



FY19 ANNUAL REPORT

Henry & Horne 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. Henry & Horne LLP also has not performed any procedures relating to this annual report.

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ARIZONA LOTTERY OVERVIEW

ABOUT

The Arizona Lottery was established by public initiative and began operations on July 1, 1981. Our mission is to support Arizona programs for the public benefit by maximizing net revenue in a responsible manner. The Arizona Lottery is fully funded by monies generated through the sale of its products. Beneficiary transfers, generated from Lottery sales, fund a variety of state programs. Since its inception, the agency has returned more than \$8 billion in prizes to players, generated more than \$4.2 billion for beneficiary programs, and paid almost \$1 billion in commissions to retailers.

A MESSAGE FROM THE DIRECTOR

Gregory Edgar

As we look forward to fiscal year (FY) 2020, this is an excellent opportunity to reflect on the enormous progress the Arizona Lottery has made in recent years and the ways we've positively impacted the lives of all Arizonans.

Since 2015, and under the administration of Governor Doug Ducey, Arizona Lottery has generated more than \$4.5 billion in sales and contributed more than \$1 billion to important programs that make Arizona a better place to live, work and play. That return amounts to more than 24 percent of the agency's overall return in its 38-year history.



The Arizona Lottery began FY19 with a goal to cross the threshold of \$1 billion in annual revenue while breaking the \$220 million barrier for net return. We surpassed that sales goal with \$1.077 billion in revenue (a \$96 million increase over FY18), with more than \$230 million (an \$18.4 million increase over FY18) of that going to 18 vital programs and services that would otherwise rely on taxpayers for their funding. The agency's four-year growth rate is nearly 44 percent.

The Arizona Lottery also served as a vital economic engine for our retail partners who earned more than \$73 million in commissions. Under Governor Ducey, Lottery has generated more than \$300 million for retailers large and small in every corner of our great state.

All of this was made possible by our players who spent their hard-earned dollars to be entertained and dream of hitting it big. In FY19, those players won more than \$706 million in prizes.

We set these new records by focusing our efforts on those opportunities that allowed us to build on our previous successes and continued excellence in basic business practices. We worked with major game matrix updates in the Mega Millions® draw game in October 2017, that accelerated jackpot growth to a near-record \$1.5 billion in October 2018. We increased player awareness through statewide promotions and system-wide jackpot alerts. We developed new games, like Triple Twist and Fast Play™, and conducted seven second-chance promotions that augmented the winning experience for our players. We launched more than 50 instant scratch games (Scratchers®) including our first \$25 game. We created several new and unique ticket designs focusing on culturally significant subjects in Arizona and also introduced a ticket featuring local rock and roll legend, Alice Cooper, which garnered global attention for the Arizona Lottery.

We also took steps to improve the overall player and retailer experience in FY19. We invested in new touch screen and debit card enabled vending machines. We developed and implemented a new smartphone mobile app to allow players to check their tickets on the go. We also expanded the retail experience to Walmart Supercenters and Costco, making Arizona Lottery games available to a broader audience than ever before.

All this effort shows just how dedicated the Arizona Lottery is to having a positive impact on the communities we serve. Through our marketing efforts, we gave almost \$500,000 to Community Sponsorships of Arizona charities in FY19, above and beyond our legislatively mandated beneficiary transfers, demonstrating how this agency is committed to giving back to the people of Arizona every day. From foster children and vulnerable families to higher education to its homeless population, parks and wildlife conservation and so much more, these lottery-funded programs are vital to communities across Arizona.

Within the agency, the implementation of the Arizona Management System, a process of continuous improvement espoused by Governor Ducey, continues to yield big returns by helping us to build on the ways we are challenging business processes in place for years and constantly finding new ways to improve. This is making our agency more efficient and more responsive to employees, allowing us to return more to Arizona.

The Arizona Lottery team deserves the credit for this spectacular and record-setting FY19. These numbers reflect their hard work, dedication and innovation. Through their efforts, we have been able to give more to our players, more to the state we love and more to the Arizona Lottery's beneficiary programs. Looking ahead to FY20 and beyond, the Arizona Lottery is positioned to do even more by creating novel and entertaining games for our players that help to fund a better quality of life for communities across the Grand Canyon State.

OUR LEADERSHIP

The men and women who direct the Arizona Lottery through ongoing strategic planning and continuous 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

Russ Harben
Deputy Director: Operations

Sherri Zendri
Deputy Director: Legal Services

Raynie Hosto
Deputy Director: Sales

Chris Rogers
Deputy Director: Marketing and Products

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 also 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

Julie Katsel
Commissioner at Large
Represents: Retail

Chad Wilson
Vice-Chair
Represents: Marketing

Trent Crump
Commissioner
Represents: Law Enforcement

Debbie Roth
Commissioner
Represents: Retail

PRODUCT INNOVATION

The Arizona Lottery gives players a wide array of entertaining games specifically created to enhance the play experience by exciting their senses, rewarding their play and introducing new players to Lottery products. These include:

DRAW GAMES

Arizona Lottery draw games continued to be popular with players in FY19. One lucky Arizonan bought a near-record winning The Pick™ ticket, Arizona's own in-state jackpot game, worth more than \$14 million. Both Powerball® and Mega Millions generated big excitement across Arizona, as jackpots rolled over several times, with Mega Millions topping out at a near-record jackpot over \$1.5 billion and a Powerball jackpot soaring above \$680 million, both in October 2018. Though no Arizonans were lucky enough to win those jackpots, five won big with million-dollar Powerball prizes, and one won a million-dollar Mega Millions draw! A new draw game, Triple Twist™, was introduced, and the first jackpot winner took home \$1.9 million. Second Chance promotions also proved popular with draw game players, with 25 Arizona Lottery Powerball players setting sail on the "Powerball Power Cruise" and "Twisted Tuesdays" rewarding The Pick players with free Triple Twist tickets.

SCRATCHERS

Scratchers® sales soared to over \$750 million in FY19, a 5.5 percent increase over the previous fiscal year! Contributing to this increase were the first \$25 game, Super Mega Crossword, and our third \$30 game, Arizona Millionaire's Club, featuring 12 top prizes of \$1,000,000. In September 2018, the third version of the \$20 Cash Explosion game was launched, generating more than \$89.7 million in sales in FY19. Since FY15, three Cash Explosion games have been introduced totaling over \$575 million in sales. Other notable introductions in FY19 include two Hispanic-themed games, Lucha Libre Loot and Arizona 7, featuring the artwork of artist-in-residence, Emily Costello. Also in FY19, the \$2 Bingo game received a major facelift which has been well-received by players. Two games, featuring the well-known brands of Wheel of Fortune® and The Home Depot®, were introduced and included second-chance promotions. Five other promotions were launched in FY19, including a yearlong bingo and crossword promotion. Bingo and crossword are two of the Arizona Lottery's most popular Scratchers themes and represented over 28 percent of total Scratchers sales in FY19.

INSTANT TABS

In FY19, Instant Tabs grew in popularity again with sales reaching almost \$10 million, surpassing FY18 figures by more than 13 percent. The Arizona Lottery continues to grow this category with an additional 47 retailers licensed in FY19, exposing more players to the product. Charitable retailers, including veterans and fraternal organizations, who become Instant Tab retailers earn a 20 percent commission on every sale, helping contribute to causes important to them and their community.

FAST PLAY

The Arizona Lottery saw big sales gains with Fast Play, an entirely new category of game (introduced in FY18) that combines the best of a draw game and the best of an instant-win scratch ticket. By building on that year's success with six new games and introducing new marketing opportunities like "Fast Play Fridays" and second-chance promotions, Fast Play generated nearly \$18 million in sales in FY19.

MARKETING ACHIEVEMENTS

The Arizona Lottery Marketing team brought forward several innovative and effective promotions, online player tools and advertising campaigns that directly contributed to FY19's record sales and returns to beneficiaries.

Creative and effective Arizona Lottery marketing campaigns were recognized by the advertising and public relations industries in FY19, including multiple Public Relations Society of America's (PRSA) Awards of Merit, the Arizona Innovation Marketing Association (AZIMA) Mastery Award and numerous American Advertising Federation Phoenix ADDY Awards.

The Arizona Lottery website (ArizonaLottery.com) was relaunched in FY19 with a wealth of information for players and the general public. Redesigned for a new internet audience that is also equipped with smartphones, this website houses all the information anyone needs to understand and play Arizona Lottery draw and instant games. It is optimized for mobile use and sees more than one million hits every month.

Players were introduced to a whole new way to play in FY19 with the Arizona Lottery Players Club. This website, located within the ArizonaLottery.com website, is their home to get the latest information and rules on second-chance promotions, enter their non-winning tickets, check to see if they've won a second-chance drawing and so much more.

Finally, the Arizona Lottery's partnership with the Arizona Diamondbacks saw continued success in FY19. The Arizona Lottery sponsors their 50/50 raffle, where one lucky ticket holder wins half of the money from raffle sales during every home game and the other half is donated to a Diamondbacks beneficiary charity. That has, over the years, resulted in hundreds of thousands of dollars for fans and for these charities, some of which are also Arizona Lottery beneficiaries.

WINNERS' STORIES

BRIDGETTE – MILLION DOLLAR MADNESS PROMOTION, \$250,000

Bridgette from Phoenix is a single mom and Navy Veteran who lives in Phoenix; she was excited to be able to finally buy her own home!

MIGUEL – \$215 MILLION CASH EXPLOSION®, \$10,000

Miguel, from Pima County, was really excited when he saw the \$215 Million Cash Explosion was a \$10,000 winner! He plans on using his winnings towards his daughter's Quinceañera.

RYAN – ROYAL MILLIONS, \$1,000

Ryan is an Australian native who has lived in Gilbert for 5 years. His son was born in America and has never been to Australia or met his grandparents, so Ryan is excited to put this win towards his upcoming trip home so his son can finally meet them!

ASHLEY – MILLION DOLLAR MADNESS PROMOTION, \$250,000

Ashley thought it was a joke at first, having entered the drawing in Phoenix to win some extra cash for a volunteer trip to Southeast Asia. Now, Ashley says she can volunteer even longer.

MICHAEL – TRIPLE TWIST, \$1,900,000

Michael is from Tucson and is the Arizona Lottery's first-ever Triple Twist jackpot winner. The first thing he says he'll do is pay off his daughter's school loans!



NICK – FANTASY 5™, \$262,000

Nick is from the small, small town of Happy Jack. He is excited to be able to pay bills, help their kids and buy a new car!

TRAVIS – GREEN LINE SLINGO TRIO, \$50,000

Travis bought his ticket in Winslow before sitting down to eat with his daughter and didn't finish scratching it before their food arrived. Days later, he pulled ticket out of his truck door compartment and then realized it was a winner.

THOMAS – FANTASY 5 MILLION DOLLAR GIVEAWAY, \$1,000,000

Thomas has lived in Mesa for 28 years with his family and is excited to pay off his house and share some of the winnings with his four daughters and grandchildren.

JUSTIN – \$100,000 CROSSWORD, \$100,000

Justin and his wife live in Goodyear and say this seems like a dream come true! They say they are finally pregnant after 8 years and plan on giving their daughter an incredible life!

MICHAEL – CHERRY TWIST FAST PLAY, \$30,767

Michael says that being a young adult in Flagstaff is extremely difficult! He plans on paying existing debt and starting over with this blessing.



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:

FY19 BENEFICIARIES		
	General Fund	\$138,106,619
	University Bond Fund	\$39,819,449
	Healthy Arizona	\$21,411,500
	Mass Transit (LTAF)	\$11,464,200
	Heritage Fund	\$10,000,000
	Commerce Authority Arizona Competes Fund	\$3,500,000
	Court Appointed Special Advocates (CASA)	\$3,509,310
	Economic Security Homeless Services	\$1,000,000
	Internet Crimes Against Children/ Victims' Rights Enforcement Fund	\$1,000,000
	Department of Gaming	\$300,000
	Tribal College Dual Enrollment Fund	\$250,000
Total Beneficiary Transfers		\$230,361,078

OUR BENEFICIARIES

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, HealthyStart, 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 and sustaining Arizona's unique native wildlife and 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.



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 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 allows students 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

The Arizona Lottery is proud to work with more than 3,000 retailers across the state. These accessible locations create an exciting experience and build lasting relationships for their loyal customers.

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

RETAILER COMMISSIONS

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 2019, the Arizona Lottery paid more than \$73 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 almost \$1 billion in commissions to its retail partners.

For licensing and licensing renewal information, please contact 480.921.4486.

Scratchers® is a registered service mark of the California Lottery.





INDEPENDENT AUDITORS' REPORT

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, 2019, and the related statements of net position, statements of revenues, expenses, and changes in net position, statement of cash flows and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express 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 respective financial position of the Arizona State Lottery as of June 30, 2019, 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. The 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 25, 2019, on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control over financial reporting and compliance.

Henry + Horne, LLP

Tempe, Arizona
October 25, 2019

Arizona State Lottery

A Proprietary Fund of the State of Arizona

Management's Discussion and Analysis (Unaudited)

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, 2019, 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, 2019. 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, 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)

FINANCIAL HIGHLIGHTS

- The Arizona Lottery (Lottery) surpassed the \$1 billion threshold for the first time, achieving record sales of almost \$1.08 billion in fiscal year 2019. This was a 9.7% increase over the prior fiscal year, equating to over \$95 million in additional sales.
- The Lottery returned over \$230 million to designated state programs in fiscal year 2019, with all beneficiaries receiving full funding. Since its inception in July 1981, the Lottery has generated \$4.2 billion for Arizona programs.
- Scratcher games continued to be strong performers with record sales of \$750.3 million in fiscal year 2019, an increase of \$39.4 million over the prior year. Demand for tickets at the \$10, \$20, and \$30 price points helped drive this sales increase.
- Draw game sales were also impressive in FY 2019, reflecting sales growth of almost 21% over the previous year. Game jackpots, the first full year of Fast Play, and the successful introduction of Triple Twist contributed to this increase.
- The instant tab product line exhibited substantial growth in its niche market, with an increase of almost \$1.2 million over the prior fiscal year, representing a growth rate of almost 14%.
- The Lottery's retail partners earned over \$73 million in commissions and incentives in fiscal year 2019.

REVENUES

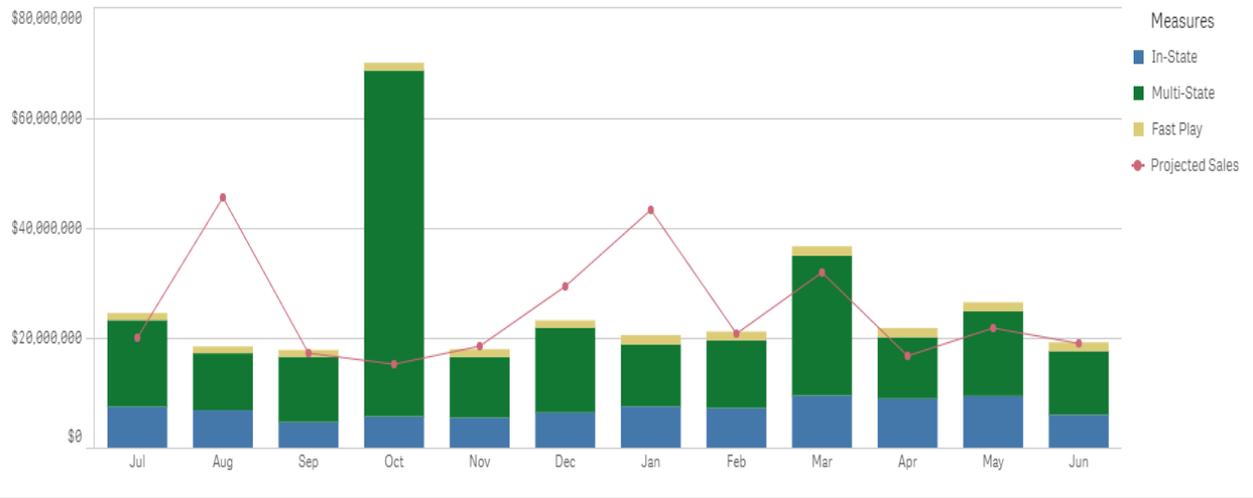
Total game sales were almost \$1.08 billion in fiscal year 2019 as compared to \$981.4 million in fiscal year 2018, reflecting increases in both instant and draw game products. In general, draw game sales are largely jackpot-driven, impacting sales increases or decreases in any given year. Jackpots for both Powerball and Mega Millions in October helped drive the FY 2019 overall draw game sales increase of \$54.8 million over the prior year. A comparison of draw game sales for FY 2019 broken down by multi-state, in-state, and Fast Play is depicted in the following chart.

Arizona State Lottery

A Proprietary Fund of the State of Arizona

Management's Discussion and Analysis (Unaudited)

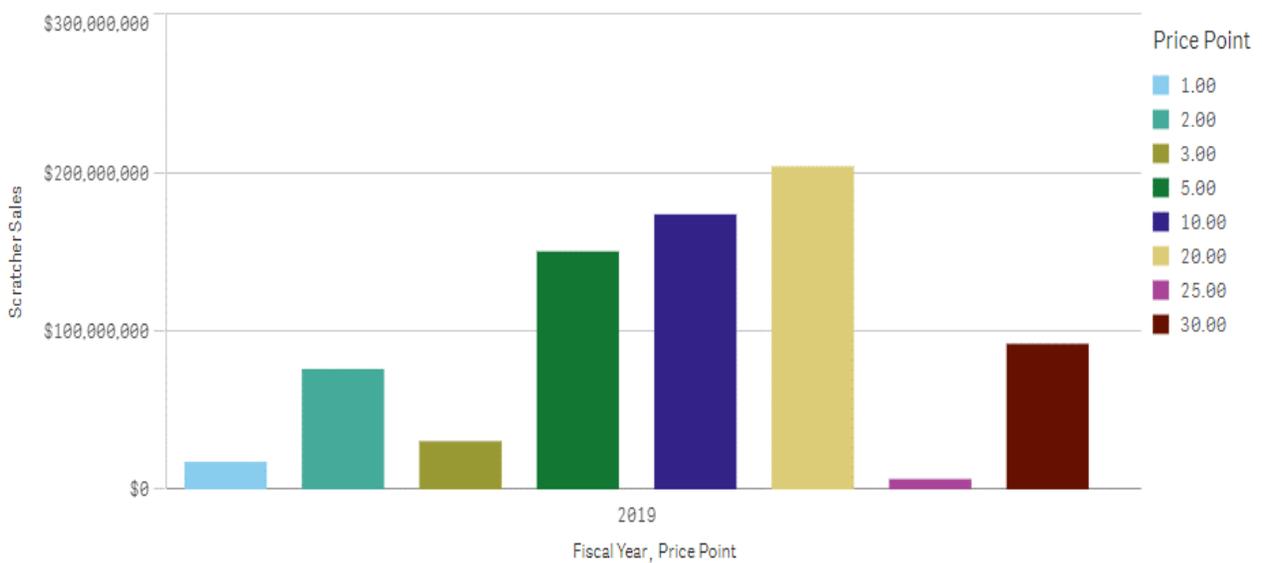
FY 2019 Draw Sales by Multi-State & In-State



The Lottery closed the year with a sales increase of \$95.4 million, equating to a 9.7% increase over the prior year. The instant ticket product line was a large contributor to this gain, with sales growth of \$40.6 million over the prior year (\$39.4 million from the Scratchers product line and \$1.2 million from instant tab tickets). Continued sales growth in the \$10, \$20, and \$30 price points helped to generate this increase.

The chart below displays Scratchers sales by price point for FY 2019 and the subsequent table summarizes Lottery product sales and the incremental change between fiscal years. Sales are presented in millions of dollars.

FY19 Instant Sales by Price Point



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

Product Sales	FY 2019	FY 2018	Change	Percentage
Scratchers	\$ 750.3	\$ 710.9	\$ 39.4	5.5%
Instant Tabs	9.9	8.7	1.2	13.8%
Powerball	111.2	118.5	(7.3)	-6.2%
Mega Millions	103.0	60.9	42.1	69.1%
The Pick	44.1	40.3	3.8	9.4%
Fantasy 5	19.7	17.8	1.9	10.7%
Pick 3	12.3	11.7	0.6	5.1%
All or Nothing	-	2.1	(2.1)	NA
5 Card Cash	-	2.4	(2.4)	NA
Triple Twist	8.6	-	8.6	NA
Fast Play	17.7	8.1	9.6	118.5%
Total	\$ 1,076.8	\$ 981.4	\$ 95.4	9.7%

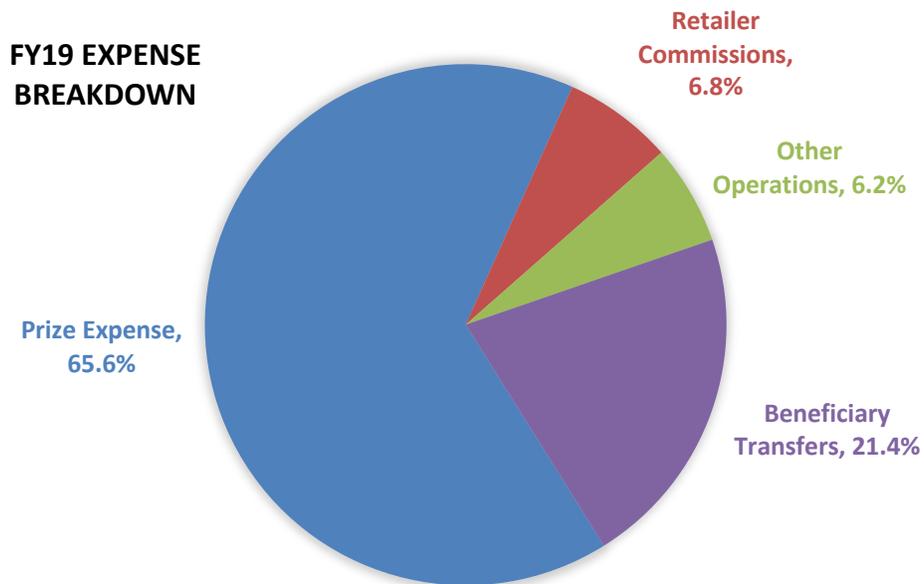
Other operating revenues were \$275,522 for FY 2019, which is primarily composed of restitution income and assignment fees. Sales returns and allowances, comprised of damaged tickets and promotional tickets were (\$444,127) for the year ended June 30, 2019. Total operating revenues, the sum of game sales and other operating revenues, less sales returns and allowances were \$1,076.6 billion for the year ended June 30, 2019, as compared to \$981.6 million for the year ended June 30, 2018. This increase was a direct reflection of higher game sales.

Non-operating revenues (investment income) for the year ended June 30, 2019, were \$747,094 as compared to \$433,203 for the year ended June 30, 2018. 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 2019:

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



Lottery total operating expenses were \$837.5 million for fiscal year ended June 30, 2019 as compared to \$766.7 million for fiscal year ended June 30, 2018. Of this amount, \$809.3 million were incurred in direct support of Lottery game sales in FY 2019. In comparison, \$741.4 million of total operating expenses for FY 2018 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 in directly related to Lottery game sales include items such as marketing, personnel expenses, depreciation/amortization, and other administrative costs. These expenses totaled \$28.2 million in FY 2019 as compared to \$25.3 million in FY 2018. Increased personnel expenses plus higher administrative costs contributed to the overall increase for FY 2019. The following table compares Lottery operating expenses between fiscal years. All expenses are presented in millions of dollars.

Operating Expenses	FY 2019	FY 2018	Change	Percentage
Instant & Online Prizes	\$ 706.5	\$ 647.6	\$ 58.9	9.1%
Retailer Commissions & Incentives	73.1	66.8	6.3	9.4%
On-Line System Expense	13.5	11.3	2.2	19.5%
Instant Ticket Distribution Expenses	6.2	6.3	(0.1)	-1.6%
Instant Ticket Printing Expenses	10.0	9.4	0.6	6.4%
Total Direct Costs	809.3	741.4	67.9	9.2%
Other Operating Expenses	28.2	25.3	2.9	11.5%
Total	\$ 837.5	\$ 766.7	\$ 70.8	9.2%

Arizona State Lottery

A Proprietary Fund of the State of Arizona

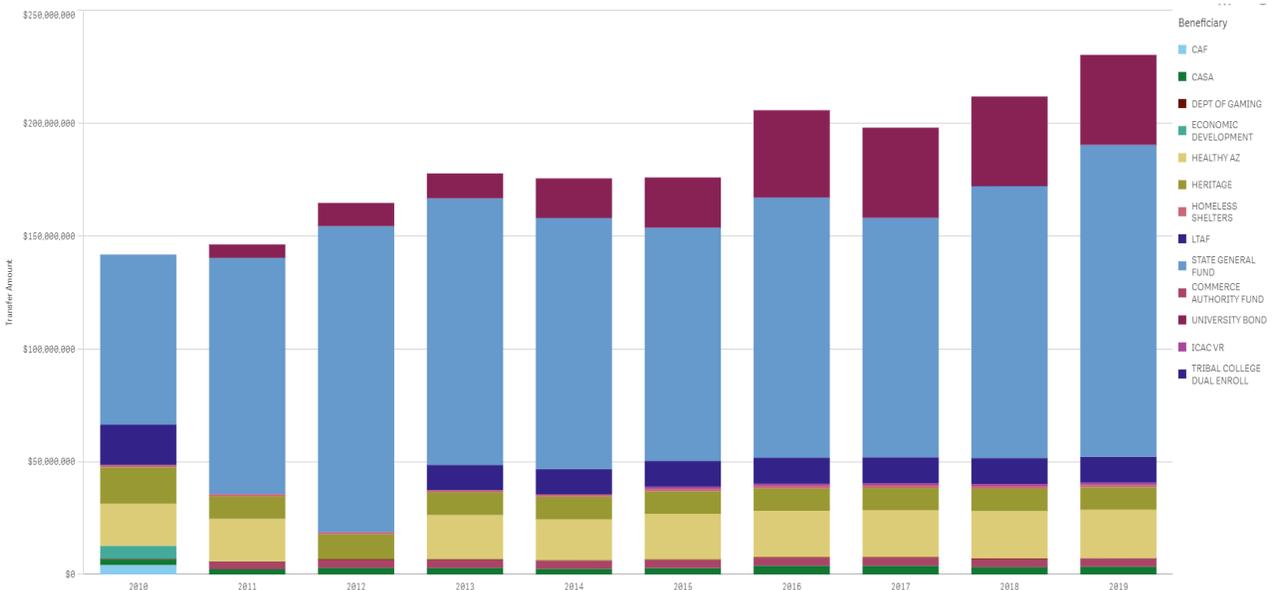
Management's Discussion and Analysis (Unaudited)

Increases in prize expense, retailer commissions, online system expenses, and ticket printing correlate with the increase in product sales. Aggregate prize expenses represented 65.6% of product sales in FY 2019 as compared to 66% of product sales in FY 2018. Prize expense is largely driven by the higher market share of Scratchers tickets, especially the \$20 and \$30 price points. These tickets carry a higher associated prize expense, driving up the cumulative prize percentage.

Of the \$28.2 million for other operating expenses in FY 2019, \$15.5 million was used for advertising and promotion, \$5.9 million was used to compensate Lottery employees, \$0.9 million was for depreciation, and \$5.9 million was used for other administrative expenses. In comparison, of the \$25.3 million in total operating expenses for FY 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 for other administrative expenses. Administrative costs were higher in FY 2019 primarily due to the implementation of a new back office system.

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 \$230.4 million in FY 2019, as compared to \$211.9 million transferred in FY 2018. The increase in product sales resulted in a corresponding increase in transferable revenues of \$18.5 million, with all designated beneficiary programs receiving full funding. The total transfer rate as a percentage of sales was 21.4% in FY 2019 and 21.6% in FY 2018. The following chart outlines transfers to Lottery beneficiaries over the last 10 years:



Arizona State Lottery

A Proprietary Fund of the State of Arizona

Management's Discussion and Analysis (Unaudited)

OTHER FINANCIAL INFORMATION

Net Position. The Lottery's total net position was \$15.4 million at June 30, 2019 as compared to \$5.9 million for June 30, 2018.

The Lottery's total assets at June 30, 2019 were \$137.5 million, as compared to \$90.4 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, 2019, were \$122.3 million, as compared to \$84.3 million the previous year. Liabilities consisted of accounts payable and accrued expenses, prize liabilities, amounts due to other state funds, net pension, and deferred inflows related to pensions.

The following table summarizes the statement of net position.

Statement of Net Position	FY 2019	FY 2018
Current assets	\$ 111.4	\$ 72.5
Capital assets	15.4	5.9
Other assets - deposits	10.7	12.0
Total assets	137.5	90.4
Deferred outflows of resources	1.1	0.8
Total assets and deferred outflows of resources	138.6	91.2
Current liabilities	115.7	77.7
Net pension liability	6.6	6.6
Total liabilities	122.3	84.3
Deferred inflows of resources	1.0	1.0
Net position	15.3	5.9
Total liabilities and net position	\$ 138.6	\$ 91.2

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 2019 was approved in the regular legislative session of 2018. 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

Arizona State Lottery

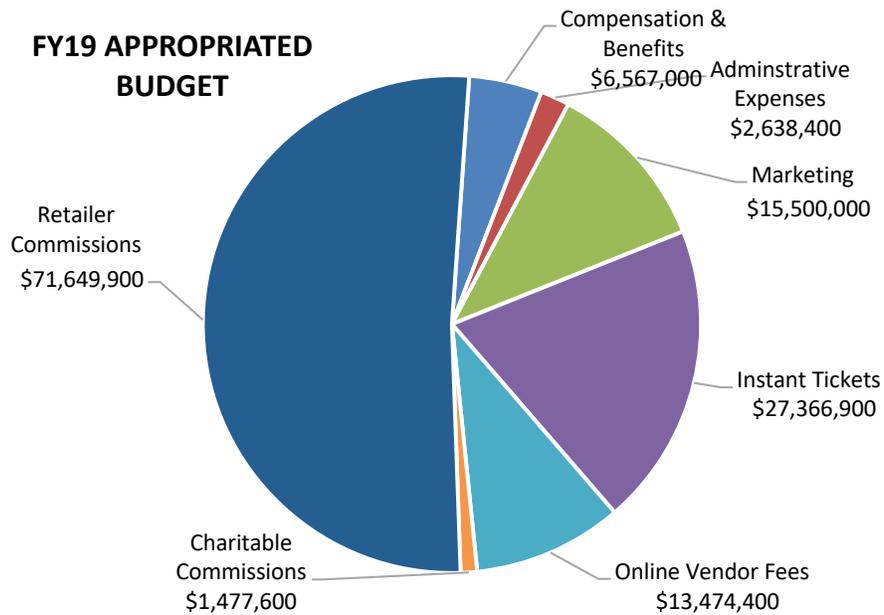
A Proprietary Fund of the State of Arizona

Management's Discussion and Analysis (Unaudited)

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."

The Lottery's approved appropriation was \$125.3 million for Fiscal Year 2019 based on an estimated \$951.3 million in total sales, but the appropriation was increased to \$138.7 million as a result of actual revenues exceeding original estimates.

The following chart depicts the fiscal year 2019 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 2019 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

Statement of Net Position

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		June 30, 2019
CURRENT ASSETS		
Cash and investments, substantially all held by the State Treasurer	\$	96,306,045
Accounts receivable, net of allowance for doubtful accounts of \$195,403		8,633,385
Scratch ticket inventory		6,214,291
Pull tab inventory		281,765
Total current assets		<u>111,435,486</u>
CAPITAL ASSETS		
Land and land improvements		1,268,695
Buildings		4,309,192
Furniture, fixtures, and equipment		16,021,731
Intangible assets		599,324
Leasehold improvements		328,341
Less accumulated depreciation and amortization		<u>(7,169,588)</u>
Total capital assets		<u>15,357,695</u>
OTHER ASSETS		
Deposit - MUSL		<u>10,697,000</u>
Total assets		<u>137,490,181</u>
DEFERRED OUTFLOWS OF RESOURCES		
Related to pensions - ASRS		1,138,600
Related to OPEB - ADOA		33,165
Total deferred outflows of resources		<u>1,171,765</u>
Total assets and deferred outflows of resources	\$	<u>138,661,946</u>
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION		
CURRENT LIABILITIES		
Accounts payable	\$	9,434,525
Accrued expenses		303,176
Prize liability		67,561,985
Due to other state funds		<u>38,466,619</u>
Total current liabilities		115,766,305
NET PENSION & OPEB LIABILITY		
Net pension liability		5,496,308
Net OPEB liability		<u>1,058,849</u>
Total net pensions & OPEB liability		<u>6,555,157</u>
Total liabilities		<u>122,321,462</u>
DEFERRED INFLOWS OF RESOURCES		
Related to pensions - ASRS		715,135
Related to OPEB - ADOA		<u>267,652</u>
Total deferred inflows of resources		<u>982,787</u>
Total liabilities and deferred inflows of resources		<u>123,304,249</u>
NET POSITION		
Net investment in capital assets		15,357,695
Unrestricted (deficit)		<u>-</u>
Total net position	\$	<u>15,357,695</u>

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

	Year Ended June 30, 2019
OPERATING REVENUES	
Ticket sales	
Scratchers	\$ 750,278,323
Powerball	111,184,626
Mega Millions	102,951,884
The Pick	44,058,583
Fantasy 5	19,743,211
Pick 3	12,276,022
Fast Play	17,753,412
Triple Twist	8,630,254
Instant Tab	9,913,704
Total ticket sales	1,076,790,019
Sales Returns & Allowances	(444,127)
Net Ticket Sales	1,076,345,892
Other operating revenues	275,522
Total operating revenues	1,076,621,414
OTHER EXPENSES	
Direct costs	
Prize expense	706,491,066
Retailer commissions and incentives	73,148,766
On-line system expense	13,467,781
Scratcher system and distribution expenses	6,228,449
Tickets purchased	9,969,828
Total direct costs	809,305,890
Advertising and promotion	15,491,344
Wages and related expenses	5,913,094
Depreciation	904,456
Administrative expenses	5,887,919
Total operating expenses	837,502,703
OPERATING INCOME	239,118,711
NONOPERATING REVENUES - Investment income	747,094
INCOME BEFORE TRANSFERS	239,865,805
TRANSFERS TO OTHER STATE FUNDS	230,361,078
CHANGE IN NET POSITION	9,504,727
NET POSITION, beginning of year	5,852,968
NET POSITION, end of year	\$ 15,357,695

Arizona State Lottery
A Proprietary Fund of the State of Arizona
Statement of Cash Flows

	Year Ended June 30, 2019
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from retailers-net of validations, commissions, and incentives	\$ 458,583,950
Cash from other sources	3,971,380
Cash payments for prizes and related taxes	(144,529,394)
Cash payments to suppliers of goods or services	(53,378,131)
Cash payments to employees	(6,164,627)
	<u>258,483,178</u>
Net cash provided by operating activities	<u>258,483,178</u>
CASH FLOWS USED BY NONCAPITAL FINANCING ACTIVITIES	
Payments to beneficiaries per Arizona Statutes	(212,643,991)
	<u>(212,643,991)</u>
CASH FLOWS USED BY CAPITAL FINANCING ACTIVITIES	
Payments for acquisition of capital assets	(7,470,000)
	<u>(7,470,000)</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Receipts of interest	715,375
	<u>715,375</u>
Net increase (decrease) in cash	39,084,562
CASH AT BEGINNING OF YEAR	<u>57,221,483</u>
CASH AT END OF YEAR	<u>\$ 96,306,045</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating income	\$ 239,118,711
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation	904,456
Pension expense	(70,616)
Employer pension contribution	(458,470)
Other post-employment benefit adjustment	43,792
Changes in operating assets and liabilities	
Accounts receivable	(783,909)
MUSL interest	31,719
Pre-paid expenses - ADOA	2,477,989
Ticket and pull tab inventory	977,069
Deposit - MUSL	(1,175,637)
Accounts payable and accrued expenses	(5,960,157)
Prizes and withholding payable	23,378,231
	<u>258,483,178</u>
Net cash provided by operating activities	<u>\$ 258,483,178</u>
NONCASH CAPITAL AND FINANCING ACTIVITIES:	
Capital asset acquisitions included in accounts payable	\$ 2,939,182
Total noncash investing/financing activities	<u>\$ 2,939,182</u>

Arizona State Lottery

A Proprietary Fund of the State of Arizona

Notes to Basic Financial Statements

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

The Arizona State Lottery ("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 ("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, 2018 through June 30, 2019, the Lottery held 112 instant games of which 74 games expired during the fiscal year. During 2019, the Lottery continued the "The Pick," "Fantasy 5," "Pick 3," "Powerball," "Mega Millions", and "FastPlay" on-line games. The Lottery introduced a new playstyle "Triple Twist" on 12/16/2018. As required, the Lottery has deposits with "Powerball," and "Mega Millions," multistate on-line lottery games, of \$10.7 million at June 30, 2019. The Lottery also sold instant tab lottery tickets to non-profit organizations, age-restricted outlets, and some approved retailers. These games are printed and sold by the Lottery, though are administered and paid out by the purchasing non-profit organizations, age-restricted outlets and approved retailers. 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 ("Fund"), which is a proprietary fund of the State, accounts for revenues received from the sale of lottery tickets. 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, 2018 to June 30, 2019.
- 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

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

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%. SB 1477 was effective starting in FY16.

In April 2015, House Bill (HB) 2517 was signed by the Governor of Arizona which requires that if the monies transferred to the Internet Crimes Against Children Enforcement is less than \$900,000 each fiscal year, and if the monies transferred to Victim's Rights Enforcement Fund is less than \$100,000 each fiscal year, the difference shall be transferred from forfeited unclaimed prizes but not to exceed \$1,000,000 in any fiscal year. HB2517 was effective immediately in April 2015. FY19 transfers from forfeited unclaimed prizes to the Internet Crimes Against Children Fund and Victims' Rights Enforcement Fund were \$620,600. All remaining forfeited unclaimed prizes offset prize expense.

Prize liability activity for the year ended June 30, 2019 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Prize Liability	\$ 44,183,756	800,315,743	(776,937,514)	\$ 67,561,985

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, 2019, the Fund's accounts payable and accrued expenses balance includes an accrual of vacation pay and related benefits of \$303,176. 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.

Arizona State Lottery

A Proprietary Fund of the State of Arizona

Notes to Basic Financial Statements

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

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.

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."

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.

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 Website at www.aztreasury.gov or by contacting the Treasurer's Office at 1700 West Washington St., 1st Floor, Phoenix, AZ, 85007-2812.

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

Note 2 – Cash and Investments Held by the State Treasurer (continued)

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 State Board of Investment's ("Board") 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 Board reviews the activities and performance of the pool monthly.

At June 30, 2019, the Lottery's deposits with the Treasurer were as follows:

	2019
Cash	\$ 44,889,155
Prize fund cash	51,416,890
Total cash and investments held by State Treasurer	\$ 96,306,045

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, 2019, 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

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, 2019, as follows:

	<u>2019</u>
General Fund	\$ 138,106,619
University Bond Fund	39,819,449
Healthy Arizona	21,411,500
Local Transportation Assistance Fund - Mass Transit	11,464,200
Heritage Fund	10,000,000
Commerce Authority Arizona Competes Fund	3,500,000
Court-appointed Special Advocate Fund	3,509,310
Economic Security Homeless Services	1,000,000
Internet Crimes Against Children Fund/ Victim's Rights Enforcement Fund	1,000,000
Department of Gaming	300,000
Tribal College Dual Enrollment Fund	<u>250,000</u>
Total transfers to other State funds	<u>\$ 230,361,078</u>

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, 2019:

	<u>2019</u>
State General Fund	<u>38,466,619</u>
Total due to other state funds	<u>\$ 38,466,619</u>

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 year ended June 30, 2019 is as follows:

	2019				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, being depreciated:					
Land improvements	330,865	-	-	-	330,865
Buildings & Leasehold Improvements	4,700,084	-	(62,550)	-	4,637,534
Furniture, fixtures, and equipment	5,297,542	10,724,188	-	-	16,021,730
Intangible assets	599,324	-	-	-	599,324
Total capital assets	<u>12,118,100</u>	<u>10,724,188</u>	<u>(315,005)</u>	<u>-</u>	<u>22,527,283</u>
Less accumulated depreciation for:					
Land improvements	(330,865)	-	-	-	(330,865)
Buildings & Leasehold Improvements	(3,138,618)	(180,686)	-	-	(3,319,304)
Furniture, fixtures, and equipment	(2,296,215)	(623,881)	-	-	(2,920,096)
Intangible assets	(499,434)	(99,889)	-	-	(599,323)
Total accumulated depreciation	<u>(6,265,132)</u>	<u>(904,456)</u>	<u>-</u>	<u>-</u>	<u>(7,169,588)</u>
Total capital assets, net	<u>\$ 5,852,968</u>	<u>\$ 9,819,732</u>	<u>\$ (315,005)</u>	<u>\$ -</u>	<u>\$ 15,357,695</u>

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, 2019, pledged revenues totaled approximately \$225,981,168, of which \$37,502,850 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 \$375,008,400.

Arizona State Lottery

A Proprietary Fund of the State of Arizona

Notes to Basic Financial Statements

Note 6 – Commitments

The Lottery enters into various contracts for goods and services during the normal course of its business. All contracts 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, 2020. Rent expense for the facilities was approximately \$71,364 for the year ended June 30, 2019.

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 for calendar year 2016, then for \$5,099 per month and \$5,201 per month for calendar year 2017 and 2018 respectively. The lease agreement was extended in December 2018 for one additional year at \$5,305 per month with an option to extend for three years until December 2022. Rent expense for the facilities was approximately \$63,040 for the year ended June 30, 2019.

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

Year ending June 30,	
2020	103,195
2021	29,735
Total	<u>\$ 132,930</u>

Note 7 – Contingencies

Jackpot 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 \$52,778,776 at June 30, 2019. Approximately \$50,392,971 of the total aggregate future payments at June 30, 2019 relate to annuities purchased from five separate insurance companies, of which \$20,188,171 relates to a single insurance company.

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

Note 7 – 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 arise 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 - ASRS

The Lottery contributes to the Arizona State Retirement Plan ("Plan"), a retirement plan administered by the Arizona State Retirement System (ASRS) and a health benefit premium benefit plan administered by the Arizona Department of Administration (ADOA OPEB). The ASRS Plan is a component of the State of Arizona. The Lottery reported \$(53,712) of pension expenditure related to the pension plan to which it contributes. In addition, the Lottery reported \$33,165 of other post-employment benefit expenses related to the health insurance premium benefit ADOA OPEB plan.

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 (OPEB) plan. Although the ASRS pension plan has been recorded at June 30, 2019, the ASRS health insurance premium (OPEB) plan and long-term disability (OPEB) plan have not been recorded due to the relative insignificant to the Lottery's financial statements. However, they have been further disclosed in the notes to the financial statements and required supplementary information below. 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.

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:

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

Note 8 – Pensions and Other Postemployment Benefits (continued)

	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 consecutive months of last 120 months	Highest 60 consecutive 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 retirement benefit option chosen determines the survivor benefit. 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.

Health insurance premium benefits are available to retired or disabled members with 5 years of credited service. The benefits are payable only with respect to allowable health insurance premiums for which the member is responsible. For members with 10 or more years of service, benefits range from \$100 per month to \$260 per month depending on the age of the member and dependents. For members with 5 to 9 years of service, the benefits are the same dollar amounts as above multiplied by a vesting fraction based on completed years of service.

Active members are eligible for a monthly long-term disability benefit equal to two-thirds of monthly earnings. Members receiving benefits continue to earn service credit up to their normal retirement dates. Members with long-term disability commencement dates after June 30, 1999, are limited to 30 years of service or the service on record as of the effective disability date if their service is greater than 30 years.

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

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 year ended June 30, 2019, active ASRS members were required by statute to contribute at the actuarially determined rate of 11.80 percent (11.64 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 11.80 percent (11.18 percent for retirement, 0.46 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 10.53 percent (10.41 percent for retirement, 0.06 percent for health insurance benefit, and 0.06 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 year ended June 30, 2019, were \$458,470. The Lottery's contributions for the current and 3 preceding years for pension benefits, all of which were equal to the required contributions, were as follows:

Years ended June 30,	Health Benefit Supplement Fund	Long-Term Disability Fund
2019	\$ 18,618	\$ 6,411
2018	16,993	6,129
2017	18,600	4,650
2016	16,700	4,003

Pension liability – At June 30, 2019, the Lottery reported the following asset and liability for its proportionate share of the ASRS's net pension/OPEB asset or liability.

ASRS	Net pension/OPEB (asset) Liability
Pension	5,496,308
Health insurance premium benefit	(14,350)
Long-term disability	20,524

The net asset and net liability were measured as of June 30, 2018. The total 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, 2017, to the measurement date of June 30, 2018. The total liabilities as of June 30, 2018, reflect changes in actuarial assumptions based on the results of an actuarial experience study for the 5-year period ended June 30, 2016, including decreasing the discount rate from 8.0 percent to 7.5 percent, changing the projected salary increases from 3.0–6.75 percent to 2.7–7.2 percent, decreasing the inflation rate from 3 percent to 2.3 percent, and changing the mortality rates.

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

Note 8 – Pensions and Other Postemployment Benefits (continued)

The Lottery's proportion of the net asset or net liability was based on the Lottery's actual contributions to the plan relative to the total of all participating employers' contributions for the year ended June 30, 2018. The Lottery's proportion measured as of June 30, 2018, and the change from its proportions measured as of June 30, 2017, were:

ASRS	Proportion June 30, 2018	Increase (decrease) from June 30, 2017
Pension	0.03941%	0.00350%
Health insurance premium benefit	0.03985%	0.00363%
Long-term disability	0.03928%	0.00313%

Pension expense – For the year ended June 30, 2019 the Lottery recognized the following pension and OPEB expense.

ASRS	Pension/OPEB expense
Pension	53,712
Health insurance premium benefit	14,316
Long-term disability	7,578

Deferred outflows/inflows of resources – At June 30, 2019, the Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions and OPEB from the following sources:

	Pension		Health insurance premium benefit		Long-term disability	
	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources
Difference between expected and actual experience	\$ 151,419	\$ 30,300	\$ -	\$ 13,244	\$ 525	\$ -
Changes of assumptions or other inputs	145,442	487,323	27,673	-	4,445	-
Net difference between projected and actual earning on pension plan investments	-	132,173	-	28,666	-	1,988
Changes in proportion and differences between Lottery contributions and proportionate share of contributions	383,269	65,339	185	19	1,133	-
Lottery contributions subsequent to the measurement date	458,470	-				
Total	\$ 1,138,600	\$ 715,135	\$ 27,858	\$ 41,929	\$ 6,103	\$ 1,988

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

Note 8 – Pensions and Other Postemployment Benefits (continued)

The amounts reported as deferred outflows of resources related to ASRS pensions and OPEB resulting from Lottery contributions subsequent to the measurement date will be recognized as an increase of the net asset or a reduction of the net liability in the year ended June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions and OPEB will be recognized as expense as follows:

Year ended June 30,	Pension	Health Insurance premium benefit	Long-term disability
2020	\$ 49,321	\$ 5,520	\$ 218
2021	200,497	5,520	218
2022	(59,275)	587	751
2023	-	1,903	848
2024	-	-	1,862
Thereafter	-	-	-

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

ASRS

Actuarial valuation date	June 30, 2017
Actuarial roll forward date	June 30, 2018
Actuarial cost method	Entry age normal
Asset valuation	Fair Value
Discount rate	7.5%
Project salary increases	2.7 - 7.2% for pensions/not applicable for OPEB
Inflation	2.3%
Permanent benefit increases	Included for pensions/not applicable for OPEB
Mortality rates	2017 SRA Scale U-MP for pensions and health insurance premium benefit
Recovery rates	2012 GLDT for long-term disability
Healthcare cost trend rate	Not applicable

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, 2016. The ASRS Board adopted the experience study which recommended changes and those changes were effective as of the June 30, 2017 actuarial valuation.

Arizona State Lottery

A Proprietary Fund of the State of Arizona

Notes to Basic Financial Statements

Note 8 – Pensions and Other Postemployment Benefits (continued)

The long-term expected rate of return on ASRS pension plan investments was determined to be 7.5 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 geometric real rates of return for each major asset class are summarized in the following table:

Asset Class	Target allocation	Long-term expected geometric real rate of return
Equity	50%	5.50%
Fixed income	30%	3.83%
Real estate	20%	5.85%
Total	100%	

Actual returns may be different due to volatility of returns.

Discount rate – At June 30, 2018, the discount rate used to measure the ASRS total pension and OPEB liability was 7.5 percent, which was a decrease of 0.5 from the discount rate used as of June 30, 2017. 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 Retirement, HBS and LTD Fund'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 and OPEB liability.

Sensitivity of the Lottery's proportionate share of the ASRS net pension and OPEB liability to changes in the discount rate – The following table presents the Lottery's proportionate share of the net pension and OPEB liability calculated using the discount rate of 7.5 percent, as well as what the Lottery's proportionate share of the net pension and OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.5 percent) or 1 percentage point higher (8.5 percent) than the current rate:

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

Note 8 – Pensions and Other Postemployment Benefits (continued)

	June 30, 2019		
	1% Decrease (6.5% Discount Rate)	Current (7.5% Discount Rate)	1% Increase (8.5% Discount Rate)
Lottery's proportionate share Retirement	\$ 7,835,114	\$ 5,496,308	\$ 3,542,274
HBS	\$ 50,844	\$ (14,350)	\$ (69,882)
LTD	\$ 23,259	\$ 20,524	\$ 17,870

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 - Other Postemployment Benefits (OPEB) – ADOA

Plan Description -- 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. Title 38 Chapter 4 of the A.R.S assigns the authority to establish and amend the benefit provisions to the Arizona State Legislature.

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. ADOA does not issue a separate, publicly available financial report.

Other Postemployment Benefits (OPEB) Liability -- At June 30, 2019, the Lottery reported a OPEB liability of \$1,058,849 for its proportionate share. The change in the Lottery's OPEB liability was \$46,940. The liability was measured as of June 30, 2018 to be reported as of June 30, 2019 under GASB 75.

Benefits Provided -- The ADOA provides medical and accident benefits to retired State employees and their dependents. Dental and vision benefits are also available but are not valued as there is no implicit subsidization in the retiree rates.

Funding Policy -- The ADOA's current funding policy for the single-employer plan is pay-as-you-go for OPEB benefits. There are no dedicated assets at this time to offset the total OPEB liability.

Arizona State Lottery

A Proprietary Fund of the State of Arizona

Notes to Basic Financial Statements

Note 9 - Other Postemployment Benefits (OPEB) – ADOA (continued)

OPEB Liability -- At June 30, 2019, Lottery reported a liability of \$1,058,849 its proportionate share of the ADOA's total OPEB liability. The total OPEB liability was measured as of June 30, 2018 and was determined by an actuarial valuation as of that date. The total OPEB liability as of June 30, 2018, reflects the following changes of benefit terms and actuarial assumptions:

- A limit was placed on the out-of-pocket maximum for the EPO health insurance option and copays were increased for all health insurance options.
- The discount rate increased due to changes in the bond index.
- Per capita costs and contributions and related trend rates were updated to reflect updated experience.
- Assumed retirement rates, turnover rates, disability incidence rates, and mortality rates for healthy and disabled lives were updated to be the same as those used for ASRS' annual actuarial valuation.

Lottery's proportion measured as of June 30, 2017 and 2018, was 0.12 percent.

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

	2019	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ -	\$ 36,129
Changes of assumptions or other inputs	-	231,523
Net difference between projected and actual earnings on pension plan investments	-	-
Total	\$ -	\$ 267,652

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

Year ended June 30,	
2020	\$ (48,205)
2021	(48,205)
2022	(48,205)
2023	(48,205)
2024	(48,205)
Thereafter	(26,627)

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

Note 9 - Other Postemployment Benefits (OPEB) – ADOA (continued)

OPEB Expenses - At June 30, 2019, the Lottery reported OPEB expenses as follow:

Reporting Date for Employer under GASB 75	June 30,2019
Measurement Date for Employer under GASB 75	June 30,2018
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Components of OPEB Expenses	
Service Cost	\$ 86,395
Interest on the total OPEB liability	38,767
Current-period benefit changes	-
Expensed portion of current-period difference between expected and actual experience	-
Expensed portion of current-period changes of assumptions or other inputs	(6,380)
Recognition of beginning of year deferred outflows of resources as OPEB expense	(41,825)
Total OPEB expenses	<u>\$ 76,957</u>

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:

Actuarial valuation date	June 30,2018	
Actuarial cost method	Entry age normal	
Salary increases	2.7% to 7.2% varying by years of service	
Discount rate	3.87% as of June 30, 2018	
Health cost trend rates:		
Medical (pre-65)	6.0% graded to 4.5% over 4 years as of June 30, 2018	
Medical (post-65)	4.50%	
Prescription drug	8.5% graded to 4.5% over 4 years as of June 30, 2018	
Administrative costs	3.00%	
Contribution trend rates	6.5% graded to 4.5% over 4 years as of June 30, 2018	
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 projected generationally from 2014 with 1% improvement per year

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, 2018 measurement date is 3.87%. The index value as of the prior measurement date (June 30, 2017) was 3.58%.

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

Note 9 - Other Postemployment Benefits (OPEB) – ADOA (continued)

Sensitivity – The following table presents the Lottery's total OPEB liability calculated using the discount rate of 3.87 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 (2.87 percent) or 1 percentage point higher (4.87 percent) than the current rate. Also shown is the OPEB liability using the healthcare cost and contribution trend rates that are 1 percentage point lower or 1 percent point higher than the current rates

	June 30, 2019		
	1% Decrease (2.87% Discount Rate)	Current (3.87% Discount Rate)	1% Increase (4.87% Discount Rate)
Lottery's Total OPEB Liability	\$ 1,239,082	\$ 1,058,849	\$ 916,013
	1% Decrease Trend Rates	Current Trend Rates	1% Increase Trend Rates
Lottery's Total OPEB Liability	\$ 869,131	\$ 1,058,849	\$ 1,268,908

Note 10 – Major Vendors

The Lottery has three vendors that represent approximately 84% of its purchases for the year ended June 30, 2019.

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 is covered pursuant to the State Risk Management statute, A.R.S. § 41-621 which provides a combination of self-insurance and private excess insurance to cover these risks. There is no limit to the coverage.

Note 12 – Subsequent Event

In December 2018, the State entered into a forward delivery contract for \$246,355,000 in Lottery Revenue Refunding Bonds, Series 2019 that will be issued in October 2019 to: (1) refund, in advance of maturity, Lottery Revenue Bonds, Series 2010A and (2) pay costs of issuance. The bonds are payable solely from and secured by pledged revenues consisting of all Lottery revenues deposited to the Fund net of operating expenses of the Lottery. 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 \$320,825,381.

REQUIRED SUPPLEMENTARY INFORMATION

Arizona State Lottery
Schedule of Proportionate Share of the Net Pension/OPEB Liability Cost-Sharing
Pension Plan

ASRS- Pension	Reporting Fiscal Year					2014 through 2010
	(Measurement Date)					
	2019 (2018)	2018 (2017)	2017 (2016)	2016 (2015)	2015 (2014)	
Lottery's proportion of the net pension liability	0.039410%	0.035910%	0.035630%	0.041980%	0.042442%	Information
Lottery's proportionate share of the net pension liability	\$ 5,496,308	\$ 5,594,078	\$ 5,751,040	\$ 6,538,813	\$ 6,279,956	not available
Lottery's covered-employee payroll	\$ 4,047,380	\$ 3,862,106	\$ 3,321,318	\$ 3,039,467	\$ 3,962,274	
Lottery's proportionate share of the net pension liability as a percentage of its covered employees payroll	135.80%	144.85%	173.16%	215.13%	158.49%	
Plan fiduciary net position as a percentage of the total pension liability	73.00%	69.92%	67.05%	68.35%	69.49%	

ASRS- Health Insurance premium benefit	Reporting Fiscal Year		
	(Measurement Date)		
	2019 (2018)	2018 (2017)	2017 through 2010
Lottery's proportion of the net OPEB (asset)	0.039850%	0.036220%	Information
Lottery's proportionate share of the net OPEB (asset)	\$ (14,350)	\$ (19,781)	not available
Lottery's covered-employee payroll	\$ 4,047,380	\$ 3,862,106	
Lottery's proportionate share of the net OPEB (asset) as a percentage of its covered employees payroll	-0.35%	-0.51%	
Plan fiduciary net position as a percentage of the total OPEB liability	102.00%	103.57%	

ASRS- Long-term disability	Reporting Fiscal Year		
	(Measurement Date)		
	2019 (2018)	2018 (2017)	2017 through 2010
Lottery's proportion of the net OPEB liability	0.039280%	0.036150%	Information
Lottery's proportionate share of the net OPEB liability	\$ 20,524	\$ 13,104	not available
Lottery's covered-employee payroll	\$ 4,047,380	\$ 3,862,106	
Lottery's proportionate share of the net OPEB liability as a percentage of its covered employees payroll	0.51%	0.34%	
Plan fiduciary net position as a percentage of the total OPEB liability	78.00%	84.44%	

Arizona State Lottery
Schedule of Proportionate Share of the Total OPEB Liability - ADOA

ADOA - OPEB	Reporting Fiscal Year		
	(Measurement Date)		
	2019 (2018)	2018 (2017)	2017 through 2010
Lottery's proportion of the net OPEB liability	0.120000%	0.120000%	Information
Lottery's proportionate share of the net OPEB liability	\$ 1,058,849	\$ 1,011,909	not available
Lottery's covered-employee payroll	\$ 3,360,126	\$ 3,271,788	
Lottery's proportionate share of the net OPEB liability as a percentage of its covered employees payroll	31.51%	30.93%	

There are no dedicated assets at this time to offset the total OPEB liability

Arizona State Lottery Schedule of Pension/OPEB Contributions

ASRS - Pension	Fiscal Year						2013 through 2010
	2019	2018	2017	2016	2015	2014	
Statutorily required contribution	\$ 434,381	\$ 410,063	\$ 362,004	\$ 382,689	\$ 444,044	\$ 432,185	Information not available
Lottery's contributions in relation to the statutorily required contribution	434,381	410,063	362,004	382,689	444,044	432,185	
Lottery's contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
Lottery's covered-employee payroll	\$ 3,885,340	\$ 3,762,046	\$ 3,358,108	\$ 3,527,088	\$ 4,081,287	\$ 3,745,104	
Lottery's contributions as a percentage of covered-employee payroll	11.18%	10.90%	10.78%	10.85%	10.88%	11.54%	
<hr/>							
ASRS - Health insurance premium benefit	Fiscal Year						2016 through 2010
	2019	2018	2017				
Statutorily required contribution	\$ 17,873	\$ 16,553	\$ 18,805				Information not available
Lottery's contributions in relation to the statutorily required contribution	17,873	16,553	18,805				
Lottery's contribution deficiency (excess)	\$ -	\$ -	\$ -				
Lottery's covered-employee payroll	\$ 3,885,340	\$ 3,762,046	\$ 3,358,108				
Lottery's contribution as a percentage of covered-employee payroll	0.46%	0.44%	0.56%				
<hr/>							
ASRS - Long-term disability	Fiscal Year						2016 through 2010
	2019	2018	2017				
Statutorily required contribution	\$ 6,217	\$ 6,019	\$ 4,701				Information not available
Lottery's contributions in relation to the statutorily required contribution	6,217	6,019	4,701				
Lottery's contribution deficiency (excess)	\$ -	\$ -	\$ -				
Lottery's covered-employee payroll	\$ 3,885,340	\$ 3,762,046	\$ 3,358,108				
Lottery's contribution as a percentage of covered-employee payroll	0.16%	0.16%	0.14%				
<hr/>							
ADOA - OPEB	Fiscal Year						2016 through 2010
	2019	2018	2017				
Statutorily required contribution	\$ 33,165	\$ 30,879	\$ 32,938				Information not available
Lottery's contributions in relation to the statutorily required contribution	33,165	30,879	32,938				
Lottery's contribution deficiency (excess)	\$ -	\$ -	\$ -				
Lottery's covered-employee payroll	\$ 3,360,126	\$ 3,271,788	\$ 3,592,604				
Lottery's contribution as a percentage of covered-employee payroll	0.99%	0.94%	0.92%				

Arizona State Lottery

Schedule of Changes in Net OPEB Liability and Related Ratios

	2019	2018
Total OPEB liability		
Service Cost	86,395	115,725
Interest	38,767	36,665
Change of benefit terms	-	(100,175)
Differences between expected and actual experience	-	(49,461)
Changes of assumptions	(47,343)	(260,878)
Expected benefit payments ¹	(30,879)	(32,938)
Net change in Total OPEB liability	46,940	(291,062)
Total OPEB Liability -- beginning	1,011,909	1,302,971
Total OPEB Liability -- ending	1,058,849	1,011,909
Covered employee payroll ²	3,360,126	3,271,788
Plan total OPEB liability as a percentage of covered employee payroll	31.5%	30.9%

¹ Benefit payments of \$33,165 projected for the year ended June 30, 2019.

² Annualized pay of active employees not waiving coverage as of June 30, 2017 valuation date.
Assumed to increase by the wage inflation rate of 2.70% for the June 30, 2018 measurement date.

Arizona State Lottery Notes to Required Supplementary Information

Note 1 – Changes of Assumptions

The Arizona State Retirement System (ASRS) annual actuarial valuation as of June 30, 2018 report is available at <https://www.azasrs.gov/sites/default/files/pdf/Employer-Manual-2019.pdf>

For details about actuarial assumptions, see section IV. Actuarial Section.



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

To the 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 Arizona State Lottery, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated October 25, 2019.

Internal Control over Financial Reporting

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

Henry + Horne, LLP

Tempe, Arizona
October 25, 2019



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