

NEW YORK STATE LOTTERY

**Financial Statements
Years Ended March 31, 2016 and 2015
With Independent Auditor's Report**



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NEW YORK STATE LOTTERY
Financial Statements
Years Ended March 31, 2016 and 2015

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INDEPENDENT AUDITOR'S REPORT

The New York State Gaming Commission

Report on the Financial Statements

We have audited the accompanying statement of net position of the New York State Lottery (the Lottery), an enterprise fund of the State of New York, as of March 31, 2016, and the related statement of revenue, expenses, and change in net position and cash flows for the year then ended, and the related notes to the basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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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 New York State Lottery as of March 31, 2016, and the change in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the Lottery's financial statements present only the New York State Lottery enterprise fund of the State of New York and do not purport to, and do not, present fairly the financial position of the State of New York, as of March 31, 2016, the change in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 7 to the financial statements, as of April 1, 2015, the Lottery adopted Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*. Our opinion is not modified with respect to this matter.

Other Matters

Audit of Prior Year Financial Statements

The 2015 financial statements were audited by other auditors and their report thereon, dated July 17, 2015, contained an unmodified opinion on those financial statements in accordance with accounting principles generally accepted in the United States of America.



Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the required schedules of the Lottery's proportionate share of the net pension liability and the Lottery's contributions on pages 4 through 9 and 32 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Mitchell Titus, LLP

July 28, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

The management of the New York State Lottery (New York Lottery or Lottery) offers readers the following general overview and analysis of the New York Lottery's financial position and activities for the fiscal years ended March 31, 2016 and 2015. We encourage readers to consider this information in conjunction with the detailed financial statements and explanatory notes that follow. The New York Lottery's basic financial statements for the fiscal years ended March 31, 2016 and 2015 have been prepared in accordance with accounting principles generally accepted in the United States of America.

FINANCIAL HIGHLIGHTS

- New York Lottery revenues totaled \$9.691 billion, while net proceeds earned for Lottery Aid to Education reached \$3.302 billion for fiscal year 2016.
- New York Lottery revenues in fiscal year 2016 were more than the revenues of 2015 by \$534.2 million, or 5.8%. In fiscal year 2015, the annual revenue decreased by \$70.2 million, or 0.8%.
- Net proceeds earned for Lottery Aid to Education in fiscal year 2016 were greater than the net proceeds of 2015 by \$191.2 million, or 6.1%. Comparatively, the annual earnings for education in fiscal year 2015 were less than the net proceeds of 2014 by \$62.4 million, or 2.0%.
- Prize expense increased by \$232.8 million or 5.3% during fiscal year 2016. Prize expense decreased by \$11.0 million, or 0.2%, during fiscal year 2015. Prize expense generally follows the changes occurring in sales of the corresponding games.
- Operating income increased by \$218.8 million, or 7.1%, during fiscal year 2016. Operating income decreased by \$36.8 million, or 1.2%, during fiscal year 2015.
- Nonoperating income decreased by \$102.1 million during fiscal year 2016 after increasing by \$200.3 million during fiscal year 2015. Changes in this category are generally the result of unrealized gains/losses on investments, which can change by large amounts in either direction from year to year.
- Working capital (current assets minus current liabilities) increased by \$38.1 million in fiscal year 2016 after decreasing by \$22.8 million in fiscal year 2015.

OVERVIEW OF FINANCIAL STATEMENTS

The New York Lottery presents its financial statements using the accrual basis of accounting, which is comparable to the method used by many private sector businesses. The accrual basis recognizes revenues when earned, not when received. Likewise, expenses are recognized when incurred, not when paid. The Lottery prepares the following three financial statements for fiscal years 2016 and 2015:

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

OVERVIEW OF FINANCIAL STATEMENTS *(continued)*

Statements of Net Position – This statement provides information on the nature and amount of the Lottery's assets, deferred outflow of resources, liabilities and net position at the close of fiscal years 2016 and 2015. The relationship of assets and deferred outflow of resources to liabilities and resulting net position is one indicator of the financial condition of the Lottery and can also be a reflection of changes within the Lottery.

Statements of Revenue, Expenses, and Changes in Net Position – This statement reflects the Lottery's operating and nonoperating revenues and expenses and the change in net position for the year.

Statements of Cash Flows – This statement is presented on the direct method of reporting and reflects cash flows from operating activities as well as capital and noncapital financing and investing activities. Cash collections and payments are reflected in this statement to arrive at the net increase or decrease in cash and cash equivalents for the year.

The above-mentioned financial statements, the notes to the financial statements and this management's discussion and analysis provide information about the Lottery's overall financial condition.

This management's discussion and analysis is meant to be an introduction to the financial statements and to assist readers in understanding the results of the operations and the financial condition of the New York Lottery. The notes to the financial statements are an integral part of the statements and include additional data and explanations, which are to be used in concert with the financial statements.

Following the notes to the financial statements are pension schedules, presented as Required Supplementary Information, presented as required supplementary information, which provide details on the Lottery's net pension liability and contributions.

The New York Lottery deposits its net proceeds into six accounts held in joint custody by the Commissioner of Taxation and Finance and the State Comptroller. These six accounts and the purpose of the funds are as follows:

- Lottery Education Account – Accumulates the required deposits for Aid to Education from revenues, not including video gaming revenues.
- Prize Pending Account – Consists of Lottery prizes that have not yet been paid from revenues, excluding video gaming revenues.
- Administration Account – Utilized to pay for the Lottery's administrative costs that are not related to or funded by video gaming revenues.
- Video Gaming Education Account – Accumulates the required deposits for Aid to Education from video gaming operations.
- Video Gaming Prize Pending Account – Consists of video gaming prizes awarded that have not yet been claimed.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

OVERVIEW OF FINANCIAL STATEMENTS *(continued)*

- Video Gaming Administration Account – Utilized to pay the administrative costs of video gaming.

FINANCIAL ANALYSIS

Summary of Net Position – The comparative summary of net position represents the Lottery's financial position as of the fiscal years 2016, 2015, and 2014 (in millions):

	FY 2016	FY 2015	FY 2014	FY 2016 vs. FY 2015		FY 2015 vs. FY 2014	
				Dollar change	Percent change	Dollar change	Percent change
Capital assets	\$ -	\$ -	\$ -	\$ -	- %	\$ -	- %
Other assets	2,711	2,637	2,544	74	2.8	93	3.7
Total assets	2,711	2,637	2,544	74	2.8	93	3.7
Total deferred outflows of resources	-	-	-	-	-	-	-
Current liabilities	1,078	967	935	111	11.5	32	3.4
Noncurrent liabilities	1,231	1,277	1,299	(46)	(3.6)	(22)	(1.7)
Total liabilities	2,309	2,244	2,234	65	2.9	10	0.4
Restricted net position	157	139	150	18	12.9	(11)	(7.3)
Unrestricted net position	245	254	160	(9)	(3.5)	94	58.8
Total net position	\$ 402	\$ 393	\$ 310	\$ 9	2.3	\$ 83	26.8

Capital Assets – Capital assets consist of equipment and leasehold improvements. During fiscal years 2016 and 2015, there were no changes in capital assets. Additional information about the Lottery's capital assets can be found in Note 1 of the notes to the basic financial statements.

Other Assets – Other assets consist of cash and cash equivalents, accounts receivable, instant ticket inventory, and investments. During fiscal year 2016, other assets increased by \$73.9 million which represented an increase of 2.8% from the previous year. This increase was primarily a result of an increase in cash. In fiscal year 2015, other assets increased by \$93.6 million, which represented an increase of 3.7% from the previous year.

Deferred Outflows of Resources – Deferred outflows of resources consists of deferred pension costs. During fiscal year 2016, this account has been added to the financial statements as a result of the implementation of Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions* and has an ending balance of \$442,000.

Current Liabilities – Current liabilities consist of prizes awarded in the past year that remain unclaimed, amounts due to education, accrued expenses, accounts payable, the value of Lottery tickets purchased in advance of game drawings (unearned ticket sales), and the short-term portion of long-term prizes payable and amounts due to employees for unused vacation leave. In total, these accounts increased by \$111.7 million during fiscal year 2016. This change can be compared to the fiscal year ended March 31, 2015 when there was a \$31.7 million annual increase in total current liabilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

FINANCIAL ANALYSIS *(continued)*

Noncurrent Liabilities – Noncurrent liabilities consist of amounts due to be paid more than one year after the close of the fiscal year for installment prizes and unused employee vacation leave. During fiscal year 2016, noncurrent liabilities decreased by \$45.9 million, with the decrease occurring primarily in the category of long-term prizes payable. During fiscal year 2015, noncurrent liabilities decreased by \$21.3 million, with the decrease occurring primarily in the category of long-term prizes payable. Additional information about the Lottery's noncurrent liabilities can be found in Note 5 of the notes to the financial statements.

Net Position – Restricted net position for future prizes consists of prize funds that are in excess of prizes actually claimed at the fiscal year end, but which are necessary to ensure future prize payments. For example, prize funds from past sales are utilized to pay an accumulating or future New York Lotto, Powerball, Mega Millions or Cash 4 Life jackpot or contribute toward a created but unclaimed instant ticket prize. These amounts are available by statute for this purpose.

Unrestricted net position listed on the statement of net position is largely the cumulative result of increased fair value of the investments held by the Lottery to pay annuity prizes. Since the full maturity value of the investments is needed to pay the annuity prizes, the Lottery does not expect to realize any permanent gain on these investments.

Summary of Revenue, Expenses, and Changes in Net Position – The following summary compares the Lottery's revenues, expenses and changes in net position for the fiscal years 2016, 2015 and 2014 (in millions).

	FY 2016	FY 2015	FY 2014	FY 2016 vs. FY 2015		FY 2015 vs. FY 2014	
				Dollar change	Percent change	Dollar change	Percent change
<i>Operating revenue</i>							
Lottery revenue, net	\$ 9,691	\$ 9,156	\$ 9,226	\$ 535	5.8 %	\$ (70)	(0.8)%
<i>Operating expenses</i>							
Direct expenses	(6,245)	(5,938)	(5,958)	307	(5.2)	(20)	0.3
Indirect expenses	(129)	(120)	(133)	9	(7.5)	(13)	9.8
Total operating expenses	(6,374)	(6,058)	(6,091)	316	(5.2)	(33)	0.5
Operating income	3,317	3,098	3,135	219	7.1	(37)	(1.2)
<i>Nonoperating income (expenses)</i>							
Nonoperating income	51	158	(34)	(107)	(67.7)	192	564.7
Nonoperating expenses	(58)	(62)	(71)	(4)	6.5	(9)	12.7
Total nonoperating income (expenses)	(7)	96	(105)	(103)	(107.3)	201	191.4
Income before required allocation	3,310	3,194	3,030	116	3.6	164	5.4
Required allocation – contribution for aid to education	(3,301)	(3,111)	(3,173)	190	(6.1)	(62)	2.0
Change in net position	9	83	(143)	(74)	(89.2)	226	158.0
Net position beginning of year	393	310	453	83	26.8	(143)	(31.6)
Net position end of year	\$ 402	\$ 393	\$ 310	\$ 9	2.3	\$ 83	26.8

Revenues – The New York Lottery exists for the sole purpose of raising revenue to help support Aid to Education. The Lottery achieves its mission through the sale of Lottery tickets at approximately 17,500 licensed retail locations across the state. The Lottery also achieves its mission through nine licensed video lottery gaming facilities located in Saratoga, Monticello, Farmington, Hamburg, Batavia, Tioga, Vernon, Yonkers, and New York City.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

FINANCIAL ANALYSIS *(continued)*

During fiscal year 2016, the Lottery achieved \$3.792 billion in draw sales, \$3.912 billion in instant sales, and \$1.987 billion in video lottery gaming net machine income for a total of \$9.691 billion, an increase of \$534.2 million, or 5.8%, over the previous fiscal year. During fiscal year 2015, the Lottery achieved \$3.491 billion in draw sales, \$3.760 billion in instant sales, and \$1.905 billion in video lottery gaming net machine income for a total of \$9.156 billion, a decrease of \$70.2 million, or 0.8%, over the previous fiscal year. The most significant growth was generated in draw sales during fiscal year 2016, while instant sales generated the most significant growth in fiscal year 2015.

The following compares the Lottery's revenues by game and the percentage of total revenues by game for the fiscal years 2016, 2015, and 2014 (in millions).

Game	FY 2016		FY 2015		FY 2014	
	Revenue	Percent of total revenues	Revenue	Percent of total revenues	Revenue	Percent of total revenues
Mega Millions	\$ 255	2.6%	\$ 288	3.1%	\$ 400	4.3%
Lotto	97	1.0	84	0.9	95	1.0
Take 5	241	2.5	239	2.6	256	2.8
Numbers	903	9.3	870	9.5	874	9.5
Win 4	911	9.4	852	9.3	831	9.0
Quick Draw	787	8.1	694	7.6	654	7.1
Pick 10	30	0.3	28	0.3	29	0.3
Sweet Million	-	-	6	0.1	33	0.4
Powerball	460	4.8	305	3.3	463	5.0
Other Multi-State Draw Games *	108	1.1	125	1.4	-	-
Promo game	-	-	-	-	2	-
Instant	3,912	40.4	3,760	41.1	3,677	39.9
Subtotal traditional lottery	7,704	79.5	7,251	79.2	7,314	79.3
Video gaming, net **	1,987	20.5	1,905	20.8	1,912	20.7
Total revenues	\$ 9,691	100.0%	\$ 9,156	100.0%	\$ 9,226	100.0%

* Other Multi-State Draw Games include Cash 4 Life and Monopoly Millionaires' Club.

**

Video gaming revenue represents net machine income after awarding prizes. Video gaming credits played and won were as follows:

	FY 2016	FY 2015	FY 2014
Credits played	\$ 37,266	\$ 33,971	\$ 32,348
Credits won	(35,279)	(32,066)	(30,436)
Net machine income	\$ 1,987	\$ 1,905	\$ 1,912

Direct Expenses – Direct expenses consist of prize expense for traditional Lottery games, commissions to Lottery retailers and video lottery gaming facilities, fees to gaming contractors, expenses of providing instant tickets to players, and telecommunications. The largest expenditure in this category is prize expense, which made up approximately 75% of direct expenses during each of the three years being discussed. Prizes increased by \$232.8 million to \$4.629 billion in fiscal year 2016. At the same time, retailer commissions increased by \$63.9 million to \$1.347 billion and gaming contractor fees increased by \$7.4 million to \$227.1 million.

Prizes decreased by \$11.0 million to \$4.397 billion in fiscal year 2015. At the same time, retailer commissions decreased by \$7.6 million to \$1.283 billion and gaming contractor fees remained flat.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

FINANCIAL ANALYSIS *(continued)*

Other Operating Expenses – Other operating expenses include marketing, state agency charges, personal services, fringe benefits and other administrative costs. These costs were \$128.8 million during fiscal year 2016, which was 6.8% higher than the prior year. Corresponding costs in fiscal year 2015 were \$120.6 million, which was 9.8% lower than in fiscal year 2014.

Nonoperating Revenues (Expenses) – Nonoperating revenues and expenses consist of miscellaneous income plus the net growth or decline in the fair value of investments used to fund long-term prizes. Investment income of \$49.5 million in 2016, \$148.9 million in 2015 and \$(35.4) million in 2014 consists of both the fair value adjustments of investments plus the normal growth of the value of Lottery investments as the securities move closer to maturity. The market-driven fair value adjustment, which is subject to considerable variance over time, is the primary factor in causing any large differences from year to year. Investment expense is a reflection of the Lottery expending the investment income to increase the valuation of the long-term prizes payable to winners. The annual fair value adjustment of investments (shown here as income) flows to the unrestricted net position balance on the statement of net position.

Income Before Required Allocation and Change in Net Position – The revenues and expenses for fiscal year 2016 resulted in income before required allocation totaling \$3.310 billion. This amount consists of a required allocation for Aid to Education of \$3.302 billion that transfers out as a contribution for Aid to Education and an \$8.5 million increase in net position for the year. The \$8.5 million increase in net position is a combination of an \$18.0 million increase in net position restricted for prizes and a \$9.5 million decrease in unrestricted net position. The revenues and expenses for fiscal year 2015 resulted in income before required allocation totaling \$3.194 billion. This amount consists of a required allocation for Aid to Education of \$3.111 billion that transfers out as a contribution for Aid to Education and an \$83.1 million increase in net position for the year. The \$83.1 million increase in net position is a combination of an \$11.2 million decrease in net position restricted for prizes and a \$94.3 million increase in unrestricted net position.

Summary and Outlook – As a mature business entity, the New York Lottery generally anticipates only moderate but steady growth from year to year. An opportunity to move beyond normal growth would not be expected unless there were an addition of new games or an expansion in gaming facilities.

Contacting New York Lottery's Financial Management – This financial report is designed to provide the State of New York, the public, and other interested parties with an overview of the financial results of the New York State Lottery and an explanation of the Lottery's financial condition. If you have any questions about this report or require additional information, email info@gaming.ny.gov or write to The New York State Gaming Commission Communications Office, One Broadway Center, P.O. Box 7500, Schenectady, NY 12301-7500.

NEW YORK STATE LOTTERY

Statements of Net Position

Years Ended March 31, 2016 and 2015

(In thousands)

	<u>2016</u>	<u>2015</u>
ASSETS		
<i>Current assets</i>		
Cash and cash equivalents	\$ 724,407	\$ 490,819
Accounts receivable	455,443	526,292
Instant ticket inventory	10,273	10,704
Investments	99,667	112,255
Total current assets	<u>1,289,790</u>	<u>1,140,070</u>
<i>Noncurrent assets</i>		
Long-term investments, net	1,421,189	1,497,026
Total noncurrent assets	<u>1,421,189</u>	<u>1,497,026</u>
Total assets	2,710,979	2,637,096
Deferred outflows of resources	442	-
Total assets and deferred outflows of resources	<u>2,711,421</u>	<u>2,637,096</u>
LIABILITIES		
<i>Current liabilities</i>		
Prizes payable	130,207	138,019
Unclaimed prizes	582,709	577,253
Due to education	346,081	213,309
Accounts payable and accrued liabilities	8,422	26,978
Unearned ticket sales	9,813	9,714
Compensated absences	1,157	1,464
Total current liabilities	<u>1,078,389</u>	<u>966,737</u>
<i>Noncurrent liabilities</i>		
Compensated absences	134	120
Pension contribution payable	2,667	-
Net pension liability	1,883	-
Long-term prizes payable	1,226,840	1,277,256
Total noncurrent liabilities	<u>1,231,524</u>	<u>1,277,376</u>
Total liabilities	<u>2,309,913</u>	<u>2,244,113</u>
NET POSITION		
Restricted for future prizes	156,955	138,995
Unrestricted	244,553	253,988
Total net position	<u><u>\$ 401,508</u></u>	<u><u>\$ 392,983</u></u>

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY

Statements of Revenue, Expenses, and Changes in Net Position

Years Ended March 31, 2016 and 2015

(In thousands)

	<u>2016</u>	<u>2015</u>
OPERATING REVENUE		
Lottery revenue, net	\$ 9,690,511	\$ 9,156,336
<i>Operating expenses</i>		
Prize expense	(4,629,657)	(4,396,853)
Retailer commissions	(1,346,488)	(1,282,568)
Gaming contractor fees	(227,116)	(219,731)
Instant ticket direct expenses	(22,970)	(20,566)
Telecommunications	(18,492)	(17,827)
Total direct expenses	<u>(6,244,723)</u>	<u>(5,937,545)</u>
Marketing and advertising expense	(85,620)	(75,812)
Personal service and fringe benefits	(32,177)	(28,883)
Other administrative costs	(5,273)	(11,443)
State agency charges	(5,725)	(4,441)
Total indirect expenses	<u>(128,795)</u>	<u>(120,579)</u>
Total operating expenses	<u>(6,373,518)</u>	<u>(6,058,124)</u>
Operating income	<u>3,316,993</u>	<u>3,098,212</u>
NONOPERATING REVENUE (EXPENSES)		
Investment income	49,542	148,914
Other revenue, net	2,102	8,982
Investment expense, net	(58,332)	(62,443)
Total nonoperating (expenses) revenue	<u>(6,688)</u>	<u>95,453</u>
Income before required allocation	3,310,305	3,193,665
Required allocation for aid to education	<u>(3,301,780)</u>	<u>(3,110,570)</u>
Change in net position	8,525	83,095
Net position, beginning of year	<u>392,983</u>	<u>309,888</u>
Net position, end of year	<u><u>\$ 401,508</u></u>	<u><u>\$ 392,983</u></u>

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY
 Statements of Cash Flows
 Years Ended March 31, 2016 and 2015
 (In thousands)

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from net lottery revenue	\$ 9,729,563	\$ 9,137,343
Cash payments for prizes	(4,712,200)	(4,432,987)
Cash payments for commissions	(1,346,460)	(1,282,577)
Cash payments for contractor fees	(229,139)	(219,238)
Cash payments for telecommunications	(18,492)	(17,827)
Cash payments for instant ticket direct expenses	(22,491)	(22,052)
Cash payments for other operating expenses	(138,254)	(127,041)
Other cash receipts	2,102	8,982
Net cash provided by operating activities	<u>3,264,629</u>	<u>3,044,603</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from investment maturities	112,477	127,118
Purchases of investments	-	(84,265)
Proceeds from investment sales	-	11,804
Interest on cash and cash equivalents and investments	25,490	24,386
Net cash provided by investing activities	<u>137,967</u>	<u>79,043</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash transfer to State for Aid to Education	(3,169,008)	(3,215,584)
Cash received from State General Fund for Lottery Aid Guarantee	-	66,765
Net cash used in noncapital financing activities	<u>(3,169,008)</u>	<u>(3,148,819)</u>
Net increase (decrease) in cash and cash equivalents	233,588	(25,173)
Cash and cash equivalents, beginning of year	490,819	515,992
Cash and cash equivalents, end of year	<u>\$ 724,407</u>	<u>\$ 490,819</u>
<i>Reconciliation of operating income to net cash provided by operating activities</i>		
Operating income	\$ 3,316,993	\$ 3,098,212
<i>Adjustments to reconcile operating income to net cash provided by operating activities</i>		
Other cash receipts	2,102	8,982
<i>Change in operating assets, deferred outflows and liabilities</i>		
(Increase) decrease in accounts receivable, net	70,849	(47,292)
(Increase) decrease in ticket inventory	431	(1,563)
Decrease in prizes payable	(116,561)	(105,295)
Increase in unclaimed prizes	5,456	106,072
Decrease in compensated absences	(292)	(217)
Increase in deferred outflows	(442)	-
Increase in net pension liability	1,883	-
Increase in pension contribution payable	2,667	-
Decrease in accounts payable and accrued liabilities	(18,556)	(14,523)
Increase in unearned ticket sales	99	227
Net cash provided by operating activities	<u>\$ 3,264,629</u>	<u>\$ 3,044,603</u>
<i>Noncash investing activities</i>		
Decrease (increase) in unrealized gains on investments	\$ (10,664)	\$ 85,313
Amortization of investment discount	34,716	37,382

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The New York State Lottery (Lottery) was established in 1967. In 1976, the Lottery was placed under the Division of the Lottery, an independent unit of the New York State Department of Taxation and Finance, which operates in accordance with the provisions of the New York State Lottery for Education Law (Tax Law Article 34). On February 1, 2013, the Division of Lottery was merged with the New York State Racing and Wagering Board into a single oversight entity called the New York State Gaming Commission, which was given responsibility to administer traditional and video lottery games as part of its overall responsibility for regulation and enforcement of gaming activity in New York. The purpose of the Lottery is to raise revenue for education in the State of New York (State) through the administration of lottery games.

These financial statements represent only the Lottery and do not present the financial position of the State nor changes in the State's financial position and cash flows. However, the Lottery is included in the State of New York's basic financial statements as an enterprise fund.

The Lottery applies all applicable Governmental Accounting Standards Board (GASB) pronouncements and prepares its financial statements under the economic resources measurement focus, whereby all inflows, outflows and balances affecting net position are reported, and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The primary operating revenue of the Lottery is ticket sales from games. Nonoperating income consists mostly of investment income and unrealized gains on investments. Operating expenses consist of direct expenses for prizes, commissions to Lottery retailers, fees to gaming contractors, expenses for providing instant tickets to players, and telecommunications. Other operating expenses that are indirect to the results of each game include marketing, state agency charges, personal services, and fringe benefits. Nonoperating expense includes the amortization of the discount on long-term prizes payable.

The more significant accounting policies of the Lottery are described below:

Revenue Recognition

(i) Draw Games

Revenue from ticket sales for Lotto, Sweet Million, Quick Draw, Take 5, Pick 10, Mega Millions, Powerball, Cash 4 Life, Monopoly Millionaires' Club, Numbers and Win-4 games, and promotional games (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 drawings take place.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

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

Revenue Recognition *(continued)*

(ii) Instant Games

Revenue from Instant Games is recognized based on the dollar value of the total number of tickets available for sale. Tickets are available for sale upon being activated on the Lottery Validation System at the retailer locations.

(iii) Video Gaming

Revenue from video lottery gaming is recognized based on net machine income, which is defined as amounts played less prizes won.

Prize Expense

The Lottery recognizes prize expense for draw games equivalent to the actual prize liability incurred for each drawing. Prize expense for instant games is recognized when instant books are activated by retailers and is based on the percentage of sales allocated to prizes for each game. Video lottery revenue is reported net of prizes, so prize expense is not recognized on these games. Prize expense is adjusted accordingly for any prizes unclaimed within the time period allowed by law.

Commissions and Fees

Retailers selling draw and instant game tickets receive a commission of 6% based on the total tickets sold. Video gaming facilities receive a varying percent of incremental annual net machine income according to provisions of Section 1612 of the Tax Law. The particular percent applied to a range of net machine income can vary depending on the facility's number of video gaming machines, geographical area of the state, population level, or proximity to Native American gaming facilities. The draw game contractor and the video gaming central processing contractor receive fees equal to a contractual percentage of the sales generated through the network maintained by the respective contractor. The instant game contractor is paid a fee equal to a contractual percentage of instant sales. Video lottery terminal contractors receive a fee equal to a contractual percentage of revenue, adjusted for the units of service provided. All other gaming contractors are paid fees based on the units of service provided (see Note 13).

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

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

Accounts Receivable

Accounts receivable primarily represent amounts due from retailers through a Lottery gaming contractor and amounts due from video lottery gaming facilities, net of commissions and fees, as well as amounts due from agents for Instant Game tickets which have been activated, but not yet settled. Instant ticket settlements occur within 45 days after a book of tickets is activated. Video lottery gaming receivables are received two business days after each sales day and draw games are collected within four business days after the close of each sales week.

Allocation of Revenue from Ticket Sales

The allocation of ticket sales is made in accordance with the provisions of the New York State Lottery for Education Law which requires:

- Allocations of ticket sales revenue to New York for educational purposes are to be at least 20% for the New York State Lottery Instant Games, 30% for multi-state games such as Mega Millions, Powerball, Cash 4 Life and Monopoly Millionaires' Club, 35% for Take 5, Numbers, Win-4, and Pick 10, 45% for Lotto, Sweet Million, and promotional games, and 25% for Quick Draw. In addition, the Lottery has statutory authority to issue up to five Instant Games per year with at least 10% for educational purposes. For video lottery, the required allocation to education is a varying percent of each facility's annual incremental net machine income, depending on factors such as the facility's number of video gaming machines, geographical area of the state, population level, and proximity to Native American gaming facilities.
- Allocations of ticket sales revenue for the payment of lottery prizes are not to exceed 65% for the New York State Lottery Instant Games, 55% for multi-state games such as Mega Millions, Powerball, Cash 4 Life and Monopoly Millionaires' Club, 50% for Take 5, Numbers, Win-4, and Pick 10, 40% for Lotto and Sweet Million and 60% for Quick Draw. In addition, the Lottery has statutory authority to issue up to five Instant Games per year with up to 75% allocated to prizes. Video lottery is required to pay prizes that average no less than 90% of gross sales.
- Allocations of ticket sales revenue from all traditional games for the payment of Lottery administrative expenses (including agent commissions and contractor fees) are not to exceed 15%. For video lottery, 10% of net revenue (the total revenue wagered after payout for prizes) is allocated for Lottery Administration. Unlike traditional games, the video lottery administrative allocation does not include commissions and fees, which are described separately (see previously within Commissions and Fees). Any excess of the maximum allocation over actual administrative expenses is allocated to education. Such allocations amounted to approximately \$497,419,000 and \$464,791,000 for fiscal years 2016 and 2015, respectively. Administrative expenses incurred by the Lottery represent telecommunications, advertising, salary and other operating costs.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

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

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Lottery considers cash equivalents to be amounts held with banks and amounts held under the joint custody of the Commissioner of Taxation and Finance and the Comptroller of the State of New York through the Short-Term Investment Pool, which is used for the temporary investment of funds not required for immediate payments.

Investments

Investments, consisting of U.S. Government-backed obligations (zero coupon bonds and stripped Government securities) and New York City Transitional Finance Authority municipal bonds, are carried at fair value. Investment income represents accretion of bond discount, interest on bonds and deposits, and the change in fair value of investments.

Inventory

Instant game tickets are purchased from printing vendors. Tickets not activated for sale are held in inventory and are valued at cost by game. Tickets are charged to instant ticket direct expense under the first-in, first-out (FIFO) accounting method when activated for sale by the lottery retailers. At the conclusion of an instant game, unused inventory is charged to instant ticket direct expense.

Capital Assets

Capital assets consist of equipment and leasehold improvements, which are carried at historical cost. Equipment is capitalized when it has cost in excess of \$40,000 and a useful life of two years or more. Leasehold improvements are capitalized when they have a cost of \$100,000 or more. Depreciation of equipment is computed using the straight-line method over five years, the estimated useful lives of the assets. Leasehold improvements and equipment acquired under capital leases are amortized using the straight-line method over ten and five years, respectively, which is the lesser of their useful lives or the term of the leases. Changes in capital assets and related accumulated depreciation are shown below, by major class of asset, for the years ended March 31, 2016 and 2015 (in thousands).

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Capital Assets (continued)

	2014	Additions	Deletions	2015	Additions	Deletions	2016
<i>Leasehold improvements</i>							
Cost	\$ 4,526	\$ -	\$ -	\$ 4,526	\$ -	\$ -	\$ 4,526
Accumulated depreciation	(4,526)	-	-	(4,526)	-	-	(4,526)
Net value	-	-	-	-	-	-	-
<i>Equipment</i>							
Cost	1,911	-	-	1,911	-	-	1,911
Accumulated depreciation	(1,911)	-	-	(1,911)	-	-	(1,911)
Net value	-	-	-	-	-	-	-
Total	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is reflected in other revenues, net in the period of disposal.

Prizes Payable

Lotto, Powerball, Mega Millions and Cash 4 Life jackpot players have the option of selecting a lump sum payment or a long-term annuity payment. Some instant games also have jackpot prizes that are long-term annuity payments. Prizes payable represents the liability for those prizes which are payable in annual installments. Such prize payments are funded by the Lottery's investments. The amortization of the long-term annuity payment discount is recorded as investment expense in these financial statements. Any excess of investment maturities over related annuity prize payments are recorded in restricted net position and made available for future prizes.

Unclaimed Prizes

Unclaimed prizes at March 31, 2016 and 2015 were \$582,709,000 and \$577,253,000, respectively. Prizes unclaimed for one year after the drawing date (lapsed) are forfeited by the ticket holder. Total prizes lapsed amounted to approximately \$103,815,000 and \$64,647,000 for fiscal years 2016 and 2015, respectively. These forfeited prizes are netted against prize expense in the statements of revenue, expense, and changes in net position.

Under State Tax Law Section 1614, the Lottery retains forfeited prizes for supplemental prizes in subsequent lottery games. During the fiscal years 2016 and 2015, these supplemental prizes were used for Mega Millions, Powerball, Cash 4 Life, Lotto, Quick Draw, Take 5, Monopoly Millionaires' Club, Numbers, Win 4, and various Instant Games.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

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

Restricted Net Position

Restricted net position for prizes includes forfeited prizes and other prize assets that are restricted under State Tax Law Sections 1612 and 1614 for the purpose of meeting future prize expense.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and related notes. Actual results could differ from those estimates.

Adoption of New Accounting Pronouncements

During the year ended March 31, 2016, the Lottery adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement revises existing standards for measuring and reporting pension liabilities. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, and information about the fiduciary net position of the pension plan and addition to and deductions from the pension plan's fiduciary net position have been determined on the same basis as they are reported by the State and Local Employees' Retirement System (ERS).

NOTE 2 CASH AND CASH EQUIVALENTS

Lottery deposits of cash and cash equivalents are made in accordance with State Finance Law Sections 92c and 98a and State Tax Law Sections 1611 and 1612. Lottery sales receipts are allocated and deposited in separate fund accounts for prizes, education, and administration under the joint custody of the Commissioner of Taxation and Finance and the Comptroller of the State of New York. Per Section 98a of the State Finance Law, the accounts for prizes and administration earn interest through participation in a short-term investment pool administered by the Office of the State Comptroller of the State of New York. The prize account interest is used for future lottery prizes. The carrying amount of the joint custody accounts included in cash and cash equivalents were \$706,141,000 and \$460,129,000 at March 31, 2016 and 2015, respectively.

The Lottery also maintains sole custody accounts which are used for daily cash management purposes. The Lottery manages the investment of its cash balances to minimize its uninvested funds. At March 31, 2016 and 2015, the amount of sole custody accounts included in cash and cash equivalents were \$18,266,000 and \$30,690,000, respectively.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 2 CASH AND CASH EQUIVALENTS *(continued)*

The Lottery's deposits are collateralized under a program administered by the Office of the State Comptroller of the State of New York. To manage custodial credit risk, the State requires that its depository banks pledge collateral based on available bank balances. All securities pledged as collateral are held by the State's fiscal agent in the name of the State. The Lottery's deposits with financial institutions were fully collateralized at fiscal year-end. The Lottery manages custodial credit risk by using several financial institutions and by minimizing balances in the sole custody accounts.

NOTE 3 INVESTMENTS

The Lottery is authorized by the Office of the State Comptroller per State statute to invest prize funds which will provide for the payment of prizes payable (see Note 4). The Lottery invests these funds in U.S. Government-backed obligations, New York City Transitional Finance Authority municipal bonds, and Agency for International Development Bonds, which are guaranteed by the full faith and credit of the United States. The fair value of these investments at March 31, 2016 and 2015 was \$1,520,856,000 and \$1,609,281,000, respectively. During fiscal years 2016 and 2015, approximately \$34,716,000 and \$37,382,000, respectively, of amortized discount was included in investment income.

The amortized costs of these investments consisted of the following at March 31 (in thousands):

	<u>2016</u>	<u>2015</u>
Maturity value	\$ 1,636,317	\$ 1,748,794
Unamortized discount	<u>(335,130)</u>	<u>(369,846)</u>
Total at amortized cost	1,301,187	1,378,948
Less: Investments, maturing within one year, at amortized cost	<u>98,148</u>	<u>110,175</u>
Long-term investments, at amortized cost	<u><u>\$ 1,203,039</u></u>	<u><u>\$ 1,268,773</u></u>

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 3 INVESTMENTS *(continued)*

Maturities of the investments in each of the five fiscal years following March 31, 2016, and five year incremental totals thereafter, are as follows (in thousands):

	<u>Maturities</u>	<u>Interest due</u>	<u>Total</u>
2017	\$ 99,565	\$ 23,622	\$ 123,187
2018	100,336	23,063	123,399
2019	100,206	22,432	122,638
2020	104,806	21,738	126,544
2021	104,325	20,901	125,226
2022–2026	429,859	89,886	519,745
2027–2031	233,872	69,258	303,130
2032–2036	123,144	58,988	182,132
2037–2041	275,992	25,870	301,862
2042–2046	64,212	-	64,212
	<u>\$ 1,636,317</u>	<u>\$ 355,758</u>	<u>\$ 1,992,075</u>

Credit risk is the risk that an issuer will not fulfill its obligations. The Lottery's policy is to follow State law which limits the investments that the Lottery can make and generally limits the Lottery's exposure to credit risk. The Lottery has generally limited its investments to obligations backed by the full faith of the U.S. government. Beginning in 2011, the Lottery held similarly rated New York City Transitional Finance Authority municipal bonds. The credit ratings of the Lottery's investments as published by Moody's and Standard & Poor's are included below for those investments where credit ratings were available.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Lottery's policy for managing this risk is generally to hold investment securities to maturity, at which time the fair value of the investment is equal to its stated maturity value.

As of March 31, 2016 and 2015, the Lottery had the following investments and maturities (amounts in thousands):

Investment type	2016 Fair value	Moody's credit rating	S&P credit rating	2016 Investment maturities		
				Less than five years	5 years to 10 years	More than 10 years
U.S. Treasury Strips	\$ 653,057	N/A	N/A	\$ 247,762	\$ 153,997	\$ 251,298
New York City Transitional Finance Authority Bonds	534,809	Aa1	AAA	87,618	119,409	327,782
Agency for International Development Bonds	332,990	N/A	N/A	169,107	131,354	32,529
Total	<u>\$ 1,520,856</u>			<u>\$ 504,487</u>	<u>\$ 404,760</u>	<u>\$ 611,609</u>

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 3 INVESTMENTS *(continued)*

Investment type	2015 Fair value	Moody's credit rating	S&P credit rating	2015		
				Investment maturities		
				Less than five years	5 years to 10 years	More than 10 years
U.S. Treasury Strips	\$ 670,230	N/A	N/A	\$ 235,562	\$ 165,857	\$ 268,811
New York City Transitional Finance Authority Bonds	538,036	Aa1	AAA	66,974	115,913	355,149
Agency for International Development Bonds	401,015	N/A	N/A	208,340	155,992	36,683
Total	<u>\$ 1,609,281</u>			<u>\$ 510,876</u>	<u>\$ 437,762</u>	<u>\$ 660,643</u>

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to perform on a transaction, the Lottery will not be able to recover the value of investment securities that are in the possession of an outside party. To manage this risk, all of the Lottery's investments are insured or registered securities held by the Lottery or its agent in the Lottery's name.

NOTE 4 PRIZES PAYABLE

Prizes payable consisted of the following at March 31 (in thousands):

	<u>2016</u>	<u>2015</u>
Total obligation	\$ 2,062,053	\$ 2,169,576
Unamortized discount	<u>(705,006)</u>	<u>(754,301)</u>
Total carrying amount	1,357,047	1,415,275
Less: Prizes payable within one year	<u>130,207</u>	<u>138,019</u>
Long-term prizes payable	<u>\$ 1,226,840</u>	<u>\$ 1,277,256</u>

The amortized discount on the prizes payable is based on interest rates ranging from 0.07% to 7.78% and reflects the interest rates earned by the investments held to fund the related liabilities. The amortization of discount is recorded as investment expense in the statements of revenues, expenses, and changes in net position and amounted to \$58,332,000 and \$62,443,000 for fiscal years 2016 and 2015, respectively.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 4 PRIZES PAYABLE (continued)

The aggregate amount of prizes payable due in each of the five fiscal years following March 31, 2016, and the five year incremental totals thereafter, is as follows (in thousands):

2017	\$	124,726
2018		124,124
2019		124,773
2020		125,313
2021		125,603
2022–2026		527,989
2027–2031		321,732
2032–2036		174,302
2037–2041		118,847
2042–2046		101,422
2047–2051		75,943
2052–2056		53,379
Thereafter		63,900
		\$ 2,062,053

NOTE 5 LONG-TERM LIABILITIES

The Lottery's long-term liabilities as of March 31, 2016 and 2015 are comprised of the following (in thousands):

	Balance at March 31, 2015	Additions	Deductions	Balance at March 31, 2016	Current portion
Compensated absences (Note 11)	\$ 1,584	\$ 1,127	\$ (1,420)	\$ 1,291	\$ 1,157
Pension contribution payable (Note 7)	-	2,667	-	2,667	362
Net pension liability (Note 7)	-	1,883	-	1,883	-
Prizes payable (Note 4)	1,415,275	74,441	(132,669)	1,357,047	130,207
	Balance at March 31, 2014	Additions	Deductions	Balance at March 31, 2015	Current portion
Compensated absences (Note 11)	\$ 1,801	\$ 1,448	\$ (1,665)	\$ 1,584	\$ 1,464
Prizes payable (Note 4)	1,458,127	108,034	(150,886)	1,415,275	138,019

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 6 AID TO EDUCATION

The required allocation and contribution transferred out for aid to education during the fiscal years ended March 31, 2016 and 2015 are as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Cash transferred to education	\$ 3,169,008	\$ 3,215,584
Amount received from the State General Fund for Lottery aid guarantee	-	(66,765)
Net cash transferred to education	3,169,008	3,148,819
Prior-year payable	(213,309)	(251,558)
Current-year payable	346,081	213,309
Required allocation to education	<u>\$ 3,301,780</u>	<u>\$ 3,110,570</u>

NOTE 7 PENSION BENEFITS

Substantially all employees of the Lottery are members of the State and Local Employees' Retirement System (ERS) and the Public Employees' Group Life Insurance Plan (GLIP). The two programs are part of the State and Local Retirement System (System) which is a cost-sharing, multiple employer public employee retirement system. The Comptroller of the State of New York is sole trustee and administrative head of the System.

For purposes of determining net pension liability and other pension-related amounts, information about the fiduciary net position of ERS and additions to and deductions from the ERS fiduciary net position has been determined on the same basis reported by the System. The System issues a publicly available financial report that includes financial statements, expanded disclosures, and required supplementary information for the System. The report may be obtained by writing to the New York State and Local Retirement System, Office of the State Comptroller, 110 State Street, Albany, New York, 12244-0001, or at www.osc.state.ny.us/pension/cafr.htm.

The System provides retirement benefits as well as death and disability benefits. Retirement benefits are established by the New York State Retirement and Social Security Law. Vesting, retirement benefits, and contributory requirements depend upon the point in time at which an employee last joined the System. Most members of the System who joined before July 27, 1976 are enrolled in a noncontributory plan; the Lottery contributes the entire amount determined to be payable to the System. Personnel who joined the System on or after July 27, 1976 are required by law to contribute some percent of their gross salary for a specified number of years of employment; the Lottery withholds and contributes the balance payable to the System for these employees.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 7 PENSION BENEFITS *(continued)*

The Lottery paid to the Office of the State Comptroller of the State of New York \$2,921,000 for 2016, \$3,213,000 for 2015, and \$3,132,000 for 2014, to cover required employer contributions for retirement benefits and equaled 100% of the required contribution in each of the respective years. These payments made represent 16.73%, 17.52%, and 15.59% of covered payroll for each of the years, respectively.

Net Pension Liabilities and Other Pension-Related Amounts

At March 31, 2016, the Lottery recognized a net pension liability of \$1,883,161 for its proportionate share of the ERS net pension liability.

The State's proportionate share of the collective net pension liability reported at March 31, 2016, was measured as of March 31, 2015, and was determined using an actuarial valuation as of April 1, 2014, with update procedures used to roll forward the total pension liability to March 31, 2015. The State's proportion of the ERS net pension liability measured at March 31, 2015, was 35% for ERS, which was consistent with the proportions allocated to the State at March 31, 2014. The State's proportion related to the plan was determined consistently with the manner in which contributions to the pension plan are determined. The State's total projected long-term contribution effort to ERS was compared to the total projected long-term contribution effort from all employers to ERS in order to determine the State's proportion of the plan's net pension liability.

The Office of the State Comptroller provided the Lottery with its proportionate share of the ERS collective liability. The Statewide proportionate share of the ERS collective net pension liability measured at March 31, 2015 allocated to the Lottery enterprise fund was 0.13%, which is consistent with the allocation of the ERS collective net pension liability measured as of March 31, 2014.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 7 PENSION BENEFITS *(continued)*

Actuarial Assumptions

The total pension liability for the March 31, 2015 measurement date was determined by using an actuarial valuation as of April 1, 2014, with update procedures used to roll forward the total pension liability to March 31, 2015. The actuarial valuation for ERS used the following actuarial assumptions:

Actuarial cost method	Entry age normal
Inflation	2.7%
Salary scale	4.9%
Investment rate of return, including inflation	7.5% compounded annually, net of investment expenses
Cost-of-living adjustments	1.4% annually
Decrements	Developed from the Plan's 2010 experience study for period April 1, 2005 through March 31, 2010
Mortality improvement	Society of Actuaries Scale MP-2014

Expected Rate of Return

The long-term expected rate of return on pension plan investments was determined in accordance with Actuarial Standard of Practice (ASOP) No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*. ASOP No. 27 provides guidance on the selection of an appropriate assumed investment rate of return. Consideration was given to expected future real rates of return (expected returns, net of pension plan investment expense and inflation) for equities and fixed income as well as historical investment data and plan performance. Best estimates of arithmetic real rates of return for each major asset class included in the target asset allocation for each plan as of April 1, 2014 are summarized below:

Asset Class	Target Allocation	Long-term Expected Rate of Return
Domestic equity	38%	7.30%
International equity	13	8.55
Private equity	10	11.00
Real estate	8	8.25
Absolute return strategies	3	6.75
Opportunistic portfolio	3	8.60
Real estate	3	8.65
Bonds and mortgages	18	4.00
Cash	2	2.25
Inflation-indexed bonds	2	4.00
Total	100%	

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 7 PENSION BENEFITS *(continued)*

Discount Rate

The discount rate used to calculate the ERS total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumes that contributions from plan members will be made at the current contribution rates and that contributions from employers will be made at statutorily required rates, actuarially. Based upon the assumptions, the System's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

The following presents the Lottery's current period net pension liability using the current period discount rate assumption of 7.5%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.5%) or 1 percentage-point higher (8.5%) than the current assumption (in thousands):

	<u>1% Decrease (6.5%)</u>	<u>Current Assumption (7.5%)</u>	<u>1% Increase (8.5%)</u>
Lottery net pension liability (asset)	\$ 12,552	\$ 1,883	\$ (7,124)

The Lottery recognized a net pension liability of \$1,883,161 for its proportionate share of the ERS net pension liability. For the year ended March 31, 2016, the Lottery recognized pension expense of \$1,704,279, related to ERS, and deferred outflows of resources related to ERS from the following sources:

	<u>Lottery Deferred Outflows of Resources</u>
Difference expected and actual experience	\$ 60,282
Net difference between projected and actual investment earnings on pension plan investments	327,081
Changes in proportion and differences between employer contributions and proportionate share of contributions	55,044
Contributions made subsequent to measurement date	-
Total	<u><u>\$ 442,407</u></u>

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 7 PENSION BENEFITS (continued)

Discount Rate (continued)

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions for Lottery will be recognized in pension expense in the amount of \$111,000 each year over the next four fiscal years.

NOTE 8 OPERATING INCOME

Composition of operating income for fiscal 2016 and 2015 by type of lottery game is as follows (in thousands):

	2016					
	Expenses					
	Revenue	Prizes**	Commissions	Fees	Instant Direct Expense	Net
Mega Millions	\$ 254,542	\$ (127,291)	\$ (14,937)	\$ (2,495)	\$ -	\$ 109,819
Lotto	96,686	(38,311)	(5,363)	(1,118)	-	51,894
Take 5	241,181	(120,029)	(14,471)	(2,149)	-	104,532
Pick 10	29,631	(13,832)	(1,778)	(264)	-	13,757
Numbers	902,496	(441,794)	(54,150)	(8,043)	-	398,509
Win 4	911,433	(462,409)	(54,686)	(8,122)	-	386,216
Sweet Million	-	65	-	-	-	65
Powerball	460,045	(214,000)	(27,603)	(4,132)	-	214,310
Other Multi-State Draw Games***	107,640	(50,778)	(6,373)	(1,015)	-	49,474
Instants	3,912,254	(2,636,201)	(237,292)	(40,480)	(22,970)	975,311
Quick Draw	787,230	(523,491)	(47,234)	(7,879)	-	208,626
Total traditional lottery	7,703,138	(4,628,071)	(463,887)	(75,697)	(22,970)	2,512,513
Video gaming	1,987,373 *	(1,586)	(882,601)	(151,419)	-	951,767
	<u>\$ 9,690,511</u>	<u>\$ (4,629,657)</u>	<u>\$ (1,346,488)</u>	<u>\$ (227,116)</u>	<u>\$ (22,970)</u>	3,464,280
Telecommunications						(18,492)
Other operating expenses						(128,795)
Total operating income						<u><u>\$ 3,316,993</u></u>

* Video gaming revenue represents net machine income after awarding prizes. Video gaming credits played and won were as follows:

Credits played	\$ 37,265,964
Credits won	<u>(35,278,591)</u>
Net machine income	<u>\$ 1,987,373</u>

** Prizes unclaimed after one year are forfeited and are netted against prizes.

*** Other Multi-State Draw Games include Cash 4 Life and Monopoly Millionaires' Club.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 8 OPERATING INCOME (continued)

	2015					Net
	Expenses				Instant Direct Expense	
	Revenue	Prizes**	Commissions	Fees		
Mega Millions	\$ 287,809	\$ (130,844)	\$ (16,942)	\$ (3,003)	\$ -	\$ 137,020
Lotto	83,960	(22,644)	(4,578)	(1,047)	-	55,691
Take 5	239,022	(117,605)	(14,341)	(2,145)	-	104,931
Pick 10	27,983	(12,192)	(1,679)	(251)	-	13,861
Numbers	870,505	(419,064)	(52,230)	(8,029)	-	391,182
Win 4	852,017	(430,108)	(51,121)	(7,863)	-	362,925
Sweet Million	6,305	(3,727)	(378)	(57)	-	2,143
Powerball	304,540	(146,098)	(18,273)	(2,941)	-	137,228
Other Multi-State Games***	124,989	(87,661)	(7,499)	(1,122)	-	28,707
Instants	3,760,139	(2,572,353)	(226,024)	(41,341)	(20,566)	899,855
Quick Draw	693,758	(454,677)	(41,626)	(7,883)	-	189,572
Total traditional lottery	7,251,027	(4,396,973)	(434,691)	(75,682)	(20,566)	2,323,115
Video gaming	1,905,309 *	120	(847,877)	(144,049)	-	913,503
	<u>\$ 9,156,336</u>	<u>\$ (4,396,853)</u>	<u>\$ (1,282,568)</u>	<u>\$ (219,731)</u>	<u>\$ (20,566)</u>	3,236,618
Telecommunications						(17,827)
Other operating expenses						<u>(120,579)</u>
Total operating income						<u>\$ 3,098,212</u>

* Video gaming revenue represents net machine income after awarding prizes. Video gaming credits played and won were as follows:

Credits played	\$ 33,970,899
Credits won	<u>(32,065,590)</u>
Net machine income	<u>\$ 1,905,309</u>

** Prizes unclaimed after one year are forfeited and are netted against prizes.

*** Other Multi-State Draw Games include Cash 4 Life and Monopoly Millionaires' Club.

NOTE 9 DEFERRED COMPENSATION

The State offers its employees, including Lottery employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the plan are placed in trust for the participants and their beneficiaries.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 10 POSTRETIREMENT BENEFITS

As a New York State (State) agency, the Lottery participates in the New York State Health Insurance Program (NYSHIP), which is administered by the State as an agent multiple employer defined benefit plan. Under the plan, the State provides certain healthcare for eligible retired employees and their dependents. In order to qualify, retirees must meet certain age requirements and minimum service periods that vary based on the time they last entered benefits-eligible service. Retirees generally contribute a percent of the cost of single and dependent coverage for health insurance benefits. The percent varies based on when the employee retired. The percent also varies based on salary grade for those retiring on or after January 1, 2012. The State covers 100% of the cost of single coverage for employees retired prior to January 1, 1983 who are enrolled in the Empire Plan or another plan of equal or lower cost. NYSHIP does not issue a stand-alone financial report and NYSHIP's agent activities are included within the financial statements of the State.

During the fiscal years ended March 31, 2016, and 2015, NYSHIP provided health insurance coverage through the Empire Plan, an indemnity health insurance plan with managed care components; various Health Maintenance Organizations (HMOs); and through the Student Employee Health Plan (SEHP). Generally, these include hospital, medical, mental health and substance abuse benefits, and prescription drug benefits.

The Lottery's policy regarding retiree healthcare benefits is to pay the amounts billed through the State's fringe benefit rate on a pay-as-you-go basis. The Lottery has no obligation beyond the payment of the State's fringe benefit rate for retiree healthcare benefits. The State's policy is that the State is responsible for recording the annual required contribution and the actuarial accrued liability under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* for the Lottery's retiree health care benefits in the State's governmental-wide financial statements.

At March 31, 2016 and 2015, the Lottery had between 196 and 191 retired and/or spouses of retired employees receiving these benefits with an annual pay-as-you-go cost of approximately \$2,015,000 and \$1,810,000, respectively. Employee costs were approximately \$433,000 and \$382,000 as of March 31, 2016 and 2015.

NOTE 11 EMPLOYEES' COMPENSATED ABSENCES

Under the terms of the Lottery's personnel policies and its union agreements, vacation pay benefits may be paid upon termination up to a maximum of 225 hours. The Lottery recognizes employees' compensated absence benefits when earned. The liability for employees' compensated absences was approximately \$1,291,000 and \$1,584,000 as of March 31, 2016 and 2015, respectively, and is recorded as a liability in the statements of net position.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 12 LEASES

The Lottery has entered into operating leases for equipment and building space. Rental expense was approximately \$2,570,000 and \$2,554,000 in 2016 and 2015, respectively.

Future minimum lease payments under all noncancelable leases having initial or remaining terms in excess of one year as of March 31, 2016 are as follows (in thousands):

	Operating Leases
2017	\$ 2,528
2018	2,422
2019	2,306
2020	1,402
2021	672
2022 and thereafter	855
Total minimum payments required	\$ 10,185

NOTE 13 COMMITMENTS AND CONTINGENCIES

Contractual Arrangements

The Lottery maintains a gaming network of approximately 17,500 retailer locations where all traditional lottery games are sold. Instant Game tickets are also sold through approximately 4,500 self-service terminals. International Game Technology (IGT) (formerly GTECH Corporation) is responsible for operating all traditional Lottery games, including maintenance of terminals and related communication services, under a contract expiring on August 5, 2017.

Instant Game sales are also supported by services provided under additional contracts:

- (1) Under a contract that expires August 14, 2018, Scientific Games International is the primary supplier of Instant Game tickets.
- (2) Under a contract expiring August 23, 2018, Pollard Banknote Limited is an alternate supplier of Instant Game tickets.
- (3) Under a contract that expires on August 21, 2018, IGT Global Solutions Corporation (formerly GTECH Printing Corporation) is an alternate supplier of Instant Game tickets.

NEW YORK STATE LOTTERY
Notes to Financial Statements
Years Ended March 31, 2016 and 2015

NOTE 13 COMMITMENTS AND CONTINGENCIES *(continued)*

Contractual Arrangements *(continued)*

Video lottery games are offered on approximately 18,400 video gaming machines spread over nine video lottery gaming facilities. Everi Games, Inc. (formerly MGAM Systems, Inc.) provides a central processing system for the operation of video lottery games under a contract expiring on December 31, 2017. Video lottery gaming machines are provided under contracts expiring December 31, 2017 with three different companies (Bally Gaming Inc., International Game Technology, and Spielo International USA, Inc.). These contracts are paid based on a contractual percentage of revenue, adjusted for units of service provided.

Litigation

The Lottery has been named as a defendant in several lawsuits. While the ultimate outcome of these lawsuits cannot be predicted at this time, it is the opinion of management and in-house counsel that the disposition of any litigation in which the Lottery is involved will not have a material adverse effect on the financial position of the Lottery.

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

NEW YORK STATE LOTTERY

Required Supplementary Information (Unaudited)
Years Ended March 31, 2016 and 2015

Schedule of the Lottery's Proportionate Share of the Net Pension Liabilities for New York State and Local Employees' Retirement System

March 31, 2016

(Amounts in thousands)

Lottery's proportion of the net pension liability		0.13%
Lottery's proportionate share of the net pension liability	\$	1,883
Covered payroll		17,460
Lottery's proportionate share of the net pension liability as a percentage of covered payroll		10.78%
Plan's fiduciary net position as a percentage of the total pension liability		97.95%

The "Schedule of the Lottery's Proportionate Share of the Net Pension Liabilities for New York State and Local Employees' Retirement System" presented above is to illustrate the required 10-year trend of information. However, until we can compile a full 10-year trend of information, we are presenting the information for which information is available.

Schedule of the Lottery's Contributions for New York State and Local Employees' Retirement System

March 31, 2016

(Amounts in thousands)

Contractually determined contribution	\$	2,921
Lottery's contributions in relation to the contractually determined contribution		2,921
Contribution excess/deficiency		-
Lottery's covered payroll		17,460
Lottery's contributions as a percentage of covered payroll		16.73%

The "Schedule of the Lottery's Contributions for New York State and Local Employees' Retirement System" presented above is to illustrate the required 10-year trend of information. However, until we can compile a full 10-year trend of information, we are presenting the information for which information is available.

