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FY18 ANNUAL REPORT

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Moss Adams LLP has not been engaged to perform and has not performed, since the date of the report included herein, any procedures on the financial statements addressed in that report. Moss Adams LLP also has not performed any procedures relating to this annual report.

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## ARIZONA LOTTERY OVERVIEW

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### ABOUT

The Arizona Lottery's mission is to maximize revenue in a responsible manner to support Arizona programs that benefit everyone. The Arizona Lottery is fully funded by monies generated through the sale of its products. Beneficiary transfers, generated from Lottery sales, total more than \$4 million per week and fund a variety of state programs. Since the Arizona Lottery began in July, 1981, we have returned more than \$8 billion in prizes to players, generated nearly \$4 billion for the state and paid in excess of \$900 million in commissions to retailers.

### A MESSAGE FROM THE DIRECTOR

**Gregory Edgar**

As we look forward to fiscal year 2019, this is an excellent opportunity to reflect on the progress the Arizona Lottery has made and the ways we've effected a positive impact on all Arizonans.

The Arizona Lottery began FY18 with a goal to generate annual revenue of \$1 billion and an annual return to beneficiaries of \$250 million by 2020, and we nearly reached it in a record year: \$981 million in revenue (an almost \$130 million increase over FY17), with \$212.7 million of that going to 18 vital programs and services that would otherwise rely on taxpayers for their funding. Lottery retailers and players were also big winners. Our retail partners earned almost \$67 million in commissions and our players won more than \$637 million in prizes.





We achieved this unprecedented success by continuing excellence in basic business practices, building on our previous successes and focusing our energies on sustainable opportunities. We launched more than 55 instant win games, including Royal Millions, our second \$30 Scratchers® game. We launched an entirely new category of instant draw games called "Fast Play™". We had major game matrix updates in the Mega Millions® draw game that have accelerated jackpot growth. We conducted our first-ever second-chance million-dollar giveaway contest. We created several new and unique ticket designs focusing on culturally significant subjects in Arizona, including the Arizona Cardinals and Dia de los Muertos. We increased player awareness through statewide promotions and system-wide jackpot alerts. We developed games that augmented the winning experience for our players. We invested in popular licensed properties. We worked hard to make the retail experience more customer friendly for both our retail partners and our players.

The Arizona Lottery is passionate about the significant and indelible impact this agency has had, and continues to have, on our state. Local non-profits, small businesses, corporations, individuals, families and other state agencies all benefit from the dollars we raise. We allocated \$520,000 to charities through our Community Sponsorships in FY18; monies that are not included in our legislatively mandated beneficiary transfers, showing how we are giving back to the people of Arizona every day. As I always say, the Arizona Lottery touches every corner of our great state. From Arizona's foster children and vulnerable families, to its homeless population, parks and wildlife conservation and so much more, I witness the powerful impact that lottery-funded programs have every day. Lottery dollars make our communities better and they help to make Arizona the best state to live, work and play. Internally, we continued to make big improvements through the implementation of the Arizona Management System. We built on the ways we challenged business processes that had been in place for decades and found new ways to improve our operations, making our agency more efficient and more responsive to employees ... ultimately returning more to Arizona.

Our team deserves the credit as we continued to grow, improve and pull together as one to achieve our FY18 results. It is because of them that I am so thrilled to present Arizona Lottery's financial success. These numbers are a reflection of the hard work, dedication and innovation that we have all invested into our agency to give more to our players, to the state we love and to Arizona Lottery's beneficiary programs. As we look to FY19 and beyond, the Arizona Lottery is poised to increase our impact on our beneficiaries and our great state by continuing to create inventive and entertaining games for our players that help create a better quality of life for communities across Arizona.

## OUR LEADERSHIP

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The men and women who direct the Arizona Lottery through ongoing strategic planning and continued process improvement are guided by its core values: Integrity, Transparency, Teamwork, Customer Service, Mutual Respect, Accountability, Innovation, Commitment and Passion. These are more than words: They are a roadmap to continued success, creating a culture of teamwork and professional staff development. Abiding by these values allowed us to realize incremental sales growth and subsequent monetary transfers to fund significant programs across Arizona.

**Gregory Edgar**  
Executive Director

**Raynie Hosto**  
Deputy Director: Sales

**Chris Rogers**  
Deputy Director: Marketing and Products

**Biju Kamaleswaran**  
Deputy Director: Operations

**Sherri Zendri**  
Deputy Director: Legal Services

## COMMISSION

The Arizona Lottery's Board of Commissioners works alongside the leadership team they oversee to manage the agency. The five members are appointed by the Governor and serve for a term of five years. Each commissioner brings their own life and professional experiences and expertise to their role and each is responsible for a unique aspect crucial to conducting, administering and regulating the Arizona State Lottery. The Commission ensures the Lottery makes decisions that maximize sales, providing increased funding for important programs that serve every corner of our state.

**Jeff Weintraub**  
Chair  
Represents: CPA

**Chad Wilson**  
Commissioner  
Represents: Marketing

**M.L. "Andy" Anderson**  
Commissioner  
Represents: Law Enforcement

**Debbie Roth**  
Commissioner  
Represents: Retail

## **PRODUCT INNOVATION**

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The Arizona Lottery provides players with a variety of fun and engaging games designed to pique players' interest, excite their senses, reward their play and introduce new players to our products. These include:

### **DRAW GAMES**

In FY18, a lucky Arizonan became a multi-millionaire playing our in-state jackpot game, The Pick™. The record \$11.9 million jackpot was won in November, 2017. Both Powerball® and Mega Millions generated big excitement across Arizona, as jackpots rolled over several times, some reaching hundreds of millions of dollars before being hit. Though no Arizonans were lucky enough to win those jackpots, three won big with million-dollar Powerball prizes and one won a million-dollar Mega Millions draw!

### **SCRATCHERS**

Scratchers sales soared to almost \$711 million in FY18, our strongest showing yet! In October 2017 the Arizona Lottery launched Royal Millions, our second \$30 ticket. With five top prizes of \$3.5 million, the game became an instant player favorite. We also introduced the extremely popular Hispanic-themed Dia de los Muertos ticket, each one a work of art created by our artist-in-residence, Emily Costello, a first for a state lottery! In total, we launched more than 55 instant-win games in FY2018 and demand for these games was so strong that it was a real challenge to print enough tickets to keep them in stock for players.

### **INSTANT TABS**

In FY18, Instant Tabs became even more popular, exceeding FY17 sales by more than 11 percent. The Arizona Lottery continues to grow this category as more players are introduced to the product through added retail locations. Charitable retailers, like veterans and fraternal organizations, who become Instant Tab retailers earn 20 percent commission on every sale.

### **FAST PLAY**

We also introduced an entirely new category of game that combines the best of a draw game and the best of an instant-win scratch ticket, called "Fast Play", which generated more than \$8 million in sales in its first few months. Players match symbols to win cash prizes, as they would on a scratch ticket, but on a slip that was printed just for them at the moment they wanted to play. Some jackpots are predetermined and others roll until someone wins big! There's custom excitement built into this game for every kind of player.



## WINNER STORIES

### JESSICA – \$3 CROSSWORD CONNECT, \$20,000

Jessica from Mesa asked her fiancé to buy her a certain Scratchers ticket, but he purchased a \$3 Crossword Connect ticket instead. The ticket he picked was a winning ticket of \$20,000!

### JAMES – \$1 MILLION AND MORE!

In addition to winning the Million Dollar Giveaway second chance grand prize, James got an exclusive Arizona Diamondbacks experience!

### BERNADETTE – POWERBALL, \$50,000

Bernadette plans to use some of her winnings to help her local animal shelters.

### VICTOR – CASH EXPLOSION, \$50,000

Victor is one of Arizona Lottery's luckiest players, winning \$50,000 on the Cash Explosion Scratchers ticket – just last year, he won \$100,000 on the same ticket at the same exact retail location!

### SUZANNE – MONEY CLIP, \$100,000

While waiting for an appointment at her nail salon, Suzanne went across the street and bought a Money Clip Scratchers ticket. She couldn't believe it because her lucky number is four and the winning number she matched with was also four!



Cash Explosion® is a registered trademark of Ohio Lottery.

## THE SCHROEDERS – ULTIMATE MILLIONS, \$3.5 MILLION

The couple won the last top-prize ticket for Ultimate Millions, and are now \$3.5 million richer!

## IVAN – \$250,000 CROSSWORD, \$250,000

Ivan and his mom came in from Eloy to collect what they thought was \$1,000 – but he had actually won \$250,000 on the Arizona Lottery \$250,000 Crossword Scratchers ticket! Ivan plays the lottery every week and says this win couldn't have come at a better time. He has been wanting to buy a new house for him and his daughter.

## RENE – DECADE OF DOLLARS, \$5,000 A MONTH FOR 10 YEARS

Rene won a \$600,000 top prize on a \$10 Decade of Dollars Scratchers ticket and will be taking home \$5,000 a month for the next 10 years! Rene almost passed out when he realized he won. He is excited to take a vacation to Hawaii and then buy a truck and a new home.

## KEVIN – LADY LUCK, \$50,000

When Kevin won \$50,000 on a \$5 Lady Luck Scratchers ticket, she didn't think it was real! She remembers playing when Lady Luck first came out, and this time she finally won!

## DEB – FANTASY 5™, \$52,000

Deb was stopping at a retailer in Littlefield to get some water and decided to play Fantasy 5. She is so excited about her win and plans to buy an RV so she can travel with her pup.



## BENEFICIARY TRANSFERS

State law mandates exactly how Arizona Lottery ticket sales directly fund agencies and programs that work to make our state a better place to live, work and play. Lottery transfer dollars go to 13 funds, reaching 18 different programs.

These beneficiaries include:

FY18 BENEFICIARIES		
	<b>General Fund</b>	\$120,390,082
	<b>University Bond Fund</b>	\$39,610,181
	<b>Healthy Arizona</b>	\$21,012,200
	<b>Mass Transit (LTAF)</b>	\$11,529,000
	<b>Heritage Fund</b>	\$10,000,000
	<b>Commerce Authority Arizona Competes Fund</b>	\$3,500,000
	<b>Court Appointed Special Advocate Fund</b>	\$3,322,336
	<b>Economic Security Homeless Services</b>	\$1,000,000
	<b>Internet Crimes Against Children/ Victims' Rights Enforcement Fund</b>	\$1,000,000
	<b>Department of Gaming</b>	\$300,000
	<b>Tribal College Dual Enrollment Fund</b>	\$250,000
<b>Total Beneficiary Transfers</b>		<b>\$211,913,799</b>



## OUR BENEFICIARIES

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### UNIVERSITY BOND FUND

Used for the University Capital Improvement Lease-to-Own and Bond (UCI) Fund, these dollars to date have provided valuable debt service for more than \$185 million in financing. This financing has allowed the university system to build out critical research and academic expansions while also addressing deferred maintenance on older buildings.

### HEALTHY ARIZONA

This unique fund, administered by the Department of Health Services, impacts five different programs across Arizona that assist individuals and families with health-related needs. The various programs that benefit from this fund include Women, Infants and Children (WIC), Arizona Area Health Educational Centers, Health Start, Pregnancy Prevention and the Arizona Biomedical Research Commission.

### LOCAL TRANSPORTATION ASSISTANCE FUND

The Local Transportation Assistance Fund was established in 1981 and is supported by the Arizona Lottery. Money from Arizona Lottery ticket sales goes to cities and towns in Maricopa County for public transportation. This fund is expanding neighborhood bus routes and light rail for everyone, especially older adults, people with disabilities and low-income residents who are most affected by limited transportation options.



#### HERITAGE FUND

The Heritage Fund is used to protect endangered species, acquire habitat for the benefit of sensitive species, provide access to outdoor recreational opportunities and educate children and adults about wildlife. The Heritage Fund is critical to recovering or sustaining Arizona's unique native wildlife and to managing more than 800 species. For nearly 30 years, the fund has contributed to significant and nationally-recognized wildlife conservation success stories, including the Bald Eagle Nestwatch Program, acquiring 18,000 acres of land for wildlife conservation and public enjoyment, the reintroduction of critical species to Arizona and much more.

#### COMMERCE AUTHORITY ARIZONA COMPETES FUND

The Arizona Lottery contributes to the Arizona Competes Fund, which awards grants for attracting, expanding or retaining Arizona's core enterprises. These vital funds also support and advance programs for rural businesses, small businesses and business development projects that enhance Arizona's economic development.

#### COURT APPOINTED SPECIAL ADVOCATES OF ARIZONA

CASA stands for Court Appointed Special Advocates. The Arizona Lottery funds CASA volunteers, who are everyday people appointed by a judge to speak for abused and neglected children in court. CASA trains and supports these qualified and compassionate adults to fight for a child's right to be safe, to be treated with dignity and respect, and to learn and grow in the security of a loving family. CASA of Arizona and its volunteers have been advocating for abused and neglected children in Arizona for over 30 years and have served more than 20,600 children. CASA strives to ensure that society is fulfilling its most fundamental obligation to children in need.

A smaller version of the Arizona Lottery logo, with "Arizona" in red and "Lottery" in blue script.

**GIVES  
BACK**

### HOMELESS SERVICES

Administered by the Department of Economic Security, this fund is used to provide grants to nonprofit organizations for homeless emergency programs, transitional shelters, rapid re-housing and rental assistance. These programs focus on placing Arizona's homeless in permanent housing and advocate for homelessness prevention education across Arizona.

### INTERNET CRIMES AGAINST CHILDREN TASK FORCE

The Internet Crimes Against Children Task Force program helps state and local law enforcement agencies develop an effective response to cyber enticement and child pornography cases. Funds support forensic and investigative components, training and technical assistance, victim services, and community education. The Arizona Internet Crimes Against Children Task Force is comprised of investigators from city, county, state and federal agencies. Special emphasis is placed on locating, prosecuting, and imprisoning people who intentionally exploit children. Lead by the Phoenix Police Department's Internet Crimes Against Children Unit, the AZICAC Task Force diligently pushes to fulfill this goal with highly trained and professional investigators and cutting edge forensics and technology.

### VICTIMS' RIGHTS ENFORCEMENT FUND

The fund, administered by the Department of Public Safety, benefits the Arizona Attorney General's Office of Victim Services. Primary focuses of the fund are providing legal representation to enforce the rights of crime victims as counsel of record in criminal cases, as well as providing social services to assist crime victims during the course of legal representation.

### DIVISION OF PROBLEM GAMBLING

Through the Arizona Department of Gaming, the Office of Problem Gambling provides and supports effective problem gambling prevention, treatment and education programs throughout Arizona. The Arizona Lottery helps support a sustainable continuum of services that reduces the impact of problem gambling in Arizona. These include the Arizona Gaming Department's annual Problem Gambling Symposium, which helps train professionals to identify and treat the issues that can lead to irresponsible gaming. The Division of Problem Gambling strives to accomplish its mission by being culturally sensitive and responsive to the needs of partners and those it serves. They focus on being professional, collaborative, equitable and innovative in their solutions to address problem gambling.

### TRIBAL COLLEGE DUAL ENROLLMENT PROGRAM FUND

Administered by the Department of Education, the Tribal College Dual Enrollment program provides choice and access to higher education for Native American high school students. The program gives thousands of students the opportunity to take a college course for both high school and college credit.



### HEALTHY FAMILIES ARIZONA

The Department of Child Safety's Healthy Families Arizona is a voluntary home visitation program that serves pregnant women and families of newborns. Program services are designed to strengthen families during the critical first years of a child's life. Through its efforts to support and educate families, the program has shown to reduce incidences of child abuse and neglect, provide stability for at-risk families and has grown a new generation of healthy families in the state.





## RETAIL PARTNERS

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The Arizona Lottery is proud to have a network of more than 3,000 retailers across the state. These accessible locations create an exciting experience and lasting relationship for their loyal customers.

To find the nearest retailer, visit [ArizonaLottery.com/Retailers](https://www.arizonalottery.com/Retailers)

### RETAILER COMMISSION

As an Arizona Lottery retail partner, every store receives a 6.5 percent commission on all Lottery sales, one of the highest commission rates in the country. Retailers also have the opportunity to earn an additional .5 percent performance incentive, as well as a variety of additional incentives through Lottery promotions.

In Fiscal Year 2018, the Arizona Lottery paid close to \$66 million in commissions to retailers across the state. Players benefit while shopping at an Arizona Lottery retailer, and the retailer benefits through increased traffic to their store, selling more products and building lasting relationships with their customers. Since our inception, the Arizona Lottery has given more than \$900 million in commissions to its retail partners.

For licensing and licensing renewal information, please contact 480.921.4486.



## Report of Independent Auditors

To the Commissioners of  
Arizona State Lottery  
Phoenix, Arizona

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Arizona State Lottery (the “Lottery”, a proprietary fund of the State of Arizona), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Lottery’s basic financial statements 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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 Lottery’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

## ***Opinions***

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

## ***Other Matters***

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the schedule of proportionate share of the net pension liability, the schedule of contributions, and the schedule of changes in net OPEB liability and related ratios 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.

### *Annual Report*

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. Lottery's annual report, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

## ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2018 on our consideration of 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 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 Lottery's internal control over financial reporting and compliance.



Scottsdale, Arizona  
October 31, 2018



# Arizona State Lottery

## A Proprietary Fund of the State of Arizona

### Management's Discussion and Analysis (Unaudited)

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This discussion and analysis of the Lottery's financial statements is a required component of financial reporting under *Governmental Accounting Standards* and was prepared by Arizona Lottery Management. It provides an overview of financial activities as of and for the year ended June 30, 2018, and should be read in conjunction with the Lottery's financial statements and notes to the financial statements.

This annual report consists of three types of financial statements and accompanying notes that provide explanations and details of accounting policies, account balances and activities. Account balances and activities are shown as of and for the year ended June 30, 2018. The statement of net position; the statement of revenues, expenses, and changes in net position; and the notes are presented using the accrual method of accounting. Under this method, financial transactions are recorded when earned or incurred regardless of when cash is received or disbursed. The statement of cash flows reflects cash receipts and disbursements during the same 12-month period.

The statement of net position provides information about the assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position of the Lottery. Assets consist of cash, substantially all held by the State Treasurer, amounts owed to the Lottery from licensed Lottery retailers and other State agencies, ticket inventory, and property. Liabilities represent amounts owed by the Lottery to vendors, to employees for wages and benefits, to prize winners, and to other State funds. Fund net position represents the portion of the Lottery's assets that are not encumbered by liabilities. It serves as an indicator of the net worth of the Lottery.

A summary of the financial results of operations for the 12-month period is presented in the statement of revenues, expenses, and changes in net position. Operating revenues include sales of Lottery tickets, retailer licensing fees, and commissions earned on the sales of Lottery tickets at Lottery offices and special events. Direct costs and administrative expenses comprise the operating expenses section of this statement. Direct costs are variable expenses that fluctuate with the level of sales. Marketing and overhead costs are included in the administrative expenses category.

Non-operating revenues consist of interest earned on prize fund cash investments from the State Treasurer and interest credited to the Lottery's Multistate Lottery Association (MUSL) unreserved account for interest earned on prize reserves at MUSL. The transfer's category includes transfers to other state funds as required by Lottery statutes.

The statement of cash flows includes cash receipts and disbursements from operating, noncapital financing, and investment earnings. This statement also includes a reconciliation of operating income presented on the accrual basis of accounting to net cash provided by operating activities. The notes to the financial statements present information on accounting policies, transfers and statutory requirements, commitments, contingencies, and retirement benefits. These notes are an integral part of the financial statements.

# Arizona State Lottery

## A Proprietary Fund of the State of Arizona

### Management's Discussion and Analysis (Unaudited)

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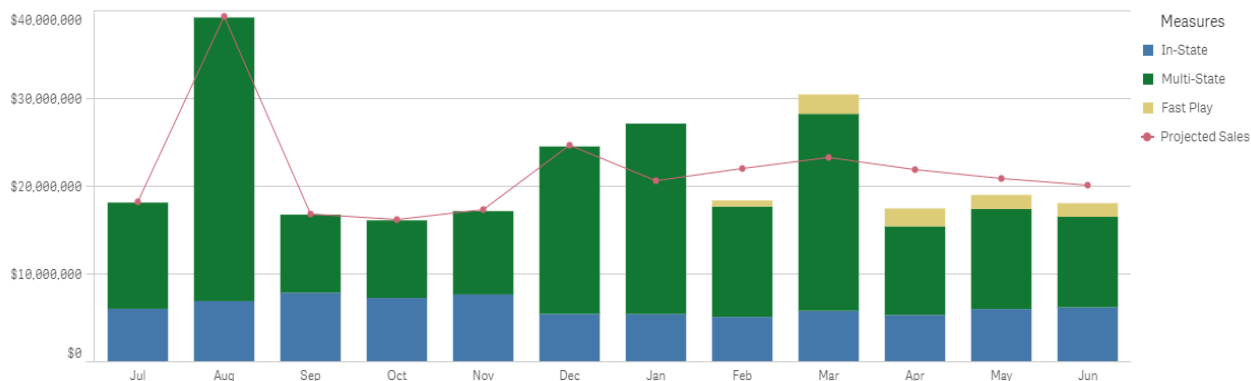
#### FINANCIAL HIGHLIGHTS

- The Arizona Lottery (Lottery) achieved record sales of \$981.4 million in fiscal year 2018, a 15.2% increase over the prior fiscal year, amounting to almost \$130 million in additional sales.
- The Lottery returned almost \$212 million to designated state programs in fiscal year 2018, with all beneficiaries receiving full funding. Since its inception in July 1981, the Lottery has generated \$3.98 billion for Arizona programs.
- Scratcher games continued to be strong performers with record sales of \$710.9 million in fiscal year 2018, an increase of \$78.1 million over the prior year. Demand for tickets at the \$10, \$20, and \$30 price points helped drive this sales increase.
- Draw sales were also impressive in FY 2018, reflecting sales growth of almost 24% over the previous year. Game jackpots as well as the successful introduction of Fast Play in February 2018 helped contribute to this increase.
- The instant tab product line exhibited moderate growth in its niche market, with an increase of almost \$1.0 million over the prior fiscal year, representing a growth rate of about 12%.
- The Lottery's retail partners earned almost \$67 million in commissions and incentives in fiscal year 2018.

#### REVENUES

Total game sales were \$981.4 million in fiscal year 2018 as compared to \$852.0 million in fiscal year 2017, reflecting increases in both instant and draw game products. In general, draw game sales are largely jackpot-driven, impacting sales increases or decreases in any given year. A comparison of draw game sales for FY 2018 broken down by multi-state, in-state, and Fast Play is depicted in the chart below.

FY 2018 Draw Sales by Multi-State & In-State

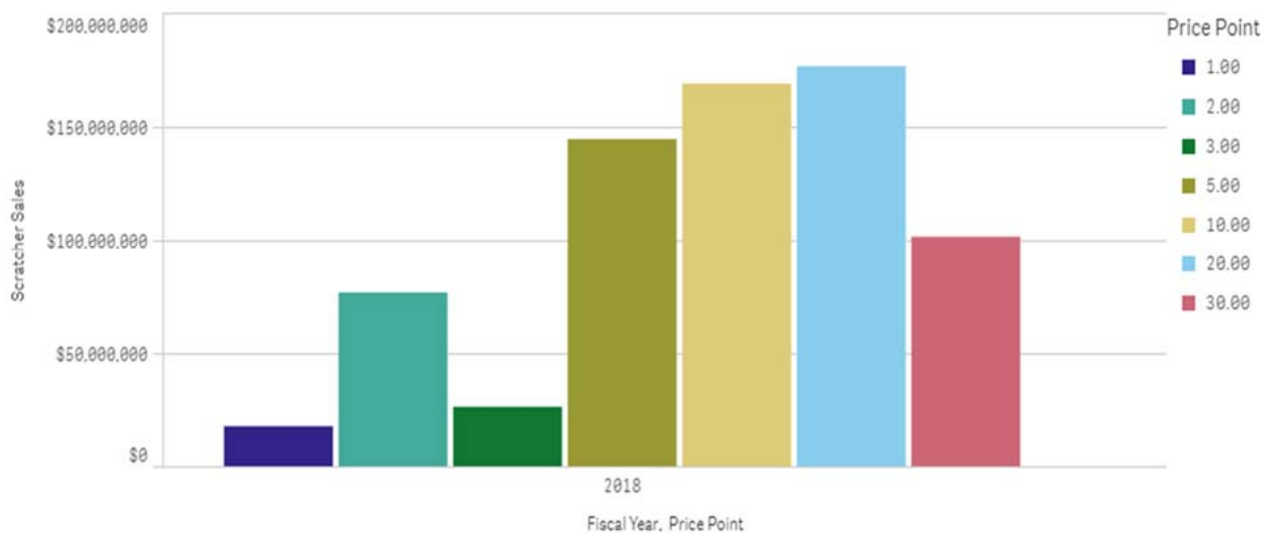


## Arizona State Lottery A Proprietary Fund of the State of Arizona Management's Discussion and Analysis (Unaudited)

The Lottery closed the year with a sales increase of \$129.4 million, equating to a 15.2% increase over the prior year. The instant ticket product line was the largest contributor to this gain, resulting in growth of \$79.1 million over the prior year (\$78.1 million from the Scratchers product line and \$1.0 million from instant tab tickets). Continued sales growth in the \$10, \$20, and \$30 price points helped to generate this increase.

The following chart displays Scratchers sales by price point for FY 2018 and the subsequent table summarizes Lottery product sales and the incremental change between fiscal years.

FY18 Instant Sales by Price Point



Product Sales	FY 2018	FY 2017	Change	Percentage
Scratchers	\$ 710.9	\$ 632.8	\$ 78.1	12.3%
Instant Tabs	8.7	7.8	0.9	11.5%
Powerball	118.5	102.4	16.1	15.7%
Mega Millions	60.9	41.4	19.5	47.1%
The Pick	40.3	31.5	8.8	27.9%
Fantasy 5	17.8	18.4	(0.6)	-3.3%
Pick 3	11.7	11.1	0.6	5.4%
All or Nothing	2.1	2.9	(0.8)	-27.6%
5 Card Cash	2.4	3.7	(1.3)	-35.1%
Fast Play	8.1	-	8.1	NA
<b>Total</b>	<b>\$ 981.4</b>	<b>\$ 852.0</b>	<b>\$ 129.4</b>	<b>15.2%</b>

# Arizona State Lottery

## A Proprietary Fund of the State of Arizona

### Management's Discussion and Analysis (Unaudited)

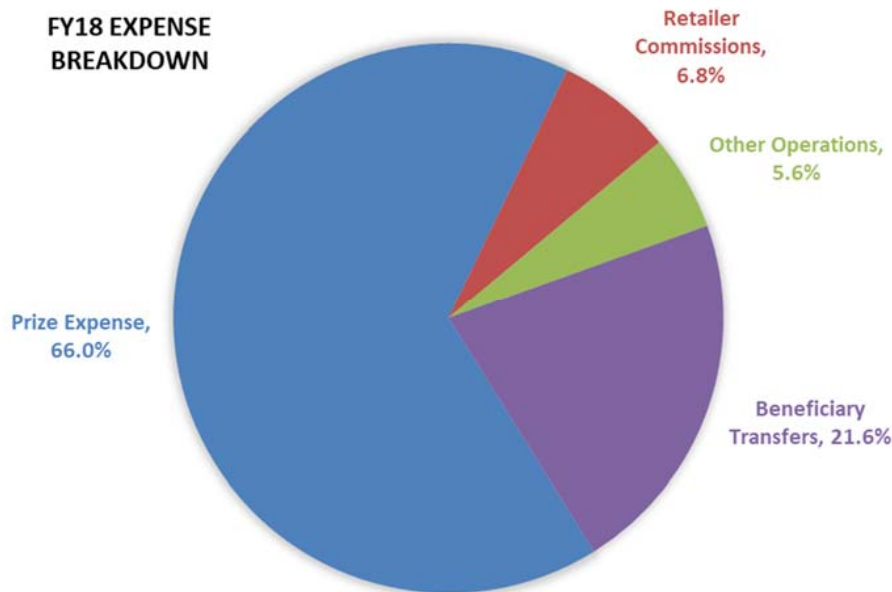
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Other operating revenue is composed of license fees and other miscellaneous revenue. Other operating revenues were \$395,955 and sales returns and allowances were (\$156,507) for the year ended June 30, 2018. Total operating revenues, the sum of game sales and other operating revenues, less sales returns and allowances were \$981.6 million for the year ended June 30, 2018, as compared to \$853.2 million for the year ended June 30, 2017. This increase was a direct reflection of higher game sales.

Non-operating revenues (investment income) for the year ended June 30, 2018, were \$433,203 as compared to \$213,272 for the year ended June 30, 2017. Non-operating revenue is comprised of interest earned on invested cash. The increase year-over-year was due to changes in cash management strategies.

#### EXPENSES

The Lottery is required to return no less than 50% of annual revenues as prizes and to spend no more than 18.5% of annual revenues on Lottery operations (including retailer commissions). Remaining funds are statutorily dedicated and transferred to various state beneficiaries. The following chart provides a high-level breakdown of Lottery funds expended for FY 2018:





## Arizona State Lottery

### A Proprietary Fund of the State of Arizona

#### Management's Discussion and Analysis (Unaudited)

Lottery total operating expenses were \$766.7 million for fiscal year ended June 30, 2018 as compared to \$655.3 million for fiscal year ended June 30, 2017. Of this amount, \$741.4 million were incurred in direct support of Lottery game sales in FY 2018. In comparison, \$632.5 million of total operating expenses for FY 2017 were direct game-related expenses. These expenses include instant and on-line prize expense, retailer commissions and incentives, instant ticket printing and distribution costs, and vendor compensation for maintaining and supporting the on-line gaming system.

Other operating expenses not directly related to Lottery game sales include items such as marketing, personnel expenses, depreciation/amortization, and other administrative costs. These expenses totaled \$25.3 million in FY 2018 as compared to \$22.8 million in FY 2017. Additional spending for advertising and promotional purposes plus higher operational costs contributed to the increase for FY 2018. The following table compares Lottery operating expenses between fiscal years. All expenses are presented in millions of dollars.

Operating Expenses	FY 2018	FY 2017	Change	Percentage
Instant & Online Prizes	\$ 647.6	\$ 551.0	\$ 96.6	17.5%
Retailer Commissions & Incentives	66.8	57.2	9.6	16.8%
On-Line Vendor Fees	11.3	8.9	2.4	27.0%
Instant Ticket Distribution Expenses	6.3	6.7	(0.4)	-6.0%
Instant Ticket Printing Expenses	9.4	8.7	0.7	8.0%
Total Direct Costs	741.4	632.5	108.9	17.2%
Operating Expenses	25.3	22.8	2.5	11.0%
<b>Total</b>	<b>\$ 766.7</b>	<b>\$ 655.3</b>	<b>\$ 111.4</b>	<b>17.0%</b>

The increase in prize expense, retailer commissions, and on-line system expenses correlates with the increase in product sales. Aggregate prize expenses represented approximately 66% of product sales in FY 2018 as compared to 65% of product sales in FY 2017. This is largely due to a higher market share of Scratchers tickets at the \$20 and \$30 price points. These tickets carry a higher associated prize expense, driving up the overall prize percentage. The decrease in instant ticket distribution expenses of (\$.4) million reflects the impact of a more favorable contract rate for ticket vending machines.

Of the \$25.3 million for other operating expenses in fiscal year 2018, \$15.5 million was used for advertising and promotion, \$5.1 million was used to compensate Lottery employees, \$1.0 million was for depreciation, and \$3.7 million was used for other administrative expenses. In comparison, of the \$22.8 million in total operating expenses for fiscal year 2017, \$14.7 million was used for advertising and promotion, \$5.1 million was used to compensate Lottery employees, .3 million was for depreciation, and \$2.7 million was used for other administrative expenses.

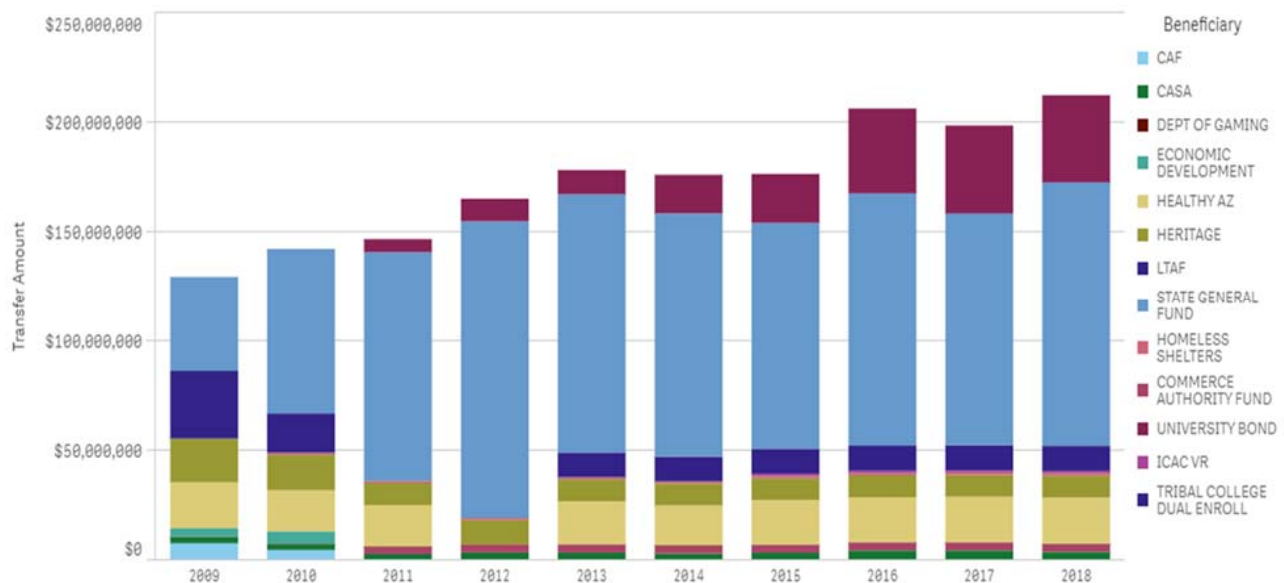
# Arizona State Lottery

## A Proprietary Fund of the State of Arizona

### Management's Discussion and Analysis (Unaudited)

#### TRANSFERS TO OTHER STATE FUNDS

Lottery proceeds are statutorily directed to various benefiting funds. Note 3 to the financial statements details the amounts transferred to other State Funds. The Lottery transferred \$211.9 million in fiscal year 2018, as compared to \$198.1 million transferred in fiscal year 2017. The increase in product sales resulted in a corresponding increase in transferable revenues of \$13.8 million, with all designated beneficiary programs receiving full funding. The total transfer rate as a percentage of sales was 21.6% in fiscal year 2018 and 23.2% in fiscal year 2017. The following chart outlines transfers to Lottery beneficiaries over the last 10 years:



#### OTHER FINANCIAL INFORMATION

**Net Position.** The Lottery's total net position was \$5.9 million at June 30, 2018 as compared to \$3.7 million for June 30, 2017.

The Lottery's total assets at June 30, 2018 were \$90.4 million, as compared to \$98.3 million the previous year. Assets consisted primarily of cash held by the State Treasurer, net receivables from Lottery retailers for the sale of Lottery products, Scratchers ticket and instant tab inventory, net investment in capital assets, and deposits with MUSL (Multi-State Lottery).

Total liabilities at June 30, 2018, were \$84.3 million, as compared to \$93.8 million the previous year. Liabilities consisted of accounts payable and accrued expenses, prize liabilities, amounts due to other funds, amounts due to other state funds, and net pension liability.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Management's Discussion and Analysis (Unaudited)**

The following table summarizes the statement of net position:

Statement of Net Position	FY 2018	FY 2017
Current assets	\$ 72.5	\$ 85.1
Capital assets	5.9	3.7
Other assets - deposits	12.0	9.5
Total assets	90.4	98.3
Deferred outflows of resources	0.8	1.0
Total assets and deferred outflows of resources	91.2	99.3
Current liabilities	77.7	88.1
Net pension liability	6.6	5.7
Total liabilities	84.3	93.8
Deferred inflows of resources	1.0	1.8
Net position	5.9	3.7
Total liabilities and net position	\$ 91.2	\$ 99.3

**Revenue Bonds.** Laws 2010, Sixth Special Session of the State Legislature, amended Lottery statutes to allow the State to issue Lottery Revenue Bonds. These bonds provide additional working capital to pay appropriated expenditures of the State's General Fund. The bonds are payable solely from and secured by pledged revenues consisting of, until July 1, 2012, amounts distributable to the State General Fund from the Lottery pursuant to Lottery law, and from and after July 1, 2012 all Lottery revenues deposited to the Lottery fund net of Lottery operating expenses. (See Note 3 to the financial statements.)

**BUDGETARY HIGHLIGHTS**

The Lottery's budget is set by the legislative appropriations process on an annual basis. The budget for fiscal year 2018 was approved in the regular legislative session of 2017. The Lottery's appropriation for sales-related expenditures is based on approved percentages of projected revenues and is allowed to adjust without a supplemental appropriations request if actual revenues exceed projected revenues. The appropriation does not include an amount for prizes because Lottery statute sets this amount at "not less than 50% of the total annual revenues accruing from the sale of Lottery tickets or shares."



# Arizona State Lottery

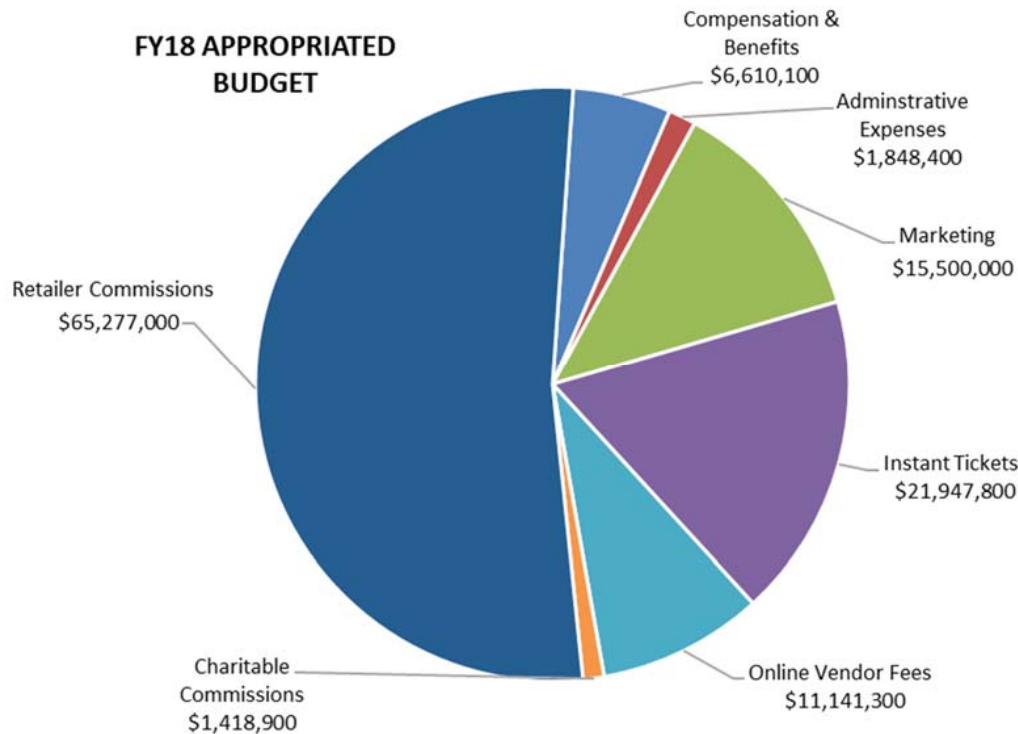
## A Proprietary Fund of the State of Arizona

### Management's Discussion and Analysis (Unaudited)

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The Lottery's approved appropriation was \$114.4 million for Fiscal Year 2018 based on an estimated \$887.7 million in total sales, but was increased to \$123.7 million as a result of actual revenues exceeding projections.

The following chart depicts the fiscal year 2018 appropriated budget based on actual sales:



#### CONTACTING THE LOTTERY'S FINANCIAL MANAGEMENT

This management's discussion and analysis (MD&A) is designed to provide Arizona citizens, Arizona government officials, our players, retailers, and other interested parties with an overview of the Lottery's financial activity for Fiscal Year 2017 and to demonstrate the Lottery's accountability for the money received from the sale of Lottery products.

If you have questions about the MD&A or need additional information, contact the Arizona Lottery's Deputy Director: Operations, 4740 East University, Phoenix, Arizona 85034.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Statements of Net Position**

**ASSETS AND DEFERRED OUTFLOWS OF RESOURCES**

	June 30, 2018
<b>CURRENT ASSETS</b>	
Cash and investments, substantially all held by the State Treasurer	\$ 57,221,483
Accounts receivable, net of allowance for doubtful accounts of \$257,758.16	7,849,476
Scratch ticket inventory	7,291,636
Pull tab inventory	181,489
Total current assets	72,544,084
<b>CAPITAL ASSETS</b>	
Land and land improvements	1,268,695
Buildings	4,347,540
Furniture, fixtures, and equipment	5,297,543
Intangible assets	599,324
Leasehold improvements	352,544
Work in progress	252,455
Less accumulated depreciation and amortization	(6,265,133)
Total capital assets	5,852,968
<b>OTHER ASSETS</b>	
Deposit - MUSL	9,521,364
ADOA asset pre-paid	2,477,989
Total assets	90,396,405
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	
Related to pensions - ASRS	724,061
Related to OPEB - ADOA	30,879
Total deferred outflows of resources	754,940
Total assets and deferred outflows of resources	\$ 91,151,345
<b>LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION</b>	
<b>CURRENT LIABILITIES</b>	
Accounts payable	\$ 12,475,158
Accrued expenses	283,518
Prize liability	11,967,080
Due to other funds	32,216,676
Due to other state funds	20,749,532
Total current liabilities	77,691,964
<b>NET PENSION AND OPEB LIABILITY</b>	6,605,987
Total liabilities	84,297,951
<b>DEFERRED INFLOWS OF RESOURCES</b>	
Related to pensions - ASRS	731,912
Related to OPEB - ADOA	268,514
Total deferred inflows of resources	1,000,426
Total liabilities and deferred inflows of resources	85,298,377
<b>NET POSITION</b>	
Net investment in capital assets	5,852,968
Unrestricted (deficit)	-
Total net position	\$ 5,852,968

See accompanying notes.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Statements of Revenues, Expenses, and Changes in Net Position**

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	Year Ended June 30 2018
OPERATING REVENUES	
Ticket sales	
Scratchers	\$ 710,886,936
Powerball	118,509,867
Mega Millions	60,900,765
The Pick	40,243,104
Fantasy 5	17,786,257
Pick 3	11,710,743
AON	2,144,400
5 Card Cash	2,382,590
Fast Play	8,099,976
Instant Tab	8,713,206
Total ticket sales	981,377,844
Sales returns & allowance	(156,507)
Net ticket sales	981,221,337
Other operating revenues	395,955
Total operating revenues	981,617,292
OTHER EXPENSES	
Direct costs	
Prize expense	647,652,599
Retailer commissions and incentives	66,834,258
On-line system expense	11,302,374
Scratcher system and distribution expenses	6,271,738
Tickets purchased	9,383,153
Total direct costs	741,444,122
Advertising and promotion	15,493,360
Wages and related expenses	5,135,469
Depreciation	971,325
Administrative expenses	3,648,733
Total operating expenses	766,693,009
OPERATING INCOME	214,924,283
NONOPERATING REVENUES - Investment income and other	433,203
INCOME BEFORE TRANSFERS	215,357,486
TRANSFERS TO OTHER STATE FUNDS	211,913,799
CHANGE IN NET POSITION	3,443,687
NET POSITION, beginning of year, as restated (Note 1)	2,409,281
NET POSITION, end of year	\$ 5,852,968

See accompanying notes.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Statements of Cash Flows**

	Year Ended June 30, 2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Cash received from retailers-net of validations, commissions, and incentives	\$ 401,867,771
Cash from other sources (Pollard A/R, MUSL, assignment fees, Superior Court)	4,806,265
Cash payments for prizes and related taxes	(131,613,041)
Cash payments to suppliers of goods or services	(45,628,423)
Cash payments for pre-paid asset to ADOA	(3,497,400)
Cash payments to employees	(6,094,141)
Net cash provided by operating activities	<u>219,841,031</u>
<b>CASH FLOWS USED BY NONCAPITAL FINANCING ACTIVITIES</b>	
Payments to beneficiaries per Arizona Statutes	<u>(238,567,317)</u>
<b>CASH FLOWS USED BY CAPITAL FINANCING ACTIVITIES</b>	
Payments for acquisition of capital assets	<u>(62,524)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Receipts of interest	<u>406,150</u>
Net increase (decrease) in cash	(18,382,660)
<b>CASH AT BEGINNING OF YEAR</b>	<u>75,604,143</u>
<b>CASH AT END OF YEAR</b>	<u><u>\$ 57,221,483</u></u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	
Operating income	\$ 214,924,283
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation	971,325
Pension expense	(178,323)
Employer pension contribution	(780,849)
Changes in operating assets and liabilities	
Accounts receivable	(2,476,987)
MUSL interest	27,053
Pre-paid and other assets	(2,730,444)
Ticket and pull tab inventory	(3,291,009)
Deposit - MUSL	(43,774)
Accounts payable and accrued expenses	3,848,429
Prizes payable and due to other funds	9,571,327
Net cash provided by operating activities	<u><u>\$ 219,841,031</u></u>
<b>NONCASH CAPITAL AND FINANCING ACTIVITIES</b>	
Capital asset acquisitions included in accounts payable	<u>\$ 2,830,000</u>
Total noncash investing/financing activities	<u><u>\$ 2,830,000</u></u>

See accompanying notes.



# Arizona State Lottery

## A Proprietary Fund of the State of Arizona

### Notes to Basic Financial Statements

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#### Note 1 – Nature of Operations and Summary of Significant Accounting Policies

The Arizona State Lottery (the "Lottery") was created by enactment of Title 5, Chapter 5 to the Arizona Revised Statutes (A.R.S.), which was an initiative measure approved by the voters of the State of Arizona (the "State") in 1980. The Lottery commenced operations in 1981. The accompanying financial statements present information as to the transactions of the Lottery.

For the period July 1, 2017 through June 30, 2018, the Lottery held 114 instant games of which 79 games expired during the fiscal year. During 2018, the Lottery continued the "The Pick," "Fantasy 5," "Pick 3," "Powerball," "Mega Millions" on-line games and discontinued "Five Card Cash," and "All or Nothing" on April 14, 2018. The Lottery introduced a new game "Fast Play" on February 11, 2018. As required, the Lottery has deposits with "Powerball," and "Mega Millions," multistate on-line lottery games, of \$9.5 million at June 30, 2018. The Lottery also sold instant tab lottery tickets to non-profit organizations and aged-restricted outlets. These games are printed and sold by the Lottery, though are administered and paid out by the purchasing non-profit organizations. The Lottery prepares its financial statements in accordance with accounting principles generally accepted in the United States of America.

**State Lottery Fund** – The State Lottery Fund (the "Fund"), which is a proprietary fund of the State, accounts for revenues received from the sale of lottery tickets and the receipt of license fees. The Fund is operated in a manner similar to a private business enterprise where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, management control, accountability, or other purposes. Activities accounted for in the proprietary fund follows all applicable Governmental Accounting Standards Board pronouncements. The Fund accounts for prize payments, operational expenses (including consulting), promotional, advertising expenses, and transfers of monies to other State funds. Receipts from each type of lottery game are allocated as follows:

- Not less than 50% of the total annual revenue from Lottery ticket sales is apportioned for the payment of prizes to the holders of winning tickets for the period July 1, 2017 to June 30, 2018.
- Not more than 18.5% is apportioned for payment of Lottery operating expenditures as defined by Arizona Revised Statute 5-555. Legislation enacted in 2008 set this limit and also removed a 4% cap on advertising expenditures.

**Cash and investments** – Substantially all the Lottery's cash is held by the State Treasurer for pooled investment purposes. Statutes require the State Treasurer to invest these pooled funds in obligations of the U.S. government and are recorded at fair value.

**Accounts receivable** – Retailers are billed weekly for tickets sold. Payments from retailers are mainly received through electronic withdrawals from retailer accounts one week after the amounts are billed. Accounts receivable represents amounts that have been billed but not yet collected. An allowance for doubtful accounts is recorded in the amount of any balances that are not paid by retailers, generally one week after amounts are billed.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 1 – Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Ticket inventory** – Ticket inventory is stated at cost, which represents the amount incurred by the Lottery for purchasing the tickets located in the vendor's warehouses or held by retailers. The cost of tickets is charged to agency operations upon the recognition of revenue under the procedures described above.

**Capital assets** – Capital assets of the Fund, which consists principally of buildings, land, land improvements, and office furniture and equipment are stated at historical cost. The Lottery defines capital assets as assets with an individual cost of more than \$5,000. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. Expenditures for normal repairs and maintenance are charged to operations as incurred, whereas expenditures for major renewals, replacements, and betterments are capitalized and depreciated. Depreciation is computed using the straight-line method. Capital assets are depreciated on the following basis:

Buildings	40 years
Improvements	40 years
Fixtures and equipment	3–10 years
Intangible assets	6 years

**Investments and investment income** – The provisions of GASB Statement No. 72, *Fair Value Measurement and Application*, have been implemented in the Lottery as of June 30, 2016. This standard addresses the Lottery's reporting related to fair value measurements and provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The Lottery reports investments at fair value on the statement of net position as determined by quoted market prices with any realized or unrealized gains and losses reported in the statement of revenues, expenses, and changes in net position. Investment income from all investments is recognized by the Lottery in the period it is earned and gains and losses are recognized as revenue in the period in which they occur. Investment income also includes earnings on invested cash held by the State Treasurer and invested prize, reserves held by the Multistate Lottery Association (MUSL).

**Sales and revenue recognition** – Revenue is recognized and the related direct expenses of ticket sales, including prize expense, are accrued based upon the known relationship of the amount of ticket sales to the amount of prizes for each game. This method of measuring revenue is necessary in order to properly match revenues and expenses. The Lottery's operating revenues result from exchange transactions associated with the principle activity of the fund. Non-operating revenues result from non-exchange transactions or from ancillary activities of the fund.

# Arizona State Lottery

## A Proprietary Fund of the State of Arizona

### Notes to Basic Financial Statements

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#### Note 1 – Nature of Operations and Summary of Significant Accounting Policies (continued)

**Prize expense and prize liability** – Instant ticket prize expense is estimated and recognized when ticket packs are settled and is based on the design of the game. Game designs include certain guaranteed prizes in each pack of tickets and prizes placed randomly by the gaming vendor. When validations for the game have ended, differences between estimated and actual prizes awarded for the randomly placed tickets are adjusted to prize expense and prize liability. Prize expense for draw games is recognized as drawings are held, based on the estimated or known cost of the prize payments. Prize expense is adjusted as prizes are claimed and the actual cost of the prize is known. Prize liabilities for prizes are recorded when the prize expense is recognized. The prize liability represents a liability for prizes which are unclaimed for games in progress. Prizes unclaimed for 180 days after the drawing date are forfeited by the ticket holder. The Lottery retains 70% of all forfeited unclaimed prizes, under State statute, for use as additional prizes in future games. State statute also requires that 30% of all forfeited unclaimed prizes be transferred to the Court Appointed Special Advocate Account, a fund within the State's General Fund. In April 2015, Senate Bill (SB) 1477 was signed by the Governor of Arizona which requires that 15% of all forfeited unclaimed prizes be transferred to the tribal college dual enrollment program fund but not to exceed \$250,000 in any fiscal year. SB 1477 adjusted the 70% retained for additional prizes in future games to 55%. All remaining forfeited unclaimed prizes offset prize expense. SB 1477 was effective starting in FY16.

**Compensated absences** – Vacation leave vests with the employee as it is earned. Employees may carry forward only the amount of vacation benefits equal to the maximum allowable accumulated credits for the preceding calendar year. Accordingly, at June 30, 2018, the Fund's accounts payable and accrued expenses balance includes an accrual of vacation pay and related benefits of \$283,518, respectively. Upon termination or retirement, an employee will be compensated for accumulated leave dependent upon accumulated time. Payment will be based on the individual's rate of pay at termination or retirement. Upon death, the same benefits shall be paid to the employee's beneficiary.

**Pensions** – For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the pension plan's fiduciary net position and additions to/deductions from the plan's fiduciary net position have been determined on the same basis as they are reported by the plan. 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.

**Postemployment benefits other than pensions (OPEB)** – For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the Arizona Department of Administration OPEB plan (ADOA) and additions to/deductions from ADOA's fiduciary net position have been determined on the same basis as they are reported by ADOA. For this purpose, ADOA recognizes benefit payments when due and payable in accordance with the benefit terms. Investments are reported at fair value, except for money market investments and participating interest-earning investment contracts that have a maturity at the time of purchase of one year or less, which are reported at cost.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 1 – Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Deferred outflows and inflows of resources** – The statement of net position and balance sheet include separate sections for deferred outflows of resources and deferred inflows of resources. Deferred outflows of resources represent a consumption of net position that applies to future periods that will be recognized as an expense or expenditure in future periods. Deferred inflows of resources represent an acquisition of net position or fund balance that applies to future periods and will be recognized as revenue in future periods.

**Commissions** – Retailers receive a commission of 6.5% on gross ticket sales. Charitable instant tab retailers receive a commission of 20% on gross ticket sales.

**Advertising costs** – Advertising costs are expensed as incurred.

**Income taxes** – The Lottery is exempt from Federal and Arizona income taxes. Accordingly, no provision for income taxes has been made.

**Net position** – Net position of the Lottery are classified and displayed as two components:

- a. Net investment in capital assets – Consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- b. Unrestricted net position – All other net funds that do not meet the definition of "net investment in capital assets" or "restricted".

Net position as of July 1, 2017, has been restated as follows for the implementation of GASB statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions*.

Net Position as previously reported at June 30, 2017	\$ 3,679,314
Prior period adjustment - Implementation of GASB 75:	
Net OPEB liability (measurement date as June 30,2016)	(1,270,033)
Net position, as restated, July1, 2017	\$ 2,409,281

**Use of estimates** – The preparation of financial statements in accordance 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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.



# Arizona State Lottery

## A Proprietary Fund of the State of Arizona

### Notes to Basic Financial Statements

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#### Note 2 – Cash and Investments Held by the State Treasurer

All cash is deposited or invested with the Arizona State Treasurer (Treasurer). The Treasurer is part of the State's financial reporting entity and issues a separately published Annual Financial Report. A copy of the Treasurer's Annual Financial Report can be obtained from its Web site at [www.aztreasury.gov](http://www.aztreasury.gov) or by contacting the Treasurer's Office at 1700 West Washington St., 1<sup>st</sup> Floor, Phoenix, AZ, 85007-2812.

A.R.S. requires state agencies' monies to be deposited with the Treasurer, and further requires those deposits to be invested in various pooled funds. Cash and investments held by the Treasurer represent the Board's portion of those monies. The Treasurer invests idle monies of the state agencies in an internal investment pool (Pool 3) and distributes interest to the participants. Interest earned from these invested monies is allocated monthly based on the average daily balance. Participant shares in the pool are purchased and sold based on the net asset value of the shares, and a participant's portion of the pool is not identified with specific investments. Accordingly, the Board's portion of these deposits and investments approximates the Board's value of pool shares. The Treasurer's internal investment Pool 3 is not required to be registered (and is not registered) with the Securities and Exchange Commission under the Investment Company Act of 1940. In accordance with A.R.S. §35-311, the State Board of Investments reviews the activities and performance of the pool monthly.

At June 30, 2018, the Lottery's deposits with the Treasurer were as follows:

	2018
Cash	\$ 16,794,489
Prize fund cash	40,426,994
	<hr/>
Total cash and investments held by State Treasurer	\$ 57,221,483
	<hr/> <hr/>

**Custodial credit risk** – For cash and investments, custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the Lottery will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. As of June 30, 2018, all of the Lottery's securities are held by the State of Arizona in the Lottery's name. The Lottery manages custodial credit risk in accordance with A.R.S. and its investment policy. The A.R.S. require collateral for deposits at 102 percent of all deposits that federal depository insurance does not cover.

**Concentration of credit risk** – Statutes do not include any requirements for concentration of credit risk.

**Interest rate risk** – Statutes require that public monies invested in securities and deposits have a maximum maturity of 5 years. The maximum maturity for investments in repurchase agreements is 180 days.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 3 – Transfers and Statutory Requirements**

As required by A.R.S. Section 5-505, the Lottery recorded transfers during the years ended June 30, 2018, as follows:

	2018
General Fund	\$ 120,390,082
University Bond Fund	39,610,181
Healthy Arizona	21,012,200
Mass Transit (LTAF)	11,529,000
Heritage Fund	10,000,000
Commerce Authority Arizona Competes Fund	3,500,000
Court-appointed Special Advocate Fund	3,322,336
Economic Security Homeless Services	1,000,000
Internet Crimes Against Children / Victim's Rights Enforcement	1,000,000
Department of Gaming	300,000
Tribal College Dual Enrollment Fund	250,000
Total transfers to other State funds	\$ 211,913,799

These transactions met the minimum percentage requirements imposed upon the Lottery by statute.

Of the transfer balances above, the following was included in due to other State funds as of June 30, 2018:

	2018
State general fund	\$ 20,749,532
Total due to other state funds	\$ 20,749,532

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

**Note 4 – Capital Assets**

Capital asset activity for the years ended June 30, 2018, is as follows:

	2018				Ending Balance
	Beginning Balance	Increases	Decreases	Transfers	
Capital assets, not being depreciated:					
Land	\$ 937,830	\$ -	\$ -	\$ -	\$ 937,830
Construction in progress	-	252,455	-	-	252,455
Capital assets, not being depreciated	937,830	252,455	-	-	1,190,285
Capital assets, being depreciated:					
Land improvements	330,865	-	-	-	330,865
Buildings	4,661,736	38,348	-	-	4,700,084
Furniture, fixtures, and equipment	2,443,366	2,854,176	-	-	5,297,542
Intangible assets	599,324	-	-	-	599,324
Capital assets, being depreciated	8,035,291	2,892,524	-	-	10,927,815
Total capital assets	8,973,121	3,144,979	-	-	12,118,100
Less accumulated depreciation for:					
Land improvements	(330,865)	-	-	-	(330,865)
Buildings	(2,384,588)	(323,392)	-	(407,135)	(3,115,115)
Furniture, fixtures, and equipment	(2,178,807)	(117,408)	-	-	(2,296,215)
Leasehold Improvements	-	(23,503)	-	-	(23,503)
Intangible assets	(399,547)	(99,887)	-	-	(499,434)
Total accumulated depreciation	(5,293,807)	(564,190)	-	(407,135)	(6,265,132)
Total capital assets, net	\$ 3,679,314	\$ 2,580,789	\$ -	\$ (407,135)	\$ 5,852,968

**Note 5 – Pledged Revenues**

The Lottery has pledged portions of its gross revenues towards the payment of debt service on the State Lottery Revenue Bonds Series 2010A issued by the State. These bonds provide additional working capital to the State to pay appropriated expenditures of the State's General Fund. The bonds are payable solely from and secured by pledged revenues consisting of, until July 1, 2012, amounts distributable to the State General Fund from the Lottery pursuant to Lottery law, and from and after July 1, 2012, all Lottery revenues deposited to the Fund net of operating expenses of the Lottery. At June 30, 2018, pledged revenues totaled approximately \$207,505,463, of which \$37,500,750 was required to be transferred to cover debt service. Future pledged revenues required to be transferred to pay all remaining debt service for the bonds through final maturity of July 1, 2029, is approximately \$412,511,250.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 6 – Commitments**

The Lottery enters into various contracts for goods and services during the normal course of its business. All contacts and purchasing activity are subject to the Arizona State Procurement Code and the rules of the Arizona State Procurement Office. All contracts have incorporated into them the "Standard Terms and Conditions" as required by the Arizona State Procurement Office. These terms and conditions in all the contracts allow for cancellation for lack of funding in the current fiscal year or next fiscal year. The contract may also be terminated for the Lottery's convenience at any time with no penalty when it is in the best interest of the State. The Lottery initially entered into a five-year contract with Scientific Games, Inc. for computer processing services at a base contract rate of 4.256% of on-line sales in August 2016 which was extended in February 2018 for additional 2 years with an option to extend until August 2026.

The Lottery entered a commercial rental agreement effective December 1, 2014, to lease a facility in Tucson, Arizona for approximately \$5,947 per month, and payment of certain additional expenses relating to the leased premises to November 30, 2019. Rent expense for the facilities was approximately \$71,364 for the years ended June 30, 2018.

In 2015, the Lottery entered into a three-year lease agreement for retail space at the Phoenix Sky Harbor Airport for approximately \$4,999 per month. Rent expense for the facilities was approximately \$59,988 for the years ended June 30, 2018.

Future minimum rental payments due under the lease agreements are as follow:

Year ending June 30,	
2019	\$ 131,352
2020	<u>29,735</u>
Total	<u>\$ 161,087</u>

**Note 7 – Loss Contingencies**

Winners are offered the option of cash or 30-year annuity for the PICK online game. The annuities are purchased from qualifying insurance companies, which have the highest ratings from among A.M. Best Company, Standard & Poor's, Moody's, Duff & Phelps, or Weiss. Purchases of annuities transfer liabilities for prizes to the insurance company. However, the Lottery may incur liabilities for prizes in the event of a default of an insurance company. Aggregate future payments to prize winners on existing annuities totaled \$55,141,378 at June 30, 2018. Approximately \$52,258,943 of the total aggregate future payments at June 30, 2018, relate to annuities purchased from five separate insurance companies, of which \$21,298,152 relates to a single insurance company.



# Arizona State Lottery

## A Proprietary Fund of the State of Arizona

### Notes to Basic Financial Statements

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#### **Note 7 – Loss Contingencies (continued)**

Tort claims against the Lottery, its agents, officers, and employees who are acting in the scope and course of their employment with the Lottery are covered pursuant to the State Risk Management statute, A.R.S. § 41-621. There is no limit to that coverage. Therefore, as to any claims based on tort, there is no contingent liability to the budget of the Lottery. The Lottery is involved in various legal proceedings, which arose in the normal course of business. Management of the Lottery does not believe that the ultimate resolution of these matters will have a material effect on the financial position, results of operations, or cash flows of the Lottery.

#### **Note 8 – Pensions and Other Postemployment Benefits**

The Lottery contributes to the Arizona State Retirement Plan (the "Plan"), a retirement plan administered by the Arizona State Retirement System (ASRS). The Plan is a component unit of the State of Arizona. The Lottery reported \$(178,323) of pension expenditure related to the pension plan to which it contributes. In addition, the Lottery reported \$30,879 of other post-employment benefit expenses related to health insurance premium benefit.

#### **Arizona State Retirement Plan**

**Plan description** – The ASRS administers a cost-sharing multi-employer defined benefit pension plan, a cost-sharing multiple-employer defined benefit health insurance premium benefit (OPEB) plan, and a cost-sharing multiple-employer defined benefit long-term disability (OBEP) plan. The Arizona State Retirement System Board governs the ASRS according to the provisions of A.R.S. Title 38, Chapter 5, Articles 2 and 2.1. The ASRS issues a publicly available financial report that includes its financial statements and required supplementary information. The report is available on its website at [www.azasrs.gov](http://www.azasrs.gov).

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 8 – Pensions and Other Postemployment Benefits**

**Benefits provided** – The ASRS provides retirement, health insurance premium supplement, long-term disability, and survivor benefits. State statute establishes benefits terms. Retirement benefits are calculated on the basis of age, average monthly compensation, and service credit as follows:

	Retirement	
	Initial membership date:	
	Before July 1, 2011	On or After July 1, 2011
Years of service and age required to achieve benefit	Sum of years and age equals 80 10 years, age 62 5 years, age 50+ any years, age 65+	30 years, age 55 25 years, age 60 10 years, age 62 5 years, age 50* any years, age 65+
Final average salary is based on	Highest 36 months of last 120 months	Highest 60 months of last 120 months
Benefit percent per year of service	2.1% to 2.3%	2.1% to 2.3%

\* with actuarially reduced benefits

Retirement benefits for members who joined the ASRS prior to September 13, 2013, are subject to automatic cost-of-living adjustments based on excess investment earnings. Members with a membership date on or after September 13, 2013, are not eligible for cost-of-living adjustments. Survivor benefits are payable upon a member's death. For retired members, the survivor benefit is determined by the retirement benefit option chosen. For all other members, the beneficiary is entitled to the member's account balance that includes the member's contributions and employer's contributions, plus interest earned.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 8 – Pensions and Other Postemployment Benefits (continued)**

**Contributions** – In accordance with State statutes, annual actuarial valuations determine active member and employer contribution requirements. The combined active member and employer contribution rates are expected to finance the costs of benefits employees earn during the year, with an additional amount to finance any unfunded accrued liability. For the years ended June 30, 2018, active ASRS members were required by statute to contribute at the actuarially determined rate of 11.50 percent (11.34 percent for retirement and 0.16 percent for long-term disability) of the members' annual covered payroll, and the Lottery was required by statute to contribute at the actuarially determined rate of 11.50 percent (10.78 percent for retirement, 0.56 percent for health insurance premium benefit, and 0.16 percent for long-term disability) of the active members' annual covered payroll. In addition, the Lottery was required by statute to contribute at the actuarially determined rate of 9.49 percent (9.17 percent for retirement, 0.21 percent for health benefit supplement, and 0.09 percent for long-term disability) of annual covered payroll of retired members who worked for the Lottery in positions that would typically be filled by an employee who contributes to the ASRS. The Lottery's contributions to the pension plan for the years ended June 30, 2018, were \$410,063. The Lottery's contributions for the current and 2 preceding years for OPEB, all of which were equal to the required contributions, were as follows:

Years ended June 30,	Health Benefit Supplement Fund	Long-Term Disability Fund
2018	\$ 21,325	\$ 6,129
2017	18,600	4,650
2016	16,700	4,003
2015	22,821	4,641

**Pension liability** – At June 30, 2018, the Lottery reported a liability of \$5,594,078, for its proportionate share of the ASRS' net pension liability. The Lottery's reported liability at June 30, 2018, decreased by \$156,962. The net pension liability was measured as of June 30, 2017. The total pension liability used to calculate the net pension liability was determined using updated procedures to roll forward the total pension liability from an actuarial valuation as of June 30, 2016, to the measurement date of June 30, 2017.

The Lottery's proportion of the net pension liability was based on fiscal year employer contributions. The Lottery's proportion measured as of June 30, 2017, was 0.03591 percent, which was an increase of 0.00028 percent from its proportion measured as of June 30, 2016.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 8 – Pensions and Other Postemployment Benefits (continued)**

**Pension expense and deferred outflows/inflows of resources** – For the years ended June 30, 2018, the Lottery recognized pension expense for ASRS of \$(178,323). At June 30, 2018, the Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2018	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ -	\$ 167,741
Changes of assumptions or other inputs	242,964	167,273
Net difference between projected and actual earnings on pension plan investments	40,162	-
Changes in proportion and differences between Lottery contributions and proportionate share of contributions	30,872	396,898
Lottery contributions subsequent to the measurement date	410,063	-
Total	\$ 724,061	\$ 731,912

The \$425,430 reported as deferred outflows of resources related to ASRS pensions resulting from Lottery contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the years ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to ASRS pensions will be recognized in pension expense as follows:

Year ended June 30,	
2019	\$ (181,471)
2020	(71,353)
2021	128,680



**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 8 – Pensions and Other Postemployment Benefits (continued)**

**Actuarial assumptions** – The significant actuarial assumptions used to measure the total pension liability are as follows:

Actuarial valuation date	June 30, 2016
Actuarial roll forward date	June 30, 2017
Actuarial cost method	Entry age normal
Asset valuation	Fair Value
Discount rate	8.00%
Project salary increases	3.00 - 6.57%
Inflation	3.00%
Permanent benefit increases	Included
Mortality rates	1994 GAM Scale BB

Actuarial assumptions used in the June 30, 2017, valuation were based on the results of an actuarial experience study for the 5-year period ended June 30, 2012. The ASRS Board adopted the experience study which recommended changes and those changes were effective as of the June 30, 2013, actuarial valuation.

The long-term expected rate of return on ASRS pension plan investments was determined to be 8.70 percent using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	2018	
	Target Allocation	Long-Term Expected Real Rate of Return
Equity	58%	3.87%
Fixed income	25%	0.91%
Real estate	10%	0.42%
Multi-asset	5%	0.17%
Commodities	2%	0.08%
Total	<u>100%</u>	<u>5.45%</u>
Inflation		<u>3.25%</u>
Expected arithmetic nominal return		<u>8.70%</u>

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 8 – Pensions and Other Postemployment Benefits (continued)**

**Discount rate** – The discount rate used to measure the ASRS total pension liability was 8 percent, which is less than the long-term expected rate of return of 8.70 percent. The projection of cash flow used to determine the discount rate assumed that contributions from participating employers will be made based on the actuarially determined rates based on the ASRS Board's funding policy, which establishes the contractually required rate under Arizona statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

**Sensitivity of the Lottery's proportionate share of the ASRS net pension liability to changes in the discount rate** – The following table presents the Lottery's proportionate share of the net pension liability calculated using the discount rate of 8 percent, as well as what the Lottery's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (7 percent) or 1 percentage point higher (9 percent) than the current rate:

	June 30, 2018		
	1% Decrease (7% Discount Rate)	Current (8% Discount Rate)	1% Increase (9% Discount Rate)
Lottery's proportionate share of the net pension liability	\$ 7,180,096	\$ 5,594,078	\$ 4,268,824

**Pension plan fiduciary net position** – Detailed information about the pension plan's fiduciary net position is available in the separately issued ASRS financial report.

**Note 9 – ADOA Other Postemployment Benefits (OPEB Plan)**

In addition to the ASRS pension and related benefits described in Note 8, the Arizona Department of Administration (ADOA) administers a single-employer defined benefit postemployment benefits for qualifying employees. The ADOA provides medical and accident benefits to retired State employees and their dependents.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 9 – ADOA Other Postemployment Benefits (OPEB Plan) (continued)**

As of the measurement period June 30, 2017, ADOA plan membership consisted of the following:

Retired members currently receiving health benefits <sup>1</sup>	6,951
Surviving spouses currently receiving health benefits	324
Active members <sup>2</sup>	<u>53,276</u>
Total	60,551

<sup>1</sup>Count excludes 2,031 spouses covered under retired members' coverage

<sup>2</sup>Excludes 6,498 active employees currently waiving medical coverage

The ADOA pays the medical costs incurred by retired employees minus a specified premium amount, which is paid for entirely by the retiree or on behalf of the retiree. Premium rates are based on a blend of active employee and retiree experience, resulting in a contribution basis which is lower than the expected claim costs for retirees only, which results in an implicit subsidization of retirees by the State. Dental and vision benefits are also available, but are not valued as there is no implicit subsidization in the retiree rates. Health insurance premium supplements payable through the ASRS are included in the valuation of pension liabilities and are not considered OPEB.

**Other postemployment benefits (OPEB) liability** – At June 30, 2018, the Lottery reported a OPEB liability of \$1,011,909 for its proportionate share. The liability was measured as of June 30, 2017 to be reported as of June 30, 2018 under GASB 75.

Reporting Date for Employer under GASB 75	June 30, 2018
<u>Measurement Date for Employer under GASB 75</u>	<u>June 30, 2017</u>
<b>Components of the total OPEB liability</b>	
Total OPEB liability	
Service cost	115,725
Interest	36,665
Change of benefit terms	(100,175)
Differences between expected and actual experience	(49,461)
Changes of assumptions	(260,878)
Expected benefit payments <sup>1</sup>	<u>(32,938)</u>
Net change in total OPEB liability	(291,062)
Total OPEB liability - beginning	<u>1,302,971</u>
Total OPEB liability - ending	<u>1,011,909</u>
Covered employee payroll <sup>2</sup>	<u>3,271,788</u>
Plan total OPEB liability as a percentage of covered employee payroll	30.9%

<sup>1</sup>Benefit payments of \$30,879 projected for the year ended June 30, 2018.

<sup>2</sup>Annualized pay of active employees not waiving coverage as of the measurement date.

Payroll as of the June 30, 2016 pro-rated from prior actuary's report.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 9 – ADOA Other Postemployment Benefits (OPEB Plan) (continued)**

**OPEB deferred outflows/inflows of resources** – At June 30, 2018, the Lottery reported deferred inflows of resources related to OPEB from the following sources:

**Deferred inflows of resources**

Changes of assumptions or other inputs	\$ 225,719
Difference between expected and actual experience in the total OPEB liability	42,795
	\$ 268,514

Other amounts reported as deferred inflows of resources related to OPEB expense will be recognized as follows:

Year ended June 30,	
2019	\$ (41,825)
2020	(41,825)
2021	(41,825)

**Actuarial assumptions** – The total OPEB liability was measured by using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

Salary increases	2.7% to 7.2% varying by years of service
Discount rate	3.58% as of June 30, 207 and 2.85% as of June 20, 2016
Health cost trend rates:	
Medical (pre-65)	6.5% graded to 4.5% by 0.5%
Medical (post-65)	4.50%
Prescription drug	9.0% graded to 4.5% by 0.5%
Administrative costs	3.00%
Contribution trend rates	7.0% graded to 4.5% by 0.5%
Mortality rates:	
Employees	RP-2014 Employee Mortality Tables projected generationally from 2014 with 1% improvement per year
Healthy Retirees and Spouses	2017 State retirees of Arizona Mortality Tables projected generationally from 2017 with 1% improvement per year
Disabled Retirees	RP-2014 Disabled Retiree Mortality Tables project generationally from 2014 with 1% improvement per year

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Basic Financial Statements**

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**Note 9 – ADOA Other Postemployment Benefits (OPEB Plan) (continued)**

**Development of discount rate** – The discount rate for OPEB funded entirely on a pay-as-you-go basis is the yield or index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher (or equivalent quality on another rating scale). For this purpose, we used the Bond Buyer 20-Bond General Obligation Municipal Bond Index. The index value as of the June 30, 2017 measurement date is 3.58%. The index value as of the prior measurement date (June 30, 2016) was 2.85%.

**Sensitivity** – The following table presents the Lottery's total OPEB liability calculated using the discount rate of 3.58 percent, as well as what the Lottery's total OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower (2.58 percent) or 1 percentage point higher (4.58 percent) than the current rate:

	June 30, 2018		
	1% Decrease <u>(2.58% Discount Rate)</u>	Current <u>(3.58% Discount Rate)</u>	1% Increase <u>(4.58% Discount Rate)</u>
Lottery's Total OPEB Liability	\$ 1,189,099	\$ 1,011,909	\$ 872,123

**Note 10 – Major Vendors**

The Lottery has three vendors that represent approximately 84% of its purchases for the years ended June 30, 2018.

**Note 11 – Risk Management**

The Lottery is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery purchases commercial insurance to cover these risks. The amount of coverage has not been exceeded by claims in the last four years.



## **Required Supplementary Information**

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**Arizona State Lottery**  
**Schedule of Proportionate Share of the Net Pension Liability**

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	Fiscal Year	
	2018 (2017)*	2017 (2016)*
Lottery's proportion of the net pension liability	0.035910%	0.035630%
Lottery's proportionate share of the net pension liability	\$ 5,594,078	\$ 5,751,040
Lottery's covered-employee payroll	\$ 3,862,106	\$ 3,321,318
Lottery's proportionate share of the net pension liability as a percentage of its covered employees payroll	144.85%	173.16%
Plan fiduciary net position as a percentage of the total pension liability	69.92%	67.05%

\*This year represents the measurement period.

## Arizona State Lottery Schedule of Pension Contributions

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	Fiscal Year	
	2018	2017
Statutorily required contribution	\$ 410,063	\$ 362,060
Lottery's contributions in relation to the statutorily required contribution	410,063	362,060
Lottery's contribution deficiency (excess)	\$ -	\$ -
Lottery's covered-employee payroll	\$ 3,862,106	\$ 3,321,318
Lottery's contribution as a percentage of covered-employee payroll	10.62%	10.90%

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Schedule of Changes in Net OPEB Liability and Related Ratios**

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	<u>2018</u>
Total OPEB liability	
Service cost	115,725
Interest	36,665
Change of benefit terms	(100,175)
Differences between expected and actual experience	(49,461)
Change of assumptions	(260,878)
Expected benefit payments <sup>1</sup>	<u>(32,938)</u>
Net change in total OPEB liability	(291,062)
Total OPEB liability - beginning	<u>1,302,971</u>
Total OPEB liability - ending	<u><u>1,011,909</u></u>
Covered employee payroll <sup>2</sup>	3,271,788
Plan total OPEB liability as a percentage of covered employee payroll	30.9%

<sup>1</sup> Benefit payments of \$30,879 projected for the year ended June 30, 2018.

<sup>2</sup> Annualized pay of active employees not waiving coverage as of the measurement date.  
Payroll as of the June 30, 2016 pro-rated from prior actuary's report.

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Notes to Required Supplementary Information**

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**Note 1 – Changes of Assumptions**

The Arizona State Retirement System (ASRS) annual actuarial valuation as of June 30, 2017 report is available at [https://www.azasrs.gov/sites/default/files/ASRS\\_CAFR\\_FY17.pdf](https://www.azasrs.gov/sites/default/files/ASRS_CAFR_FY17.pdf)

For details about actuarial assumptions in Note 8.



## **Report of Independent Auditors 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 Commissioners of  
Arizona State Lottery  
Phoenix, Arizona

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities of the Arizona State Lottery (the "Lottery") as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively Lottery's basic financial statements, and have issued our report thereon dated October 31, 2018.

### **Internal Control Over Financial Reporting**

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

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

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

### **Compliance and Other Matters**

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

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity'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.

A handwritten signature in black ink that reads "Moss Adams LLP". The signature is written in a cursive, flowing style.

Scottsdale, Arizona  
October 31, 2018

**Arizona State Lottery**  
**A Proprietary Fund of the State of Arizona**  
**Schedule of Prior Year Audit Findings**  
**Year Ended June 30, 2017**

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There were no findings reported in the prior year.



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**ArizonaLottery.com**