COLORADO LOTTERY

FINANCIAL AND COMPLIANCE AUDIT

June 30, 2017 and 2016

LEGISLATIVE AUDIT COMMITTEE

OFFICE OF THE STATE AUDITOR

Dianne E. Ray	State Auditor
Kerri Hunter	Deputy State Auditor
Bryan Brune	Contract Monitor
Eide Bailly LLP	Contractor

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Members of the Legislative Audit Committee:

We have completed the financial statement audit of the Colorado Lottery as of and for the years ended June 30, 2017 and 2016. Our audit was conducted 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.

We were engaged to conduct our audit pursuant to Section 24-35-211, C.R.S., which requires the State Auditor to audit the Lottery Fund. The reports we have issued as a result of this engagement are set forth in the table of contents which follows.

Eide Bailly LLP

Denver, Colorado
November 20, 2017

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Purposes and Scope of Audit

Authority, Purpose and Scope

The Office of the State Auditor, State of Colorado, engaged Eide Bailly, LLP to conduct the financial audit of the Colorado Lottery for the Fiscal Year ended June 30, 2017. The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery. The purpose of the audit was to express opinions on the financial statements of the Lottery for the years ended June 30, 2017 and 2016.

Eide Bailly LLP conducted the audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States of America.

The purposes and scope of this audit were:

- To express opinions on the financial statements of the Lottery as of and for the years ended June 30, 2017 and 2016, including a review of the related systems of internal controls as required by auditing standards generally accepted in the United States of America.

- To review the Lottery's compliance with rules and regulations governing the expenditure of State funds for the year ended June 30, 2017.

- To evaluate progress in implementing the prior audit recommendations, if any.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

There were no new recommendations as a result of the current year audit.

Audit Opinions and Reports

The independent auditor's reports included herein, state that the financial statements of the Lottery are fairly stated, in all material respects, in accordance with accounting principles generally accepted in the United States of America, and that no material weaknesses in internal controls were discovered during the course of the audit.

Auditor's Communication to Legislative Audit Committee

The auditor's communication to the Legislative Audit Committee describes the auditor's responsibility under auditing standards generally accepted in the United States of America and significant management judgments and estimates. This communication is located on page 64.

COLORADO LOTTERY
Background
Years Ended June 30, 2017 and 2016

In 1980, Colorado voters passed a referendum that added Article XVIII, Section 2(1) to the Colorado Constitution, allowing the establishment of a state-supervised lottery. Senate Bill 82-119 created the Lottery as a division within the Department of Revenue. The Lottery began operations on July 1, 1982 and sold its first lottery ticket on January 24, 1983.

During Fiscal Year 2017, the Lottery employed 114 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

The Lottery games are governed by rules and regulations established by a Commission of five members appointed by the Governor and approved by the Senate. By statute, Lottery Commission members must include an attorney, a certified public accountant and a law enforcement officer. Members may serve up to two 4-year terms.

Colorado Revised Statutes (C.R.S.) Section 24-35-210(9), requires that no less than 50% of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. "Net lottery proceeds" (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund within the Department of Local Affairs, the Division of Parks and Wildlife within the Department of Natural Resources, and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap, which was calculated to be $64.5 million for the year ended June 30, 2017.

Prior to 2002, amounts exceeding the GOCO cap (the spillover) were distributed to the State General Fund. For Fiscal Years 2002 through 2007, the spillover funds were distributed to the State Public School Fund Contingency Reserve. For Fiscal Year 2008, the spillover funds were transferred to the Lottery Proceeds Contingency Reserve Fund. For Fiscal Years 2009 through 2017, the spillover funds were required to be transferred to the Public School Capital Construction Assistance Fund.

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CPAs & BUSINESS ADVISORS

Independent Auditor's Report

To the Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Lottery Division
Denver, Colorado

Report on the Financial Statements

We have audited the accompanying financial statements of the Colorado Lottery, an enterprise fund of the State of Colorado, as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Colorado 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 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 opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Colorado Lottery's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Colorado Lottery as of June 30, 2017 and 2016, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Relationship with the State of Colorado
As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position and cash flows for only that portion of the financial reporting entity, the State of Colorado, which is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2017 and 2016, and the changes in its financial position, or, where applicable, its cash flows, for the years 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.

Other Matters

Required Supplementary Information
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 21, as well as the schedule of the Colorado Lottery's proportionate share of the net pension liability and the schedule of the Colorado Lottery's contributions for the Colorado Lottery's defined benefit pension plan on pages 58 through 60, 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.

Supplementary Information
Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Colorado Lottery's basic financial statements. The Schedule of Revenues and Costs for Scratch and Jackpot Games, Schedule of Percent of Prize Expense to Gross Ticket Sales and Budgetary Comparison (Supplementary Information) are presented for the purposes of additional analysis and are not a required part of the basic financial statements. The Supplementary Information is the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. The 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 financial statements or to the financial statements themselves, and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 20, 2017 on our consideration of the Colorado 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 to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Colorado Lottery's internal control over financial reporting and compliance.

Eide Bailly LLP

Denver, Colorado
November 20, 2017

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the Fiscal Years ended June 30, 2017 and 2016. Please read it in conjunction with the Lottery's financial statements, which begin on page 22. These financial statements reflect only activities of the Colorado Lottery.

Games Offered by the Colorado Lottery

Currently, the Lottery offers two different ways to play: scratch games and jackpot games. Scratch games consist of pre-printed tickets that may be purchased for various prices ($1, $2, $3, $5, $10, $20 and $50) at any Lottery retailer. When scratched, they provide instant knowledge if the ticket is a winner and can be cashed immediately at the retailer if the amount of the winnings is $599 or less. Prizes over $599 must be redeemed at the Lottery offices. On the other hand, jackpot games which include Powerball, Lotto, Cash 5, Mega Millions, Pick 3 (now with both midday and evening draws), and Lucky For Life, a new jackpot game introduced on July 17, 2016 require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or possibly more playing boards for one draw or up to thirteen weeks of draws. Each board consists of a set of numbers, with the combination of numbers required for play varying by game. The winning numbers for each game are posted after their respective draw, with drawings held every day of the week. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer if the amounts of the total winnings by ticket are $599 or less. Tickets with prizes over $599 must be redeemed at the Lottery offices. A new add-on game known as Cash 5 EZ Match was introduced on May 7, 2017, giving players the opportunity to pay an extra $1 per Cash 5 ticket for the chance to win a randomly assigned instant prize (a jackpot ticket purchase with the instant winning experience of a scratch ticket). With no draw involved and with prizes ranging from $2 to $500, winning tickets may be cashed instantly at the retailer.

Financial Highlights

- The Colorado Lottery's overall sales performance for Fiscal Year 2017 came in at $555.3 million, the third highest sales year in the Lottery's thirty-five year history. Last fiscal year's total sales of $594.4 million remained the all-time highest, with Fiscal Year 2013 sales of $566.3 million remaining in the second spot. Overall sales for Fiscal Year 2017 reflected a $39.1 million or 6.6 percent decrease from Fiscal Year 2016. Coming off the all-around, record-breaking sales year of Fiscal Year 2016; the drop in sales in the current fiscal year was mainly due to a decrease both in Powerball sales of $42.1 million and in scratch sales of $14.9 million. The unprecedented nearly $1.6 billion Powerball jackpot witnessed in January 2016 and the associated increase in Powerball sales plus the nearly $18.0 million jump in scratch sales over the previous scratch sales record of Fiscal Year 2015 drove Fiscal Year 2016 sales to the top mark. On a positive note, the introduction of the new Lucky For Life jackpot game and the new add-on game Cash 5 EZ Match plus the addition of a midday draw for the Pick 3 jackpot game during Fiscal Year 2017 resulted in an increase of $19.1 million in sales over the previous fiscal year, offsetting some of the decline mentioned above.

- Funds distributed or available for distribution from Fiscal Year 2017 sales were nearly $133.5 million, third highest in the Lottery's history. Fiscal Year 2017 distributions included a spill-over of funds to the Public School Capital Construction Assistance Fund of nearly $2.3 million. This spill-over occurred when the Great Outdoors Colorado (GOCO) proceeds cap of $64.5 million in the current fiscal year was reached. The cap for GOCO is the 1992 base year amount of $35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. This was the sixteenth year in a row the Lottery successfully reached the GOCO cap, ranging from $46.5 million in Fiscal Year 2002 to the $64.5 million in the current fiscal year. Since its start in Fiscal Year 2009, the spill-over going to

Building Excellent Schools Today (BEST), a capital construction grant program administered by the Public School Capital Construction Assistance Fund, has totaled nearly $36.6 million.

- Fiscal Year 2017 gross profit (Lottery product sales minus costs tied directly to those sales) as a percent of sales increased by 0.7 percent from the previous fiscal year (from nearly 28.3 percent to 29.0 percent). Costs tied directly to sales include prize expense, retailer commissions and bonuses, scratch ticket costs and vendor fees charged for the use of the jackpot gaming systems provided by the third party vendor IGT. A decrease of 0.8 percent in prize expense as a percentage of sales was the chief reason for the overall 0.7 percent increase in the gross profit percentage. All other costs, retailer commissions and bonuses, scratch ticket costs and vendor fees, as a percentage of sales combined for a 0.1 percent increase over the previous fiscal year. Slight increases as a percentage of sales in retailer commissions, cost of tickets and vendors fees were nearly offset by a decrease as a percentage of sales in retailer bonuses from Fiscal Year 2016 to Fiscal Year 2017.
- Total prize expense as a percentage of sales for all Lottery products decreased from 62.3 percent to 61.5 percent in Fiscal Years 2016 and 2017, respectively, with decreases from 68.3 percent to 67.5 percent for scratch games and from 50.5 percent to 48.5 percent for combined jackpot games. The decreased prize expense as a percentage of sales seen in Fiscal Year 2017 over Fiscal Year 2016 for both scratch and jackpot games was mainly due to the unpredictable increase in unclaimed prizes recognized in the current fiscal year. The writing off of prizes which expire and are no longer available to be claimed by Lottery players ultimately lowers the prize expense as a percentage of sales. The $3.6 million increase of these unclaimed prizes in the current fiscal year was chiefly made up of a nearly $1.7 million increase in Powerball unclaimed prizes directly tied to mostly smaller prizes going unclaimed from the $1.6 billion jackpot draw and the two draws leading up to it that occurred in Fiscal Year 2016 but expired in early Fiscal Year 2017. In addition, Mega Millions unclaimed prizes jumped by over $1.0 million with a single one million-dollar prize going unclaimed and scratch game unclaimed prizes jumped $0.7 million due to an increase in the number of scratch games ending in Fiscal Year 2017 over Fiscal Year 2016.
- Retailer commissions as a percentage of sales increased slightly for Fiscal Year 2017 from Fiscal Year 2016 while retailer bonuses as a percentage of sales decreased slightly. Combined retailer commission and bonus costs as a percentage of sales in Fiscal Years 2017 and 2016 were 7.3 percent and 7.4 percent, respectively. Cost of tickets sold in Fiscal Year 2017 increased 0.1 percent from the previous fiscal year due to the mix of scratch games offered, including an increase in the number of licensed property scratch games, such as Atari® and Willy Wonka™ Golden Ticket games, which carry a higher price per ticket sold for the use of the licensed name on the tickets. Vendor fees increased slightly in Fiscal Year 2017 due to the continued increase in the use by Lottery players of the self-serving Gemini terminals to purchase their lottery tickets. Gemini terminal sales carry a slightly higher vendor fee rate than sales from the retailer manned terminals.

Using this Annual Report

This annual report consists of a series of financial statements. The statements of net position provide information about the Lottery's assets, liabilities and deferred inflows and outflows and reflect the Lottery's financial position as of June 30, 2017 and 2016. The statements of revenues, expenses and changes in net position report the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2017 and 2016. Finally, the statements of cash flows outline the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2017 and 2016.

Statements of Net Position

The statements of net position present a financial snapshot of the Lottery at June 30, 2017 and 2016. It presents the fiscal resources of the Lottery (assets), the consumption of net assets that is applicable to a future reporting period (deferred outflows), the claims against those resources (liabilities), the acquisition of net assets that is applicable to a future reporting period (deferred inflows) and the residual available for future operations (net position). Assets and liabilities are classified by liquidity as either current or noncurrent.

Deferred outflows are reported in a separate section following assets, with deferred inflows reported in a separate section following liabilities. Net position is classified by the ways in which these assets may be used for future operations.

Condensed Statements of Net Position
June 30, 2017, 2016, and 2015

	2017	2016	2015
Assets			
Current assets	$ 67,863,202	$ 70,565,459	$ 57,985,990
Restricted assets	6,516,413	6,465,986	6,460,543
Capital assets	285,567	438,258	549,690
Total assets	$ 74,665,182	$ 77,469,703	$ 64,996,223
Deferred Outflows - Pensions	$ 12,888,492	$ 2,865,826	$ 1,071,597
Liabilities			
Current liabilities	$ 71,502,770	$ 73,990,705	$ 61,646,250
Long-term liabilities	780,887	782,973	796,373
Net pension liability	41,110,831	25,257,445	23,627,441
Total liabilities	$ 113,394,488	$ 100,031,123	$ 86,070,064
Deferred Inflows - Pensions	$ 1,427,150	$ 1,066,323	$ 136,155
Net Position			
Net Investment in Capital Assets	$ 285,567	$ 438,258	$ 549,690
Restricted – Licensed Agent Recovery Reserve	516,720	424,591	378,903
Restricted – Operating Reserve	1,600,000	1,500,000	1,500,000
Unrestricted - Unrealized Gain/Loss on Investments	(20,762)	333,176	125,007
Unrestricted - Unfunded Pension Liability	(29,649,489)	(23,457,942)	(22,691,999)
Total net position	$ (27,267,964)	$ (20,761,917)	$ (20,138,399)

The Lottery's total assets at June 30, 2017 were $74.7 million. Assets consisted primarily of cash and investments of $47.4 million, including restricted balances of $2.1 million, receivables from Lottery retailers for the sales of Lottery products of $21.0 million, prepaid prize expense with Multi-State Lottery Association (MUSL) of over $4.4 million, scratch ticket inventory of over $1.4 million and a net investment in fixed assets of nearly $0.3 million.

Comparable figures at June 30, 2016 were $77.5 million in total assets, principally including cash and investments of $50.1 million, including restricted balances of $1.9 million, receivables from retailers of $20.9 million, prepaid prize expense with MUSL of over $4.5 million, scratch ticket inventory of nearly $1.5 million and a net investment in fixed assets of over $0.4 million.

Comparable figures at June 30, 2015 were $65.0 million in total assets, principally including cash and investments of $38.4 million, including restricted balances of $1.9 million, receivables from retailers of $20.2 million, prepaid prize expense with MUSL of nearly $4.6 million, scratch ticket inventory of $1.1 million and a net investment in fixed assets of over $0.5 million.

The Lottery's total assets decreased by $2.8 million from Fiscal Year 2016 to Fiscal Year 2017. This decrease in total assets was primarily made up of the decreases in cash and investments of $2.6 million, in net investment in fixed assets of over $0.1 million, and in MUSL prepaid prize expense of $0.1 million. The decrease in cash and investments of $2.6 million was due to the decreases of nearly $2.6 million in the accrued prizes not yet paid to Lottery players, in accrued bonuses due to Lottery retailers of $0.6 million, and in payables to Lottery vendors of $0.4 million, offset by increases in funds available for distributions to proceeds partners of $0.8 million and the amount due to MUSL for prizes of over $0.2 million. The Lottery's total assets increased by $12.5 million from Fiscal Year 2015 to Fiscal Year 2016. This increase was primarily made up of the increases in cash and investments of $11.6 million, in receivables from retailers of nearly $0.7 million and in scratch ticket inventory of over $0.3 million, offset by a slight combined decrease of $0.1 million in MUSL prepaid prize and other prepaid expenses and in the net investment in fixed assets.

The Lottery's total liabilities at June 30, 2017 totaled $113.4 million, which consisted primarily of net pension liability of $41.1 million recorded in accordance with Governmental Accounting Standards Board (GASB) Statement No. 68, GASB Statement No. 71 and GASB Statement No. 73, prize liability on all Lottery products of nearly $35.4 million, proceeds distributions due to recipients of $32.7 million, over $1.2 million due to retailers for bonuses, and MUSL payments due and wages and benefits due to Lottery employees of $0.8 million each.

The Lottery's total liabilities at June 30, 2016 totaled over $100.0 million, which consisted primarily of net pension liability of nearly $25.3 million tied to the GASB Statements mentioned above, prize liability on all the Lottery products of nearly $38.0 million, proceeds distributions due to recipients of $31.9 million, nearly $1.0 million due to Lottery vendors and retailer bonus payments due of over $1.8 million.

The Lottery's total liabilities at June 30, 2015 totaled $86.1 million, which consisted primarily of net pension liability of $23.6 million tied to GASB No. 68 and No. 71, prize liability on all Lottery products of about $26.0 million, proceeds distributions due of $31.8 million, Lottery vendor payments due of $1.6 million and retailer bonus payments due of $1.3 million.

The Lottery's total liabilities of $113.4 million at June 30, 2017 increased by nearly $13.4 million over the previous fiscal year chiefly due to the over $15.8 million increase in the net pension liability, the $0.8 million increase in funds available for proceeds distribution, and the nearly $0.3 million increase in the amount due to MUSL, offset by decreases of $2.6 million in prize liability, $0.6 million in retailer bonus liability and $0.4 million in vendor liability. Remaining liability categories showed much smaller changes from June 30, 2016 to June 30, 2017.

The Lottery's total liabilities of over $100.0 million at June 30, 2016 increased by nearly $14.0 million over the previous fiscal year chiefly due to the $12.0 million increase in prize liability and the net pension liability increase of $1.6 million. Additional increases of $0.5 million each in amounts due to MUSL and to retailer for bonuses were offset by a decrease of $0.6 million in amounts due to vendors. Remaining liability categories showed much smaller changes from June 30, 2015 to June 30, 2016.

The Lottery's total liabilities of $86.1 million at June 30, 2015 increased by $23.6 million over total liabilities at June 30, 2014 chiefly due to the first-time recording of net pension liability of $23.6 million with all other liabilities remaining nearly the same as the $62.5 million at June 30, 2014. Decreases of nearly $1.0 million in the amount due to vendors and $0.4 million in the amount due to MUSL were nearly offset by an increase of $1.3 million in proceeds distributions due to recipients.

Components of the Lottery's net position are: 1) an amount to represent the Lottery's net investment in capital assets as required by the reporting model under GASB Statement No. 34, (see "Total Capital Assets" on the statements of net position); 2) a Licensed Agent Recovery Reserve (bonding reserve) funded by retailers in accordance with Section 24-35-219, C.R.S. to cover any uncollectible receivable accounts; 3) an amount representing the funds held by the Lottery in an operating reserve to ensure the operation of the Lottery for the ensuing year in accordance with Section 24-35-210 (4.1)(a), C.R.S. (see "Cash and Investments – Operating Reserve") on the statements of net position; 4) unrestricted, unrealized gain/loss on investments, which represents an adjustment made by the Lottery to reflect its share of unrealized gains or losses on investments held by the State Treasurer and 5) unrestricted, unfunded pension liability, which represents the Lottery's share of the State's unfunded net pension liability as calculated by PERA.

The Lottery's total net position decreased over $6.5 million from June 30, 2016 to June 30, 2017. This included 1) a decrease in investment in capital assets of $153 thousand due to the depreciation expense of $197 thousand recognized in Fiscal Year 2017 combined with a net loss of $8 thousand on the disposal of fixed assets offset by current year additions of capital assets of $52 thousand; 2) an increase in the Licensed Agent Recovery Reserve (also known as bonding reserve) from $425 thousand to $517 thousand; 3) a net increase in operating reserve of $100 thousand from $1.5 million to $1.6 million; 4) an unrealized loss on investments of $354 thousand resulting from a net decrease in the adjustments on State Treasury investments; and 5) a net increase in unfunded pension liability of $6.2 million.

Following is a schedule of net position for Fiscal Years 2017 and 2016:

	2017	2016	Change
Net Investment in Capital Assets	$ 285,567	$ 438,258	$ (152,691)
Restricted - Licensed Agent Recovery Reserve	516,720	424,591	92,129
Restricted - Operating Reserve	1,600,000	1,500,000	100,000
Unrestricted - Unrealized Gain or Loss on Investments	(20,762)	333,176	(353,938)
Unrestricted - Unfunded Pension Liability	(29,649,489)	(23,457,942)	(6,191,547)
Total net position	$ (27,267,964)	$ (20,761,917)	$ (6,506,047)

The change in net position from June 30, 2015 to June 30, 2016 consisted of a decrease in investment in capital assets of $111 thousand due to depreciation expense of $443 thousand recognized in Fiscal Year 2016 combined with a net loss of $3 thousand on the disposal of fixed assets offset by current year additions of capital assets of $335 thousand, an increase in the bonding reserve from $379 thousand to $425 thousand, a net increase in unrealized gain on investments of $208 thousand, and a net decrease in unfunded pension liability of $766 thousand. The fifth component operating reserve remained the same at $1.5 million from the prior fiscal year to the current one.

Following is a schedule of net position for Fiscal Years 2016 and 2015:

	2016	2015	Change
Net Investment in Capital Assets	$ 438,258	$ 549,690	$ (111,432)
Restricted - Licensed Agent Recovery Reserve	424,591	378,903	45,688
Restricted - Operating Reserve	1,500,000	1,500,000	-
Unrestricted - Unrealized Gain or Loss on Investments	333,176	125,007	208,169
Unrestricted - Unfunded Pension Liability	(23,457,942)	(22,691,999)	(765,943)
Total net position	$ (20,761,917)	$ (20,138,399)	$ (623,518)

Statements of Revenues, Expenses and Changes in Net Position

The statements of revenues, expenses and changes in net position present the financial activity of the Lottery over the fiscal year. The focus is on operating revenues and expenses that have a significant effect on the distributions paid to the proceeds recipients.

Condensed Statements of Revenues, Expenses and Changes in Net Position
For the Fiscal Years Ended June 30, 2017, 2016, and 2015

	2017	2016	2015
Operating Revenues	$ 555,333,490	$ 594,411,905	$ 538,025,144
Direct Operating Expenses	394,451,245	426,499,528	382,148,410
Gross Profit on Sale of Tickets	160,882,245	167,912,377	155,876,734
Other Operating Expenses			
Marketing and communications	13,634,184	11,295,008	13,823,454
Wages and benefits	9,411,009	9,223,414	9,635,406
Other operating expenses	5,168,772	5,353,196	5,437,874
Total Other Operating Expenses	28,213,965	25,871,618	28,896,734
Other Operating Revenue	177,409	858,465	195,041
Total Operating Income	132,845,689	142,899,224	127,175,041
Nonoperating Revenues (Expenses)			
Investment income	314,792	813,205	442,094
Unfunded pension expense	(6,191,547)	(765,943)	(660,976)
Proceeds distributions	(133,474,981)	(143,570,004)	(127,980,868)
Total Nonoperating Expenses	(139,351,736)	(143,522,742)	(128,199,750)
Change in Net Position	(6,506,047)	(623,518)	(1,024,709)
Net Position, Beginning of Year	(20,761,917)	(20,138,399)	(19,113,690)
Net Position, End of Year	$ (27,267,964)	$ (20,761,917)	$ (20,138,399)

Sales Activities

Revenues from the sales of Lottery products for the Fiscal Year ended June 30, 2017 ended on a stronger note at $555.3 million, despite a slower start through the holiday season. Although the third highest sales mark in the Lottery's history, sales revenues for the current fiscal year were down from the previous record-breaking fiscal year of 2016 by $39.1 million, representing a 6.6 percent drop. At $594.4 million, Fiscal Year 2016 overall sales were up from the previous fiscal year amount of $538.0 million; the $56.4 million increase representing a 10.5 percent increase from Fiscal Year 2015 sales.

Fiscal Year 2017 scratch sales of over $380.2 million represented a $14.9 million or 3.8 percent decrease from the prior fiscal year scratch sales of nearly $395.2 million. Scratch sales were down for the first seven months of the fiscal year when compared to the prior fiscal year's first seven months with a deficit of $21.3 million, rebounding in the last five months of the fiscal year with the $6.4 million increase over the same time frame in Fiscal Year 2016. Most of the decline in scratch sales in Fiscal Year 2017 can be attributed to the $13.5 million drop in the sales of the $50 priced ticket. The introduction of the new $50 priced ticket in Fiscal Year 2016 resulted in $35.7 million in sales and a drop to $22.2 million in Fiscal Year 2017, due to the fact that all remaining inventory of the game was nearly sold out in the current fiscal year. The remaining decrease of $1.4 million can be attributed to the overall decline of the other priced tickets. Sales of the $1, $2, $3, $5 and $20 priced tickets were all down compared to the prior fiscal year by a combined total of $10.9 million with the biggest drop in sales of $7.4 million of the $5 priced scratch games. An increase of $9.5 million in the $10 priced games, however, nearly made up this deficit with strong showing in the $10 scratch crossword game category and from the new Willy Wonka Golden Ticket introduced late in the fiscal year.

Fiscal Year 2016 scratch sales of $395.2 million represented a $18.0 million or 4.8 percent increase over Fiscal Year 2015 scratch sales of $377.2 million, with fiscal year scratch sales climbing to a new record level. The increase can be attributed to the introduction of the new $50 priced ticket resulting in $35.7 million sales combined with an increase in sales of $3.0 million and $0.7 million of the $5 and $2 priced tickets, respectively.

Jackpot game sales saw a $24.2 million decrease in Fiscal Year 2017 due to the drop off of Powerball sales of $42.1 million, with more "normal" jackpot levels seen throughout the current fiscal year as compared to the unprecedented nearly $1.6 billion Powerball jackpot seen in January 2016 of the previous fiscal year, and to the declines in Mega Millions sales of $3.0 million and in Cash 5 base game sales of nearly $1.4 million. As previously mentioned in the *Financial Highlights* section, the introduction of the new Lucky For Life game and the Cash EZ Match add-on game and the addition of a midday draw for Pick 3 increased jackpot sales by $19.1 million for these games. This, plus an increase in Lotto sales of $3.2 million due to fewer, yet higher jackpots in Fiscal Year 2017, brought the total decrease in jackpot sales to $24.2 million or a 12.1 percent drop.

Jackpot game sales saw a $38.4 million increase in Fiscal Year 2016 from Fiscal Year 2015 primarily due to the $43.1 million or a 59.9 percent increase in Powerball sales mainly associated with the buying frenzy seen across the nation as the highest-ever national jackpot rose to nearly $1.6 billion. With a modest increase in Pick 3 sales of $215 thousand or 2.5 percent, all other jackpot games sales dropped by a combined total of just $4.9 million, resulting in an overall 23.4 percent increase in jackpot sales in Fiscal Year 2016 compared to Fiscal Year 2015.

The following tables compare Lottery product sales between fiscal years.

Product Sales	2017	2016	Difference	Change
Scratch	$ 380,249,492	$ 395,162,447	$ (14,912,955)	(3.8) %
Powerball	73,002,056	115,122,117	(42,120,061)	(36.6)
Lotto	30,609,106	27,422,320	3,186,786	11.6
Mega Millions	25,789,410	28,763,801	(2,974,391)	(10.3)
Cash 5	17,632,114	18,991,636	(1,359,522)	(7.2)
Cash 5 EZ Match	1,060,341	-	1,060,341	N/A
Pick 3	10,995,867	8,949,584	2,046,283	22.9
Lucky For Life	15,995,104	-	15,995,104	N/A
Total	$ 555,333,490	$ 594,411,905	$ (39,078,415)	

Product Sales	2016	2015	Difference	Change
Scratch	$ 395,162,447	$ 377,164,257	$ 17,998,190	4.8 %
Powerball	115,122,117	72,009,314	43,112,803	59.9
Lotto	27,422,320	29,837,628	(2,415,308)	(8.1)
Mega Millions	28,763,801	31,015,743	(2,251,942)	(7.3)
Cash 5	18,991,636	19,263,308	(271,672)	(1.4)
Pick 3	8,949,584	8,734,894	214,690	2.5
Total	$ 594,411,905	$ 538,025,144	$ 56,386,761	

Other Operating Revenues

Other operating revenues for the Fiscal Years ended June 30, 2017 and June 30, 2016 totaled $0.2 million and $0.9 million, respectively. The major reason for the nearly $0.7 million decrease from Fiscal Year 2016 to the current fiscal year was due to the drop in liquidated damages charged to Scientific Games for failure to satisfy or perform the duties and obligations as outlined in the Scratch ticket contract between the Lottery and Scientific Games.

Nonoperating Revenues

Nonoperating revenues for the years ended June 30, 2017 and June 30, 2016 totaled $0.3 million and $0.8 million, respectively. The major reason for the $498 thousand decrease was the GASB Statement No. 31 adjustment recording the Lottery's share of the unrealized losses on investments held by the Treasury which resulted in a decrease in revenue of $562 thousand as a result of the change from a net gain of $208 thousand in Fiscal Year 2016 to a net loss of $354 thousand in Fiscal Year 2017. Additionally, despite a decrease in the average cash balances held by both the Treasury and by the MUSL group in the current fiscal year, an increase in interest rates paid on investments in Fiscal Year 2017 offset some of the overall decline in nonoperating interest revenue by $64 thousand.

Total Revenues

Total revenues were $555.8 million and $596.1 million for the years ended June 30, 2017 and 2016, respectively. The major contributing factor to the decrease in total revenues of approximately $40.3 million was primarily due to the overall 6.6 percent decrease in jackpot and scratch game sales for a total decrease of $39.1 million in game sales in the current fiscal year. In addition, other operating revenue decreased by nearly $0.7 million and investment income decreased by $0.5 million as outlined above.

Major Expenses

Nearly $394.5 million or 93.3 percent of the Lottery's total expenses of $422.7 million for Fiscal Year ended June 30, 2017 were incurred in direct support of the Lottery games. These expenses include prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the jackpot gaming system. Of the $394.5 million spent in Fiscal Year 2017 for the direct support of the Lottery games, $341.5 million was for prize expense associated with those games.

In comparison, approximately $426.5 million or 94.3 percent of the Lottery's total expenses of $452.4 million for the Fiscal Year ended June 30, 2016 were game-related expenses. Of the $426.5 million spent in Fiscal Year 2016 for direct support of the Lottery games, $370.5 million was spent for prize expense associated with those games.

Total prize expense in Fiscal Year 2017 decreased $29.0 million from Fiscal Year 2016. Based on the overall prize expense as a percentage of sales of 62.3 percent in Fiscal Year 2016 and on the overall sales decrease of $39.1 million in Fiscal Year 2017, a $24.4 million decrease in prize expense would have been expected. The additional $4.6 million decrease in prize expense can be primarily attributed to the jump in unclaimed prizes written off in Fiscal Year 2017 mentioned earlier, and to a lesser degree to the change in sales product mix. Total unclaimed prizes increased from $9.5 million or 1.6% of sales in Fiscal Year 2016 to $13.2 million or 2.4% of sales in Fiscal Year 2017 for a total decrease to prize expense of $3.6 million. The additional $1.0 million decrease in prize expense can be attributed to several changes in the sales mix. In the scratch area, when compared to the prior fiscal year, Fiscal Year 2017 saw shifts in the sales mix due to the sellout of the $50 scratch game inventory combined with both increases and decreases in prize expense percentages of the $50, $20 and $10 price point scratch games due to the number and amounts of second chance drawing prizes recorded from one fiscal year to the next. Combined, these changes netted to a $0.5 million savings to scratch prize expense. In the jackpot area, the drop in Powerball sales was replaced with sales of the new jackpot games which carry higher prize expense percentages. However, a significant drop in the Lotto prize expense in the current fiscal year more than offset the jackpot prize percentage increase caused by the Powerball sales shift, resulting in an additional $0.5 million savings in the overall jackpot prize expense. The overall 2.0 percent product shift from jackpot sales (from 33.5 percent of total sales to 31.5 percent) to scratch sales (from 66.5 percent of total sales to 68.5 percent) had little effect to the overall prize expense change in the current fiscal year compared to Fiscal Year 2016.

Total prize expense in Fiscal Year 2016 increased $39.0 million from Fiscal Year 2015. Based on the overall prize expense as a percentage of sales of 61.6 percent in Fiscal Year 2015 and on the overall sales increase of $56.4 million in Fiscal Year 2016, a $34.7 million increase in prize expense would have been expected. The additional $4.3 million increase in prize expense in Fiscal Year 2016 compared to Fiscal Year 2015 can be attributed to several factors. These included the introduction and high sales of the new $50 scratch game which carried a higher prize expense than other scratch price points and the recording of the $3 million second chance draw associated with the game; the drop in the amount of unclaimed scratch prizes, and an increase in the overall prize expense for all jackpot games, partially offset by a product shift from scratch sales to jackpot sales due to the fact that jackpot games generally carry lower prize expense percentage than do scratch games.

As a percentage of sales, the overall other game-related expenses other than prize expense increased from 9.4 percent in Fiscal Year 2016 to 9.5 percent in Fiscal Year 2017. Increases in retailer commissions, costs of tickets and vendor fees cost percentages were offset by a decrease in the retailer bonuses percentage. Following are tables comparing the game-related expenses between Fiscal Years 2017 and 2016:

Game-Related Expenses	2017	% of Sales	2016	% of Sales	Difference	Change in % of Sales
Prize Expense						
Scratch	$ 256,841,122	67.5 %	$ 269,831,938	68.3 %	$ (12,990,816)	(0.8) %
Powerball	33,189,585	45.5	55,934,400	48.6	(22,744,815)	(3.1)
Lotto	14,569,038	47.6	16,170,096	59.0	(1,601,058)	(11.4)
Mega Millions	11,408,993	44.2	13,838,464	48.1	(2,429,471)	(3.9)
Cash 5	9,294,847	52.7	10,399,581	54.8	(1,104,734)	(2.1)
Cash 5 EZ Match	648,493	61.2	-	N/A	648,493	N/A
Pick 3	5,509,525	50.1	4,339,071	48.5	1,170,454	1.6
Lucky For Life	10,056,946	62.9	-	N/A	10,056,946	N/A
Total prize expense	341,518,549	61.5	370,513,550	62.3	$ (28,995,001)	(0.8)
Retailer compensation						
Commissions	37,031,098	6.7	39,527,758	6.7	(2,496,660)	-
Bonuses	3,694,336	0.6	4,394,548	0.7	(700,212)	(0.1)
Ticket costs	2,950,426	0.5	2,486,931	0.4	463,495	0.1
Vendor fees	9,256,836	1.7	9,576,741	1.6	(319,905)	0.1
Total direct op. exp.	$ 394,451,245	71.1 %	$ 426,499,528	71.7 %	$ (32,048,283)	(0.6) %

Following are tables comparing the game-related expenses between Fiscal Years 2016 and 2015:

Game-Related Expenses	2016	% of Sales	2015	% of Sales	Difference	Change in % of Sales
Prize Expense						
Scratch	$ 269,831,938	68.3 %	$ 250,776,391	66.5 %	$ 19,055,547	1.8 %
Powerball	55,934,400	48.6	34,701,513	48.2	21,232,887	0.4
Lotto	16,170,096	59.0	16,356,901	54.8	(186,805)	4.2
Mega Millions	13,838,464	48.1	14,827,976	47.8	(989,512)	0.3
Cash 5	10,399,581	54.8	10,446,120	54.2	(46,539)	0.6
Pick 3	4,339,071	48.5	4,390,086	50.3	(51,015)	(1.8)
Total prize expense	370,513,550	62.3	331,498,987	61.6	39,014,563	0.7
Retailer compensation						
Commissions	39,527,758	6.7	35,964,041	6.7	3,563,717	-
Bonuses	4,394,548	0.7	3,851,251	0.7	543,297	-
Ticket costs	2,486,931	0.4	2,480,847	0.5	6,084	(0.1)
Vendor fees	9,576,741	1.6	8,353,284	1.5	1,223,457	0.1
Total direct op. exp.	$ 426,499,528	71.7 %	$ 382,148,410	71.0 %	$ 44,351,118	0.7 %

Non game-related expenses totaled $28.2 million in Fiscal Year 2017 compared to $25.9 million in Fiscal Year 2016, a $2.3 million or nearly 9.1 percent increase. Of the $28.2 million non game-related expenses in Fiscal Year 2017, $13.6 million was for marketing agency fees, promotions and institutional and product advertising. The increase was chiefly due to a nearly $2.3 million increase in specific product and proceeds advertising costs tied to the advertising for new games over the previous fiscal year's amount of $11.3. Other significant non game-related expenses included $9.4 million for wages and benefits, $1.4 million for payments made to other state agencies including indirect cost allocations paid to the Department of Revenue and to the Office of Information Technology, $0.9 million for delivery of scratch games, and $0.8 million for building rental expenses. Increases in non game-related expenses of the indirect cost allocation for the Lottery's share of Department of Revenue overhead ($0.3 million), of wages and benefits (nearly $0.2 million), and of equipment maintenance ($0.1 million) were offset by decreases in expenses of equipment purchases ($0.3 million) and of depreciation (over $0.2 million).

Non game-related expenses totaled $25.9 million in Fiscal Year 2016 compared to $28.9 million in Fiscal Year 2015, a 10.5 percent or $3.0 million decrease. Of the $25.9 million expenses that were non game-related in Fiscal Year 2016, nearly $11.3 million, a $2.5 million drop from the previous fiscal year's amount of $13.8 million, was for marketing agency fees, promotions and institutional and product advertising. The decline was chiefly due to a nearly $2.6 million drop in specific product and proceeds advertising costs. Approximately $9.2 million, a $0.4 million or 4.3 percent decrease from Fiscal Year 2015, was for wages and benefits. The remainder of the changes to non-game-related expenses was mainly made up of an increase in equipment purchases offset by decreases to indirect cost allocations and depreciation.

Nonoperating Expenses

Nonoperating expenses were $6.2 million in Fiscal Year 2017 for unfunded pension expense, tied to the requirements of GASB Statement No. 68, GASB Statement No. 71, and GASB Statement No. 73. Fiscal Year 2016 unfunded pension expense was $766 thousand.

Distributions to the Proceeds Recipients

The Lottery's proceeds distribution for Fiscal Year 2017 totaled $133.5 million, a decrease of $10.1 million or 7.0 percent from Fiscal Year 2016 proceeds amount of $143.6 million, the highest in the Lottery's history. As a percentage of total revenue the Lottery returned 24.0 percent in Fiscal Year 2017, a slight decrease of 0.1 percent from the 24.1 percent in Fiscal Year 2016. Of these total proceeds, $64.5 million, the cap amount, was allocated to the Great Outdoors Colorado Trust Fund, nearly $53.4 million to the Conservation Trust Fund and over $13.3 million to the Division of Parks and Outdoor Recreation per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 24-35-210. Due to the fact that the maximum distribution to Great Outdoors Colorado of $64.5 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, nearly $2.3 million spilled over into the Public School Capital Construction Assistance Fund pursuant to C.R.S. 22-43.7-104 (2)(b)(III).

Capital Assets

The Lottery's investment in net capital assets at June 30, 2017, 2016, and 2015 amounted to $0.3 million, $0.4 million, and $0.5 million, respectively. The investment in capital assets as of June 30, 2017, 2016 and 2015 included computer equipment, servers, back office computer system, drawing equipment, modular furniture, cameras, recorders and leasehold improvements net of accumulated depreciation. The asset values of equipment decreased by $87,398 from Fiscal Year 2016 to Fiscal Year 2017.

The decrease in equipment from Fiscal Year 2016 to Fiscal Year 2017 was due to the purchase and capitalization of miscellaneous computer equipment and a Wi-Fi system upgrade totaling nearly $52 thousand, more than offset by the write off of miscellaneous computer equipment for $139 thousand. The $60 thousand decrease in asset values of equipment from Fiscal Year 2015 to Fiscal Year 2016 was due to the $335 thousand purchase and capitalization offset by the $395 thousand write off of miscellaneous computer and other equipment. Capital assets are shown on the Statement of Net Position at the cost on the day of acquisition.

Analysis of changes in capital assets is as follows:

Capital Assets as of
June 30, 2017, 2016, and 2015

	2017	2016	2015
Capital Assets			
Equipment	$ 5,924,273	$ 6,011,671	$ 6,071,861
Leasehold Improvements	64,711	64,711	64,711
Less: Accumulated Depreciation	(5,703,417)	(5,638,124)	(5,586,882)
Net capital assets	$ 285,567	$ 438,258	$ 549,690

Budgetary Highlights

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (the Long Bill), which determines budgets for every agency within the State. Many of the appropriation lines in the Long Bill are at the Department of Revenue (department) level, and the department has the discretion to allocate them among each agency within the department. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. Department level re-allocations were approved in employee benefits, variable vehicle, legal services and vehicle lease payments. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in Fiscal Year 2017.

The approved Lottery budget at the beginning of Fiscal Year 2017 was $526.0 million. Department level reallocations approved throughout the fiscal year decreased the overall budget slightly by $46,690 to an amended total of over $525.9 million. This included a reallocation or roll-up for Amortization and Supplemental Amortization Equalization, Health and Life, and Short Term Disability totaling $1.6 million to the Personal Services category during the fiscal year. Total expenditures and roll-forwards for Fiscal Year 2017 on a budget basis came to $423.3 million, resulting in excess appropriations (or savings) of nearly $102.6 million.

Economic Outlook

According to the June, 2017 Colorado Economic Outlook published by the Governor's Office of State Planning and Budgeting, Colorado has the lowest unemployment rate in the nation with only 2.3% unemployment for April, 2017. Colorado's economy has expanded in the first half of calendar year 2017 and the expansion is expected to continue. Much of the growth is attributable to technology-related sectors. Unemployment and ongoing challenges faced by the oil and gas industry have subsided recently. However, growth in areas besides the Front Range continues to struggle, especially in areas heavy with agricultural industry.

Building on the state's success, the Colorado Lottery is projecting sales of $584.5 million and proceeds to recipients of $133.7 million for FY 2018. Although spillover proceeds to the Building Excellent Schools Today (BEST) program is not projected to be as high as Fiscal Year 2017, we are expecting to exceed the statutory capped amount that is distributed to Great Outdoors Colorado, resulting in spillover to the BEST program of $0.6 million.

The Lottery expects to achieve these goals by continuing to introduce new and different games in Fiscal Year 2018 and by enhancing existing products. Building on the success of our Scratch game Frogger, which offered players the chance to enter a code from the ticket to play free an electronic version of Frogger on their computer or phone, the Lottery plans to introduce more free "Play for Fun electronic games" in FY 2018.

The Lottery will be making enhancements to the Mega Millions game in October, 2017 and to the Powerball game in April 2018. The Mega Millions game will have a matrix change where players must select 5 numbers out of 70 numbers, down from 75 plus an additional 1 number out of 25 numbers, up from 15. This will allow some of the prize amounts to be increased. The Mega Millions game will also increase in price from $1 to $2. The Powerball game will add an option for players to enter a bonus drawing for an additional $1. The bonus draws will be held on Mondays and Thursdays (in addition to the regular Powerball drawings held on Saturdays and Wednesdays). These enhancements are expected to increase sales modestly in Fiscal Year 2018 and beyond.

The Lottery provides 50% of net proceeds to Great Outdoors Colorado (GOCO), up to a $35 million cap in 1992 dollars that adjusts annually with inflation. As the cap continues to increase by an estimated $1 million annually, the Lottery must generate an additional $10-$13 million in revenue each year in order to meet the cap. The effort required to meet the ever-increasing cap is even greater given jackpot game sales fatigue, the aging population, and evolving technology. The Lottery cannot rely on luck with record jackpots each year to achieve our goals. Instead, we must continually change our business model to adapt to changing demographics and technology.

In order to maintain the continued success of all our products and remain relevant, the Lottery must be innovative and embrace interactive technology. Although we cannot sell our products over the internet, we can take advantage of the interactive aspect using the traditional retailer sales model to reach the space between internet sales and traditional sales. We can get consumers to play some of our games digitally by using their phones or computers and by offering free games on our web site. This "space between" can appeal to today's consumers that use their phones for everything, including new segments of the state's population that do not currently or traditionally play lottery games.

Contacting the Lottery's Financial Management

This management discussion and analysis report is designed to provide Colorado citizens, Colorado government officials, our players, retailers and other interested parties with a general overview of the Lottery's financial activity for Fiscal Year 2017 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact John Caligaris, the Colorado Lottery's Controller, 225 North Main Street, Pueblo, CO 81003.

COLORADO LOTTERY
Statements of Net Position
June 30, 2017 and 2016

	2017	2016
ASSETS		
Current Assets:		
Cash and Investments	$ 45,319,051	$ 48,143,610
Accounts Receivable, net of the allowance for doubtful accounts of $151,555 in 2017 and $203,463 in 2016	21,001,734	20,877,979
Consignment Inventory, at Cost	162,080	95,370
Warehouse Inventory, at Cost	1,284,359	1,376,545
Prepaid Expenses	95,978	71,955
Total Current Assets	67,863,202	70,565,459
Reserved and Restricted Assets:		
Cash and Investments-Operating Reserve	1,600,000	1,500,000
Cash and Investments-Licensed Agent Recovery Reserve Receipts	516,720	424,591
Prepaid Prize Expense with MUSL	4,399,693	4,541,395
Total Reserved and Restricted Assets	6,516,413	6,465,986
Capital Assets:		
Equipment	5,924,273	6,011,671
Leasehold Improvements	64,711	64,711
Less Accumulated Depreciation and Amortization	(5,703,417)	(5,638,124)
Total Capital Assets	285,567	438,258
TOTAL ASSETS	74,665,182	77,469,703
DEFERRED OUTFLOWS - PENSIONS	12,888,492	2,865,826
TOTAL ASSETS AND DEFERRED OUTFLOWS	$ 87,553,674	$ 80,335,529

See Notes to Financial Statements

COLORADO LOTTERY
Statements of Net Position
June 30, 2017 and 2016

	2017	2016
LIABILITIES		
Current Liabilities:		
Accounts Payable	$ 543,157	$ 963,432
Prize Liability	35,358,009	37,970,798
Payable to MUSL	822,931	569,030
Accrued Annual and Sick Leave	593	-
Wages and Benefits	806,265	750,542
Retailer Bonus Liability	1,227,820	1,821,535
Funds Available for Distribution	32,743,995	31,915,368
Total Current Liabilities	71,502,770	73,990,705
Long-Term Liabilities:		
Accrued Annual and Sick Leave	749,741	747,820
Expired Warrants Liability	31,146	35,153
Net Pension Liability	41,110,831	25,257,445
Total Long-Term Liabilities	41,891,718	26,040,418
TOTAL LIABILITIES	113,394,488	100,031,123
DEFERRED INFLOWS - PENSIONS	1,427,150	1,066,323
NET POSITION		
Net Investment in Capital Assets	285,567	438,258
Restricted-Licensed Agent Recovery Reserve	516,720	424,591
Restricted-Operating Reserve	1,600,000	1,500,000
Unrestricted-Unrealized Gain/Loss on Investments	(20,762)	333,176
Unrestricted-Unfunded Pension Liability	(29,649,489)	(23,457,942)
TOTAL NET POSITION	(27,267,964)	(20,761,917)
TOTAL LIABILITIES AND NET POSITION	$ 87,553,674	$ 80,335,529

COLORADO LOTTERY
Statements of Revenues, Expenses, and Changes in Fund Net Position
For the Years Ended June 30, 2017 and 2016

	2017	2016
OPERATING REVENUES		
Gross Ticket Sales	$ 555,333,490	$ 594,411,905
DIRECT OPERATING EXPENSES		
Prize Expense	341,518,549	370,513,550
Retailer Commissions and Bonuses	40,725,434	43,922,306
Cost of Tickets and Vendor Fees	12,207,262	12,063,672
Total Direct Operating Expenses	394,451,245	426,499,528
GROSS PROFIT ON SALE OF TICKETS	160,882,245	167,912,377
OTHER OPERATING EXPENSES		
Marketing and Communications	13,634,184	11,295,008
Administration Fees Paid to MUSL	119,397	111,812
Wages and Benefits	9,413,153	9,223,414
Professional Services	274,144	255,983
State Agencies Services	712,736	745,102
Department of Revenue Services	702,836	434,425
Travel	96,939	103,110
Equipment (including loss on disposition of equipment of $7,713 and $3,749, respectively)	184,231	458,148
Depreciation	196,608	442,583
Space Rental	814,119	790,701
Rents for Equipment	28,389	29,720
Motor Pool Leasing	265,607	292,821
Materials and Supplies	103,644	143,339
Telephone	253,274	240,517
Equipment Maintenance	308,589	202,905
Printing	19,047	18,128
Delivery Expense	932,271	923,863
Other	154,797	160,039
Total Other Operating Expenses	28,213,965	25,871,618
OTHER OPERATING REVENUE	177,409	858,465

COLORADO LOTTERY
Statements of Revenues, Expenses, and Changes in Fund Net Position
(Continued)
For the Years Ended June 30, 2017 and 2016

	2017	2016
TOTAL OPERATING INCOME	$ 132,845,689	$ 142,899,224
NONOPERATING REVENUES (EXPENSES)		
Investment Income	314,792	813,205
Unfunded Pension Expense	(6,191,547)	(765,943)
Funds Distributed for Current Year	(100,730,986)	(111,654,636)
Funds Available for Distribution for Current Year	(32,743,995)	(31,915,368)
Total Nonoperating Revenues (Expenses)	(139,351,736)	(143,522,742)
NET INCOME(LOSS)	$ (6,506,047)	$ (623,518)
NET POSITION, BEGINNING OF YEAR	(20,761,917)	(20,138,399)
Net Change in Net Position	(6,506,047)	(623,518)
NET POSITION, END OF YEAR	$ (27,267,964)	$ (20,761,917)

COLORADO LOTTERY
Statements of Cash Flows
For the Years Ended June 30, 2017 and 2016

	2017	2016
Cash Flows from Operating Activities		
Cash received from retailers	$ 555,809,670	$ 595,446,771
Cash paid in prizes	(344,236,811)	(358,758,960)
Cash paid in retailer commissions	(37,031,098)	(39,527,758)
Cash payments to suppliers	(31,145,800)	(29,343,208)
Cash payments to employees for services	(9,354,916)	(9,283,398)
Cash paid in retailer bonus	(4,290,282)	(3,915,411)
Net cash provided by operating activities	129,750,763	154,618,036
Cash Flows from Noncapital Financing Activities		
Distribution of net proceeds	(132,646,354)	(143,474,253)
Net cash used by noncapital financing activities	(132,646,354)	(143,474,253)
Cash Flows from Capital and Related Financing Activities		
Acquisition of capital assets	(51,631)	(334,900)
Net cash used by capital and related financing activities	(51,631)	(334,900)
Cash Flows from Investing Activities		
Interest received	668,730	605,036
Change in fair market value of investments	(353,938)	208,169
Net cash provided by investing activities	314,792	813,205
Increase (Decrease) in Cash and Investments	(2,632,430)	11,622,088
Cash and Investments, Beginning of Year (including $1,924,591 and $1,878,903, respectively, in restricted accounts)	50,068,201	38,446,113
Cash and Investments, End of Year, (including $2,116,720 and $1,924,591, respectively, in restricted accounts)	$ 47,435,771	$ 50,068,201

COLORADO LOTTERY
Statements of Cash Flows
(Continued)
For the Years Ended June 30, 2017 and 2016

	2017	2016
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	$ 132,845,689	$ 142,899,224
Adjustments of reconcile operating income to net cash provided by operating activities		
Depreciation	196,608	442,583
Gain on disposition of equipment	7,713	3,749
Change in:		
Accounts Receivable	(123,755)	(660,056)
Warehouse and Consignment Inventory	25,476	(346,791)
Prepaid Expenses	(24,023)	3,778
Prepaid Prize Expense with MUSL	141,702	40,245
Liabilities (excluding funds available for distribution)	(3,318,647)	12,235,304
Net cash provided by operating activities	$ 129,750,763	$ 154,618,036
Reconciliation of Cash and Investments		
Cash and investments	$ 45,319,051	$ 48,143,610
Restricted cash and investments- Licensed Agent Recovery Reserve	516,720	424,591
Restricted cash and investments- Operating Reserve	1,600,000	1,500,000
Cash and Investments, End of Year	$ 47,435,771	$ 50,068,201

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Colorado Lottery (the Lottery) began operations April 30, 1982 under the provisions of Section 24-35-202, C.R.S. The Lottery operates under a commission and provides operation and service of lottery games as authorized by the statute. The Lottery's revenues are predominantly earned from the sale of lottery products, including scratch games and jackpot games including Lotto, Powerball, Cash 5, Cash 5 EZ Match, Mega Millions, Pick 3, and Lucky For Life.

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado, for the Fiscal Years ended June 30, 2017 and 2016. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery in accordance with accounting principles generally accepted in the United States of America.

The accounting policies of the Lottery conform to accounting principles generally accepted in the United States of America as applicable to governments. The following is a summary of the more significant policies.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains, losses and other changes in net position during the reporting period. Actual results could differ from those estimates.

Fund Accounting

Government resources are allocated to and accounted for in separate sub-entities called funds, based upon the purposes for which the resources are to be spent and the means by which spending activities are controlled. A fund is a fiscal and accounting entity with a self-balancing set of accounts that comprise its assets, liabilities, net position, revenues and expenditures.

Enterprise Fund

The Lottery accounts for its operations as an enterprise fund. The intent of the State of Colorado Legislature is that the Lottery's costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. The Lottery defines operating revenues as those earned as a direct result of the fund's principal ongoing operations, i.e., the sale of lottery products. Operating expenses include expenses incurred in earning those revenues such as prize payments, the cost of tickets, vendor fees, retailer commissions and bonuses, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pensions

The Lottery participates in the State Division Trust Fund (SDTF), a cost-sharing multiple-employer defined benefit pension fund administered by the Public Employees' Retirement Association of Colorado ("PERA"). The net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, information about the fiduciary net position and additions to/deductions from the fiduciary net position of the SDTF have been determined using the economic resources measurement focus and the accrual basis of accounting. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Basis of Accounting

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements. The Lottery accounts for funds using the accrual basis of accounting. Revenues from scratch ticket sales are recognized at the point of ticket pack activation. Revenues from Lotto, Powerball, Cash 5, Cash 5 EZ Match, Mega Millions, Pick 3, and Lucky For Life ticket sales are recognized when the tickets are sold. Prize expense for scratch tickets is recognized at the point of ticket activation. Prize expense for Lotto, Powerball, Cash 5, Cash 5 EZ Match, Mega Millions, Pick 3, and Lucky For Life is recognized when tickets are sold. Other operating expenses are recognized when they are incurred.

Budget

By October 24th of each year, the Department of Revenue Executive Director submits to the Governor's Office of State Planning and Budgeting a proposed legislative budget for the fiscal year commencing the following July 1. The legislative budget includes proposed expenditures and the means of financing them.

Public hearings are conducted by the Joint Budget Committee to obtain clarification and taxpayer comments. Prior to June 30, the budget is legally enacted through passage of a law referred to as the Long Bill.

During the fiscal year, the approved legislative budget may be modified due to roll-forward authorization, supplemental budget approval or line item transfer authorization. All modifications must be approved by the State Controller and the Office of State Planning and Budgeting and the Legislature.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from retailers for activated scratch ticket packs and uncollected jackpot game sales. Billable accounts receivable consist of amounts due from retailers for settled scratch ticket packs and uncollected jackpot game sales. Billable accounts receivable is invoiced weekly and is electronically transferred from the retailers' accounts into the Lottery's account one week following the invoice date.

Allowance for doubtful accounts represents a provision for receivables that will probably not be collected in the future. Consideration of the economic climate, credit-worthiness of individual account debtors, bankruptcy of debtor, discontinuance of debtor's business, and failure of repeated attempts to collect and barring of collection by statute of limitations are factors used in considering when an account becomes uncollectible. The accrual of a loss contingency is required when a loss is probable and/or can be reasonably estimated.

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve are shown net of estimated uncollectible receivables of $151,555 and $203,463 as of June 30, 2017 and 2016, respectively.

Warehouse Inventory

Warehouse inventory represents unsold tickets in possession of the Lottery and is stated at cost, using the specific identification method.

Consignment Inventory

Inventory on consignment represents non-activated ticket inventory in the possession of retailers who act as agents of the Lottery. The retailer cannot sell a pack of tickets until the pack is activated by the retailer, which then enables the winning tickets to be cashed. The activation is therefore the point at which the transfer of ownership is recognized. Since the Lottery still owns non-activated tickets, the tickets are included in the inventory and reported on the statements of net position. Consignment inventory is stated at cost using the specific identification method.

Supplies Inventory

The State of Colorado's threshold for recording supplies inventories is $100,000 per location. The supplies inventory of the Lottery consistently falls below the $100,000 threshold per location. Accordingly, no supplies inventory appears on the statements of net position.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Prepaid Prize Expense

As part of the Lottery's agreement with the Multi-State Lottery Association (MUSL), for both the Powerball and Mega Millions games, a certain percentage of sales must be paid to MUSL, when required, to bring the set prize and grand prize reserves up to the reserve requirement amounts as determined by MUSL. No payments were required to be made to the Powerball reserves in Fiscal Years 2017 or 2016 to bring the reserves to the required amounts. Rather in Fiscal Year 2017, MUSL rebalanced the Powerball reserves and new reserve ceilings were determined for each member state. This resulted in a refund of $119,661 of the Powerball reserves. During Fiscal Year 2017 a total of $140,713 was transferred from the Mega Million Prize Reserve to cover the payment of lower-tier prizes. Of this amount, repayments of $118,669 were subsequently required to be made back to MUSL to meet the rebalanced reserve requirement, resulting in a net decrease of the Mega Millions reserve of $22,044. During Fiscal Year 2016 a total of $36,063 was transferred from the Mega Millions Prize Reserve to cover the payment of lower-tier prizes causing a decrease in the prepaid prize expense with MUSL. No repayments were required to be made to the Mega Millions reserve in Fiscal Year 2016. In addition, with the Lottery's approval, MUSL holds small amounts in an unreserved account to be used to pay miscellaneous, unforeseen expenses. The unreserved account included in prepaid prize expense at June 30, 2017 was nominal at $3, with a balance of $0 at June 30, 2016.

Capital Assets

Capital assets, which include internal use computer software, equipment, vehicles, and leasehold improvements, are stated at cost. The Lottery adheres to the state policy of capitalizing equipment only if the cost exceeds $5,000 and has a useful life of more than one year. Depreciation for equipment and internal use computer software is computed on the straight-line method over estimated useful lives ranging from three to ten years. Depreciation for vehicles is computed on the straight-line method over an estimated useful life of five years. Leasehold improvements are depreciated over the greater of five years or the term of the lease. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains or losses are recognized in current operations.

Deferred Outflows/Inflows of Resources

In addition to assets, the Statements of Net Position includes a separate section for deferred outflows of resources. This separate element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Lottery's Deferred Outflows – Pensions represents the amount of pension contributions made to the State pension plan subsequent to the December 31, 2016 measurement date, the deferred variance in expected to actual investment earnings and the deferred experience gains and losses.

In addition to liabilities, the Statements of Net Position includes a separate section for deferred inflows of resources. This separate element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The Lottery's Deferred Inflows – Pension represents the change in the Lottery's "proportionate share" developed to distribute the aggregate plan liability and expense among all the employers' represented by the cost-sharing multiple-employer defined benefit pension plan in which the Lottery participates, the deferred experience gains and losses, the change in pension investments and the change of assumptions.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Accrued Wages and Benefits

At the end of each fiscal year, the state shifts the pay date for the month of June for employees paid on a monthly basis, deferring the date from the last working day of June to the first working day of July. For the Lottery, along with other minor payroll accruals, this created a liability for accrued wages and benefits at June 30, 2017 and 2016 of $806,265 and $750,542, respectively.

Prize Liability and Prize Expense

Under the provisions of Section 24-35-210 (9), C.R.S., the Lottery must pay no less than fifty percent (50%) of total ticket sales as prizes. In the aggregate, the Lottery continues to meet this requirement. Additional prize expense and corresponding liability may be incurred as a result of market fluctuations in the cost of annuities used to pay various jackpots (see Note 11).

All scratch, jackpot game and special drawing prizes are accounted for using the accrual basis of accounting. Scratch prize liability and expense are recognized at the point of ticket pack activation. The liability and expense for jackpot game prizes are recognized at the point of retail sale and are adjusted as the jackpot game draws occur and actual prize liability is determined. The liability for special drawing prizes is accrued on the first day of sales of the associated game. Prize liability for all games is reduced as prizes are paid to winners. The net prize liability at June 30, 2017 and 2016 was $35,358,009 and $37,970,798, respectively.

Payments of scratch prize amounts of $150 or less may be made at the Lottery or at the retail outlet; payment of scratch prize amounts of $151 to $599 may be made at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of $600 or more are paid by the Lottery. Retailer accounts are credited for any prize payments retailers make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes accrued as a liability will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of $7,259,105 for Fiscal Year ended June 30, 2017 and $6,542,002 for Fiscal Year ended June 30, 2016.

Payments of cumulative jackpot game prize amounts of $150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of $151 to $599 on a single ticket may be made at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of $600 or more on a single ticket must be made at the Lottery. Retailer accounts are credited for any prize payments retailers make on a daily basis. Jackpot game prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed jackpot game prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed jackpot game prizes resulted in a decrease to prize expense of $5,920,255 for Fiscal Year ended June 30, 2017 and $3,005,052 for the Fiscal Year ended June 30, 2016.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Retailer Bonus Liability

Pursuant to provisions 5.17, 10.13 and 14.19 of the Colorado Lottery Commission Rules and Regulations, each licensee is entitled to receive a cashing bonus of one percent (1%) of each prize paid by the licensee up to and including $599.99**.** In addition, a marketing performance bonus up to five-tenths of one percent (0.5%) of total product sales may be earned by licensees that meet the criteria set forth by the Lottery Director or their designee. In the event there is a residual from the accrual of the one percent (1%) cashing bonus and/or the five-tenths (0.5%) marketing bonus, the Director may provide additional compensation to licensees or may revert the excess amount thereby decreasing the bonus expense.

The cashing bonus is accrued as tickets are sold and paid as winning tickets are redeemed. The write off of the accrued cashing bonus liability tied to unclaimed prizes at the end of the 180-day claim period in Fiscal Years 2017 and 2016 is recorded as a reduction of bonus expense.

The marketing performance bonus is accrued monthly and paid to retailers in accordance with the criteria as set out in the fiscal year marketing performance plan as approved by the Director. The write off of any excess marketing performance bonus accrued is recorded as a reduction of bonus expense.

Licensed Agent Recovery Reserve

Under the provisions of Section 24-35-219, C.R.S., a Licensed Agent Recovery Reserve, established on January 1, 1988, is used to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Executive Director of the Department of Revenue and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of $2,000 surety coverage per outlet at their discretion. As of June 30, 2017 and June 30, 2016, the Lottery had reserved $516,720 and $424,591, respectively. The Lottery utilizes restricted net assets before using unrestricted net assets for bad debts.

Lottery Fund Net Position

In accordance with Section 24-35-210 (4.1)(a), C.R.S., the Lottery is required to reserve "sufficient monies, as of the end of the fiscal year, to ensure the operation of the Lottery for the ensuing fiscal year." The moneys reserved by the lottery shall be held in cash and investments.

In June 2002 the Lottery Commission approved a balance in net assets "equal to the net value of the Lottery's capital assets". As of June 30, 2017 and June 30, 2016, the Lottery had reserved $285,567 and $438,258, respectively.

In April 2005, the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of $1.7 million. The amount held in this operating reserve is reviewed annually and adjusted accordingly. The annual reviews were completed in December 2016 and January 2015. The reserve increased to $1.6 million in Fiscal Year 2017 from the $1.5 million in Fiscal Year 2016, in accordance with the reviews.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Equipment Expense

Included in “The Statement of Revenues, Expenses, and Changes in Fund Net Position” is an account titled equipment. This account reports the gain or loss on disposed assets, fixed asset purchases under the capitalization threshold, software purchases under the capitalization threshold, and other miscellaneous equipment transactions that do not qualify for capitalization.

Compensated Leave

All permanent employees of the Lottery may accrue annual and sick leave based on length of service subject to certain limitations on the amount that will be paid upon termination. In addition, employees who are classified as non-exempt from overtime pay have accumulated overtime which must be taken as compensatory time or paid. The estimated cost of compensated absences for which employees are vested is as follows:

	June 30, 2016	Increases	Decreases	June 30, 2017
Annual leave	$ 641,192	$ 531,492	$ (525,783)	$ 646,901
Sick leave	106,156	38,126	(41,691)	102,591
Total annual and sick leave	747,348	569,618	(567,474)	749,492
Compensatory time	472	3,383	(3,013)	842
Total compensated leave	$ 747,820	$ 573,001	$ (570,487)	$ 750,334

	June 30, 2015	Increases	Decreases	June 30, 2016
Annual leave	$ 677,970	$ 509,843	$ (546,621)	$ 641,192
Sick leave	114,819	34,565	(43,228)	106,156
Total annual and sick leave	792,789	544,408	(589,849)	747,348
Compensatory time	522	4,520	(4,570)	472
Total compensated leave	$ 793,311	$ 548,928	$ (594,419)	$ 747,820

The short-term portion of the above accrued annual and sick leave at June 30, 2017 and June 30, 2016 is $593 and $0, respectively. This represents the amount to be paid out to known current employees planning to retire and cash in their leave balances within the next twelve months.

Expired Warrants Liability

Expired warrants liability represents the expiration of aged uncashed warrants and imprest checks which expired on or before June 30, 2003. In accordance with Section 15-12-914 (2), C.R.S., recipients are entitled to claim payment up to 21 years after original date of issue. Pursuant to Section 24-35-212 (2), C.R.S., the amount of these uncashed warrants shall remain in the Lottery fund. Pursuant to the Unclaimed Property Act, Section 38-13-113, C.R.S., the funds to cover the liability for any uncashed warrants, which expire after June 30, 2003 are transferred to the Unclaimed Property Fund.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Lottery must request reimbursement from the Unclaimed Property Fund for any warrants presented for payment that expired after June 30, 2003. No request for reimbursement was made for Fiscal Years ending June 30, 2017 and June 30, 2016 from the Unclaimed Property Fund.

Promotional Activity

The Lottery engages in three types of promotional activities in an attempt to enhance sales, to increase player awareness and to increase the player base: special promotions and drawings, direct giveaways, and buy x-get-y. The number and amount of promotional activities can and do vary year over year due to such factors as budget availability, retailer and special events participation, and new product introductions. Specific promotional coupons/tickets are distributed/awarded to players through special promotions and drawings and can be redeemed/claimed at any lottery office for a specified Lottery product. Specific promotional coupons/tickets with a total face value of $1,700 and $0 were redeemed in Fiscal Years ended June 30, 2017 and June 30, 2016, respectively.

Scratch and jackpot game tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the Fiscal Years ended June 30, 2017 and June 30, 2016, scratch tickets with a total face value of $169,867 and $182,982, respectively, were given away. Free jackpot tickets with a total face value of $600 were given away in Fiscal Year 2017, with no free jackpot tickets given away in Fiscal Year 2016.

For the “buy x-get-y” promotions, players are given the opportunity to receive a “free” jackpot ticket when a qualifying purchase is made, for instance buy five Lotto tickets receive a free Pick 3 ticket. During the Fiscal Year ended June 30, 2017, Lotto jackpot game tickets with a total face value of $612,477 were given away during a “Buy $4 of Lucky For Life Tickets, Get a Free Lotto Ticket” promotion, used to introduce the new Lucky For Life game to Colorado players while promoting a game with which players were already familiar. During the Fiscal Year ended June 30, 2016, jackpot games tickets with a total face value of $239,160 were given away through this buy x-get-y method. The increase in Fiscal Year 2017 over the previous fiscal year was mostly due to the introduction of a new jackpot game in the current fiscal year with the goal of creating excitement around that game.

Scratch and jackpot game tickets and coupon promotions are valued at cost. For the Fiscal Years ended June 30, 2017 and June 30, 2016, $435,200 and $281,220, respectively, were recorded as costs related to special promotions and drawings, direct giveaways, and free tickets. These costs were included in Marketing and Communications expense in the statements of revenues, expenses and changes in fund net position.

Reclassifications

Certain reclassifications of amounts previously reported have been made to the accompanying financial statements to maintain consistency between periods presented. The reclassifications had no impact on net income or previously reported net position.

Subsequent Events

The Lottery has evaluated subsequent events through November 20, 2017, the date which the financial statements were available to be issued.

NOTE 2 – Change in Accounting Policy

Implementation of GASB Statement No. 73

Effective July 1, 2015 for Fiscal Year 2016, the Lottery adopted GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68.* The implementation of this standard extends the approach to accounting and financial reporting established in Statement 68 to all pensions.

NOTE 3 – CASH AND INVESTMENTS

Cash

Cash includes petty cash funds, change funds, an imprest account, a depository account and cash on deposit with the State Treasurer. A detail of cash at June 30, 2017 and 2016 is as follows:

	2017	2016
Petty cash	$ 1,150	$ 1,100
Change funds	73,000	72,000
Imprest account	168,000	180,000
Depository accounts	50,000	50,000
Cash on deposit with State Treasurer	45,026,901	47,840,510
Total unrestricted cash and investments	45,319,051	48,143,610
Restricted cash and investments - Licensed Agent		
Recovery Reserve Receipts on deposit with State Treasurer	516,720	424,591
Operating Reserve on deposit with State Treasurer	1,600,000	1,500,000
Total restricted cash and investments	2,116,720	1,924,591
Total cash and investments	$ 47,435,771	$ 50,068,201

Cash on Deposit with State Treasurer

Under the provisions of Section 24-35-210 (6), C.R.S., the State Treasurer shall invest the monies of the Lottery in excess of operating and prize payment expenses and all authorized transfers. Interest or any other return on investments is paid to the Lottery Fund account on a monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for Fiscal Years 2017 and 2016 was 1.13% and 0.97%, respectively.

NOTE 3 – CASH AND INVESTMENTS (CONTINUED)

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1, C.R.S. The State Treasury acts as a bank for all state agencies and institutions of higher education, with the exception of the University of Colorado. Moneys deposited in the Treasury are invested until the cash is needed. As of June 30, 2017, the Lottery had cash on deposit with the State Treasurer of $47,143,621, which represented approximately 0.7 percent of the total $6,770.2 million fair value of deposits in the State Treasurer's Pool (Pool).

On the basis of the Lottery's participation in the Pool, the Lottery reports as an increase or decrease in cash its share of the Treasurer's unrealized gains and losses on the Pool's underlying investments. The State Treasurer does not invest any of the Pool's resources in any external investment pool, and there is no assignment of income related to participation in the Pool. The unrealized gains/losses included in income reflect only the change in fair value for the fiscal year.

Additional information on investments of the State Treasurer's Pool may be obtained in the state's Comprehensive Annual Financial Report for the year ended June 30, 2017.

The Lottery reports its share of the Treasurer's unrealized gains and losses based on its participation in the State Treasurer's Pool only at fiscal year end.

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Lottery's deposit policy for custodial credit risk requires compliance with the provisions of state law. State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Colorado; bonds of any city, county, school district or special road district of the State of Colorado; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

The Lottery accounts are held in Public Deposit Protection Act (PDPA) qualified institutions, thus balances held in the Lottery's accounts in excess of $250,000 per institution are secured through PDPA with guaranteed securities.

Statements of Cash Flows

The statements of cash flows are prepared under the direct method then adjusted for prize payments and commission and bonus payments to retailers, which are netted from cash received from retailers and applied against accounts receivable balances. For cash flow purposes, cash and investments include restricted cash and investments held by the State Treasurer in its cash and investment pool.

NOTE 4 – SCHEDULE OF CHANGES IN CAPITAL ASSETS

	June 30, 2016	Increases	Decreases	June 30, 2017
Capital assets being depreciated:				
Equipment and software	$ 6,011,671	$ 51,631	$ (139,029)	$ 5,924,273
Leasehold improvements	64,711	-	-	64,711
Total historical costs	6,076,382	51,631	(139,029)	5,988,984
Less accumulated depreciation for equipment	(5,573,431)	(196,591)	131,316	(5,638,706)
Less accumulated depreciation for leasehold improvements	(64,693)	(18)	-	(64,711)
Total accumulated depreciation	(5,638,124)	(196,609)	131,316	(5,703,417)
Total capital assets, being depreciated, net	$ 438,258	$ (144,978)	$ (7,713)	$ 285,567

	June 30, 2015	Increases	Decreases	June 30, 2016
Capital assets being depreciated:				
Equipment and software	$ 6,071,861	$ 334,900	$ (395,090)	$ 6,011,671
Leasehold improvements	64,711	-	-	64,711
Total historical costs	6,136,572	334,900	(395,090)	6,076,382
Less accumulated depreciation for equipment	(5,535,149)	(429,623)	391,341	(5,573,431)
Less accumulated depreciation for leasehold improvements	(51,733)	(12,960)	-	(64,693)
Total accumulated depreciation	(5,586,882)	(442,583)	391,341	(5,638,124)
Total capital assets, being depreciated, net	$ 549,690	$ (107,683)	$ (3,749)	$ 438,258

NOTE 5 – OPERATING LEASES

The Lottery occupies office and warehouse space in Pueblo, Denver, Grand Junction and Fort Collins. Rental payments are contingent upon the continuing availability of funds. Specific lease information follows:

Pueblo

Office – The Lottery entered into an agreement with Midtown RLLLP on April 19, 2005 and the lease agreement began on June 27, 2005. The original lease was superseded July 31, 2012 when a new lease agreement was executed. A lease amendment was signed on April 9, 2013 to provide the Lottery with funds to offset the costs of equipment and cabling, moving/relocation, and security equipment connected with acquiring the first and mezzanine floors of the building. A new lease amendment was signed on October 18, 2016 to clarify the Lottery's use of landlord owned equipment, and to agree to share the cost of a new uninterruptable power supply and a new power distribution system. The lease expires on June 30, 2022. The lease contains an option to renew for two additional five-year terms commencing on July 1, 2022. There are no other provisions for extension or renewal.

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a new lease agreement with Santa Fe 250 LLC which was signed by the State Controller's Office on June 10, 2016 and became effective July 1, 2016 and expires June 30, 2019. The warehouse loft space included in the prior lease was eliminated from the agreement along with physical access to the loft. The lease contains an option to renew for two additional three-year term commencing on July 1, 2019. The lease also contains a holdover clause where the Lottery will become a month-to-month tenant if the Lottery fails to vacate the premises upon expiration or sooner termination of this lease. The rent to be paid by the Lottery during such continued occupancy shall be the same being paid by the Lottery as of the date of expiration or sooner termination. Landlord and the Lottery each hereby agree to give the other party at least thirty days written notice prior to termination of any holdover tenancy.

Denver

Office – The Lottery occupies office space in the Galleria Towers Building in Denver. The Lottery entered into a lease agreement, which began July 1, 2009 and expires June 30, 2019. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Galleria Acquisitions, Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

Warehouse – On December 11, 2009, the Lottery entered into a lease agreement with Valley Business Corp., Inc. beginning on December 11, 2009 and expiring on June 30, 2015. Exercising its first renewal option, the Lottery executed Amendment #1 to the lease with Valley Business Corp. effective July 23, 2015, which extended the term of the lease from June 30, 2015 through June 30, 2020 and made certain modifications to the existing premises. The lease contains one (1) more option to renew for an additional consecutive period of five years. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Valley Business Corp. Inc. and the

NOTE 5 – OPERATING LEASES (CONTINUED)

Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

Fort Collins

The Lottery occupies space leased by the Department of Revenue and is responsible for reimbursing the Department of Revenue for lease payments.

Grand Junction

The Lottery occupies space in the Grand Junction State Services Building and is responsible for reimbursing the Capitol Complex Division of the Colorado Department of Personnel and Administration for lease payments.

Wireless Jackpot Signage

Effective June 21, 2016 the Lottery amended the IGT contract providing the jackpot gaming system to include the lease of 1,500 new in-store wireless jackpot signs capable of displaying information regarding jackpot amounts. Installation of the new signs is on a schedule agreed upon from time-to-time by the parties. The lease commenced on the effective date and will expire on June 30, 2021 unless the IGT contract is sooner terminated or further extended.

	FUTURE MINIMUM LEASE PAYMENTS					
LOCATION	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**	**Later Years**
Pueblo Office	$ 353,206	$ 363,685	$ 374,592	$ 385,713	$ 397,261	$ -
Pueblo Warehouse	168,805	168,805	-	-	-	-
Denver	217,589	223,570	-	-	-	-
Denver Warehouse	113,718	116,577	119,522	-	-	-
In-store signage	259,616	373,016	431,424	481,824	-	-
	$ 1,112,934	$ 1,245,653	$ 925,538	$ 867,537	$ 397,261	$ -

NOTE 6 – OTHER REVENUE

A schedule of other revenue for the Fiscal Years ended June 30, 2017 and 2016 follows:

	2017	2016
License fees	$ 63,756	$ 64,239
Fines and penalties	11,898	738,404
Assignment fees	1,500	1,200
Net licensed agent recovery reserve receipts	92,129	45,688
Other	8,126	8,934
Total	$ 177,409	$ 858,465

NOTE 7 – DISTRIBUTION OF NET PROCEEDS

In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. The State Treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Wildlife and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is $35 million in 1992 dollars and is adjusted annually based on the consumer price index, which was calculated to be $64.5 million for the year ended June 30, 2017. Any excess over the limit shall be transferred to the State Public School Capital Construction Assistance Fund.

Income available for distribution at June 30:

	2017	2016
Operating income	$ 132,845,689	$ 142,899,224
Plus: Investment income	314,792	813,205
Less: Unfunded pension expense	(6,191,547)	(765,943)
Income before distributions	126,968,934	142,946,486
Change in licensed agent recovery reserve	(92,129)	(45,688)
Change in fair market value of investments	353,938	(208,169)
Change in operating reserve	(100,000)	-
Change in investment in capital assets	152,691	111,432
Less: Unfunded pension expense not included in distribution calculation	6,191,547	765,943
Income available for distribution	133,474,981	143,570,004
Less distributions prior to year-end	(100,730,986)	(111,654,636)
Income available for distribution	$ 32,743,995	$ 31,915,368

NOTE 7 – DISTRIBUTION OF NET PROCEEDS (CONTINUED)

	Accrued at June 30, 2016	Proceed Distribution Expenses	Distributions Paid	Accrued at June 30, 2017
Great Outdoors Colorado	$ 7,887,187	$ 64,463,929	$ (58,252,680)	$ 14,098,436
Public School Capital Construction Assistance Fund	8,070,499	2,273,562	(8,070,499)	$ 2,273,562
Conservation Trust Fund	12,766,147	53,389,992	(53,058,541)	$ 13,097,598
Division of Parks and Outdoor Recreation	3,191,535	13,347,498	(13,264,634)	$ 3,274,399
	$ 31,915,368	$ 133,474,981	$ (132,646,354)	$ 32,743,995

	Accrued at June 30, 2015	Proceed Distribution Expenses	Distributions Paid	Accrued at June 30, 2016
Great Outdoors Colorado	$ 13,912,352	$ 63,714,505	$ (69,739,670)	$ 7,887,187
Public School Capital Construction Assistance Fund	1,997,456	8,070,499	(1,997,456)	8,070,499
Conservation Trust Fund	12,727,847	57,428,001	(57,389,701)	12,766,147
Division of Parks and Outdoor Recreation	3,181,962	14,356,999	(14,347,426)	3,191,535
	$ 31,819,617	$ 143,570,004	$ (143,474,253)	$ 31,915,368

NOTE 8 – PENSION PLANS

Defined Benefit Pension Plan

Plan Description

Eligible employees of the Lottery are provided with pensions through the State Division Trust Fund (SDTF)—a cost-sharing multiple-employer defined benefit pension plan administered by PERA. Plan benefits are specified in Title 24, Article 51 of the Colorado Revised Statutes (C.R.S.), administrative rules set forth at 8 C.C.R. 1502-1, and applicable provisions of the federal Internal Revenue Code. Colorado State law provisions may be amended from time to time by the Colorado General Assembly. PERA issues a publicly available comprehensive annual financial report that can be obtained at *www.copera.org/investments/pera-financial-reports*.

NOTE 8 – PENSION PLANS (CONTINUED)

Benefits Provided

PERA provides retirement, disability, and survivor benefits. Retirement benefits are determined by the amount of service credit earned and/or purchased, highest average salary, the benefit structure(s) under which the member retires, the benefit option selected at retirement, and age at retirement. Retirement eligibility is specified in tables set forth at C.R.S. § 24-51-602, 604, 1713, and 1714.

The lifetime retirement benefit for all eligible retiring employees under the PERA Benefit Structure is the greater of the:

- Highest average salary multiplied by 2.5 percent and then multiplied by years of service credit

- The value of the retiring employee's member contribution account plus a 100 percent match on eligible amounts as of the retirement date. This amount is then annuitized into a monthly benefit based on life expectancy and other actuarial factors.

In all cases the service retirement benefit is limited to 100 percent of highest average salary and also cannot exceed the maximum benefit allowed by federal Internal Revenue Code.

Members may elect to withdraw their member contribution accounts upon termination of employment with all PERA employers; waiving rights to any lifetime retirement benefits earned. If eligible, the member may receive a match of either 50 percent or 100 percent on eligible amounts depending on when contributions were remitted to PERA, the date employment was terminated, whether 5 years of service credit has been obtained and the benefit structure under which contributions were made.

Benefit recipients who elect to receive a lifetime retirement benefit are generally eligible to receive post-retirement cost-of-living adjustments (COLAs), referred to as annual increases in the C.R.S. Benefit recipients under the PERA benefit structure who began eligible employment before January 1, 2007 receive an annual increase of 2 percent, unless PERA has a negative investment year, in which case the annual increase for the next three years is the lesser of 2 percent or the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for the prior calendar year. Benefit recipients under the PERA benefit structure who began eligible employment after January 1, 2007 receive an annual increase of the lesser of 2 percent or the average CPI-W for the prior calendar year, not to exceed 10 percent of PERA's Annual Increase Reserve for the SDTF.

Disability benefits are available for eligible employees once they reach five years of earned service credit and are determined to meet the definition of disability. State Troopers whose disability is caused by an on-the-job injury are immediately eligible to apply for disability benefits and do not have to meet the five years of service credit requirement. The disability benefit amount is based on the retirement benefit formula considering a minimum 20 years of service credit, if deemed disabled.

Survivor benefits are determined by several factors, which include the amount of earned service credit, highest average salary of the deceased, the benefit structure(s) under which service credit was obtained, and the qualified survivor(s) who will receive the benefits.

NOTE 8 – PENSION PLANS (CONTINUED)

Contributions

Eligible employees and the Lottery are required to contribute to the SDTF at a rate set by Colorado statute. The contribution requirements are established under C.R.S. § 24-51-401, et seq. Eligible employees with the exception of State Troopers are required to contribute 8 percent of their PERA-includable salary.

The employer contribution requirements for all employees except State Troopers are summarized in the table below:

	Fiscal Year 2015		**Fiscal Year 2016**		**Fiscal Year 2017**	
	CY2014	*CY 2015*	*CY2015*	*CY 2016*	*CY2016*	*CY2017*
	7/1/14 - 12/31/14	1/1/15 - 6/30/15	7/1/15 - 12/31/15	1/1/16 - 6/30/16	7/1/16 - 12/31/16	1/1/17 - 6/30/17
Employer Contribution Rate	10.15%	10.15%	10.15%	10.15%	10.15%	10.15%
Amount of Employer Contribution Apportioned to the Heath Care Trust Fund as specified in C.R.S. Section 24-51-208(1)(f)	-1.02%	-1.02%	-1.02%	-1.02%	-1.02%	-1.02%
Amount Apportioned to the SDTF	9.13%	9.13%	9.13%	9.13%	9.13%	9.13%
Amortization Equalization Disbursement (AED) as specified in C.R.S. Section 24-51-411*	3.80%	4.20%	4.20%	4.60%	4.60%	5.00%
Supplemental Amortization Equalization Disbursement (SAED) as specified in C.R.S., Section 24-51-411	3.50%	4.00%	4.00%	4.50%	4.50%	5.00%
Total Employer Contribution Rate to the SDTF	16.43%	17.33%	17.33%	18.23%	18.23%	19.13%

*Rates are expressed as a percentage of salary as defined in C.R.S. § 24-51-101(42).

Employer contributions are recognized by the SDTF in the period in which the compensation becomes payable to the member and the Lottery is statutorily committed to pay the contributions to the SDTF. Employer contributions recognized by the SDTF from the Lottery were $591,737, $580,355, and $615,643 for the Fiscal Years ended June 30, 2017, 2016, and 2015, respectively and represented 100% of the total required contributions for each year. These amounts do not include any AED or SAED contributions.

NOTE 8 – PENSION PLANS (CONTINUED)

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

At June 30, 2017 and 2016, the Lottery reported a liability of $41,110,831 and $25,257,445, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of December 31, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2015. Standard update procedures were used to roll forward the total pension liability to December 31, 2016. The Lottery proportion of the net pension liability was based on the Lottery contributions to the SDTF for the calendar year 2016 relative to the total contributions of participating employers to the SDTF.

At December 31, 2016, the Lottery proportion was .2238160821 percent, which was a decrease of .0160221637 percent from its proportion of .2398382458 percent measured as of December 31, 2015. For the Fiscal Year ended June 30, 2017 and Fiscal Year ended June 30, 2016, the Lottery recognized pension expense of $7,479,410 and $1,974,400, respectively. At June 30, 2017, the Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Year ended June 30, 2017		Year ended June 30, 2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between actual and expected experience	$ 408,646	$ -	$ 367,791	$ 816
Changes of assumptions or other inputs	10,458,861	126,541	-	298,976
Net difference between projected and actual earnings on pension plan investments	1,362,856	-	1,919,444	-
Changes in proportion and differences between contributions recognized and proportionate share of contributions	10,656	1,300,609	-	766,531
Contributions subsequent to the measurement date	647,473	-	578,591	-
Total	$ 12,888,492	$ 1,427,150	$ 2,865,826	$ 1,066,323

The amount of $647,473 reported as deferred outflows of resources related to pensions, resulting from contributions subsequent to the measurement date, will be recognized as a reduction of the net pension liability in the Fiscal Year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Year Ending June 30,	
2018	$ 5,705,292
2019	4,716,222
2020	377,927
2021	14,427

NOTE 8 – PENSION PLANS (CONTINUED)

Actuarial assumptions

The total pension liability in the December 31, 2015 actuarial valuation was determined using the following actuarial assumptions and other inputs:

Actuarial cost method	Entry age
Price inflation	2.80 percent
Real wage growth	1.10 percent
Wage inflation	3.90 percent
Salary increases, including wage inflation	3.90 – 9.57 percent
Long-term investment Rate of Return, net of pension plan investment expenses, including price inflation	7.50 percent
Discount rate	7.50 percent
Post-retirement benefit increases:	
PERA benefit structure hired prior to 1/1/07; and DPS benefit structure (automatic)	2.00 percent
PERA benefit structure hired after 12/31/06 (ad hoc, substantively automatic)	Financed by the Annual Increase Reserve

Based on the 2016 experience analysis and the October 28, 2016 actuarial assumptions workshop, revised economic and demographic assumptions were adopted by PERA's Board on November 18, 2016 and effective as of December 31, 2016. These revised assumptions shown below were reflected in the roll-forward calculation of the total pension liability from December 31, 2015 to December 31, 2016:

Actuarial cost method	Entry age
Price inflation	2.40 percent
Real wage growth	1.10 percent
Wage inflation	3.50 percent
Salary increases, including wage inflation	3.50 – 9.17 percent
Long-term investment rate of return, net of pension plan investment expenses, including price inflation	7.25 percent
Discount rate	5.26 percent
Post-retirement benefit increases:	
PERA benefit structure hired prior to 1/1/07 and DPS benefit structure (automatic)	2.00 percent
PERA benefit structure hired after 12/31/06 (ad hoc, substantively automatic)	Financed by the Annual Increase Reserve

Mortality rates used in the December 31, 2015 valuation were based on the RP-2000 Combined Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements based on a projection of Scale AA to 2020 with Males set back 1 year, and Females set back 2 years. Active member mortality was based upon the same mortality rates but adjusted to 55 percent of the base rate for males and 40 percent of the base rate for females. For disabled retirees, the RP-2000 Disabled Mortality Table (set back 2 years for males and set back 2 years for females) was assumed.

NOTE 8 – PENSION PLANS (CONTINUED)

The actuarial assumptions used in the December 31, 2015 valuation were based on the results of an actuarial experience study for the period January 1, 2008 through December 31, 2011, adopted by PERA's Board on November 13, 2012, and an economic assumption study, adopted by PERA's Board on November 15, 2013 and January 17, 2014.

As a result of the 2016 experience analysis and the October 28, 2016 actuarial assumptions workshop, revised economic and demographic actuarial assumptions including withdrawal rates, retirement rates for early reduced and unreduced retirement, disability rates, administrative expense load, and pre- and post-retirement and disability mortality rates were adopted by PERA's Board on November 18, 2016 to more closely reflect PERA's actual experience. As the revised economic and demographic assumptions are effective as of the measurement date, December 31, 2016, these revised assumptions were reflected in the total pension liability roll-forward procedures.

Healthy mortality assumptions for active members reflect the RP-2014 White Collar Employee Mortality Table, a table specifically developed for actively working people. To allow for an appropriate margin of improved mortality prospectively, the mortality rates incorporate a 70 percent factor applied to male rates and a 55 percent factor applied to female rates.

Healthy, post-retirement mortality assumptions reflect the RP-2014 Healthy Annuitant Mortality Table, adjusted as follows:

- **Males:** Mortality improvement projected to 2018 using the MP-2015 projection scale, a 73 percent factor applied to rates for ages less than 80, a 108 percent factor applied to rates for ages 80 and above, and further adjustments for credibility.

- **Females:** Mortality improvement projected to 2020 using the MP-2015 projection scale, a 78 percent factor applied to rates for ages less than 80, a 109 percent factor applied to rates for ages 80 and above, and further adjustments for credibility.

For disabled retirees, the mortality assumption was changed to reflect 90 percent of the RP-2014 Disabled Retiree Mortality Table.

The long-term expected return on plan assets is reviewed as part of regular experience studies prepared every four or five years for PERA. Recently, this assumption has been reviewed more frequently. The most recent analyses were outlined in presentations to PERA's Board on October 28, 2016. As a result of the October 28, 2016 actuarial assumptions workshop and the November 18, 2016 PERA Board meeting, the economic assumptions changed, effective December 31, 2016, as follows:

- Investment rate of return assumption decreased from 7.50 percent per year, compounded annually, net of investment expenses to 7.25 percent per year, compounded annually, net of investment expenses.

- Price inflation assumption decreased from 2.80 percent per year to 2.40 percent per year.

- Real rate of investment return assumption increased from 4.70 percent per year, net of investment expenses, to 4.85 percent per year, net of investment expenses.

- Wage inflation assumption decreased from 3.90 percent per year to 3.50 percent per year.

NOTE 8 – PENSION PLANS (CONTINUED)

Several factors were considered in evaluating the long-term rate of return assumption for the SDTF, including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation.

As of the November 18, 2016 adoption of the current long-term expected rate of return by the PERA Board, the target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	30 Year Expected Geometric Real Rate of Return*
U.S. Equity - Large Cap	21.20%	4.30%
U.S. Equity - Small Cap	7.42%	4.80%
Non U.S. Equity - Developed	18.55%	5.20%
Non U.S. Equity - Emerging	5.83%	5.40%
Core Fixed Income	19.32%	1.20%
High Yield	1.38%	4.30%
Non U.S. Fixed Income - Developed	1.84%	0.60%
Emerging Market Debt	0.46%	3.90%
Core Real Estate	8.50%	4.90%
Opportunity Fund	6.00%	3.80%
Private Equity	8.50%	6.60%
Cash	1.00%	0.20%
Total	100.00%	

* In setting the long-term expected rate of return, projections employed to model future returns provide a range of expected long-term results that, including expected inflation, ultimately support a long-term expected rate of return assumption of 7.25%.

NOTE 8 – PENSION PLANS (CONTINUED)

Discount rate

The discount rate used to measure the total pension liability was 5.26 percent. The projection of cash flows used to determine the discount rate applied the actuarial cost method and assumptions shown above. In addition, the following methods and assumptions were used in the projection of cash flows:

- Updated economic and demographic actuarial assumptions adopted by PERA's Board on November 18, 2016.

- Total covered payroll for the initial projection year consists of the covered payroll of the active membership present on the valuation date and the covered payroll of future plan members assumed to be hired during the year. In subsequent projection years, total covered payroll was assumed to increase annually at a rate of 3.50%.

- Employee contributions were assumed to be made at the current member contribution rate. Employee contributions for future plan members were used to reduce the estimated amount of total service costs for future plan members.

- Employer contributions were assumed to be made at rates equal to the fixed statutory rates specified in law and effective as of the measurement date, including current and estimated future AED and SAED, until the Actuarial Value Funding Ratio reaches 103%, at which point, the AED and SAED will each drop 0.50% every year until they are zero. Additionally, estimated employer contributions included reductions for the funding of the AIR and retiree health care benefits. For future plan members, employer contributions were further reduced by the estimated amount of total service costs for future plan members not financed by their member contributions.

- Employer contributions and the amount of total service costs for future plan members were based upon a process used by the plan to estimate future actuarially determined contributions assuming an analogous future plan member growth rate.

- The AIR balance was excluded from the initial fiduciary net position, as, per statute, AIR amounts cannot be used to pay benefits until transferred to either the retirement benefits reserve or the survivor benefits reserve, as appropriate. As the ad hoc post-retirement benefit increases financed by the AIR are defined to have a present value at the long-term expected rate of return on plan investments equal to the amount transferred for their future payment, AIR transfers to the fiduciary net position and the subsequent AIR benefit payments have no impact on the Single Equivalent Interest Rate (SEIR) determination process when the timing of AIR cash flows is not a factor (i.e., the plan's fiduciary net position is not projected to be depleted). When AIR cash flow timing is a factor in the SEIR determination process (i.e., the plan's fiduciary net position is projected to be depleted), AIR transfers to the fiduciary net position and the subsequent AIR benefit payments were estimated and included in the projections.

- Benefit payments and contributions were assumed to be made at the end of the month.

NOTE 8 – PENSION PLANS (CONTINUED)

Based on the above assumptions and methods, the projection test indicates the SDTF's fiduciary net position was projected to be depleted in 2039 and, as a result, the municipal bond index rate was used in the determination of the discount rate. The long-term expected rate of return of 7.25 percent on pension plan investments was applied to periods through 2039 and the municipal bond index rate, the December average of the Bond Buyer General Obligation 20-year Municipal Bond Index published weekly by the Board of Governors of the Federal Reserve System, was applied to periods on and after 2039 to develop the discount rate. For the measurement date, the municipal bond index rate was 3.86 percent, resulting in a discount rate of 5.26 percent.

As of the prior measurement date, the projection test indicated the SDTF'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 plan investments of 7.50 percent was applied to all periods of projected benefit payments to determine the total pension liability. The discount rate determination did not use a municipal bond index rate and the discount rate was 7.50 percent, 2.24 percent higher compared to the current measurement date.

Sensitivity of the Lottery's proportionate share of the net pension liability to changes in the discount rate. The following presents the proportionate share of the net pension liability calculated using the discount rate of 5.26 percent, as well as what the proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (4.26 percent) or 1-percentage-point higher (6.26 percent) than the current rate:

	1% Decrease (4.26%)	Current Discount Rate (5.26%)	1% Increase (6.26%)
Proportionate share of the net pension liability	$ 50,918,309	$ 41,110,831	$ 33,053,233

Pension plan fiduciary net position

Detailed information about the SDTF's fiduciary net position is available in PERA's comprehensive annual financial report which can be obtained at www.copera.org/investments/pera-financial-reports.

NOTE 9 – OTHER RETIREMENT PLANS

Voluntary Investment Program

Plan Description

Employees of the Lottery that are also members of the SDTF may voluntarily contribute to the Voluntary Investment Program, an Internal Revenue Code Section 401(k) defined contribution plan administered by PERA. Title 24, Article 51, Part 14 of the C.R.S., as amended, assigns the authority to establish the Plan provisions to the PERA Board of Trustees. PERA issues a publicly available comprehensive annual financial report for the Program. That report can be obtained at *www.copera.org/investments/pera-financial-reports.*

NOTE 9 – OTHER RETIREMENT PLANS (CONTINUED)

Funding Policy

The Voluntary Investment Program is funded by voluntary member contributions up to the maximum limits set by the Internal Revenue Service, as established under Title 24, Article 51, Section 1402 of the C.R.S., as amended. Employees are immediately vested in their own contributions and investment earnings.

Defined Contribution Plan (DC Plan)

Plan Description

Employees of the State of Colorado that were hired on or after January 1, 2006 and employees of certain community colleges that were hired on or after January 1, 2008 which were eligible to participate in the SDTF, a cost-sharing multiple-employer defined benefit pension plan, have the option to participate in the SDTF or the Defined Contribution Retirement Plan (PERA DC Plan). The PERA DC Plan is an Internal Revenue Code Section 401(a) governmental profit-sharing defined contribution plan. Title 24, Article 51, Part 15 of the C.R.S., as amended, assigns the authority to establish Plan provisions to the PERA Board of Trustees. The DC Plan is also included in PERA's comprehensive annual financial report as referred to above.

Funding Policy

All participating employees in the PERA DC Plan, with the exception of State Troopers, are required to contribute 8.00 percent of their PERA-includable salary and the State of Colorado is required to contribute 10.15 percent of PERA-includable salary on behalf of these employees. All participating State Troopers are required to contribute 10.00 percent of their PERA-includable salary and the State of Colorado is required to contribute 12.85 percent of PERA-includable salary on behalf of these employees.

Additionally, the State of Colorado is required to contribute AED and SAED to the SDTF as follows:

	Fiscal Year 2015		**Fiscal Year 2016**		**Fiscal Year 2017**	
	CY2014	*CY 2015*	*CY2015*	*CY 2016*	*CY2016*	*CY2017*
	7/1/14 - 12/31/14	1/1/15 - 6/30/15	7/1/15 - 12/31/15	1/1/16 - 6/30/16	7/1/16 - 12/31/16	1/1/17 - 6/30/17
Amortization Equalization Disbursement (AED) as specified in C.R.S. Section 24-51-411	3.80%	4.20%	4.20%	4.60%	4.60%	5.00%
Supplemental Amortization Equalization Disbursement (SAED) as specified in C.R.S., Section 24-51-411*	3.50%	4.00%	4.00%	4.50%	4.50%	5.00%
Total Additional Employer Contribution Rate to the SDTF	7.30%	8.20%	8.20%	9.10%	9.10%	10.00%

*Rates are expressed as a percentage of salary as defined in C.R.S. § 24-51-101(42).

NOTE 9 – OTHER RETIREMENT PLANS (CONTINUED)

Participating employees of the PERA DC Plan are immediately vested in their own contributions and investment earnings and are immediately 50 percent vested in the amount of employer contributions made on their behalf. For each full year of participation, vesting of employer contributions increases by 10 percent. Forfeitures are used to pay expenses of the PERA DC Plan in accordance with PERA Rule 16.08 as adopted by the PERA Board of Trustees in accordance with Title 24, Article 51, Section 204 of the C.R.S. As a result, forfeitures do not reduce pension expense. Participating employees in the PERA DC Plan contributed $13,060,000 and the State of Colorado recognized pension contributions of $10,382,000 for the PERA DC Plan.

457 Deferred Compensation Plan

The PERA Deferred Compensation Plan (457) was established July 1, 2009, as a continuation of the State's deferred compensation plan which was established for state and local government employees in 1981. At July 1, 2009, the State's administrative functions for the 457 plan were transferred to PERA, where all costs of administration and funding are borne by the plan participants. In calendar year 2016, participants were allowed to make contributions of up to 100 percent of their annual gross salary (reduced by their 8 percent PERA contribution) to a maximum of $18,000. Participants who are age 50 and older, and contributing the maximum amount allowable were allowed to make an additional $6,000 contribution in 2016. Special 457(b) catch-up contributions allow a participant for 3 years prior to the normal retirement age to contribute the lesser of (1) Twice the annual limit ($36,000 in 2015, 2016, and 2017), or (2) The basic annual limit plus the amount of the basic limit not used in prior years (only allowed if not using age 50 or over catch-up contributions). Contributions and earnings are tax deferred. At December 31, 2016, the plan had 17,921 participants.

The Lottery made contributions to other retirement plans totaling $11,905 during Fiscal Year 2017.

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE

Health Care Trust Fund

Plan Description

The Lottery contributes to the Health Care Trust Fund ("HCTF"), a cost-sharing multiple-employer healthcare trust administered by PERA. The HCTF benefit provides a health care premium subsidy and health care programs (known as PERACare) to PERA participating benefit recipients and their eligible beneficiaries. Title 24, Article 51, Part 12 of the C.R.S., as amended, establishes the HCTF and sets forth a framework that grants authority to the PERA Board to contract, self-insure and authorize disbursements necessary in order to carry out the purposes of the PERACare program, including the administration of health care subsidies. PERA issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for the HCTF. That report can be obtained at www.copera.org/investments/pera-financial-reports.

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE (CONTINUED)

Funding Policy

The Lottery is required to contribute at a rate of 1.02 percent of PERA-includable salary for all PERA members as set by statute. No member contributions are required. The contribution requirements for the Lottery are established under Title 24, Article 51, Part 4 of the C.R.S., as amended. The apportionment of the contributions to the HCTF is established under Title 24, Article 51, Section 208(1)(f) of the C.R.S., as amended. For the Fiscal Years ending June 30, 2017, 2016, and 2015, the Lottery contributions to the HCTF were $65,749, $64,484, and $68,405, respectively, equal to their required contributions for each year.

NOTE 11 – CONTINGENCIES AND COMMITMENTS

Prize Annuities – The Lottery purchases annuity contracts in the name of individual jackpot prize winners. Although the annuity contracts are in the name of the individual winners, the Lottery retains title to the annuity contracts.

The Lottery remains liable for the payment of the guaranteed prizes in the event the insurance companies issuing the annuity contracts default. The following estimated prize payments for which annuity contracts have been purchased are due in varying amounts and are estimated to continue through February 22, 2080 based on updated life expectancy tables.

Specified prize payments	$121,090,669
Lifetime prize payments	31,068,000
Total guaranteed prize payments	$152,158,669

Prize Commitment – The Lottery also acts as a transfer agent for the single Powerball Jackpot Winner on October 10, 2007. These funds are held in trust at the MUSL in securities deemed appropriate by the Grand Prize Trust Agreement. The future value of this prize was $15,718,000 as of June 30, 2017.

Self-insurance – The State of Colorado currently self-insures its agencies, officials and employees for the risks of losses to which they are exposed. These include general liability, motor vehicle liability, and workers' compensation. The Lottery participates in the Risk Management Fund. State agency premiums are based on an assessment of risk exposure and historical experience. The State Risk Management Fund is a Special Purpose General Fund used for claims adjustment, investigation, defense and authorization for the settlement and payment of claims or judgments against the state. The State insures its property through private carriers and is self-insured against general liability risks for both its officials and employees. It is also self-funded for employee healthcare plans, however, the risk resides with the employees.

Colorado employers are liable for occupational injuries and diseases of their employees. Benefits are prescribed by the Worker's Compensation Act of Colorado for medical expenses and loss of wages resulting from job-related injuries. The state utilizes the services of BroadspireServices, Inc. to administer its plan. The state reimburses BroadspireServices, Inc. for the current cost of claims paid and related administrative expenses.

NOTE 11 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

Risk management liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims and other economic and social factors.

The limits of liability for which the state accepts responsibility pursuant to Section 24-10-114(1), C.R.S., are as follows:

Liability	Limits of Liability
General and automobile	Each person $350,000 Each occurrence $990,000

Before January 1, 1999, the Group Benefit Plans Fund provided an employer-paid short-term disability plan for all employees. On January 1, 1999, PERA began covering short-term disability claims for state employees eligible under its retirement plan. The Group Benefit Plans Fund continues to provide short-term disability coverage for employees not yet qualified for the retirement plan and secondary benefits for employees also covered under the PERA short-term disability plan.

The Group Benefit Plans short-term disability program provides an employee with 60 percent of their pay beginning after 30 days of disability or exhausting their sick leave balance, whichever is later. This benefit expires six months after the beginning of the disability. Although fully insured, the Group Benefit Plans disability program includes a risk-sharing feature that provides experience rating refunds calculated as earned premium less the aggregate of incurred claims, claim reserve, retention charge and refunds paid previously over the term of the contract. Refunds, when applicable, are paid annually.

Furniture and Equipment – The State of Colorado carries a $5,000 deductible replacement policy on all state owned furniture and equipment per Colorado Revised Statutes 24-30-1510.5(3)(a)(IV). For each loss incurred, the Lottery is responsible for the first $5,000 of the deductible. Any loss in excess of $5,000 is covered by the insurance carrier up to replacement cost.

Gaming Operations Commitments – The Lottery enters into long-term contracts with certain significant vendors related to providing jackpot data processing services and the design, production, and promotion of scratch tickets in support of the Lottery's gaming operations The Lottery entered into a contract with IGT formally GTECH for jackpot data processing services, effective November 9, 2014 through June 30, 2021. The contract contains an Option to Extend for continued performance for up to a maximum of two (2) two-year extensions. Additionally, upon written notice the Lottery may unilaterally extend the term of the contract beyond the initial term or renewal term for a period not to exceed two months. Effective June 21, 2016 the Lottery amended the IGT contract to include the lease of new in-store wireless jackpot signs, as well as to provide service and replacement of existing in-store wireless jackpot signage. The Lottery also exercised the option to purchase 25 additional Lottery ticket vending machines. The maximum amount payable under the contract, excluding renewal terms if any, is $75,403,000. Payments for the jackpot data processing contract were $9,965,028 for Fiscal Year ended June 30, 2017 and $10,254,260 for Fiscal Year ended June 30, 2016.

NOTE 11 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

For scratch ticket production, the Lottery exercised the option to extend the contracts with its three scratch ticket vendors for three additional periods of 12 months beginning July 1, 2014 and ending on June 30, 2017. The total costs of the three extended contracts with additional modifications were not to exceed a total of $12,064,704. Payments under these contracts were $3,129,696, $2,811,440 and $2,350,306 for the Fiscal Years ended June 30, 2017, 2016 and 2015, respectively. The Lottery entered into new contracts in June 2017 with these same three scratch ticket vendors, effective July 1, 2017 through June 30, 2023. The contracts each contain an option to extend for continued performance for up to a maximum of two (2) two-year extensions. The total costs of the new contracts under the initial term are not to exceed $30,000,000.

The Lottery was approved as a member of the MUSL on February 26, 2001 and thus entered into an agreement with MUSL on June 6, 2001 to become a member and participate in Powerball games. As a member, the Lottery agrees to abide by the terms of the Multi-State Agreement dated September 16, 1987 and to any amendments to that agreement duly made by the board. The Lottery will remain a member indefinitely. Pursuant to this agreement, the Lottery will make payments to MUSL for administrative fees, weekly prize expenses, promotional purchases, miscellaneous reimbursements and assessments and contributions to the prize reserves.

On November 15, 2012, the MUSL Powerball Group unanimously agreed to accept the recommendations of the Finance & Audit Committee and the Executive Committee and set the Prize Reserve Account (PRA) cap to $80 million reduced from the previous $100 million cap.

The total amount contributed by the Lottery to the Powerball prize reserves as of June 30, 2017 was $3,338,197 and is based on a percentage of sales. This amount is shown as prepaid prize expense – MUSL on the statements of net position. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold. As of June 30, 2017 the excess funds held by MUSL over Colorado's required reserves balance of $3,034,725 was $303,472, the maximum allowable excess amount.

In 2009, the Powerball and Mega Millions governing bodies entered discussions regarding cross-selling the Powerball and Mega Millions games, whereby each state currently selling Mega Millions tickets would also sell Powerball tickets and those states currently selling Powerball tickets would also sell Mega Million tickets. On March 10, 2010, the Lottery commission voted to allow the Colorado Lottery to participate in the cross-selling of the Mega Millions game. The rule became effective as of April 30, 2010 and the first day of ticket sales was May 16, 2010. MUSL agreed to undertake the administrative functions associated with the Mega Millions game for the states currently participating in their Powerball game. MUSL immediately began collecting a percentage of sales to fund the newly formed Mega Millions prize reserve fund. On March 22, 2013, the MUSL Mega Millions Game Group set the maximum prize reserve fund at $45 million. The Colorado Lottery's balance in the reserve as of June 30, 2017 was $1,061,493. For the Mega Millions reserve, MUSL also reserves the right to hold funds not to exceed 110% of the required balance. As of June 30, 2017 Colorado's required Mega Millions reserve balance was $106,149 therefore, no excess funds were held by MUSL over the required amount.

NOTE 11 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

In addition, MUSL may deposit and hold any Unreserved Account Funds in trust for the benefit of member lotteries. These funds will not be comingled with any other funds held in trust and can be used only for authorized uses of the unreserved funds. MUSL held a nominal $3 amount in the unreserved fund as of June 30, 2017.

Other Major Vendor Commitments –The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery's products beginning on July 1, 2012 and expiring on June 30, 2015. On June 22, 2015 the Lottery exercised the option for an additional term beginning July 1, 2015 and ending on June 30, 2016 and on May 11, 2016 exercised the option for the final twelve-month term beginning July 1, 2016 and ending on June 30, 2017. The total compensation allowed for services performed under the first and second Option Letters was $14,950,000 each, with payments totaling $13,025,919 for the Fiscal Year ended June 30, 2017 and $10,595,661 for the Fiscal Year ended June 30, 2016.

Litigation – The Colorado Lottery is one of several states due to receive restitution from two individuals, after they were convicted of various charges in connection with manipulating computer coding used to generate winning lottery numbers and then collecting the resulting jackpot prizes. The affected computer coding and host machines have since been replaced with independently certified code and hardware.

According to the 1st individual's plea agreement and resulting court order, a total restitution of $2,222,863.60, with interest as applied at Iowa's standard statutory rate, will be paid to four states, with the Colorado Lottery's share being $1,137,980. The 2nd plea agreement and resulting court order agrees to a total restitution of $804,095, with interest as applied at Iowa's standard statutory rate, to two states, with the Colorado Lottery's share being $568,990, joint and several with the 1st individual.

The Lottery's attorneys have interpreted the court order as follows: $568,990 (the first half of the $1,137,980) will be paid to Colorado from either or both individuals. If the 2nd individual pays the entire $568,990 due Colorado, all of the 1st individual's restitution payments will go to the other states until they have been fully paid. Only after all states are paid, would the 1st individual's restitution payments be directed to Colorado. The Colorado Lottery's total potential recovery from restitution is $1,137,980.

The likelihood of collecting any of the restitution from either individual is unknown. The Lottery has not collected any restitution or recorded any estimated revenue from possible future payments. If the Lottery receives any future restitution payments, the payments will be recorded as revenue in the period the payments are received.

NOTE 12 – TAX, SPENDING AND DEBT LIMITATIONS

In November 1992, the Colorado voters passed Section 20, Article X of the Colorado Constitution, commonly known as the Taxpayer's Bill of Rights (TABOR). TABOR contains revenue, spending, tax and debt limitations that apply to the State of Colorado and all local governments. In the same general election, Article XXVII was passed creating the State Board of the Great Outdoors Colorado Trust Fund. The simultaneous passage of these two constitutional amendments raised questions as to whether there are irreconcilable conflicts between the two amendments.

The General Assembly determined in Section 24-77-102 (17) (b) (IX), C.R.S., that the net proceeds from the Lottery are excluded from the scope of "state fiscal year spending" for purposes of TABOR. The Colorado Supreme Court, in response to an interrogatory from the General Assembly, approved that determination.

TABOR is complex and subject to further legislative and judicial interpretation. The Lottery believes it is in compliance with both of these constitutional amendments.

NOTE 13 – RELATED PARTY TRANSACTIONS

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs and the Governor's Office of Information Technology for information and communications technology (ICT) services. Interagency charges were $1,747,625 and $1,530,473 for the Fiscal Years ended June 30, 2017 and 2016, respectively.

REQUIRED SUPPLEMENTARY INFORMATION

COLORADO LOTTERY
Schedule of the Colorado Lottery's Proportionate Share of the Net Pension Liability
Colorado Public Employees' Retirement Association

Last 10 Calendar Years*

	2016	2015	2014
Lottery's proportion of the net pension liability	0.2238160821%	0.2398382458%	0.2511816995%
Lottery's proportionate share of the net pension liability	$ 41,110,831	$ 25,257,445	$ 23,627,442
Lottery's covered payroll	$ 6,440,000	$ 6,745,555	$ 6,885,135
Lottery's proportionate share of the net pension liability as a percentage of its covered payroll	638.37%	383.22%	354.03%
Plan fiduciary net position as a percentage of the total pension liability	42.60%	56.10%	59.80%

* Calendar Year 2014 was the 1st year of implementation, therefore only three years are shown.

COLORADO LOTTERY
Schedule of the Colorado Lottery's Contributions
Colorado Public Employees' Retirement Association

Last 10 Fiscal Years*

	2017	2016	2015
Contractually required contribution	$ 1,159,077	$ 1,142,872	$ 1,150,328
Contributions in relation to the contractually required contribution	(1,159,077)	(1,142,872)	(1,150,328)
Contribution deficiency (excess)	$ -	$ -	$ -
Lottery's covered payroll	$ 6,594,985	$ 6,520,365	$ 6,917,645
Contributions as a percentage of covered payroll	17.58%	17.53%	16.63%

* The amounts presented for each fiscal year were determined as of 6/30.

* Fiscal year 2015 was the 1st year of implementation, therefore only three years are shown.

Changes of benefit terms. There have been no changes in benefit terms since the last valuation.

Changes of assumptions. There have been no changes in actuarial assumptions or methods since the last valuation.

SUPPLEMENTARY INFORMATION

COLORADO LOTTERY
Schedule of Revenue and Costs for Scratch and Jackpot Games
For the Fiscal Year Ended June 30, 2017

		Jackpot Games							FY 2017	FY 2016
	Scratch	Lotto	Powerball	Cash 5	Cash 5 EZ Match	Mega Millions	Pick 3	Lucky For Life	Total	Scratch and Jackpot Games
TICKET SALES	$ 380,249,492	$ 30,609,106	$ 73,002,056	$ 17,632,114	$ 1,060,341	$ 25,789,410	$ 10,995,867	$ 15,995,104	$ 555,333,490	$ 594,411,905
PRIZE EXPENSE	(256,841,122)	(14,569,038)	(33,189,585)	(9,294,847)	(648,493)	(11,408,993)	(5,509,525)	(10,056,946)	(341,518,549)	(370,513,550)
NET REVENUE AFTER PRIZES	123,408,370	16,040,068	39,812,471	8,337,267	411,848	14,380,417	5,486,342	5,938,158	213,814,941	223,898,355
COMMISSIONS, BONUSES, TICKET COSTS & VENDOR FEES (Note 1)										
Retailer Commission	(26,552,836)	(1,831,468)	(4,370,849)	(1,055,778)	(63,458)	(1,543,368)	(657,668)	(955,673)	(37,031,098)	(39,527,758)
Retailer Bonus	(2,995,039)	(122,231)	(200,600)	(123,097)	(8,385)	(85,876)	(67,699)	(91,409)	(3,694,336)	(4,394,548)
Cost of Tickets Sold	(2,950,426)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	(2,950,426)	(2,486,931)
Telecomm Reimbursements	528,746	42,563	101,511	24,518	1,474	35,861	15,290	22,242	772,205	770,790
On-Line Vendor Fees	(7,096,399)	(523,486)	(1,209,506)	(294,250)	(17,030)	(435,608)	(181,166)	(271,596)	(10,029,041)	(10,347,531)
TOTAL	(39,065,954)	(2,434,622)	(5,679,444)	(1,448,607)	(87,399)	(2,028,991)	(891,243)	(1,296,436)	(52,932,696)	(55,985,978)
GROSS PROFIT ON SALE OF TICKETS	$ 84,342,416	$ 13,605,446	$ 34,133,027	$ 6,888,660	$ 324,449	$ 12,351,426	$ 4,595,099	$ 4,641,722	$ 160,882,245	$ 167,912,377
AVERAGE DAILY TICKET SALES	$ 1,041,779	$ 83,861	$ 200,006	$ 48,307	$ 2,905	$ 70,656	$ 30,126	$ 43,822	$ 1,521,462	$ 1,624,076

Note 1: Administrative costs of Lottery operations, including wages, advertising, and other expenses are not shown.

COLORADO LOTTERY
Schedule of Percent of Prize Expense to Gross Ticket Sales
For the Fiscal Year Ended June 30, 2017

		Jackpot Games							FY 2017	FY 2016
	Scratch	Lotto	Powerball	Cash 5	Cash 5	Mega Millions	Pick 3	Pick 3	Total	Total
Prize Expense	$ 256,841,122	$ 14,569,038	$ 33,189,585	$ 9,294,847	$ 648,493	$ 11,408,993	$ 5,509,525	$ 10,056,946	$ 341,518,549	$ 370,513,550
(/)Ticket Sales	$ 380,249,492	$ 30,609,106	$ 73,002,056	$ 17,632,114	$ 1,060,341	$ 25,789,410	$ 10,995,867	$ 15,995,104	$ 555,333,490	$ 594,411,905
Prize %	67.55%	47.60%	45.46%	52.72%	61.16%	44.24%	50.11%	62.88%	61.50%	62.33%

COLORADO LOTTERY
Budgetary Comparison
For the Fiscal Year Ended June 30, 2017

	Fiscal Year 2017 Original Budget	Supplemental Allocations & Internal Transfers	Fiscal Year 2017 Final Budget	Fiscal Year 2017 Actual Expenditures	Under Expended	Percent Under Expended
Personal Services	$ 11,111,214	$ 12,083	$ 11,123,297	$ 9,586,542	$ 1,536,755	13.82%
Workmen's Compensation	90,340	-	90,340	90,340	-	0.00%
Operating	1,203,156	-	1,203,156	1,021,198	181,958	15.12%
Variable Vehicle	163,062	(30,753)	132,309	117,919	14,390	10.88%
Leased Space	884,416	(50,000)	834,416	805,594	28,822	3.45%
Leased Space-Grand Junctior	6,714	-	6,714	6,714	-	0.00%
Risk Management	30,631	-	30,631	30,631	-	0.00%
Vehicle Lease Payments	154,295	(8,833)	145,462	143,103	2,359	1.62%
Travel	113,498	-	113,498	96,939	16,559	14.59%
Marketing, Communications & Sales	14,700,000	-	14,700,000	13,634,184	1,065,816	7.25%
Payments to Other Agencies	239,410	-	239,410	85,530	153,880	64.27%
Legal Services	34,999	44,036	79,035	74,207	4,828	6.11%
Indirect Costs	760,199	(13,223)	746,976	702,836	44,140	5.91%
Ticket Costs-Scratch	6,578,000	-	6,578,000	3,905,201	2,672,799	40.63%
Research	250,000	-	250,000	-	250,000	100.00%
Vendor Fees	12,571,504	-	12,571,504	10,029,041	2,542,463	20.22%
Prize Payments	424,104,016	-	424,104,016	341,518,549	82,585,467	19.47%
Retailer Compensation	52,241,350	-	52,241,350	40,725,434	11,515,916	22.04%
Multi-State Lottery Fund	177,433	-	177,433	119,397	58,036	32.71%
CORE Conversion	36,223	-	36,223	36,223	-	0.00%
OIT Payments	552,999	-	552,999	552,999	-	0.00%
TOTAL	$ 526,003,459	$ (46,690)	$ 525,956,769	$ 423,282,581	$ 102,674,188	19.52%

FY17 Staffing-FTE-Note 1	117.1	(Appropriated)	114.5	(Actual)

Reconciliation of Expenses per Statement of Revenues, Expenses and Changes in Fund Net Position to Budgeted Expenditures:

Expenses Per Statement of Revenues, Expenses and Changes in Net Position	
Prize Expense	$ 341,518,549
Commissions and Bonuses	40,725,434
Cost of Tickets & Vendor Fees	12,207,262
Operating Expenses	28,213,965
Total Expenses per Statement of Revenues, Expenses and Changes in Net Position	422,665,210
Telecommunications offset classified as revenue	772,205
Less: Non-Appropriated Expenses	
Depreciation	(196,608)
Accrued Annual and Sick Leave	(2,144)
Book Value of Assets Written Off	(7,713)
Sub-Total	423,230,950
Plus: Capitalized Purchases	51,631
	$ 423,282,581

Note 1 - The Governor's budget office has informed the departments that the appropriated FTE can be exceeded by 10% for FY 2017

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Independent Auditor's 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*

To the Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Lottery Division
Denver, Colorado

We have audited, 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, the financial statements of the Colorado Lottery, an enterprise fund of the State of Colorado as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Colorado Lottery's basic financial statements, and have issued our report thereon dated November 20, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Colorado 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Colorado Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of Colorado Lottery's internal control.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters
As part of obtaining reasonable assurance about whether the Colorado 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 Colorado 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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Eide Bailly LLP

Denver, Colorado
November 20, 2017

CPAs & BUSINESS ADVISORS

November 20, 2017

To the Members of the Legislative Audit Committee
State of Colorado, Department of Revenue, Lottery Division
Denver, Colorado

We have audited the financial statements of the Colorado Lottery as of and for the year ended June 30, 2017 and 2016, and have issued our report thereon dated November 20, 2017. Professional standards require that we advise you of the following matters relating to our audit.

Our Responsibility in Relation to the Financial Statement Audit

As communicated in our letter dated April 27, 2017 our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of its respective responsibilities.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated.

Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, as appropriate, our firm, and other firms utilized in the engagement, if applicable, have complied with all relevant ethical requirements regarding independence.

Qualitative Aspects of the Entity's Significant Accounting Practices

Significant Accounting Policies

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Colorado Lottery is included in Note 1 to the financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during Fiscal Year 2017. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

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Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements are:

Management's estimate of the prize expense and the corresponding prize liability is based on anticipated payout percentage approved by the Lottery Commissioners. The prize expense and corresponding liability are incurred as tickets are activated by Lottery approved retailers. We evaluated the key factors and assumptions used to develop the prize expense and corresponding prize liability and determined that it is reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

Management's estimate of the net pension liability is based on an actuarial valuation as of December 31, 2016. We evaluated the key factors and assumptions used to develop the net pension liability and determined that it is reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

Financial Statement Disclosures

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the Colorado Lottery's financial statements relate to:

> The disclosure of Distributions of Net Proceeds in Note 7, as this disclosure presents information regarding performance of the Lottery's commitment to funding beneficiaries throughout the State of Colorado.
>
> The disclosure of Pension Plans in Note 8, which presents the Colorado Lottery's deferred inflows and outflows of resources related to the defined benefit pension plan, as well as summarizes actuarial assumptions used in determining the Colorado Lottery's estimated total pension liability.
>
> The disclosure of Contingencies and Commitments in Note 11, which summarize the Colorado Lottery's commitments to pay annuities to prior Lotto jackpot winners, as well as gaming operations and major vendor commitments.
>
> The disclosure of Tax, Spending, and Debt Limitations in Note 12, which discloses that the net proceeds from the Colorado Lottery are excluded from the scope of TABOR.
>
> The disclosure of Related Party Transactions in Note 13, which discloses the nature of the Colorado Lottery's relationship with the State of Colorado and interdepartmental fees paid as a result of this relationship.

The financial statement disclosures are neutral, consistent, and clear.

Significant Difficulties Encountered during the Audit

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

Uncorrected and Corrected Misstatements

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit.

The following summarizes uncorrected financial statement misstatements whose effects in the current and prior periods, as determined by management, are immaterial, both individually and in the aggregate, to the financial statements taken as a whole and each applicable opinion unit.

Receivable	$1,137,980	
Allowance for doubtful accounts		$1,137,980
Bad debt expense	$1,137,980	
Settlement revenue		$1,137,980
To record settlement revenue and allowance from litigation.		

The effect of these uncorrected misstatements as of and for the year ended June 30, 2017, has no effect on net income or fund balance.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Representations Requested from Management

We have requested certain written representations from management that are included in the management representation letter dated November 20, 2017.

Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Other Significant Matters, Findings, or Issues

In the normal course of our professional association with the Colorado Lottery, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operating plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the Colorado Lottery's auditors.

Other Information in Documents Containing Audited Financial Statements

Pursuant to professional standards, our responsibility as auditors for other information in documents containing the Colorado Lottery's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. However, in accordance with such standards, we have:

> Made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Our responsibility also includes communicating to you any information which we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.

This report is intended solely for the information and use of the Legislative Audit Committee, and management of the Colorado Lottery and is not intended to be and should not be used by anyone other than these specified parties.

Eide Bailly LLP

Denver, Colorado