

Audited Financial Statements

West Virginia Lottery

Years Ended June 30, 2017 and 2016

WEST VIRGINIA LOTTERY
Audited Financial Statements
Years Ended June 30, 2017 and 2016

TABLE OF CONTENTS

	<u>Page</u>
Independent Auditor's Report	1-2
Management's Discussion and Analysis	3-11
Basic Financial Statements:	
Statements of Net Position	12
Statements of Revenues, Expenses and Changes in Fund Net Position	13
Statements of Cash Flows	14-15
Notes to Financial Statements	16-40
Required Supplementary Information:	
Schedule of The Proportionate Share of The Net Pension Liability	41
Schedule of Contributions to The PERS	42
Notes to Required Supplementary Information	43
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 <i>Government Auditing Standards</i>	44-45

INDEPENDENT AUDITOR'S REPORT

West Virginia Lottery Commission
Charleston, West Virginia

Report on the Financial Statements

We have audited the accompanying financial statements of the West Virginia Lottery (the Lottery), a component unit of the State of West Virginia, as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

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

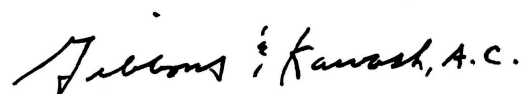
Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 11, and the schedule of the proportionate share of the net pension liability, and the schedule of contributions to the PERS on pages 41 through 43 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2017 on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 Lottery's internal control over financial reporting and compliance.



Charleston, West Virginia
September 26, 2017

WEST VIRGINIA LOTTERY**Management's Discussion and Analysis**

-Unaudited-

Our discussion of the West Virginia Lottery's (the Lottery) financial performance provides for an overview of the Lottery's financial activities for the fiscal years ended June 30, 2017 and 2016. In reading the Management's Discussion and Analysis (MD&A), the current year refers to fiscal year ending June 30, 2017, and the prior year refers to fiscal year ending June 30, 2016. This analysis is to be considered in conjunction with the financial statements, which begin on page 12.

Financial Highlights

The Lottery's operating income decreased in 2017 and decreased in 2016. The 2017 and 2016 decreases were due to competition from neighboring states. The following summary is provided below:

- Lottery revenues for the current year decreased \$57.1 million or 5.0% compared to the prior year, which decreased \$27.4 million or 2.4% from 2015.
- Commissions for the current year decreased \$17.9 million or 3.7% compared to the prior year, which decreased \$18.0 million or 3.6% from 2015.
- Gross profit for the current year decreased \$25.2 million or 4.8% compared to the prior year, which decreased \$14.5 million or 2.7% from 2015.
- Nonoperating expenses decreased \$27.6 million or 5.3% compared to the prior year, which decreased \$8.9 million or 1.7% from 2015. The predominant nonoperating expense is the distributions to the State of West Virginia, which decreased \$24.2 million or 4.8% compared to the prior year, which decreased \$7.0 million or 1.4% from 2015.

Using This Annual Report

The Lottery is a component unit of the State of West Virginia, and is accounted for as a proprietary type enterprise fund using the accrual basis of accounting much like a private business entity. As such, this report consists of a series of financial statements, along with explanatory notes to the financial statements. To assess the Lottery's financial position, the reader of these statements should pay particular attention to changes in the components of assets and liabilities as set forth in the Statements of Net Position and changes in operating revenues, expenses and nonoperating distributions to the State of West Virginia as set forth in the Statements of Revenues, Expenses and Changes in Fund Net Position.

Statements of Net Position

As shown in Table 1, current assets for the current year decreased \$9.3 million or 4.8% compared to the prior year, which decreased \$4.4 million or 2.2% from 2015, due to the timing of distributions to the State of West Virginia at year-end.

Capital assets, net of accumulated depreciation and amortization, decreased in the current year by \$1.1 million or 2.4% compared to the prior year which increased by \$7.1 million or 18.8% from 2015, due to renovations and depreciation of the Lottery headquarters building. For additional information on capital assets, please refer to Note 4 to the financial statements.

WEST VIRGINIA LOTTERY

Management's Discussion and Analysis
(Continued)

-Unaudited-

Statements of Net Position (Continued)

Table 1
Assets and Deferred Outflows
(in \$000's)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<u>Assets</u>			
Current assets	\$ 186,118	\$ 195,432	\$ 199,872
Restricted assets	-	-	1,130
Capital assets, net of accumulated depreciation and amortization	<u>43,779</u>	<u>44,874</u>	<u>37,763</u>
Total assets	<u>\$ 229,897</u>	<u>\$ 240,306</u>	<u>\$ 238,765</u>
<u>Deferred Outflows of Resources</u>			
Deferred outflows of resources related to pension	<u>\$ 2,795</u>	<u>\$ 2,573</u>	<u>\$ 1,099</u>

As shown in Table 2, the Lottery's current liabilities for the current year decreased \$11.0 million or 5.9% compared to the prior year, which increased \$3.9 million or 2.2% compared to 2015 due to the accumulation of prior year surplus transfers to the State of West Virginia combined with current year accrued transfers.

Net position - net investment in capital assets decreased in the current year by \$1.1 million or 2.4% due to depreciation, compared to the prior year which increased by \$7.1 million or 18.8% compared to 2015, due to renovations of the Lottery headquarters building. Refer to Note 4 to the financial statements for additional information on capital assets.

Net position - unrestricted changed in fiscal year 2016 due to the conversion of cash into capital assets. Net position remained stable for the year ended June 30, 2017, compared to fiscal year 2016.

WEST VIRGINIA LOTTERY

Management's Discussion and Analysis

(Continued)

-Unaudited-

Statements of Net Position (Continued)

Table 2
Liabilities, Deferred Inflows and Net Position
(in \$000's)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current liabilities	\$ 174,506	\$ 185,465	\$ 181,520
Noncurrent liabilities	<u>4,800</u>	<u>3,044</u>	<u>2,035</u>
Total liabilities	<u>\$ 179,306</u>	<u>\$ 188,509</u>	<u>\$ 183,555</u>
Deferred inflows of resources related to pension	<u>\$ 367</u>	<u>\$ 1,998</u>	<u>\$ 2,153</u>
Net position - restricted by enabling legislation	\$ -	\$ -	\$ 1,130
Net position - net investment in capital assets	43,779	44,874	37,763
Net position - unrestricted	<u>9,240</u>	<u>7,498</u>	<u>15,263</u>
Total net position	<u>\$ 53,019</u>	<u>\$ 52,372</u>	<u>\$ 54,156</u>

Capital Assets

Capital assets as of June 30, 2017 amounted to \$55.7 million (at cost). This investment in capital assets includes land, building, construction in progress and equipment. The total decrease in capital assets for the current fiscal year was 0.4%.

Table 3
Capital Assets
(in \$000's)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Construction in progress	\$ 1,350	\$ 1,164	\$ 1,090
Land	1,434	1,434	1,434
Building	46,207	46,207	38,084
Equipment	<u>6,741</u>	<u>7,155</u>	<u>7,155</u>
Total assets	<u>\$ 55,732</u>	<u>\$ 55,960</u>	<u>\$ 47,763</u>

Capital asset activities included \$8.1 million in renovations to the Lottery headquarters building during the year ending June 30, 2016. Additional information on capital assets can be found in Note 4 of the financial statements.

WEST VIRGINIA LOTTERY

Management's Discussion and Analysis

(Continued)

-Unaudited-

Revenues, Expenses and Changes in Fund Net Position

The content of Table 4 is a summary of activities and is related to the discussion of Table 5.

Table 4
Revenues, Expenses and Changes in Fund Net Position
(in \$000's)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Revenues:			
On-line games	\$ 72,110	\$ 85,660	\$ 76,724
Instant games	94,369	102,542	103,276
Racetrack video lottery	521,318	537,729	557,803
Limited video lottery	347,555	360,814	373,221
Table games	38,958	43,545	46,928
Historic resort	<u>5,207</u>	<u>6,346</u>	<u>6,052</u>
	1,079,517	1,136,636	1,164,004
Less commissions:			
On-line games	5,043	6,001	5,372
Instant games	6,606	7,178	7,229
Racetrack video lottery	268,177	275,496	286,778
Limited video lottery	170,302	176,799	182,878
Table games	16,512	18,453	19,885
Historic resort	<u>2,733</u>	<u>3,302</u>	<u>3,069</u>
	469,373	487,229	505,211
Less on-line prize costs	36,227	43,132	38,162
Less instant ticket prize costs	61,959	67,695	68,314
Less ticket costs	1,408	1,618	1,516
Less vendor fees and costs	<u>6,915</u>	<u>8,116</u>	<u>7,456</u>
	106,509	120,561	115,448
Gross profit	<u>503,635</u>	<u>528,846</u>	<u>543,345</u>
Administrative expenses:			
Advertising and promotions	4,157	4,975	5,229
Wages and related benefits	10,305	9,885	10,266
Telecommunications	1,037	965	944
Contractual and professional	4,520	4,560	5,160
Rental	394	425	271
Depreciation and amortization	1,281	1,086	1,354
Other administrative expenses	<u>1,572</u>	<u>1,230</u>	<u>1,466</u>
	23,266	23,126	24,690
Other operating income	<u>10,677</u>	<u>10,528</u>	<u>11,313</u>
Operating income	<u>491,046</u>	<u>516,248</u>	<u>529,968</u>
Nonoperating income (expense):			
Investment income	934	788	406
Distributions to municipalities and counties	(6,812)	(7,072)	(7,315)
Distributions for capital reinvestment	(7,468)	(10,446)	(11,717)
Distributions to the State of West Virginia	<u>(477,053)</u>	<u>(501,302)</u>	<u>(508,329)</u>
	(490,399)	(518,032)	(526,955)
Net Income	<u>647</u>	<u>(1,784)</u>	<u>3,013</u>
Net position, beginning of year	<u>52,372</u>	<u>54,156</u>	<u>51,143</u>
Net position, end of year	<u>\$ 53,019</u>	<u>\$ 52,372</u>	<u>\$ 54,156</u>

WEST VIRGINIA LOTTERY

Management's Discussion and Analysis
(Continued)

-Unaudited-

Sales and Prizes, Commissions, Ticket Costs and Vendor Fees

Table 5 compares sales (referred to as lottery revenues in financial statements), prizes, commissions, ticket printing costs, vendor fees and costs and gross profit for each lottery game category for fiscal years 2017, 2016, and 2015. Sales and gross profits fluctuated in certain categories; however, gross profit percentages remained consistent from year to year.

Table 5
Lottery Sales
(in \$000's)

	Instant			On-Line*		
	2017	2016	2015	2017	2016	2015
Gross sales	\$ 94,369	\$ 102,542	\$ 103,276	\$ 72,110	\$ 85,660	\$ 76,724
Less direct costs:						
Prizes and bonuses	61,959	67,695	68,314	36,227	43,132	38,162
Commissions	6,606	7,178	7,229	5,043	6,001	5,372
Ticket printing costs	1,408	1,618	1,516	-	-	-
Vendor fees and costs	3,913	4,389	4,286	3,002	3,727	3,170
Total direct costs	<u>73,886</u>	<u>80,880</u>	<u>81,345</u>	<u>44,272</u>	<u>52,860</u>	<u>46,704</u>
Gross Profit	<u>\$ 20,483</u>	<u>\$ 21,662</u>	<u>\$ 21,931</u>	<u>\$ 27,838</u>	<u>\$ 32,800</u>	<u>\$ 30,020</u>
Gross profit percentage	<u>21.7%</u>	<u>21.1%</u>	<u>21.2%</u>	<u>38.6%</u>	<u>38.3%</u>	<u>39.1%</u>

* On-line games include the results of Powerball® and Mega Millions which are significant components of the results described above.

	Racetrack Video Lottery			Limited Video Lottery		
	2017	2016	2015	2017	2016	2015
Gross sales	\$ 521,318	\$ 537,729	\$ 557,803	\$ 347,555	\$ 360,814	\$ 373,221
Less direct costs:						
Prizes and bonuses	-	-	-	-	-	-
Commissions	268,177	275,496	286,778	170,302	176,799	182,878
Ticket printing costs	-	-	-	-	-	-
Vendor fees and costs	-	-	-	-	-	-
Total direct costs	<u>268,177</u>	<u>275,496</u>	<u>286,778</u>	<u>170,302</u>	<u>176,799</u>	<u>182,878</u>
Gross Profit	<u>\$ 253,141</u>	<u>\$ 262,233</u>	<u>\$ 271,025</u>	<u>\$ 177,253</u>	<u>\$ 184,015</u>	<u>\$ 190,343</u>
Gross profit percentage	<u>48.6%</u>	<u>48.8%</u>	<u>48.6%</u>	<u>51.0%</u>	<u>51.0%</u>	<u>51.0%</u>

	Table Games			Historic Resort			Total		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
Gross sales	\$ 38,958	\$ 43,545	\$ 46,928	\$ 5,207	\$ 6,346	\$ 6,052	\$ 1,079,517	\$ 1,136,636	\$ 1,164,004
Less direct costs:									
Prizes and bonuses	-	-	-	-	-	-	98,186	110,827	106,476
Commissions	16,512	18,453	19,885	2,733	3,302	3,069	469,373	487,229	505,211
Ticket printing costs	-	-	-	-	-	-	1,408	1,618	1,516
Vendor fees and costs	-	-	-	-	-	-	6,915	8,116	7,456
Total direct costs	<u>16,512</u>	<u>18,453</u>	<u>19,885</u>	<u>2,733</u>	<u>3,302</u>	<u>3,069</u>	<u>575,882</u>	<u>607,790</u>	<u>620,659</u>
Gross Profit	<u>\$ 22,446</u>	<u>\$ 25,092</u>	<u>\$ 27,043</u>	<u>\$ 2,474</u>	<u>\$ 3,044</u>	<u>\$ 2,983</u>	<u>\$ 503,635</u>	<u>\$ 528,846</u>	<u>\$ 543,345</u>
Gross profit percentage	<u>57.6%</u>	<u>57.6%</u>	<u>57.6%</u>	<u>47.5%</u>	<u>48.0%</u>	<u>49.3%</u>	<u>46.7%</u>	<u>46.5%</u>	<u>46.7%</u>

WEST VIRGINIA LOTTERY**Management's Discussion and Analysis**

(Continued)

-Unaudited-

Instant Sales

Instant ticket sales for the current year decreased by \$8.2 million or 8.0% compared to the prior year, which decreased \$0.7 million or 0.7% from 2015. Forty-eight games were introduced in 2017 and approximately twenty-eight game options were available for play. The Lottery continues to implement the results of research and design efforts, including licensed or trademarked games, new play styles and continued monitoring of the mix of price points, play styles, and colors to create the best variety of games available. There were three ten-dollar, and two twenty-dollar tickets introduced in 2017. There were also eight five-dollar tickets and eight three-dollar tickets introduced. The Lottery has also implemented the use of pre-printed "shelf games" used to provide immediate stock should field inventory become low. These shelf games are worked into the schedule and used within one year in the event they are not used for emergency.

Instant prizes and commissions have a direct correlation to sales, therefore, as sales increase, so do the related prizes and commissions paid by the Lottery. Prize expenses for instant games are controllable by designing and printing a predetermined number and value of winning tickets. While each game has a designed prize payout structure, the overall amount paid as prize expense is consistent.

Vendor fees and costs are primarily 4.3% of instant and on-line ticket sales for 2017, 2016, and 2015. The Lottery (as is the case with most lotteries located in North America) has elected to enter into a long-term contract with a vendor to provide a central computer system, retailer terminals and related equipment to sell and cash all tickets for instant and on-line games.

Powerball® Sales

Powerball® is a \$2 Multi-State (MUSL) Lottery game designed to grow large jackpot amounts, with occasional jackpots in excess of \$400 million. Sales for the current year decreased \$12.0 million or 25.9% compared to the prior year, which increased \$12.5 million or 36.5% from 2015. Sales are generally driven by the jackpot size.

Prize costs are 50% of sales and over time such prize payouts generally reflect the design of the game and the related mathematical odds of winning.

Traditional retailers are those retailers licensed by the Lottery to sell instant and on-line games (which includes Powerball®) and by statute were paid 7% of such sales.

Mega Millions® Sales

Mega Millions® sales offers jackpots starting at \$15 million and other prizes ranging from \$1 to \$1,000,000. Sales for the current year decreased \$1.0 million or 8.1% compared to the prior year, which decreased \$1.6 million or 11.7% from 2015.

Approximately 50% of every dollar wagered goes back to the players in prizes and by statute 7% of sales are paid to retailer commissions.

All Other On-line Games

All other on-line games consist of Daily 3, Daily 4, Cash 25, Travel Keno and the Multi-State game Hot Lotto™. Sales for the current year decreased \$0.5 million or 2.0% compared to the prior year, which decreased \$1.9 million or 6.7% from 2015.

WEST VIRGINIA LOTTERY

Management's Discussion and Analysis (Continued)

-Unaudited-

All Other On-line Games (Continued)

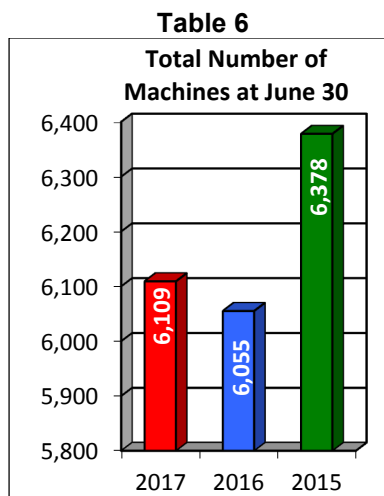
In general, prize costs by game will increase or decrease from year-to-year in proportion to the sales for a particular game. Prizes and commissions have remained consistent as presented in Table 4.

Racetrack Video Lottery

Racetrack video lottery revenues are reported as total wagers net of prizes and credits. Revenues for the current year decreased \$16.4 million or 3.1% compared to the prior year, which decreased \$20.1 million or 3.6% from 2015.

A portion of racetrack video lottery sales, as prescribed by statute, are paid to racetracks and other private entities associated with the racing industry and are reported as commissions. See Note 6 to the financial statements for further discussion of racetrack video lottery distributions. Commissions in the current year decreased \$7.3 million or 2.7% compared to the prior year which decreased \$11.3 million or 3.9% compared to 2015 due to competition from neighboring states.

During the year ended June 30, 2017, increased competition from gaming operations in neighboring states has led the racetracks to re-evaluate their gaming environments which have resulted in changes to the gaming floors. The changes in active machines are presented in Table 6 below which illustrates the last three fiscal years.



Limited Video Lottery

Sales for the current year decreased \$13.3 million or 3.7% compared to the prior year, which decreased \$12.4 million or 3.3% from 2015. Commissions are paid to operators and retailers as provided for by statute and have a direct correlation to changes in sales. For the current year, commissions decreased \$6.5 million or 3.7% compared to the prior year decrease of \$6.1 million or 3.3% from 2015.

Table 7 illustrates the number of machines which decreased by 70 machines for the current year compared to the prior year decrease of 151 machines from 2015.

WEST VIRGINIA LOTTERY

Management's Discussion and Analysis (Continued)

-Unaudited-

Limited Video Lottery (Continued)

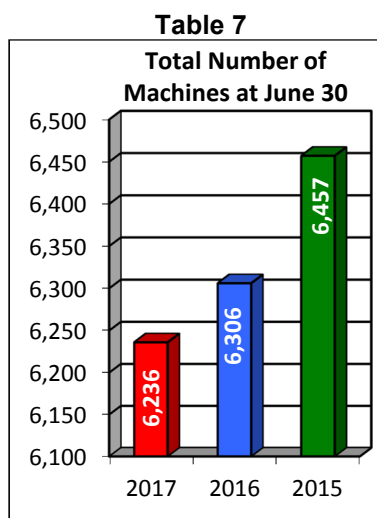


Table Games

Revenues from table games are calculated at a 35% privilege tax of adjusted gross receipts. Revenues for the current year decreased \$4.6 million or 10.5% compared to the prior year, which decreased \$3.4 million or 7.2% from 2015.

A portion of table games revenues are paid to entities associated with the racetracks and are reported as commissions. See Note 8 to the financial statements. Commissions for the current year decreased \$1.9 million or 10.5% compared to the prior year, which decreased \$1.4 million or 7.2% from 2015.

Historic Resort

Video Lottery revenues from Historic Resort are calculated as defined in Note 9 to the financial statements. Revenues from Historic Resort table games are calculated at a 35% privilege tax of adjusted gross receipts.

Combined revenues of video lottery and table games at the Historic Resort for the current year decreased \$1.1 million or 17.9% compared to the prior year, which increased \$294 thousand or 4.9% from 2015.

A portion of revenues are paid to entities associated with the Historic Resort and are reported as commissions. Commissions for the current year decreased \$570 thousand or 17.3% compared to the prior year, which increased \$233 thousand or 7.6% from 2015.

WEST VIRGINIA LOTTERY

Management's Discussion and Analysis (Continued)

-Unaudited-

Other Operating Income

Refer to Table 4. Changes in other operating income are primarily related to fees collected for the permitting and licensure of manufacturers, operators, retailers and service technicians. Every May 1, a \$1,000 permit fee is assessed on each limited video lottery permit held by operators and retailers.

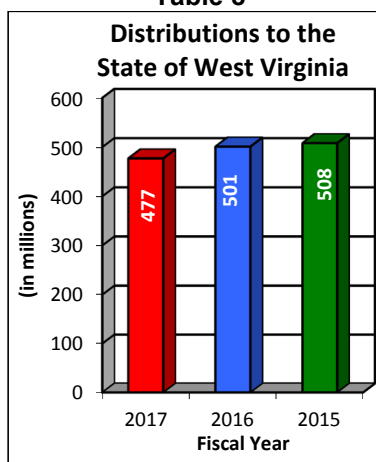
Nonoperating Income (Expense)

Refer to Table 4. Nonoperating expenses reflect a 2% distribution to counties and incorporated municipalities of net terminal income from limited video lottery operations. This distribution will fluctuate with any changes in limited video lottery revenues.

A portion of net revenue from racetrack video lottery is accrued and distributed to each racetrack for capital improvements.

Refer to Table 8. The Lottery's distributions to the State of West Virginia for the current fiscal year decreased by \$24.0 million compared to the prior year, which decreased by \$7.0 million from 2015.

Table 8



Requests for Information

This financial report is designed to provide a general overview of the Lottery's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Deputy Director of Finance and Administration, West Virginia Lottery, 900 Pennsylvania Avenue, Charleston WV 25302.

WEST VIRGINIA LOTTERY
STATEMENTS OF NET POSITION
(In Thousands)

June 30, 2017 and 2016

<u>ASSETS</u>	<u>2017</u>	<u>2016</u>
Current assets:		
Cash and cash equivalents	\$ 156,550	\$ 166,621
Accounts receivable	27,533	26,643
Inventory	553	380
Other assets	1,482	1,788
Total current assets	<u>186,118</u>	<u>195,432</u>
Noncurrent assets:		
Capital assets	55,732	55,960
Less accumulated depreciation and amortization	<u>(11,953)</u>	<u>(11,086)</u>
Total noncurrent assets	<u>43,779</u>	<u>44,874</u>
Total assets	<u>\$ 229,897</u>	<u>\$ 240,306</u>
 <u>DEFERRED OUTFLOWS OF RESOURCES</u>		
Deferred outflows of resources related to pension	<u>\$ 2,795</u>	<u>\$ 2,573</u>
 <u>LIABILITIES</u>		
Current liabilities:		
Accrued nonoperating distributions to the State of West Virginia	\$ 132,693	\$ 135,265
Estimated prize claims	15,621	15,981
Accounts payable	1,404	1,961
Other accrued liabilities	<u>24,788</u>	<u>32,258</u>
Total current liabilities	<u>174,506</u>	<u>185,465</u>
Noncurrent liabilities:		
Net pension liability	<u>4,800</u>	<u>3,044</u>
Total liabilities	<u>\$ 179,306</u>	<u>\$ 188,509</u>
 <u>DEFERRED INFLOWS OF RESOURCES</u>		
Deferred inflows of resources related to pension	<u>\$ 367</u>	<u>\$ 1,998</u>
 <u>NET POSITION</u>		
Net position:		
Net investment in capital assets	\$ 43,779	\$ 44,874
Unrestricted	<u>9,240</u>	<u>7,498</u>
Total net position	<u>\$ 53,019</u>	<u>\$ 52,372</u>

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

WEST VIRGINIA LOTTERY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
(In Thousands)

Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Lottery revenues:		
On-line games	\$ 72,110	\$ 85,660
Instant games	94,369	102,542
Racetrack video lottery	521,318	537,729
Limited video lottery	347,555	360,814
Table games	38,958	43,545
Historic resort	5,207	6,346
	<u>1,079,517</u>	<u>1,136,636</u>
Less commissions:		
On-line games	5,043	6,001
Instant games	6,606	7,178
Racetrack video lottery	268,177	275,496
Limited video lottery	170,302	176,799
Table games	16,512	18,453
Historic resort	2,733	3,302
	<u>469,373</u>	<u>487,229</u>
Less on-line prize costs	36,227	43,132
Less instant prize costs	61,959	67,695
Less ticket costs	1,408	1,618
Less vendor fees and costs	6,915	8,116
	<u>106,509</u>	<u>120,561</u>
Gross profit	<u>503,635</u>	<u>528,846</u>
Administrative expenses:		
Advertising and promotions	4,157	4,975
Wages and related benefits	10,305	9,885
Telecommunications	1,037	965
Contractual and professional	4,520	4,560
Rental	394	425
Depreciation and amortization	1,281	1,086
Other administrative expenses	1,572	1,230
	<u>23,266</u>	<u>23,126</u>
Other operating income	<u>10,677</u>	<u>10,528</u>
Operating income	<u>491,046</u>	<u>516,248</u>
Nonoperating income (expense):		
Investment income	934	788
Distributions to municipalities and counties	(6,812)	(7,072)
Distributions for capital reinvestment	(7,468)	(10,446)
Distributions to the State of West Virginia	(477,053)	(501,302)
	<u>(490,399)</u>	<u>(518,032)</u>
Increase (decrease) in net position	<u>647</u>	<u>(1,784)</u>
Net position, beginning of year	<u>52,372</u>	<u>54,156</u>
Net position, end of year	<u>\$ 53,019</u>	<u>\$ 52,372</u>

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

WEST VIRGINIA LOTTERY

STATEMENTS OF CASH FLOWS
(In Thousands)

Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Cash receipts from customers and other sources	\$ 1,089,304	\$ 1,154,450
Cash payments for:		
Personnel costs	(10,181)	(10,140)
Suppliers	(12,097)	(12,135)
Other operating costs	<u>(580,168)</u>	<u>(607,531)</u>
Cash provided by operating activities	<u>486,858</u>	<u>524,644</u>
Cash flows from noncapital financing activities:		
Nonoperating distributions to the State of West Virginia	(479,625)	(489,957)
Distributions to municipalities and counties	(6,808)	(7,117)
Distributions to racetracks from racetrack capital reinvestment fund	<u>(11,309)</u>	<u>(18,203)</u>
Cash used in noncapital financing activities	<u>(497,742)</u>	<u>(515,277)</u>
Cash flows from capital and related financing activities:		
Purchases of capital assets	<u>(186)</u>	<u>(8,197)</u>
Cash flows from investing activities:		
Investment earnings	<u>999</u>	<u>729</u>
Net increase (decrease) in cash and cash equivalents	(10,071)	1,899
Cash and cash equivalents, beginning of year	<u>166,621</u>	<u>164,722</u>
Cash and cash equivalents, end of year	<u>\$ 156,550</u>	<u>\$ 166,621</u>

(Continued)

WEST VIRGINIA LOTTERY
STATEMENTS OF CASH FLOWS
(In Thousands)
(Continued)

Years Ended June 30, 2017 and 2016

	2017	2016
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 491,046	\$ 516,248
Adjustments to reconcile operating income to cash provided by operating activities:		
Depreciation and amortization	1,281	1,086
Pension expense	766	360
Changes in operating accounts:		
(Increase) decrease in:		
Accounts receivable	(890)	7,286
Inventory	(173)	77
Other assets	241	165
Deferred outflows of resources	(863)	(980)
Increase (decrease) in:		
Estimated prize claims	(360)	70
Accounts payable	(557)	(197)
Other accrued liabilities	(3,633)	529
Cash provided by operating activities	\$ 486,858	\$ 524,644

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

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS

1 - LEGISLATIVE ENACTMENT

The West Virginia Lottery (the Lottery) was established by the State Lottery Act (the Act) passed April 13, 1985, which created a fund in the State Treasury designated as the "State Lottery Fund." The purpose of the Act was to establish and implement a state-operated lottery under the supervision of a state lottery commission (the Commission) and a Director. The Commission, consisting of seven members, and the Director are appointed by the Governor. Under the Act, the Commission has certain powers and the duty to establish rules for conducting games, to select the type and number of gaming systems or games, to enter into contracts and agreements, and to do all acts necessary or incidental to the performance of its duties and exercise of its power and duty to operate the Lottery in a highly efficient manner. The Act provides that a minimum annual average of 45% of the gross amount received from each lottery shall be allocated for prizes and also provides for certain limitations on expenses necessary for operation and administration of the Lottery. To the extent available, remaining net profits are to be distributed to the State of West Virginia (the State) and local governments as required by law. As the State is able to impose its will over the Lottery, the Lottery is considered a component unit of the State and its financial statements are presented in the comprehensive annual financial report of the State as a discretely presented component unit.

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The West Virginia Lottery is accounted for as a proprietary fund special purpose government engaged in business type activities. In accordance with accounting principles generally accepted in the United States of America for governmental entities, the financial statements are prepared on the accrual basis of accounting which requires recognition of revenue when earned and expenses when incurred.

Use of Estimates

Certain estimates and assumptions are required by management in the preparation of the financial statements in accordance with generally accepted accounting principles (GAAP). The significant estimates and assumptions that affect the reporting of amounts of assets and liabilities at the statement of net position dates and revenues and expenses for the years then ended are those required in the determination of estimated prize claims. Actual results in the near-term could differ from the estimates used to prepare these financial statements.

Lottery Game Operations

The West Virginia Lottery derives its revenues from four basic types of lottery games: instant, on-line, video type games, and table games. The Lottery develops multiple game themes and prize structures to comply with its enabling legislation, including aggregate annual minimum prize provisions. All bonded retailers and agents comprised principally of grocery and convenience stores serve as the primary distribution channel for instant and on-line lottery sales to the general public.

The Lottery has contracted with a private vendor to manufacture, distribute, and provide data processing support for instant and on-line lottery games. Under the terms of the agreements, the Lottery pays a percentage of gross revenues for the processing and manufacturing of the games.

Revenue from instant games is recognized when game tickets are sold to the retailers, and the related prize expense is recorded based on the specific game prize structure. Instant ticket sales and related prizes do not include the value of free plays issued for the purpose of increasing the odds of winning a prize.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Lottery Game Operations (Continued)

Sales of on-line lottery tickets are made by licensed agents to the public with the use of computerized terminals. On-line games include POWERBALL®, a multi-state “jackpot” game; HOT LOTTO™, a multi-state “lotto” game; MEGA MILLIONS®, a multi-state lotto game; Cash25 “lotto” game; Daily 3 and 4 “numbers” games; and Travel, an online “keno” game. Revenue is recognized when the agent sells the tickets to the public. Prize expense is recognized on the basis of actual drawing results.

Commissions are paid to instant game retailers and on-line agents at the rate of seven percent of gross sales. A portion of the commission not to exceed one and one quarter percent of gross sales may be paid from unclaimed prize moneys. The amount paid from unclaimed prize moneys is credited against prize costs. In addition, retailers and agents are paid limited bonus incentives that include prize shares on winning tickets they sold and a ticket cashing bonus on winning tickets they cash. On a weekly basis, retailers and agents must remit amounts due to the Lottery. Retailers may not be able to order additional instant tickets if payment has not been made for the previous billing period, while an agent's on-line terminal may be rendered inactive if payment is not received. No one retailer or agent accounts for a significant amount of the Lottery's sales or accounts receivable. Historically credit losses have been nominal and no allowance for doubtful accounts receivable is considered necessary.

Racetrack video lottery is a self-activated video version of lottery games. The board-operated games allow a player to place bets for the chance to be awarded credits which can either be redeemed for cash or be replayed as additional bets. The games allow a player to use coins, currency, tokens, or tickets, to place bets for the chance to receive coins, tokens, or ticket awards which may be redeemed for cash or used for replay in the games. The racetrack video lottery games' prize structures are designed to award prizes, or credits, at a stipulated rate of total bets played, and prize expense is netted against total video credits played. The Lottery recognizes as racetrack video lottery revenue “gross terminal income” equivalent to all wagers, net of related prizes. Amounts required by statute to be paid to private and local government entities are reported as commissions.

Racetrack video lottery legislation has established specific requirements for racetrack video lottery and imposed certain restrictions limiting the licensing for the operation of racetrack video lottery games to horse and dog racetracks in West Virginia, subject to local county elections permitting the same. The legislation further stipulates the distribution of revenues from racetrack video lottery games, and requires any licensed racetrack to be responsible for acquiring the necessary equipment and bearing the risk associated with the costs of operating and marketing the games.

Limited video lottery is also a self-activated video version of lottery games located in limited licensed retailer areas restricted for adult amusement. The games allow a player to use currency to place bets for the chance to receive free games or vouchers which may be redeemed for cash. The limited video lottery games' prize structures are designed to award prizes, at a stipulated rate of total bets played, and prize expense is netted against total video credits played. The Lottery recognizes as limited video lottery revenue “gross terminal income” equivalent to all wagers, net of related prizes. Amounts required by statute to be paid to private entities are reported as commissions. Limited video lottery permit holders are statutorily responsible for acquiring equipment and bearing the risk associated with the costs of operating the games.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Lottery Game Operations (Continued)

Table games legislation has established specific requirements for table games and imposed certain restrictions limiting the licensing for operation of table games to horse and dog racetracks and a historic resort in West Virginia, subject to local county elections permitting the same. Each location licensed as an agent of the Commission to operate West Virginia table games shall have written rules of play for each table game it operates which must be approved by the Commission. All wagers and pay-offs of winning wagers shall be made according to those rules of play. For the privilege of holding a table games license, there is levied a privilege tax of thirty-five percent of each licensee's adjusted gross receipts from the operation of Lottery table games which the Lottery records as revenue. Amounts required by statute to be paid to private and local government entities are reported as commissions. The legislation further stipulates the distribution of revenues from West Virginia table games, and requires any licensed location to be responsible for acquiring the necessary equipment and bearing the risk associated with the costs of operating and marketing the games.

Historic resort lottery games are a combination of self-activated video lottery games as well as table games which are located at a licensed historic resort hotel as defined by the WV Code. Video lotteries at the historic resort are board-operated games that allow a player to place bets for the chance to be awarded credits which can either be redeemed for cash or be replayed as additional bets. The video lottery games allow a player to use coins, currency, tokens, or tickets, to place bets for the chance to receive coins, tokens, or ticket awards which may be redeemed for cash or used for replay in the games.

The historic resort video lottery games' prize structures are designed to award prizes, or credits, at a stipulated rate of total bets played, and prize expense is netted against total video credits played. The Lottery recognizes video lottery revenue consisting of "gross terminal income" equivalent to all wagers, net of related prizes; and historic resort table games revenue consisting of a privilege tax of thirty-five percent of adjusted gross receipts for the operation of table game as historic resort lottery revenues.

Amounts required by statute to be paid to the private and local government entities are reported as commissions. The Lottery Act as amended has established specific requirements for historic resort video and table games lotteries and imposed certain restrictions limiting the licensing for operation of historic resort lottery games in West Virginia, subject to local county elections permitting the same. The legislation further stipulates the distribution of revenues from historic resort lottery games, and requires the licensed historic resort to be responsible for acquiring the necessary equipment and bearing the risk associated with the costs of operating and marketing the games.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of deposits on hand with the State Treasurer of West Virginia and interest-earning deposits in State investments pools maintained by the West Virginia Board of Treasury Investments (BTI). The West Virginia Money Market Pool is carried at amortized cost and the West Virginia Short Term Bond Pool is carried at fair value.

Inventory

Inventory consists of instant game tickets available for sale to approved Lottery retailers and are carried at cost as determined by the specific identification method.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other Assets

Other assets consist of deposits restricted for payment of certain Multi-State Lottery Association activities and prepaid expenses.

Capital Assets

The Lottery has adopted a policy of capitalizing assets with individual amounts exceeding \$25,000 and a useful life greater than one year. These assets include a building, leasehold improvements, and purchased equipment comprised principally of technology property, office furnishings and equipment necessary to administer lottery games, and are carried at cost. Depreciation is computed by the straight-line method over the estimated economic useful lives of the assets, which are as follows:

Building	40 years
Leasehold improvements	5 years
Equipment	3-5 years

The Lottery leases, under a cancelable operating lease, various office spaces for field operations. The Lottery also leases various office equipment under agreements considered to be cancelable operating leases.

Accrued Employee Benefits

Employees fully vest in all earned but unused annual leave. In accordance with State personnel policies, employees hired prior to July 1, 2001, vest in unused sick leave only upon retirement, at which time such unused leave can be converted into post-retirement health care coverage or additional periods of credited service for purposes of determining retirement benefits. To the extent that eligible conversion benefits are determined, a liability has been accrued as a result of the Lottery's participation in the State's post-employment benefits plan, in accordance with GAAP. The Lottery accrues a liability for estimated liabilities that may arise in connection with compensated absences at the current rate of employee pay. The Lottery's annual leave transactions for years ending June 30, 2017 and June 30, 2016 are as follows (in thousands):

	<u>Year Ending June 30</u>	
	<u>2017</u>	<u>2016</u>
Beginning estimated liabilities	\$ 570	\$ 564
Leave expenses incurred	574	570
Leave expenses paid	<u>570</u>	<u>564</u>
Ending estimated liabilities	<u>\$ 574</u>	<u>\$ 570</u>
Liabilities estimated to be paid in one year	<u>\$ 574</u>	<u>\$ 570</u>

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Public Employees Retirement System (PERS) and additions to/deductions from PERS's fiduciary net position have been determined on the same basis as they are reported by PERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments of the PERS are reported at fair value.

Deferred Outflows of Resources/Deferred Inflows of Resources

Deferred outflows of resources represents a consumption of net position that applies to future periods and so will not be recognized as an outflow of resources (expense) until that time. Currently the Lottery has recognized deferred outflows of resources related to pensions (See Note 11). Deferred inflows of resources represents an acquisition of net position that applies to future periods and so will not be recognized as an inflow of resources (revenue) until that time. Currently the Lottery has recognized deferred inflows of resources related to pensions (See Note 11).

Net Position

Net position is presented as either unrestricted, restricted by enabling legislation for capital project, or as net investment in capital assets which represents the net book value of all property and equipment of the Lottery. When an expense is incurred for purposes for which both restricted and unrestricted net position is available, restricted resources are applied first.

Operating Revenues and Expenses

Operating revenues and expenses for proprietary funds such as the Lottery are revenues and expenses that result from providing services and producing and delivering goods and/or services. Operating revenues for the Lottery are derived from providing various types of lottery games. Operating expenses include commissions, prize costs, other direct costs of providing lottery games, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Advertising and Promotions

The Lottery expenses the costs of advertising and promotions as they are incurred.

3 - CASH AND CASH EQUIVALENTS

At June 30, 2017 and 2016, the carrying amounts of deposits with financial institutions were \$468 thousand and \$1,430 thousand, respectively, with bank balances of \$553 and \$1,445 thousand, respectively. Deposits up to \$250 thousand are insured by the Federal Depository Insurance Corporation. Any balances over the insured amount are collateralized with securities held by the State of West Virginia's agent in the State's name.

At June 30, 2017 and 2016, the carrying amounts of deposits with financial institutions, the State Treasurer, and the West Virginia Board of Treasury Investments (BTI) were as follows (in thousands):

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

	2017	2016
Deposits with financial institutions	\$ 468	\$ 1,430
Cash on hand at the Treasurer's Office	17,239	7,386
Investments with BTI reported as cash equivalents	138,843	157,805
	\$ 156,550	\$ 166,621

The State Treasurer has statutory responsibility for the daily cash management activities of the State's agencies, departments, boards and commissions and transfers funds to the BTI for investment in accordance with West Virginia statutes, policies set by the BTI and by provisions of bond indentures and trust agreements when applicable.

The Lottery's cash balances are invested by the BTI in the BTI's West Virginia Money Market Pool and the BTI's West Virginia Short Term Bond Pool. Investment income is pro-rated to the Lottery at rates specified by the BTI based on the balance of the deposits maintained in relation to the total deposits of all state agencies participating in the pool. Investments in the West Virginia Money Market Pool are available to the Lottery with overnight notice. Investments in the West Virginia Short Term Bond Pool are available to the Lottery on the first day of each month.

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

The West Virginia Money Market Pool has been rated AAAM by Standard & Poor's. A fund rated "AAAM" has extremely strong capacity to maintain principal stability and to limit exposure to principal losses due to credit, market, and/or liquidity risks. "AAAM" is the highest principal stability fund rating assigned by Standard & Poor's. Neither the BTI itself nor the West Virginia Short Term Bond Pool has been rated for credit risk by any organization.

The BTI limits the exposure to credit risk in the West Virginia Money Market Pool by requiring all corporate bonds to be rated A+ by Standard & Poor's (or its equivalent) or higher. Commercial paper must be rated at least A-1 by Standard & Poor's and P-1 by Moody's. The pool must have at least 15% of its assets in United States Treasury obligations or obligations guaranteed as to repayment of interest and principal by the United States of America.

The following table provides information on the credit ratings of the WV Money Market Pool's investments (in thousands):

Security Type	Credit Rating		Carrying Value	Percent of Pool Assets
	Moody's	S&P		
Commercial paper	P-1	A-1+	\$ 358,377	20.10%
	P-1	A-1	706,150	39.60
Corporate bonds and notes	Aa3	AA-	6,285	0.35
	A1	A	3,200	0.18
U.S. Treasury notes *	Aaa	AA+	97,823	5.49
U.S. Treasury bills *	P-1	A-1+	69,837	3.92

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

Security Type	Credit Rating		Carrying Value	Percent of Pool Assets
	Moody's	S&P		
Negotiable certificates of deposit	P-1	A-1+	174,000	9.76
	P-1	A-1	156,476	8.78
Money market funds	Aaa	AAAm	100,005	5.61
Repurchase agreements (underlying securities):				
U.S. Treasury notes *	P-1	A-1	50,000	2.80
U.S. Treasury notes *	NR	A-1	60,800	3.41
			<u>\$1,782,953</u>	<u>100.00%</u>

* U.S. Treasury issues are explicitly guaranteed by the United States government and are not subject to credit risk.

The BTI limits the exposure to credit risk in the West Virginia Short Term Bond Pool by requiring all corporate bonds to be rated BBB- or higher by Standard & Poor's (or its equivalent). Commercial paper must be rated at least A-1 by Standard & Poor's and P-1 by Moody's. Mortgage-backed and asset-backed securities must be rated AAA by Standard & Poor's and Aaa by Moody's. The pool must have at least 15% of its assets in United States Treasury obligations or obligations guaranteed as to repayment of interest and principal by the United States of America. The following table provides information on the credit ratings of the WV Short Term Bond Pool's investments (in thousands):

Security Type	Credit Rating		Carrying Value	Percent of Pool Assets
	Moody's	S&P		
Commercial paper	P-1	A-1+	\$ 9,963	1.32%
	P-1	A-1	13,940	1.85
Corporate asset backed securities	Aaa	AAA	68,441	9.06
	Aaa	NR	79,853	10.58
	NR	AAA	67,375	8.92
	NR	AA	2,003	0.26
Corporate bonds and notes	Aaa	AA+	2,935	0.39
	Aaa	AA+	4,019	0.53
	Aa1	AA+	5,027	0.67
	Aa2	AA+	4,036	0.53
	Aa2	AA	6,989	0.93
	Aa2	AA-	17,124	2.27
	Aa3	AA-	15,106	2.00
	Aa2	A	4,011	0.53
	Aa3	A+	1,104	0.15
	A1	AA-	16,588	2.20

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

Security Type	Credit Rating		Carrying Value	Percent of Pool Assets
	Moody's	S&P		
Corporate bonds and notes (continued)				
	A1	A+	19,078	2.53
	A1	A	6,355	0.84
	A1	A-	7,276	0.96
	A2	A+	2,616	0.35
	A2	A	25,032	3.32
	A2	A-	10,079	1.33
	A3	A	10,747	1.42
	A3	A-	30,242	4.01
	A3	BBB+	20,183	2.67
	Baa1	A	1,501	0.20
	Baa1	A-	11,991	1.59
	Baa1	BBB+	47,392	6.28
	Baa1	BBB	8,495	1.12
	Baa2	A-	1,018	0.13
	Baa2	BBB	28,770	3.81
	Baa2	BBB-	3,000	0.40
	Baa2	NR	2,000	0.26
	Baa2	BBB+	10,268	1.36
	Baa3	BBB	15,627	2.07
	Baa3	BBB-	7,166	0.95
	Ba1	BBB	2,005	0.27
	Ba1	BBB-	2,304	0.31
	Ba2	BBB-	824	0.11
	NR	BBB+	2,637	0.35
	NR	BBB-	1,990	0.26
U.S. agency mortgage backed securities	Aaa	AA+	37,287	4.94
Corporate mortgage backed securities	Aaa	AAA	4,217	0.56
	Aaa	NR	17,281	2.29
U.S. Treasury notes *	Aaa	AA+	87,588	11.60
Money market funds	Aaa	AAAm	11,479	1.52
			\$ 754,962	100.00%

NR = Not Rated

* U.S. agency mortgage backed securities are explicitly guaranteed by the United States government and are not considered to have credit risk.

Interest Rate Risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The overall weighted average maturity of the investments of the West Virginia Money Market Pool cannot exceed 60 days. Maximum maturity of individual securities cannot exceed 397 days from date of purchase, except for government floating rate notes, which can be up to 762 days. The following table provides information on the weighted average maturities for the various asset types in the West Virginia Money Market Pool:

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

Security Type	Carrying Value (In Thousands)	WAM (Days)
Repurchase agreements	\$ 110,800	3
U.S. Treasury notes	97,823	44
U.S. Treasury bills	69,837	88
Commercial paper	1,064,527	36
Certificates of deposit	330,476	41
Corporate bonds and notes	9,485	79
Money market funds	100,005	3
	<u>\$ 1,782,953</u>	

The weighted average maturity of the investments of the West Virginia Money Market Pool as of June 30, 2017 is 36 days.

The overall effective duration of the investments of the West Virginia Short Term Bond Pool cannot exceed 731 days. Maximum effective duration of individual securities cannot exceed 1,827 days (five years) from date of purchase. The following table provides information on the effective duration for the various asset types in the West Virginia Short Term Bond Pool:

Security Type	Carrying Value (In Thousands)	Effective Duration (Days)
Corporate bonds and notes	\$ 355,535	412
Corporate asset backed securities	217,672	423
Commercial paper	23,903	113
U.S. Treasury bonds and notes	87,588	766
U.S. agency mortgage backed securities	37,287	148
Corporate mortgage backed securities	21,498	347
Money market funds	11,479	1
	<u>\$ 754,962</u>	

The effective duration of the investments in the West Virginia Short Term Bond Pool as of June 30, 2017 is 426 days.

Concentration of credit risk – Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single corporate issuer. West Virginia statutes prohibit the West Virginia Money Market Pool and West Virginia Short Term Bond Pool from investing more than 5% of its assets in securities issued by one corporate name or corporate issue. At June 30, 2017, the pool did not have any investments in any one private corporation or association that represented more than 5% of assets.

Custodial credit risk – The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Lottery will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2017, neither the West Virginia Money Market Pool nor West Virginia Short Term Bond Pool held securities that were subject to custodial credit risk. Repurchase agreements are collateralized at 102%, and the collateral is held in the name of the BTI.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

3 - CASH AND CASH EQUIVALENTS (Continued)

Foreign currency risk – Foreign currency risk is the risk that changes in exchange rates will affect the fair value of an investment or a deposit. At June 30, 2017, neither the West Virginia Money Market Pool nor West Virginia Short Term Bond Pool held securities that were subject to foreign currency risk.

4 - CAPITAL ASSETS

A summary of capital asset activity is as follows (in thousands):

	Historical cost at June 30, 2015	Additions	Deletions	Historical cost at June 30, 2016	Additions	Deletions	Historical cost at June 30, 2017
Capital assets, not depreciated							
Construction in progress	\$ 1,090	\$ 74	\$ -	\$ 1,164	\$ 186	\$ -	\$ 1,350
Land	1,434	-	-	1,434	-	-	1,434
Capital assets, being depreciated							
Building	38,084	8,123	-	46,207	-	-	46,207
Improvements	260	-	-	260	-	(260)	-
Equipment	6,895	-	-	6,895	-	(154)	6,741
	<u>\$ 47,763</u>	<u>\$ 8,197</u>	<u>\$ -</u>	<u>\$ 55,960</u>	<u>\$ 186</u>	<u>\$ (414)</u>	<u>\$ 55,732</u>
	Accumulated depreciation at June 30, 2015	Additions	Deletions	Accumulated depreciation at June 30, 2016	Additions	Deletions	Accumulated depreciation at June 30, 2017
Building	\$ 3,093	\$ 971	\$ -	\$ 4,064	\$ 1,183	\$ -	\$ 5,247
Improvements	260	-	-	260	-	(260)	-
Equipment	6,647	115	-	6,762	98	(154)	6,706
	<u>\$ 10,000</u>	<u>\$ 1,086</u>	<u>\$ -</u>	<u>\$ 11,086</u>	<u>\$ 1,281</u>	<u>\$ (414)</u>	<u>\$ 11,953</u>

5 - PARTICIPATION IN THE MULTI-STATE LOTTERY

The Lottery is a member of the Multi-State Lottery (MUSL), which operates the semi-weekly POWERBALL® jackpot lotto game, the HOT LOTTO™ game, and MEGA MILLIONS® jackpot game on behalf of other participating lotteries. MUSL is currently comprised of 33 member state lotteries, including the District of Columbia and the United States Virgin Islands. MUSL is managed by a Board of Directors, which is comprised of the lottery directors or their designee from each of the party states. The Board of Directors' responsibilities to administer the Multi-State Lottery POWERBALL®, HOT LOTTO™, and MEGA MILLIONS® games are performed by advisory committees or panels staffed by officers and independent contractors appointed by the board. These officers and consultants serve at the pleasure of the board and the board prescribes their powers, duties and qualifications. The Executive Committee carries out the budgeting and financing of MUSL, while the board contracts the annual independent audit. A copy of the audit may be obtained by writing to the Multi-State Lottery Association, 4400 N.W. Urbandale Drive, Urbandale, Iowa 50322.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

5 - PARTICIPATION IN THE MULTI-STATE LOTTERY (Continued)

Each MUSL member sells game tickets through its agents and makes weekly wire transfers to the MUSL in an amount equivalent to the total prize pool less the amount of prizes won in each state. Lesser prizes are paid directly to the winners by each member lottery. The prize pool for POWERBALL®, HOT LOTTO™, and MEGA MILLIONS® is 50% of each drawing period's sales, with minimum jackpot levels.

Revenues derived from the Lottery's participation in the MUSL POWERBALL® jackpot game were \$34,514,013 and \$46,553,463 for the years ended June 30, 2017 and 2016, respectively, and related prize costs were \$17,258,816 and \$23,293,171, respectively.

Revenues derived from the Lottery's participation in the HOT LOTTO™ game were \$4,848,437 and \$4,790,589 for the years ended June 30, 2017 and 2016, respectively, and related prize costs were \$2,424,609 and \$2,396,142, respectively.

Revenues derived from the Lottery's participation in the MEGA MILLIONS® game were \$11,057,403 and \$12,035,877 for the years ended June 30, 2017 and 2016, respectively, and related prize costs were \$5,591,600 and \$6,022,537, respectively.

MUSL places a percentage of game sales from each game in separate prize reserve funds that serve as a contingency reserve to protect the respective MUSL Product Groups from unforeseen prize liabilities. These funds can only be used at the discretion of the respective MUSL Product Group. Once the prize reserve funds exceed the designated limit, the excess becomes part of that particular prize pool. Prize reserve fund monies are refundable to MUSL Product Group members if the MUSL disbands or, after one year, if a member leaves the MUSL. The applicable sales percentage contribution as well as the reserve fund limit for the MUSL games is as follows (in thousands):

	<u>POWERBALL®</u>	<u>HOT LOTTO™</u>	<u>MEGA MILLIONS®</u>
Required Contribution (% of sales)	2%	3%	1%
Reserve Fund Cap	\$125,000	\$9,000	\$45,000

The Lottery's share of the prize reserve fund balances with MUSL as of June 30, were as follows (in thousands):

	<u>2017</u>		<u>2016</u>	
	<u>Total Prize Reserve</u>	<u>Lottery Share</u>	<u>Total Prize Reserve</u>	<u>Lottery Share</u>
POWERBALL ®	\$ 117,892	\$ 1,626	\$ 111,422	\$ 1,626
HOT LOTTO™	6,070	440	7,170	497
MEGA MILLIONS ®	38,041	542	38,541	545
	<u>\$ 162,003</u>	<u>\$ 2,608</u>	<u>\$ 157,133</u>	<u>\$ 2,668</u>

Lottery prize reserves held by the MUSL are invested according to a Trust agreement the Lottery has with MUSL outlining investment policies. The policies restrict investments to direct obligations of the United States Government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States Government, and mutual funds of approved investments. The average portfolio maturity is never more than one year, except that up to one third of the portfolio may have an average maturity of up to two years. The maximum maturity for any one security does not exceed five years.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

5 - PARTICIPATION IN THE MULTI-STATE LOTTERY (Continued)

The interest earned on prize reserve fund monies is used to pay MUSL operating expenses and any amounts over and above the expenses are credited to an unreserved fund. The Lottery records this interest when earned. This fund had a balance of \$15,316,619 and \$16,259,687 at June 30, 2017 and 2016, of which the Lottery's share was \$1,403,281 and \$1,565,451, respectively.

6 - RACETRACK VIDEO LOTTERY

The racetrack video lottery legislation stipulates the distribution of racetrack video lottery revenues. This legislation has been amended since inception to restate revenue distribution based on revenue benchmarks. Initially, four percent (4%) of gross terminal revenue is allocated for lottery administrative costs. Fifty-seven percent (57%) of net terminal revenue (gross less 4%) is allocated in lieu of commissions to: the racetracks (46.5%); other private entities associated with the racing industry (8.7%); and the local county and municipal governments (2%). The remaining forty-three percent (43%) of net terminal revenue is allocated for distribution to the State as specified in the Racetrack Video Lottery Act or subsequent State budget, as described in Note 10 titled "Nonoperating Distributions to the State of West Virginia."

The first benchmark occurs when the current year net terminal revenue meets the fiscal year 1999 net terminal revenue. The counties and incorporated municipalities split 50/50 the two percent (2%) net terminal revenue.

The second benchmark occurs when the current year gross terminal revenue meets the fiscal year 2001 gross terminal revenue. The four percent (4%) is no longer allocated for lottery administrative costs; instead the State receives this for distribution as specified by legislation or the State budget.

The final benchmark occurs when the current year net terminal revenue meets the fiscal year 2001 net terminal revenue. At this point a 10% surcharge is applied to net terminal revenue, with 62% of the surcharge allocated for distribution to the State as specified by legislation or the State budget, and 38% of the surcharge allocated to separate capital reinvestment funds for each licensed racetrack. After deduction of the surcharge, 49% of the net terminal revenue is allocated in lieu of commissions to: the racetracks (42%); other private entities associated with the racing industry (5%); and the local county and incorporated municipality governments (2%). The remaining net terminal revenue (51%) is allocated for distribution to the State as specified in the Racetrack Video Lottery Act or subsequent State budget, as described in Note 10.

Amounts from the capital reinvestment fund may be distributed to each racetrack if qualifying expenditures are made within the statutory timeframe; otherwise amounts accumulated in the fund revert to the state excess lottery revenue fund. The Lottery, along with the Rhode Island and Delaware state lotteries, participate in Multi-Jurisdictional Wide Area Progressive (MWAP) video games. This allows each of the lotteries to offer a higher progressive jackpot than they could generate alone. MUSL manages the progressive games and charges each participant a MWAP contribution fee which is a percentage of the amount wagered. This fee was of 0.75% for years ended June 30, 2017 and June 30, 2016 respectively.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

6 - RACETRACK VIDEO LOTTERY (Continued)

A summary of racetrack video lottery revenues for the years ended June 30, 2017 and 2016, follows (in thousands):

	<u>2017</u>	<u>2016</u>
Total credits (bets) played	\$ 5,799,475	\$ 5,965,083
Credits (prizes) won	(5,203,814)	(5,350,676)
Promotional credits played	(74,278)	(76,444)
MWAP Contributions	<u>(65)</u>	<u>(234)</u>
Gross terminal income	521,318	537,729
Administrative costs	<u>(14,765)</u>	<u>(14,909)</u>
Net terminal income	506,553	522,820
Commissions	<u>(268,177)</u>	<u>(275,496)</u>
Racetrack video lottery revenues available for distribution	<u>\$ 238,376</u>	<u>\$ 247,324</u>

A summary of racetrack video lottery revenues paid or accrued for certain State funds to conform with the legislation follows (in thousands):

	<u>2017</u>	<u>2016</u>
State Lottery Fund	\$ 107,819	\$ 108,547
State Excess Lottery Revenue Fund	125,225	132,941
Capital Reinvestment Fund	<u>5,332</u>	<u>5,836</u>
Total nonoperating distributions	<u>\$ 238,376</u>	<u>\$ 247,324</u>

On March 12, 2011, the Legislature passed Senate Bill 550 which provides for the creation of the Racetrack Modernization Fund. The Modernization Fund is available to reimburse the licensed tracks \$1 for every \$2 spent on the costs of facility modernization. For the years ended June 30, 2015 through June 30, 2020, the Lottery is to transfer up to \$9 million from racetrack administrative surplus funds to the Modernization Fund, which is allocated to each track on a pro rata basis according to their administrative contribution for the fiscal year. For each of the years ended June 30, 2017 and 2016, the Lottery transferred \$4.5 million to the Racetrack Modernization Fund.

7 - LIMITED VIDEO LOTTERY

The limited video lottery legislation established specific requirements imposing certain restrictions limiting the licensing for the operation of limited video lottery games to 9,000 terminals placed in licensed retailers. These licensed retailers must hold a qualifying permit for the sale and consumption on premises of alcohol or non-intoxicating beer. The Lottery has been charged with the administration, monitoring and regulation of these machines. The legislation further stipulates the distribution of revenues from limited gross terminal income be deposited into the state lottery fund for administrative costs. Then, the state share percentage of gross profit is to be transferred to the State Excess Lottery Revenue Fund. Such percentage is between 30 and 50 percent and is subject to change on a quarterly basis. Two percent is distributed to counties and incorporated municipalities in the manner prescribed by the statute. The remaining amount of gross profit is paid to retailers and/or operators as prescribed in the Act and is recorded as limited video lottery commissions in the financial statements. Municipal and county distributions are accounted for as nonoperating expenses. A summary of limited video lottery revenues for the years ended June 30, 2017 and 2016 follows (in thousands):

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

7 - LIMITED VIDEO LOTTERY (Continued)

	<u>2017</u>	<u>2016</u>
Total credits played	\$ 4,259,475	\$ 4,339,155
Credits (prizes) won	<u>(3,911,920)</u>	<u>(3,978,341)</u>
Gross terminal income	347,555	360,814
Administrative costs	<u>(6,951)</u>	<u>(7,216)</u>
Gross profit	340,604	353,598
Commissions	(170,302)	(176,799)
Distributions to municipalities and counties	<u>(6,812)</u>	<u>(7,072)</u>
Limited video lottery revenues available for distribution	<u>\$ 163,490</u>	<u>\$ 169,727</u>

8 - TABLE GAMES

The passage of table games legislation allowed local referendums in each of the four counties in which a race track is located to approve table games. All four counties have authorized table games at their respective tracks.

Table games include blackjack, roulette, craps, and various types of poker. The Lottery receives a privilege tax of 35% of adjusted gross receipts, from each licensed racetrack, which is deposited weekly into the Lottery's racetrack table games fund.

From the gross amounts deposited into the table games fund, the Lottery, on a monthly basis retains 3% of the adjusted gross receipts for administrative expenses. From the administrative allowance, at least \$100,000 and not more than \$500,000 annually will be transferred to the Lottery's compulsive gambling treatment fund.

The Lottery then transfers 2.25% of adjusted gross receipts from all thoroughbred and greyhound racetracks participating in licensed table games to the special funds established by each thoroughbred and greyhound racetrack table games licensee for the payment of regular racetrack purses to be divided equally among each licensee. A transfer of 1.8% of the adjusted gross receipts is made from all licensed racetracks to the thoroughbred development fund and the greyhound breeding development fund to be divided pro rata among the development funds.

Transfers of 2% of the adjusted gross receipts are made from each licensed racetrack to the county commissions of the counties where racetracks participating in licensed table games are located to be divided pro rata among the counties. Transfers of 3% of the adjusted gross receipts are made from each licensed racetrack to the governing bodies of municipalities within counties where racetracks participating in licensed table games are located as prescribed by statute. A transfer of .5% of the adjusted gross receipts to the governing bodies of municipalities in which a racetrack table games licensee is located is to be divided equally among the municipalities. The Lottery, in accordance with the enabling legislation, will distribute the remaining amounts hereinafter referred to as the net amounts in the racetrack table games funds as follows:

- A transfer of 4%, into a special fund to be established by the West Virginia Racing Commission to be used for payment into the pension plan for all employees of each licensed racing association.
- A transfer of 10%, to be divided and paid in equal shares, to each county commission in the state where table games are not located.

WEST VIRGINIA LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)**8 - TABLE GAMES (Continued)**

- A transfer of 10%, to be divided and paid in equal shares, to the governing bodies of each municipality in the state where table games are not located.
- A transfer of 76% to the Excess Lottery Fund.

The table games adjusted gross receipts for the year ended June 30, 2017 and 2016 were \$111,308,255 and \$124,415,228, respectively. A summary of table games revenues for the years ended June 30, 2017 and 2016 follows (in thousands):

	<u>2017</u>	<u>2016</u>
Table games privilege tax	\$ 38,958	\$ 43,545
Interest on table games fund	21	9
Administrative costs	<u>(3,339)</u>	<u>(3,732)</u>
Total available for distribution	35,640	39,822
<u>Less distributions:</u>		
Racetrack purse funds	2,504	2,799
Thoroughbred & greyhound development funds	2,004	2,239
Racing commission pension plan	980	1,096
Municipalities/counties	<u>11,024</u>	<u>12,319</u>
Total distributions	16,512	18,453
Table games distribution to the state		
Excess Lottery Fund	<u>\$ 19,128</u>	<u>\$ 21,369</u>

9 - HISTORIC RESORT HOTEL

The Historic Resort Hotel legislation authorizes video lottery and table games at a licensed historic resort hotel which is defined as “a resort hotel registered with the United States Department of the Interior as a national historic landmark in its National Registry of Historic Places having not fewer than five hundred guest rooms under common ownership and having substantial recreational guest amenities in addition to the gaming facility.”

Historic Resort Video Lottery

Historic Resort Hotel legislation, as amended, dictates the distribution of video lottery revenues. Thirty three and a half percent (33.5%) of gross terminal income is allocated to Historic Resort Hotel Fund, two and a half percent (2.5%) is allocated to the State Excess Lottery Revenue Fund, and seventeen percent (17%) of gross terminal income is allocated to the Human Resource Benefit Fund. The remaining forty-seven percent (47%) of gross terminal income is then subject to a ten percent (10%) surcharge which is allocated to separate capital reinvestment funds for the licensed historic resort hotel. After deduction of the surcharge, the remaining forty-two and three-tenths percent (42.3%) of gross terminal income is retained by the historic resort hotel. A summary of historic resort hotel video lottery revenues for the years ended June 30, 2017 and 2016 follows (in thousands):

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

9 - HISTORIC RESORT HOTEL (Continued)

	<u>2017</u>	<u>2016</u>
Total credits played	\$ 68,721	\$ 64,217
Credits (prizes) won	(63,853)	(58,842)
Promotional credits played	<u>(1,129)</u>	<u>(888)</u>
Gross terminal income	3,739	4,487
Capital reinvestment	(176)	(211)
Excess Lottery/Modernization	(33)	(40)
Hotel commissions	<u>(1,581)</u>	<u>(1,898)</u>
Net terminal income	<u>\$ 1,949</u>	<u>\$ 2,338</u>
Historic Resort Hotel Fund	\$ 1,314	\$ 1,575
Human Resource Benefit Fund	<u>635</u>	<u>763</u>
Total	<u>\$ 1,949</u>	<u>\$ 2,338</u>

Historic Resort Table Games

Each historic resort hotel licensee is subject to a privilege tax of thirty five percent (35%) of adjusted gross receipts, of which thirty percent (30%) is deposited directly into the Historic Resort Hotel Fund and five percent (5%) is deposited directly into the Human Resource Benefit Fund. The historic resort hotel table games adjusted gross receipts for the years ended June 30, 2017 and 2016 were \$4,193,851 and \$5,312,061, respectively.

The following table shows the privilege tax and the accrued distributions (in thousands) for the years ended June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Table games privilege tax	<u>\$ 1,468</u>	<u>\$ 1,859</u>
Historic Resort Hotel Fund	\$ 1,258	\$ 1,594
Human Resource Benefit Fund	<u>210</u>	<u>265</u>
Total distributions	<u>\$ 1,468</u>	<u>\$ 1,859</u>

Historic Resort Hotel Fund

Historic Resort Hotel Fund deposits are allocated after a fifteen percent (15%) lottery administrative cost. The remaining Historic Resort Hotel Fund net income (gross deposits less 15%) are distributed as follows:

WEST VIRGINIA LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)**9 - HISTORIC RESORT HOTEL (Continued)**Historic Resort Hotel Fund (Continued)

- 4% is paid to the county where the gaming facility is located;
- 2.5% is paid to the municipality where the gaming facility is located as prescribed by statute;
- 2.5% is divided and paid in equal shares to the remaining municipalities in the county where the gaming facility is located;
- 2.5% is divided and paid in equal shares, to each county commission in the state where the gaming facility is not located;
- 2.5% is divided and paid in equal shares, to each municipality in the State not already receiving a distribution.
- 86% is transferred to the Excess Lottery Revenue Fund.

A summary of Historic Resort Hotel Fund revenues and related distributions is as follows (in thousands) for the years ended June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Historic Resort Hotel video lottery	\$ 1,314	\$ 1,575
Historic Resort table games	1,258	1,594
Interest on Historic Resort Hotel Fund	<u>2</u>	<u>-</u>
Historic Resort Hotel Fund deposits	<u>2,574</u>	<u>3,169</u>
Administrative costs	<u>(390)</u>	<u>(481)</u>
Historic Resort Hotel Fund net income	<u>\$ 2,184</u>	<u>\$ 2,688</u>
Municipalities/Counties	\$ 307	\$ 376
Excess Lottery Revenue Fund	<u>1,877</u>	<u>2,312</u>
Total distributions	<u>\$ 2,184</u>	<u>\$ 2,688</u>

10 - NONOPERATING DISTRIBUTIONS TO THE STATE OF WEST VIRGINIA

The Lottery periodically distributes surplus funds, exclusive of amounts derived from limited video lottery and a portion of racetrack video lottery funds, to the State of West Virginia in accordance with the current governing legislation. For the years ended June 30, 2017 and 2016, the State Legislature budgeted \$157,257,444 and \$156,129,575 respectively of estimated profits of the Lottery for distributions to designated special revenue accounts of the State of West Virginia. With regard to the State Lottery Fund, legislation stipulates that debt service payments be given a priority over all other transfers in instances where estimated profits are not sufficient to provide for payment of all appropriated distributions. Debt service payments of \$1,800,000, \$1,000,000, and \$500,000 per month for the first ten months of each fiscal year currently have such priority. Transfers made pursuant to the State Excess Lottery Revenue Fund have similar requirements; currently debt service payments are \$5,900,000 per month for the first ten months of each fiscal year. In addition, Legislation provides that, if in any month, there is a shortage of funds in the State Excess Lottery Revenue Fund to make debt service payments, the necessary amount shall be transferred from the State Lottery Fund to cover such shortfall, after the State Lottery Fund debt service payments have been made. Repayments to the State Lottery Fund are required to be made in subsequent months as funds become available. For the years ended June 30, 2017 and 2016, the Lottery made or accrued all budgeted distributions and accrued additional distributions from the State Lottery Fund and State Excess Lottery Revenue Fund of \$132,692,744 and \$135,264,932, respectively. The Lottery does not have a legally adopted annual budget.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

10 - NONOPERATING DISTRIBUTIONS TO THE STATE OF WEST VIRGINIA (Continued)

A summary of the required statutory and budgeted distributions to certain state agencies to conform with the various legislation follows (in thousands):

	<u>2017</u>	<u>2016</u>
<u>Budgetary distributions:</u>		
<u>Administrative Operations Account:</u>		
General Purpose Account	\$ -	\$ 4,631
 <u>State Lottery Fund:</u>		
Bureau of Senior Services	59,139	69,027
Department of Education	18,006	17,953
Library Commission	11,429	11,421
Higher Education - Central Office	7,157	7,215
Tourism	6,216	8,000
Natural Resources	3,096	3,189
Division of Culture & History	4,332	4,745
Department of Education & Arts	1,186	1,586
General Reserve Fund	13,700	-
Economic Development Authority	9,998	9,995
School Building Authority	18,000	18,000
Community and Technical College	4,998	4,998
Total State Lottery Fund	<u>157,257</u>	<u>156,129</u>
 <u>State Excess Lottery Revenue Fund:</u>		
General Purpose Account	65,000	69,265
Education Improvement Fund	29,000	29,000
WV Infrastructure Council Fund	26,000	36,000
Higher Education Improvement Fund	15,000	15,000
State Park Improvement Fund	5,000	5,000
School Building Authority	18,992	18,992
Economic Development Fund	18,986	18,989
Refundable Credit - General Revenue Fund	10,000	10,000
Racing Commission	2,000	2,000
WV Department of Health and Human Resources	61,378	44,512
General Revenue Fund	12,800	-
Distributions to Statutory Funds and Purposes		
Parking Garage Fund	754	755
Capitol Dome and Improvements Fund	2,155	2,201
Capitol Renovation and Improvements Fund	2,796	2,808
Development Office Promotion Fund	1,525	1,531
Research Challenge Fund	2,033	2,042
Tourism Promotion Fund	5,659	5,695
Cultural Facilities and Capitol Resources Fund	1,434	1,500
Worker's Compensation Debt Reduction Fund	5,500	6,735
State Debt Reduction Fund	20,000	20,000
General Revenue Fund	1,514	1,815
Historic Resort Hotel Fund	34	14
Racing Commission	4,066	4,084
Non-Governmental Budgeted Transfers	10,112	12,159
Excess Lottery Surplus (General Fund)	-	18,355
Total State Excess Lottery Revenue Fund	<u>321,738</u>	<u>328,452</u>

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

10 - NONOPERATING DISTRIBUTIONS TO THE STATE OF WEST VIRGINIA (Continued)

	<u>2017</u>	<u>2016</u>
Total Required Statutory and Budgetary Distributions	<u>478,995</u>	<u>489,212</u>
Veterans Instant Ticket Fund	<u>630</u>	<u>745</u>
Total nonoperating distributions to the State of West Virginia (cash basis)	479,625	489,957
Accrued nonoperating distributions, beginning of year	(135,265)	(123,920)
Accrued nonoperating distributions, end of year	<u>132,693</u>	<u>135,265</u>
Total nonoperating distributions to the State of West Virginia	<u>\$ 477,053</u>	<u>\$ 501,302</u>

11 - RETIREMENT BENEFITS

All full-time Lottery employees are eligible and required to participate in the West Virginia Public Employees' Retirement System (PERS). The PERS is one of several plans administered by the West Virginia Consolidated Public Retirement Board (CPRB). The CPRB issues a publicly available financial report that includes financial statements for PERS that can be obtained at www.wvretirement.com.

Plan Description

PERS is a multiple employer defined benefit cost sharing public employee retirement system covering substantially all employees of the State and its component units, as well as employees of participating non-State governmental entities who are not participants of another state or municipal retirement system.

PERS provides retirement benefits as well as death and disability benefits. Qualification for normal retirement is age 60 with five years of service or at least age 55 with age and service equal to 80 or greater. For all employees hired after July 1, 2015, qualification for normal retirement is age 62 with 10 years of service or at least age 55 with age and service equal to 80 or greater. The straight-life annuity retirement benefit is equivalent to 2% of average salary multiplied by years of service. Average salary is the average of the three consecutive highest annual earnings out of the last fifteen years of earnings. For all employees hired after July 1, 2015, average salary is the average of the five consecutive highest annual earnings out of the last fifteen years of earnings. Terminated members with at least five years of contributory service who do not withdraw their accumulated contributions may elect to receive their retirement annuity beginning at age 62. For all employees hired after July 1, 2015, this age increases to 64.

Chapter 5, Article 10 of the West Virginia State Code assigns the authority to establish and amend the provisions of the plan to the State Legislature.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

11 - RETIREMENT BENEFITS (Continued)

Contributions

Per Chapter 5, Article 10, members hired prior to July 1, 2015 contribute 4.5% of annual earnings. All members hired July 1, 2015 and later, will contribute 6% of annual earnings. State and non-state governmental employers' contribution rates were 12.0%, 13.5% and 14.0% of covered employees' annual earnings for fiscal years ending June 30, 2017, 2016, and 2015, respectively. Contribution rates for members are established by statutes, subject to legislative limitations and are not actuarially determined. Contribution rates for employers are established by the Legislature. Although contributions are not actuarially determined, actuarial valuations are performed to assist the legislature in establishing appropriate contribution rates for employers. Contributions to the pension plan from the Lottery were \$862,728, \$979,596, and \$1,039,330 for the year ended June 30, 2017, 2016 and 2015, respectively.

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

At June 30, 2017 and 2016, respectively, the Lottery reported a liability of \$4,800,254 and \$3,044,279 for its proportionate share of the net pension liability. The net pension liability reported at June 30, 2017 was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of July 1, 2015, rolled forward to the measurement date of June 30, 2016 using the actuarial assumptions and methods described in the *Actuarial Assumptions* section of this note. The Lottery's proportion of the net pension liability was based on the Lottery's share of contributions to the pension plan relative to the contributions of all participating plan employers for the year ended June 30, 2016. At June 30, 2016, the Lottery's proportion was 0.52 percent, which is a decrease of .03 from its proportion as of June 30, 2015.

For the years ended June 30, 2017 and 2016, respectively, the Lottery recognized pension expense of \$765,956 and \$360,666. At June 30, 2017, the Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

	<u>June 30, 2017</u>	
	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Net difference between projected and actual earnings on pension plan investments	\$ 1,509	\$ -
Differences between expected and actual experience	400	-
Difference in assumptions	-	234
Changes in proportion and differences between Lottery contributions and proportionate share of contributions	23	133
Lottery contributions made subsequent to the measurement date of June 30, 2016	<u>863</u>	<u>-</u>
Total	<u>\$ 2,795</u>	<u>\$ 367</u>

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

11 - RETIREMENT BENEFITS (Continued)

	June 30, 2016	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual earnings on pension plan investments	\$ 929	\$ 1,596
Differences between expected and actual experience	623	-
Difference in assumptions	-	366
Changes in proportion and differences between Lottery contributions and proportionate share of contributions	42	36
Lottery contributions made subsequent to the measurement date of June 30, 2015	979	-
Total	\$ 2,573	\$ 1,998

The \$862,728 reported as deferred outflows of resources related to pensions resulting from Lottery contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year Ended June 30:</u>	
2018	\$ 232
2019	218
2020	653
2021	462

Actuarial Assumptions

The total pension liability in the June 30, 2016 actuarial valuation was determined using the following actuarial assumptions:

Inflation	3.0 percent
Salary increases	3.0 - 6.0 percent, average, including inflation
Investment rate of return	7.5 percent, net of pension plan investment expense

The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions:

Inflation	1.9 percent
Salary increases	3.0 - 6.0 percent, average, including inflation
Investment rate of return	7.5 percent, net of pension plan investment expense

Mortality rates were based on 110% of the RP-2000 Non-Annuitant, Scale AA for healthy males, 101% of RP-2000 Non-Annuitant Scale AA for healthy females, 96% of RP-2000 Disabled Annuitant, Scale AA for disabled males, and 107% of RP-2000 Disabled Annuitant, Scale AA for disabled females.

The actuarial assumptions used in the June 30, 2016 and 2015, valuation were based on the results of an actuarial experience study for the period July 1, 2009 through June 30, 2014.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

11 - RETIREMENT BENEFITS (Continued)

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-term Expected Rate of Return	Weighted Average Expected Real Rate of Return
US equity	27.5%	7.0%	1.92%
International equity	27.5%	7.7%	2.12%
Core fixed income	7.5%	2.7%	0.20%
High yield fixed income	7.5%	5.5%	0.41%
Real estate	10.0%	7.0%	0.70%
Private equity	10.0%	9.4%	0.94%
Hedge funds	10.0%	4.7%	0.47%
Total	100.00%		6.76%
Inflation (CPI)			1.90%
			<u>8.66%</u>

Discount Rate

The discount rate used to measure the total pension liability was 7.5%. The projections of cash flows used to determine the discount rates assumed that employer contributions will continue to follow the current funding policies. Based on those assumptions, the fiduciary net position of the plan was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rates of return on pension plan investments were applied to all periods of projected benefit payments to determine the total pension liabilities of the plan. Although discount rates are subject to change between measurement dates, there were no changes in the current period.

Regarding the sensitivity of the net pension liability to changes in the discount rate, the following table presents the Lottery's proportionate share of the net pension liability calculated using the current discount rate of 7.5% as well as what the Lottery's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate (in thousands):

	Net Pension Liability (Asset)
1% decrease (6.5%)	\$ 8,689
Current discount rate (7.5%)	\$ 4,800
1% increase (8.5%)	\$ 1,498

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

12 - OTHER POSTEMPLOYMENT BENEFITS (OPEB)

Plan Description

The Lottery participates in the West Virginia Other Postemployment Benefits Plan (OPEB Plan) of the West Virginia Retiree Health Benefit Trust Fund, a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the West Virginia Public Employees Insurance Agency (WVPEIA). The OPEB Plan provides retiree post-employment health care benefits for participating state and local government employers. The provisions of the Code of West Virginia, 1931, as amended (the Code), assigns the authority to establish and amend benefit provisions to the WVPEIA board of trustees. The WVPEIA issues a publicly available financial report that includes financial statements and required supplementary information for the OPEB Plan. That report may be obtained by writing to Public Employees Insurance Agency, 601 57th Street, S.E., Suite 2, Charleston, West Virginia, 25304-2345, or by calling 1-888-680-7342.

Funding Policy

The Code requires the OPEB Plan bill the participating employers 100% of the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GAAP. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. State of West Virginia plan employers are billed per active health policy per month.

The ARC rate is \$357 and \$429 per employee per month for the years ending June 30, 2017 and 2016, respectively. The Lottery's ARC was \$505,570, \$643,693, and \$600,469 and the Lottery has paid premiums of \$288,942, \$284,421, and \$287,861, which represent 57.2%, 44.2%, and 47.9% of the ARC, respectively, for the years ending June 30, 2017, 2016, and 2015. As of June 30, 2017, 2016, and 2015, the Lottery has recorded a liability of \$5,206,989, \$4,990,361, and \$4,631,089, respectively, for OPEB.

13 - LEASING ACTIVITY

The Lottery leases, under cancelable operating leases, various office spaces for field operations. The Lottery also leases various office equipment under agreements considered to be cancelable operating leases. Rental expense for the fiscal years ended June 30, 2017 and 2016 approximated \$394,515 and \$424,517 respectively.

The Lottery is a lessor of certain office space under the terms of cancellable operating leases to various tenants. Rental revenues for the years ended June 30, 2017 and 2016 were \$1,004,928 and \$593,960, respectively.

WEST VIRGINIA LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)**14 - COMMITMENTS**

The Lottery Commission has designated unexpended administrative funds from various fiscal years for the acquisition of capital assets. As of June 30, 2017 and 2016, \$9,460,433 and \$9,655,947, respectively, are included in unrestricted net position for this purpose.

15 - RISK MANAGEMENT

The Lottery is exposed to various risks of loss related to torts; theft of, or damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Lottery participates in several risk management programs administered by the State of West Virginia and other providers. Each of the state administered risk pools have issued separate audited financial reports on their operations. Those reports include the required supplementary information regarding the reconciliation of claims liabilities by type of contract and ten-year claim development information. Complete financial statements of the individual risk pools can be obtained directly from their respective administrative offices.

Public Employees' Insurance Agency (PEIA)

The Lottery participates in the Public Employees Insurance Agency (PEIA) which provides an employee benefit insurance program to employees. PEIA was established by the State of West Virginia for State agencies, institutions of higher education, Boards of Education and component units of the State. In addition, local governmental entities and certain charitable and public service organizations may request to be covered by PEIA. PEIA provides a base employee benefit insurance program which includes hospital, surgical, major medical, prescription drug and basic life and accidental death. Underwriting and rate setting policies are established by PEIA. The cost of all coverage, as determined by PEIA shall be paid by the participants. Premiums are established by PEIA and are paid monthly, and are dependent upon, among other things, coverage required, number of dependents, state vs. non state employees and active employees vs. retired employees and level of compensation. Coverage under these programs is limited to \$1 million for lifetime for health and \$10,000 of life insurance coverage.

The PEIA risk pool retains all risks for the health and prescription features of its indemnity plan. PEIA has fully transferred the risks of coverage of the Managed Care Organization (MCO) Plan to the plan provider, and has transferred the risks of the life insurance coverage to a third party insurer. PEIA presently charges equivalent premiums for participants in either the indemnity plan or the MCO Plan. Altogether, PEIA insures approximately 205,000 individuals, including participants and dependents.

Board of Risk and Insurance Management (BRIM)

The Lottery participates in the West Virginia Board of Risk and Insurance Management (BRIM), a risk pool currently operating as a risk management and insurance program for all State agencies, component units, and other local governmental agencies who wish to participate. The Lottery pays an annual premium to BRIM for its general insurance coverage. Underwriting and rate setting policies are established by BRIM. The cost of all coverage as determined by BRIM shall be paid by the participants. The BRIM risk pool retains the risk of the first \$1 million per property event and purchases excess insurance on losses above that level. Excess coverage through an outside insurer under this program is limited to \$200 million per event, subject to limits on certain property. BRIM has \$1 million per occurrence coverage maximum on all third-party liability claims. During the year ended June 30, 2017, no changes in coverage were made and paid claims did not exceed coverage.

Workers Compensation Insurance

The Lottery carries workers compensation insurance coverage through a commercial insurance carrier. The commercial insurance carrier is paid a monthly rated premium to provide compensation for injuries sustained in the course of employment.

WEST VIRGINIA LOTTERY
NOTES TO FINANCIAL STATEMENTS
(Continued)

16 - CONTINGENCIES

The Lottery is involved in certain claims and legal actions arising from the ordinary course of conducting business. Although the outcome of these claims and legal actions are presently indeterminable; it is the opinion of the Lottery's management, after a review of legal activities, that no adjustments to the financial statements are warranted and that any resolution of outstanding claims or legal actions are not expected to have a material adverse effect on the accompanying financial statements.

17 - EFFECT OF NEW ACCOUNTING PRONOUNCEMENTS

The GASB has issued two statements relating to accounting and financial reporting for pension and postemployment benefit plans: Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*; and Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 7*. The provisions of Statement Nos. 75 and 82 are effective for periods beginning after June 15, 2017. Lottery management has not determined the effect these statements will have on its financial statements.

The GASB has also issued Statement No. 87, *Leases*, which improves accounting and financial reporting for leases by governments. This Statement increases the usefulness of government's financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The provisions of this Statement are effective for reporting periods beginning after December 15, 2019. Lottery management has not determined the effect, if any, this statement will have on its financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

THE WEST VIRGINIA LOTTERY
 SCHEDULE OF THE PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
 (In Thousands)

Public Employees Retirement System Plan

	Years Ended June 30		
	2017	2016	2015
Lottery's proportion (percentage) of the net pension liability	0.52%	0.55%	0.55%
Lottery's proportionate share of the net pension liability	\$ 4,800	\$ 3,044	\$ 2,035
Lottery's covered payroll	\$ 7,259	\$ 7,421	\$ 7,415
Lottery's proportionate share of the net pension liability as a percentage of its covered payroll	66.12%	41.02%	27.44%
Plan fiduciary net position as a percentage of the total pension liability	86.11%	91.29%	93.98%

Note: All amounts presented are as of the measurement date,
 which is one year prior to the fiscal year end date.

THE WEST VIRGINIA LOTTERY
 SCHEDULE OF CONTRIBUTIONS TO THE PERS
 (In Thousands)

	Years Ended June 30				
	2017	2016	2015	2014	2013
Statutorily required contribution	\$ 863	\$ 980	\$ 1,039	\$ 1,075	\$ 1,072
Contributions in relation to the statutorily required contribution	<u>863</u>	<u>980</u>	<u>1,039</u>	<u>1,075</u>	<u>1,072</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Lottery's covered payroll	\$ 7,192	\$ 7,259	\$ 7,421	\$ 7,415	\$ 7,658
Contributions as a percentage of covered-employee payroll	12.00%	13.50%	14.00%	14.50%	14.00%

See Independent Auditor's Report and accompanying Notes to Required Supplementary Information.

THE WEST VIRGINIA LOTTERY

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

1 - TREND INFORMATION PRESENTED

The accompanying schedules of the Lottery's proportionate share of the net pension liability and contributions to PERS are required supplementary information to be presented for 10 years. However, until a full 10 year trend is compiled, information is presented in the schedules for those years for which information is available.

2 - PLAN AMENDMENT

The PERS was amended to make changes which apply to new employees hired July 1, 2015 and later, as follows:

- For employees hired prior to July 1, 2015, qualification for normal retirement is age 60 with five years of service or at least age 55 with age and service equal to 80 or greater. For employees hired July 1, 2015 and later, qualification for normal retirement is 62 with 10 years of service or at least age 55 with age and service equal to 80 or greater.
- The straight life annuity retirement benefit is equivalent to 2% of average salary multiplied by years of service. For employees hired prior to July 1, 2015, average salary is the average of the three consecutive highest annual earnings out of the last fifteen years of earnings. For all employees hired July 1, 2015 and later, average salary is the average of the five consecutive highest annual earnings out of the last fifteen years of earnings.
- For employees hired prior to July 1, 2015, terminated members with at least five years of contributory service who do not withdraw their accumulated contributions may elect to receive their retirement annuity beginning at age 62. For all employees hired July 1, 2015 and later, this age increases to 64.
- For all employees hired prior to July 1, 2015, employees are required to contribute 4.5% of annual earnings. All employees hired July 1, 2015 and later, are required to contribute 6% of annual earnings.

3 - ASSUMPTIONS

An experience study, which was based on the years 2009 through 2014, was completed prior to the 2015 actuarial valuation. As a result, several assumptions were changed for the actuarial valuations as follows:

	2016 and 2015	2014
Projected salary increases:		
State	3.0-4.6%	4.25-6.0%
Nonstate	3.35-6.0%	4.25-6.0%
Inflation rate	3.0% (2016), 1.9% (2015)	2.2%
Mortality rates	Healthy males - 110% of RP-2000 Non-Annuitant, Scale AA Healthy females - 101% of RP-2000 Non-Annuitant, Scale AA Disabled males - 96% of RP-2000 Disabled Annuitant, Scale AA Disabled females - 107% of RP-2000 Disabled Annuitant, Scale AA	Healthy males - 1983 GAM Healthy females - 1971 GAM Disabled males - 1971 GAM Disabled females - Revenue ruling 96-7
Withdrawal rates		
State	1.75-35.1%	1 - 26%
Non-state	2-35.8%	2 - 31.2%
Disability rates	0 - .675%	0 - .8%

**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**

West Virginia Lottery Commission
Charleston, West Virginia

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the West Virginia Lottery (the Lottery), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated September 26, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Lottery's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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 Lottery's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. 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 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 entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Gibbons & Kawash, A.C.

Charleston, West Virginia
September 26, 2017