STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Financial Statement Audit

For the Year Ended June 30, 2015

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

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

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AGENCY OFFICIALS

Director	B.R. Lane (Acting) – effective April 6, 2015 Jayme Odom (Acting) – March 21, 2015 to April 5, 2015 Michael Jones – October 10, 2011 to March 20, 2015
Deputy Director	Vacant – effective November 15, 2014 Victor Golden – December 15, 2008 to November 14, 2014
Chief of Staff	Jayme Odom – effective January 23, 2015 Vacant – January 20, 2015 to January 22, 2015 Alison Walters (Acting) – November 17, 2014 to January 19, 2015 Sara Barnett – January 17, 2012 to November 16, 2014
Chief Transition Officer	Vacant – effective June 24, 2015 Sara Barnett – November 17, 2014 to June 23, 2015
Chief Financial Officer	Brett Finley (Acting) – effective December 19, 2015 Christian Froelich – August 1, 2014 to December 18, 2015 Brett Finley (Acting) – August 1, 2013 to July 31, 2014 James Scroggins – April 2, 2012 to July 31, 2013
Chief Operations Officer	Harold Mays – effective January 6, 2013
General Counsel	Nellie Viner – effective February 27, 2015 Daymon Ruttenberg – November 11, 2012 to February 26, 2015
Chief Internal Auditor	Amy De Weese – effective June 1, 2015 Vacant – January 16, 2015 to May 30, 2015 Melinda Westwater – June 17, 2013 to January 15, 2015

Agency offices are located at:

101 West Jefferson Street
Springfield, Illinois 62702

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

FINANCIAL STATEMENT REPORT

SUMMARY

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

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

SUMMARY OF FINDINGS

The auditors identified matters involving the Department's internal control over financial reporting that they considered to be a significant deficiency. The significant deficiency is described in the accompanying Schedule of Findings as Finding 2015-001.

FINDING (GOVERNMENT AUDITING STANDARDS)

Finding No.	Page No.	Description	Finding Type
2015-001	32	Errors identified in GAAP Reporting Forms Submitted to the Illinois Office of the Comptroller and Year-end Department Financial Statements	Significant deficiency

PRIOR FINDING NOT REPEATED

A	34	Weakness in the General IT Control Environment over Key Systems

EXIT CONFERENCE

The Department elected to waive a formal exit conference.

The response to the recommendation was provided by Amy De Weese, Chief Internal Auditor, in an email dated January 15, 2016.

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

Independent Auditors' Report

Honorable Frank J. Mautino
Auditor General
State of Illinois

Report on the Financial Statements

As Special Assistant Auditors for the Auditor General, we have audited the accompanying basic financial statements of the State of Illinois Department of the Lottery (the Department) as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of June 30, 2015, and the changes in financial position and cash flows for the year then ended, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in Note 2(a), the financial statements of the Department are intended to present the financial position, the changes in financial position and, where applicable, cash flows of only that portion of the business-type activities of the State of Illinois that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Illinois as of June 30, 2015, and the changes in its financial position or, where applicable, its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

The Department adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, during the year ended June 30, 2015. Statement No. 68 established standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, expenses and expenditures. The adoption of this statement required the Department to restate net position by $(53,647) thousand at June 30, 2014.

Other Matters

Required Supplementary Information

Management has omitted a management's discussion and analysis and related pension information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary and Other Information

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

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 15, 2016 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

KPMG LLP

Chicago, Illinois
January 15, 2016

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY
Statement of Net Position (Deficit)
June 30, 2015
(In thousands of dollars)

Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	$	16,205
Cash equity in State Treasury		245,963
Prepaid assets		20,000
Investments, short-term		36,428
Accounts receivable, net of allowance of $15,798		35,861
Private management contract receivable		32,618
Total current assets		387,075
Noncurrent assets:		
Investments		265,231
Capital assets being depreciated, net		93
Total noncurrent assets		265,324
Deferred outflows of resources - pension		11,718
Total assets and deferred outflows of resources		664,117
Liabilities and Deferred Inflows of Resources		
Current liabilities:		
Prizes payable		235,017
Accounts payable and accrued liabilities		82,259
Due to other Government – Federal		72
Due to other State funds		60,803
Unearned revenue		2,789
Other liabilities		1,222
Current portion of long-term annuity prizes payable		34,409
Total current liabilities		416,571
Noncurrent liabilities:		
Noncurrent portion of long-term annuity prizes payable		238,318
Net pension liability		65,780
Noncurrent other		828
Total noncurrent liabilities		304,926
Deferred inflows of resources - pension		2,345
Total liabilities and deferred inflows of resources		723,842
Net Position (Deficit)		
Invested in capital assets		93
Unrestricted		(59,818)
Total net position (deficit)	$	(59,725)

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

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

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

Year ended June 30, 2015

(In thousands of dollars)

Operating revenues:		
Charges for sales and services	$	2,837,805
Private management contract fee		10,000
Other		6,487
Total operating revenues		2,854,292
Operating expenses:		
Cost of sales and services		161,607
Prizes and claims		1,823,572
General and administrative		147,078
Recovery of private management contract fee		(21,776)
Depreciation		55
Total operating expenses		2,110,536
Operating income		743,756
Nonoperating revenues (expenses):		
Investment income		11,533
Interest expense		(12,298)
Other		(8)
Total nonoperating expenses, net		(773)
Change in net position before transfers		742,983
Transfers to other State funds		(743,905)
Change in net position		(922)
Net position (deficit) at beginning of year, as restated (see Note 12)		(58,803)
Net position (deficit) at end of year	$	(59,725)

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

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

Year ended June 30, 2015

(In thousands of dollars)

Cash flows from operating activities:	
Cash received from sales and services	$ 2,829,941
Cash receipts from other operating activities	43,616
Cash payments for commissions and bonuses	(161,607)
Cash payments for general and administrative expenses	(109,686)
Cash payments for lottery prizes	(1,742,988)
Net cash provided by operating activities	859,276
Cash flows from noncapital financing activities:	
Cash transfers-out to other funds	(690,166)
Net cash used in noncapital financing activities	(690,166)
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(5)
Net cash used in capital and related financing activities	(5)
Cash flows from investing activities:	
Interest and dividends on investments	57
Purchase of investments	(33,594)
Proceeds from investment maturities	39,983
Cash paid for long-term annuity prizes payable	(39,825)
Net cash used in investing activities	(33,379)
Net increase in cash and cash equivalents	135,726
Cash and cash equivalents at beginning of year	126,442
Cash and cash equivalents at end of year	$ 262,168
Reconciliation of cash and cash equivalents to the statement of net position (deficit):	
Total cash and cash equivalents per the statement of net position (deficit)	$ 16,205
Add cash equity in State Treasury	245,963
Cash and cash equivalents at end of year	$ 262,168

(Continued)

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

Year ended June 30, 2015

(In thousands of dollars)

Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	743,756
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		55
Provision for uncollectible accounts		1,959
Recovery of private management contract fee		(21,776)
Changes in assets and liabilities:		
Increase in prepaid assets		(20,000)
Increase in accounts receivable		(10,962)
Increase in other receivables		(9,921)
Decrease in private management contract receivable		27,129
Increase in prizes payable		66,932
Increase in accounts payable and accrued liabilities		44,726
Decrease in intergovernmental payables		(112)
Increase in due to other State funds		135
Increase in unearned revenues		1,139
Decrease in other liabilities		(37)
Increase in long-term annuity prizes payable		33,594
Decrease in noncurrent other liabilities		(101)
Increase in deferred inflows and outflows of resources and net change in pension liability		2,760
Net cash provided by operating activities	$	859,276
Noncash investing, capital and financing activities:		
Decrease in unrealized gains on investments	$	(922)
Interest accreted on investments		12,285
Interest accretion on long-term annuity prizes payable		(12,285)
Release of long-term annuity prizes payable		(100)
Transfer of assets to other State funds		(8)

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

(1) Organization

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

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

Financial Reporting Entity

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

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

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

(2) Summary of Significant Accounting Policies

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

(a) Basis of Accounting and Presentation

The financial statements of the State of Illinois, Department of the Lottery, are intended to present the financial position, changes in financial position, and cash flows of only that portion of the activities of the State of Illinois that are attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2015, the changes in financial position and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

(b) Cash and Cash Equivalents

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

(c) Prepaid Assets

On June 30, 2015, the Department transferred $20.0 million to the Virginia Lottery to fund future multi-state lottery prize settlements in order to satisfy Illinois' financial obligations to the multi-state games in the absence of a fiscal year 2016 prize appropriation due to the budget impasse at June 30, 2015.

(d) Investments

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

(e) Allowances and Provisions

The allowance for doubtful accounts at June 30, 2015 is based on an analysis of the historical collection experience for accounts receivable, which considers the age of the receivable and current economic conditions.

(f) Interfund Transactions

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

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

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

(g) Capital Assets

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

(h) Compensated Absences

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

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

(i) Net Position (Deficit)

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

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

Restricted – This consists of net position that is legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the State's policy to use restricted resources first, then unrestricted resources when they are needed. There is no restricted net position as of June 30, 2015.

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

(j) Classification of Revenues and Expenses

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

Revenue

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

Expenses

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

(k) Lottery Revenue

Draw Games

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

Instant Games

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

(l) Prizes and Claims – Ticket Expense

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

(m) Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(n) Pensions

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

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

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

(o) Current Adoption of GASB Statements

Effective for the year ended June 30, 2015, the Department adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27,* which establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, expenses, and expenditures. The statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. The implementation of this statement significantly impacted the Department's financial statements and footnote disclosures with the recognition of a net pension liability, deferred outflows of resources and deferred inflows of resources on the Statement of Net Position (Deficit) and pension expense included within general and administrative expense on the Statement of Revenues, Expenses, and Changes in Net Position (Deficit). Additionally, the requirements of this statement resulted in the restatement of beginning net position (deficit). Information regarding the Department's participation in SERS is disclosed in Note 7.

GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, is effective for the Department beginning with its year ended June 30, 2015. The objective of this statement is to establish standards related to government combinations and disposals of government operations, including combinations in which no consideration is provided, such as government mergers and transfers of operations, and combinations in which consideration is provided, such as disposal of government operations. The implementation of this statement had no impact on the Department's financial statements.

During the year ended June 30, 2015, the Department adopted GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68,* which addresses an issue regarding the application of the transition provisions of GASB Statement No. 68. The statement clarifies the accounting for contributions to a defined benefit pension plan after the measurement date of a government's beginning net pension liability. The provisions of this statement were incorporated with the implementation of GASB Statement No. 68.

(p) Future Adoption of GASB Statements

GASB Statement No. 72, *Fair Value Measurement and Application*, will be effective for the Department beginning with the year ending June 30, 2016. The objective of this statement is to provide specific accounting and financial reporting guidance for determining and applying fair value measurements.

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

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

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

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, will be effective for the Department beginning with the year ending June 30, 2016. The objective of this statement is to identify, in the context of the current governmental financial reporting environment, the hierarchy of GAAP.

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

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

(3) Deposits and Investments

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

(a) Deposits

Deposits in the custody of the State Treasurer of approximately $246 million as of June 30, 2015, are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Details on the nature of these deposits and investments are available within the State's CAFR.

Bank deposits for the enterprise funds held outside of the State Treasury of approximately $16 million as of June 30, 2015, are held in Federal Deposit Insurance Corporation (FDIC) insured depository institutions. The Department has agreements under which these institutions insure balances in excess of FDIC insurance limits from loss by pledging securities as collateral. The collateral amounts equal or exceed the excess deposit amounts.

(b) Investments

As of June 30, 2015, the Department had the following investments outside of the State Treasury:

		Fair value (thousands)	Weighted average maturity (years)
Annuities	$	382	4.080
U.S. Treasury bonds		301,277	7.371
Total	$	301,659	

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

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

(4) Interfund Balance and Activity

(a) Balance Due from /to Other Funds

The following balance (amount expressed in thousands) at June 30, 2015, represent amounts due to other State funds.

Fund	Due to Other State funds		2015	Description/Purpose
Lottery	Capital Projects	$	59,830	Due to other State funds for
	Other State funds		973	allocation of lottery proceeds
		$	60,803	and for administrative expenses.

(b) Transfers to Other Funds

The Department reports transfers out in the Statement of Revenues, Expenses, and Changes in Net Position (Deficit), for the amounts required by statute to be transferred to the Common School Fund, Capital Projects Fund, and other State funds for lottery games designated for special purposes. The following balances (amounts expressed in thousands) for the year ended June 30, 2015 represent amounts transferred to other State funds:

Fund	Transfers out to Other State funds		2015	Description/Purpose
Lottery	Common School	$	678,550	Transfers to Common School,
	Capital Projects		61,563	Capital Projects, and other State
	Other State funds		3,792	funds pursuant to statutory
		$	743,905	requirements.

(5) Capital Assets

Capital asset activity (amounts expressed in thousands) for the year ended June 30, 2015 was as follows:

		Balance June 30, 2014	Additions	Deletions	Net transfers	Balance June 30, 2015
Capital assets being depreciated:						
Equipment	$	1,443	5	—	(36)	1,412
Less accumulated depreciation		(1,292)	(55)	—	28	(1,319)
Total capital assets, net	$	151	(50)	—	(8)	93

(6) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2015 were as follows:

	June 30, 2014	Additions	Deletions	June 30, 2015	Due within one year
Compensated absences	$ 978	739	794	923	95
Obligations to Lottery prize winners – group contracts	433	—	51	382	60
Obligations to Lottery prize winners – annuities	266,396	45,881	39,932	272,345	34,349
Net pension liability	57,772	8,008	—	65,780	—
Total long-term obligations	$ 325,579	54,628	40,777	339,430	34,504

(b) Obligations to Lottery Prize Winners

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

For certain prize winners, annuities (group contracts) were purchased in the name of the Department for which the Department has retained the rights of ownership. The present value of these annuities and the related liability installments owed to prize winners were as follows at June 30, 2015:

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

Fiscal year	Current	Long-term	Total
2016	$ 62	—	62
2017	—	62	62
2018	—	62	62
2019	—	62	62
2020		62	62
2021-2022		112	112
Total future prize payments	62	360	422
Less present value adjustments	(2)	(38)	(40)
Present value at June 30, 2015	$ 60	322	382

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

The fair value of the investments approximated $301 million at June 30, 2015. Interest rates range from 1.8% to 7.7%, and prizes payable are scheduled annually through 2043 as follows (amounts expressed in thousands):

Fiscal year	Current	Long-term	Total
2016	$ 37,077	—	37,077
2017	—	29,279	29,279
2018	—	21,898	21,898
2019	—	20,273	20,273
2020	—	20,163	20,163
2021-2043	—	241,969	241,969
Total future prizes	37,077	333,582	370,659
Adjustments to present value	(2,728)	(95,586)	(98,314)
Present value of future prizes	34,349	237,996	272,345
Adjustments to fair value	2,019	26,913	28,932
Fair value of future prizes at June 30, 2015	$ 36,368	264,909	301,277

The amortized discount on the prizes payable reflects the interest rates earned by the investments held to fund the related liabilities. The amortization of discount is recorded as interest expense in the Statement of Revenues, Expenses, and Changes in Net Position and amounted to $12.3 million for the year ended June 30, 2015.

(7) Pension Plan

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

1 and 2 members, except where noted. SERS issues a separate CAFR available at www.srs.illinois.gov or that may be obtained by writing to SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

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

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

Regular Formula Tier 1	**Regular Formula Tier 2**
A member must have a minimum of eight years of service credit and may retire at: • Age 60, with 8 years of service credit. • Any age, when the member's age (years & whole months) plus years of service credit (years & whole months) equal 85 years (1,020 months) (Rule of 85) with eight years of credited service. • Between ages 55-60 with 25-30 years of service credit (reduced 1/2 of 1% for each month under age 60). The retirement benefit is based on final average compensation and credited service. Final average compensation is the 48 highest consecutive months of service within the last 120 months of service. Under the Rule of 85, a member is eligible for the first 3% increase on January 1 following the first full year of retirement, even if the member is not age 60. If the member retires at age 60 or older, he/she will receive a 3% pension increase every year on January 1, following the first full year of retirement. If the member retires before age 60 with a reduced retirement benefit, he/she will receive a 3% pension increase every January 1 after the member turns age 60 and has been retired at least one full year. These pension increases are not limited by the 75% maximum.	A member must have a minimum of 10 years of credited service and may retire at: • Age 67, with 10 years of credited service. • Between ages 62-67 with 10 years of credited service (reduced 1/2 of 1% for each month under age 67). The retirement benefit is based on final average compensation and credited service. For regular formula employees, final average compensation is the average of the 96 highest consecutive months of service within the last 120 months of service. The retirement benefit is calculated on a maximum salary of $106,800. This amount increases annually by 3% or one-half of the Consumer Price Index, whichever is less. If the member retires at age 67 or older, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every year on January 1, following the first full year of retirement. The calendar year 2014 rate is $110,631. If the member retires before age 67 with a reduced retirement benefit, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every January 1 after the member turns age 67 and has been retired at least one full year. These pension increases are not limited by the 75% maximum

Additionally, the Plan provides an alternative retirement formula for State employees in high risk jobs, such as State policemen, fire fighters, and security employees. Employees qualifying for benefits under the alternative formula may retire at an earlier age depending on membership in Tier 1 or Tier 2. The retirement formula is 2.5% for each year of covered service and 3.0% for each year of non-covered service. The maximum retirement annuity payable is 80% of final average compensation as calculated under the alternative formula. The Department has no employees in high risk jobs.

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

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

Contributions. Contribution requirements of active employees and the State are established in accordance with Chapter 40, section 5/14-133 of the Illinois Compiled Statutes. Member contributions are based on fixed percentages of covered payroll ranging between 4.00% and 12.50%. Employee contributions are fully refundable, without interest, upon withdrawal from State employment. Tier 1 members contribute based on total annual compensation. Tier 2 members contribute based on an annual compensation rate not to exceed $106,800 with limitations for future years increased by the lessor of 3% or one-half of the annual percentage increase in the Consumer Price Index. For 2015, this amount was $111,572.

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

For fiscal year 2015, the required employer contributions were computed in accordance with the State's funding plan. This funding legislation provides for a systematic 50-year funding plan with an ultimate goal to achieve 90% funding of the plan's liabilities. In addition, the funding plan provided for a 15-year phase-in period to allow the State to adapt to the increased financial commitment. Since the 15-year phase-in period ended June 30, 2010, the State's contribution will remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved. For fiscal year 2015, the employer contribution rate was 42.339%. The Department's contribution amount for fiscal year 2015 was $4.302 million.

Pension liability, deferred outflows of resources, deferred inflows of resources and expense related to pensions. At June 30, 2015, the Department reported a liability of $65.78 million for its proportionate share of the State's net pension liability for SERS on the Statement of Net Position (Deficit). The net pension liability was measured as of June 30, 2014 (current year measurement date), and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Department's portion of the net pension liability was based on the Department's proportion of employer contributions relative to all employer contributions made to the plan during the year ended June 30, 2014. As of the current year measurement date of June 30, 2014, the Department's proportion was 0.2427%, which was an increase of 0.0061% from its proportion measured as of the prior year measurement date of June 30, 2013.

For the year ended June 30, 2015, the Department recognized pension of expense of $2.760 million. At June 30, 2015, the Department reported deferred outflows and deferred inflows of resources related to the pension liability from the following sources (amounts expressed in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 287	$ -
Changes of assumptions	5,964	-
Net difference between projected and actual investment earnings on pension plan investments	-	2,345
Changes in proportion	1,165	-
Department contributions subsequent to the measurement date	4,302	-
Total	$ 11,718	$ 2,345

Deferred outflows of resources of $4.302 million were reported related to pensions resulting from Department contributions subsequent to the measurement date and will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized as pension expense as follows (amounts expressed in thousands):

Year ended June 30,	
2016	$ 1,480
2017	1,480
2018	1,480
2019	631
Total	$ 5,071

Actuarial Methods and Assumptions. The total pension liability was determined by an actuarial valuation as of June 30, 2014, using the following actuarial assumptions, applied to all periods included in the measurement:

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

Inflation: 3.0%

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

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

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

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

The long-term expected real rate of return on pension plan investments was determined based on the simulated average 10-year annualized geometric return for each major asset class. These returns are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage. For each major asset class that is included in the pension plan's target asset allocation, calculated as of the measurement date of June 30, 2014, the best estimates of the geometric real rates of return as summarized in the following table:

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

Discount Rate. A discount rate of 7.09% was used to measure the total pension liability. This single blended discount rate was based on the expected rate of return on pension plan investments of 7.25% and a municipal bond rate of 4.29%, based on an index of 20 year general obligation bonds with an average AA credit rating as published by the Federal Reserve. The projection of cash flows used to determine this single discount rate assumed that plan member contributions will be made at the current contribution rate and that contributions will be made based on the statutorily required rates under Illinois law. Based on these assumptions, the pension plan's fiduciary net position and future contributions will be sufficient to finance the benefit payments through the year 2065. As a result, the long-term expected rate of return on pension plan investments was applied to projected benefit payments through the year 2065, and the municipal bond rate was applied to all benefit payments after that date.

(Continued)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate. The net pension liability for the System was calculated using the stated discount rate, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current rate as shown below (amounts expressed in thousands):

	1% Decrease 6.09%	Discount Rate 7.09%	1% Increase 8.09%
Department's proportionate share of the net pension liability	$ 79,259	$ 65,780	$ 54,585

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

Payables to the pension plan. At June 30, 2015, the Department reported a payable of $254 thousand to SERS for the outstanding amount of contributions to the pension plans required for the year ended June 30, 2015.

(8) Postemployment Benefits

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

Public Act 97-0695 was signed into law on June 21, 2012. Effective July 1, 2013, all retirees within state retirement systems began paying a premium for health and vision benefits at a rate determined by CMS. The rate was a percentage of the retiree's annuity and differed depending on whether the retiree was enrolled in Medicare. Five class action lawsuits were filed challenging the validity of this legislation on the grounds that it violated provisions of the Illinois Constitution of 1970, including the Pension Protection Clause. The five suits were consolidated in the Circuit Court of Sangamon County. The Circuit Court dismissed each of them for failure to state a cause of action, without certifying any classes. The Illinois Supreme Court allowed direct appeal. On July 3, 2014, the Illinois Supreme Court issued an opinion in the retiree health insurance premium case. The Illinois Supreme Court disagreed with the Circuit Court and determined the Circuit Court should not have dismissed the case. The Supreme Court remanded the case back to the Circuit Court for reconsideration. As a result, the Sangamon County Circuit Court directed on August 28, 2014, all retirement systems to discontinue withholding the retiree and survivor health insurance premiums. The refunding of the withheld premiums was repaid from an escrow account by June 15, 2015.

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

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

(9) Risk Management

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

The Department's risk management activities are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the general fund of the State. The claims are not considered to be a liability of the Department; and accordingly, have not been reported in the Department's financial statements for the year ended June 30, 2015.

(10) Private Management Agreement

The State (acting through the Department) entered into a 10-year private management agreement (PMA) with Northstar Lottery Group, LLC (Private Manager) effective January 18, 2011, for the purpose of providing all equipment, services, and functions necessary to operate the Lottery for the State, except for those specifically retained by the State as defined within the PMA. Under the terms of the agreement, the compensation to be paid under the PMA is comprised of the reimbursement of operating expenses and incentive compensation payments. Incentive compensation is subject to annual adjustments in accordance with the agreement. For the year ended June 30, 2015, total compensation for reimbursement of operating expenses to Northstar under the PMA was $121.7 million and is included in general and administrative expenses. Of this amount, $81.0 million was outstanding at June 30, 2015, and is included in accounts payable and accrued liabilities.

On September 18, 2015, the State (acting through the Department) executed a Letter Agreement of Termination ("Letter Agreement"), which resolved certain outstanding disputes between Northstar and the Department. The Letter Agreement contains provisions regarding Northstar paying the Department for not meeting net income goals pursuant to the PMA, a retroactive supply agreement reduction, and Northstar's reimbursement of legal fees related to prior disputes.

The Department has recorded a receivable from Northstar at June 30, 2015, in the amount of $32.6 million. Of this amount, $10.0 million represents shortfall payments for not meeting net income goals. The remaining $22.6 million is comprised of $19.1 million for excess advances for expense reimbursements, $3.3 million for the retroactive supply agreement reduction, and $0.2 million for reimbursement of legal fees.

(11) Commitments and Contingencies

(a) Lease Commitments

The Department leases certain facilities and equipment necessary for operations, primarily from other State agencies. All leases are operating leases and the majority are month-to-month. Total lease costs for the year ended June 30, 2015 amounted to $923 thousand.

(b) Litigation

The Letter Agreement resolved outstanding disputes in connection with Northstar and its suppliers.

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

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

(c) Contingent Liabilities

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

(12) Restatement

In accordance with the Department's adoption of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27,* the net pension liability, deferred outflows of resources, deferred inflows of resources and pension expense have been recognized in the financial statements. See Note 7. Therefore, the financial statements have been restated as of July 1, 2014, as follows (amounts expressed in thousands):

Net Deficit, June 30, 2014, as previously reported	$	(5,156)
Restatement – deferred outflow of resources – pension		4,125
Restatement – net pension liability		(57,772)
Net Deficit, July 1, 2014, as restated	$	(58,803)

(13) Subsequent Events

On September 18, 2015, the State (acting through the Department) executed a Letter Agreement of Termination ("Letter Agreement"), which resolved certain outstanding disputes between Northstar and the Department. See Note 10.

The State of Illinois has not adopted a fiscal year 2016 operating budget as of the date of this report. The Department is part of the executive branch and operates under a budget where resources primarily from the State Lottery Fund are appropriated for the use of the Department. Consequently, the Department is presently unable to make payments from appropriated accounts to vendors and other State agencies. Payments to prizewinners are being made pursuant to legislation enacted on December 7, 2015. Payments to Department employees for work performed are being made pursuant to a July 2015 court order.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Combining Schedule of Net Position (Deficit)

June 30, 2015

(In thousands of dollars)

Assets and Deferred Outflows of Resources	State Lottery (0711)	Deferred Prize Winners (0978)	Lottery Security Deposits (1309)	Eliminations	Total
Current assets:					
Cash and cash equivalents	$ 15,284	—	921	—	16,205
Cash equity in State Treasury	244,501	1,462	—	—	245,963
Prepaid assets	20,000	—	—	—	20,000
Investments, short-term	60	36,368	—	—	36,428
Accounts receivable, net of allowance of $15,798	35,861	—	—	—	35,861
Private management contract receivable	32,618	—	—	—	32,618
Due from other Department funds	1,256	—	—	(1,256)	—
Total current assets	349,580	37,830	921	(1,256)	387,075
Noncurrent assets:					
Investments	322	264,909	—	—	265,231
Capital assets being depreciated, net	93	—	—	—	93
Total noncurrent assets	415	264,909	—	—	265,324
Deferred outflows of resources - pension	11,718	—	—	—	11,718
Total assets and deferred outflows of resources	361,713	302,739	921	(1,256)	664,117
Liabilities and Deferred Inflows of Resources					
Current liabilities:					
Prizes payable	235,017	—	—	—	235,017
Accounts payable and accrued liabilities	82,259	—	—	—	82,259
Due to other Government - Federal	72	—	—	—	72
Due to other Department funds	—	1,256	—	(1,256)	—
Due to other State funds	60,803	—	—	—	60,803
Unearned revenue	2,789	—	—	—	2,789
Other liabilities	95	206	921	—	1,222
Current portion of long-term annuity prizes payable	60	34,349	—	—	34,409
Total current liabilities	381,095	35,811	921	(1,256)	416,571
Noncurrent liabilities:					
Noncurrent portion of long-term annuity prizes payable	322	237,996	—	—	238,318
Net pension liability	65,780	—	—	—	65,780
Noncurrent other	828	—	—	—	828
Total noncurrent liabilities	66,930	237,996	—	—	304,926
Deferred inflows of resources - pension	2,345	—	—	—	2,345
Total liabilities and deferred inflows of resources	450,370	273,807	921	(1,256)	723,842
Net Position (Deficit)					
Invested in capital assets	93	—	—	—	93
Unrestricted	(88,750)	28,932	—	—	(59,818)
Total net position (deficit)	$ (88,657)	28,932	—	—	(59,725)

See accompanying independent auditors' report.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

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

Year ended June 30, 2015

(In thousands of dollars)

		State Lottery (0711)	Deferred Prize Winners (0978)	Eliminations	Total
Operating revenues:					
Charges for sales and services	$	2,837,805	—	—	2,837,805
Private management contract fee		10,000	—	—	10,000
Other		6,487	—	—	6,487
Total operating revenues		2,854,292	—	—	2,854,292
Operating expenses:					
Cost of sales and services		161,607	—	—	161,607
Prizes and claims		1,823,572	—	—	1,823,572
General and administrative		147,078	—	—	147,078
Recovery of private management contract fee		(21,776)	—	—	(21,776)
Depreciation		55	—	—	55
Total operating expenses		2,110,536	—	—	2,110,536
Operating income		743,756	—	—	743,756
Nonoperating revenues (expenses):					
Investment income		170	11,363	—	11,533
Interest expense		(13)	(12,285)	—	(12,298)
Other		(108)	100	—	(8)
Total nonoperating revenues (expenses), net		49	(822)	—	(773)
Change in net position (deficit) before transfers		743,805	(822)	—	742,983
Transfers from other State funds		100	—	(100)	—
Transfers to other State funds		(743,905)	(100)	100	(743,905)
Change in net position		—	(922)	—	(922)
Net position (deficit), July 1, 2014 (as restated)		(88,657)	29,854	—	(58,803)
Net position (deficit), June 30, 2015	$	(88,657)	28,932	—	(59,725)

See accompanying independent auditors' report.

KPMG LLP
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200 East Randolph Drive
Chicago, IL 60601-6436

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

Honorable Frank J. Mautino
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the State of Illinois Department of the Lottery (the Department), which comprise the statement of net position (deficit) as of June 30, 2015, and the related statements of revenues, expenses, and changes in net position (deficit) and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 15, 2016.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings as Finding 2015-001 that we consider to be a significant deficiency.

Compliance and Other Matters

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

Department's Response to Findings

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Chicago, Illinois
January 15, 2016

Finding 2015-001 Errors identified in GAAP Reporting Forms Submitted to the Illinois Office of the Comptroller and Year-End Department Financial Statements

The State of Illinois Department of the Lottery's (Department) year-end financial statements, prepared in accordance with generally accepted accounting principles (GAAP) and submitted to the Illinois Office of the Comptroller, contained errors in certain accounts and disclosures, which are considered to be deficiencies in internal control over financial reporting.

During the audit of the June 30, 2015 Department financial statements, auditors noted errors in the Department's GAAP Reporting forms submitted to the Office of the Comptroller and Department financial statements as follows:

1) During testing of the Department's accounts receivable, auditors identified the Department incorrectly recorded a transfer of $20.0 million to the Virginia Lottery to fund future multi-state lottery prize settlements in accounts receivable. This transfer was done at June 30, 2015 in order to fund Illinois' future financial obligations to the multi-state games (Mega Millions and Powerball) in the absence of a fiscal year 2016 budgetary appropriation to pay game winners. The misclassification resulted in an overstatement of accounts receivable and an understatement of prepaid assets of $20.0 million. This was discussed with Department management and they subsequently made a correcting entry.

2) During testing of the Department's online liabilities, an unreconciled difference of $1.689 million was identified. This difference was discussed with Department management and they considered the amount to be immaterial to the financial statements and did not record a correcting entry.

3) During testing of the Department's general and administrative expenses, a number of errors regarding the amounts recorded were identified and included the following:

   - Annual compensation for reimbursement of operating expenses to the Private Manager was understated by $3.90 million.

   - The Department inaccurately recorded demobilization and disentanglement expenses related to the private management agreement (PMA) of $1.88 million and $1.23 million, respectively. These errors resulted in general and administrative expenses being overstated by $3.11 million.

   Department management considered the net amount for these two items (an understatement of general and administrative expenses of $0.79 million) to be immaterial to the financial statements and did not record a correcting entry.

4) During testing of the Department's financial statements, particularly the notes, auditors identified errors regarding the amounts disclosed, which included the following:

- The amount of annual compensation for reimbursement of operating expenses to the Private Manager under the PMA, was overstated by $8.8 million. This was discussed with Department management at which time they adjusted the disclosure.

- $3.8 million for the retroactive supply agreement reduction, was overstated by $0.5 million. This was discussed with Department management at which time they adjusted the disclosure.

The Illinois Office of the Comptroller requires State agencies to prepare GAAP Reporting Packages for each of their funds to assist in the annual preparation of the Statewide financial statements and the Lottery financial statements. GAAP Reporting Package instructions are specified in the Comptroller's Statewide Accounting Management System (SAMS) Manual, Chapter 27.

In addition, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies to establish and maintain a system of internal fiscal and administrative controls which shall provide assurance that revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial and statistical reports and to maintain accountability over the State's resources.

In discussing these conditions, Lottery management indicated the budget impasse at June 30 and certain unforeseen subsequent events resulted in the issues identified.

Because of the significance of the errors and inaccuracies noted, auditors consider this to be a significant deficiency in the Department's internal control over financial and fiscal operations. 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. (Finding Code No. 2015-001, 2014-001, 2013-001, 12-01)

Recommendation:

We recommend the Department improve their preparation and review process of GAAP Reporting Packages and financial statements to ensure they are prepared in a complete and accurate manner.

Lottery Response:

The Lottery agrees and will continue to review current procedures to ensure GAAP financial reporting and the financial statements are prepared completely and accurately.

A. **<u>FINDING</u>** (Weaknesses in the General IT Control Environment over Key Systems)

During prior year engagements, the State of Illinois Department of the Lottery (Department) had not implemented a sufficient level of controls over its computing environment to ensure protection from unauthorized access.

Testing performed during the current engagement identified improvements in the Department's controls over its computing environment such that it was no longer considered a significant deficiency. As a result, the prior finding was not repeated. (Finding Code No. 2014-002, 2013-002, 12-02)