STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Financial Statement Audit

For the Year Ended June 30, 2017

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

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

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STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

AGENCY OFFICIALS

Director (Acting) (10/24/16 – Present)	Mr. Greg Smith
Director (Acting) (07/01/16 – 10/23/16)	Mr. Tim McDevitt
Deputy Director	Vacant
Chief of Staff	Ms. Jayme Odom
Chief Financial Officer (09/25/17 – Present)	Ms. Carol Radwine
Chief Financial Officer (07/01/17 – 09/24/17)	Vacant
Chief Financial Officer (07/01/16 – 06/30/17)	Mr. Mark Lewis
General Counsel (04/17/17 – Present)	Ms. Annice Kelly
General Counsel (Acting) (02/23/17 – 04/16/17)	Ms. Rana Janney
General Counsel (07/01/16 – 02/22/17)	Ms. Nellie Viner
Chief Transition Officer	Vacant
Chief Operations Officer	Mr. Harold Mays
Chief Internal Auditor (06/16/17 – Present)	Mr. Darick Clark
Chief Internal Auditor (04/15/17 – 06/15/17)	Vacant
Chief Internal Auditor (07/01/16 – 04/14/17)	Ms. Amy DeWeese

LOTTERY CONTROL BOARD MEMBERS

Chair	Mr. Jonathan “Blair” Garber
Member	Ms. Elba Aranda-Suh
Member	Ms. Haydee Olinger
Member (03/20/17 – Present)	Mr. James Floyd
Member (07/01/16 – 03/19/17)	Vacant
Member	Vacant

The Department’s offices are located at:

122 S. Michigan Avenue, 19th Floor Chicago, Illinois 60603	101 W. Jefferson Street Springfield, Illinois 62702

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying basic financial statements of the 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 material weakness and a significant deficiency. The material weakness is described in the accompanying Schedule of Findings and Responses on pages 33-36 as Finding 2017-001, *Noncompliance with the Illinois Lottery Law*. The significant deficiency is described in the accompanying Schedule of Findings and Responses on pages 37-38 as Finding 2017-002, *Inadequate Control over Online Games Prize Liabilities*.

EXIT CONFERENCE

The findings and recommendations appearing in this report were discussed with Department personnel at an exit conference on December 12, 2017. Attending were:

State of Illinois, Department of the Lottery		**KPMG LLP**	
Gregory Smith	Acting Director	Kurt Gabouer	Partner
Carol Radwine	Chief Financial Officer	Jane Kim	Manager
Amber Chappell	Finance Manager	Brent Whitford	Senior Associate
Druanne Allen	Budget Manager	**Office of the Auditor General**	
Darick Clark	Chief Internal Auditor	Paul Usherwood, CPA	Senior Audit Manager
		Daniel J. Nugent, CPA	Senior Audit Manager

The responses to the recommendations were provided by Darick Clark, Chief Internal Auditor, in emails dated December 19, 2017 and December 21, 2017.

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 as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the State of Illinois, Department of the Lottery'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.

KPMG LLP is a Delaware limited liability partnership and the U.S. member
firm of the KPMG network of independent member firms affiliated with
KPMG International Cooperative ("KPMG International"), a Swiss entity.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the State of Illinois, Department of the Lottery as of June 30, 2017, and the respective 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 State of Illinois, Department of the Lottery 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 are attributable to the transactions of the State of Illinois, Department of the Lottery. They do not purport to, and do not, present fairly the financial position of the State of Illinois as of June 30, 2017, and the changes in its financial position or, where applicable, its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted 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 State of Illinois, Department of the Lottery's basic financial statements. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The accompanying supplementary information, as listed in the table of contents, is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplementary information, as listed in the table of contents, 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 December 22, 2017 on our consideration of the State of Illinois, Department of the Lottery'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 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 State of Illinois, Department of the Lottery'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 State of Illinois, Department of the Lottery's internal control over financial reporting and compliance.

/s/KPMG LLP

Chicago, Illinois
December 22, 2017

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY
Statement of Net Position (Deficit)
June 30, 2017
(in thousands of dollars)

Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	$	37,539
Cash equity in State Treasury		80,094
Investments, short-term		24,277
Accounts receivable, net of allowance of $19,197		50,324
Other receivables		1
Due from other State funds		1
Total current assets		192,236
Noncurrent assets:		
Investments		263,286
Capital assets being depreciated, net		37
Total noncurrent assets		263,323
Deferred outflows of resources – pension		21,525
Total assets and deferred outflows of resources		477,084
Liabilities and Deferred Inflows of Resources		
Current liabilities:		
Prizes payable		76,517
Accounts payable and accrued liabilities		12,980
Due to other Government – Federal		61
Due to other State funds		10,044
Unearned revenue		1,545
Other liabilities		1,301
Current portion of long-term annuity prizes payable		22,606
Total current liabilities		125,054
Noncurrent liabilities:		
Noncurrent portion of long-term annuity prizes payable		242,143
Due to other State funds		89,046
Net pension liability		82,700
Noncurrent other		707
Total noncurrent liabilities		414,596
Deferred inflows of resources – pension		3,288
Total liabilities and deferred inflows of resources		542,938
Net Position (Deficit)		
Invested in capital assets		37
Unrestricted		(65,891)
Total net position (deficit)	$	(65,854)

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, 2017

(in thousands of dollars)

Operating revenues:		
Charges for sales and services	$	2,843,956
Other		6,152
Total operating revenues		2,850,108
Operating expenses:		
Cost of sales and services		160,045
Prizes and claims		1,820,110
General and administrative		137,821
Depreciation		21
Total operating expenses		2,117,997
Operating income		732,111
Nonoperating revenues (expenses):		
Investment income (expense)		(10,183)
Interest expense		(11,181)
Other		60
Total nonoperating revenues (expenses), net		(21,304)
Change in net position before transfers		710,807
Transfers to other State funds		(732,666)
Change in net position (deficit)		(21,859)
Net position (deficit) at beginning of year		(43,995)
Net position (deficit) at end of year	$	(65,854)

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, 2017

(in thousands of dollars)

Cash flows from operating activities:	
Cash received from sales and services	$ 2,842,019
Cash receipts from other operating activities	19,849
Cash payments for commissions and bonuses	(160,045)
Cash payments for general and administrative expenses	(243,425)
Cash payments for lottery prizes	(1,826,892)
Net cash provided by operating activities	631,506
Cash flows from noncapital financing activities:	
Cash transfers – out to other funds	(738,265)
Net cash used in noncapital financing activities	(738,265)
Cash flows from investing activities:	
Interest and dividends on investments	261
Purchase of investments	(3,809)
Proceeds from investment maturities	31,265
Cash paid for long-term annuity prizes payable	(30,752)
Net cash used in investing activities	(3,035)
Net decrease in cash and cash equivalents	(109,794)
Cash and cash equivalents at beginning of year	227,427
Cash and cash equivalents at end of year	$ 117,633
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)	$ 37,539
Add cash equity in State Treasury	80,094
Cash and cash equivalents at end of year	$ 117,633

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, 2017

(in thousands of dollars)

Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	732,111
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		21
Provision for uncollectible accounts		1,603
Changes in assets and liabilities:		
Decrease in accounts receivable		28,075
Increase in due from other funds		(1)
Decrease in prizes payable		(6,782)
Decrease in accounts payable and accrued liabilities		(129,957)
Decrease in intergovernmental payables		(8)
Decrease in due to other State funds		(1,152)
Decrease in unearned revenues		(1,870)
Decrease in other liabilities		(173)
Increase in long-term annuity prizes payable		3,809
Increase in deferred inflows and outflows of resources and net change in pension liability		5,830
Net cash provided by operating activities	$	631,506

Noncash investing, capital and financing activities:		
Increase in unrealized gains on investments	$	21,848
Interest accreted on investments		11,153
Interest accretion on long-term annuity prizes payable		(11,153)
Release of long-term annuity prizes payable		(282)

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, 2017, the changes in financial position and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

(b) Cash and Cash Equivalents

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

(c) Investments

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

(d) Fair Value of Financial Instruments

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

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

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

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

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

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the valuation methodologies used to measure the Department's financial instruments at fair value. There have been no changes in the methodologies used at June 30, 2017 when compared to June 30, 2016.

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

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

(e) Allowances and Provisions

The allowance for doubtful accounts at June 30, 2017 is based on an analysis of the historical collection experience for accounts receivable, which considers the age of the receivable and current economic conditions.

(f) Interfund Transactions

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

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

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

(g) Capital Assets

Capital assets, which consist of equipment, automobiles, and internally developed computer software, are reported at historical cost. Contributed assets are reported at estimated fair value at the time received. Capital assets are depreciated using the straight-line method. The capitalization threshold for capital assets is $5,000 and the estimated useful lives range from 60 to 180 months.

(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)

(Continued)

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 (deficit) 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 (deficit) as of June 30, 2017.

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

(j) Classification of Revenues and Expenses

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

Revenue

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

Expenses

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

(k) Lottery Revenue

Draw Games

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

Instant Games

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

(l) Prizes and Claims – Ticket Expense

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

(m) Estimates

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

(n) Pensions

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

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

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

(o) Current Adoption of GASB Statements

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plan Other Than Pension Plans*, is 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. The implementation of this statement had no direct impact on the Department's financial statements.

GASB Statement No. 77, *Tax Abatement Disclosures*, is effective for the Department beginning with the year ending June 30, 2017. The objective of this statement is to provide financial statement users with essential information about the nature and magnitude of the reduction in tax revenues through tax abatement programs in order to better assess the government's financial position and results of operations. The Department does not enter into tax abatement agreements.

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

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

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

(p) Future Adoption of GASB Statements

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. 81, *Irrevocable Split-Interest Agreements*, will be effective for reporting periods beginning after December 15, 2016. The Department is not presently, and does not expect to be, a party to an irrevocable split-interest agreement.

GASB Statement No. 83, *Certain Asset Retirement Obligations*, will be effective for reporting periods beginning after June 15, 2018. This statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for asset retirement obligations. The Department currently has no asset retirement obligations.

GASB Statement No. 84, *Fiduciary Activities*, will be effective for reporting periods beginning after December 15, 2018. The objective of this statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. This statement applies to fiduciary funds, which the Department has only proprietary funds.

GASB Statement No. 85, *Omnibus 2017*, will be effective for reporting periods beginning after June 15, 2017. The objective of this statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]).

(Continued)

GASB Statement No. 86, *Certain Debt Extinguishment Issues,* will be effective for reporting periods beginning after June 15, 2017. The primary objective of this statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources – resources other than the proceeds of refunding debt – are placed in an irrevocable trust for the sole purpose of extinguishing debt. This statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The Department currently has no debt.

GASB Statement No. 87, *Leases,* will be effective for reporting periods beginning after December 15, 2019. The objective of this statement is to better meet the informational needs of financial statement users by improving accounting and financial reporting for leases by governments.

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 $80 million as of June 30, 2017, 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 $38 million as of June 30, 2017, are held in Federal Deposit Insurance Corporation (FDIC) insured depository institutions. The Department has an agreement under which one of these institutions insures balances in excess of FDIC insurance limits from loss by pledging securities as collateral. The collateral amount exceeded the deposited amount of $8 million at June 30, 2017. The Department has not incurred any losses on deposits exceeding the value of pledged securities and considers the risk minimal.

(b) Investments

As of June 30, 2017, the Department had the following investments outside of the State Treasury:

		Fair value (thousands)	Weighted average maturity (years)
Annuities	$	276	2.871
U.S. Treasury bonds		287,287	7.466
Total	$	287,563	

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

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

(4) Fair Value Measurements

The following table presents assets (amounts expressed in thousands) measured at fair value on a recurring basis at June 30, 2017:

		Level 1	Level 2	Level 3	Total
Annuities	$	—	—	276	276
U.S. Treasury bonds		287,287	—	—	287,287
Total assets at fair value	$	287,287	—	276	287,563

The change in assets measured at fair value using Level 3 inputs for the year ended June 30, 2017 is as follows:

		2017
Balance, beginning of the year	$	330
Change in value of annuities		(54)
Balance, end of the year	$	276

(5) Interfund Balance and Activity

(a) Balance Due from/to Other Funds

The following balance (amounts expressed in thousands) at June 30, 2017, represent amounts due to other State funds.

Fund	Due to Other State funds		2017	Description/Purpose
Lottery	Capital Projects	$	98,382	Due to other State funds for allocation of lottery proceeds and for administrative expenses.
	Other State funds		708	
		$	99,090	

Of the $98.382 million due to the Capital Projects Fund as of June 30, 2017, the Department expects to pay $9.336 million of the amount due by June 30, 2018. The remaining $89.046 million due is not expected to be paid by June 30, 2018.

(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, 2017 represent amounts transferred to other State funds:

Fund	Other State funds		2017	Description/Purpose
Lottery	Common School	$	705,625	Transfers to Common School, Capital Projects, and other State funds pursuant to statutory requirements.
	Capital Projects		24,336	
	Other State funds		2,694	
Deferred Prize Winners	Other State funds		11	
		$	732,666	

(6) Capital Assets

Capital asset activity (amounts expressed in thousands) for the year ended June 30, 2017 was as follows:

		Balance June 30, 2016	Additions	Deletions	Net transfers	Balance June 30, 2017
Capital assets being depreciated:						
Equipment	$	1,018	—	—	—	1,018
Less accumulated depreciation		(960)	(21)	—	—	(981)
Total capital assets, net	$	58	(21)	—	—	37

(7) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2017 were as follows:

		Balance June 30, 2016	Additions	Deletions	Balance June 30, 2017	Amounts Due within one year
Compensated absences	$	895	1,218	1,279	834	127
Obligations to Lottery prize winners – group contracts		330	—	54	276	60
Obligations to Lottery prize winners – annuities		280,722	14,962	31,211	264,473	22,546
Net pension liability		65,511	17,189	—	82,700	—
Total long-term obligations	$	347,458	33,369	32,544	348,283	22,733

(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, 2017:

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

Fiscal year		Current	Long-term	Total
2018	$	62	—	62
2019		—	62	62
2020		—	62	62
2021		—	62	62
2022		—	50	50
Total future prize payments		62	236	298
Less present value adjustments		(2)	(20)	(22)
Present value at June 30, 2017	$	60	216	276

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 $287 million at June 30, 2017. 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
2018	$	24,720	—	24,720
2019		—	22,561	22,561
2020		—	22,451	22,451
2021		—	24,540	24,540
2022		—	21,897	21,897
2023-2043		—	232,625	232,625
Total future prizes		24,720	324,074	348,794
Adjustments to present value		(2,174)	(82,147)	(84,321)
Present value of future prizes		22,546	241,927	264,473
Adjustments to fair value		1,671	21,143	22,814
Fair value of future prizes at June 30, 2017	$	24,217	263,070	287,287

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 (Deficit) and amounted to $11 million for the year ended June 30, 2017.

(8) Pension Plan

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

Benefit Provisions. SERS provides retirement benefits based on the member's final average compensation and the number of years of credited service that have been established. The retirement benefit formula available to general State employees is 1.67% for each year of covered service and 2.2% for each year of noncovered service. The maximum retirement annuity payable is 75% of final average compensation as calculated under the regular formula. The minimum monthly retirement annuity payable is $15 for each year of covered employment and $25 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	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,

(Continued)

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.	whichever is less, every year on January 1, following the first full year of retirement. The calendar year 2016 rate is $111,572. If the member retires before age 67 with a reduced retirement benefit, he/she will receive a pension increase of 3% or one-half of the Consumer Price Index for the preceding calendar year, whichever is less, every January 1 after the member turns age 67 and has been retired at least one full year. These pension increases are not limited by the 75% maximum

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

SERS also provides occupational and nonoccupational (including temporary) disability benefits. To be eligible for nonoccupational (including temporary) disability benefits, an employee must have at least 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 2017, this amount was $112,408.

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 2017, 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 2017, the employer contribution rate was 44.568%. The Department's contribution amount for fiscal year 2017 was $4.681 million.

Pension liability, deferred outflows of resources, deferred inflows of resources and expense related to pensions. At June 30, 2017, the Department reported a liability of $82.7 million for its proportionate share of the State's net pension liability for SERS on the Department's Statement of Net Position (Deficit). The net pension liability was measured as of June 30, 2016 (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, 2016. As of the current year measurement date of June 30, 2016, the Department's proportion was 0.2422%, which was an increase of 0.0083% from its proportion measured as of the prior year measurement date of June 30, 2015.

For the year ended June 30, 2017, the Department recognized pension expense of $10.44 million. At June 30, 2017, 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	$ 126	$ 2,022
Changes of assumptions	12,712	—
Net difference between projected and actual investment earnings on pension plan investments	1,756	—
Changes in proportion	2,250	1,266
Department contributions subsequent to the measurement date	4,681	—
Total	$ 21,525	$ 3,288

The Department reported $4.681 million of deferred outflows of resources related to pensions resulting from Department contributions subsequent to the measurement date. These will be recognized as a reduction of the net pension liability in the year ending June 30, 2018. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized as pension expense as follows (amounts expressed in thousands):

Year ending June 30,		
2018	$	4,449
2019		3,600
2020		3,195
2021		2,312
Total	$	13,556

Actuarial Methods and Assumptions. The total pension liability was determined by an actuarial valuation as of June 30, 2016, using the following actuarial assumptions, applied to all periods included in the measurement:

Mortality: 105 percent of the RP 2014 Healthy Annuitant mortality table, sex distinct, with rates projected to 2015; generational mortality improvement factors were added.

Inflation: 2.75%

Investment Rate of Return: 7.00%, 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 20-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, 2016, 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	23%	5.80%
Developed Foreign Equity	13%	6.10%
Emerging Market Equity	7%	8.50%
Private Equity	9%	7.40%
Hedge Funds	3%	3.60%
Intermediate Investment Grade Bonds	11%	1.60%
Long-term Government Bonds	3%	1.60%
TIPS	5%	1.30%
High Yield and Bank Loans	5%	4.80%
Opportunistic Debt	4%	4.80%
Emerging Market Debt	2%	4.10%
Real Estate	10%	4.50%
Infrastructure	5%	5.90%
Total	**100%**	**5.04%**

Discount Rate. A discount rate of 6.64% was used to measure the total pension liability as of the measurement date of June 30, 2016 as compared to a discount rate of 7.02% used to measure the total pension liability as of the prior year measurement date. The June 30, 2016 single blended discount rate was based on the expected rate of return on pension plan investments of 7.00% and a municipal bond rate of 2.85%, 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 2072. As a result, the long-term expected rate of return on pension plan investments was applied to projected benefit payments through the year 2072, and the municipal bond rate was applied to all benefit payments after that date.

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

	1% Decrease 5.64%	Discount Rate 6.64%	1% Increase 7.64%
Department's proportionate share of the net pension liability	$ 99,811	$ 82,700	$ 68,737

Payables to the pension plan. At June 30, 2017, the Department reported a payable of $229 thousand to SERS for the outstanding amount of contributions to the pension plans required for the year ended June 30, 2017.

(9) Postemployment Benefits

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

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

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

(10) Risk Management

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

The Department's risk management activities are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the general fund of the State. The claims are not considered to be a liability of the Department; and accordingly, have not been reported in the Department's financial statements for the year ended June 30, 2017.

(11) Private Management Agreement

The State (acting through the Department) entered into a 10-year private management agreement (PMA) with Northstar Lottery Group, LLC (Private Manager) effective January 18, 2011, for the purpose of providing all equipment, services, and functions necessary to operate the Lottery for the State, except for those specifically retained by the State as defined within the PMA. Under the terms of the agreement, the compensation to be paid under the PMA is comprised of the reimbursement of operating expenses and incentive compensation payments. Incentive compensation is subject to annual adjustments in accordance with the agreement. For the year ended June 30, 2017, total compensation for reimbursement of operating expenses to Northstar under the PMA was $108.9 million and is included in general and administrative expenses. Of this amount, $11.4 million was outstanding at June 30, 2017, and is included in accounts payable and accrued liabilities.

On September 18, 2015, the State (acting through the Department) executed a Letter Agreement of Termination (Letter Agreement), which resolved certain outstanding disputes between Northstar and the Department. The Letter Agreement contains provisions regarding Northstar paying the Department for not meeting net income goals pursuant to the PMA, a retroactive supply agreement reduction, and Northstar's reimbursement of legal fees related to prior disputes. Under the terms of the Second Amendment to the Letter Agreement, Northstar will continue in its role as private manager until January 1, 2018 with options to renew.

The Department has recorded a receivable from Northstar at June 30, 2017, in the amount of $28.5 million. This amount is comprised solely of excess advance for expense reimbursements from fiscal year 2017.

See also Note 13 for further information regarding the Private Manager.

(12) Commitments and Contingencies

(a) Lease Commitments

The Department leases certain facilities and equipment necessary for operations, primarily from other State agencies. All leases are operating leases and the majority are month-to-month. Total lease costs for the year ended June 30, 2017 amounted to $874 thousand.

(b) Litigation

As discussed in Note 11, the Letter Agreement resolved outstanding disputes in connection with Northstar and its suppliers.The Department is routinely involved in a number of legal proceedings and claims that cover a wide range of matters.

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 IGT (formerly GTECH Corporation) as its systems provider either as a sole provider or as part of a consortium, the State will be liable for compensating IGT 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 maximum amount payable would be $55 million. This amount shall be prorated in the event the supply agreement is terminated on a different date. The supply agreement with IGT was extended through July 1, 2018 through the Second Amendment to the Letter Agreement. See also Note 13 for further information.

(13) Subsequent Events

On October 13, 2017, the State (acting through the Department compliant with the statutory requirement of the Lottery having a private manager) entered into a 10-year private management agreement with Camelot Illinois LLC (Camelot), for the purpose of providing specified lottery management services to the State. The effective date of the contract is October 13, 2017, and the term includes a period for transitioning from Northstar Lottery Group, LLC to Camelot. The contract with the current private manager, Northstar, will end on January 1, 2018, and Camelot will commence its management contract obligations on January 2, 2018.

Additionally, the State (acting through the Department) executed an Amendment to the Northstar Letter Agreement of Termination, extending the supply agreements with IGT and Scientific Games through April 1, 2019, or earlier in accordance with the terms of such Supply Agreements. These agreements will be assumed under the new agreement with Camelot. The anticipated residual value balance for IGT for the remainder of their supply agreement will be prorated through the end of this amended agreement and is expected to be between $30.9 and $34.4 million. See Note 12 (c) for further information regarding the residual value.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Combining Schedule of Net Position (Deficit)

June 30, 2017

(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	$	36,729	—	810	—	37,539
Cash equity in State Treasury		77,879	2,215	—	—	80,094
Investments, short-term		60	24,217	—	—	24,277
Accounts receivable, net of allowance of $19,197		50,324	—	—	—	50,324
Other receivables		—	1	—	—	1
Due from other Department funds		1,863	—	—	(1,863)	—
Due from other State funds		1	—	—	—	1
Total current assets		166,856	26,433	810	(1,863)	192,236
Noncurrent assets:						
Investments		216	263,070	—	—	263,286
Capital assets being depreciated, net		37	—	—	—	37
Total noncurrent assets		253	263,070	—	—	263,323
Deferred outflows of resources – pension		21,525	—	—	—	21,525
Total assets and deferred outflows of resources		188,634	289,503	810	(1,863)	477,084
Liabilities and Deferred Inflows of Resources						
Current liabilities:						
Prizes payable		76,517	—	—	—	76,517
Accounts payable and accrued liabilities		12,980	—	—	—	12,980
Due to other Government – Federal		61	—	—	—	61
Due to other Department funds		—	1,863	—	(1,863)	—
Due to other State funds		10,044	—	—	—	10,044
Unearned revenue		1,545	—	—	—	1,545
Other liabilities		127	364	810	—	1,301
Current portion of long-term annuity prizes payable		60	22,546	—	—	22,606
Total current liabilities		101,334	24,773	810	(1,863)	125,054
Noncurrent liabilities:						
Noncurrent portion of long-term annuity prizes payable		216	241,927	—	—	242,143
Due to other State funds		89,046	—	—	—	89,046
Net pension liability		82,700	—	—	—	82,700
Noncurrent other		707	—	—	—	707
Total noncurrent liabilities		172,669	241,927	—	—	414,596
Deferred inflows of resources – pension		3,288	—	—	—	3,288
Total liabilities and deferred inflows of resources		277,291	266,700	810	(1,863)	542,938
Net Position (Deficit)						
Invested in capital assets		37	—	—	—	37
Unrestricted		(88,694)	22,803	—	—	(65,891)
Total net position (deficit)	$	(88,657)	22,803	—	—	(65,854)

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, 2017

(in thousands of dollars)

	State Lottery (0711)	Deferred Prize Winners (0978)	Eliminations	Total
Operating revenues:				
Charges for sales and services	$ 2,843,956	—	—	2,843,956
Other	6,152	—	—	6,152
Total operating revenues	2,850,108	—	—	2,850,108
Operating expenses:				
Cost of sales and services	160,045	—	—	160,045
Prizes and claims	1,820,110	—	—	1,820,110
General and administrative	137,821	—	—	137,821
Depreciation	21	—	—	21
Total operating expenses	2,117,997	—	—	2,117,997
Operating income	732,111	—	—	732,111
Nonoperating revenues (expenses):				
Investment income (expense)	512	(10,695)	—	(10,183)
Interest expense	(28)	(11,153)	—	(11,181)
Other	(239)	299	—	60
Total nonoperating revenues (expenses), net	245	(21,549)	—	(21,304)
Change in net position (deficit) before transfers	732,356	(21,549)	—	710,807
Transfers from other State funds	299	—	(299)	—
Transfers to other State funds	(732,655)	(310)	299	(732,666)
Change in net position (deficit)	—	(21,859)	—	(21,859)
Net position (deficit), July 1, 2016	(88,657)	44,662	—	(43,995)
Net position (deficit), June 30, 2017	$ (88,657)	22,803	—	(65,854)

See accompanying independent auditors' report.

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

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

Honorable Frank J. Mautino
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the State of Illinois, Department of the Lottery, which comprise the statement of net position (deficit) as of June 30, 2017, 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, which collectively comprise the State of Illinois, Department of the Lottery's basic financial statements, and have issued our report thereon dated December 22, 2017.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying Schedule of Findings and Responses, we identified certain deficiencies in internal control that we consider to be a material weakness and a significant deficiency.

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. We consider the deficiency described in the accompanying Schedule of Findings and Responses as Finding 2017-001 to be a material weakness.

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. We consider the deficiency described in the accompanying Schedule of Findings and Responses as Finding 2017-002 to be a significant deficiency.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Department of the Lottery's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Responses as Finding 2017-001.

State of Illinois, Department of the Lottery's Responses to Findings

The State of Illinois, Department of the Lottery's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The State of Illinois, Department of the Lottery's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the responses.

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 State of Illinois, Department of the Lottery'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 State of Illinois, Department of the Lottery's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

/s/KPMG LLP

Chicago, Illinois
December 22, 2017

Finding 2017-001 Noncompliance with the Illinois Lottery Law

The Department of the Lottery (Department) did not transfer the required amount to the Capital Projects Fund (Fund 694), as required by the Illinois Lottery Law (Law), and did not properly disclose the noncurrent portion of the liabilities associated with not making the transfer in its financial statements.

During testing, the auditors noted the amount owed to Fund 694 from the State Lottery Fund (Fund 711) has grown to $98.382 million. This amount has been steadily increasing since June 30, 2015, because the actual annual amount of cash transferred to Fund 694 from Fund 711 has been less than required by the Law. The following is an analysis of the actual transfers and cash deposits into Fund 694 and amounts due to Fund 694 (in thousands) over the past three fiscal years:

	Fiscal Year Ended June 30,		
	2015	2016	2017
Amount to Transfer into Fund 694	$ 61,563	$ 29,216	$ 24,336
Actual Cash Deposits into Fund 694	8,000	-	15,000
Difference	$ 53,563	$ 29,216	$ 9,336

	As of June 30,		
	2015	2016	2017
Due to Fund 694	$ 59,830	$ 89,046	$ 98,382

In analyzing Fund 711's current assets for the last three years, there were sufficient funds available from current assets to pay current liabilities (less amounts due to Fund 694) with current assets left over. The following summary analysis shows Fund 711's current assets, current liabilities (excluding the amount due to Fund 694), and cash balances (in thousands) over the past three fiscal years:

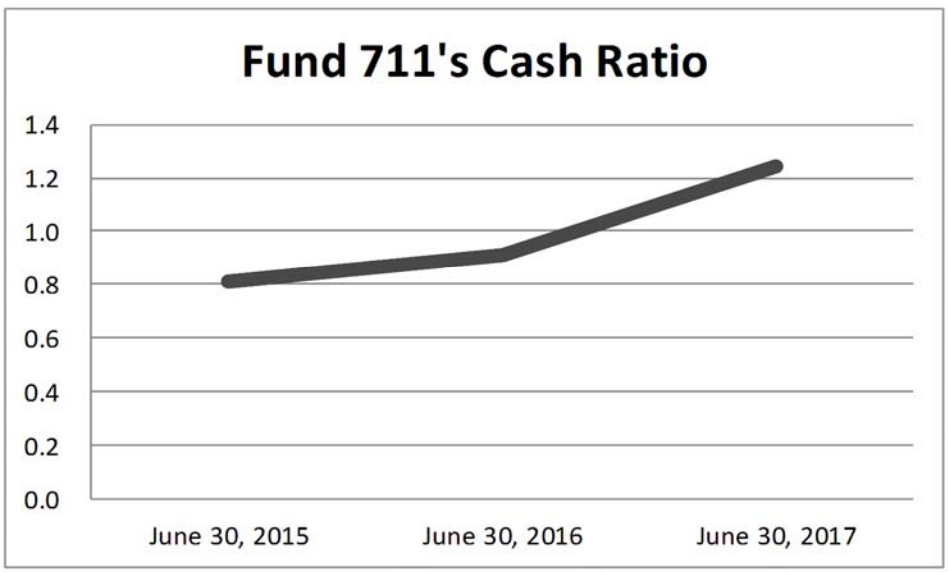
	Fiscal Year Ended June 30,		
	2015	2016	2017
Current Assets	$ 349,580	$ 306,434	$ 166,856
Current Liabilities*	321,265	246,690	91,998
Excess Current Assets	$ 28,315	$ 59,744	$ 74,858
*less amount due to Fund 694			

	As of June 30,		
	2015	2016	2017
Cash Equity in State Treasury	$ 244,501	$ 198,266	$ 77,879
Cash and Cash Equivalents	15,284	26,542	36,729
Total Cash	$ 259,785	$ 224,808	$ 114,608

Finally, the cash ratio, a comparison of total cash to current liabilities, is one metric to analyze liquidity, or ability to satisfy an entity's short-term obligations with cash. The higher the cash ratio, the more capable an entity is to pay its current liabilities. The cash ratio is generally a more conservative look at an entity's ability to cover its liabilities than many other liquidity ratios because other current assets, including accounts receivable, are left out of the equation and some current liabilities have not yet been invoiced by vendors. A cash ratio of 1.0 or greater is an indicator an entity is better positioned to cover its current liabilities. The following is a summary analysis and chart of Fund 711's increasing cash ratio (in thousands) over the past three fiscal years:

	As of June 30,		
	2015	2016	2017
Total Cash	$ 259,785	$ 224,808	$ 114,608
Current Liabilities*	321,265	246,690	91,998
Cash Ratio**	0.809	0.911	1.246

*less amounts due to Fund 694
**Cash Ratio = (Total Cash / Current Liabilities)



The Law (20 ILCS 1605/9.1(o)) requires the Department distribute the proceeds of lottery tickets and shares sold in the following priority order and manner:

1) to pay prizes and retailer bonuses;
2) to pay costs related to administering the Lottery (including all amounts due under the Management Agreement to the Private Manager);
3) to distribute the net revenue from specialty tickets into specific State funds, as provided by § 21.5, § 21.6, § 21.7, § 21.8, and § 21.9 of the Law;
4) to transfer into the Common School Fund (Fund 412) an amount equal to the proceeds transferred into Fund 412 from Fund 711 in Fiscal Year 2009, as adjusted for inflation; and,
5) to deposit, on or before the last day of each fiscal year, any remaining proceeds into Fund 694.

In addition, the auditors noted the Department had not properly disclosed its current and noncurrent liabilities associated with the interfund balances due to Fund 694 from Fund 711. Department management corrected this error in the Department's final financial statements.

Under generally accepted accounting principles (GAAP), liabilities are reported in order of relative maturity where current liabilities are expected to or required to be paid in cash within one year, and noncurrent liabilities are expected to be liquidated in cash in excess of one year, from the balance sheet date. Also, Governmental Accounting Standards Board Statement No. 38, Paragraph 14(c)), *Certain Financial Statement Note Disclosures*, requires the Department disclose its interfund balances not expected to be repaid within one year from the date of the financial statements. Finally, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires the Department establish and maintain a system, or systems, of internal administrative and fiscal controls to provide assurance transfers of assets are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over the State's resources.

Department officials stated the insufficient transfers were due to:

1) excess transfers from Fund 711 to Fund 412 which occurred up to June 30, 2009; and,
2) the Law's annual deadline for transferring cash from Fund 711 to Fund 694 occurring on the last day of the State's fiscal year, which does not allow the Department to perform a close of its accounting records to determine the actual amount of net proceeds to transfer into Fund 694.

Further, Department officials indicated the development of a reasonable estimate is complicated by an unknown liability for prizes won (particularly, if a jackpot was to be won) on June 30 but after the transfer would have to be completed and the fact the Lottery has to maintain sufficient cash reserves to continue normal operations until non-cash assets at June 30 are converted to cash, such as accounts receivable.

In regards to the excess transfers referenced by the Department's management, until June 30, 2009, the Department's predecessor agencies had historically made cash transfers into Fund 412 in excess of Fund 711's accrual basis net income. These excess transfers were recorded as a due from Fund 412 on Fund 711's financial statements (effectively, an account receivable). As of June 30, 2009, this amount of excess transfers was $69.9 million. At June 30, 2012, the Department determined – due to the statutory changes within Public Act 096-0034 (effective on July 13, 2009) – the excess contributions would not be collected. As such, the Department recorded an adjustment of $69.842 million to reclassify the due from Fund 412 as a transfer. Through the end of fieldwork, the Department has not been able to recoup the $69.9 million in excess transfers, which has caused a shortage of cash available to perform current period transfers.

Due to the significance of the issues noted, the auditors concluded these conditions represent noncompliance with the law, which could have a direct and material effect on the determination of financial statement amounts, and a material weakness in the Department's internal control over financial reporting for classifying and reporting current and noncurrent liabilities. Further, these conditions represent material noncompliance with applicable laws and regulations in the Department's financial and fiscal operations and a material weakness in the Department's internal control over compliance for not preventing, or detecting and correcting, these conditions.

Failure to make required deposits delays Fund 694's receipt of cash resources and represents noncompliance with State law. (Finding Code No. 2017-001)

Recommendation:

We recommend the Department study its estimation process for the amount due to Fund 694 so the annual transfer can better approximate the amount required to transfer in accordance with the Law, absent a statutory change in the transfer date. Further, the Department should continue to seek a legislative remedy to allow the Department to "true-up" its annual required transfer after finalizing its accounting records. In addition, the Department should properly report the current and noncurrent portions of the amount due to Fund 694 from Fund 711 during its financial reporting process.

Department Response:

The Department accepts the recommendation. As noted in the finding, excess transfers to the Common School Fund in the amount of $69.9 million did occur and have never been recouped. The write-off of this amount, previously categorized as a due from the Common School Fund (account receivable), resulted in a cash shortage which affects our prior and future transfers.

The amount to transfer into the Capital Projects Fund, as shown in the first table of the finding, is not known until after the Department's accounting records are finalized in September. Statute requires the transfer of net proceeds by June 30, which requires significant estimation. This estimation is further complicated because the Department must have sufficient cash reserves to meet the prioritized requirements set forth in Illinois Lottery Law, as stated in the finding.

The Department has previously sought a legislative change to allow for a true-up of annual transfers in subsequent year transfers. We will continue to seek legislative change to allow for a remedy that improves our ability to make transfers based on the actual amount of net proceeds, knowing that the $69.9 million cash shortage will impact our available cash.

 (Continued)

Finding 2017-002 Inadequate Control over Online Games Prize Liabilities

The Department of the Lottery (Department) did not exercise adequate internal control over reporting its online games prize liabilities at June 30, 2017.

During testing, we noted the following:

- The Department had not eliminated online prize liabilities, totaling $4.647 million, related to the Pick 3 plus FIREBALL and Pick 4 plus FIREBALL which had expired between September 2015 through June 2017 for games between September 2014 and June 2016. Due to this error, the Department had either not offered a special prize pool or transferred these proceeds into the Common School Fund (Fund 412).

  The Illinois Administrative Code (11 Ill. Admin. Code 1770.190(k)) states the Department will hold unclaimed prize money for the duration of the claim period as established by game rule and manage unclaimed prizes in accordance with the Illinois Lottery Law (Law). The Department's *Game Rules, Procedures for Claiming On-Line Game Prizes* (Section 2.6), provides all prizes must be redeemed within one year from the ticket's drawing date. Further, the Law (20 ILCS 1605/19) provides all unclaimed prize money not included in a special prize pool shall be transferred into Fund 412.

- The Department had an unreconciled difference of $2.032 million within its accounts for prize liabilities from online games. Further, the Department's estimate for its prize liabilities from online games for Fiscal Year 2015 and Fiscal Year 2016 were not adjusted to reflect actual amounts paid as of June 30, 2017. As a result of these errors, the Department's prizes payable and prizes and claims expense accounts were overstated by $2.602 million and the due to the Capital Projects Fund (Fund 694) and transfers out to Fund 694 accounts were understated by $2.602 million.

  The Law (20 ILCS 1605/9.1(o)) requires the Department distribute the proceeds of lottery tickets and shares sold in the following priority order and manner:

  1) to pay prizes and retailer bonuses;
  2) to pay costs related to administering the Lottery (including all amounts due under the Management Agreement to the Private Manager);
  3) to distribute the net revenue from specialty tickets into specific State funds, as provided by § 21.5, § 21.6, § 21.7, § 21.8, and § 21.9 of the Law;
  4) to transfer into Fund 412 an amount equal to the proceeds transferred into Fund 412 from Fund 711 in Fiscal Year 2009, as adjusted for inflation; and,
  5) to deposit, on or before the last day of each fiscal year, any remaining proceeds into Fund 694.

These amounts were deemed immaterial by Department management and were not corrected in the Department's final financial statements; however, we determined these exceptions represent a significant deficiency in the Department's internal control over financial reporting. Further, these conditions represent a significant deficiency in the Department's internal control over compliance for not preventing, or detecting and correcting, these conditions.

In accordance with generally accepted accounting principles (GAAP), all of the Department's assets, liabilities, revenues, and expenses should be properly reported in the Department's financial statements. Further, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires the Department establish and maintain a system, or systems, of internal fiscal and administrative controls to provide assurance (1) resources are utilized efficiently and in compliance with applicable law and (2) revenues, expenses, transfers, and resources applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial reports and to maintain accountability over the State's resources.

Department officials stated the gaming system, which was used to identify purged tickets (unclaimed winning tickets), did not properly include the expired Pick 3 plus FIREBALL and Pick 4 plus FIREBALL amounts.

Failure to handle unclaimed prizes in accordance with State laws and regulations resulted in either the Department not offering a special prize pool game or delayed Fund 412's receipt of cash resources as required by Law. Further, failure to ensure expired prize liabilities reconcile to supporting documentation and the Department performs a "true-up" of prior period estimates reduces the reliability of Statewide financial reporting, could result in errors or other irregularities going undetected, and represents noncompliance with State law. (Finding Code No. 2017-002)

Recommendation:

We recommend the Department decide how to handle its unclaimed prizes in excess of one year since the prize's drawing date in accordance with the Law and ensure its accounting records correctly reflect this position. Further, the Department should ensure its online games prize liabilities reconcile to supporting documentation and a "true-up" process occurs within a timely manner for its prior period estimates to reflect actual conditions.

Department Response:

The Department accepts the recommendation. Upon discovering the purged ticket report exported from the gaming system did not properly include the expired Pick 3 plus FIREBALL and Pick 4 plus FIREBALL amounts, the Department immediately took corrective action. Department staff utilized a report outside of the gaming system's data warehouse to identify the previously unrecorded expired Pick 3 plus FIREBALL and Pick 4 plus FIREBALL amounts. This problem was not discovered until after the Department had completed its financial statements for Fiscal Year 2017. On a go forward basis, the Department will (1) ensure this matter is corrected during Fiscal Year 2018 and (2) work to complete this reconciliation in a timely manner during each year's fiscal year end close.

Prior Finding Not Repeated

A. **FINDING** (Noncompliance with the Illinois Lottery Law)

During the prior engagement, the Department of the Lottery (Department) established non-appropriated spending authority and made deposits for multi-state lottery prize liabilities that had not occurred in violation of the Illinois Lottery Law.

During the current engagement, our testing did not identify any similar inappropriate usage of non-appropriated spending authority or prepayments of lottery prize payments. (Finding Code No. 2016-001).