



**CALIFORNIA STATE LOTTERY FUND**

Financial Statements

June 30, 2016

(With Independent Auditors' Report Thereon)

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KPMG LLP  
500 Capitol Mall, Ste 2100  
Sacramento, CA 95814-4754

## **Independent Auditors' Report**

The Commissioners  
The California State Lottery Fund, State of California:

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

We have audited the accompanying financial statements of the business-type activities of the California State Lottery Fund (the Lottery), a Fund of the State of California, which comprise the Statement of Net Position as of and for the year ended June 30, 2016, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the Lottery's basic 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 U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### ***Opinion***

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



***Emphasis of Matter***

As discussed in Note 1, the financial statements of the Lottery are intended to present the net position and changes in net position and cash flows of only that portion of the State of California that is attributable to the operations of the Lottery. They do not purport to, and do not, present fairly the net position of the State of California as of June 30, 2016, the changes in its net position, or, where applicable, the cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

***Other Matters***

*Required Supplementary Information*

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 3–10 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.

**KPMG LLP**

Sacramento, California  
December 19, 2016

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

**(Unaudited)**

The following discussion and analysis of the California State Lottery's financial performance provides an overview of financial activities for the fiscal year ended June 30, 2016. Please read it in conjunction with the California State Lottery Financial Statements that follow this section.

### **FINANCIAL HIGHLIGHTS**

- The California State Lottery (Lottery) continued its mission of maximizing funding for education by achieving record-breaking sales again in fiscal year 2015-16. Sales were nearly \$6.3 billion, an increase of approximately \$750.7 million or 13.6 percent compared to the prior fiscal year.
- Once again the funds the Lottery allocated to California public schools were the highest in Lottery history at more than \$1.58 billion, making this the 16th consecutive year the Lottery has transferred more than \$1 billion to its beneficiary.
- Powerball<sup>®</sup> sales skyrocketed this fiscal year, increasing 89.9 percent to \$707.2 million, due in large part to a record \$1.59 billion jackpot in January 2016. That jackpot was split by three winning tickets, including one in California.
- Scratchers<sup>®</sup> games provided nearly \$4.4 billion in sales, an increase of \$436.4 million or 11.1 percent over the prior year. The increase in Scratchers sales was due to continued demand for \$10 and \$20 price-point tickets, as well as the introduction of the California Lottery's first \$30 price-point game, to coincide with the 30th anniversary of the Lottery.
- The Lottery returned more than \$4.3 billion to the public in the form of prizes and retailer compensation. Of this, the Lottery paid approximately \$3.9 billion in prizes to players, and approximately \$433 million in commissions, cashing bonuses, and other applicable fees to retailers.

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

These required statements offer short-term and long-term financial information about the Lottery. The statement of net position provides information about the nature and amounts of investments in resources (assets) and obligations (liabilities) at the close of the fiscal year. All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position. This statement measures the success of the Lottery's operations over the past year. The final required financial statement is the statement of cash flows. The primary purpose of this statement is to provide information about the Lottery's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities, and provides answers to such questions as where did cash come from and what was cash used for. The financial statements are prepared on the accrual basis in accordance with accounting principles generally accepted in the United States of America. The Lottery is structured as a single enterprise fund with revenues recognized when earned, not when received.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Unaudited)

**FINANCIAL ANALYSIS**

**NET POSITION**

A summary of the California State Lottery's net position is presented below:

	<u>June 30, 2015</u>	<u>June 30, 2016</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Current and other assets	\$ 1,770,779,207	\$ 2,154,619,921	\$ 383,840,714	21.7 %
Capital assets	<u>129,585,496</u>	<u>163,916,171</u>	<u>34,330,675</u>	<u>26.5 %</u>
Total assets	\$ 1,900,364,703	\$ 2,318,536,092	\$ 418,171,389	22.0 %
Deferred outflows of resources	<u>\$ 9,647,778</u>	<u>\$ 20,124,824</u>	<u>\$ 10,477,046</u>	<u>108.6 %</u>
Total assets and deferred outflows	\$ 1,910,012,481	\$ 2,338,660,916	\$ 428,648,435	22.4 %
Current liabilities	\$ 1,017,411,730	\$ 1,408,464,850	\$ 391,053,120	38.4 %
Non-current liabilities	<u>872,816,908</u>	<u>871,985,718</u>	<u>(831,190)</u>	<u>(0.1 %)</u>
Total liabilities	\$ 1,890,228,638	\$ 2,280,450,568	\$ 390,221,930	20.6 %
Deferred inflows of resources	<u>\$ 15,765,896</u>	<u>\$ 2,247,801</u>	<u>\$ (13,518,095)</u>	<u>(85.7 %)</u>
Total liabilities and deferred inflows	\$ 1,905,994,534	\$ 2,282,698,369	\$ 376,703,835	19.8 %
Net investment in capital assets	\$ 129,585,496	\$ 163,916,171	\$ 34,330,675	26.5 %
Restricted by legislation	94,228,359	146,172,959	51,944,600	55.1 %
Unrestricted deficit	<u>(219,795,908)</u>	<u>(254,126,583)</u>	<u>(34,330,675)</u>	<u>15.6 %</u>
Total net position	<u>\$ 4,017,947</u>	<u>\$ 55,962,547</u>	<u>\$ 51,944,600</u>	<u>1292.8 %</u>

**CHANGE IN NET POSITION**

A summary of the California State Lottery's change in net position is presented below:

	<u>June 30, 2015</u>	<u>June 30, 2016</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Operating revenues – Lottery sales	\$ 5,524,850,593	\$ 6,275,597,288	\$ 750,746,695	13.6 %
Prizes	<u>3,501,745,873</u>	<u>3,955,791,373</u>	<u>454,045,500</u>	<u>13.0 %</u>
Sales after prizes	\$ 2,023,104,720	\$ 2,319,805,915	\$ 296,701,195	14.7 %
Game costs	<u>479,216,726</u>	<u>547,747,915</u>	<u>68,531,189</u>	<u>14.3 %</u>
Income before operating expenses	\$ 1,543,887,994	\$ 1,772,058,000	\$ 228,170,006	14.8 %
Operating expenses	<u>180,646,414</u>	<u>212,389,463</u>	<u>31,743,049</u>	<u>17.6 %</u>
Operating income	\$ 1,363,241,580	\$ 1,559,668,537	\$ 196,426,957	14.4 %

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Unaudited)

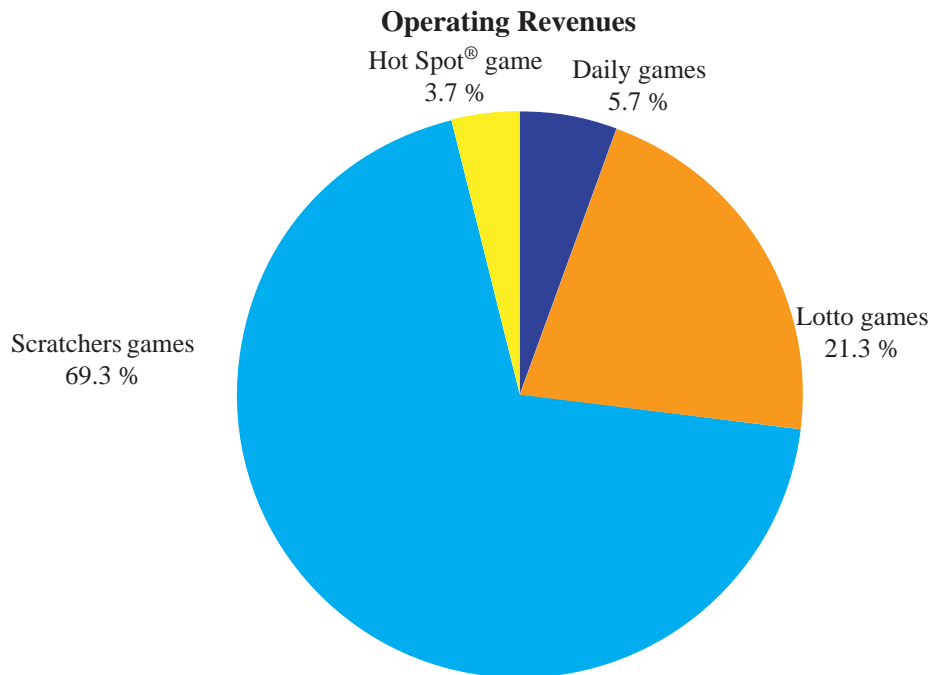
**CHANGE IN NET POSITION (continued)**

Non-operating expenses	<u>\$ (1,370,122,178)</u>	<u>\$ (1,507,723,937)</u>	<u>\$ (137,601,759)</u>	<u>10.0 %</u>
Change in net position	\$ (6,880,598)	\$ 51,944,600	\$ 58,825,198	(854.9 %)
Total net position – beginning of year	101,108,957	4,017,947	(97,091,010)	(96.0 %)
Accounting change adjustment	<u>(90,210,412)</u>	<u>-</u>	<u>90,210,412</u>	<u>(100.0 %)</u>
Total net position – end of year	<u><u>\$ 4,017,947</u></u>	<u><u>\$ 55,962,547</u></u>	<u><u>\$ 51,944,600</u></u>	<u><u>1292.8 %</u></u>

The accounting change adjustment to the beginning of year total net position in fiscal year 2014-15 was due to the implementation of GASB 68, *Accounting and Financial Reporting for Pensions*.

**REVENUES**

The following chart shows the major sources and the percentages of operating revenues for the fiscal year ended June 30, 2016:



**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Unaudited)

**REVENUES (continued)**

A summary of total revenues for the fiscal years ended June 30, 2015 and 2016, and the amount and percentage of change in relation to prior year amounts is as follows:

	<u>June 30, 2015</u>	<u>June 30, 2016</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Operating revenues:				
Lotto games	\$ 1,064,489,378	\$ 1,337,129,994	\$ 272,640,616	25.6 %
Scratchers games	3,915,381,412	4,351,826,436	436,445,024	11.1 %
Hot Spot game	206,439,141	232,286,264	25,847,123	12.5 %
Daily games	338,540,662	354,354,594	15,813,932	4.7 %
Total operating revenues	<u>\$ 5,524,850,593</u>	<u>\$ 6,275,597,288</u>	<u>\$ 750,746,695</u>	<u>13.6 %</u>
Non-operating revenues:				
Unrealized gains (losses) on investments	\$ (7,489,809)	\$ 54,507,804	\$ 61,997,613	(827.8 %)
Interest accreted/earned on investments	34,756,618	34,316,081	(440,537)	(1.3 %)
Interest on funds held by State Treasurer	1,247,278	3,287,907	2,040,629	163.6 %
Other income	53,155	193,432	140,277	263.9 %
Total non-operating revenues	<u>\$ 28,567,242</u>	<u>\$ 92,305,224</u>	<u>\$ 63,737,982</u>	<u>223.1 %</u>
Total revenues	<u>\$ 5,553,417,835</u>	<u>\$ 6,367,902,512</u>	<u>\$ 814,484,677</u>	<u>14.7 %</u>

Lottery operating revenues increased \$750.7 million or 13.6 percent over the previous year. Lotto games sales increased \$272.6 million or 25.6 percent, due mainly to a record-breaking \$1.59 billion Powerball jackpot in January 2016. Scratchers sales increased \$436.4 million or 11.1 percent, due in part to the introduction of California's first \$30 price-point game, as well as an overall dynamic product mix offering a successful balance between specialty tickets and core games. Hot Spot sales increased 12.5 percent as the Lottery continued to offer increased prize payout promotions.

Non-operating revenues increased \$63.7 million due primarily to unrealized gains on investments purchased to pay annuitized prizes. Interest on funds held by the State Treasurer increased due to an increase in the interest rate as well as an increase in the amount of funds earning interest because of the large deposits related to the Powerball jackpot in January. Other income increased because of the sale of fully depreciated fleet vehicles.



**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Unaudited)

**EXPENSES**

The Lottery Act requires that the Lottery return not less than 87 percent of annual revenues to the public in the form of prizes and contributions to education, and spend no more than 13 percent of annual revenues on operating expenses. Lottery prize payment expense, contributions to education, and operating expenses are shown below as a percentage of operating revenue for the year ended June 30, 2016.

<u>Lottery Sales</u>	<u>\$ 6,275,597,288</u>	<u>100.0 %</u>
Revenue returned to the public		
Prizes	\$ 3,955,791,373	63.0 %
Allocation of sales to education	<u>1,559,681,787</u>	<u>24.9 %</u>
<u>Total revenue returned to the public</u>	<u>\$ 5,515,473,160</u>	<u>87.9 %</u>
Expenses of the Lottery		
Retailer costs	\$ 432,985,606	6.9 %
Game costs	114,762,309	1.8 %
Operating expenses	212,389,463	3.4 %
Less bartered operating expenses	<u>(13,250)</u>	<u>0.0 %</u>
<u>Total expenses of the Lottery</u>	<u>\$ 760,124,128</u>	<u>12.1 %</u>

A summary of the total funds transferred by the Lottery to the education community for the fiscal year ended June 30, 2016, is shown below.

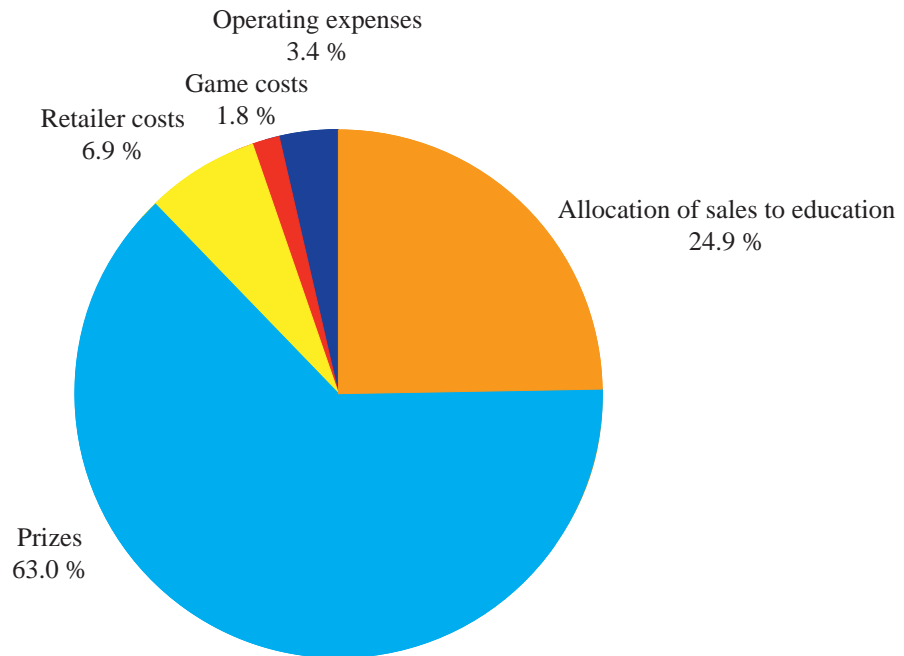
Revenues to Education	
Allocation of sales	\$ 1,559,681,787
Unclaimed prizes directly allocated to the Education Fund	24,266,723
Interest income	3,287,907
Other income	193,432
Less bartered income	<u>(13,250)</u>
<u>Total declared for allocation to the Education Fund</u>	<u>\$ 1,587,416,599</u>

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**(Unaudited)**

**EXPENSES (continued)**

The following chart shows prizes, game costs, operating expenses, and allocation to education as a percentage of operating revenues for the fiscal year ended June 30, 2016:

**Prizes and Allocation of Sales Returned to the Public, and Expenses of the Lottery  
as a Percentage of Operating Revenues**



**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Unaudited)

**EXPENSES (continued)**

A summary of expenses for the fiscal years ended June 30, 2015 and 2016, and the amount and percentage change in relation to prior year amounts is as follows:

	<u>June 30, 2015</u>	<u>June 30, 2016</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Prizes:				
Draw game prizes	\$ 841,928,424	\$ 989,591,302	\$ 147,662,878	17.5 %
Scratchers game prizes	2,659,817,449	2,966,200,071	306,382,622	11.5 %
Total prizes	<u>\$ 3,501,745,873</u>	<u>\$ 3,955,791,373</u>	<u>\$ 454,045,500</u>	<u>13.0 %</u>
Game costs:				
Retailer costs	\$ 380,344,945	\$ 432,985,606	\$ 52,640,661	13.8 %
Draw/Scratchers game costs	98,871,781	114,762,309	15,890,528	16.1 %
Total game costs	<u>\$ 479,216,726</u>	<u>\$ 547,747,915</u>	<u>\$ 68,531,189</u>	<u>14.3 %</u>
Operating expenses:				
Salaries, wages, and benefits	\$ 70,480,064	\$ 79,415,769	\$ 8,935,705	12.7 %
Advertising	62,273,530	74,280,130	12,006,600	19.3 %
Promotion, public relations, and point of sale	10,664,151	10,990,631	326,480	3.1 %
Other professional services	11,843,044	14,367,836	2,524,792	21.3 %
Depreciation and amortization	8,950,492	13,528,573	4,578,081	51.1 %
Other general and administrative expenses	16,435,133	19,806,524	3,371,391	20.5 %
Total operating expenses	<u>\$ 180,646,414</u>	<u>\$ 212,389,463</u>	<u>\$ 31,743,049</u>	<u>17.6 %</u>
Non-operating expenses:				
Allocation to Education Fund	\$ 1,364,542,013	\$ 1,563,149,876	\$ 198,607,863	14.6 %
Interest imputed on annuitized prize liability	34,147,407	36,879,285	2,731,878	8.0 %
Total non-operating expenses	<u>\$ 1,398,689,420</u>	<u>\$ 1,600,029,161</u>	<u>\$ 201,339,741</u>	<u>14.4 %</u>
Total expenses	<u>\$ 5,560,298,433</u>	<u>\$ 6,315,957,912</u>	<u>\$ 755,659,479</u>	<u>13.6 %</u>

Prize expense and retailer costs increased as sales increased. Draw/Scratchers game costs increased because payments to the gaming system vendor are based on a percentage of sales, and also due to the increased cost of Scratchers ticket inventory. Advertising expense increased due to an increase in the number of media campaigns. Other professional services increased due to more external contracts related to IT and facilities. Depreciation and amortization increased due to the depreciation of purchased gaming equipment. Other general and administrative expenses increased primarily due to an increase in shared costs of the State and an accrual of a legal contingency. The allocation to the Education Fund increased mainly because of the increase in sales.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Unaudited)

**CAPITAL ASSETS**

A summary of capital assets as of June 30, 2015 and 2016, and the amount and percentage of change in relation to prior year amounts is as follows:

	<u>June 30, 2015</u>	<u>June 30, 2016</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Non-depreciable capital assets:				
Land	\$ 9,743,325	\$ 11,577,348	\$ 1,834,023	18.8 %
Depreciable capital assets:				
Gaming equipment	\$ 29,597,905	\$ 47,987,567	\$ 18,389,662	62.1 %
Vending machines	53,267,042	65,615,099	12,348,057	23.2 %
Buildings	77,726,298	88,258,190	10,531,892	13.5 %
Data processing equipment	14,429,088	14,920,430	491,342	3.4 %
Office furniture and equipment	7,884,540	8,007,120	122,580	1.6 %
Leasehold improvements	813,658	620,651	(193,007)	(23.7 %)
Other	10,002,578	10,097,552	94,974	0.9 %
Subtotal	<u>\$ 193,721,109</u>	<u>\$ 235,506,609</u>	<u>\$ 41,785,500</u>	<u>21.6 %</u>
Less accumulated depreciation	<u>(73,878,938)</u>	<u>(83,167,786)</u>	<u>(9,288,848)</u>	<u>12.6 %</u>
Total depreciable capital assets	<u>\$ 119,842,171</u>	<u>\$ 152,338,823</u>	<u>\$ 32,496,652</u>	<u>27.1 %</u>
Capital assets, net	<u>\$ 129,585,496</u>	<u>\$ 163,916,171</u>	<u>\$ 34,330,675</u>	<u>26.5 %</u>

Capital assets increased 26.5 percent over the previous fiscal year. The increase in land and buildings is due to the ongoing implementation of the Lottery's Facilities Master Plan to purchase buildings as replacements for leased facilities. The increase in gaming equipment and vending machines is due primarily to the Lottery purchasing rather than using vendor-owned equipment. The decrease in leasehold improvements is due to disposing of fully depreciated improvements the Lottery no longer uses. More information on the Lottery's capital assets can be found in Note 5.

**NON-CURRENT LIABILITIES**

At June 30, 2016, the California State Lottery had approximately \$872 million in non-current liabilities, a decrease of \$0.8 million from the previous year. Non-current liabilities include a \$58.6 million net other postemployment benefits obligation (NOO), an increase of \$9.4 million, and a net pension liability of \$104.5 million, an increase of \$23.8 million. These increases are offset by a \$34 million decrease in long-term prize liability, as the majority of jackpot and annuity-level prize winners choose the cash option rather than annuitized payments. Additional detailed information on long-term prize liability may be found in Note 6 and additional information on the NOO and pension liability may be found in Note 10.

**CONTACTING THE LOTTERY'S FINANCIAL MANAGER**

This financial report is designed to provide a general overview of the Lottery's finances and to demonstrate the accountability for the money the Lottery earns. If you have questions about this report or need additional financial information, contact the California State Lottery, Finance Division, 700 N. 10th Street, Sacramento, CA 95811.

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**CALIFORNIA STATE LOTTERY FUND**  
**STATEMENT OF NET POSITION**  
**JUNE 30, 2016**

**Assets**

Cash and cash equivalents (Note 2)	\$ 741,273,140
Investments, current portion (Note 2)	88,393,211
Accounts receivable, net of allowances (Note 3)	461,785,811
Due from state funds (Note 4)	1,393,715
Ticket inventories	7,065,785
Other	5,311,678
Total current assets	<u>\$ 1,305,223,340</u>

Investments, less current portion (Note 2)	\$ 840,662,283
Capital assets, net (Note 5)	163,916,171
Long-term prepaid charges, net	8,734,298
Total non-current assets	<u>\$ 1,013,312,752</u>

Total assets \$ 2,318,536,092

**Deferred Outflows of Resources** \$ 20,124,824

**Total Assets and Deferred Outflows of Resources** \$ 2,338,660,916

**Liabilities**

Accounts payable	\$ 42,190,053
Current prize liability (Note 6)	968,568,491
Due to state funds (Note 7)	384,734,510
Accrued liabilities	10,112,541
Unearned revenue	2,859,255
Total current liabilities	<u>\$ 1,408,464,850</u>

Prize liability, less current portion (Note 6)	\$ 708,900,489
Other postemployment benefits (Note 10)	58,564,000
Net pension liability (Note 10)	104,521,229
Total non-current liabilities	<u>\$ 871,985,718</u>

Total liabilities \$ 2,280,450,568

**Deferred Inflows of Resources** \$ 2,247,801

**Total Liabilities and Deferred Inflows of Resources** \$ 2,282,698,369

**Net Position**

Net investment in capital assets (Note 5)	\$ 163,916,171
Restricted by legislation for prizes (Note 2)	146,172,959
Unrestricted deficit	<u>(254,126,583)</u>

**Total Net Position** \$ 55,962,547

See accompanying notes to the financial statements.

**CALIFORNIA STATE LOTTERY FUND**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET FUND POSITION**  
**YEAR ENDED JUNE 30, 2016**

Operating revenues: Lottery sales	\$ 6,275,597,288
Prizes	<u>3,955,791,373</u>
Sales after prizes	<u>\$ 2,319,805,915</u>
Less game costs:	
Retailer costs	\$ 432,985,606
Gaming system costs	78,276,791
Scratchers <sup>®</sup> game costs	<u>36,485,518</u>
Total game costs	<u>\$ 547,747,915</u>
Income before operating expenses	<u>\$ 1,772,058,000</u>
Operating expenses:	
Salaries, wages, and benefits	\$ 79,415,769
Advertising	74,280,130
Promotion, public relations, and point of sale	10,990,631
Other professional services	14,367,836
Depreciation and amortization	13,528,573
Other general and administrative expenses	<u>19,806,524</u>
Total operating expenses	<u>\$ 212,389,463</u>
Operating income	<u>\$ 1,559,668,537</u>
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	\$ 92,111,792
Interest expense imputed on annuitized prize liability	(36,879,285)
Other income	193,432
Allocation to Education Fund (Note 7)	<u>(1,563,149,876)</u>
Total non-operating expenses	<u>\$ (1,507,723,937)</u>
Change in net position	\$ 51,944,600
Total net position - beginning balance	<u>4,017,947</u>
Total net position - ending balance	<u><u>\$ 55,962,547</u></u>

See accompanying notes to the financial statements.

**CALIFORNIA STATE LOTTERY FUND**  
**STATEMENT OF CASH FLOWS**  
**YEAR ENDED JUNE 30, 2016**

Cash flows from operating activities:	
Receipts from customers	\$ 6,345,402,331
Payments for prizes	(3,898,470,983)
Payments to retailers	(432,981,585)
Payments to suppliers for goods and services	(248,079,019)
Payments to employees	(59,404,681)
Internal activity-payments to state funds	(21,819,041)
Receipts from other states	272,641,008
Other receipts	<u>58,628</u>
Net cash flows provided by operating activities	<u>\$ 1,957,346,658</u>
Cash flows from non-capital financing activities:	
Distributions to Education Fund	<u>\$ (1,562,888,715)</u>
Net cash flows used in non-capital financing activities	<u>\$ (1,562,888,715)</u>
Cash flows from capital and related financing activities:	
Proceeds from disposal of property and equipment	\$ 190,425
Payments for capital assets	<u>(47,872,993)</u>
Net cash flows used in capital and related financing activities	<u>\$ (47,682,568)</u>
Cash flows from investing activities:	
Purchase of securities	\$ (11,199,821)
Proceeds from matured securities	92,557,000
Investment Portfolio and SMIF interest received	<u>20,660,785</u>
Net cash flows provided by investing activities	<u>\$ 102,017,964</u>
Increase in cash and cash equivalents	<u>\$ 448,793,339</u>
Cash and cash equivalents at July 1, 2015	<u>\$ 292,479,801</u>
Cash and cash equivalents at June 30, 2016	<u><u>\$ 741,273,140</u></u>

See accompanying notes to the financial statements.



**CALIFORNIA STATE LOTTERY FUND  
STATEMENT OF CASH FLOWS  
YEAR ENDED JUNE 30, 2016**

Cash flows from operating activities:	
Operating income	\$ 1,559,668,537
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	\$ 13,528,573
Provision for doubtful accounts	463,186
Provision for returned tickets	(333,092)
Provision for free ticket redemptions	8,911,298
Net gain on retirement or disposal of capital assets	(176,681)
Other income	193,432
Changes in assets and liabilities:	
Decrease in accounts receivable	39,417,258
Decrease in ticket inventories	2,875,653
Decrease in other assets	66,021
Decrease in long-term prepaid charges	3,646,130
Decrease in accounts payable	(9,296,757)
Increase in prize liability	329,961,398
Decrease in due to state funds	(10,607,636)
Decrease in accrued liabilities	(612,508)
Decrease in unearned revenues	(63,435)
Increase in OPEB and net pension liability	<u>19,705,281</u>
Net cash flows provided by operating activities	<u>\$ 1,957,346,658</u>

Supplemental disclosure of non-cash activities:

Interest accreted on annuitized prizes	<u>\$ 36,879,285</u>
Unclaimed prizes directly allocated to the Education Fund	<u>\$ 24,266,723</u>
Unrealized gain on investments	<u>\$ 54,507,804</u>
Interest accreted on zero coupon bonds	<u>\$ 16,225,568</u>

See accompanying notes to the financial statements.

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization**

The California State Lottery Fund (the Fund) was created with the passage of the California State Lottery Act of 1984 (the Act). The Fund is a part of the primary government of the State of California and is reported as a proprietary fund and business-type activity within the State of California's financial statements. The purpose of the Act is to support the preservation of the rights, liberties, and welfare of the people by providing additional monies to benefit education without the imposition of additional or increased taxes. The operations of the Fund are separate and distinct from other operations of the State of California.

On April 8, 2010, the Governor signed Assembly Bill (AB) 142 amending the Act to allow the California State Lottery (Lottery) to offer its players a higher prize payout percentage. Research shows that higher prize payouts result in increased sales revenues and thus will afford increased allocations to education. Under AB 142 beginning with the 2010-11 fiscal year, the Lottery is required to return not less than 87 percent of revenues to the public in the form of prizes and contributions to education, and to spend no more than 13 percent of revenues on operating expenses of the Lottery.

**Basis of Presentation**

The Fund is accounted for as an enterprise fund. The financial statements are prepared on the accrual basis of accounting and the economic resources measurement focus in accordance with accounting principles generally accepted in the United States of America. Operating revenues and expenses are those that result from providing services and producing and delivering goods and/or services. The principal operating revenues of the Fund come from the sale of lottery tickets. The principal operating expenses of the Fund are prizes, retailer commissions, game costs, contractual services, advertising and marketing, salaries and benefits, depreciation of assets, and general and administrative costs.

**Revenue Recognition – Scratchers Games**

Sales of Scratchers tickets are made to the public through contracted retailers. Revenue is recognized upon the sale of tickets to the retailers for active games. An allowance is recognized for the retailers' right to return unsold tickets. Operating revenue is reduced for free tickets and for unsold tickets remaining in vending machines. Retailers receive a commission of up to six percent which is recognized when tickets are sold to the retailers.

**Revenue Recognition - Draw Games**

Lottery sales for draw games are made to the public through gaming terminals at contracted retailers. Revenue is recognized upon the sale to the public. With the exception of Powerball® and Mega Millions®, the public has the right to cancel a sale on the same day before pool closure. All Powerball and Mega Millions sales are final. The applicable retailers' commission of four and one-half to six percent is recognized when sales are made to the public. Recognition of the revenue from sales for future draws is considered unearned until those draws become current. The retailers' commission related to the unearned revenue is reflected as a prepaid expense until the revenue is recognized.

**Prizes – Scratchers Games**

Prize expense for Scratchers games is recognized based on the predetermined prize structure for each game in the period revenue is recognized. Prizes that are not claimed are recognized as unclaimed prizes 180 days after the end of each game. Unclaimed prizes not directly payable by the Lottery are recognized as a reduction of prize expense and included in the Lottery's operating income that is allocated to the Education Fund. Unclaimed prizes directly payable by the Lottery are allocated directly to the Education Fund.

**CALIFORNIA STATE LOTTERY FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2016**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Prizes – Scratchers Games (continued)**

Scratchers games with annuitized prizes are generally paid in equal, annual installments over 20 or 25 years. Some games offer graduated, annual payments, and others offer the choice of an annuitized prize paid in weekly or monthly installments or a lump sum cash payment. Prize expense for annuity prizes is based on the present value of the annuity using an interest rate equal to the interest yield on the zero coupon U.S. Treasury bonds. Interest earned is imputed on the annuity using the same interest rate.

**Prizes - Draw Games**

Powerball and Mega Millions - Prize expense for each of the twice-weekly multi-state draw games is recognized on the basis of the predetermined prize structure when the revenue is recognized. Nine distinct prize categories for each game are established which are dependent upon the amount of money wagered and the quantity of numbers to be matched. In the event that no winning share for a specific prize category of Powerball or Mega Millions is selected, all monies allocated for that prize are carried forward to the following drawing and remain in the pool for that same prize category.

The total Grand/Jackpot Prize liability for each multi-state Powerball or Mega Millions drawing is shared by each participating state lottery (Party Lottery) as follows: each Party Lottery is responsible for an amount equal to a percentage of that Party Lottery's Powerball or Mega Millions sales, said percentage being the proportion of the total Grand/Jackpot Prize liability to the total Powerball or Mega Millions sales. The California Lottery is prohibited by state law from paying fixed prizes and participating in the liability calculation for prize levels two through nine. The California Lottery is therefore solely responsible for its own prize liability for levels two through nine for the multi-state games.

Powerball and Mega Millions Grand/Jackpot Prizes won in California are paid in 30 graduated, annual installments. For each game, winners have up to 60 days after the date the Lottery validates the winning ticket and authorizes payment to irrevocably elect to receive the cash value of the prize instead of annual payments. Payments for all other prize categories are made in a single payment.

In the event that a Powerball or Mega Millions Grand/Jackpot Prize won in California is unclaimed, the prize monies will be returned to the Party Lotteries in the same ratio that each Party Lottery contributed to the prize plus interest, and the amount contributed by the California State Lottery will be allocated directly to the Education Fund. The unclaimed prize monies for all other Powerball or Mega Millions prize categories won in California but not claimed within the specified period are allocated directly to the Education Fund.

SuperLotto Plus® - Prize expense for the twice-weekly draw game is recognized on the basis of the predetermined prize structure when the revenue is recognized. Nine distinct prize categories are established which are dependent upon the amount of money wagered and the quantity of numbers to be matched. In the event that no winning share for a specific prize category in SuperLotto Plus is chosen, all monies allocated for that prize are carried forward to the following drawing and added to the 5 of 5 plus Mega number category (Grand Prize).

SuperLotto Plus Grand/Jackpot Prizes of \$1 million or more won prior to April 1, 1998, are paid in 20 equal, annual installments. Grand/Jackpot Prizes of \$1 million or more won between April 1, 1998, and May 10, 2013, are paid either in 26 graduated, annual payments or in a single payment equal to the cash value of the 26-payment annuity, in accordance with the rules and regulations of the Lottery. Beginning September 21, 2005, claimants have up to 60 days after the Lottery validates the winning ticket and authorizes payment to irrevocably elect to receive the cash payment instead of the annuitized payments. Starting May 11, 2013, Grand Prizes are paid in 30 graduated, annual payments or in a single payment equal to the estimated cost to fully fund the advertised annuity prize. Such estimated cost is determined by market pricing for U.S. Treasury bonds. Payments for all other prize categories are made in a single payment. All SuperLotto Plus prizes won but not claimed within the specified period are allocated directly to the Education Fund.

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Prizes - Draw Games (continued)**

Fantasy 5 - Prize expense for the seven-draws-per-week game is recognized on the basis of the predetermined prize structure when the revenue is recognized. Distinct prize categories are established which are dependent upon the amount of money wagered and the quantity of numbers to be matched. In the event that no winning share for a specific prize category is selected, all monies allocated for that prize category are carried forward to the following drawing and added to the 5 of 5 prize category. All Fantasy 5 prizes won but not claimed within the specified period are allocated directly to the Education Fund.

Daily 3 - Prize expense for the two-draws-per-day game is recognized on the basis of the predetermined prize structure when the revenue is recognized. Distinct prize categories are established which are dependent upon the amount of money wagered, the quantity of numbers to be matched, and the order of numbers chosen. All Daily 3 prizes won but not claimed within the specified period are allocated directly to the Education Fund.

Daily 4 - Prize expense for the seven-draws-per-week game is recognized on the basis of the predetermined prize structure when the revenue is recognized. Distinct prize categories are established which are dependent upon the amount of money wagered, the quantity of numbers to be matched, and the order of numbers chosen. All Daily 4 prizes won but not claimed within the specified period are allocated directly to the Education Fund.

Daily Derby<sup>®</sup> - Prize expense for the seven-draws-per-week game is recognized on the basis of the predetermined prize structure when the revenue is recognized. Distinct prize categories are established which are dependent upon the amount of money wagered, the quantity of numbers to be matched, and the order of numbers chosen. In the event that no winning share for a specific prize category is selected, all monies allocated for that prize category are carried forward to the following drawing and added to the Grand Prize category. All Daily Derby prizes won but not claimed within the specified period are allocated directly to the Education Fund.

Hot Spot<sup>®</sup> - Prize expense for the multiple-draws-per-day game is recognized on the basis of the predetermined prize structure when the revenue is recognized. The game includes Typical Prize Pools for the 8 Spot Match 8 of 8, the 9 Spot Match 9 of 9, and the 10 Spot Match 10 of 10 categories, and Typical Prize Amounts for all other spots. The Hot Spot Wagered Prize Fund (fund) balance is adjusted daily based upon daily sales contributions and prizes won. In the event the balance in the fund is not sufficient to pay the allocations and amounts of a particular draw, prizes will be systematically reduced until the fund is sufficient to pay the reduced amounts. The Director will authorize promotions to ensure that the fund balance at the end of any given fiscal year is liquidated. All Hot Spot prizes won but not claimed within the specified period are allocated directly to the Education Fund.

Raffle - The Lottery may periodically conduct raffle games. The \$1 million top prizes for the two raffle games held to date were each paid in single payments.

**Cash Equivalents**

Cash equivalents represent cash deposited in the Surplus Money Investment Fund (SMIF) of the State of California.

**Investments**

The Lottery applies Statement No. 31 of the Governmental Accounting Standards Board (GASB 31), *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This statement establishes accounting and financial reporting standards for all investments held by governmental external investment pools and establishes fair value standards for other governmental entities. In accordance with GASB 31, the Lottery has stated investments at fair value. The difference between the carrying value and the fair value of investments is reported as a component of total net position restricted by legislation for prizes on the statement of net position.

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Investments (continued)**

The Lottery applies GASB 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3*. This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement also are required to be disclosed.

During the fiscal year ended June 30, 2016, the Lottery adopted GASB 72, *Fair Value Measurement and Application*, which supersedes some paragraphs of GASB 31 and requires additional disclosures related to fair value measurements, the level of fair value hierarchy, and valuation techniques.

**Allowances for Doubtful Accounts, Ticket Returns, and Free Ticket Redemptions**

The allowance for doubtful accounts is based on an analysis of collectability of accounts receivable which considers the age of the accounts and historical collection results. An allowance for ticket returns for Scratchers games is estimated using sales revenue and historical return data for the games in progress at the end of the reporting period. An allowance for free ticket redemptions for Scratchers games is estimated using sales revenue and free ticket redemption data for games in progress at the end of the reporting period.

**Ticket Inventories**

Inventories are carried at cost and consist of tickets for games in progress not yet sold to retailers and tickets for future games. The cost of tickets is charged to operations when the tickets are sold to retailers. The cost of unissued and returned tickets is written off at the end of each game.

**Capital Assets**

The Lottery has adopted a policy of capitalizing assets with an acquisition cost or established value of \$5,000 or greater. Additionally, the Lottery capitalizes all gaming equipment as well as the purchase of like-kind assets totaling \$5 million or more in a single purchase. Capital assets are carried at cost. Depreciation on property and equipment is computed using the straight-line method over estimated useful lives ranging from one to ten years. Depreciation on buildings, improvements, and land improvements is computed using the straight-line method over estimated useful lives of five to 40 years. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations in the period of disposal. Amortization of leasehold improvements is computed using the straight-line method over the remaining lease terms.

**Long-term Prepaid Charges**

The Lottery incurs costs in connection with certain contracts which extend beyond a one-year period. These costs are prepaid and amortized over the life of the contracts.

**Pensions**

During the year ended June 30, 2015, the Lottery adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement revised existing standards for measuring and reporting pension liabilities. This Statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Pensions (continued)**

benefits. This Statement requires that most changes in the net pension liability be included in pension expense in the period of the change.

For purposes of measuring the net pension liability, deferred outflows and inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the California Lottery Fund and additions to or deductions from the California Lottery Fund's fiduciary net position have been determined on the same basis as they are reported by the California Public Employees' Retirement System (CalPERS) Financial Office. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value.

**Deferred Outflows of Resources and Deferred Inflows of Resources**

Changes in net pension liability not included in pension expense are reported as deferred outflows of resources or deferred inflows of resources. Employer contributions subsequent to the measurement date of the net pension liability are reported as deferred outflows of resources. The unamortized net difference between projected and actual earnings on investments are recorded as deferred inflows of resources.

**Advertising**

Advertising costs are expensed when the related liability is incurred. Advertising expense totaled \$74,280,130 for the year ended June 30, 2016.

**Investment Earnings**

Investment earnings are composed of unrealized gains or losses associated with the change in fair value of investments and interest income including interest accreted on investments. Unrealized gains and losses are generally not realized as the investments are held to maturity at which time they are used to satisfy annuitized prizes. As investments must be stated at fair value, investment earnings or losses are created as a result of the adjustment from carrying value to fair value. Generally, all cash is held on deposit with the California State Treasurer and is invested by that office in the Surplus Money Investment Fund. Interest on funds held by the State Treasurer is distributed quarterly.

**Restricted Assets**

All of the Lottery's investments are restricted in that they are held to maturity in order to pay annuitized prizes. In addition, a portion of the Lottery's cash and cash equivalents and accounts receivable are also restricted to satisfy outstanding prize liability. At June 30, 2016, restricted cash and cash equivalents is approximately \$432.4 million and restricted accounts receivable is approximately \$457.5 million.

**Compensated Absences Payable**

Vested vacation balances are included in accrued liabilities and adjusted quarterly.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets 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.



**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

## **2. DEPOSITS AND INVESTMENTS**

The Lottery presents its deposits and investments in accordance with GASB 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3*. This statement requires the disclosure of the following risks to the extent that they exist at the date of the statement of net position:

### **Interest Rate Risk**

Interest rate risk is the risk that the value of fixed income securities will decline due to changing interest rates. The prices of fixed income securities with longer time to maturity tend to be more sensitive to changes in interest rates than those with shorter durations.

### **Credit Risk**

Credit risk is the risk that a debt issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline.

### **Custodial Credit Risk**

Custodial credit risk is the risk that, in the event a financial institution or counterparty fails, the investor will not be able to recover the value of its deposits, investments, or collateral.

### **Concentration of Credit Risk**

Concentration of credit risk is the risk of loss attributed to the magnitude of an investor's holdings in a single issuer.

### **Investments**

The deposit and investment policies of the Lottery are determined by the Lottery Commission and state statute. Prize investments consist of zero coupon U.S. Treasury bonds, zero coupon agency bonds, and municipal bonds. Zero coupon U.S. Treasury bonds and zero coupon agency bonds are carried at fair value and are adjusted for the accretion of interest based on the purchase yield and maturity date. Municipal bonds are carried at fair value, and interest is accrued based on the coupon rate.

As mentioned in Note 1, The Lottery adopted GASB 72 during fiscal year 2015-16. The Lottery holds investments that are measured at fair value on a recurring basis. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Because investing is not a core part of the Lottery's mission, the Lottery determined that the disclosure related to these investments need only be disaggregated by major type.

The Lottery categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles, based on the valuation inputs used to measure the fair value of the asset. The Lottery uses Level 1 inputs, which are quoted prices in active markets for identical assets. The Lottery applies the market approach to value its investments, which uses prices and other relevant information generated by market transactions involving identical or similar assets. The Lottery uses a third party brokerage firm to obtain quoted market prices of its debt securities.

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**2. DEPOSITS AND INVESTMENTS (continued)**

**Investments (continued)**

As of June 30, 2016, the Lottery's investments consist of the following:

	<u>Face Amount</u>	<u>Cost</u>	<u>Fair Value</u>
Current portion:			
U.S. Treasury Bonds	\$ 14,333,000	\$ 13,578,503	\$ 14,306,051
U.S. Agency Bonds	31,529,000	23,950,708	31,482,136
U.S. Municipal Bonds	41,320,000	41,426,684	42,605,024
Total current portion	<u>\$ 87,182,000</u>	<u>\$ 78,955,895</u>	<u>\$ 88,393,211</u>
Long-term portion:			
U.S. Treasury Bonds	\$ 482,669,000	\$ 283,150,119	\$ 372,461,995
U.S. Agency Bonds	152,040,000	73,328,381	131,341,030
U.S. Municipal Bonds	291,095,000	291,822,029	336,859,258
Total long-term portion	<u>\$ 925,804,000</u>	<u>\$ 648,300,529</u>	<u>\$ 840,662,283</u>
Total investments	<u>\$ 1,012,986,000</u>	<u>\$ 727,256,424</u>	<u>\$ 929,055,494</u>

Yields on the Lottery's investments range from 0.34 percent to 5.89 percent for Treasury bonds, from 3.57 percent to 5.51 percent for agency bonds, and from 4.19 percent to 6.06 percent for municipal bonds.

The following represents the changes in fair value of investments for the year ended June 30, 2016:

Changes in fair value of investments:	
Unrealized investment gains at July 1, 2015	\$ 76,430,085
Unrealized investment gain, current period	54,507,804
Total unrealized investment gains	<u>\$ 130,937,889</u>

The fair value of the investments is equal to the original cost plus accreted interest plus the unrealized investment gains. As a result of investment restructuring transactions completed in 2010, the interest imputed on prize liability does not equal the interest earned on the restructured investment portfolio. The difference is reported in the statement of revenues, expenses, and changes in net position and results in an adjustment to net position restricted by legislation. As the realized and unrealized investment gain and loss activity relates to investments that must be held to satisfy prize liabilities, they are deemed statutorily restricted and therefore reported as restricted by legislation.

**Interest Rate Risk – Investments**

The Lottery does not have a specific policy to manage interest rate risk, as investments are purchased to mirror the payment stream of recorded prize liability. The Lottery's investments have weighted average maturities based on the final maturity dates of all investments as follows:

U.S. Treasury Bonds	12.01 years
U.S. Agency Bonds	5.86 years
U.S. Municipal Bonds	5.90 years
Surplus Money Investment Fund	0.46 years



**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**2. DEPOSITS AND INVESTMENTS (continued)**

**Credit Risk and Concentration of Credit Risk - Investments**

The Lottery has adopted a specific policy to manage credit risk in the Lottery's investment portfolio. The zero coupon U.S. Treasury bonds and U.S. Treasury bills are backed by the full faith and credit of the United States government. Therefore, the U.S. Treasury obligation investments are not considered to have credit risk or a concentration of credit risk, as defined by the Governmental Accounting Standards Board. The Lottery's policy to manage credit risk requires municipal bonds to have a minimum double A credit rating by Fitch, Moody's, or Standard and Poor's to be eligible for purchase as part of the Lottery's investment portfolio. Agency bonds have a triple A credit rating and the Surplus Money Investment Fund is not rated at June 30, 2016. Credit risk is further mitigated by a \$2.7 million par value agency bond reserve. The bond reserve has a fair value of \$2,247,680.

As of June 30, 2016, the fair value of the Lottery's investment portfolio expressed as a percentage of Moody's credit rating categories was as follows:

Moody's Credit Rating	Fair Value	Percent of Total Portfolio
Aaa	\$ 558,606,129	60.12 %
Aa1	153,483,773	16.52 %
Aa2	36,110,019	3.89 %
Aa3	153,369,778	16.51 %
Baa2	22,384,318	2.41 %
Ba1	5,101,477	0.55 %
Totals	<u>\$ 929,055,494</u>	<u>100.00 %</u>

The following table provides information about the Lottery's concentration of credit risk. It shows investments by any one issuer representing five percent or more of the Lottery's total portfolio, and not explicitly guaranteed by the U.S. government.

Issuer	Cost	Fair Value	Percent of Total Portfolio	Moody's Credit Rating
State of California	\$ 94,366,123	\$ 101,078,279	10.88 %	Aa3
Commonwealth of Massachusetts	\$ 62,546,830	\$ 75,251,300	8.10 %	Aa1

**Custodial Credit Risk – Investments**

The Lottery does not have a formal investment policy for custodial credit risk for investments. As of June 30, 2016, all the prize investments are uninsured, registered investments held in book-entry form by the State Treasurer's Office in a master custody account with Citibank, N.A.

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**2. DEPOSITS AND INVESTMENTS (continued)**

**Deposits**

The following deposits, included in cash and cash equivalents, are in pools managed by other State of California government units and are not evidenced by securities. Interest income earned on outstanding cash balances is allocated among pool participants based on average daily cash balances. As of June 30, 2016, the carrying value of deposits in the Surplus Money Investment Fund approximated fair value.

State Treasury	\$ 12,834,349
Surplus Money Investment Fund (SMIF)	728,400,000
	\$ 741,234,349

The total cash and cash equivalents of \$741,273,140 also includes retailer payments delivered to the Lottery but not deposited into Lottery accounts by period end. At June 30, 2016, this cash on hand totaled \$38,791.

The SMIF consists of available cash of all special funds of the State of California which do not have investment authority of their own. Cash balances in excess of needs in any of these participating funds are invested by the State Treasurer. The Pooled Money Investment Board (PMIB) provides regulatory oversight over the State Treasurer's pooled investment program and is responsible for determining whether any cash balances of the participating funds are in excess of current needs and available for investment, or whether it is necessary to liquidate previous investments to meet current requirements. The PMIB is composed of the State Treasurer, as chairman; the State Controller; and the Director of Finance for the State of California.

All of the resources of the SMIF are invested through the Pooled Money Investment Account (PMIA). By law, PMIA monies can be invested only in the following categories: U.S. Government securities; securities of federally-sponsored agencies; debentures; domestic corporate bonds; interest-bearing time deposits in California banks, savings and loan associations, and credit unions; prime-rated commercial paper; repurchase and reverse repurchase agreements; security loans; banker's acceptances; negotiable certificates of deposit; and loans to various bond funds.

At June 30, 2016, the allocation of the deposits held by the Lottery in the SMIF was estimated as follows:

	Lottery's Share of SMIF
U.S. Treasury Securities	\$ 327,169,507
Federal Agency Debt	96,675,512
Supranational Debentures	5,798,512
Bank Notes	7,731,571
Certificates of Deposit	160,188,551
Commercial Paper	72,349,404
Time Deposits	53,632,358
AB 55 and General Fund Loans	4,854,585
Total	\$ 728,400,000

The value of the deposits in the State Treasurer's pooled investment program, including the SMIF, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2016, this difference was immaterial to the valuation of the deposits held by the Lottery in the SMIF.

The Lottery's share in the interest earnings of the PMIA is based on its ratio of dollar-day contributions to the total dollar-day investments of the PMIA. The overall return on investment for the PMIA was 0.43 percent for the year ended June 30, 2016.

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**3. ACCOUNTS RECEIVABLE**

Accounts receivable consists of the following:

Amounts due, primarily from retailers	\$ 528,803,527
Less: Allowance for free ticket redemption	(39,395,285)
Allowance for doubtful accounts	(5,563,687)
Allowance for ticket returns	(22,058,744)
Accounts receivable, net	<u>\$ 461,785,811</u>

**4. DUE FROM STATE FUNDS**

Due from state funds consists primarily of interest income due on cash deposited with the State Treasurer in the Surplus Money Investment Fund.

**5. CAPITAL ASSETS**

Capital assets consist of the following:

	Beginning Balance	Increase	Decrease	Ending Balance
Non-depreciable capital assets:				
Land	\$ 9,743,325	\$ 1,834,023	\$ -	\$ 11,577,348
Depreciable capital assets:				
Gaming equipment	29,597,905	18,389,662	-	47,987,567
Vending machines	53,267,042	14,019,953	(1,671,896)	65,615,099
Buildings	77,726,298	10,531,892	-	88,258,190
Data processing equipment	14,429,088	1,427,792	(936,450)	14,920,430
Office furniture and equipment	7,884,540	131,112	(8,532)	8,007,120
Leasehold improvements	813,658	-	(193,007)	620,651
Other	10,002,578	1,538,559	(1,443,585)	10,097,552
	<u>\$ 203,464,434</u>	<u>\$ 47,872,993</u>	<u>\$ (4,253,470)</u>	<u>\$ 247,083,957</u>
Less accumulated depreciation and amortization:				
Gaming equipment	\$ (15,093,360)	\$ (3,168,086)	\$ -	\$ (18,261,446)
Vending machines	(27,361,749)	(3,679,951)	1,671,896	(29,369,804)
Buildings	(7,537,098)	(1,902,710)	-	(9,439,808)
Data processing equipment	(10,303,731)	(2,702,525)	936,450	(12,069,806)
Office furniture and equipment	(6,401,714)	(1,007,741)	8,532	(7,400,923)
Leasehold improvements	(808,340)	(2,379)	193,007	(617,712)
Other	(6,372,946)	(1,065,181)	1,429,840	(6,008,287)
	<u>\$ (73,878,938)</u>	<u>\$ (13,528,573)</u>	<u>\$ 4,239,725</u>	<u>\$ (83,167,786)</u>
Capital assets, net	<u>\$ 129,585,496</u>	<u>\$ 34,344,420</u>	<u>\$ (13,745)</u>	<u>\$ 163,916,171</u>

Depreciation and amortization charged to income on capital assets was \$13,528,573 for the year ended June 30, 2016.

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2016**

**6. PRIZE LIABILITY**

Prize liability consists of the following:

	<u>Scratchers Games</u>	<u>Draw Games</u>	<u>Total</u>
Current:			
Annuitized prizes	\$ 20,787,235	\$ 530,569,867	\$ 551,357,102
Other prizes	<u>374,262,903</u>	<u>42,948,486</u>	<u>417,211,389</u>
Total current prize liability	<u>\$ 395,050,138</u>	<u>\$ 573,518,353</u>	<u>\$ 968,568,491</u>
Long-term annuitized prizes	\$ 178,126,000	\$ 848,937,000	\$ 1,027,063,000
Less imputed interest	<u>(43,431,947)</u>	<u>(274,730,564)</u>	<u>(318,162,511)</u>
Net present value of long-term prizes	<u>\$ 134,694,053</u>	<u>\$ 574,206,436</u>	<u>\$ 708,900,489</u>
Total prize liability	<u>\$ 529,744,191</u>	<u>\$ 1,147,724,789</u>	<u>\$ 1,677,468,980</u>

The amount of prizes due within one year is \$968,568,491.

Long-term prize liability as of June 30, 2016, for each of the next five years and for subsequent years is as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
For the year ending June 30, 2018	\$ 37,900,918	\$ 26,642,960	\$ 64,543,778
2019	36,587,024	25,603,826	62,190,850
2020	35,292,543	24,499,755	59,792,298
2021	34,086,980	23,568,769	57,655,749
2022	32,929,289	22,686,218	55,615,507
2023-2027	136,703,214	80,518,316	217,221,530
2028-2032	78,059,216	21,438,746	99,497,962
2033-2037	41,900,278	3,566,435	45,466,713
2038-2042	33,562,403	2,071,095	35,633,498
2043-2044	<u>10,682,544</u>	<u>600,060</u>	<u>11,282,604</u>
Total long-term prize liability	<u>\$ 477,704,309</u>	<u>\$ 231,196,180</u>	<u>\$ 708,900,489</u>

Activity in the prize liability accounts consists of:

Balance, July 1, 2015	\$ 1,334,895,020
Prize expense	3,955,791,373
Prize payments	(3,898,470,983)
Grand/Jackpot Prize contributions from Other Party Lotteries	272,641,008
Interest imputed on annuities	36,879,285
Unclaimed prizes	<u>(24,266,723)</u>
Balance, June 30, 2016	<u>\$ 1,677,468,980</u>

**CALIFORNIA STATE LOTTERY FUND  
NOTES TO FINANCIAL STATEMENTS  
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**7. DUE TO STATE FUNDS**

Due to state funds consists of the following:

Due to Education Fund	\$ 383,764,890
Due to other state funds	<u>969,620</u>
 Total due to state funds	 <u><u>\$ 384,734,510</u></u>

Activity in the Due to Education Fund account consists of:

Balance, July 1, 2015	\$ 359,237,006
Allocation to Education Fund, earned by the California State Lottery Fund	\$ 1,563,149,876
Unclaimed prizes directly allocated to the Education Fund	<u>24,266,723</u>
	\$ 1,587,416,599
 Distribution to the Education Fund	 <u>(1,562,888,715)</u>
 Balance, June 30, 2016	 <u><u>\$ 383,764,890</u></u>

**8. LEASES**

The Lottery leases office, warehouse, and parking lot facilities under operating leases. These leases expire in various years through September 30, 2023. Most operating leases have a provision for early termination. These leases could be terminated between February 2017 and September 2023.

The future minimum lease payments under operating leases as of June 30, 2016, are as follows:

	<u>Operating Leases</u>
For the year ending June 30, 2017	\$ 1,187,222
2018	580,271
2019	426,794
2020	380,001
2021	412,983
Thereafter	<u>483,191</u>
 Total minimum payments	 <u><u>\$ 3,470,462</u></u>

Rental expense for all operating leases totaled \$1,361,055 for the year ended June 30, 2016.

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
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**9. INVESTMENT EARNINGS**

Investment earnings consist of:

Interest on funds held by State Treasurer	\$ 3,287,907
Change in Fair Value of Investments	54,507,804
Interest accreted/earned on investments	34,316,081
Total investment earnings	<u>\$ 92,111,792</u>

**10. RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS**

**Retirement Plan**

As mentioned in Note 1, the Lottery adopted GASB 68 during the 2014-15 fiscal year. GASB 68 requires that the reported results pertain to liability and asset information within certain defined timeframes. For this current year report, the following timeframes were used:

Valuation date (VD)	June 30, 2014
Measurement date (MD)	June 30, 2015
Measurement period (MP)	July 1, 2014 to June 30, 2015

At the time provisions of GASB 68 were adopted, the Lottery was not able to determine the amounts of all deferred outflows and inflows of resources related to pensions, so it was not practical to restate the prior period financial statements.

**Plan Description, Benefits Provided, and Employees Covered**

The Lottery contributes to the Public Employees' Retirement Fund (PERF) administered by CalPERS, an agent multiple-employer public employee defined benefit pension plan. The State of California (State) is considered the employer and the Lottery is a department of the State. The Lottery has employees who are enrolled in either the State Miscellaneous Plan (First Tier and Second Tier) or the State Peace Officers/Firefighters Plan. CalPERS provides retirement benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public entities within the State and uses the accrual basis of accounting. Benefit provisions and all other requirements are established by state statute. All state agencies are considered collectively to be a single employer, and the actuarial present value of vested and non-vested accumulated plan benefits attributable to the Lottery's employees is determined as the Lottery's percentage of the State as a single employer. Similarly, the net assets available for benefits of Lottery employees is determined as the Lottery's percentage of the State. CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. CalPERS' annual financial report may be obtained by writing to the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, CA 94229 or by visiting the CalPERS web site at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov).

Generally, full-time employees are eligible to participate as members of CalPERS and are eligible to retire at age 50 with at least five years of service or age 55 with at least ten years of service, depending on the plan selected by the employee. Employees hired after January 1, 2013, must be at least age 52 to retire. Annual retirement benefits are determined based on age at retirement, the length of membership service, and the amount of earnings based on the highest or last 12 or 36 consecutive months' average. Health care and dental benefits may be provided to members depending on the date hired and the years of credited service of a member. If members are not fully vested, the health care and dental contributions are prorated based on the years of service.

**CALIFORNIA STATE LOTTERY FUND  
NOTES TO FINANCIAL STATEMENTS  
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**10. RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS (continued)**

**Contributions**

Section 20814(c) of the California Public Employees' Retirement Law (PERL) requires that the employer contribution rates for all public employers are determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through the CalPERS' annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of employees.

For the measurement period ended June 30, 2015, the average active employee contribution rate for the Miscellaneous Plan is 6.587 percent of annual pay, and the employer's contribution rate is 24.265 percent of annual payroll; for the Peace Officers/Firefighters Plan, the average active employee contribution rate is 11.498 percent of annual pay, and the employer's contribution rate is 36.780 percent of annual payroll. These rates reflect PERL Section 20683.2, which mandates that certain employees contribute more as of July 1, 2013. Furthermore, any reduction in employer contributions due to the increase in the employee contributions must be paid by the employer towards the unfunded liability. It is the responsibility of the employer to make necessary accounting adjustments to reflect the impact due to any employer-paid member contributions or situations where members are paying a portion of the employer contribution.

**Discount Rate**

In preparation for implementing GASB 68, CalPERS prepared the GASB 68 Accounting Valuation Reports for the State of California for the eight plans in which the State participates. CalPERS utilized a discount rate of 7.65 percent, which includes the plans' administrative expenses. The State Controller's Office (SCO) used a calculated percentage based on the Lottery's share of the pensionable compensation to the State's total pensionable compensation amounts for each plan in which the Lottery participates, to provide the Lottery's net pension liability and related GASB 68 accounting elements. The Lottery's calculated percentages were 0.33587 percent for the State Miscellaneous Plan and 0.08278 percent for the State Peace Officers/Firefighters Plan.

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

At the start of the measurement period, July 1, 2014, the Lottery's net pension liability was \$80.7 million. Due to the change in the Lottery's calculated percentage of pensionable compensation for each plan since the prior measurement date, the Lottery recognized an adjustment to the beginning net pension liability and the beginning deferred inflows of resources. The adjustment resulted in an increase in net pension liability of approximately \$7.7 million and an increase in deferred inflows of resources of approximately \$1.5 million, recognized as deferred outflows of resources and amortized to pension expense over the expected average remaining service life of the plans, as shown below.

For the year ended June 30:	Pension expense
2016	\$ 2,435,317
2017	2,435,317
2018	2,435,317
2019	1,948,254
Total	<u>\$ 9,254,205</u>



**CALIFORNIA STATE LOTTERY FUND  
NOTES TO FINANCIAL STATEMENTS  
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**10. RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS (continued)**

**Pension Liabilities, Pension Expense, and Deferred Outflows and Deferred Inflows of Resources Related to Pensions (continued)**

In the current year, this adjustment resulted in an increase to pension expense of \$2.4 million. In addition, for the measurement period ending June 30, 2015 (the measurement date), the Lottery incurred a pension expense of \$8.8 million, recognized in the current year. The Lottery's total pension expense as of June 30, 2016, was \$11.2 million.

After adjusting the beginning balances, the Lottery's net pension liability for the Miscellaneous Plan increased \$14.9 million during the measurement period (MP) to \$94.8 million, and the Lottery's net pension liability for the Peace Officers/Firefighters Plan increased \$1.5 million during the MP to \$9.7 million. As of June 30, 2016, the Lottery recognized a total net pension liability of \$104.5 million.

As of the measurement date of June 30, 2015, the California Lottery Fund had deferred outflows and deferred inflows of resources related to pensions as follows:

Deferred outflows of resources	Miscellaneous Plan	Peace Officers/ Firefighters Plan	Total
Pension contributions made subsequent to the measurement date	\$ 10,371,960	\$ 1,009,587	\$ 11,381,547
Change in proportionate share	6,818,888	-	6,818,888
Net difference between projected and actual earnings on pension plan investments	1,732,377	192,012	1,924,389
Total	<u>\$ 18,923,225</u>	<u>\$ 1,201,599</u>	<u>\$ 20,124,824</u>

Deferred inflows of resources	Miscellaneous Plan	Peace Officers/ Firefighters Plan	Total
Change in proportionate share	\$ (1,526,145)	\$ 12,024	\$ (1,514,121)
Net difference between projected and actual earnings on pension plan investments	(544,535)	(189,145)	(733,680)
Total	<u>\$ (2,070,680)</u>	<u>\$ (177,121)</u>	<u>\$ (2,247,801)</u>

Exclusive of deferred outflows related to payments after the measurement date, the net amount of deferred outflows (inflows) of resources related to pensions that will be recognized in pension expense during the next five years and thereafter is as follows:

Measurement Period Ended June 30:	Miscellaneous Plan	Peace Officers/ Firefighters Plan	Total
2016	\$ 1,528,023	\$ (90,086)	\$ 1,437,937
2017	1,528,023	(90,576)	1,437,447
2018	981,222	(90,576)	890,646
2019	2,443,317	281,446	2,724,763
2020	-	4,683	4,683
Thereafter	-	-	-
Total	<u>\$ 6,480,585</u>	<u>\$ 14,891</u>	<u>\$ 6,495,476</u>



**CALIFORNIA STATE LOTTERY FUND**  
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**10. RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS (continued)**

**Actuarial Methods and Assumptions Used to Determine Total Pension Liability**

For the measurement period ended June 30, 2015, the total pension liability was determined by rolling forward the June 30, 2014, total pension liability. The June 30, 2014, and the June 30, 2015, total pension liabilities were based on the following actuarial methods and assumptions:

Actuarial Cost Method:	Entry Age Normal in accordance with the requirements of GASB Statement No. 68.
Amortization Method/Period:	For details, see June 30, 2013, Funding Valuation Report.
Asset Valuation Method:	Actuarial Value of Assets. For details, see June 30, 2013, Funding Valuation Report.
Inflation:	2.75 %
Salary Increases:	Varies by entry age and service.
Payroll Growth:	3.00 %
Investment Rate of Return:	7.50 %, net of pension plan investment and administrative expenses; includes inflation.
Retirement Age:	The probabilities of retirement are based on the 2014 CalPERS Experience Study for the period from 1997 to 2011.
Mortality Rate Table:	The probabilities of mortality are based on the 2014 CalPERS Experience Study for the period from 1997 to 2011. Pre-retirement and post-retirement mortality rates include 20 years of projected mortality improvement using Scale BB published by the Society of Actuaries.
Post Retirement Benefit Increase:	Contract cost of living adjustment up to 2.75 % until purchasing power protection allowance floor on purchasing power applies.

The Mortality Rate Table used was developed based on CalPERS specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on the Mortality Rate Table, please refer to the 2014 CalPERS Experience Study.

All other actuarial assumptions used in the June 30, 2014, valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality, and retirement rates. The Experience Study report can be obtained at CalPERS' website under Forms and Publications.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS' staff took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

**CALIFORNIA STATE LOTTERY FUND  
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**10. RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS (continued)**

**Actuarial Methods and Assumptions Used to Determine Total Pension Liability (continued)**

The table below reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. An expected inflation rate of 2.5 percent was used for real return years 1-10. For real return years 11+, an inflation rate of 3 percent was used. These geometric rates of return are net of administrative expenses.

Asset Class	New Strategic Allocation	Real Return Years 1 - 10	Real Return Years 11+
Global equity	51.00 %	5.25 %	5.71 %
Global fixed income	19.00 %	0.99 %	2.43 %
Inflation sensitive	6.00 %	0.45 %	3.36 %
Private equity	10.00 %	6.83 %	6.95 %
Real estate	10.00 %	4.50 %	5.13 %
Infrastructure and forestland	2.00 %	4.50 %	5.09 %
Liquidity	2.00 %	(0.55 %)	(1.05 %)
Total	100.00 %		

**Sensitivity of the Net Pension Liability to Changes in the Discount Rate**

The following presents the net pension liability of the California Lottery Fund as of June 30, 2015, calculated using the discount rate of 7.65 percent, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65 percent) or 1 percentage-point higher (8.65 percent) than the current rate:

	Discount Rate - 1 % (6.65 %)	Current Discount Rate (7.65 %)	Discount Rate + 1 % (8.65 %)
Miscellaneous Plan	\$ 133,972,866	\$ 94,857,230	\$ 62,039,239
Peace Officers/Firefighters Plan	14,119,694	9,663,999	6,009,713
Total	<u>\$ 148,092,560</u>	<u>\$ 104,521,229</u>	<u>\$ 68,048,952</u>

**Pension Plan Fiduciary Net Position**

Each plan's fiduciary net position disclosed in the accounting valuation report provided by CalPERS may differ from the plan's assets reported in the funding actuarial valuation report due to several reasons; the accounting valuation report must keep items such as deficiency reserves, fiduciary self-insurance, and other postemployment benefits expenses included as assets. These amounts are excluded for rate setting purposes in the funding actuarial valuation report.

**CALIFORNIA STATE LOTTERY FUND  
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**10. RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS (continued)**

**Other Postemployment Benefits**

Post-retirement health care benefits are also provided to Lottery employees through the programs sponsored by the State as administered by CalPERS and the California Department of Human Resources (CalHR). As the post-retirement health care plan is sponsored by the State it is considered a single-employer plan. The Lottery is considered a department of the State. The total other postemployment benefits (OPEB) actuarial accrued liability is reported at the State level.

Health care and dental benefits may be provided to members depending on the date hired and the member's years of credited service. Post-retirement health benefits include medical, prescription drug, and dental benefits, and are currently funded on a pay-as-you-go basis. Employer contributions for health premiums during the 2015-16 fiscal year maintained the 100/90 percent contribution formula established by Government Code. Under this formula, the State uses 100 percent of the weighted average premiums of the four largest health benefit plans in order to calculate the maximum amount the State will contribute toward the retiree's health benefits. The State also contributes 90 percent of this average for the health benefits of each of the retiree's dependents. The retiree is responsible for paying all health benefit plan costs that exceed the average of the four largest benefit plans. The monthly estimated contribution is \$705 for a single enrollee, \$1,343 for an enrollee and one dependent, and \$1,727 for an enrollee and two or more dependents. Dental care premiums vary by plan and number of dependents. The contribution formulas are subject to approval and amendment by the State Legislature. If members are not fully vested, the health care and dental contributions are prorated based on the years of service.

The Lottery paid approximately \$4.9 million for post-retirement health and dental benefits for retired members for the year ended June 30, 2016. The Lottery adopted GASB 45 during the 2007-08 fiscal year. GASB 45 was implemented prospectively and the Lottery had a zero net OPEB obligation (NOO) upon adoption. The Lottery's annual OPEB cost (AOC) is calculated based on the annual required contribution (ARC). The AOC recorded by the Lottery is calculated by the primary government and represents an allocation of the total ARC of the State, adjusted for interest and other adjustments. The allocation is based on the Lottery's retiree health benefit costs in relation to the total State retiree health benefit costs. The ARC represents the normal cost plus an amortization of the difference between the actuarial accrued liability and any assets available to pay benefits. For the year ended June 30, 2016, the Lottery's ARC was \$14,372,000 and the Lottery's AOC was \$14,546,000. The total NOO liability recorded as of June 30, 2016, is \$58,564,000. The following table shows the components of the Lottery's AOC, the amount actually contributed to the plan and the NOO as of and for the year ended June 30, 2016, and the previous two fiscal years.

Net OPEB obligation (NOO), July 1, 2013	\$ 33,788,000
Allocated annual OPEB cost (AOC)	11,346,000
Fund allocated contributions	<u>(4,020,000)</u>
Net OPEB obligation (NOO), July 1, 2014	41,114,000
Allocated annual OPEB cost (AOC)	12,904,000
Fund allocated contributions	<u>(4,872,000)</u>
Net OPEB obligation (NOO), July 1, 2015	49,146,000
Allocated annual OPEB cost (AOC)	14,546,000
Fund allocated contributions	<u>(5,128,000)</u>
Net OPEB obligation (NOO), June 30, 2016	<u>\$ 58,564,000</u>

**CALIFORNIA STATE LOTTERY FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
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**10. RETIREMENT PLAN AND OTHER POSTEMPLOYMENT BENEFITS (continued)**

**Other Postemployment Benefits (continued)**

The actuarial valuation report for OPEB may be obtained by writing to the Office of State Controller Betty T. Yee, P.O. Box 942850, Sacramento, CA 94250, or by visiting the State Controller's Web site at [www.SCO.ca.gov](http://www.SCO.ca.gov). The Lottery's ARC, AOC, and NOO are calculated and adjusted for on an annual basis.

**11. COMMITMENTS AND CONTINGENCIES**

A contract has been awarded to IGT (formerly GTECH) that includes both gaming and telecommunication systems and services. The Lottery pays a fee of 1.36 percent of sales up to \$4 billion, 1.20 percent of sales over \$4 billion and up to \$5 billion, and 1.10 percent of sales over \$5 billion in one year. The original contract ran through October 13, 2009, and had a total estimated cost of \$300 million. A series of contract extensions were awarded. The latest, signed by the Director of the Lottery in September 2010, extends the contract to October 13, 2019, and includes a complete upgrade of the gaming system. The total contract expenditure is not to exceed \$1.075 billion. Approximately \$831.7 million in fees have been incurred under the contract as of June 30, 2016.

The Lottery has been named as a defendant in various lawsuits and claims. Legal counsel has determined that it is probable that one of these claims may be settled in favor of the plaintiff. As a result, a legal contingency of \$1.35 million has been recorded in the accompanying statement of net position.

**12. RISK MANAGEMENT**

Since its inception, the Lottery has been primarily self-insured for risks such as flood, business interruption, theft, employee errors and omissions, and other potential liabilities. Losses are recognized when conditions for accrual are met.

The Lottery has purchased property insurance for its owned facilities, including its headquarters building and central utility plant, its Sacramento District Office, and its Northern Distribution Center, and thereby has transferred the risk of loss due to a catastrophic event from the Lottery to the insurance carrier. The Lottery has purchased automobile insurance for its fleet of vehicles through the California Department of General Services, Office of Risk & Insurance Management.

Liabilities for workers' compensation costs are accrued based on estimates derived from the State Compensation Insurance Fund. This estimate is based on actuarial reviews of the employee workers' compensation program and includes indemnity payments, compensation benefits, and leave benefits. The liability for workers' compensation claims is not material to the financial statements taken as a whole.

**13. SUBSEQUENT EVENTS**

The Lottery has evaluated subsequent events from the statement of net position date through December 19, 2016, the date at which financial statements were available to be issued, and determined that there are no other items to disclose.