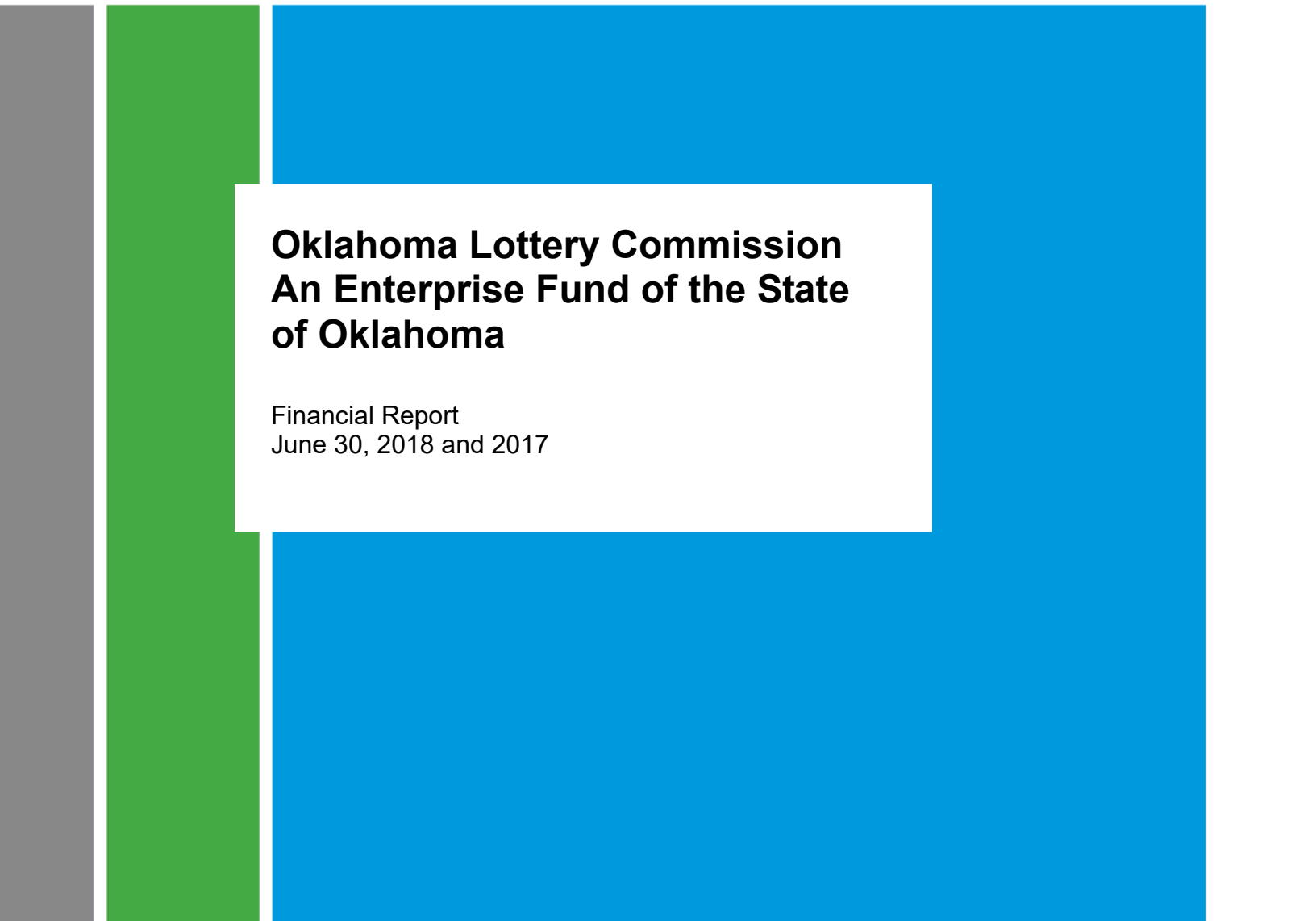




Oklahoma Lottery Commission An Enterprise Fund of the State of Oklahoma

Financial Report
June 30, 2018 and 2017

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Independent Auditor's Report

To the Board of Trustees
Oklahoma Lottery Commission
An Enterprise Fund of the State of Oklahoma

Report on the Financial Statements

We have audited the accompanying financial statements of the Oklahoma Lottery Commission (the OLC), an enterprise fund of the State of Oklahoma, as of and for the years ended June 30, 2018 and 2017; and the related notes to the financial statements, which collectively comprise the OLC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Oklahoma Lottery Commission as of June 30, 2018 and 2017, and the respective changes in financial position, and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 of the financial statements, the financial statements present only OLC and do not purport to, and do not, present fairly the financial position of the State of Oklahoma, as of June 30, 2018 and 2017, the changes in its financial position, or, where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters*Required Supplementary Information*

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 17, 2018 on our consideration of the OLC'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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the OLC's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the OLC's internal control over financial reporting and compliance.

RSM US LLP

Oklahoma City, Oklahoma
September 17, 2018

**Oklahoma Lottery Commission
An Enterprise Fund of the State of Oklahoma**

**Management's Discussion and Analysis
June 30, 2018 and 2017**

Management of the Oklahoma Lottery Commission (the OLC) provides this management's discussion and analysis of their financial performance for the readers of the OLC's financial statements. This narrative provides an overview of the OLC's financial activity for the fiscal years ended June 30, 2018 and 2017. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the OLC's financial activities based on facts, decisions and conditions currently facing management.

Understanding the OLC's Financial Statements

The OLC, an instrumentality of the State of Oklahoma, is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this Management's Discussion and Analysis and are designed to highlight the OLC's net position and changes to its net position resulting from the OLC's operations.

The most important relationship demonstrated within the OLC's financial statements is the requirement that the OLC transfer all net proceeds, "as defined," to the State Treasurer for the Oklahoma Education Lottery Trust Fund (OELTF). Accordingly, a significant focus of these financial statements is determining net proceeds available for transfer to the OELTF.

The OLC is also required to transfer annually the first \$750,000, for both 2018 and 2017, of unclaimed prize money to the Oklahoma Department of Mental Health and Substance Abuse Services (ODMHSAS). This is discussed further on page 6 of the management's discussion and analysis.

Financial and Activity Highlights

Revenues from lottery games totaled \$221,110,396 and \$151,502,503, respectively, for the fiscal years ended June 30, 2018 and 2017. The OLC returned \$129,610,748 and \$73,342,027 to winners of lottery games; paid commissions and incentives to retailers totaling \$14,039,604 and \$10,042,954; incurred other game-related expenses of \$10,819,307 and \$8,665,829; and had operating expenses of \$6,169,674 and \$4,818,714 for each of the respective fiscal years of 2018 and 2017. The OLC's net position decreased by \$2,975,310 in fiscal year 2017 and increased by \$1,233,807 in fiscal year 2017. Transfers made and due to the OELTF were \$63,229,605 and \$53,063,688, respectively, for fiscal years ended June 30, 2018 and 2017.

Revenues from lottery games totaled \$151,502,503 and \$189,621,594, respectively, for the fiscal years ended June 30, 2017 and 2016. The OLC returned \$73,342,027 and \$95,517,232 to winners of lottery games; paid commissions and incentives to retailers totaling \$10,042,954 and \$12,421,019; incurred other game-related expenses of \$8,665,829 and \$7,985,458; and had operating expenses of \$4,818,714 and \$4,465,112 for each of the respective fiscal years of 2017 and 2016. The OLC's net position increased by \$1,233,807 in fiscal year 2016 and increased by \$2,528,359 in fiscal year 2016 after the cumulative effect of accounting changes. Transfers made and due to the OELTF were \$53,063,688 and \$66,406,789, respectively, for fiscal years ended June 30, 2017 and 2016.

The OLC's investment in capital assets includes machinery, equipment, computers and software. Capital assets, net of accumulated depreciation, at June 30, 2018, were \$101,011, a decrease of \$2,396 from June 30, 2017. Capital assets, net of accumulated depreciation, at June 30, 2017, were \$103,407, an increase of \$30,225 from June 30, 2016. Additional information concerning the OLC's capital assets is contained in Note 4 to the financial statements.

The OLC did not have any long-term debt at June 30, 2018 or 2017.

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Management's Discussion and Analysis
June 30, 2018 and 2017

The following table summarizes the OLC's Statement of Net Position as of June 30:

	2018	2017	2016
Current assets	\$ 37,911,537	\$ 21,932,922	\$ 35,941,023
Noncurrent assets:			
Capital assets, net	101,011	103,407	73,182
Deposit with MUSL	4,491,364	4,435,515	4,615,654
Total assets	<u>\$ 42,503,912</u>	<u>\$ 26,471,844</u>	<u>\$ 40,629,859</u>
Deferred outflows of resources	<u>\$ 476,707</u>	<u>\$ 762,054</u>	<u>\$ 270,957</u>
Current liabilities	\$ 31,658,092	\$ 12,574,752	\$ 27,899,129
Noncurrent liabilities	549,829	954,526	385,097
Total liabilities	<u>\$ 32,207,921</u>	<u>\$ 13,529,278</u>	<u>\$ 28,284,226</u>
Deferred inflows of resources	<u>\$ 89,746</u>	<u>\$ 46,358</u>	<u>\$ 192,135</u>
Net position			
Net position, invested in capital assets	\$ 101,011	\$ 103,407	\$ 73,182
Restricted net position—expendable	10,581,941	13,554,855	12,351,273
Total net position	<u>\$ 10,682,952</u>	<u>\$ 13,658,262</u>	<u>\$ 12,424,455</u>

Net position decreased from fiscal year 2017 to fiscal year 2018 by \$2,975,310. This decrease was primarily attributable due the use of available assets to offset prize liabilities. Prize liabilities (or payouts) were increased significantly in fiscal year 2018 in an attempt to bolster sales. This initiative resulted in a significant increase in instant ticket sales. An amendment to the Oklahoma Education Lottery Act now requires OLC to transfer any remaining net proceeds to the Oklahoma Education Lottery Trust Fund.

Net position increased from fiscal year 2016 to fiscal year 2017. The increase was primarily attributable to an increase in pension-related deferred outflows of resources and a decrease in liabilities partially offset by a decrease in assets. The decrease in assets and liabilities are due to sales decreasing 20 percent from fiscal year 2016 to fiscal year 2017.

Oklahoma Lottery Commission
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Management's Discussion and Analysis
June 30, 2018 and 2017

The following table summarizes the OLC's statement of revenues, expenses, and changes in net position for the years ended June 30:

	2018	2017	2016
Operating revenues:			
Gaming revenues	\$ 221,110,396	\$ 151,502,503	\$ 189,621,594
Other revenues	117,431	105,145	112,090
Total operating revenues	221,227,827	151,607,648	189,733,684
Nonoperating revenue, interest income	415,801	309,357	340,285
Total revenue	\$ 221,643,628	\$ 151,917,005	\$ 190,073,969
Less prize expense	\$ 129,610,748	\$ 73,342,027	\$ 95,517,232
Less retailer commissions/incentives	14,039,604	10,042,940	12,421,019
Less other direct game costs	10,819,307	8,665,829	7,985,458
Less operating expenses	6,169,674	4,818,714	4,465,112
Total expense	160,639,333	96,869,510	120,388,821
Transfers:			
Transfers to ODMHSAS	750,000	750,000	750,000
Transfers to OELTF	63,229,605	53,063,688	66,406,789
Total transfers	63,979,605	53,813,688	67,156,789
Total expense and transfers	\$ 224,618,938	\$ 150,683,198	\$ 187,545,610
Changes in net position	\$ (2,975,310)	\$ 1,233,807	\$ 2,528,359
Net position at beginning of year	13,658,262	12,424,455	9,896,096
Net position at end of year	\$ 10,682,952	\$ 13,658,262	\$ 12,424,455

Sales increased from fiscal year 2017 to fiscal year 2018 fueled by a significant growth in the instant ticket product category. A 2017 legislative change allowed the Oklahoma Lottery to invest more money in prize payouts which resulted in an over 80 percent increase in product sales. Draw sales also saw an increase due to a major price point change for the Mega Millions game (\$1 per ticket changed to \$2 per ticket) and to a significant overhaul of the draw game product portfolio.

Sales decreased from fiscal year 2016 to fiscal year 2017. Online sales during this period decreased mostly because of Power Ball sales. In fiscal year 2017, the OLC had only one jackpot over \$500 million. Powerball sales are significantly down in fiscal year 2017 compared to fiscal year 2016, due to the large jackpot that occurred on January 16, 2016. The jackpot amount reached \$1.59 billion dollars. There was also a decrease in overall scratcher sales from fiscal year 2016 to fiscal year 2017. Due to the fact that the prize payout for Scratch Tickets in Oklahoma is one of the lowest payout rates in the Nation. Scratch ticket sales have continued to decrease.

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**Management's Discussion and Analysis
June 30, 2018 and 2017**

Net proceeds of the OLC must be transferred to the State Treasurer for the OELTF, with the following exceptions: 1) the cost of property and equipment, net of depreciation, and related debt and 2) other assets that cannot be transferred due to statutory or other legal restriction, including restricted cash from unclaimed prizes, deposits with Multi-State Lottery (MUSL), and the Restricted Fidelity Fund. Unclaimed prizes, after required transfers to the Department of Mental Health and Substance Abuse Services, must be added to a pool from which future prizes are awarded or used for special prize promotions. Deposits with MUSL result from a set-aside of prize expenses paid to MUSL and are available for prize reserves and promotional expenses of MUSL games. The Restricted Fidelity Fund is derived from the licensing fees of new retailers, which may be retained by the OLC up to the budgeted expenses from the fund for the next fiscal year plus \$500,000, in 2018 and 2017, and used to cover losses the OLC may experience due to nonfeasance, misfeasance or malfeasance of a lottery retailer and to pay the costs of vendor, retailer and employee background investigations conducted by the Oklahoma State Bureau of Investigation and for audits conducted by the State Auditor and Inspector.

For the years ended June 30, 2018 and 2017, the total transfers made or due to the OELTF related to operations were \$63,229,605 and \$53,063,688, respectively. Since inception to June 30, 2018, total transfers made or due to the OELTF were \$8,868,382,658. For each of the years ended June 30, 2018 and 2017, the OLC transferred \$750,000 in unclaimed prize funds to the Department of Mental Health and Substance Abuse Services for the treatment of compulsive gambling disorders and educational programs related to such disorders. From inception to June 30, 2018, total transfers to the Oklahoma Department of Mental Health and Substance Abuse Services were \$7,294,600.

The following is a condensed version of the OLC's statement of cash flows for the years ended June 30:

	2018	2017	2016
Cash provided by (used in):			
Operating activities	\$ 63,971,632	\$ 51,409,831	\$ 71,403,997
Noncapital financing activities	(52,346,711)	(62,530,117)	(58,257,720)
Capital and related financing activities	(32,073)	(59,766)	(11,978)
Investing activities	391,343	323,201	322,477
Net increase (decrease) in cash	11,984,191	(10,856,851)	13,456,776
Cash at beginning of year	19,401,756	30,258,607	16,801,831
Cash at end of year	<u>\$ 31,385,947</u>	<u>\$ 19,401,756</u>	<u>\$ 30,258,607</u>

Potential Factors Impacting Future Operations

Future operations always have the potential to be impacted by economic factors and rising costs. The OLC strives to maximize the contribution to education, while maintaining new and entertaining games that engage players. In order to meet these goals, the OLC strives to keep costs low and introduce new games regularly. The OLC is always looking for opportunities to participate in new regional and multi-state games. The OLC is also trying to develop new local games to stay up-to-date with player demands.

Contacting the OLC's Financial Management

This financial report is designed to provide a general overview of the OLC's financial activity for all those interested in the OLC's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Executive Director, Oklahoma Lottery Commission, 405-522-7700, 3817 North Santa Fe, Oklahoma City, Oklahoma 73118.

Oklahoma Lottery Commission
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Statements of Net Position
June 30, 2018 and 2017

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 25,025,735	\$ 10,106,881
Cash equivalents—restricted	6,360,212	9,294,875
Retailer accounts receivable	6,173,206	2,008,613
Accounts receivable—Multi-State Lottery	352,384	522,553
Total current assets	37,911,537	21,932,922
Noncurrent assets:		
Capital assets, net	101,011	103,407
Deposit with Multi-State Lottery	4,491,364	4,435,515
Total noncurrent assets	4,592,375	4,538,922
Total assets	\$ 42,503,912	\$ 26,471,844
Deferred outflows of resources:		
Deferred pension plan outflows	\$ 476,707	\$ 762,054
Liabilities		
Current liabilities:		
Due to Oklahoma Education Lottery Trust Fund	\$ 20,914,955	\$ 9,282,061
Due to Multi-State Lottery	1,192,631	1,062,618
Prizes payable	6,256,006	1,365,318
Accounts payable	2,826,206	339,389
Accrued liabilities	302,315	141,994
Unearned revenue	165,979	383,372
Total current liabilities	31,658,092	12,574,752
Noncurrent liabilities:		
Accrued compensated absences	69,844	63,295
Net pension liability	479,985	891,231
Total noncurrent liabilities	549,829	954,526
Total liabilities	\$ 32,207,921	\$ 13,529,278
Deferred inflows of resources:		
Deferred pension plan inflows	\$ 89,746	\$ 46,358
Net position:		
Investment in capital assets	\$ 101,011	\$ 103,407
Restricted net position - expendable:		
Unclaimed prizes	6,090,577	9,119,340
Multi-state lottery	4,491,364	4,435,515
Total net position	\$ 10,682,952	\$ 13,658,262

See notes to financial statements.

Oklahoma Lottery Commission
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Statements of Revenues, Expenses, and Changes in Net Position
Years Ended June 30, 2018 and 2017

	2018	2017
Operating revenues:		
Scratcher games	\$ 127,627,940	\$ 67,988,294
Pick 3 game	5,302,479	5,354,850
Cash 5 game	4,021,953	3,955,690
Poker Pick game	656,613	1,174,623
Lucky for Life game	1,985,662	-
Hot Lotto game	4,202,896	8,450,755
Lotto America	4,976,458	-
Mega Millions game	22,786,249	18,238,718
Powerball game	49,550,146	46,339,573
Total revenue from the sale of lottery tickets	221,110,396	151,502,503
Retailer application fees	111,740	100,595
Other	5,691	4,550
Total operating revenues	221,227,827	151,607,648
Direct costs:		
Prize expense:		
Scratcher games	82,973,686	36,133,704
Pick 3 game	2,605,230	2,509,110
Cash 5 game	1,947,064	1,818,841
Poker Pick game	334,475	563,300
Lucky for Life game	1,102,030	-
Hot Lotto game	1,833,990	4,152,268
Lotto America	2,386,544	-
Mega Millions game	11,403,738	8,768,703
Powerball game	25,023,991	19,396,101
Total prize expense	129,610,748	73,342,027
Commissions and incentives to retailers	14,039,604	10,042,940
Instant and online costs	10,819,307	8,665,829
Total direct costs	154,469,659	92,050,796
Gross profit	66,758,168	59,556,852
Operating expenses:		
Advertising and promotion	3,134,817	2,004,465
Salaries, wages and benefits	2,513,040	2,363,518
Contracted and professional services	202,902	166,427
Depreciation	34,469	29,541
Equipment	15,748	18,364
Rent expense	149,179	144,705
Office supplies	22,875	23,403
Travel	13,193	9,745
Other general and administrative	83,451	58,546
Total operating expenses	6,169,674	4,818,714
Operating income	60,588,494	54,738,138

(Continued)

Oklahoma Lottery Commission
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Statements of Revenues, Expenses, and Changes in Net Position (Continued)
Years Ended June 30, 2018 and 2017

	2018	2017
Nonoperating income, interest income	<u>\$ 415,801</u>	<u>\$ 309,357</u>
Change in net position before transfers	61,004,295	55,047,495
Transfers:		
Required payments to Oklahoma Department of Mental Health and Substance Abuse Services	(750,000)	(750,000)
Required payments to and due to Oklahoma Education Lottery Trust Fund	<u>(63,229,605)</u>	<u>(53,063,688)</u>
Total transfers	<u>(63,979,605)</u>	<u>(53,813,688)</u>
Changes in net position	(2,975,310)	1,233,807
Net position at beginning of year	<u>13,658,262</u>	12,424,455
Net position at end of year	<u><u>\$ 10,682,952</u></u>	<u><u>\$ 13,658,262</u></u>

See notes to financial statements.

Oklahoma Lottery Commission
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Statements of Cash Flows
Years Ended June 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from retailers	\$ 203,180,462	\$ 144,402,085
Cash payments to prize winners	(124,590,047)	(79,515,441)
Cash payments to suppliers for goods and services	(12,134,253)	(11,201,694)
Cash payments to employees for services	(2,428,681)	(2,455,258)
Cash receipts to fund deposit with Multi-State Lottery	(55,849)	180,139
Net cash provided by operating activities	63,971,632	51,409,831
Cash flows from noncapital financing activities:		
Payments to Oklahoma Department of Mental Health and Substance Abuse Services	(750,000)	(750,000)
Payments to Oklahoma Education Lottery Trust Fund	(51,596,711)	(61,780,117)
Net cash used in noncapital financing activities	(52,346,711)	(62,530,117)
Cash flows from capital and related financing activities, purchase of capital assets	(32,073)	(59,766)
Cash flows from investing activities, interest received	391,343	323,201
Net change in cash and cash equivalents	11,984,191	(10,856,851)
Cash and cash equivalents at beginning of year	19,401,756	30,258,607
Cash and cash equivalents at end of year	<u>\$ 31,385,947</u>	<u>\$ 19,401,756</u>
Operating activities:		
Operating income	\$ 60,588,494	\$ 54,738,138
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation	34,469	29,541
Bad-debt expense	36,230	569
Changes in operating assets, deferred outflows, liabilities and deferred inflows:		
Retailer accounts receivable	(4,176,365)	3,152,713
Accounts receivable—Multi-State Lottery	170,169	(15,876)
Deposit with Multi-State Lottery	(55,849)	180,139
Deferred pension plan outflows	285,347	(491,097)
Due to Multi-State Lottery	130,013	(364,588)
Accounts payable and accrued liabilities	2,653,687	(315,201)
Prizes payable	4,890,688	(5,808,826)
Net pension liability	(411,246)	575,258
Unearned revenue	(217,393)	(125,162)
Deferred pension plan inflows	43,388	(145,777)
Net cash provided by operating activities	\$ 63,971,632	\$ 51,409,831

See notes to financial statements.

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 1. Reporting Entity

The Oklahoma Lottery Commission (the OLC), was formed by the citizens of Oklahoma upon passage of a legislative referendum authorizing the Oklahoma Education Lottery Act (the Act), codified as Title 3A, Section 701, et. seq., of the Oklahoma Statutes. The OLC is an enterprise fund of the State of Oklahoma (the State) responsible for administering lotteries in accordance with the Act. The Act established a board of seven trustees appointed by the governor to oversee operations of the OLC. The OLC transfers net proceeds as defined by the Act.

Note 2. Significant Accounting Policies

Method of accounting: The OLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the costs of providing lottery games to the general public on a continuing basis are to be financed through the sale of lottery game tickets. The Act requires that all costs of providing lottery games, including capital costs, be recovered from the sale of lottery game tickets.

The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for accounting principles generally accepted applicable to governmental proprietary activities in the United States of America. The OLC applies all applicable GASB pronouncements.

Basis of accounting: The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when they are earned, and expenses are recognized when they are incurred.

The primary operating revenue of the OLC is ticket sales from games. Nonoperating income primarily consists of interest income. "Operating expenses" are defined under the Act as "all costs of doing business, including but not limited to prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, amounts held in or paid from the Fidelity Revolving Fund pursuant to Section 20 of this Act, debt service payments for the payment of initial expenses of start-up, administration and operation of the OLC and other operating costs." The transfers are statutory required transfers to the Oklahoma Education Lottery Trust Fund (OELTF) and the Oklahoma Department of Mental Health and Substance Abuse Services.

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 financial statements and accompanying notes. Actual results could differ from those estimates.

Revenue recognition: Revenue for Pick 3, Cash 5, Poker Pick, Lucky for Life, Hot Lotto, Lotto America, Mega Millions, and Powerball (collectively referred to as online games) is recognized when tickets are sold to the public by contracted retailers, except for tickets sold in advance of the draw date for which unearned revenue is recorded. Revenue for scratcher games is recognized upon activation of ticket packs for sale by the retailers.

Every scratcher ticket game has a predetermined number of free tickets in its prize structure. Revenue and prize expense are shown net of free tickets.

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 2. Significant Accounting Policies (Continued)

Commissions: Retailers receive a 6 percent commission on total sales and 0.75 percent commission on prizes cashed.

Prizes: Prize expense for scratcher ticket games is recorded at the time the related revenue is recognized based on the predetermined prize structure for each game; periodically, the prize expense is adjusted for unclaimed prizes. Prize expense for online games is recorded at the time the related revenue is recognized based on the known prizes.

Unclaimed prizes: Prizes must be claimed within 90 days after the game-end (end of sales) for scratcher games and within 180 days after the draw date for online games. The first \$750,000 for fiscal year 2018 and 2017 of unclaimed prize money accruing annually must be transferred to the Oklahoma Department of Mental Health and Substance Abuse Services for the treatment of compulsive gambling disorders and educational programs related to such disorders.

In accordance with Section 724 of the Act, unclaimed prizes are added to a pool from which future prizes are awarded or used for special prize promotions. Under the Act, unclaimed prizes do not constitute net lottery proceeds and are restricted funds that are not available for transfer to the OELTF. Total unclaimed prizes amounted to \$2,774,690 and \$6,935,663 for fiscal years 2018 and 2017, respectively. Unclaimed prizes are netted against prize expense in the statement of revenues, expenses, and changes in net position.

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 fiduciary net position of the Oklahoma Public Retirement System (OPERS) and additions to/deductions from OPERS and fiduciary net position have been determined on the same basis as they are reported by OPERS. 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 inflows of resources: Deferred inflows of resources are the acquisition of net position by the OLC that are applicable to a future reporting period. At June 30, 2018 and 2017, the OLC had deferred inflows of resources of \$89,746 and \$46,358, respectively. See Note 8 for additional discussion regarding deferred inflows of resources.

Deferred outflows of resources: Deferred outflows of resources are the consumption of net position by the OLC that are applicable to a future reporting period. At June 30, 2018 and 2017, the OLC had deferred outflows of resources of \$476,707 and \$762,054, respectively. See Note 8 for additional discussion regarding deferred outflows of resources.

Net position: The OLC's net position is classified as follows.

Investment in capital assets: This represents the OLC's total investment in capital assets.

Restricted net position, expendable: Net position not invested in capital is restricted by state statute. Restricted net position consists primarily of cash maintained in the OLC's restricted fidelity fund, deposits with the Multi-State Lottery (MUSL), and balance of unclaimed prizes to be used on future prizes or special prize promotions.

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 2. Significant Accounting Policies (Continued)

Gross proceeds: Gross proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games.

Operating expenses: Operating expenses, as defined by the Act, in the determination of net proceeds, consist of all costs of doing business including, but not limited to, prizes, commissions, and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of property and equipment, and other operating costs.

Cash and cash equivalents: The OLC's cash and cash equivalents are considered to be cash on hand and on an interest in an internal investment pool held by the Oklahoma State Treasurer.

Retailer accounts receivable: Retailer accounts receivable represents lottery proceeds due from retailers for online ticket sales and activated ticket packs for scratcher games, less commissions due to retailers and prizes paid by the retailers. Lottery proceeds are collected weekly by the OLC from retailer trust accounts established in trust for benefit of the OLC.

Capital assets, net: Capital assets, which consist of machinery, equipment, computers and software, are stated at cost less accumulated depreciation. The OLC capitalizes all property and equipment purchases of \$500 or more. Depreciation is computed using the straight-line method over the following estimated useful lives: machinery and equipment—five to ten years; computers and software—three to five years. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

Restricted cash: In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a retailer for the OLC. The fund is used to cover losses the OLC may incur due to misfeasance, nonfeasance, or malfeasance of retailers and to contract for investigations, reviews, or audits. At the end of any fiscal year, the OLC must transfer to the OELTF any amount in the restricted fidelity fund which exceeds the budgeted expenses from the fund for the next fiscal year plus \$500,000 for both fiscal years 2018 and 2017. At June 30, 2018 and 2017, no amounts were available for transfer as net proceeds. During fiscal years 2018 and 2017, \$73,777 and \$111,266, respectively, was used to reimburse the OLC for retailer accounts that were delinquent and in collection status and for the retailer application fees. Receipts from retailers in collection status are deposited back to the fidelity fund. The fidelity fund is held in a separate account. As of June 30, 2018 and 2017, the balance in the fidelity fund totaled \$233,734 and \$193,087, respectively and is included in the accompanying statement of net position with cash equivalents restricted and expendable restricted net position.

Current unclaimed prizes in excess of \$750,000 for both fiscal years 2018 and 2017, and the balance from prior years are included in cash equivalents restricted and expendable restricted net position in the accompanying statement of net position. These funds are to be utilized to enhance future OLC prizes or promotions and totaled \$6,126,478 and \$9,101,788 as of June 30, 2018 and 2017, respectively.

Risk management: The OLC is exposed to various risks of loss related to torts, destruction of assets due to theft or damage, errors and omissions, injuries to employees, and natural disasters. The OLC has coverage that substantially covers these risks through a self-insured pool for agencies of the State of Oklahoma. This coverage is administered by the Risk Management Division of the Department of Central Services for the State of Oklahoma.

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Notes to Financial Statements

Note 2. Significant Accounting Policies (Continued)

Compensated absences: Employees earn the right to be compensated during absences for vacation and compensatory time. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and compensatory time is accrued in the period in which it is earned.

Bad-debt expense: The OLC recognizes bad-debt expense when retailer account receivables are greater than 90 days old. The accounts receivable balance due to the OLC is satisfied at that time by a transfer of funds from the restricted fidelity fund. The OLC may continue its effort to collect these accounts. Any collection from a retailer balance previously charged to bad-debt expense will be deposited back to the restricted fidelity fund. For the years ended June 30, 2018 and 2017, bad-debt expense was \$36,230 and \$569, respectively.

New accounting pronouncements issued not yet adopted: The GASB has issued a new accounting pronouncement which will be effective to OLC in fiscal year ended June 30, 2021. OLC is currently evaluating the impact that this new standard will have on its financial statements. A description of the new accounting pronouncement is described below:

- GASB Statement No. 87, issued June 2017, establishes a single approach to accounting for and reporting leases by state and local governments. Under this statement, a government entity that is a lessee must recognize (1) a lease liability and (2) an intangible asset representing the lessee's right to use the leased asset. In addition, the Commission must report the (1) amortization expense for using the lease asset over the shorter of the term of the lease or the useful life of the underlying asset, (2) interest expense on the lease liability and (3) note disclosures about the lease. The Statement provides exceptions from the single-approach for short-term leases, financial purchases, leases of assets that are investments, and certain regulated leases. This statement also addresses accounting for lease terminations and modifications, sale-leaseback transactions, non-lease components embedded in lease contracts (such as service agreements), and leases with related parties.

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Notes to Financial Statements

Note 3. Cash and Cash Equivalents

The OLC's investment in OK INVEST is carried at \$31,385,947 and \$19,401,756 at June 30, 2018 and 2017, respectively. Cash equivalents are recorded at cost. The OLC obtained the fair value from the State Treasurer of their interest in the pool, which amounted to \$31,429,944 and \$19,475,037 at June 30, 2018 and 2017, respectively. Management believes the difference between cost and fair value is immaterial to the financial statements as a whole due to the short duration of investments held by the pool and information provided by the State.

Agencies and funds that are considered to be part of the State's reporting entity in the State's Comprehensive Annual Financial Report are allowed to participate in OK INVEST. Oklahoma statutes and the State Treasurer establish the primary objectives and guidelines governing the investment of funds in OK INVEST. Safety, liquidity, and return on investment are the objectives that establish the framework for the day-to-day OK INVEST management, with an emphasis on safety of the capital and the probable income to be derived and meeting the State and its funds' and agencies' daily cash flow requirements. Guidelines in the Investment Policy address credit quality requirements, diversification percentages and the types and maturities of allowable investments. The specifics regarding these policies can be found on the State Treasurer's website at <http://www.ok.gov/treasurer>. The State Treasurer, at his discretion, may further limit or restrict such investments on a day-to-day basis. OK INVEST includes a substantial investment in securities with an overnight maturity as well as in U.S. government securities with a maturity of up to three years. OK INVEST maintains an overall weighted average maturity of less than four years.

Participants in OK INVEST maintain interest in its underlying investments and, accordingly, may be exposed to certain risks. As stated in the State Treasurer information statement, the main risks are interest rate risk, credit/ default risk, liquidity risk, and U.S. government securities risk. Interest rate risk is the risk that during periods of rising interest rates, the yield and market value of the securities will tend to be lower than prevailing market rates; in periods of falling interest rates, the yield will tend to be higher.

Custodial credit risk of investments is the risk that in the event of a bank failure, the government's investments may not be returned to it. OK INVEST is not insured or guaranteed by the State, the FDIC, or any other government agency.

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 4. Capital Assets, Net

The following is a summary of changes in capital assets and accumulated depreciation during the years ended June 30, 2018 and 2017:

Capital Assets	Year Ended June 30, 2018			
	Beginning Balance	Additions	Deletions	Ending Balance
Machinery and equipment	\$ 927,348	\$ 32,073	\$ -	\$ 959,421
Computers and software	409,567	-	-	409,567
	1,336,915	32,073	-	1,368,988
Accumulated depreciation:				
Machinery and equipment	824,616	33,794	-	858,410
Computers and software	408,892	675	-	409,567
	1,233,508	34,469	-	1,267,977
Total capital assets, net	\$ 103,407	\$ (2,396)	\$ -	\$ 101,011

Capital Assets	Year Ended June 30, 2017			
	Beginning Balance	Additions	Deletions	Ending Balance
Machinery and equipment	\$ 867,582	\$ 59,766	\$ -	\$ 927,348
Computers and software	409,567	-	-	409,567
	1,277,149	59,766	-	1,336,915
Accumulated depreciation:				
Machinery and equipment	796,949	27,667	-	824,616
Computers and software	407,018	1,874	-	408,892
	1,203,967	29,541	-	1,233,508
Total capital assets, net	\$ 73,182	\$ 30,225	\$ -	\$ 103,407

Note 5. Compensated Absences

The current portion of accrued compensated absences is included in accrued liabilities in the accompanying statements of net position. The following is a summary of changes in the OLC's liability for compensated absences during the year ended June 30:

	Beginning Balance	Additions	Deletions	Ending Balance	Current Portion
Compensated absences 2018	\$ 189,883	\$ 60,155	\$ 40,506	\$ 209,533	\$ 139,689
Compensated absences 2017	\$ 207,370	\$ 116,973	\$ 134,460	\$ 189,883	\$ 126,588

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Notes to Financial Statements

Note 6. Operating Leases

The OLC has entered into various operating leases for office space and equipment used in its daily operations. Pursuant to Oklahoma State Statutes, the OLC's operating leases are limited to terms of one year and must be renewed annually. Accordingly, the OLC has no long-term commitments under the operating leases as of June 30, 2018 or 2017. Rent expense under all operating leases was \$149,179 and \$144,705 for the years ended June 30, 2018 and 2017, respectively.

Note 7. Education Lottery Account

In accordance with the Act, all net proceeds of the OLC are transferred to the Education Lottery Account. Net proceeds consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games, less operating expenses and prizes. OLC estimates that net proceeds will approximate 35 percent of total revenue. Each month, OLC transfers the amounts necessary to satisfy appropriations made by the Legislature to Higher Education and Common Education. Each quarter, OLC transfers amounts to cover the appropriations to Career Tech, Teachers' Retirement and the Voluntary School Consolidation Fund. OLC transfers the remaining 35 percent of revenues plus any additional profits, unless specifically exempted by statute, at the end of the year. During the year ended June 30, 2018, the Act was amended. The OLC is now required to transfer to the Oklahoma Education Lottery Trust Fund the first \$50 million of net proceeds. All remaining net proceeds remaining will be transferred as well.

According to the Act, amounts transferred to the OELTF are to be appropriated by the legislature to education programs according to the parameters established in the Act. Following is an executive summary of these statutory provisions. For the full text, see Title 3A, Section 713 of the Oklahoma Statutes, available on the OLC website.

5 percent	Teachers' Retirement System Dedicated Revenue Revolving Fund
5 percent	School Consolidation and Assistance Fund (SCAF): If the SCAF equals \$5,000,000, this 5 percent will be allocated to public schools to purchase technology equipment to conduct on-line testing
45 percent	Kindergarten through twelfth grade public education, including compensation and benefits for public school teachers and support employees, and early childhood development programs
45 percent	Tuition grants, loans, and scholarships to citizens of this state for attending colleges and universities located within this state or to attend Oklahoma Department of Career and Technology Education institutions; construction of educational facilities or capital outlay projects or technology for elementary school districts, independent school districts, the Oklahoma State System of Higher Education, and career and technology education; endowed chairs for professors at institutions of higher education operated by the Oklahoma State System of Higher Education; and programs and personnel of the Oklahoma School for the Deaf and the Oklahoma School for the Blind

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 7. Education Lottery Account (Continued)

The following is a summary of the amounts available for transfer to the OELTF during the years ended June 30, 2018 and 2017:

	2018	2017
Net position, beginning of year	\$ 13,658,262	\$ 12,424,455
Change in net position before transfers to OELTF	60,254,295	54,297,495
Net position available for transfer to OELTF before capital assets and assets restricted from transfer	73,912,557	66,721,950
Less capital assets, net of accumulated depreciation	(101,011)	(103,407)
Less assets restricted from transfer	(10,851,576)	(13,730,390)
Net position available for transfer to OELTF	<u>\$ 62,959,970</u>	<u>\$ 52,888,153</u>

Actual transfers to and due to OELTF for the years ended June 30, 2018 and 2017 totaled \$63,229,605 and \$53,063,688, respectively. Actual transfers exceeded amounts available for transfer due to pension activity being unknown at the time of calculation and therefore being excluded for the years ended June 30, 2018 and 2017.

For the year ended June 30, 2018, the first \$50 million transferred is appropriated based on the above allocation. The amount transferred in excess of \$50 million will be appropriated to public schools based on the audited end of year average daily membership in grades PK-12 during the preceding school year for the purpose of implementing pre-kindergarten through third grade reading intervention initiatives or science, technology, engineering and math (STEM) programs.

Note 8. Retirement Program

Plan description: The OLC contributes to the Oklahoma Public Employees Retirement System (OPERS) cost sharing multiple-employer defined benefit plan. OPERS was established in 1964 by the Oklahoma Legislature and covers substantially all employees of the State, except those covered by six other plans sponsored by the State, and also covers employees of participating counties and local agencies. The Plan provides that all eligible persons, except those specifically excluded, shall become members of OPERS as a condition of their employment. The supervisory authority for the management and operation of OPERS is its Board of Trustees.

OPERS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits, and survivor benefits. The Plan's provisions are established under Title 74 of the Oklahoma Statutes.

Benefits provided: Members qualify for full retirement benefits at their specified normal retirement age or, for any person who became a member prior to July 1, 1992, when the sum of the member's age and years of credited service equals or exceeds 80 (Rule of 80), and for any person who became a member after June 30, 1992, when the member's age and years of credited service equals or exceeds 90 (Rule of 90).

Normal retirement date is further qualified to require that all members employed on or after January 1, 1983 must have six or more years of full-time equivalent employment with a participating employer before being eligible to receive benefits. Credited service is the sum of participating and prior service. Prior service includes nonparticipating service before January 1, 1975, or the entry date of the employer and active wartime military service.

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Notes to Financial Statements

Note 8. Retirement Program (Continued)

A member with a minimum of ten years of participating service may elect early retirement with reduced benefits beginning at age 55 if the participant became a member prior to November 1, 2011, or age 60 if the participant became a member on or after November 1, 2011.

Disability retirement benefits are available for members having eight years of credited service whose disability status has been certified as being within one year of the last day on the job by the Social Security Administration. Disability retirement benefits are determined in the same manner as retirement benefits, but payable immediately without an actuarial reduction.

Benefits are determined at 2 percent of the average annual salary received during the highest thirty-six months of the last ten years of participating service, but not to exceed the applicable annual salary cap, multiplied by the number of years of credited service. Members who join OPERS on or after July 1, 2013, will have their salary averaged over the highest 60 months of the last ten years. Normal retirement age under the Plan is 62 or Rule of 80/90 if the participant became a member prior to November 1, 2011, or age 65 or Rule of 90 if the participant became a member on or after November 1, 2011.

Members who elect to pay the additional contribution rate, which became available in January 2004, will receive benefits using a 2.5 percent computation factor for each full year the additional contributions are made. In 2004, legislation was enacted to provide an increased benefit to retiring members who were not yet eligible for Medicare. The Medicare Gap benefit option became available to members under age 65 who retired on or after May 1, 2006. Members may elect to receive a temporary increased benefit to cover the cost of health insurance premiums until the member is eligible to receive Medicare. After the member becomes eligible for Medicare, the retirement benefit will be permanently reduced by an actuarially determined amount. The option is irrevocable, must be chosen prior to retirement, and is structured to have a neutral actuarial cost to the Plan.

Members become eligible to vest fully upon termination of employment after attaining eight years of credited service, or the members' contributions may be withdrawn upon termination of employment.

Contributions: The contribution rates for each member category of the Plan are established by the Oklahoma Legislature after recommendation by the Board based on an actuarial calculation, which is performed to determine the adequacy of such contribution rates.

Each member participates based on their qualifying gross salary earned, excluding overtime. There is no cap on the qualifying gross salary earned, subject to Internal Revenue Service (IRS) limitations on compensation.

For 2018 and 2017, *state agency employers* contributed 16.5 percent on all salary, and *state employees* contributed 3.5 percent on all salary.

Contributions to the pension plan from the Oklahoma Lottery Commission were \$238,323 and \$239,231 for the years ended June 30, 2018 and 2017, respectively.

Members have the option to elect to increase the benefit computation factor for all future service from 2.0 percent to 2.5 percent. The election is irrevocable, binding for all future employment under OPERS, and applies only to full years of service. Those who make the election pay the standard contribution rate plus an additional contribution rate, 2.91 percent which is actuarially determined.

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 8. Retirement Program (Continued)

Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions: At June 30, 2018 and 2017, the Oklahoma Lottery Commission reported a liability of \$479,985 and \$891,231, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2017 and 2016, respectively, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2017 and 2016, respectively. The Oklahoma Lottery Commission's proportion of the net pension liability was based on the Oklahoma Lottery Commission's share of contributions to the pension plan relative to the contributions of all participating employers. At June 30, 2017 and 2016, the Oklahoma Lottery Commission's proportion was 0.08877707 percent and 0.08982094 percent, respectively.

For the years ended June 30, 2018 and 2017, the Oklahoma Lottery Commission recognized pension expense of \$155,812 and \$177,615, respectively. At June 30, 2018 and 2017, the Oklahoma Lottery Commission reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	June 30, 2018		June 30, 2017	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Changes of assumption	\$ 213,085	\$ -	\$ 142,481	\$ -
Differences between expected and actual experience	-	85,835	-	39,163
Difference between projected and actual investment earnings on pension plan investments	21,442	-	372,915	-
Changes in proportion and differences between OLC contributions and proportionate share of contributions	3,857	3,912	7,427	7,195
Total deferred amounts to be recognized in pension expense in future periods	238,384	89,746	522,823	46,358
OLC contributions subsequent to the measurement date	238,323	-	239,231	-
Total deferred amounts related to pension	\$ 476,707	\$ 89,746	\$ 762,054	\$ 46,358

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Notes to Financial Statements

Note 8. Retirement Program (Continued)

Deferred pension outflows resulting from the OLC's Employer' contributions subsequent to the measurement date, totaling \$238,323 and \$239,231 at June 30, 2018 and 2017, will be recognized as a reduction of the net pension liability in the years ended June 30, 2019 and 2018, respectively. Deferred outflows totaling \$21,442 as of June 30, 2018 and deferred outflow of \$372,915, resulting from the difference between projected and actual investment earnings will be recognized in pension expense over five years. The other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension will be recognized in pension expense using the average expected remaining service life of the Plan members, both active and inactive. The average expected remaining service life of the Plan is determined by taking the calculated total future service years of the Plan divided by the number of people in the Plan including retirees. The total future service years of the Plan are estimated at 2.97 years as of June 30, 2018 and 3.08 years as of June 30, 2017, and are determined using the mortality, termination, retirement and disability assumptions associated with the Plan. Deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows at June 30:

	June 30, 2018 Deferred Outflows (Inflows)
2019	\$ 53,136
2020	138,003
2021	34,145
Thereafter	(76,648)
	<u>\$ 148,636</u>

Actuarial assumptions: The total pension liability as of June 30, 2018 and 2017, was determined based on an actuarial valuation prepared as of July 1, 2017 and July 1, 2016, respectively using the following actuarial assumptions:

2017

- Investment return—7.00 percent for 2017 compounded annually net of investment expense and including inflation
- Salary increases—3.5 percent to 9.5 percent per year including inflation
- Mortality rates—Active participants and nondisabled pensioners—RP-2014 Mortality Table projected to 2025 by Scale MP-2016 (disabled pensioners set forward 12 years)
- No annual post-retirement benefit increases
- Assumed inflation rate—2.75 percent
- Payroll growth—3.5 percent per year
- Actuarial cost method—Entry age
- Select period for the termination of employment assumptions—10 years

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 8. Retirement Program (Continued)

2016

- Investment return—7.25 percent for 2016 and compounded annually net of investment expense and including inflation
- Salary increases—4.5 percent to 8.4 percent per year including inflation
- Mortality rates—Active participants and nondisabled pensioners—RP-2000 Mortality Table projected to 2010 by Scale AA (disabled pensioners set forward 15 years)
- No annual post-retirement benefit increases
- Assumed inflation rate—3.0 percent
- Payroll growth—4.0 percent per year
- Actuarial cost method—Entry age
- Select period for the termination of employment assumptions—10 years

The actuarial assumptions used in the July 1, 2017 and 2016, valuation are based on the results of the most recent actuarial experience study, which cover the three-year period ending June 30, 2016. The experience study report is dated April 13, 2017.

The long-term expected rate of return on pension plan investments was determined using a log-normal distribution analysis 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 asset allocation and best estimates of geometric real rates of return for each major asset class as of June 30, 2018 and 2017, are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
U.S. Large Cap Equity	38.0%	5.3%
U.S. Small Cap Equity	6.0%	5.6%
US Fixed	25.0%	0.7%
International Stock	18.0%	5.6%
Emerging Market Stock	6.0%	6.4%
TIPS	3.5%	0.7%
Rate Anticipation	3.5%	1.5%
Total	<u>100.0%</u>	

Discount rate: The discount rate used to measure the total pension liability was 7.00 percent for 2018 and 7.25 percent for 2017. The projection of cash flows used to determine the discount rate assumed that contributions from Plan members and the employers will be made at the current contribution rate as set out in state statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability. The discount rate determined does not use a municipal bond rate.

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 8. Retirement Program (Continued)

Sensitivity of the Oklahoma Lottery Commission's proportionate share of the net pension liability to changes in the discount rate: The following presents the Oklahoma Lottery Commission's proportionate share of the net pension liability calculated using the discount rate of 7.00 percent for June 30, 2018 and 7.25 percent for June 30, 2017, as well as what Oklahoma Lottery Commission's net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate:

	June 30, 2018			June 30, 2017		
	Current			Current		
	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)	1% Decrease (6.25%)	Discount Rate (7.25%)	1% Increase (8.25%)
Oklahoma Lottery Commission's proportionate share of the net pension liability	\$ 1,418,615	\$ 479,985	\$ (314,815)	\$ 1,824,392	\$ 891,231	\$ 99,057

Pension plan fiduciary net position: Detailed information about the pension plan's fiduciary net position is available in separately issued financial statements, June 30, 2017 CAFR, available at <http://www.opers.ok.gov/Websites/opers/images/pdfs/CAFR-2017-OPERS.pdf>.

Note 9. Contingencies

The OLC is subject to litigation in the ordinary course of its operations. In the opinion of the OLC's management and its legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the OLC for the years ended June 30, 2018 and 2017.

Note 10. Contractual Arrangements

In August 2005, the OLC entered into a contract with Scientific Games International, Inc. (SGI) to provide, amongst other things, services and equipment to operate its lotteries. Due to Oklahoma Statutes, the OLC may not contract for a period longer than one year. However, the contract with SGI contained seven one-year renewal options, which the OLC's Board of Trustees renewed annually. In August 2013, the last one-year renewal option matured and a similar contract was entered into with SGI. This contract contains nine one-year renewal options. Under the terms of the contract, the OLC pays SGI a fee based on a percentage of the OLC's sales. For the years ended June 30, 2018 and 2017, the OLC paid SGI \$10,819,307 and \$8,665,829, respectively.

The OLC is a member of the MUSL, which operates games on behalf of participating lotteries. MUSL currently operates the Powerball, Mega Millions, and Hot Lotto games for the OLC. Under the OLC's agreement with the MUSL, the OLC must remit 50 percent of its Powerball ticket sales, 50 percent of its Hot Lotto ticket sales, and 50 percent of its Mega Millions ticket sales. This payment is to cover the OLC's share of current jackpot prizes based on the OLC's percent of sales for each drawing and the OLC share of the prize reserve fund. The OLC is responsible for paying winning tickets purchased in Oklahoma; therefore, it is able to deduct winning tickets sold from the amount due to the MUSL on its ticket sales. As of June 30, 2018 and 2017, the OLC owed the MUSL \$1,192,631 and \$1,062,618 for ticket sales, and the MUSL owed the OLC \$352,384 and \$522,553 for non-jackpot-winning tickets. The OLC has recorded these items at their gross amounts in the accompanying statements of net position.

Oklahoma Lottery Commission
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Notes to Financial Statements

Note 10. Contractual Arrangements (Continued)

As noted above, OLC's payments to MUSL includes the OLC share of the prize reserve fund. The prize reserve fund serves as a contingency reserve to protect all the MUSL members, including the OLC, from unforeseen prize liabilities. These funds are in the possession of the MUSL and are included in expendable restricted net position.

The balances of the deposits are made up of the following:

	June 30	
	2018	2017
Set prize reserve account	\$ 587,478	\$ 656,862
Prize reserve account	3,093,211	2,807,939
Balance of unreserved account	810,674	970,714
	<u>\$ 4,491,364</u>	<u>\$ 4,435,515</u>

Required Supplementary Information

Oklahoma Lottery Commission
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Required Supplementary Information
Schedule of OLC's Proportionate Share of the Net Pension Liability
Oklahoma Public Employees Retirement Plan
Last 10 Fiscal Years*

	June 30		
	2018	2017	2016
Measurement date	June 30, 2017	June 30, 2016	June 30, 2015
OLC's proportion of the net pension liability	0.08877707%	0.08982094%	0.08784744%
OLC's proportionate share of the net pension liability	\$ 479,985	\$ 891,231	\$ 315,973
OLC's covered-employee payroll	1,455,835	1,610,474	1,552,939
OLC's proportionate share of the net pension liability as a percentage of its covered-employee payroll	32.97%	55.34%	20.35%
Plan fiduciary net position as a percentage of the total pension liability	94.3%	89.5%	96.0%

Notes to Schedule:

* Only the fiscal years ended June 30, 2018, 2017 and 2016 are presented because 10-year data is not yet available.

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Required Supplementary Information
Schedule of OLC's Contributions
Oklahoma Public Employees Retirement Plan
Last 10 Fiscal Years

	June 30									
	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Contractually required to contribute	\$ 238,170	\$ 240,213	\$ 265,728	\$ 256,235	\$ 252,220	\$ 260,035	\$ 289,515	\$ 295,643	\$ 317,954	\$ 295,497
Contributions in relation to the contractually required contributions	238,323	239,231	266,041	256,235	252,220	260,035	289,515	295,643	317,954	295,497
Contributions deficiency (excess)	\$ (153)	\$ 982	\$ (313)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
OLC's covered-employee payroll	1,443,455	1,455,835	1,610,474	1,552,939	1,528,606	1,575,970	1,754,636	1,907,374	2,051,316	2,037,910
Contributions as a percentage of covered-employee payroll	16.51%	16.43%	16.52%	16.50%	16.50%	16.50%	16.50%	15.50%	15.50%	14.50%

**Oklahoma Lottery Commission
An Enterprise Fund of the State of Oklahoma**

**Required Supplementary Information
Notes to Required Supplementary Information
Oklahoma Public Employees Retirement Plan**

Valuation Date

Actuarially determined contributions are calculated as of the beginning of the fiscal year in which contributions are reported.

Methods and assumptions used to determine contribution rates:

Actuarial cost method	Entry age
Amortization method	Level percentage of payroll, closed
Remaining amortization period	12 years
Asset valuation method	5-year moving average
Inflation	2.75 percent for 2017, 3.00 percent for 2016 and 2015
Salary increase	4.50 to 8.40 percent, including inflation
Investment rate of return	7.00 percent for 2017, 7.25 percent for 2016 and 7.50 percent for 2015, compounded annually, net of investment expense and including inflation
Retirement age	Age 65 for all members hired on or after November 1, 2011, age 62 for members hired prior to November 1, 2011
Mortality	For 2017, active participants and nondisabled pensioners – RP-2014 Mortality Table projected to 2025 by Scale MP-2016 (disabled pensioners set forward 12 years). For 2016, active participants and nondisabled pensioners – RP-2000 Mortality Table projected to 2010 by Scale AA (disabled pensioners set forward 15 years)

Other Information

The Plan has been amended by House Bill 2630 in 2014 which states that effective November 1, 2015, OPERS shall create a defined contribution plan for most people first employed by a participating employer. Exemptions from the new defined contribution plan include hazardous duty members and district attorneys, assistant district attorneys and employees of the district attorney's office. Each employer shall send to OPERS the difference between the required employer contribution to OPERS and the amount required to match the participating employee's contribution in the defined contribution plan.

Senate Bill 2120, also enacted in 2014, amends House Bill 2630 to further exempt from the new defined contribution plan county elected officials and employees of a county, county hospital, city or town, conservation district, circuit engineering district, and any public or private trust in which a county, city or town participates. Senate Bill 2120 also states that employees who participate in the defined contribution system are excluded from the \$105 health subsidy.

New employees specifically exempted from the defined contribution plan will participate in the existing defined benefit plan.

**Report Required by
*Government Auditing Standards***

**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***

Independent Auditor's Report

To The Board of Trustees
Oklahoma Lottery Commission
An Enterprise Fund of the State of Oklahoma

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 Oklahoma Lottery Commission (the OLC), an enterprise fund of the State of Oklahoma, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the OLC's basic financial statements, and have issued our report thereon dated September 17, 2018. Our report includes an emphasis of matter paragraph acknowledging that the OLC is an enterprise fund of the State of Oklahoma and these financial statements reflect only the assets, liabilities, deferred outflows and deferred inflows of resources, and revenues and expenses of that enterprise fund and not the State of Oklahoma as a whole.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the OLC'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 OLC's internal control. Accordingly, we do not express an opinion on the effectiveness of the OLC'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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses as item 2018-001 that we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the OLC'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*.

OLC's Response to the Finding

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

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.

RSM US LLP

Oklahoma City, Oklahoma
September 17, 2018

Oklahoma Lottery Commission

Schedule of Findings and Responses

Findings Required to be Reported by *Government Auditing Standards* Year Ended June 30, 2018

Internal Controls Over Financial Reporting

Finding 2018-001

Finding: The Oklahoma Lottery Commission (the Lottery) should have established internal controls to ensure that appropriate reconciliations are performed on a timely basis. For the year ended June 30, 2018, prize enhancements used of approximately \$2.9 million were recorded as a reduction to prizes payable instead of being recognized as prize expense.

Condition: When restricted cash is used for prize enhancements for any games offered by the Lottery, the use of those funds should be recorded as prize expense on the statement of revenues, expenses and changes in net position.

Context: Pervasive to prizes payable and prize expense.

Effect: Potential misstatement of prizes payable and prize expense as of year end.

Cause: The Commission did not properly reconcile its prizes payable liability as of June 30, 2018.

Recommendation: We recommend the Lottery implement controls to verify prizes payable is appropriate as of year end.

Management's Response: Since the May 2017 Lottery law change regarding minimum mandated profit requirements, Lottery and RSM staff engaged in discussions regarding how to properly document needed changes in the financials, including the planned usage of unclaimed funds to enhance prize payouts. After this entry was made in the draft year-end financials, discussions continued and the Lottery determined that the entry needed to be revised, and recorded the adjustment to its 2018 financial statements. Going forward, Lottery staff will implement procedures to help ensure that the reconciliation of the prizes payable liability properly considers unclaimed funds that are used to enhance prize payouts.

