659,524
Funds Available for Distribution	36,458,259	30,463,958
Total Current Liabilities	82,858,225	73,250,713
Long-Term Liabilities:		
Accrued Annual and Sick Leave	776,135	784,134
Expired Warrants Liability	22,616	26,731
Net Pension Liability	25,422,465	45,852,060
Other Postemployment Benefits Liability	1,075,746	1,066,928
Total Long-Term Liabilities	27,296,962	47,729,853
TOTAL LIABILITIES	110,155,187	120,980,566
DEFERRED INFLOWS		
Pensions	13,761,517	2,165,329
Other Postemployment Benefits	34,881	17,849
TOTAL DEFERRED INFLOWS	13,796,398	2,183,178
NET POSITION		
Investment in Capital Assets	422,552	284,956
Restricted-Licensed Agent Recovery Reserve	688,356	593,286
Restricted-Operating Reserve	1,800,000	1,700,000
Unrestricted (deficit)	(35,667,929)	(39,863,100)
TOTAL NET POSITION	(32,757,021)	(37,284,858)
TOTAL LIABILITIES AND NET POSITION	\$ 91,194,564	\$ 85,878,886

COLORADO LOTTERY
Statements of Revenues, Expenses, and Changes in Fund Net Position
For the Years Ended June 30, 2019 and 2018

	2019	2018 (Restated)
OPERATING REVENUES		
Gross Ticket Sales	\$ 679,779,611	\$ 611,993,333
DIRECT OPERATING EXPENSES		
Prize Expense	416,939,144	383,487,725
Retailer Commissions and Bonuses	51,574,521	46,126,563
Cost of Tickets and Vendor Fees	14,896,906	13,114,854
Total Direct Operating Expenses	483,410,571	442,729,142
GROSS PROFIT ON SALE OF TICKETS	196,369,040	169,264,191
OTHER OPERATING EXPENSES		
Marketing and Communications	14,883,619	13,597,868
Administration Fees Paid to MUSL	158,031	127,308
Wages and Benefits	7,195,223	18,741,540
Professional Services	619,373	308,442
State Agencies Services	1,015,058	1,009,405
Department of Revenue Services	698,576	718,738
Travel	109,018	82,057
Equipment	76,654	241,291
Depreciation	141,928	176,158
Space Rental	919,465	889,867
Rents for Equipment	33,169	31,269
Motor Pool Leasing	300,504	315,012
Materials and Supplies	195,458	154,633
Telephone	148,290	174,281
Equipment Maintenance	340,011	332,596
Printing	19,644	14,529
Delivery Expense	1,026,532	1,011,990
Other	178,933	162,616
Total Other Operating Expenses	28,059,486	38,089,600
OTHER OPERATING REVENUE	185,141	163,651

COLORADO LOTTERY
Statements of Revenues, Expenses, and Changes in Fund Net Position
(Continued)
For the Years Ended June 30, 2019 and 2018

	2019	2018 (Restated)
TOTAL OPERATING INCOME	\$ 168,494,695	\$ 131,338,242
NONOPERATING REVENUES (EXPENSES)		
Investment Income	2,318,941	382,486
Transfer-In Pension Direct Distribution	175,361	-
Funds Distributed for Current Year	(130,002,901)	(110,272,844)
Funds Available for Distribution for Current Year	(36,458,259)	(30,463,958)
Total Nonoperating Expenses	(163,966,858)	(140,354,316)
NET INCOME (LOSS)	4,527,837	(9,016,074)
NET POSITION, BEGINNING OF YEAR	(37,284,858)	(28,268,784)
Net Change in Net Position	4,527,837	(9,016,074)
NET POSITION, END OF YEAR	\$ (32,757,021)	\$ (37,284,858)

COLORADO LOTTERY
Statements of Cash Flows
For the Years Ended June 30, 2019 and 2018

	2019	2018 (Restated)
Cash Flows from Operating Activities		
Cash received from retailers	\$ 678,630,691	\$ 611,338,227
Cash paid in prizes	(417,383,824)	(380,834,168)
Cash paid in retailer commissions	(45,128,159)	(40,701,692)
Cash payments to suppliers	(34,228,882)	(33,454,467)
Cash payments to employees for services	(10,194,559)	(9,943,892)
Cash paid in retailer bonus	(5,587,019)	(3,994,596)
	<u>166,108,248</u>	<u>142,409,412</u>
Cash Flows from Noncapital Financing Activities		
Distribution of net proceeds	(160,466,859)	(143,016,839)
	<u>(160,466,859)</u>	<u>(143,016,839)</u>
Cash Flows from Capital and Related Financing Activities		
Acquisition of capital assets	(279,524)	(175,547)
	<u>(279,524)</u>	<u>(175,547)</u>
Cash Flows from Investing Activities		
Interest received	1,480,237	935,239
Change in fair market value of investments	838,704	(552,753)
	<u>2,318,941</u>	<u>382,486</u>
Increase (Decrease) in Cash and Investments	7,680,806	(400,488)
Cash and Investments, Beginning of Year (including \$2,293,286 and \$1,924,591 in restricted accounts for 2019 and 2018, respectively)	<u>47,035,283</u>	<u>47,435,771</u>
Cash and Investments, End of Year, (including \$2,488,356 and \$2,293,286 in restricted accounts for 2019 and 2018, respectively)	<u>\$ 54,716,089</u>	<u>\$ 47,035,283</u>

COLORADO LOTTERY
Statements of Cash Flows
(Continued)
For the Years Ended June 30, 2019 and 2018

	2019	2018 (Restated)
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 168,494,695	\$ 131,338,242
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	141,928	176,158
Wages and Benefits - Pension and OPEB Adjustment	(3,356,467)	8,639,276
Transfer-In Pension Direct Distribution	175,361	-
Change in:		
Accounts Receivable	(1,953,278)	(1,060,921)
Warehouse and Consignment Inventory	260,583	(423,636)
Prepaid Expenses	(27,529)	1,780
Prepaid Prize Expense with MUSL	(1,228,143)	(319,445)
Liabilities (excluding funds available for distribution)	3,601,098	4,057,958
Net cash provided by operating activities	\$ 166,108,248	\$ 142,409,412
Reconciliation of Cash and Investments		
Cash and investments	\$ 52,227,733	\$ 44,741,997
Restricted cash and investments- Licensed Agent		
Recovery Reserve	688,356	593,286
Restricted cash and investments- Operating Reserve	1,800,000	1,700,000
Cash and Investments, End of Year	\$ 54,716,089	\$ 47,035,283

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Colorado Lottery (the Lottery) began operations April 30, 1982 under the provisions of Section 24-35-202, C.R.S. (recodified to Section 44-40-102 in 2018). The Lottery operates under a commission and provides operation and service of lottery games as authorized by the statute. The Lottery's revenues are predominantly earned from the sale of lottery products, including scratch games and jackpot games including Lotto, Powerball, Cash 5, Cash 5 EZ Match, Mega Millions, Pick 3, and Lucky For Life.

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado, for the Fiscal Years ended June 30, 2019 and 2018. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery in accordance with accounting principles generally accepted in the United States of America.

The accounting policies of the Lottery conform to accounting principles generally accepted in the United States of America as applicable to governments. The following is a summary of the more significant policies.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities and deferred inflows of resources and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains, losses and other changes in net position during the reporting period. Actual results could differ from those estimates.

Fund Accounting

Government resources are allocated to and accounted for in separate sub-entities called funds, based upon the purposes for which the resources are to be spent and the means by which spending activities are controlled. A fund is a fiscal and accounting entity with a self-balancing set of accounts that comprise its assets, deferred outflows of resources, liabilities, deferred inflows of resources, net position, revenues and expenditures.

Enterprise Fund

The Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the Lottery's costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. The Lottery defines operating revenues as those earned as a direct result of the fund's principal ongoing operations, i.e., the sale of lottery products. Operating expenses include expenses incurred in earning those revenues such as prize payments, the cost of tickets, vendor fees, retailer commissions and bonuses, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Pensions

The Lottery participates in the State Division Trust Fund (SDTF), a cost-sharing multiple-employer defined benefit pension fund administered by the Public Employees' Retirement Association of Colorado ("PERA"). The net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, information about the fiduciary net position and additions to/deductions from the fiduciary net position of the SDTF have been determined using the economic resources measurement focus and the accrual basis of accounting. 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.

The Colorado General Assembly passed significant pension reform through Senate Bill (SB) 18-200: *Concerning Modifications To the Public Employees' Retirement Association Hybrid Defined Benefit Plan Necessary to Eliminate with a High Probability the Unfunded Liability of the Plan Within the Next Thirty Years*. The bill was signed into law by Governor Hickenlooper on June 4, 2018. A brief description of some of the major changes to plan provisions required by SB 18-200 for the SDTF are listed below. A full copy of the bill can be found online at www.leg.colorado.gov.

- Increases employer contribution rates for the SDTF by 0.25 percent on July 1, 2019.
- Increases employee contribution rates for the SDTF by a total of 2 percent (to be phased in over a period of 3 years starting on July 1, 2019).
- As specified in C.R.S. § 24-51-413, the State is required to contribute \$225 million each year to PERA starting on July 1, 2018. A portion of the direct distribution payment is allocated to the SDTF based on the proportionate amount of annual payroll of the SDTF to the total annual payroll of the SDTF, School Division Trust Fund, Judicial Division Trust Fund, and Denver Public Schools Division Trust Fund.
- Modifies the retirement benefits, including temporarily suspending and reducing the annual increase for all current and future retirees, increases the highest average salary for employees with less than five years of service credit on December 31, 2019 and raises the retirement age for new employees.
- Member contributions, employer contributions, the direct distribution from the State, and the annual increases will be adjusted based on certain statutory parameters beginning July 1, 2020, and then each year thereafter, to help keep PERA on path to full funding in 30 years.
- Expands eligibility to participate in the PERA DC Plan to certain new members of the State Division hired on or after January 1, 2019, who are classified State College and University employees. Beginning January 1, 2021, and every year thereafter, employer contribution rates for the SDTF will be adjusted to include a defined contribution supplement based on the employer contribution amount paid to defined contribution plan participant accounts that would have otherwise gone to the defined benefit trusts to pay down the unfunded liability plus any defined benefit investment earnings thereon.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Other Postemployment Benefits (OPEB)

The Lottery participates in the Health Care Trust Fund (HCTF), a cost-sharing multiple-employer defined benefit OPEB fund administered by the Public Employees' Retirement Association of Colorado ("PERA"). The net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, OPEB expense, information about the fiduciary net position and additions to/deductions from the fiduciary net position of the HCTF have been determined using the economic resources measurement focus and the accrual basis of accounting. For this purpose, benefits paid on behalf of health care participants are recognized when due and/or payable in accordance with the benefit terms. Investments are reported at fair value.

Basis of Accounting

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements. The Lottery accounts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of ticket pack activation. Revenues from Lotto, Powerball, Cash 5, Cash 5 EZ Match, Mega Millions, Pick 3, and Lucky For Life ticket sales are recognized when the tickets are sold. Prize expense for scratch tickets is recognized at the point of ticket activation. Prize expense for Lotto, Powerball, Cash 5, Cash 5 EZ Match, Mega Millions, Pick 3, and Lucky For Life is recognized when tickets are sold. Other operating expenses are recognized when they are incurred.

Budget

By October 24th of each year, the Department of Revenue Executive Director submits to the Governor's Office of State Planning and Budgeting a proposed legislative budget for the fiscal year commencing the following July 1. The legislative budget includes proposed expenditures and the means of financing them.

Public hearings are conducted by the Joint Budget Committee to obtain clarification and taxpayer comments. Prior to June 30, the budget is legally enacted through passage of a law referred to as the Long Bill.

During the fiscal year, the approved legislative budget may be modified due to roll-forward authorization, supplemental budget approval or line item transfer authorization. All modifications must be approved by the State Controller and the Office of State Planning and Budgeting and the Legislature.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from retailers for activated scratch ticket packs and uncollected jackpot game sales. Billable accounts receivable consist of amounts due from retailers for settled scratch ticket packs and uncollected jackpot game sales. Billable accounts receivable is invoiced weekly and is electronically transferred from the retailers' accounts into the Lottery's account one week following the invoice date.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Allowance for doubtful accounts represents a provision for receivables that will probably not be collected in the future. Consideration of the economic climate, credit-worthiness of individual account debtors, bankruptcy of debtor, discontinuance of debtor's business, and failure of repeated attempts to collect and barring of collection by statute of limitations are factors used in considering when an account becomes uncollectible. The accrual of a loss contingency is required when a loss is probable and/or can be reasonably estimated.

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 44-40-121, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve are shown net of estimated uncollectible receivables of \$116,665 and \$122,970 as of June 30, 2019 and 2018, respectively.

Warehouse Inventory

Warehouse inventory represents unsold tickets in possession of the Lottery and is stated at cost, using the specific identification method.

Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Lottery. The retailer cannot sell a pack of tickets until the pack is activated by the retailer, which then enables the winning tickets to be cashed. The activation is therefore the point at which the transfer of ownership is recognized. Since the Lottery still owns non-activated tickets, the tickets are included in the inventory and reported on the Statements of Net Position. Consignment inventory is stated at cost using the specific identification method.

Supplies Inventory

The State of Colorado's threshold for recording supplies inventories is \$100,000 per location. The supplies inventory of the Lottery consistently falls below the \$100,000 threshold per location. Accordingly, no supplies inventory appears on the Statements of Net Position.

Prepaid Prize Expense

As part of the Lottery's agreement with the Multi-State Lottery Association (MUSL), for both the Powerball and Mega Millions games, a certain percentage of sales must be paid to MUSL, when required, to bring the set prize and grand prize reserves up to the reserve requirement amounts as determined by MUSL. During Fiscal Year 2019, a total of \$437,914 was transferred from the Powerball Set Prize Reserve to cover the payment of lower-tier prizes. Repayments of \$454,274 to the Powerball Set Prize Reserve and net transfers of \$124,965 to the Powerball Grand Prize Reserve were made to meet the rebalanced reserve requirements of the Lottery. At fiscal year end, a slight total deficit of \$38 thousand still existed between the total set prize and grand prize reserve requirements of over \$3.3 million and the amount held by MUSL. During Fiscal Year 2018, a total of \$705,399 was transferred from the Powerball Set Prize Reserve to cover the payment of lower-tier prizes. Repayments of \$750,315 including net transfers of \$229,203 from the grand prize reserve were made to meet the reserve requirements.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

With the change to Mega Millions to a \$2 game and to its odds of winning in late October 2017, the total reserve requirement was increased to \$100 million for all Mega Millions member states. The Lottery's Mega Millions reserve requirement remained at approximately \$2.7 million during Fiscal Year 2019 from the previous fiscal year. With a \$1.1 million deficit to the required amount at the end of Fiscal Year 2018, payments of over \$1.2 million, representing two percent of sales, were made in Fiscal Year 2019 to not only make up this deficit but to cover the \$139,616 payment of lower-tier prizes transferred out of the Mega Millions Prize reserve during the fiscal year. At the end Fiscal Year 2019, a slight deficit of approximately \$18 thousand existed. In Fiscal Year 2018 payments of \$617 thousand were made to the Mega Millions reserve. In addition, with the Lottery's approval, MUSL holds small amounts in an unreserved account to be used to pay miscellaneous, unforeseen expenses. The unreserved account included in prepaid prize expense at June 30, 2019 and 2018 was nominal at \$3.

Capital Assets

Capital assets, which include internal use computer software, equipment, vehicles, and leasehold improvements, are stated at cost. The Lottery adheres to the state policy of capitalizing equipment only if the cost exceeds \$5,000 and has a useful life of more than one year. Depreciation for equipment and internal use computer software is computed on the straight-line method over estimated useful lives ranging from three to ten years. Depreciation for vehicles is computed on the straight-line method over an estimated useful life of five years. Leasehold improvements are depreciated over the greater of five years or the term of the lease. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains or losses are recognized in current operations.

Deferred Outflows/Inflows of Resources

In addition to assets, the Statements of Net Position includes a separate section for deferred outflows of resources. This separate element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Lottery's Deferred Outflows for Pensions and OPEB represents the amount of pension and health care trust fund contributions made to the State plans subsequent to the December 31, 2018 measurement date, the deferred variance in expected to actual investment earnings, the deferred experience gains and losses, changes in employer proportion and differences between contributions recognized and proportionate share of contributions and changes in assumptions.

In addition to liabilities, the Statements of Net Position includes a separate section for deferred inflows of resources. This separate element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The Lottery's Deferred Inflows for Pensions and OPEB represents the change in the Lottery's "proportionate share" developed to distribute the aggregate plan liability and expense among all the employers' represented by the cost-sharing multiple-employer defined benefit pension plan in which the Lottery participates, the deferred experience gains and losses, and the change in pension and health care investments.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Accrued Wages and Benefits

At the end of each fiscal year, the state shifts the pay date for the month of June for employees paid on a monthly basis, deferring the date from the last working day of June to the first working day of July. For the Lottery, along with other minor payroll accruals, this created a liability for accrued wages and benefits at June 30, 2019 and 2018 of \$1,076,709 and \$927,389, respectively.

Prize Liability and Prize Expense

Under the provisions of Section 44-40-111 (9), C.R.S., the Lottery must pay no less than fifty percent (50%) of total ticket sales as prizes. In the aggregate, the Lottery continues to meet this requirement. Additional prize expense and corresponding liability may be incurred as a result of market fluctuations in the cost of annuities used to pay various jackpots (see Note 11).

All scratch, jackpot game and special drawing prizes are accounted for using the accrual basis of accounting. Scratch prize liability and expense are recognized at the point of ticket pack activation. The liability and expense for jackpot game prizes are recognized at the point of retail sale and are adjusted as the jackpot game draws occur and actual prize liability is determined. The liability for special drawing prizes is accrued on the first day of sales of the associated game. Prize liability for all games is reduced as prizes are paid to winners. The net prize liability at June 30, 2019 and 2018 was \$36,623,032 and \$37,101,507, respectively.

Payments of scratch prize amounts of \$150 or less may be made at the Lottery or at the retail outlet; payment of scratch prize amounts of \$151 to \$599 may be made at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of \$600 or more are paid by the Lottery. Retailer accounts are credited for any prize payments retailers make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes accrued as a liability will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of \$9,075,526 for Fiscal Year ended June 30, 2019 and \$6,137,678 for Fiscal Year ended June 30, 2018.

Payments of cumulative jackpot game prize amounts of \$150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of \$151 to \$599 on a single ticket may be made at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of \$600 or more on a single ticket must be made at the Lottery. Retailer accounts are credited for any prize payments retailers make on a daily basis. Jackpot game prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed jackpot game prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed jackpot game prizes resulted in a decrease to prize expense of \$4,764,600 for Fiscal Year ended June 30, 2019 and \$4,010,642 for Fiscal Year ended June 30, 2018.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Retailer Bonus Liability

As outlined in the Lottery Retailer Application, each licensee is entitled to receive a cashing bonus of one percent (1%) of each prize paid by the licensee up to and including \$599.99. In addition, a marketing performance bonus up to five-tenths of one percent (0.5%) of total product sales may be earned by licensees that meet the criteria set forth by the Lottery Director or their designee. In the event there is a residual from the accrual of the one percent (1%) cashing bonus and/or the five-tenths (0.5%) marketing bonus, the Director may provide additional compensation to licensees or may revert the excess amount thereby decreasing the bonus expense.

The cashing bonus is accrued as tickets are sold and paid as winning tickets are redeemed. The write off of the accrued cashing bonus liability tied to unclaimed prizes at the end of the 180-day claim period in Fiscal Years 2019 and 2018 is recorded as a reduction of bonus expense.

The marketing performance bonus is accrued monthly and paid to retailers in accordance with the criteria as set out in the fiscal year marketing performance plan as approved by the Director. The write off of any excess marketing performance bonus accrued is recorded as a reduction of bonus expense.

Licensed Agent Recovery Reserve

Under the provisions of Section 44-40-121, C.R.S., a Licensed Agent Recovery Reserve, established on January 1, 1988, is used to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Executive Director of the Department of Revenue and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of \$2,000 surety coverage per outlet at their discretion. As of June 30, 2019 and June 30, 2018, the Lottery had reserved \$688,356 and \$593,286, respectively. The Lottery utilizes restricted net position before using unrestricted net position for bad debts.

Lottery Fund Net Position

In accordance with Section 44-40-111 (5)(a), C.R.S., the Lottery is required to reserve “sufficient monies, as of the end of the fiscal year, to ensure the operation of the Lottery for the ensuing fiscal year.” The moneys reserved by the lottery shall be held in cash and investments.

In June 2002 the Lottery Commission approved a balance in net assets “equal to the net value of the Lottery’s capital assets”. As of June 30, 2019 and June 30, 2018, the Lottery had reported \$422,552 and \$284,956, respectively.

In April 2005, the Lottery set up a separate operating reserve independent of the net operating reserve in the amount of \$1.7 million. The amount held in this operating reserve is reviewed annually and adjusted accordingly. The annual reviews were completed in January 2019 and January 2018. The reserve increased to \$1.8 million in Fiscal Year 2019 from the \$1.7 million in Fiscal Year 2018, in accordance with the reviews.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Equipment Expense

Included in “The Statement of Revenues, Expenses, and Changes in Fund Net Position” is an account titled equipment. This account reports the gain or loss on disposed assets, fixed asset purchases under the capitalization threshold, software purchases under the capitalization threshold, and other miscellaneous equipment transactions that do not qualify for capitalization.

Compensated Leave

All permanent employees of the Lottery may accrue annual and sick leave based on length of service subject to certain limitations on the amount that will be paid upon termination. In addition, employees who are classified as non-exempt from overtime pay have accumulated overtime which must be taken as compensatory time or paid. The estimated cost of compensated absences for which employees are vested is as follows:

	<u>June 30, 2018</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2019</u>
Annual leave	\$ 660,648	\$ 586,632	\$ (562,650)	\$ 684,630
Sick leave	124,021	46,778	(36,403)	134,396
Total annual and sick leave	<u>784,669</u>	<u>633,410</u>	<u>(599,053)</u>	<u>819,026</u>
Compensatory time	2,913	16,844	(18,751)	1,006
Total compensated leave	<u>\$ 787,582</u>	<u>\$ 650,254</u>	<u>\$ (617,804)</u>	<u>\$ 820,032</u>
	<u>June 30, 2017</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2018</u>
Annual leave	\$ 646,901	\$ 547,795	\$ (534,048)	\$ 660,648
Sick leave	102,591	44,868	(23,438)	124,021
Total annual and sick leave	<u>749,492</u>	<u>592,663</u>	<u>(557,486)</u>	<u>784,669</u>
Compensatory time	842	15,420	(13,349)	2,913
Total compensated leave	<u>\$ 750,334</u>	<u>\$ 608,083</u>	<u>\$ (570,835)</u>	<u>\$ 787,582</u>

The short-term portion of the above accrued annual and sick leave at June 30, 2019 and June 30, 2018 is \$43,897 and \$3,448, respectively. This represents the amount to be paid out to known current employees planning to retire and cash in their leave balances within the next twelve months.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Promotional Activity

The Lottery engages in three types of promotional activities in an attempt to enhance sales, to increase player awareness and to increase the player base: special promotions and drawings, direct giveaways, and buy x-get-y. The number and amount of promotional activities can and do vary year over year due to such factors as budget availability, retailer and special events participation, and new product introductions. Specific promotional coupons/tickets are distributed/awarded to players through special promotions and drawings and can be redeemed/claimed at any lottery office for a specified Lottery product. Specific promotional coupons/tickets with a total face value of \$2,000 and \$3,904 were redeemed in Fiscal Years ended June 30, 2019 and June 30, 2018, respectively.

Scratch and jackpot game tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the Fiscal Years ended June 30, 2019 and June 30, 2018, scratch tickets with a total face value of \$160,594 and \$156,729, respectively, were given away. No free jackpot tickets were given away in Fiscal Year 2019 and Fiscal Year 2018.

For the “buy x-get-y” promotions, players are given the opportunity to receive a “free” jackpot ticket when a qualifying purchase is made, for instance buy five Lotto tickets receive a free Pick 3 ticket. During the Fiscal Year ended June 30, 2019, free promotional tickets from a variety of jackpot games with a total face value of \$22,416 were given away with several different buy x qualifiers. During the Fiscal Year ended June 30, 2018, Powerball jackpot game tickets with a total face value of \$328,182 were given away with several different buy x qualifiers. The associated prize expense of the tickets of \$164,091 was reimbursed by MUSL through the approved use of the funds by the Powerball Group.

Scratch and jackpot game tickets and coupon promotions are valued at cost. For the Fiscal Years ended June 30, 2019 and June 30, 2018, \$113,168 and \$118,673, respectively, were recorded as costs related to special promotions and drawings, direct giveaways, and free tickets. These costs were included in Marketing and Communications expense in the statements of revenues, expenses and changes in fund net position.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 2 – CASH AND INVESTMENTS

Cash

Cash includes petty cash funds, change funds, an imprest account, a depository account and cash on deposit with the State Treasurer. A detail of cash at June 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Petty cash	\$ 1,550	\$ 1,150
Change funds	73,000	73,000
Imprest account	200,000	169,000
Depository accounts	50,000	50,000
Cash on deposit with State Treasurer	<u>51,903,183</u>	<u>44,448,847</u>
 Total unrestricted cash and investments	 <u>52,227,733</u>	 <u>44,741,997</u>
 Restricted cash and investments - Licensed Agent		
Recovery Reserve Receipts on deposit with State Treasurer	688,356	593,286
Operating Reserve on deposit with State Treasurer	<u>1,800,000</u>	<u>1,700,000</u>
 Total restricted cash and investments	 <u>2,488,356</u>	 <u>2,293,286</u>
 Total cash and investments	 <u>\$ 54,716,089</u>	 <u>\$ 47,035,283</u>

Cash on Deposit with State Treasurer

Under the provisions of Section 44-40-111 (6), C.R.S., the State Treasurer shall invest the monies of the Lottery in excess of operating and prize payment expenses and all authorized transfers. Interest or any other return on investments is paid to the Lottery Fund account on a monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for Fiscal Years 2019 and 2018 was 2.22% and 1.65%, respectively.

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1, C.R.S. The State Treasury acts as a bank for all state agencies and institutions of higher education, with the exception of the University of Colorado. Moneys deposited in the Treasury are invested until the cash is needed. As of June 30, 2019, the Lottery had cash on deposit with the State Treasurer of \$54,391,539, which represented approximately 0.6 percent of the total \$9,096.5 million fair value of deposits in the State Treasurer's Pool (Pool). As of June 30, 2019, the Pool's resources included \$73.7 million of cash on hand and \$9,022.8 million of investments.

On the basis of the Lottery's participation in the Pool, the Lottery reports as an increase or decrease in cash its share of the Treasurer's unrealized gains and losses on the Pool's underlying investments. The State Treasurer does not invest any of the Pool's resources in any external investment pool, and there is no assignment of income related to participation in the Pool. The unrealized gains/losses included in income reflect only the change in fair value for the fiscal year.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 2 – CASH AND INVESTMENTS (CONTINUED)

Additional information on investments of the State Treasurer's Pool may be obtained in the State's Comprehensive Annual Financial Report for the year ended June 30, 2019.

The Lottery reports its share of the Treasurer's unrealized gains and losses based on its participation in the State Treasurer's Pool only at fiscal year end.

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Lottery's deposit policy for custodial credit risk requires compliance with the provisions of state law. State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Colorado; bonds of any city, county, school district or special road district of the State of Colorado; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

The Lottery accounts are held in Public Deposit Protection Act (PDPA) qualified institutions, thus balances held in the Lottery's accounts in excess of \$250,000 per institution are secured through PDPA with guaranteed securities.

Statements of Cash Flows

The statements of cash flows are prepared under the direct method then adjusted for prize payments and commission and bonus payments to retailers, which are netted from cash received from retailers and applied against accounts receivable balances. For cash flow purposes, cash and investments include restricted cash and investments held by the State Treasurer in its cash and investment pool.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 3 – SCHEDULE OF CHANGES IN CAPITAL ASSETS

	<u>June 30, 2018</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2019</u>
Capital assets being depreciated:				
Equipment and software	\$ 5,998,573	\$ 279,524	\$ -	\$ 6,278,097
Leasehold improvements	64,711	-	-	64,711
Total historical costs	<u>6,063,284</u>	<u>279,524</u>	<u>-</u>	<u>6,342,808</u>
Less accumulated depreciation for equipment	<u>(5,713,617)</u>	<u>(141,928)</u>	<u>-</u>	<u>(5,855,545)</u>
Less accumulated depreciation for leasehold improvements	<u>(64,711)</u>	<u>-</u>	<u>-</u>	<u>(64,711)</u>
Total accumulated depreciation	<u>(5,778,328)</u>	<u>(141,928)</u>	<u>-</u>	<u>(5,920,256)</u>
Total capital assets, being depreciated, net	<u>\$ 284,956</u>	<u>\$ 137,596</u>	<u>\$ -</u>	<u>\$ 422,552</u>
	<u>June 30, 2017</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2018</u>
Capital assets being depreciated:				
Equipment and software	\$ 5,924,273	\$ 175,547	\$ (101,247)	\$ 5,998,573
Leasehold improvements	64,711	-	-	64,711
Total historical costs	<u>5,988,984</u>	<u>175,547</u>	<u>(101,247)</u>	<u>6,063,284</u>
Less accumulated depreciation for equipment	<u>(5,638,706)</u>	<u>(176,158)</u>	<u>101,247</u>	<u>(5,713,617)</u>
Less accumulated depreciation for leasehold improvements	<u>(64,711)</u>	<u>-</u>	<u>-</u>	<u>(64,711)</u>
Total accumulated depreciation	<u>(5,703,417)</u>	<u>(176,158)</u>	<u>101,247</u>	<u>(5,778,328)</u>
Total capital assets, being depreciated, net	<u>\$ 285,567</u>	<u>\$ (611)</u>	<u>\$ -</u>	<u>\$ 284,956</u>

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 4 – OPERATING LEASES

The Lottery occupies office and warehouse space in Pueblo, Denver, Grand Junction, and Fort Collins. Rental payments are contingent upon the continuing availability of funds. Specific lease information follows:

Pueblo

Office – The Lottery entered into an agreement with Midtown RLLLP on April 19, 2005 and the lease agreement began on June 27, 2005. The original lease was superseded July 31, 2012 when a new lease agreement was executed. A lease amendment was signed on April 9, 2013 to provide the Lottery with funds to offset the costs of equipment and cabling, moving/relocation, and security equipment connected with acquiring the first and mezzanine floors of the building. A new lease amendment was signed on October 16, 2016 to clarify the Lottery's use of landlord owned equipment, and to agree to share the cost of a new uninterruptable power supply and a new power distribution system. The lease expires on June 30, 2022. The lease contains an option to renew for two additional five-year terms commencing on July 1, 2022. There are no other provisions for extension or renewal.

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease agreement, which was signed by the State Controller's Office on June 10, 2016 and became effective July 1, 2016 and expired June 30, 2019. Signed on November 19, 2018 by the State Controller's Office, the Lottery executed Amendment #1 to the lease with Santa Fe 250, LLC. Becoming effective July 1, 2019, the amendment extended the term of the lease from July 1, 2019 through June 30, 2024 and established the monthly rent for the extended term.

Denver

Office – The Lottery occupies office space in the Galleria Towers Building in Denver. The Lottery entered into a lease agreement, which began July 1, 2009 and expired June 30, 2019. Signed on May 22, 2019 by the State Controller's Office, the Lottery entered into a new lease agreement which will become effective on July 1, 2019 and expiring on June 30, 2024. The lease contains an option to renew for one additional five-year term commencing on July 1, 2024. There are no other provisions for extension or renewal.

Warehouse – On December 11, 2009, the Lottery entered into a lease agreement with Valley Business Corp., Inc. beginning on December 11, 2009 and expiring on June 30, 2015. Exercising its first renewal option, the Lottery executed Amendment #1 to the lease with Valley Business Corp. effective July 23, 2015, which extended the term of the lease from June 30, 2015 through June 30, 2020 and made certain modifications to the existing premises. The lease contains one (1) more option to renew for an additional consecutive period of five years. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Valley Business Corp. Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 4 – OPERATING LEASES (CONTINUED)

Fort Collins

The Lottery occupies space leased by the Department of Revenue and is responsible for reimbursing the Department of Revenue for lease payments.

Grand Junction

The Lottery occupies space in the Grand Junction State Services Building and is responsible for reimbursing the Capitol Complex Division of the Colorado Department of Personnel and Administration for lease payments.

Wireless Jackpot Signage

Effective June 21, 2016 the Lottery amended the IGT contract providing the jackpot gaming system to include the lease of 1,500 new in-store wireless jackpot signs capable of displaying information regarding jackpot amounts. Installation of the new signs is on a schedule agreed upon from time-to-time by the parties. The lease commenced on the effective date and will expire on June 30, 2021. The Lottery executed Option Letter #3 and extended the IGT contract through July 12, 2025. Contract Amendment #7 was executed on June 7, 2019 to establish new prices and rates, including for the lease of these jackpot signs.

LOCATION	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	Later Years
Pueblo Office	\$ 374,592	\$ 385,713	\$ 397,261	\$ -	\$ -	\$ -
Pueblo Warehouse	191,364	191,364	191,364	191,364	191,364	-
Denver Office	203,354	209,335	215,316	221,297	227,278	-
Denver Warehouse	119,522	-	-	-	-	-
In-store signage	667,000	749,500	840,250	940,075	1,049,882	1,209,158
	<u>\$ 1,555,832</u>	<u>\$ 1,535,912</u>	<u>\$ 1,644,191</u>	<u>\$ 1,352,736</u>	<u>\$ 1,468,524</u>	<u>\$ 1,209,158</u>

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 5 – OTHER REVENUE

A schedule of other revenue for the Fiscal Years ended June 30, 2019 and 2018 follows:

	<u>2019</u>	<u>2018</u>
License fees	\$ 64,470	\$ 62,853
Fines and penalties	16,239	16,403
Assignment fees	1,800	1,200
Net licensed agent recovery reserve receipts	95,070	76,566
Other	<u>7,562</u>	<u>6,629</u>
 Total	 <u>\$ 185,141</u>	 <u>\$ 163,651</u>

NOTE 6 – DISTRIBUTION OF NET PROCEEDS

The net proceeds amount is equal to the Lottery's net income plus or minus the changes in the components of net position as described earlier. In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. The State Treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Wildlife and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is \$35 million in 1992 dollars and is adjusted annually based on the consumer price index, which was calculated to be \$68.5 million for the year ended June 30, 2019. Any excess over the limit shall be transferred to the State Public School Capital Construction Assistance Fund.

Income available for distribution at June 30:

	<u>2019</u>	<u>2018</u>
Net Income before distributions	\$ 170,988,997	\$ 131,720,728
Changes in Net Position:		
Change in licensed agent recovery reserve	(95,070)	(76,566)
Change in fair market value of investments	(838,704)	552,753
Change in operating reserve	(100,000)	(100,000)
Change in investment in capital assets	(137,596)	611
Change in unfunded pension and OPEB revenue/expense	<u>(3,356,467)</u>	<u>8,639,276</u>
Income available for distribution	166,461,160	140,736,802
Less distributions prior to year-end	<u>(130,002,901)</u>	<u>(110,272,844)</u>
 Income available for distribution	 <u>\$ 36,458,259</u>	 <u>\$ 30,463,958</u>

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 6 – DISTRIBUTION OF NET PROCEEDS (CONTINUED)

	<u>Accrued at June 30, 2018</u>	<u>Proceed Distribution Expenses</u>	<u>Distributions Paid</u>	<u>Accrued at June 30, 2019</u>
Great Outdoors Colorado	\$ 11,114,576	\$ 68,494,436	\$ (76,116,027)	\$ 3,492,985
Public School Capital				
Construction Assistance Fund	4,117,403	14,736,143	(4,117,403)	14,736,143
Conservation Trust Fund	12,185,583	66,584,464	(64,186,743)	14,583,304
Division of Parks and Outdoor Recreation	<u>3,046,396</u>	<u>16,646,117</u>	<u>(16,046,686)</u>	<u>3,645,827</u>
	<u>\$ 30,463,958</u>	<u>\$ 166,461,160</u>	<u>\$ (160,466,859)</u>	<u>\$ 36,458,259</u>

	<u>Accrued at June 30, 2017</u>	<u>Proceed Distribution Expenses</u>	<u>Distributions Paid</u>	<u>Accrued at June 30, 2018</u>
Great Outdoors Colorado	\$ 14,098,436	\$ 66,250,998	\$ (69,234,858)	\$ 11,114,576
Public School Capital				
Construction Assistance Fund	2,273,562	4,117,403	(2,273,562)	4,117,403
Conservation Trust Fund	13,097,598	56,294,721	(57,206,736)	12,185,583
Division of Parks and Outdoor Recreation	<u>3,274,399</u>	<u>14,073,680</u>	<u>(14,301,683)</u>	<u>3,046,396</u>
	<u>\$ 32,743,995</u>	<u>\$ 140,736,802</u>	<u>\$ (143,016,839)</u>	<u>\$ 30,463,958</u>

NOTE 7 – PENSION PLANS

Defined Benefit Pension Plan

Plan Description

Eligible employees of the Lottery are provided with pensions through the State Division Trust Fund (SDTF)—a cost-sharing multiple-employer defined benefit pension plan administered by PERA. Plan benefits are specified in Title 24, Article 51 of the Colorado Revised Statutes (C.R.S.), administrative rules set forth at 8 C.C.R. 1502-1, and applicable provisions of the federal Internal Revenue Code. Colorado State law provisions may be amended from time to time by the Colorado General Assembly. PERA issues a publicly available comprehensive annual financial report that can be obtained at www.copera.org/investments/pera-financial-reports.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 7 – PENSION PLANS (CONTINUED)

Benefits Provided As of December 31, 2018

PERA provides retirement, disability, and survivor benefits. Retirement benefits are determined by the amount of service credit earned and/or purchased, highest average salary, the benefit structure(s) under which the member retires, the benefit option selected at retirement, and age at retirement. Retirement eligibility is specified in tables set forth at C.R.S. § 24-51-602, 604, 1713, and 1714.

The lifetime retirement benefit for all eligible retiring employees under the PERA Benefit Structure is the greater of the:

- Highest average salary multiplied by 2.5 percent and then multiplied by years of service credit
- The value of the retiring employee's member contribution account plus a 100 percent match on eligible amounts as of the retirement date. This amount is then annuitized into a monthly benefit based on life expectancy and other actuarial factors.

In all cases the service retirement benefit is limited to 100 percent of highest average salary and also cannot exceed the maximum benefit allowed by federal Internal Revenue Code.

Members may elect to withdraw their member contribution accounts upon termination of employment with all PERA employers; waiving rights to any lifetime retirement benefits earned. If eligible, the member may receive a match of either 50 percent or 100 percent on eligible amounts depending on when contributions were remitted to PERA, the date employment was terminated, whether 5 years of service credit has been obtained and the benefit structure under which contributions were made.

As of December 31, 2018, benefit recipients who elect to receive a lifetime retirement benefit are generally eligible to receive post-retirement cost-of-living adjustments in certain years, referred to as annual increases in the C.R.S. Pursuant to SB 18-200, there are no annual increases (AI) for 2018 and 2019 for all benefit recipients. Thereafter, benefit recipients under the PERA benefit structure who began eligible employment before January 1, 2007 will receive an annual increase, unless PERA has a negative investment year, in which case the annual increase for the next three years is the lesser of 1.5 percent or the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for the prior calendar year. Benefit recipients under the PERA benefit structure who began eligible employment after January 1, 2007 will receive the lesser of an annual increase of 1.5 percent or the average CPI-W for the prior calendar year, not to exceed 10 percent of PERA's Annual Increase Reserve (AIR) for the SDTF. The automatic adjustment provision may raise or lower the aforementioned AI for a given year by up to one-quarter of 1 percent based on the parameters specified C.R.S. § 24-51-413. Disability benefits are available for eligible employees once they reach five years of earned service credit and are determined to meet the definition of disability.

Survivor benefits are determined by several factors, which include the amount of earned service credit, highest average salary of the deceased, the benefit structure(s) under which service credit was obtained, and the qualified survivor(s) who will receive the benefits.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 7 – PENSION PLANS (CONTINUED)

Contributions provisions as of June 30, 2019

Eligible employees, the Lottery, and the State are required to contribute to the SDTF at a rate set by Colorado statute. The contribution requirements are established under C.R.S. § 24-51-401, et seq. and § 24-51-413. Eligible employees with the exception of State Troopers are required to contribute 8 percent of their PERA-includable salary through June 30, 2019. Contribution rates are expressed as a percentage of salary as defined in C.R.S. § 24-51-101(42).

The employer contribution requirements for all employees except State Troopers are summarized in the table below:

	Fiscal Year 2017		Fiscal Year 2018		Fiscal Year 2019	
	CY2016	CY2017	CY2017	CY2018	CY2018	CY2019
	7/1/16 - 12/31/16	1/1/17 - 6/30/17	7/1/17 - 12/31/17	1/1/18 - 6/30/18	7/1/18 - 12/31/18	1/1/19 - 6/30/19
Employer Contribution Rate	10.15%	10.15%	10.15%	10.15%	10.15%	10.15%
Amount of Employer Contribution Apportioned to the Health Care Trust Fund as specified in C.R.S. Section 24-51-208(1)(f)	-1.02%	-1.02%	-1.02%	-1.02%	-1.02%	-1.02%
Amount Apportioned to the SDTF	9.13%	9.13%	9.13%	9.13%	9.13%	9.13%
Amortization Equalization Disbursement (AED) as specified in C.R.S. Section 24-51-411*	4.60%	5.00%	5.00%	5.00%	5.00%	5.00%
Supplemental Amortization Equalization Disbursement (SAED) as specified in C.R.S., Section 24-51-411	4.50%	5.00%	5.00%	5.00%	5.00%	5.00%
Total Employer Contribution Rate to the SDTF	18.23%	19.13%	19.13%	19.13%	19.13%	19.13%

*Rates are expressed as a percentage of salary as defined in C.R.S. § 24-51-101(42).

As specified in C.R.S. § 24-51-413, the State is required to contribute \$225 million each year to PERA starting on July 1, 2018. A portion of the direct distribution payment is allocated to the SDTF based on the proportionate amount of annual payroll of the SDTF to the total annual payroll of the SDTF, School Division Trust Fund, Judicial Division Trust Fund, and Denver Public Schools Division Trust Fund. A portion of the direct distribution allocated to the SDTF is considered a nonemployer contribution for financial reporting purposes. The direct distribution amount allocated to the Lottery for the Fiscal Year ended June 30, 2019 was \$175,361.

Employer contributions are recognized by the SDTF in the period in which the compensation becomes payable to the member and the Lottery is statutorily committed to pay the contributions to the SDTF. Employer contributions recognized by the SDTF from the Lottery were \$1,414,350, \$1,290,829, and \$1,159,077 for the Fiscal Years ended June 30, 2019, 2018, and 2017, respectively and represented 100% of the total required contributions for each year.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 7 – PENSION PLANS (CONTINUED)

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2019 and 2018, the Lottery reported a liability of \$25,422,465 and \$45,852,060, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of December 31, 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2017. Standard update procedures were used to roll forward the total pension liability to December 31, 2018. The Lottery proportion of the net pension liability was based on the Lottery contributions to the SDTF for the calendar year 2018 relative to the total contributions of participating employers and the State as a nonemployer contributing entity for participating employers of the SDTF that are outside of the State's financial reporting entity.

At December 31, 2018, the Lottery proportion was .2234220529 percent, which was a decrease of .0056323029 percent from its proportion of .2290543558 percent measured as of December 31, 2017.

For the Fiscal Year ended June 30, 2019, the Lottery recognized pension revenue of \$1,778,437 and for Fiscal Year ended June 30, 2018, the Lottery recognized pension expense of \$9,910,429. At June 30, 2019, the Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Year ended June 30, 2019		Year ended June 30, 2018	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 726,997	\$ -	\$ 714,940	\$ -
Changes of assumptions or other inputs	1,338,622	13,127,768	7,961,666	-
Net difference between projected and actual earnings on pension plan investments	1,284,123	-	-	1,726,950
Changes in proportion and differences between contributions recognized and proportionate share of contributions	177,864	633,749	428,378	438,379
Contributions subsequent to the measurement date	755,435	-	643,316	-
Total	<u>\$ 4,283,041</u>	<u>\$ 13,761,517</u>	<u>\$ 9,748,300</u>	<u>\$ 2,165,329</u>

The amount of \$755,435 reported as deferred outflows of resources related to pensions, resulting from contributions subsequent to the measurement date, will be recognized as a reduction of the net pension liability in the Fiscal Year ended June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Year Ending June 30,	
2020	(4,788,703)
2021	(6,211,510)
2022	63,083
2023	703,219

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 7 – PENSION PLANS (CONTINUED)

Actuarial assumptions

The total pension liability in the December 31, 2017 actuarial valuation was determined using the following actuarial cost method, actuarial assumptions and other inputs:

Actuarial cost method	Entry age
Price inflation	2.40 percent
Real wage growth	1.10 percent
Wage inflation	3.50 percent
Salary increases, including wage inflation	3.50 – 9.17 percent
Long-term investment Rate of Return, net of pension plan investment expenses, including price inflation	7.25 percent
Discount rate	4.72 percent
Post-retirement benefit increases:	
PERA benefit structure hired prior to 1/1/07; and DPS benefit structure (automatic)	2.00 percent compounded annually
PERA benefit structure hired after 12/31/06 (ad hoc, substantively automatic)	Financed by the Annual Increase Reserve

The revised assumptions shown below were reflected in the roll-forward calculation of the total pension liability from December 31, 2017 to December 31, 2018:

Discount rate	7.25 percent
Post-retirement benefit increases:	
PERA benefit structure hired prior to 1/1/07 and DPS benefit structure (automatic)	0% through 2019 and 1.5% compounded annually, thereafter
PERA benefit structure hired after 12/31/06 (ad hoc, substantively automatic)	Financed by the Annual Increase Reserve

Healthy mortality assumptions for active members reflect the RP-2014 White Collar Employee Mortality Table, a table specifically developed for actively working people. To allow for an appropriate margin of improved mortality prospectively, the mortality rates incorporate a 70 percent factor applied to male rates and a 55 percent factor applied to female rates.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 7 – PENSION PLANS (CONTINUED)

Healthy, post-retirement mortality assumptions reflect the RP-2014 Healthy Annuitant Mortality Table, adjusted as follows:

- **Males:** Mortality improvement projected to 2018 using the MP-2015 projection scale, a 73 percent factor applied to rates for ages less than 80, a 108 percent factor applied to rates for ages 80 and above, and further adjustments for credibility.
- **Females:** Mortality improvement projected to 2020 using the MP-2015 projection scale, a 78 percent factor applied to rates for ages less than 80, a 109 percent factor applied to rates for ages 80 and above, and further adjustments for credibility.

For disabled retirees, the mortality assumption was based on 90 percent of the RP-2014 Disabled Retiree Mortality Table.

The actuarial assumptions used in the December 31, 2016, valuations were based on the results of the 2016 experience analysis for the periods January 1, 2012, through December 31, 2015, as well as, the October 28, 2016, actuarial assumptions workshop and were adopted by the PERA Board during the November 18, 2016, Board meeting.

The long-term expected return on plan assets is reviewed as part of regular experience studies prepared every four or five years for PERA. Recently, this assumption has been reviewed more frequently. The most recent analyses were outlined in presentations to PERA's Board on October 28, 2016.

Several factors were considered in evaluating the long-term rate of return assumption for the SDTF, including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed for each major asset class. These ranges were 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 then adding expected inflation.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 7 – PENSION PLANS (CONTINUED)

As of the most recent adoption of the long-term expected rate of return by the PERA Board, the target asset allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	30 Year Expected Geometric Real Rate of Return*
U.S. Equity - Large Cap	21.20%	4.30%
U.S. Equity - Small Cap	7.42%	4.80%
Non U.S. Equity - Developed	18.55%	5.20%
Non U.S. Equity - Emerging	5.83%	5.40%
Core Fixed Income	19.32%	1.20%
High Yield	1.38%	4.30%
Non U.S. Fixed Income - Developed	1.84%	0.60%
Emerging Market Debt	0.46%	3.90%
Core Real Estate	8.50%	4.90%
Opportunity Fund	6.00%	3.80%
Private Equity	8.50%	6.60%
Cash	1.00%	0.20%
	<hr/>	
Total	<u>100.00%</u>	

* In setting the long-term expected rate of return, projections employed to model future returns provide a range of expected long-term returns that, including expected inflation, ultimately support a long-term expected rate of return assumption of 7.25%.

Discount rate

The discount rate used to measure the total pension liability was 7.25 percent. The projection of cash flows used to determine the discount rate applied the actuarial cost method and assumptions shown above. In addition, the following methods and assumptions were used in the projection of cash flows:

- Total covered payroll for the initial projection year consists of the covered payroll of the active membership present on the valuation date and the covered payroll of future plan members assumed to be hired during the year. In subsequent projection years, total covered payroll was assumed to increase annually at a rate of 3.50%.
- Employee contributions were assumed to be made at the current member contribution rates in effect for each year, including scheduled increases in SB 18-200. Employee contributions for future plan members were used to reduce the estimated amount of total service costs for future plan members.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 7 – PENSION PLANS (CONTINUED)

- Employer contributions were assumed to be made at rates equal to the fixed statutory rates specified in law for each year, including the scheduled increase in SB 18-200. Employer contributions also include current and estimated future AED and SAED, until the actuarial value funding ratio reaches 103%, at which point, the AED and SAED will each drop 0.50% every year until they are zero. Additionally, estimated employer contributions included reductions for the funding of the AIR and retiree health care benefits. For future plan members, employer contributions were further reduced by the estimated amount of total service costs for future plan members not financed by their member contributions.
- As specified in law, the State will provide an annual direct distribution of \$225 million (actual dollars), commencing July 1, 2018, that is proportioned between the State, School, Judicial, and DPS Division Trust Funds based upon the covered payroll of each Division. The annual direct distribution ceases when all Division Trust Funds are fully funded.
- Employer contributions and the amount of total service costs for future plan members were based upon a process to estimate future actuarially determined contributions assuming an analogous future plan member growth rate.
- The AIR balance was excluded from the initial fiduciary net position, as, per statute, AIR amounts cannot be used to pay benefits until transferred to either the retirement benefits reserve or the survivor benefits reserve, as appropriate. AIR transfers to the fiduciary net position and the subsequent AIR benefit payments were estimated and included in the projections.
- Benefit payments and contributions were assumed to be made at the middle of the year.

Based on the above assumptions and methods, the projection test indicates the SDTF's fiduciary net position was projected to be available to make all projected future benefit payments of current members. Therefore, the long-term expected rate of return of 7.25 percent on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability. The discount determination does not use the municipal bond index rate, and therefore, the discount rate is 7.25 percent.

As of the prior measurement date, the long-term expected rate of return on plan investments of 7.25 percent and the municipal bond index rate of 3.43 percent were used in the discount rate determination resulting in a discount rate of 4.72 percent, 2.53 percent lower compared to the current measurement date.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 7 – PENSION PLANS (CONTINUED)

Sensitivity of the Lottery’s proportionate share of the net pension liability to changes in the discount rate

The following presents the proportionate share of the net pension liability calculated using the discount rate of 7.25 percent, as well as what the proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.25 percent) or 1-percentage-point higher (8.25 percent) than the current rate:

	1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
Proportionate share of the net pension liability	<u>\$ 31,604,499</u>	<u>\$ 25,422,465</u>	<u>\$ 20,191,900</u>

Pension plan fiduciary net position

Detailed information about the SDTF’s fiduciary net position is available in PERA’s comprehensive annual financial report which can be obtained at www.copera.org/investments/pera-financial-reports.

NOTE 8 – OTHER RETIREMENT PLANS

Defined Contribution Plan (DC Plan)

Plan Description

Employees of the State of Colorado that were hired on or after January 1, 2006 and employees of certain community colleges that were hired on or after January 1, 2008 which were eligible to participate in the SDTF, a cost-sharing multiple-employer defined benefit pension plan, have the option to participate in the SDTF or the Defined Contribution Retirement Plan (PERA DC Plan).

SB 18-200 expands eligibility to participate in the PERA DC Plan to new employees hired on or after January 1, 2019, who are classified State College and University employees. The PERA DC Plan is an Internal Revenue Code Section 401(a) governmental profit-sharing defined contribution plan. Title 24, Article 51, Part 15 of the C.R.S., as amended, assigns the authority to establish Plan provisions to the PERA Board of Trustees. The DC Plan is also included in PERA’s comprehensive annual financial report as referred to above.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 8 – OTHER RETIREMENT PLANS (CONTINUED)

Funding Policy

All participating employees in the PERA DC Plan, with the exception of State Troopers, are required to contribute 8.00 percent of their PERA-includable salary and the State of Colorado is required to contribute 10.15 percent of PERA-includable salary on behalf of these employees. All participating State Troopers are required to contribute 10.00 percent of their PERA-includable salary and the State of Colorado is required to contribute 12.85 percent of PERA-includable salary on behalf of these employees.

Additionally, the State of Colorado is required to contribute AED and SAED to the SDTF as follows:

	Fiscal Year 2017		Fiscal Year 2018		Fiscal Year 2019	
	CY2016	CY2017	CY2017	CY2018	CY2018	CY2019
	7/1/16 - 12/31/16	1/1/17 - 6/30/17	7/1/17 - 12/31/17	1/1/18 - 6/30/18	7/1/18 - 12/31/18	1/1/19 - 6/30/19
Amortization Equalization Disbursement (AED) as specified in C.R.S. Section 24-51-411	4.60%	5.00%	5.00%	5.00%	5.00%	5.00%
Supplemental Amortization Equalization Disbursement (SAED) as specified in C.R.S., Section 24-51-411*	4.50%	5.00%	5.00%	5.00%	5.00%	5.00%
Total Additional Employer Contribution Rate to the SDTF	9.10%	10.00%	10.00%	10.00%	10.00%	10.00%

*Rates are expressed as a percentage of salary as defined in C.R.S. § 24-51-101(42).

Contribution requirements are established under Title 24, Article 51, Section 1505 of the C.R.S., as amended. Participating employees of the PERA DC Plan are immediately vested in their own contributions and investment earnings and are immediately 50 percent vested in the amount of employer contributions made on their behalf. For each full year of participation, vesting of employer contributions increases by 10 percent. Forfeitures are used to pay expenses of the PERA DC Plan in accordance with PERA Rule 16.80 as adopted by the PERA Board of Trustees in accordance with Title 24, Article 51, Section 204 of the C.R.S. As a result, forfeitures do not reduce pension expense. The Lottery made contributions to other retirement plans totaling \$19,036 during Fiscal Year 2019 and \$13,676 during Fiscal Year 2018.

Voluntary Investment Program

Plan Description

Employees of the Lottery that are also members of the SDTF may voluntarily contribute to the Voluntary Investment Program, an Internal Revenue Code Section 401(k) defined contribution plan administered by PERA. Title 24, Article 51, Part 14 of the C.R.S., as amended, assigns the authority to establish the Plan provisions to the PERA Board of Trustees. PERA issues a publicly available comprehensive annual financial report which includes additional information on the Voluntary Investment Program. That report can be obtained at www.copera.org/investments/pera-financial-reports.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 8 – OTHER RETIREMENT PLANS (CONTINUED)

Funding Policy

The Voluntary Investment Program is funded by voluntary member contributions up to the maximum limits set by the Internal Revenue Service, as established under Title 24, Article 51, Section 1402 of the C.R.S., as amended. Employees are immediately vested in their own contributions.

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS

Defined Benefit Other Post Employment Benefit (OPEB) Plan

Plan description

Eligible employees of the Lottery are provided with OPEB through the Health Care Trust Fund (HCTF)—a cost-sharing multiple-employer defined benefit OPEB plan administered by PERA. The HCTF is established under Title 24, Article 51, Part 12 of the Colorado Revised Statutes (C.R.S.), as amended. Colorado State law provisions may be amended from time to time by the Colorado General Assembly. Title 24, Article 51, Part 12 of the C.R.S., as amended, sets forth a framework that grants authority to the PERA Board to contract, self-insure, and authorize disbursements necessary in order to carry out the purposes of the PERACare program, including the administration of the premium subsidies. Colorado State law provisions may be amended from time to time by the Colorado General Assembly. PERA issues a publicly available comprehensive annual financial report that can be obtained at www.copera.org/investments/pera-financial-reports.

Benefits provided

The HCTF provides a health care premium subsidy to eligible participating PERA benefit recipients and retirees who choose to enroll in one of the PERA health care plans, however, the subsidy is not available if only enrolled in the dental and/or vision plan(s). The health care premium subsidy is based upon the benefit structure under which the member retires and the member's years of service credit. For members who retire having service credit with employers in the Denver Public Schools (DPS) Division and one or more of the other four Divisions (State, School, Local Government and Judicial), the premium subsidy is allocated between the HCTF and the Denver Public Schools Health Care Trust Fund (DPS HCTF). The basis for the amount of the premium subsidy funded by each trust fund is the percentage of the member contribution account balance from each division as it relates to the total member contribution account balance from which the retirement benefit is paid.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

C.R.S. § 24-51-1202 et seq. specifies the eligibility for enrollment in the health care plans offered by PERA and the amount of the premium subsidy. The law governing a benefit recipient's eligibility for the subsidy and the amount of the subsidy differs slightly depending under which benefit structure the benefits are calculated. All benefit recipients under the PERA benefit structure and all retirees under the DPS benefit structure are eligible for a premium subsidy, if enrolled in a health care plan under PERACare. Upon the death of a DPS benefit structure retiree, no further subsidy is paid.

Enrollment in the PERACare is voluntary and is available to benefit recipients and their eligible dependents, certain surviving spouses, and divorced spouses and guardians, among others. Eligible benefit recipients may enroll into the program upon retirement, upon the occurrence of certain life events, or on an annual basis during an open enrollment period.

PERA Benefit Structure

The maximum service-based premium subsidy is \$230 per month for benefit recipients who are under 65 years of age and who are not entitled to Medicare; the maximum service-based subsidy is \$115 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The basis for the maximum service-based subsidy, in each case, is for benefit recipients with retirement benefits based on 20 or more years of service credit. There is a 5 percent reduction in the subsidy for each year less than 20. The benefit recipient pays the remaining portion of the premium to the extent the subsidy does not cover the entire amount.

For benefit recipients who have not participated in Social Security and who are not otherwise eligible for premium-free Medicare Part A for hospital-related services, C.R.S. § 24-51-1206(4) provides an additional subsidy. According to the statute, PERA cannot charge premiums to benefit recipients without Medicare Part A that are greater than premiums charged to benefit recipients with Part A for the same plan option, coverage level, and service credit. Currently, for each individual PERACare enrollee, the total premium for Medicare coverage is determined assuming plan participants have both Medicare Part A and Part B and the difference in premium cost is paid by the HCTF or the DPS HCTF on behalf of benefit recipients not covered by Medicare Part A.

DPS Benefit Structure

The maximum service-based premium subsidy is \$230 per month for retirees who are under 65 years of age and who are not entitled to Medicare; the maximum service-based subsidy is \$115 per month for retirees who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The basis for the maximum subsidy, in each case, is for retirees with retirement benefits based on 20 or more years of service credit. There is a 5 percent reduction in the subsidy for each year less than 20. The retiree pays the remaining portion of the premium to the extent the subsidy does not cover the entire amount.

For retirees who have not participated in Social Security and who are not otherwise eligible for premium-free Medicare Part A for hospital-related services, the HCTF or the DPS HCTF pays an alternate service-based premium subsidy. Each individual retiree meeting these conditions receives the maximum \$230 per month subsidy reduced appropriately for service less than 20 years, as described above. Retirees who do not have Medicare Part A pay the difference between the total premium and the monthly subsidy.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

Contributions

Pursuant to Title 24, Article 51, Section 208(1)(f) of the C.R.S., as amended, certain contributions are apportioned to the HCTF. PERA-affiliated employers of the State, School, Local Government, and Judicial Divisions are required to contribute at a rate of 1.02 percent of PERA-includable salary into the HCTF.

Employer contributions are recognized by the HCTF in the period in which the compensation becomes payable to the member and the Lottery is statutorily committed to pay the contributions. Employer contributions recognized by the HCTF from the Lottery for the Fiscal Years ending June 30, 2019, 2018, and 2017 were \$75,412, \$68,826, and \$65,749.

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

At June 30, 2019, the Lottery reported a liability of \$1,075,746 for its proportionate share of the net OPEB liability. The net OPEB liability for the HCTF was measured as of December 31, 2018, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of December 31, 2017. Standard update procedures were used to roll-forward the total OPEB liability to December 31, 2018. The Lottery's proportion of the net OPEB liability was based on the Lottery's contributions to the HCTF for the calendar year 2018 relative to the total contributions of participating employers to the HCTF.

At December 31, 2018, the Lottery proportion was .0790674504 percent, which was a decrease of .0030291760 percent its proportion of .0820966264 percent measured as of December 31, 2017.

For the year ended June 30, 2019, the Lottery recognized OPEB expense of \$87,093. At June 30, 2019, the Lottery reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Year ended June 30, 2019		Year ended June 30, 2018	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 3,904	\$ 1,637	\$ 5,046	\$ -
Changes of assumptions or other inputs	7,546	-		-
Net difference between projected and actual earnings on OPEB plan investments	6,186	-	-	17,849
Changes in proportion and differences between contributions recognized and proportionate share of contributions	20,535	33,244	24,934	-
Contributions subsequent to the measurement date	40,279	N/A	34,301	N/A
Total	\$ 78,450	\$ 34,881	\$ 64,281	\$ 17,849

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

The amount of \$40,279 reported as deferred outflows of resources related to OPEB, resulting from contributions subsequent to the measurement date, will be recognized as a reduction of the net OPEB liability in the year ended June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Fiscal Year Ending June 30,		\$	
2020			1,001
2021			1,001
2022			1,003
2023			5,298
2024			(4,800)
Thereafter			(214)

Actuarial assumptions

The total OPEB liability in the December 31, 2017 actuarial valuation was determined using the following actuarial cost method, actuarial assumptions and other inputs:

Actuarial cost method	Entry age
Price inflation	2.40 percent
Real wage growth	1.10 percent
Wage inflation	3.50 percent
Salary increases, including wage inflation	3.50 percent in aggregate
Long-term investment rate of return, net of OPEB plan investment expenses, including price inflation	7.25 percent
Discount rate	7.25 percent
Health care cost trend rates	
PERA benefit structure:	
Service-based premium subsidy	0.00 percent
PERACare Medicare plans	5.00 percent
Medicare Part A premiums	3.25 percent for 2018, gradually rising to 5.00 percent in 2025
DPS benefit structure:	
Service-based premium subsidy	0.00 percent
PERACare Medicare plans	N/A
Medicare Part A premiums	N/A

Calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each actuarial valuation and on the pattern of sharing of costs between employers of each fund to that point.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

The actuarial assumptions used in the December 31, 2017, valuations were based on the results of the 2016 experience analysis for the periods January 1, 2012, through December 31, 2015, as well as, the October 28, 2016, actuarial assumptions workshop and were adopted by the PERA Board during the November 18, 2016, Board meeting. In addition, certain actuarial assumptions pertaining to per capita health care costs and their related trends are analyzed and reviewed by PERA’s actuary, as discussed below.

In determining the additional liability for PERACare enrollees who are age sixty–five or older and who are not eligible for premium–free Medicare Part A, the following monthly costs/premiums are assumed for 2018 for the PERA Benefit Structure:

Medicare Plan	Cost for Members Without Medicare Part A	Premiums for Members Without Medicare Part A
Self-Funded Medicare Supplement Plans	\$736	\$367
Kaiser Permanente Medicare Advantage HMO	602	236
Rocky Mountain Health Plans Medicare HMO	611	251
UnitedHealthcare Medicare HMO	686	213

The 2018 Medicare Part A premium is \$422 per month.

In determining the additional liability for PERACare enrollees in the PERA Benefit Structure who are age sixty–five or older and who are not eligible for premium–free Medicare Part A, the following chart details the initial expected value of Medicare Part A benefits, age adjusted to age 65 for the year following the valuation date:

Medicare Plan	Cost for Members Without Medicare Part A
Self-Funded Medicare Supplement Plans	\$289
Kaiser Permanente Medicare Advantage HMO	300
Rocky Mountain Health Plans Medicare HMO	270
UnitedHealthcare Medicare HMO	400

All costs are subject to the health care cost trend rates, as discussed below. Health care cost trend rates reflect the change in per capita health costs over time due to factors such as medical inflation, utilization, plan design, and technology improvements. For the PERA benefit structure, health care cost trend rates are needed to project the future costs associated with providing benefits to those PERACare enrollees not eligible for premium-free Medicare Part A.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

Health care cost trend rates for the PERA benefit structure are based on published annual health care inflation surveys in conjunction with actual plan experience (if credible), building block models and heuristics developed by health plan actuaries and administrators, and projected trends for the Federal Hospital Insurance Trust Fund (Medicare Part A premiums) provided by the Centers for Medicare & Medicaid Services. Effective December 31, 2017, the health care cost trend rates for Medicare Part A premiums were revised to reflect the current expectation of future increases in rates of inflation applicable to Medicare Part A premiums.

The PERA benefit structure health care cost trend rates that were used to measure the total OPEB liability are summarized in the table below:

Year	PERACare Medicare Plans	Medicare Part A Premiums
2018	5.00%	3.25%
2019	5.00%	3.50%
2020	5.00%	3.75%
2021	5.00%	4.00%
2022	5.00%	4.25%
2023	5.00%	4.50%
2024	5.00%	4.75%
2025+	5.00%	5.00%

Mortality assumptions for the determination of the total pension liability for each of the Division Trust Funds as shown below are applied, as applicable, in the determination of the total OPEB liability for the HCTF. Affiliated employers of the State, School, Local Government, and Judicial Divisions participate in the HCTF.

Healthy mortality assumptions for active members were based on the RP-2014 White Collar Employee Mortality Table, a table specifically developed for actively working people. To allow for an appropriate margin of improved mortality prospectively, the mortality rates incorporate a 70 percent factor applied to male rates and a 55 percent factor applied to female rates.

Healthy, post-retirement mortality assumptions for the State and Local Government Divisions were based on the RP-2014 Healthy Annuitant Mortality Table, adjusted as follows:

- **Males:** Mortality improvement projected to 2018 using the MP-2015 projection scale, a 73 percent factor applied to rates for ages less than 80, a 108 percent factor applied to rates for ages 80 and above, and further adjustments for credibility.
- **Females:** Mortality improvement projected to 2020 using the MP-2015 projection scale, a 78 percent factor applied to rates for ages less than 80, a 109 percent factor applied to rates for ages 80 and above, and further adjustments for credibility.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

Healthy, post-retirement mortality assumptions for the School and Judicial Divisions were based on the RP-2014 White Collar Healthy Annuitant Mortality Table, adjusted as follows:

- Males: Mortality improvement projected to 2018 using the MP-2015 projection scale, a 93 percent factor applied to rates for ages less than 80, a 113 percent factor applied to rates for ages 80 and above, and further adjustments for credibility.
- Females: Mortality improvement projected to 2020 using the MP-2015 projection scale, a 68 percent factor applied to rates for ages less than 80, a 106 percent factor applied to rates for ages 80 and above, and further adjustments for credibility.

For disabled retirees, the mortality assumption was based on 90 percent of the RP-2014 Disabled Retiree Mortality Table.

The following health care costs assumptions were updated and used in the measurement of the obligations for the HCTF:

- Initial per capita health care costs for those PERACare enrollees under the PERA benefit structure who are expected to attain age 65 and older ages and are not eligible for premium-free Medicare Part A benefits were updated to reflect the change in costs for the 2018 plan year.
- The health care cost trend rates for Medicare Part A premiums were revised to reflect the then-current expectation of future increases in rates of inflation applicable to Medicare Part A premiums.

The long-term expected return on plan assets is reviewed as part of regular experience studies prepared every four or five years for PERA. Recently, this assumption has been reviewed more frequently. The most recent analyses were outlined in presentations to PERA's Board on October 28, 2016.

Several factors were considered in evaluating the long-term rate of return assumption for the HCTF, including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed for each major asset class. These ranges were 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 then adding expected inflation.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

Health care cost trend rates reflect the change in per capita health costs over time due to factors such as medical inflation, utilization, plan design, and technology improvements. For the PERA benefit structure, health care cost trend rates are needed to project the future costs associated with providing benefits to those PERACare enrollees not eligible for premium-free Medicare Part A.

Health care cost trend rates for the PERA benefit structure are based on published annual health care inflation surveys in conjunction with actual plan experience (if credible), building block models and heuristics developed by health plan actuaries and administrators, and projected trends for the Federal Hospital Insurance Trust Fund (Medicare Part A premiums) provided by the Centers for Medicare & Medicaid Services. Effective December 31, 2017, the health care cost trend rates for Medicare Part A premiums were revised to reflect the current expectation of future increases in rates of inflation applicable to Medicare Part A premiums.

As of the most recent adoption of the long-term expected rate of return by the PERA Board, the target asset allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	30 Year Expected Geometric Real Rate of Return*
U.S. Equity – Large Cap	21.20%	4.30%
U.S. Equity – Small Cap	7.42%	4.80%
Non U.S. Equity – Developed	18.55%	5.20%
Non U.S. Equity – Emerging	5.83%	5.40%
Core Fixed Income	19.32%	1.20%
High Yield	1.38%	4.30%
Non U.S. Fixed Income – Developed	1.84%	0.60%
Emerging Market Debt	0.46%	3.90%
Core Real Estate	8.50%	4.90%
Opportunity Fund	6.00%	3.80%
Private Equity	8.50%	6.60%
Cash	1.00%	0.20%
Total	100.00%	

In setting the long-term expected rate of return, projections employed to model future returns provide a range of expected long-term returns that, including expected inflation, ultimately support a long-term expected rate of return assumption of 7.25%.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

Sensitivity of the Lottery’s proportionate share of the net OPEB liability to changes in the Health Care Cost Trend Rates

The following presents the net OPEB liability using the current health care cost trend rates applicable to the PERA benefit structure, as well as if it were calculated using health care cost trend rates that are one percentage point lower or one percentage point higher than the current rates:

	1% Decrease in Trend Rates	Current Trend Rates	1% Increase in Trend Rates
PERACare Medicare trend rate	4.00%	5.00%	6.00%
Initial Medicare Part A trend rate	2.25%	3.25%	4.25%
Ultimate Medicare Part A trend rate	4.00%	5.00%	6.00%
Net OPEB Liability	\$1,046,040	\$1,075,746	\$1,109,912

Discount rate

The discount rate used to measure the total OPEB liability was 7.25 percent. The projection of cash flows used to determine the discount rate applied the actuarial cost method and assumptions shown above. In addition, the following methods and assumptions were used in the projection of cash flows:

- Updated health care cost trend rates for Medicare Part A premiums as of the December 31, 2018, measurement date.
- Total covered payroll for the initial projection year consists of the covered payroll of the active membership present on the valuation date and the covered payroll of future plan members assumed to be hired during the year. In subsequent projection years, total covered payroll was assumed to increase annually at a rate of 3.50%.
- Employer contributions were assumed to be made at rates equal to the fixed statutory rates specified in law and effective as of the measurement date.
- Employer contributions and the amount of total service costs for future plan members were based upon a process used by the plan to estimate future actuarially determined contributions assuming an analogous future plan member growth rate.
- Transfers of a portion of purchase service agreements intended to cover the costs associated with OPEB benefits were estimated and included in the projections.
- Benefit payments and contributions were assumed to be made at the middle of the year.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 9 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

Based on the above assumptions and methods, the projection test indicates the HCTF's fiduciary net position was projected to make all projected future benefit payments of current members. Therefore, the long-term expected rate of return of 7.25 percent on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability. The discount rate determination does not use the municipal bond index rate, and therefore, the discount rate is 7.25 percent.

Sensitivity of the Lottery's proportionate share of the net OPEB liability to changes in the discount rate

The following presents the proportionate share of the net OPEB liability calculated using the discount rate of 7.25 percent, as well as what the proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.25 percent) or 1-percentage-point higher (8.25 percent) than the current rate:

	1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
Proportionate share of the net OPEB liability	<u>\$ 1,203,666</u>	<u>\$ 1,075,746</u>	<u>\$ 966,386</u>

OPEB plan fiduciary net position

Detailed information about the HCTF's fiduciary net position is available in PERA's comprehensive annual financial report which can be obtained at www.copera.org/investments/pera-financial-reports.

NOTE 10 – CONTINGENCIES AND COMMITMENTS

Prize Annuities – The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts.

The Lottery remains liable for the payment of the guaranteed prizes in the event the insurance companies issuing the annuity contracts default. The following estimated prize payments for which annuity contracts have been purchased are due in varying amounts and are estimated to continue through September 22, 2079 based on updated life expectancy tables.

Specified prize payments	\$75,657,620
Lifetime prize payments	31,901,000
Total guaranteed prize payments	<u>\$107,558,620</u>

Prize Commitment – The Lottery also acts as a transfer agent for the single Powerball Jackpot Winner on October 10, 2007. These funds are held in trust at the MUSL in securities deemed appropriate by the Grand Prize Trust Agreement. The future value of this prize was \$14,641,000 as of June 30, 2019.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

Self-insurance – The State of Colorado currently self-insures its agencies, officials and employees for the risks of losses to which they are exposed. These include general liability, motor vehicle liability, and workers’ compensation. The Lottery participates in the Risk Management Fund. State agency premiums are based on an assessment of risk exposure and historical experience. The State Risk Management Fund is a Special Purpose General Fund used for claims adjustment, investigation, defense and authorization for the settlement and payment of claims or judgments against the state. The State insures its property through private carriers and is self-insured against general liability risks for both its officials and employees. It is also self-funded for employee healthcare plans, however, the risk resides with the employees.

Colorado employers are liable for occupational injuries and diseases of their employees. Benefits are prescribed by the Worker’s Compensation Act of Colorado for medical expenses and loss of wages resulting from job-related injuries. The state utilizes the services of BroadspireServices, Inc. to administer its plan. The state reimburses BroadspireServices, Inc. for the current cost of claims paid and related administrative expenses.

Risk management liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are re-evaluated periodically to take into consideration recently settled claims, the frequency of claims and other economic and social factors.

The limits of liability for which the state accepts responsibility pursuant to Section 24-10-114(1), C.R.S., are as follows:

Liability	Limits of Liability
General and automobile	Each person \$350,000 Each occurrence \$990,000

Before January 1, 1999, the Group Benefit Plans Fund provided an employer-paid short-term disability plan for all employees. On January 1, 1999, PERA began covering short-term disability claims for state employees eligible under its retirement plan. The Group Benefit Plans Fund continues to provide short-term disability coverage for employees not yet qualified for the retirement plan and secondary benefits for employees also covered under the PERA short-term disability plan.

The Group Benefit Plans short-term disability program provides an employee with 60 percent of their pay beginning after 30 days of disability or exhausting their sick leave balance, whichever is later. This benefit expires six months after the beginning of the disability. Although fully insured, the Group Benefit Plans disability program includes a risk-sharing feature that provides experience rating refunds calculated as earned premium less the aggregate of incurred claims, claim reserve, retention charge and refunds paid previously over the term of the contract. Refunds, when applicable, are paid annually.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

Furniture and Equipment – The State of Colorado carries a \$5,000 deductible replacement policy on all state owned furniture and equipment per Colorado Revised Statutes 24-30-1510.5(3)(a)(IV). For each loss incurred, the Lottery is responsible for the first \$5,000 of the deductible. Any loss in excess of \$5,000 is covered by the insurance carrier up to replacement cost.

Gaming Operations Commitments – The Lottery enters into long-term contracts with certain significant vendors related to providing jackpot data processing services and the design, production, and promotion of scratch tickets in support of the Lottery's gaming operations. The Lottery entered into a contract with IGT formally GTECH for jackpot data processing services, effective November 9, 2014 through June 30, 2021. The contract contains an Option to Extend for continued performance for up to a maximum of two (2) two-year extensions. Effective June 21, 2016 the Lottery amended the IGT contract to include the lease of new in-store wireless jackpot signs, as well as to provide service and replacement of existing in-store wireless jackpot signage. The Lottery also exercised the option to purchase 25 additional Lottery ticket vending machines. On June 7, 2019, upon approval of the State Controller, the Lottery exercised its option to extend the contract beginning July 11, 2021 and ending July 12, 2025 and its option to increase the quantity of the services provided by IGT. Also effective June 7, 2019, Amendment #7 was signed modifying the maximum amount payable under the contract, available liquidated damages, marketing support and prices and rates. Payments for the jackpot data processing contract were \$12,147,826 for Fiscal Year ended June 30, 2019 and \$14,158,598 for Fiscal Year ended June 30, 2018.

For scratch ticket production, the Lottery entered into new contracts with its three scratch ticket vendors beginning July 1, 2017 and ending June 30, 2023. The contracts each contain an option to extend for continued performance for up to a maximum of two (2) two-year extensions. The total costs of the new contracts under the initial term are not to exceed \$30,000,000. Payments under these contracts were \$2,997,014 for the Fiscal Year ended June 30, 2019.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make payments to MUSL for administrative fees, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to the prize reserves.

On November 15, 2012, the MUSL Powerball Group unanimously agreed to accept the recommendations of the Finance & Audit Committee and the Executive Committee and set the Prize Reserve Account (PRA) cap to \$80 million reduced from the previous \$100 million cap.

The total amount contributed by the Lottery to the Powerball prize reserves as of June 30, 2019 was \$3,295,234 and is based on a percentage of sales. This amount is shown as prepaid prize expense – MUSL on the Statements of Net Position. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold. As of June 30, 2019 there were no excess funds held by MUSL over Colorado's required reserves balance of \$3,333,576, but rather a deficit of \$38,342 of the required balance.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

In 2009, the Powerball and Mega Millions governing bodies entered discussions regarding cross-selling the Powerball and Mega Millions games, whereby each state currently selling Mega Millions tickets would also sell Powerball tickets and those states currently selling Powerball tickets would also sell Mega Million tickets. On March 10, 2010, the Lottery commission voted to allow the Colorado Lottery to participate in the cross-selling of the Mega Millions game. The rule became effective as of April 30, 2010 and the first day of ticket sales was May 16, 2010. MUSL agreed to undertake the administrative functions associated with the Mega Millions game for the states currently participating in their Powerball game.

MUSL immediately began collecting a percentage of sales to fund the newly formed Mega Millions prize reserve fund. On March 22, 2013, the MUSL Mega Millions Game Group set the maximum prize reserve fund at \$45 million. With the change to the Mega Millions game mentioned earlier, on October 25, 2017 the Group set the maximum prize reserve balance at \$100 million. The Group also determined to set the additional prize reserve contribution at 2 percent of sales effective beginning with the drawing of October 31, 2017. Additional contributions will continue until maximum balance amounts are reached. On March 31, 2019 MUSL calculated a new required reserve balance for the Lottery of \$2,669,749. The Lottery's balance in the reserve held by MUSL as of June 30, 2019 was \$2,652,044; with a slight deficit of \$17,705 of the required balance.

In addition, MUSL may deposit and hold any Unreserved Account Funds in trust for the benefit of member lotteries. These funds will not be comingled with any other funds held in trust and can be used only for authorized uses of the unreserved funds. MUSL held a nominal \$3 amount in the unreserved fund as of June 30, 2019.

Other Major Vendor Commitments –The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery's products beginning on May 21, 2017 and expiring on June 30, 2020. The contract contains an option to extend for continued performance for up to a maximum of two (2) one-year extensions. The total compensation allowed for services performed under the initial term of the contract is \$44,850,000. Payments totaling \$14,159,598 were made in the Fiscal Year ended June 30, 2019.

Litigation – At times, various suits and claims may be pending against the Lottery. Although the outcome of such suits and claims cannot be predicted with certainty, the Lottery believes that the final outcome of these matters will not materially affect the financial statements of the Lottery.

The Colorado Lottery is one of several states due to receive restitution from two individuals, after they were convicted of various charges in connection with manipulating computer coding used to generate winning lottery numbers and then collecting the resulting jackpot prizes. The affected computer coding and host machines have since been replaced with independently certified code and hardware.

According to the 1st individual's plea agreement and resulting court order, a total restitution of \$2,222,863.60, with interest as applied at Iowa's standard statutory rate, will be paid to four states, with the Colorado Lottery's share being \$1,137,980. The 2nd plea agreement and resulting court order agrees to a total restitution of \$804,095, with interest as applied at Iowa's standard statutory rate, to two states, with the Colorado Lottery's share being \$568,990, joint and several with the 1st individual.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 10 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

The Lottery's attorneys have interpreted the court order as follows: \$568,990 (the first half of the \$1,137,980) will be paid to Colorado from either or both individuals. If the 2nd individual pays the entire \$568,990 due Colorado, all of the 1st individual's restitution payments will go to the other states until they have been fully paid. Only after all states are paid, would the 1st individual's restitution payments be directed to Colorado. The Colorado Lottery's total potential recovery from restitution is \$1,137,980.

The likelihood of collecting any of the restitution from either individual is unknown. The Lottery collected \$390 in Fiscal Year 2019 and has not recorded any estimated revenue from possible future payments. If the Lottery receives any future restitution payments, the payments will be recorded as revenue in the period the payments are received.

NOTE 11 – TAX, SPENDING AND DEBT LIMITATIONS

In November 1992, the Colorado voters passed Section 20, Article X of the Colorado Constitution, commonly known as the Taxpayer's Bill of Rights (TABOR). TABOR contains revenue, spending, tax and debt limitations that apply to the State of Colorado and all local governments. In the same general election, Article XXVII was passed creating the State Board of the Great Outdoors Colorado Trust Fund. The simultaneous passage of these two constitutional amendments raised questions as to whether there are irreconcilable conflicts between the two amendments.

The General Assembly determined in Section 24-77-102 (17) (b) (IX), C.R.S., that the net proceeds from the Lottery are excluded from the scope of "state fiscal year spending" for purposes of TABOR. The Colorado Supreme Court, in response to an interrogatory from the General Assembly, approved that determination.

TABOR is complex and subject to further legislative and judicial interpretation. The Lottery believes it is in compliance with both of these constitutional amendments.

NOTE 12 – RELATED PARTY TRANSACTIONS

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs and the Governor's Office of Information Technology for information and communications technology (ICT) services. Interagency charges were \$2,140,530 and \$2,137,138 for the Fiscal Years ended June 30, 2019 and 2018, respectively.

COLORADO LOTTERY
Notes to Financial Statements
Years Ended June 30, 2019 and 2018

NOTE 13 – RESTATEMENT

During fiscal year ended June 30, 2019, the Lottery reevaluated the classification and presentation of pension and other postemployment benefit expense adjustments related to GASB Statements No. 68 Accounting and Financial Reporting for Pensions - An Amendment of GASB Statement No. 27, as amended, and GASB Statement No. 75 Accounting and Financial Reporting for Financial Reporting for Postemployment Benefits Other Than Pensions, as amended and determined it would be appropriate to reclassify the amounts from a nonoperating activity to an operating activity on the Statements of Revenues, Expenses, and Changes in Net Position and the Statements of Cash Flows. As such the 2018 financial statements have been restated to reclassify the individual adjustments from nonoperating to operating activities as illustrated in the following table:

	2018 As Previously Reported	Reclassification	2018 As Restated
Statements of Revenues, Expenses and Changes in Net Position			
Wages and Benefits	\$ 10,102,264	\$ 8,639,276	\$ 18,741,540
Total Other Operating Expenses	29,450,324	8,639,276	38,089,600
Total Operating Income	139,977,518	(8,639,276)	131,338,242
Other Postemployment Benefits Expense	8,619,600	(8,619,600)	-
Unfunded PERA Pension Expense	19,676	(19,676)	-
Total Nonoperating Revenue (Expenses)	(148,993,592)	8,639,276	(140,354,316)
Statements of Cash Flows			
Total Operating Income	139,977,518	(8,639,276)	131,338,242
Adjustment to reconcile operating income to net cash provided by operating activities:			
Wages and Benefits			
- pension and OPEB adjustment	-	8,639,276	8,639,276



REQUIRED SUPPLEMENTARY INFORMATION

COLORADO LOTTERY
Schedule of the Colorado Lottery's Proportionate Share of the Net Pension Liability
Colorado Public Employees' Retirement Association

	Last 10 Calendar Years*				
	2018	2017	2016	2015	2014
Lottery's proportion of the net pension liability	0.2234220529%	0.2290545580%	0.2238160821%	0.2398382458%	0.2511816995%
Lottery's proportionate share of the net pension liability	\$ 25,422,465	\$ 45,852,060	\$ 41,110,831	\$ 25,257,445	\$ 23,627,442
Lottery's covered payroll	\$ 6,862,079	\$ 6,774,739	\$ 6,440,000	\$ 6,745,555	\$ 6,885,135
Lottery's proportionate share of the net pension liability as a percentage of its covered payroll	370.48%	676.81%	638.37%	383.22%	354.03%
Plan fiduciary net position as a percentage of the total pension liability	55.11%	43.20%	42.60%	56.10%	59.80%

* Calendar Year 2014 was the 1st year of implementation, therefore only five years are shown.

COLORADO LOTTERY
Schedule of the Colorado Lottery's Contributions
Colorado Public Employees' Retirement Association

Last 10 Fiscal Years*

	2019	2018	2017	2016	2015
Contractually required contribution	\$ 1,414,350	\$ 1,290,829	\$ 1,159,077	\$ 1,142,872	\$ 1,150,328
Contributions in relation to the contractually required contribution	<u>(1,414,350)</u>	<u>(1,290,829)</u>	<u>(1,159,077)</u>	<u>(1,142,872)</u>	<u>(1,150,328)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Lottery's covered payroll	\$ 7,191,084	\$ 6,821,281	\$ 6,594,985	\$ 6,520,365	\$ 6,917,645
Contributions as a percentage of covered payroll	19.67%	18.92%	17.58%	17.53%	16.63%

* The amounts presented for each fiscal year were determined as of 6/30.

* Fiscal year 2015 was the 1st year of implementation, therefore only five years are shown.

COLORADO LOTTERY
Schedule of the Colorado Lottery's Proportionate Share of the Net OPEB Liability
Colorado Public Employees' Retirement Association – Healthcare Trust Fund

Last 10 Calendar Years*

	2018	2017
Lottery's proportion of the net OPEB liability	0.0790674504%	0.0820966264%
Lottery's proportionate share of the net OPEB liability	\$ 1,075,746	\$ 1,066,928
Lottery's covered payroll	\$ 6,862,079	\$ 6,774,739
Lottery's proportionate share of the net OPEB liability as a percentage of its covered payroll	15.68%	15.75%
Plan fiduciary net position as a percentage of the total OPEB liability	17.03%	17.53%

* Calendar Year 2017 was the 2nd year of implementation, therefore only two years are shown.

COLORADO LOTTERY
Schedule of the Colorado Lottery's Contributions
Colorado Public Employees' Retirement Association – Healthcare Trust Fund

Last 10 Fiscal Years*

	2019	2018
Contractually required contribution	\$ 75,412	\$ 68,826
Contributions in relation to the contractually required contribution	(75,412)	(68,826)
Contribution deficiency (excess)	\$ -	\$ -
Lottery's covered payroll	\$ 7,191,084	\$ 6,821,281
Contributions as a percentage of covered payroll	1.05%	1.01%

* The amounts presented for each fiscal year were determined as of 6/30.

* Fiscal year 2018 was the 2nd year of implementation, therefore only two years are shown.

COLORADO LOTTERY
Notes to Required Supplementary Information
Years Ended June 30, 2019

Changes of pension benefit terms. Pursuant to SB 18-200, retirement benefits were modified including temporarily suspending annual increases through 2019 and reducing the annual increase for all current and future retirees thereafter from 2.0 percent to 1.5 percent.

Changes of pension assumptions. A discount rate of 7.25 percent, up from 4.72 percent, was reflected in the roll-forward calculation of the total pension liability from December 31, 2017 to December 31, 2018.

Changes of OPEB benefit terms. There have been no changes in benefit terms since the last valuation.

Changes of OPEB assumptions. The Medicare Part A premiums cost trend rates used in the actuarial valuation of the total OPEB liability at December 31, 2017 was 3.25 percent for 2018, gradually rising to 5.00 percent in 2025 up from 3.0 percent for 2017, gradually rising to 4.25 percent in 2023 in the December 31, 2016 actuarial valuation.



SUPPLEMENTARY INFORMATION

COLORADO LOTTERY
Schedule of Revenue and Costs for Scratch and Jackpot Games
For the Fiscal Year Ended June 30, 2019

	FY 2019								FY 2018	
	Scratch	Lotto	Powerball	Cash 5	Jackpot Games				Total	Scratch and Jackpot Games
					Cash 5 EZ Match	Mega Millions	Pick 3	Lucky For Life		
TICKET SALES	\$443,409,967	\$28,034,842	\$86,147,274	\$16,571,656	\$3,041,876	\$72,719,920	\$12,902,998	\$16,951,078	\$ 679,779,611	\$611,993,333
PRIZE EXPENSE	(299,240,160)	(14,529,352)	(40,950,837)	(9,159,621)	(1,777,359)	(34,900,730)	(6,209,327)	(10,171,758)	(416,939,144)	(383,487,725)
NET REVENUE AFTER PRIZES	144,169,807	13,505,490	45,196,437	7,412,035	1,264,517	37,819,190	6,693,671	6,779,320	262,840,467	228,505,608
COMMISSIONS, BONUSES, TICKET COSTS & VENDOR FEES (Note 1)										
Retailer Commission	(30,971,658)	(1,679,175)	(5,161,277)	(992,507)	(182,078)	(4,356,136)	(771,031)	(1,014,297)	(45,128,159)	(40,701,692)
Retailer Bonus	(4,847,000)	(208,063)	(510,212)	(169,575)	(32,320)	(416,456)	(117,450)	(145,286)	(6,446,362)	(5,424,871)
Cost of Tickets Sold	(2,898,566)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	(2,898,566)	(2,624,629)
Telecomm Reimbursements	505,045	31,932	98,122	18,875	3,465	82,828	14,697	19,306	774,270	764,880
On-Line Vendor Fees	(8,647,924)	(496,159)	(1,494,950)	(290,647)	(50,265)	(1,270,241)	(220,225)	(302,199)	(12,772,610)	(10,490,225)
TOTAL	(46,860,103)	(2,351,465)	(7,068,317)	(1,433,854)	(261,198)	(5,960,005)	(1,094,009)	(1,442,476)	(66,471,427)	(58,476,537)
GROSS PROFIT ON SALE OF TICKETS	\$ 97,309,704	\$ 11,154,025	\$ 38,128,120	\$ 5,978,181	\$ 1,003,319	\$ 31,859,185	\$ 5,599,662	\$ 5,336,844	\$ 196,369,040	\$ 170,029,071
AVERAGE DAILY TICKET SALES	\$ 1,214,822	\$ 76,808	\$ 236,020	\$ 45,402	\$ 8,334	\$ 199,233	\$ 35,351	\$ 46,441	\$ 1,862,410	\$ 1,676,694

Note 1: Administrative costs of Lottery operations, including wages, advertising, and other expenses are not shown.

COLORADO LOTTERY
Schedule of Percent of Prize Expense to Gross Ticket Sales
For the Fiscal Year Ended June 30, 2019

	Scratch	Jackpot Games						FY 2019	FY 2018	
		Lotto	Powerball	Cash 5	Cash 5	Mega Millions	Pick 3	Pick 3	Total	Total
Prize Expense	\$ 299,240,160	\$ 14,529,352	\$ 40,950,837	\$ 9,159,621	\$ 1,777,359	\$ 34,900,730	\$ 6,209,327	\$ 10,171,758	\$ 416,939,144	\$ 383,487,725
(/)Ticket Sales	\$ 443,409,967	\$ 28,034,842	\$ 86,147,274	\$ 16,571,656	\$ 3,041,876	\$ 72,719,920	\$ 12,902,998	\$ 16,951,078	\$ 679,779,611	\$ 611,993,333
Prize %	67.49%	51.83%	47.54%	55.27%	58.43%	47.99%	48.12%	60.01%	61.33%	62.66%

**COLORADO LOTTERY
Budgetary Comparison
For the Fiscal Year Ended June 30, 2019**

	Fiscal Year 2019 Original Budget	Supplemental Allocations & Internal Transfers	Fiscal Year 2019 Final Budget	Fiscal Year 2019 Actual Expenditures	Under Expended	Percent Under Expended
Personal Services	\$ 11,707,579	\$ -	\$ 11,707,579	\$ 11,155,726	\$ 551,853	4.71%
Workmen's Compensation	86,712	-	86,712	86,712	-	0.00%
Operating	1,189,385	-	1,189,385	1,096,068	93,317	7.85%
Variable Vehicle	155,154	5,000	160,154	158,461	1,693	1.06%
Leased Space	928,429	4,782	933,211	908,316	24,895	2.67%
Leased Space-Grand Junction	6,292	-	6,292	6,292	-	0.00%
Risk Management	23,421	-	23,421	23,421	-	0.00%
Vehicle Lease Payments	158,500	-	158,500	140,088	18,412	11.62%
Travel	113,498	-	113,498	109,018	4,480	3.95%
Marketing, Communications & Sales	14,700,000	-	14,700,000	14,641,219	58,781	0.40%
Payments to Other Agencies	239,410	-	239,410	89,403	150,007	62.66%
Legal Services	78,303	-	78,303	78,303	-	0.00%
Indirect Costs	748,494	-	748,494	698,576	49,918	6.67%
Ticket Costs-Scratch	6,578,000	-	6,578,000	4,015,733	2,562,267	38.95%
Research	250,000	-	250,000	242,400	7,600	3.04%
Vendor Fees	14,269,479	-	14,269,479	12,772,610	1,496,869	10.49%
Prize Payments	424,104,016	-	424,104,016	416,939,144	7,164,872	1.69%
Retailer Compensation	54,572,160	-	54,572,160	51,574,521	2,997,639	5.49%
Multi-State Lottery Fund	177,433	-	177,433	158,031	19,402	10.93%
CORE Conversion	76,536	-	76,536	76,536	-	0.00%
OIT Payments	759,484	20,231	779,715	777,352	2,363	0.30%
TOTAL	\$ 530,922,285	\$ 30,013	\$ 530,952,298	\$ 515,747,930	\$ 15,204,368	2.86%

FY19 Staffing-FTE-Note 1 117.1 (Appropriated) 113.4 (Actual)

Reconciliation of Expenses per Statement of Revenues, Expenses and Changes in Fund Net Position to Budgeted Expenditures:

Expenses Per Statement of Revenues, Expenses and Changes in Net Position

Prize Expense	\$ 416,939,144
Commissions and Bonuses	51,574,521
Cost of Tickets & Vendor Fees	14,896,906
Operating Expenses	<u>28,059,486</u>

Total Expenses per Statement of Revenues, Expenses and Changes in Net Position 511,470,057

Telecommunications offset classified as revenue 774,270

Less: Non-Appropriated Expenses

Depreciation	(141,928)
Accrued Annual and Sick Leave	9,540
Book Value of Assets Written Off	-
Wages and Benefits: Pension and OPEB Adjustment	<u>3,356,467</u>

Sub-Total 515,468,406

Plus: Capitalized Purchases 279,524

\$ 515,747,930

Note 1 - The Governor's budget office has informed the departments that the appropriated FTE can be exceeded by 10% for FY 2019



Independent Auditor's 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*

To the Members of the Legislative Audit Committee and Lottery Commission
State of Colorado, Department of Revenue, Lottery Division
Denver, Colorado

We have audited, 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, the financial statements of the Colorado Lottery, an enterprise fund of the State of Colorado as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the Colorado Lottery's basic financial statements, and have issued our report thereon dated October 16, 2019.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Colorado 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 Colorado Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of Colorado 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 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 over financial reporting 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 Colorado 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 Colorado 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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

The image shows a handwritten signature in cursive script that reads "Eide Bailly LLP".

Fort Collins, Colorado
October 16, 2019



October 16, 2019

To the Members of the Legislative Audit Committee and Lottery Commission
State of Colorado, Department of Revenue, Lottery Division
Denver, Colorado

We have audited the financial statements of the Colorado Lottery as of and for the year ended June 30, 2019, and have issued our report thereon dated October 16, 2019. Professional standards require that we advise you of the following matters relating to our audit.

Our Responsibility in Relation to the Financial Statement Audit under Generally Accepted Auditing Standards and *Government Auditing Standards*

As communicated in our letter dated May 2, 2019 our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of its respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, as part of our audit, we considered the internal control of the Colorado Lottery solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

We have provided our comments regarding internal controls during our audit in our Independent Auditor's 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* dated October 16, 2019.

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated.

Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, as appropriate, our firm, and other firms utilized in the engagement, if applicable, have complied with all relevant ethical requirements regarding independence.

Qualitative Aspects of the Entity's Significant Accounting Practices

Significant Accounting Policies

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Colorado Lottery is included in Note 1 to the financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during 2019. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements are:

Management's estimate of the prize expense and the corresponding prize liability is based on anticipated payout percentage approved by the Lottery Commissioners. The prize expense and corresponding liability are incurred as tickets are activated by Lottery approved retailers. We evaluated the key factors and assumptions used to develop the prize expense and corresponding prize liability and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Management's estimates of the net pension liability and net other postemployment benefits liability and related deferrals are based on the actuarial valuations as of December 31, 2018. We evaluated the key factors and assumptions used to develop the net pension and other postemployment benefits liabilities and related deferrals and determined that they are reasonable in relation to the basic financial statements taken as a whole.

Financial Statement Disclosures

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the Colorado Lottery's financial statements relate to:

The disclosure of Distributions of Net Proceeds in Note 6, as this disclosure presents information regarding performance of the Lottery's commitment to funding beneficiaries throughout the State of Colorado.

The disclosure of Pension Plans in Note 7, which presents the Colorado Lottery's deferred inflows and outflows of resources related to the defined benefit pension plan, as well as summarizes actuarial assumptions used in determining the Colorado Lottery's estimated total pension liability.

The disclosure of Other Postemployment Benefits and Life Insurance in Note 9, which presents the Colorado Lottery's deferred inflows and outflows of resources related to other postemployment benefits, as well as summarizes actuarial assumptions used in determining the Colorado Lottery's estimated total other postemployment benefits liability.

The disclosure of Contingencies and Commitments in Note 10, which summarize the Colorado Lottery's commitments to pay annuities to prior Lotto jackpot winners, as well as gaming operations and major vendor commitments.

The disclosure of Tax, Spending, and Debt Limitations in Note 11, which discloses that the net proceeds from the Colorado Lottery are excluded from the scope of TABOR.

The disclosure of Related Party Transactions in Note 12, which discloses the nature of the Colorado Lottery's relationship with the State of Colorado and interdepartmental fees paid as a result of this relationship.

Significant Difficulties Encountered during the Audit

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

Uncorrected and Corrected Misstatements

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. No misstatements were identified as a result of our audit procedures.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Representations Requested from Management

We have requested certain written representations from management that are included in the management representation letter dated October 16, 2019.

Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Other Significant Matters, Findings, or Issues

In the normal course of our professional association with the Colorado Lottery, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operating plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the Colorado Lottery's auditors.

Modification of the Auditor's Report

We have made the following modifications to our auditor's report.

Relationship with the State of Colorado

As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position and cash flows for only that portion of the financial reporting entity, the State of Colorado, which is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2019 and 2018, and the changes in its financial position, or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Restatement

As discussed in Note 13, management reevaluated the classification of pension and other postemployment benefit expense and determined it was appropriate to reclassify the amount from a nonoperating activity to an operating activity. The 2018 financial statements have been restated for this reclassification. Our opinion is not modified with respect to this matter.

This report is intended solely for the information and use of the Legislative Audit Committee, the Office of the State Auditor, the Lottery Commission, and management of the Colorado Lottery and is not intended to be and should not be used by anyone other than these specified parties. However, upon release by the Legislative Audit Committee, this report is a public document.

Eide Sallee LLP

Fort Collins, Colorado