KPMG

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Financial Statement Audit

For the Year Ended June 30, 2016

Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Table of Contents

	Page
Agency Officials	1
Financial Statement Report – Summary	2
Independent Auditors' Report	3
Basic Financial Statements:	
Statement of Net Position (Deficit)	6
Statement of Revenues, Expenses, and Changes in Net Position (Deficit)	7
Statement of Cash Flows	8
Notes to Basic Financial Statements	10
Supplementary Information:	
Combining Schedule of Net Position (Deficit) – June 30, 2016	28
Combining Schedule of Revenues, Expenses, and Changes in Net Position (Deficit) – June 30, 2016	29
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*	30
Schedule of Findings:	
Current Findings – *Government Auditing Standards*	32
Prior Finding Not Repeated	36

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

AGENCY OFFICIALS

Director	Greg Smith (Acting) – effective October 24, 2016 Tim McDevitt (Acting) – June 11, 2016 to October 23, 2016 B.R. Lane (Acting) – April 6, 2015 to June 10, 2016
Deputy Director	Vacant – effective November 15, 2014
Chief of Staff	Jayme Odom – effective January 23, 2015
Chief Transition Officer	Vacant – effective June 24, 2015
Chief Financial Officer	Mark Lewis – effective May 18, 2016 Brett Finley (Acting) – December 19, 2015 to May 17, 2016 Christian Froelich – August 1, 2014 to December 18, 2015
Chief Operations Officer	Harold Mays – effective January 6, 2013
General Counsel	Nellie Viner – effective February 27, 2015
Chief Internal Auditor	Amy DeWeese – effective June 1, 2015

Agency offices are located at:

101 West Jefferson Street
Springfield, Illinois 62702

122 South Michigan Avenue, 19th floor
Chicago, Illinois 60603

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying basic financial statements of the State of Illinois Department of the Lottery (Department) was performed by KPMG LLP.

Based on their audit, the auditors expressed an unmodified opinion on the Department's basic financial statements.

SUMMARY OF FINDINGS

The auditors identified noncompliance with certain provisions of laws, which could have a direct and material effect on the determination of financial statement amounts. The noncompliance is described in the accompanying Schedule of Findings as Finding 2016-001.

FINDING (GOVERNMENT AUDITING STANDARDS)

Finding No.	Page No.	Description	Finding Type
2016-001	32	Noncompliance with the Illinois Lottery Law	Material noncompliance

PRIOR FINDING NOT REPEATED

A	36	Errors identified in GAAP Reporting Forms Submitted to the Illinois Office of the Comptroller and Year-end Department Financial Statements	

EXIT CONFERENCE

The Department elected to waive a formal exit conference.

The response to the recommendation was provided by Amy DeWeese, Chief Internal Auditor, in an email dated December 29, 2016.

KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

Independent Auditors' Report

Honorable Frank J. Mautino
Auditor General
State of Illinois

Report on the Financial Statements

As Special Assistant Auditors for the Illinois Office of the Auditor General, we have audited the accompanying basic financial statements of the State of Illinois Department of the Lottery (the Department) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Department'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 U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of June 30, 2016, and the changes in financial position and cash flows for the year then ended, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in Note 2(a), the financial statements of the Department are intended to present the financial position, the changes in financial position and, where applicable, cash flows of only that portion of the business-type activities of the State of Illinois that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Illinois as of June 30, 2016, and the changes in its financial position or, where applicable, its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted a management's discussion and analysis and related pension information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Department's basic financial statements. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 10, 2017 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

/s/KPMG LLP

Chicago, Illinois
January 10, 2017

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Net Position (Deficit)
June 30, 2016
(In thousands of dollars)

Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	$	27,464
Cash equity in State Treasury		199,963
Investments, short-term		31,206
Accounts receivable, net of allowance of $17,594		80,002
Total current assets		338,635
Noncurrent assets:		
Investments		294,508
Capital assets being depreciated, net		58
Total noncurrent assets		294,566
Deferred outflows of resources – pension		10,475
Total assets and deferred outflows of resources		643,676
Liabilities and Deferred Inflows of Resources		
Current liabilities:		
Prizes payable		83,299
Accounts payable and accrued liabilities		142,937
Due to other Government – Federal		69
Due to other State funds		105,841
Unearned revenue		3,415
Other liabilities		1,170
Current portion of long-term annuity prizes payable		29,357
Total current liabilities		366,088
Noncurrent liabilities:		
Noncurrent portion of long-term annuity prizes payable		251,695
Net pension liability		65,511
Noncurrent other		780
Total noncurrent liabilities		317,986
Deferred inflows of resources – pension		3,597
Total liabilities and deferred inflows of resources		687,671
Net Position (Deficit)		
Invested in capital assets		58
Unrestricted		(44,053)
Total net position (deficit)	$	(43,995)

The accompanying notes to the financial statements are an integral part of these statements.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Revenues, Expenses, and Changes in Net Position (Deficit)

Year ended June 30, 2016

(In thousands of dollars)

Operating revenues:		
Charges for sales and services	$	2,855,535
Other		6,521
Total operating revenues		2,862,056
Operating expenses:		
Cost of sales and services		160,942
Prizes and claims		1,837,402
General and administrative		139,735
Depreciation		35
Total operating expenses		2,138,114
Operating income		723,942
Nonoperating revenues (expenses):		
Investment income		27,948
Interest expense		(11,996)
Total nonoperating revenues, net		15,952
Change in net position before transfers		739,894
Transfers to other State funds		(724,164)
Change in net position (deficit)		15,730
Net position (deficit) at beginning of year		(59,725)
Net position (deficit) at end of year	$	(43,995)

The accompanying notes to the financial statements are an integral part of these statements.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

Year ended June 30, 2016

(In thousands of dollars)

Cash flows from operating activities:		
Cash received from sales and services	$	2,870,260
Cash receipts from other operating activities		40,091
Cash payments for commissions and bonuses		(160,942)
Cash payments for general and administrative expenses		(101,408)
Cash payments for lottery prizes		(1,969,120)
Net cash provided by operating activities		678,881
Cash flows from noncapital financing activities:		
Cash transfers – out to other funds		(680,202)
Net cash used in noncapital financing activities		(680,202)
Cash flows from investing activities:		
Interest and dividends on investments		(81)
Purchase of investments		(33,569)
Proceeds from investment maturities		37,230
Cash paid for long-term annuity prizes payable		(37,000)
Net cash used in investing activities		(33,420)
Net decrease in cash and cash equivalents		(34,741)
Cash and cash equivalents at beginning of year		262,168
Cash and cash equivalents at end of year	$	227,427
Reconciliation of cash and cash equivalents to the statement of net position (deficit):		
Total cash and cash equivalents per the statement of net position (deficit)	$	27,464
Add cash equity in State Treasury		199,963
Cash and cash equivalents at end of year	$	227,427

The accompanying notes to the financial statements are an integral part of these statements.

(Continued)

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

Year ended June 30, 2016

(In thousands of dollars)

Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	723,942
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		35
Provision for uncollectible accounts		1,796
Changes in assets and liabilities:		
Decrease in prepaid assets		20,000
Decrease in accounts receivable		12,303
Increase in other receivables		(25,622)
Decrease in prizes payable		(151,718)
Increase in accounts payable and accrued liabilities		60,679
Decrease in intergovernmental payables		(3)
Increase in due to other State funds		1,075
Increase in unearned revenues		626
Decrease in other liabilities		(27)
Increase in long-term annuity prizes payable		33,569
Decrease in noncurrent other liabilities		—
and net change in pension liability		2,226
Net cash provided by operating activities	$	678,881

Noncash investing, capital and financing activities:		
Decrease in unrealized gains on investments	$	(15,730)
Interest accreted on investments		11,986
Interest accretion on long-term annuity prizes payable		(11,986)
Release of long-term annuity prizes payable		(303)

The accompanying notes to the financial statements are an integral part of these statements.

(1) Organization

The Department of the Lottery (the Department) is a part of the executive branch of government of the State of Illinois (State) and operates under a budget approved by the General Assembly in which resources primarily from the State Lottery Fund are appropriated for the use of the Department. Activities of the Department are subject to the authority of the Office of the Governor, the State's chief executive officer, and other departments of the executive and legislative branches of government (such as the Department of Central Management Services, the Governor's Office of Management and Budget, the State Treasurer's Office, and the State Comptroller's Office) as defined by the Illinois General Assembly. All funds appropriated to the Department and all other cash received are under the custody and control of the State Treasurer, with the exception of the security deposits for Lottery agents.

The Department is organized to provide for administering and overseeing the operations of the Illinois Lottery with the assistance of a private manager under a management agreement.

Financial Reporting Entity

As defined by U.S. generally accepted accounting principles (GAAP), the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or

2) Fiscal dependency on the primary government.

Based upon the required criteria, the Department has no component units and is not a component unit of any other entity. However, because the Department is not legally separate from the State of Illinois, the financial statements of the Department are included in the financial statements of the State of Illinois. The State of Illinois' Comprehensive Annual Financial Report (CAFR) may be obtained by writing to the State Comptroller's Office, Division of Financial Reporting, 325 West Adams Street, Springfield, Illinois, 62704-1871.

(2) Summary of Significant Accounting Policies

The financial statements of the Department have been prepared in accordance with GAAP, as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

(a) Basis of Accounting and Presentation

The financial statements of the State of Illinois, Department of the Lottery, are intended to present the financial position, changes in financial position, and cash flows of only that portion of the activities of the State of Illinois that are attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2016, the changes in financial position and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The basic financial statements provide information about the Department's proprietary (enterprise) fund. Proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place.

The Department accounts for operations of the State Lottery in which a statutorily defined amount of the net income is used for the support of the State's Common School Fund. Any net income remaining after the required transfers to the Common School Fund is transferred to the State's Capital Projects Fund. Certain ticket sales are dedicated for other State funds prior to the determination of the net income available for transfers to the Common School Fund or the Capital Projects Fund.

(b) Cash and Cash Equivalents

Cash equivalents are defined as short-term, highly liquid investments readily convertible to cash with maturities of less than 90 days at time of purchase. Cash and cash equivalents include cash on hand and cash in banks for locally held funds.

(c) Investments

Investments are reported at fair value based on quoted market prices.

(d) Fair Value of Financial Instruments

The Department follows guidance for fair value measurements that defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability on the measurement date. The guidance establishes a hierarchy of inputs used to measure fair value that prioritizes the inputs into three categories that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the transparency of inputs as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the measurement date.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data. These inputs are either directly or indirectly observable as of the measurement date.

Level 3 – Unobservable inputs for the asset or liability as of the measurement date. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the valuation methodologies used to measure the Department's financial instruments at fair value. There have been no changes in the methodologies used at June 30, 2016 when compared to June 30, 2015.

U.S. Treasury bonds—U.S. Treasury bonds are valued using prices quoted in active markets for those securities. These assets are classified as Level 1 assets.

Annuities—Annuities are valued at fair value and are comprised of insurance policies not traded on the open market. These assets are classified as Level 3 assets.

(e) Allowances and Provisions

The allowance for doubtful accounts at June 30, 2016 is based on an analysis of the historical collection experience for accounts receivable, which considers the age of the receivable and current economic conditions.

(f) Interfund Transactions

The Department has the following types of interfund transactions between Department funds and funds of other State agencies:

Services provided and used—Sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the statement of net position (deficit).

Transfers—Flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported after nonoperating revenues and expenses.

(g) Capital Assets

Capital assets, which consist of equipment, automobiles, and internally developed computer software, are reported at historical cost. Contributed assets are reported at estimated fair value at the time received. Capital assets are depreciated using the straight-line method. The capitalization threshold for capital assets is $5,000 and the estimated useful lives range from 3 to 15 years.

(h) Compensated Absences

The liability for compensated absences reported in the statement of net position (deficit) consists of unpaid, accumulated vacation and sick leave balances for Department employees. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g., Social Security and Medicare tax).

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees' Retirement System (SERS) members at December 31, 1997. Employees continue to accrue 12 sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between January 1, 1984 and December 31, 1997 (with a 50 percent cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 were converted to service time for purposes of calculating employee pension benefits.

(i) Net Position (Deficit)

In the Statement of Net Position (Deficit), equity is displayed in three components as applicable:

Invested in Capital Assets – This consists of capital assets, net of accumulated depreciation.

Restricted – This consists of net position that is legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the State's policy to use restricted resources first, then unrestricted resources when they are needed. There is no restricted net position as of June 30, 2016.

Unrestricted – This consists of net position (deficit) that does not meet the definition of "restricted" or "invested in capital assets."

(j) Classification of Revenues and Expenses

The Department classifies its revenues and expenses as either operating or nonoperating in the Statement of Revenues, Expenses, and Changes in Net Position (Deficit) according to the following criteria:

Revenue

Operating revenues, such as sale of lottery tickets, result from exchange transactions associated with the principal activity of the fund. Nonoperating revenues, such as investment income, result from nonexchange transactions or ancillary activities.

Expenses

All expenses are classified as operating, except for interest expense and losses on disposal of capital assets which are classified as nonoperating.

(k) Lottery Revenue

Draw Games

Revenue from ticket sales for Lotto, Pick 3, PowerBall, and other draw games is recognized when the related drawing takes place. Receipts from subscription sales and other ticket sales for future drawings are recorded as unearned revenue and will not be recognized as revenue until the related drawing takes place.

Instant Games

Revenue from instant games is recognized based on the dollar value of the total books of tickets settled. Tickets are available for sale upon being activated at the retailer locations.

(l) Prizes and Claims – Ticket Expense

Prize expense is accrued for instant game sales at a percentage equivalent to the total prizes included in all tickets printed for each game. Prize expense and prizes payable are reduced for an estimate of prizes that will go unclaimed and are increased if amounts claimed exceed the amounts accrued (i.e., early redemption expense). Instant games are closed at the end of the final redemption period and any remaining net payable accrued in prior periods is reversed and recorded as a reduction to prize expense.

(m) Estimates

The preparation of financial statements in conformity with GAAP 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.

(n) Pensions

In accordance with the Department's adoption of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, the net pension liability, deferred outflows of resources, deferred inflows of resources and pension expense have been recognized in the financial statements.

The net pension liability is calculated as the difference between the actuarially calculated value of the projected benefit payments attributed to past periods of service and the plans' fiduciary net position. The total pension expense is comprised of the service cost or actuarial present value of projected benefit payments attributed to the valuation year, interest on the total pension liability, plan administrative expenses, current year benefit changes, and other changes in plan fiduciary net position less employee contributions and projected earnings on plan investments. Additionally, the total pension expense includes the annual recognition of outflows and inflows of resources due to pension assets and liabilities.

For purposes of measuring the net pension liability, deferred outflows of resources, deferred inflows of resources, pension expense and expenditures associated with the Department's contribution requirements, information about the fiduciary net position of the State Employees Retirement System (SERS) and additions to/deductions from the SERS' fiduciary net position have been determined on the same basis as they are reported within the separately issued SERS financial statements. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with terms of the plan. Investments are reported at fair value.

(o) Current Adoption of GASB Statements

GASB Statement No. 72, *Fair Value Measurement and Application*, is effective for the Department beginning with its year ended June 30, 2016. The objective of this statement is to provide specific accounting and financial reporting guidance for determining and applying fair value measurements. The implementation of this statement had no direct impact on the Department's financial statements. Required disclosures have been included in Note 4.

GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68,* is effective for the Department beginning with its year ended June 30, 2016. The objective of this statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. The provisions of this statement were incorporated with the implementation of GASB Statement No. 68.

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, is effective for the Department beginning with its year ended June 30, 2016. The objective of this statement is to identify, in the context of the current governmental financial reporting environment, the hierarchy of GAAP. The implementation of this statement had no direct impact on the Department's financial statements.

GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, is effective for reporting periods beginning after June 15, 2015; however, the Department does not participate in any external investment pools.

(p) Future Adoption of GASB Statements

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plan Other Than Pension Plans*, will be effective for the Department beginning with the year ending June 30, 2017. The objective of this statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability.

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, will be effective for the Department beginning with the year ending June 30, 2018. The objective of this statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities.

GASB Statement No. 77, *Tax Abatement Disclosures*, will be effective for the Department beginning with the year ending June 30, 2017. The objective of this statement is to provide financial statement users with essential information about the nature and magnitude of the reduction in tax revenues through tax abatement programs in order to better assess the government's financial position and results of operations.

GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, will be effective for reporting periods beginning after December 15, 2015. This Statement applies to multiple-employer defined benefit pension plans, in which the Department does not participate.

GASB Statement No. 80, *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*, will be effective for reporting periods beginning after June 15, 2016. This Statement applies to component units, which the Department is not considered to be.

GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, will be effective for reporting periods beginning after December 15, 2016. The Department is not presently, and does not expect to be, a party to an irrevocable split-interest agreement.

GASB Statement No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*, will be effective for the Department beginning with the year ending June 30, 2017. The objective of this statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

(Continued)

The Department has not yet determined the impact, if any, on its financial statements as a result of adopting these statements.

(3) Deposits and Investments

The State Treasurer is the custodian of the Department's deposits and investments for funds maintained in the State Treasury. These amounts are classified as "Cash equity in State Treasury" on the Statement of Net Position (Deficit). The Department independently manages deposits and investments maintained outside the State Treasury.

(a) Deposits

Deposits in the custody of the State Treasurer of approximately $200 million as of June 30, 2016, are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Details on the nature of these deposits and investments are available within the State's CAFR.

Bank deposits for the enterprise funds held outside of the State Treasury of approximately $27 million as of June 30, 2016, are held in Federal Deposit Insurance Corporation (FDIC) insured depository institutions. The Department has an agreement under which one of these institutions insures balances in excess of FDIC insurance limits from loss by pledging securities as collateral. The collateral amount exceeded the deposited amount of $8 million at June 30, 2016. The Department has not incurred any losses on deposits exceeding the value of pledged securities and considers the risk minimal.

(b) Investments

As of June 30, 2016, the Department had the following investments outside of the State Treasury:

	Fair value (thousands)	Weighted average maturity (years)
Annuities	$ 330	3.540
U.S. Treasury bonds	325,384	7.796
Total	$ 325,714	

Interest Rate Risk: The Department does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: The Department is limited to investing in direct obligations of the United States of America or backed by the full faith and credit of the United States of America. The Department's investments in annuities are not rated.

(4) Fair Value Measurements

The following table presents assets (amounts expressed in thousands) measured at fair value on a recurring basis at June 30, 2016:

	Level 1	Level 2	Level 3	Total
Annuities	$ —	—	330	330
U.S. Treasury bonds	325,384	—	—	325,384
Total assets at fair value	$ 325,384	—	330	325,714

The change in assets measured at fair value using Level 3 inputs for the year ended June 30, 2016 is as follows:

	2016
Balance, beginning of the year	$ 382
Change in value of annuities	(52)
Balance, end of the year	$ 330

(5) Interfund Balance and Activity

(a) Balance Due from/to Other Funds

The following balance (amounts expressed in thousands) at June 30, 2016, represent amounts due to other State funds.

	Due to		
Fund	Other State funds	2016	Description/Purpose
Lottery	Common School	$ 14,628	Due to other State funds for
	Capital Projects	89,046	allocation of lottery proceeds
	Other State funds	2,167	and for administrative expenses.
		$ 105,841	

(b) Transfers to Other Funds

The Department reports transfers out in the Statement of Revenues, Expenses, and Changes in Net Position (Deficit), for the amounts required by statute to be transferred to the Common School Fund, Capital Projects Fund, and other State funds for lottery games designated for special purposes. The following balances (amounts expressed in thousands) for the year ended June 30, 2016 represent amounts transferred to other State funds:

Fund	Transfers out to Other State funds		2016	Description/Purpose
Lottery	Common School	$	691,550	Transfers to Common School, Capital Projects, and other State funds pursuant to statutory requirements.
	Capital Projects		29,216	
	Other State funds		3,398	
		$	724,164	

(6) Capital Assets

Capital asset activity (amounts expressed in thousands) for the year ended June 30, 2016 was as follows:

		Balance June 30, 2015	Additions	Deletions	Net transfers	Balance June 30, 2016
Capital assets being depreciated:						
Equipment	$	1,412	—	5	(389)	1,018
Less accumulated depreciation		(1,319)	(35)	(5)	389	(960)
Total capital assets, net	$	93	(35)	—	—	58

(7) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2016 were as follows:

		Balance June 30, 2015	Additions	Deletions	Balance June 30, 2016	Amounts Due within one year
Compensated absences	$	923	1,155	1,183	895	115
Obligations to Lottery prize winners – group contracts		382	—	52	330	60
Obligations to Lottery prize winners – annuities		272,345	45,555	37,178	280,722	29,297
Net pension liability		65,780	—	269	65,511	—
Total long-term obligations	$	339,430	46,710	38,682	347,458	29,472

(b) Obligations to Lottery Prize Winners

The Department has obligations to certain lottery prize winners for awards payable in annual installments ranging from 19 years to the life of the prize winner, with the first payment made shortly after the claim is presented for payment.

For certain prize winners, annuities (group contracts) were purchased in the name of the Department for which the Department has retained the rights of ownership. The present value of these annuities and the related liability installments owed to prize winners were as follows at June 30, 2016:

Present value of investment annuities and related prize liabilities (in thousands)

Fiscal year		Current	Long-term	Total
2017	$	62	—	62
2018		—	62	62
2019		—	62	62
2020		—	62	62
2021		—	62	62
2022		—	50	50
Total future prize payments		62	298	360
Less present value adjustments		(2)	(28)	(30)
Present value at June 30, 2016	$	60	270	330

Effective July 30, 1985, State law provides that the State Treasurer, with the consent of the Director of the Lottery, may contract to invest in securities, which provide payments corresponding to the Department's obligation to these winners. The Department has provided for other payments corresponding to the Department's obligation to other prize winners through the purchase of direct obligations of the federal government, primarily in the form of United States Treasury zero coupon bonds. As established by State law, such securities shall be maintained separate and apart from all public money or funds of the State. These investments are purchased in amounts to provide for annual annuity payments to the prize winner(s) of each qualifying individual drawing.

The fair value of the investments approximated $325 million at June 30, 2016. Interest rates range from 1.8% to 7.7% and prizes payable are scheduled annually through 2043 as follows (amounts expressed in thousands):

Fiscal year		Current	Long-term	Total
2017	$	31,556	—	31,556
2018		—	24,403	24,403
2019		—	22,357	22,357
2020		—	22,229	22,229
2021		—	24,336	24,336
2022-2043		—	250,048	250,048
Total future prizes		31,556	343,373	374,929
Adjustments to present value		(2,259)	(91,948)	(94,207)
Present value of future prizes		29,297	251,425	280,722
Adjustments to fair value		1,849	42,813	44,662
Fair value of future prizes at June 30, 2016	$	31,146	294,238	325,384

The amortized discount on the prizes payable reflects the interest rates earned by the investments held to fund the related liabilities. The amortization of discount is recorded as interest expense in the Statement of Revenues, Expenses, and Changes in Net Position and amounted to $12.0 million for the year ended June 30, 2016.

(8) Pension Plan

Plan Description. Substantially all of the Department’s full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a single-employer defined benefit pension trust fund in the State of Illinois reporting entity. SERS is governed by article 14 of the Illinois Pension Code (40 ILCS 5/1, et al.). The plan consists of two tiers of contribution requirements and benefit levels based on when an employee was hired. Members who first become an employee and participate under any of the State’s retirement plans on or after January 1, 2011 are members of Tier 2, while Tier 1 consists of employees hired before January 1, 2011 or those who have service credit prior to January 1, 2011. The provisions below apply to both Tier 1 and 2 members, except where noted. The SERS issues a separate CAFR available at www.srs.illinois.gov or that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

Benefit Provisions. SERS provides retirement benefits based on the member’s final average compensation and the number of years of credited service that have been established. The retirement benefit formula available to general State employees is 1.67% for each year of covered service and 2.2% for each year of noncovered service. The maximum retirement annuity payable is 75% of final average compensation as calculated under the regular formula. The minimum monthly retirement annuity payable is $15.00 for each year of covered employment and $25.00 for each year of noncovered employment.

Participants in SERS under the regular formula Tier 1 and Tier 2 receive the following levels of benefits based on the respective age and years of service credits.

Regular Formula Tier 1	Regular Formula Tier 2
A member must have a minimum of eight years of service credit and may retire at: • Age 60, with 8 years of service credit. • Any age, when the member's age (years & whole months) plus years of service credit (years & whole months) equal 85 years (1,020 months) (Rule of 85) with eight years of credited service. • Between ages 55-60 with 25-30 years of service credit (reduced 1/2 of 1% for each month under age 60). The retirement benefit is based on final average compensation and credited service. Final average compensation is the 48 highest consecutive months of service within the last 120 months of service. Under the Rule of 85, a member is eligible for the first 3% increase on January 1 following the first full year of retirement, even if the member is not age 60. If the member retires at age 60 or older, he/she will receive a 3% pension increase every year on January 1, following the first full year of retirement. If the member retires before age 60 with a reduced retirement benefit, he/she will receive a 3% pension increase every January 1 after the member turns age 60 and has been retired at least one full year. These pension increases are not limited by the 75% maximum.	A member must have a minimum of 10 years of credited service and may retire at: • Age 67, with 10 years of credited service. • Between ages 62-67 with 10 years of credited service (reduced 1/2 of 1% for each month under age 67). The retirement benefit is based on final average compensation and credited service. For regular formula employees, final average compensation is the average of the 96 highest consecutive months of service within the last 120 months of service. The retirement benefit is calculated on a maximum salary of $106,800. This amount increases annually by 3% or one-half of the Consumer Price Index, whichever is less. If the member retires at age 67 or older, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every year on January 1, following the first full year of retirement. The calendar year 2015 rate is $111,572. If the member retires before age 67 with a reduced retirement benefit, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every January 1 after the member turns age 67 and has been retired at least one full year. These pension increases are not limited by the 75% maximum

Additionally, the Plan provides an alternative retirement formula for State employees in high-risk jobs, such as State policemen, fire fighters, and security employees. Employees qualifying for benefits under the alternative formula may retire at an earlier age depending on membership in Tier 1 or Tier 2. The retirement formula is 2.5% for each year of covered service and 3.0% for each year of non-covered service. The maximum retirement annuity payable is 80% of final average compensation as calculated under the alternative formula.

SERS also provides occupational and nonoccupational (including temporary) disability benefits. To be eligible for nonoccupational (including temporary) disability benefits, an employee must have at least 18 months of credited service to the System. The nonoccupational (including temporary) disability benefit is equal to 50% of the monthly rate of compensation of the employee on the date of removal from the payroll. Occupational disability benefits are provided when the member becomes disabled as a direct result of injuries or diseases arising out of and in the course of State employment. The monthly benefit is equal to 75% of the monthly rate of compensation on the date of removal from the payroll. This benefit amount is reduced by Workers' Compensation or payments under the Occupational Diseases Act.

Occupational and nonoccupational death benefits are also available through the System. Certain nonoccupational death benefits vest after 18 months of credited service. Occupational death benefits are provided from the date of employment.

Contributions. Contribution requirements of active employees and the State are established in accordance with Chapter 40, section 5/14-133 of the Illinois Compiled Statutes. Member contributions are based on fixed percentages of covered payroll ranging between 4.00% and 12.50%. Employee contributions are fully refundable, without interest, upon withdrawal from State employment. Tier 1 members contribute based on total annual compensation. Tier 2 members contribute based on an annual compensation rate not to exceed $106,800 with limitations for future years increased by the lessor of 3% or one-half of the annual percentage increase in the Consumer Price Index. For 2016, this amount was $111,572.

The State is required to make payment for the required departmental employer contributions, all allowances, annuities, any benefits granted under Chapter 40, Article 5/14 of the ILCS and all administrative expenses of the System to the extent specified in the ILCS. State law provides that the employer contribution rate be determined based upon the results of each annual actuarial valuation.

For fiscal year 2016, the required employer contributions were computed in accordance with the State's funding plan. This funding legislation provides for a systematic 50-year funding plan with an ultimate goal to achieve 90% funding of the plan's liabilities. In addition, the funding plan provided for a 15-year phase-in period to allow the State to adapt to the increased financial commitment. Since the 15-year phase-in period ended June 30, 2010, the State's contribution will remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved. For fiscal year 2016, the employer contribution rate was 45.598%. The Department's contribution amount for fiscal year 2016 was $4.629 million.

Pension liability, deferred outflows of resources, deferred inflows of resources and expense related to pensions. At June 30, 2016, the Department reported a liability of $65.51 million for its proportionate share of the State's net pension liability for SERS on the Department's Statement of Net Position (Deficit). The net pension liability was measured as of June 30, 2015 (current year measurement date), and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Department's portion of the net pension liability was based on the Department's proportion of employer contributions relative to all employer contributions made to the plan during the year ended June 30, 2015. As of the current year measurement date of June 30, 2015, the Department's proportion was 0.2339%, which was a decrease of 0.0088% from its proportion measured as of the prior year measurement date of June 30, 2014.

For the year ended June 30, 2016, the Department recognized pension of expense of $6.773 million. At June 30, 2016, the Department reported deferred outflows and deferred inflows of resources related to the pension liability from the following sources (amounts expressed in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 200	$ 850
Changes of assumptions	4,806	—
Net difference between projected and actual investment earnings on pension plan investments	—	992
Changes in proportion	840	1,755
Department contributions subsequent to the measurement date	4,629	—
Total	$ 10,475	$ 3,597

Deferred outflows of resources of $4.629 million were reported related to pensions resulting from Department contributions subsequent to the measurement date and will be recognized as a reduction of the net pension liability in the year ending June 30, 2017. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized as pension expense as follows (amounts expressed in thousands):

Year ending June 30,	
2017	$ 1,072
2018	1,072
2019	248
2020	(143)
Total	$ 2,249

Actuarial Methods and Assumptions. The total pension liability was determined by an actuarial valuation as of June 30, 2015, using the following actuarial assumptions, applied to all periods included in the measurement:

Mortality: 105 percent of the RP2014 Healthy Annuitant mortality table, sex distinct, with rates projected to 2015.

Inflation: 3.0%

Investment Rate of Return: 7.25%, net of pension plan investment expense, including inflation.

Salary increases: Salary increase rates based on age-related productivity and merit rates plus inflation.

Post-retirement benefit increases of 3.00%, compounded, for Tier 1 and the lesser of 3.00% or one-half of the annual increase in the Consumer Price Index for Tier 2.

Post-retirement benefit increases of 3.00%, compounded, for Tier 1 and the lesser of 3.00% or one-half of the annual increase in the Consumer Price Index for Tier 2.

Retirement Age: Experience-based table of rates specific to the type of eligibility condition. Table was last updated for the June 30, 2014, valuation pursuant to an experience study of the period July 1, 2009 to June 30, 2013.

The long-term expected real rate of return on pension plan investments was determined based on the simulated average 10-year annualized geometric return for each major asset class. These returns 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. For each major asset class that is included in the pension plan's target asset allocation, calculated as of the measurement date of June 30, 2015, the best estimates of the geometric real rates of return as summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
U.S. Equity	30%	5.69%
Fixed Income	20%	1.62%
Hedge Funds	10%	4.00%
International Equity	20%	6.23%
Real Estate	10%	5.50%
Infrastructure	5%	6.00%
Private Equity	5%	10.10%
Total	100%	5.03%

Discount Rate. A discount rate of 7.02% was used to measure the total pension liability as of the measurement date of June 30, 2015 as compared to a discount rate of 7.09% used to measure the total pension liability as of the prior year measurement date. The June 30, 2015 single blended discount rate was based on the expected rate of return on pension plan investments of 7.25% and a municipal bond rate of 3.80%, based on an index of 20 year general obligation bonds with an average AA credit rating as published by the Federal Reserve. The projection of cash flows used to determine this single discount rate assumed that plan member contributions will be made at the current contribution rate and that contributions will be made based on the statutorily required rates under Illinois law. Based on these assumptions, the pension plan's fiduciary net position and future contributions will be sufficient to finance the benefit payments through the year 2067. As a result, the long-term expected rate of return on pension plan investments was applied to projected benefit payments through the year 2067, and the municipal bond rate was applied to all benefit payments after that date.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate. The net pension liability for the plan was calculated using the stated discount rate, as well as what the net pension liability would be if it were calculated using a discount rate that is one-percentage point lower or one-percentage point higher than the current rate as shown below (amounts expressed in thousands):

	1% Decrease to 6.02%	Stated Discount Rate 7.02%	1% Increase to 8.02%
Department's proportionate share of the net pension liability	$ 78,865	$ 65,511	$ 54,427

SERS fiduciary net position. Detailed information about the SERS fiduciary net position is available in the separately issued SERS financial report.

Payables to the pension plan. At June 30, 2016, the Department reported a payable of $245 thousand to SERS for the outstanding amount of contributions to the pension plans required for the year ended June 30, 2016.

(9) Postemployment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Central Management Services (CMS). Substantially all State employees become eligible for postemployment benefits if they eventually become annuitants of one of the State-sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed healthcare plan. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes $5,000.

The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including postemployment health, dental, vision, and life insurance benefits, is recognized as an expense by the State in the State's CAFR. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of postemployment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Central Management Services. A copy of the financial statements of the Department of Central Management Services may be obtained by writing to the Department of Central Management Services, William G. Stratton Building 401 S. Spring St., Springfield, IL 62706.

(Continued)

(10) Risk Management

The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; workers' compensation; and natural disasters. The State retains the risk of loss (i.e., self-insured) for these risks.

The Department's risk management activities are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the general fund of the State. The claims are not considered to be a liability of the Department; and accordingly, have not been reported in the Department's financial statements for the year ended June 30, 2016.

(11) Private Management Agreement

The State (acting through the Department) entered into a 10-year private management agreement (PMA) with Northstar Lottery Group, LLC (Private Manager) effective January 18, 2011, for the purpose of providing all equipment, services, and functions necessary to operate the Lottery for the State, except for those specifically retained by the State as defined within the PMA. Under the terms of the agreement, the compensation to be paid under the PMA is comprised of the reimbursement of operating expenses and incentive compensation payments. Incentive compensation is subject to annual adjustments in accordance with the agreement. For the year ended June 30, 2016, total compensation for reimbursement of operating expenses to Northstar under the PMA was $113.7 million and is included in general and administrative expenses. The full amount of $113.7 million was outstanding at June 30, 2016, and is included in accounts payable and accrued liabilities.

On September 18, 2015, the State (acting through the Department) executed a Letter Agreement of Termination (Letter Agreement), which resolved certain outstanding disputes between Northstar and the Department. The Letter Agreement contains provisions regarding Northstar paying the Department for not meeting net income goals pursuant to the PMA, a retroactive supply agreement reduction, and Northstar's reimbursement of legal fees related to prior disputes. Under the terms of the Letter Agreement, Northstar will continue in its role as private manager until a new private management agreement is executed.

The Department has recorded a receivable from Northstar at June 30, 2016, in the amount of $58.2 million. This amount is comprised of $25.6 million from fiscal year 2016, which is comprised solely of excess advance for expense reimbursements. The remaining $32.6 million is from fiscal year 2015. Of this amount, $10.0 million represents shortfall payments for not meeting net income goals, $22.4 million excess advance for expense reimbursements, and $0.2 million for reimbursement of legal fees.

(12) Commitments and Contingencies

(a) Lease Commitments

The Department leases certain facilities and equipment necessary for operations, primarily from other State agencies. All leases are operating leases and the majority are month-to-month. Total lease costs for the year ended June 30, 2016 amounted to $933 thousand.

(b) Litigation

As discussed in Note 11, the Letter Agreement resolved outstanding disputes in connection with Northstar and its suppliers.

The Department is routinely involved in a number of legal proceedings and claims that cover a wide range of matters.

(Continued)

The Department does not believe the outcome of these matters will have any material adverse effect on the financial position or results of operations of the Department.

(c) Contingent Liabilities

Per the terms of the Letter Agreement, should the replacement private manager choose not to retain GTECH as its systems provider either as a sole provider or as part of a consortium, the State will be liable for compensating GTECH for the residual value of the remainder of the original supply agreement. Assuming the supply agreement is terminated by the replacement private manager on July 1, 2017, the amount payable would be $55 million. This amount shall be prorated in the event the supply agreement is terminated on a different date.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Combining Schedule of Net Position (Deficit)

June 30, 2016

(In thousands of dollars)

Assets and Deferred Outflows of Resources	State Lottery (0711)	Deferred Prize Winners (0978)	Lottery Security Deposits (1309)	Eliminations	Total
Current assets:					
Cash and cash equivalents	$ 26,542	—	922	—	27,464
Cash equity in State Treasury	198,266	1,697	—	—	199,963
Investments, short-term	60	31,146	—	—	31,206
Accounts receivable, net of allowance of $17,594	80,002	—	—	—	80,002
Due from other Department funds	1,564	—	—	(1,564)	—
Total current assets	306,434	32,843	922	(1,564)	338,635
Noncurrent assets:					
Investments	270	294,238	—	—	294,508
Capital assets being depreciated, net	58	—	—	—	58
Total noncurrent assets	328	294,238	—	—	294,566
Deferred outflows of resources – pension	10,475	—	—	—	10,475
Total assets and deferred outflows of resources	317,237	327,081	922	(1,564)	643,676
Liabilities and Deferred Inflows of Resources					
Current liabilities:					
Prizes payable	83,299	—	—	—	83,299
Accounts payable and accrued liabilities	142,937	—	—	—	142,937
Due to other Government – Federal	69	—	—	—	69
Due to other Department funds	—	1,564	—	(1,564)	—
Due to other State funds	105,841	—	—	—	105,841
Unearned revenue	3,415	—	—	—	3,415
Other liabilities	115	133	922	—	1,170
Current portion of long-term annuity prizes payable	60	29,297	—	—	29,357
Total current liabilities	335,736	30,994	922	(1,564)	366,088
Noncurrent liabilities:					
Noncurrent portion of long-term annuity prizes payable	270	251,425	—	—	251,695
Net pension liability	65,511	—	—	—	65,511
Noncurrent other	780	—	—	—	780
Total noncurrent liabilities	66,561	251,425	—	—	317,986
Deferred inflows of resources – pension	3,597	—	—	—	3,597
Total liabilities and deferred inflows of resources	405,894	282,419	922	(1,564)	687,671
Net Position (Deficit)					
Invested in capital assets	58	—	—	—	58
Unrestricted	(88,715)	44,662	—	—	(44,053)
Total net position (deficit)	$ (88,657)	44,662	—	—	(43,995)

See accompanying independent auditors' report.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Combining Schedule of Revenues, Expenses, and Changes in Net Position (Deficit)

Year ended June 30, 2016

(In thousands of dollars)

	State Lottery (0711)	Deferred Prize Winners (0978)	Eliminations	Total
Operating revenues:				
Charges for sales and services	$ 2,855,535	—	—	2,855,535
Other	6,521	—	—	6,521
Total operating revenues	2,862,056	—	—	2,862,056
Operating expenses:				
Cost of sales and services	160,942	—	—	160,942
Prizes and claims	1,837,402	—	—	1,837,402
General and administrative	139,735	—	—	139,735
Depreciation	35	—	—	35
Total operating expenses	2,138,114	—	—	2,138,114
Operating income	723,942	—	—	723,942
Nonoperating revenues (expenses):				
Investment income	232	27,716	—	27,948
Interest expense	(10)	(11,986)	—	(11,996)
Other	(308)	308	—	—
Total nonoperating revenues (expenses), net	(86)	16,038	—	15,952
Change in net position (deficit) before transfers	723,856	16,038	—	739,894
Transfers from other State funds	308	—	(308)	—
Transfers to other State funds	(724,164)	(308)	308	(724,164)
Change in net position (deficit)	—	15,730	—	15,730
Net position (deficit), July 1, 2015	(88,657)	28,932	—	(59,725)
Net position (deficit), June 30, 2016	$ (88,657)	44,662	—	(43,995)

See accompanying independent auditors' report.

KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Honorable Frank J. Mautino
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, 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 State of Illinois Department of the Lottery (the Department), which comprise the statement of net position (deficit) as of June 30, 2016, and the related statements of revenues, expenses, and changes in net position (deficit) and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 10, 2017.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a 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 Department'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 an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying schedule of findings as Finding 2016-001.

Department's Response to Findings

The Department's response to the finding identified in our audit is described in the accompanying schedule of findings. The Department's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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 Department'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 Department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

/s/KPMG LLP

Chicago, Illinois
January 10, 2017

Finding 2016-001 Noncompliance with the Illinois Lottery Law

The Department of the Lottery (Lottery) did not comply with the Illinois Lottery Law by depositing funds with the Commonwealth of Virginia, which is the Multi-state control office, for paying prize awards attributable to Illinois sales of multi-state lottery game tickets that had not yet occurred. In addition, the Lottery inappropriately established a non-appropriated spending authority to advance the $75 million to the Commonwealth of Virginia for future multi-state lottery prize awards (Powerball and Mega Millions).

In October 2015, the Lottery submitted a Chart of Accounts Maintenance and Inquiry form (C-45) to the Illinois Office of the Comptroller (Comptroller) to establish a non-appropriated spending authority within the State Lottery Fund (Lottery Fund). The Comptroller's Statewide Accounting Management System Manual (SAMS) (Procedure 09.10.40) sets forth the required criteria for using the C-45 form to establish a non-appropriated spending authority. Specifically, the requirements are:

1. Purposes and/or resources which were not appropriated by the General Assembly;
2. the spending of the resources does not commit the General Assembly to provide State "matching" resources;
3. the General Assembly has not specifically denied the purpose;
4. the agency has the statutory authority to carry on the activities of the program; and
5. the spending is not required to be appropriated by a specific statute. In addition, "start-up" monies must be provided on an advance basis.

Prior to establishing the non-appropriated spending authority, the Lottery conducted an analysis in which they determined that each of the requirements were met with respect to the payments to Virginia as well as being in conformance with applicable law. The Comptroller subsequently approved the C-45 form indicating it was for a "CONTINUING APPROP - PAY PRIZE", thus establishing the non-appropriated spending authority from the Lottery Fund.

Auditors in performing their testing of the $75 million in payments to the Commonwealth of Virginia determined the Lottery did not comply with various provisions of the Illinois Lottery Law and failed to comply with the criteria noted above for the establishment of the non-appropriated spending authority.

As set forth in the Illinois Lottery Law, 20 ILCS 1605/9(h) (Law), "The Department is authorized to transfer prize award funds attributable to Illinois sales of multi-state lottery game tickets to the multi-state control office, or its designated depository, for deposit to such game pool account or accounts as may be established by the multi-state game directors..." At the time the $75 million was sent to the Commonwealth of Virginia the Illinois Lottery still had approximately $10 million on deposit with the Commonwealth of Virginia for future multi-state prize payments from prepayments made in fiscal year 2015 (see Illinois Lottery State Compliance Report, finding 2015-002 *Inappropriate Prepayments to Fund Out-of-State Prize Payment Obligations*).

The $75 million in payments did not constitute "prize award funds attributable to Illinois sales of multi-state lottery games tickets," but instead were prepayments for future prize liabilities. In fact, prize awards for multi-state games are not computed until after a grand/jackpot winning prize ticket has occurred. The $75 million was deposited into a separate account at the Commonwealth of Virginia and was used to pay prize liabilities upon Lottery approval.

The Finance and Operation Procedures for Mega Millions, 2. Grand/Jackpot Prize Liability and Settlement, 2.1, states: "The liability to the group for all Grand/Jackpot Prizes will be determined on the first business day following a drawing for which a Grand/Jackpot Prize winning ticket was sold. Settlement for the Grand/Jackpot

Prize(s) will occur fourteen (14) calendar days from the date of the drawing that produced the Grand/Jackpot Prize(s), through the transfer of the cash equivalent of the annuitized Grand/Jackpot Prize."

The Mega Millions Members' Finance and Operation Procedures for Powerball and Power Play, 2. Grand/Jackpot Prize Liability and Settlement, 2.1, states "The liability to the group for all Grand/Jackpot Prizes will be determined by the Multi-State Lottery Association (MUSL), through compilation and issuance of the Draw Summary Report as re-compiled by the Virginia Lottery Powerball Settlement Report, no later than the close of business on the first business day following a drawing for which a Grand/Jackpot Prize winning ticket was sold. Settlement for the Grand/Jackpot Prize(s) will occur fourteen (14) calendar days from the date of the drawing that produced the Grand/Jackpot Prize(s), through the transfer of the cash equivalent of the Grand/Jackpot Prize and/or through the purchase of securities..."

In regard to the use of the C-45 form, particularly requirement #5, where the spending is not required to be appropriated by a specific statute, auditors noted the Law sets forth that the General Assembly must authorize expenditures associated with the Lottery, including multi-state games. The Law, 20 ILCS 1605/9(g), notes the Department shall not expend State funds on a contractual basis unless those functions and expenditures are expressly authorized by the General Assembly. In addition, 20 ILCS 1605/9(h) of the Law specifically notes for multi-state games the Lottery shall not expend State funds on a contractual basis in connection with any such game unless such expenditures are expressly authorized by the General Assembly.

The October 2015 deposits were not authorized by the General Assembly. House Bill 4160 of the 99th General Assembly contained fiscal year 2016 appropriations for the Lottery, including $1 billion for prize payments. The bill passed the General Assembly on June 24, 2015, but was vetoed in total by the Governor on June 25, 2015. No further positive action was taken by the General Assembly, therefore, the veto stood. In the absence of the Governor's approval of the bill or an override of the veto by the General Assembly there was no express authorization for fiscal year 2016 Lottery expenditures until the enactment of Public Act 99-491, effective December 7, 2015. Of the $75 million deposited with the Commonwealth of Virginia $71,261,600 was not used to pay prize liabilities and was returned to the Lottery on December16, 2015, following the passage of P.A. 99-491.

Lottery management indicated that it performed a comprehensive review of applicable laws, rules and regulations and took steps to transfer the deposits to the multi-state clearinghouse that were legal and appropriate. The Lottery stated that its obligation to pay prize liabilities to the multi-state clearinghouse is created and increased by the sale of every Mega Millions and Powerball game ticket. The Lottery's ability to pay prizes to Illinois players and the clearinghouse had been suspended by the lack of an approved budget. As a result, both multi-state game groups were on the verge of terminating the Lottery's authority to sell their games. The annual financial impact of this action would have been over $90 million in lottery profit to Illinois. The circumstances were unprecedented which prompted the Lottery's evaluation of possible actions to take.

Establishment of a non-appropriated spending authority as well as making deposits for multi-state lottery prize liabilities that have not occurred violates the Illinois Lottery Law and diminishes the oversight and authority of the budgeting and appropriation process by the General Assembly and the Governor. (Finding Code No. 2016-001)

Recommendation:

We recommend the Lottery adhere to the requirements of the Illinois law concerning payment of multi-state lottery prizes and, specifically, not make deposits for such prizes without authority. If the Lottery continues to believe its actions complied with applicable statutes we recommend the Lottery seek a formal written opinion from the Illinois Office of the Attorney General as to the legality of the actions it undertook to submit deposits to the Commonwealth of Virginia for future multi-state lottery prize awards.

Lottery Response:

The Lottery determined that it could utilize a C-45 to establish non-appropriated spending authority, which it subsequently used to make $75 million in deposits (the "Deposits") from the State Lottery Fund to the multi-state control office, after performing a thorough review and analysis of the Illinois Lottery Law, SAMS, the multi-state contracts allowing the Lottery to sell multi-state game tickets and other relevant statutes and regulations. The Lottery disagrees with the conclusion that its actions violated, or were in non-compliance, with the Illinois Lottery Law.

Prior to submitting the C-45 to the Comptroller and establishing the non-appropriated spending authority within the Lottery Fund, the Lottery evaluated each requirement set forth in SAMS Procedure 09.10.40 and determined that each requirement was satisfied. Specifically, the Lottery determined that establishment of the non-appropriated spending authority (i) met the first requirement because the General Assembly had not yet appropriated any funds to the Lottery in fiscal year 2016 at the time of the Deposits, (ii) met the second requirement because the Deposits did not commit the General Assembly to provide any State "matching," (iii) met the third requirement because the General Assembly has not specifically denied the purpose for the Deposits and, indeed, has specifically instructed the Director of the Lottery to enter into agreements to participate in multi-state lotteries (*see* 20 ILCS 1605/9(h)), (iv) met the fourth requirement because the Lottery has the statutory authority to carry on the activities of the program (see *id.*) and (v) met the fifth requirement, because neither the Illinois Lottery Law nor any other statute specifically requires the Deposits to be appropriated.

With respect to the fifth requirement, the Lottery reviewed 20 ILCS 1605/9(h) of the Illinois Lottery Law, which requires, among other things, that the Lottery "[shall not] expend State funds on a contractual basis in connection with any such [multi-state] game unless such expenditures are expressly authorized by the General Assembly." Because the language states that the expenditures shall be "expressly authorized" rather than "appropriated," the Lottery concluded that this statutory requirement of "authorization" was met – and that an appropriation was not required – when the General Assembly specifically directed the Director to enter into contractual relationships with multi-state operators. The Lottery believes that Section 9(h)'s express enumeration of specific types of spending in association with the multi-state games that must be appropriated, rather than merely authorized, further supports its conclusion that the fifth requirement for a non-appropriated spending authority was met.

The Comptroller accepted the Lottery's C-45 and allowed it to make use of the established non-appropriated spending authority in order to make the Deposits. Additionally, following establishment of the non-appropriated spending authority, the Lottery's outside counsel reviewed the Lottery's analysis and concluded that the Lottery's interpretation of applicable law and requirements was reasonable.

In addition to finding it was proper to establish the non-appropriated spending authority, the Lottery determined that making the Deposits was also appropriate and in compliance with all applicable Law, rules, and contractual obligations. 20 ILCS 1605/9(h) expressly authorizes the Department to "transfer prize award funds attributable to Illinois sales of multi-state lottery game tickets to the multi-state control office, or its designated depository, for deposit to such game pool account or accounts as may be established by the multi-state game directors . . ." The Deposits consisted of monies from the State Lottery Fund (the "711 Fund"), which included revenues received from the sale of Mega Millions and Powerball tickets. *See* 20 ILCS 1605/20.

The funds transferred by the Department were deposited into reserve accounts in the multi-state control office. The Lottery retained full control over the Deposits to ensure that funds were applied exclusively to satisfy current payment obligations under the multi-state agreements. The foregoing language in 20 ILCS 1605/9(h) does not limit the Lottery's ability to make deposits to only an amount determined to be owed following calculation of a grand/jackpot liability, nor does it state that the Lottery may only make transfers once the amount of its liability is determined. The Deposits were only applied to pay Illinois' share of jackpot and high tier prizes after confirmation of the occurrence of these wins. Draw down of these funds occurred in accordance with the procedures set forth in Mega Millions' Finance and Operation Procedures for Mega Millions and Powerball games. The exact balance of funds was returned on December 16, 2015, upon request of the Lottery.

Based on the foregoing, the Lottery disagrees with the auditors' determination that it failed to comply with the Illinois Lottery Law and inappropriately established a non-appropriated spending authority. The Lottery will consider the auditors' recommendation that it seek a formal written opinion from the Illinois Office of the Attorney General regarding the legality of its actions.

Auditor's Comment:

Per the Illinois Office of the Comptroller's (Comptroller) Statewide Accounting Management System (SAMS) Manual Procedure 05.50.01, the "deposit" of $75 million with the Commonwealth of Virginia constituted an "expenditure." SAMS defines an expenditure as an "Exchange of an asset of the State or incurrence of a liability by a State agency for an asset, goods received or services rendered. (1) At the agency level…when a voucher for goods and/or services is submitted by an agency for approval and payment by the Comptroller. (2) At the Comptroller level. . .occurs when the Comptroller approves a voucher for payment." The vouchers for the $75 million were approved and recorded per Comptroller records on October 5, 2015, thus becoming an expenditure by the Lottery on that date.

The Law requires that the General Assembly must authorize expenditures associated with the Lottery, including multi-state games. In addition, the Law sets forth the Department shall not expend State funds on a contractual basis unless those functions and **expenditures** are expressly authorized by the General Assembly. For purposes of the circumstances presented in the finding, the auditors' interpretation is that expenditures are expressly authorized when an appropriation bill is passed by the General Assembly and signed by the Governor.

Further, although the Law authorizes the Department to transfer **prize award funds** attributable to Illinois sales of multi-state lottery game tickets to the multi-state control office, or its designated depository, for deposit to such game pool account or accounts as may be established by the multi-state game directors, the $75 million in payments did not constitute "prize award funds attributable to Illinois sales of multi-state lottery games tickets," but instead were prepayments for future prize liabilities.

Upon consideration of the Lottery's response to the finding, the auditors continue to believe the establishment of a non-appropriated spending authority as well as making deposits for multi-state lottery prize liabilities that have not occurred violates the Illinois Lottery Law and diminishes the oversight and authority of the budgeting and appropriation process by the General Assembly and the Governor.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Prior Finding Not Repeated

A. **FINDING** (Errors identified in GAAP Reporting Forms Submitted to the Illinois Office of the Comptroller and Year-End Department Financial Statements)

During prior year engagements, the State of Illinois Department of the Lottery (Department) had not implemented a sufficient level of controls over its preparation of GAAP Reporting Forms submitted to the Illinois Office of the Comptroller and the Department's preparation of year-end financial statements.

Testing performed during the current engagement identified improvements in the Department's controls over its financial reporting environment such that it was no longer considered a significant deficiency. As a result, the prior finding was not repeated. (Finding Code No. 2015-001, 2014-001, 2013-001, 12-01)