COLORADO LOTTERY

FINANCIAL AND COMPLIANCE AUDIT

June 30, 2016 and 2015

LEGISLATIVE AUDIT COMMITTEE

Representative Tracy Kraft-Tharp – Chair	Senator Tim Neville – Vice-Chair
Senator Kerry Donovan	Representative Lori Saine
Senator Cheri Jahn	Senator Jim Smallwood
Representative Dan Nordberg	Representative Faith Winter

OFFICE OF THE STATE AUDITOR

Dianne E. Ray	State Auditor
Kerri Hunter	Deputy State Auditor
John Kormos	Contract Monitor
Eide Bailly LLP	Contractor

AN ELECTRONIC VERSION OF THIS REPORT IS AVAILABLE AT

WWW.STATE.CO.US/AUDITOR

A BOUND REPORT MAY BE OBTAINED BY CALLING THE

OFFICE OF THE STATE AUDITOR

303.869.2800

PLEASE REFER TO REPORT NUMBER 1620F WHEN REQUESTING THIS REPORT

Members of the Legislative Audit Committee:

We have completed the financial statement audit of the Colorado Lottery as of and for the years ended June 30, 2016 and 2015. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

Eide Bailly LLP

Golden, Colorado
January 3, 2017

Table of Contents

Contents Page

Report Summary 1

Background 2

Independent Auditor's Report 3

Management's Discussion and Analysis 6

Basic Financial Statements

Statements of Net Position 21

Statements of Revenues, Expenses and Changes in Fund Net Position 23

Statements of Cash Flows 25

Notes to Financial Statements 27

Required Supplementary Information

Schedule of the Colorado Lottery's Proportionate Share of the Net Pension Liability 56

Schedule of the Colorado Lottery's Contributions 57

Notes to the Required Supplementary Information 58

Supplementary Information

Schedule of Revenue and Costs for Scratch and Jackpot Games 59

Schedule of Percent of Prize Expense to Gross Ticket Sales 60

Budgetary Comparison 61

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on the Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* 62

Independent Auditor's Required Communication to Legislative Audit Committee 64

COLORADO LOTTERY
Report Summary
Years Ended June 30, 2016 and 2015

Purposes and Scope of Audit

Authority, Purpose and Scope

The Office of the State Auditor, State of Colorado, engaged Eide Bailly, LLP to conduct the financial audit of the Colorado Lottery for the Fiscal Year ended June 30, 2016. The audit of the Colorado Lottery (the Lottery) was performed under authority of Section 24-35-211, C.R.S., which requires the State Auditor to conduct an annual audit of the Lottery. The purpose of the audit was to express opinions on the financial statements of the Lottery for the years ended June 30, 2016 and 2015.

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

The purposes and scope of this audit were:

- To express opinions on the financial statements of the Lottery as of and for the years ended June 30, 2016 and 2015, including a review of the related systems of internal controls as required by auditing standards generally accepted in the United States of America.

- To review the Lottery's compliance with rules and regulations governing the expenditure of State funds for the year ended June 30, 2016.

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

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

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

Audit Opinions and Reports

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

Auditor's Communication to Legislative Audit Committee

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

COLORADO LOTTERY
Background
Years Ended June 30, 2016 and 2015

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

During Fiscal Year 2016, the Lottery employed 113 employees in its headquarters in Pueblo and branch offices in Denver, Fort Collins and Grand Junction.

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

Colorado Revised Statutes (C.R.S.) Section 24-35-210(9), requires that no less than 50% of the total revenue from sales of lottery tickets be for prizes. The legislation also provides guidelines for distribution of net proceeds to beneficiary agencies. “Net lottery proceeds” (that is, proceeds after the payment of prizes and lottery expenses and a reserve for future operations) are to be distributed to the Conservation Trust Fund within the Department of Local Affairs, the Division of Parks and Wildlife within the Department of Natural Resources, and the Great Outdoors Colorado Trust Fund (GOCO). The amount distributed to GOCO is limited by a constitutional cap, which was calculated to be $63.7 million for the year ended June 30, 2016.

Prior to 2002, amounts exceeding the GOCO cap (the spillover) were distributed to the State General Fund. For Fiscal Years 2002 through 2007, the spillover funds were distributed to the State Public School Fund Contingency Reserve. For Fiscal Year 2008, the spillover funds were transferred to the Lottery Proceeds Contingency Reserve Fund. For Fiscal Years 2009 through 2016, the spillover funds were required to be transferred to the Public School Capital Construction Assistance Fund.

Independent Auditor's Report

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

Report on the Financial Statements
We have audited the accompanying financial statements of the Colorado Lottery, an enterprise fund of the State of Colorado, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Colorado Lottery's basic financial statements as listed in the table of contents.

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

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

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

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

Opinions
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Colorado Lottery as of June 30, 2016 and 2015, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

440 Indiana St., Ste. 200 | Golden, CO 80401-5021 | TF 877.882.7929 | T 303.986.2454 | F 303.980.5029 | EOE

Relationship with the State of Colorado
As discussed in Note 1 – Nature of Operations and Summary of Significant Accounting Policies, the financial statements of the Colorado Lottery are intended to present the financial position and cash flows for only that portion of the financial reporting entity, the State of Colorado, which is attributable to the transactions of the Colorado Lottery. They do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2016 and 2015, and the changes in its financial position, or, where applicable, its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Correction of an Error
As discussed in Note 3 to the financial statements, the Colorado Lottery has removed the activity previously reported in the Powerball Annuity Winners Trust Fund as a result of evaluating the applicability of implementing the provisions of GASB Statement No. 72, *Fair Value Measurement and Application*. Accordingly, the 2015 trust fund financial statements have also been removed from the financial statements presented to reflect the adoption of these provisions. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 20, as well as the schedule of the Colorado Lottery's proportionate share of the net pension liability and the schedule of the Colorado Lottery's contributions for the Colorado Lottery's defined benefit pension plan on pages 56 through 58, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

Other Reporting Required by *Government Auditing Standards*
In accordance with *Government Auditing Standards*, we have also issued our report dated January 3, 2017 on our consideration of the Colorado Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Colorado Lottery's internal control over financial reporting and compliance.

Eide Bailly LLP

Golden, Colorado
January 3, 2017

This discussion and analysis of the Colorado Lottery's financial performance provides an overview of financial activities for the Fiscal Years ended June 30, 2016 and 2015. Please read it in conjunction with the Lottery's financial statements, which begin on page 21. These financial statements reflect only activities of the Colorado Lottery.

Games Offered by the Colorado Lottery

Currently, the Lottery offers two different ways to play: scratch games and jackpot games. Scratch games consist of pre-printed tickets that may be purchased for various prices ($1, $2, $3, $5, $10, $20 and $50) at any Lottery retailer. When scratched, they provide instant knowledge if the ticket is a winner and can be cashed immediately at the retailer if the amount of the winnings is $599 or less. Prizes over $599 must be redeemed at the Lottery offices. Jackpot games which include Powerball, Lotto, Cash 5, Mega Millions, and Pick 3, on the other hand, require a longer playing time. Tickets are also purchased at the Lottery retailers and are printed on ticket stock as the purchase is made. Each ticket contains one or possibly more playing boards for one draw or up to thirteen weeks of draws. Each board consists of a set of numbers, the combination of numbers required for play varying by game. The winning numbers for each game are posted after their respective draw nights with drawings held on every night of the week. Players must check their numbers against the numbers drawn for each respective game to determine if they have a winning ticket. The tickets may also be cashed at the retailer if the amounts of the winnings are $599 or less. Prizes over $599 must be redeemed at the Lottery offices.

Financial Highlights

- The Colorado Lottery's overall sales performance for Fiscal Year 2016 came in at $594.4 million, an all-time high in the Lottery's thirty-four year history. Fiscal Year 2013 sales of $566.3 million moved to second place, with Fiscal Year 2012 sales of $545.3 million moving to third. Overall sales for Fiscal Year 2016 reflected a $56.4 million or 10.5 percent increase from Fiscal Year 2015. The increase in sales in Fiscal Year 2016 over Fiscal Year 2015 was primarily due to a nearly sixty percent increase in Powerball sales tied to the nearly $1.6 billion jackpot witnessed in January 2016, plus a nearly five percent increase in overall scratch sales. The increase in scratch sales was primarily due to the introduction of the new $50 priced ticket resulting in $35.7 million in sales. These combined increases resulted in an all-around, record-breaking sales year. Fiscal Year 2016 scratch sales were $395.2 million, an $18.0 million increase, with jackpot game sales ending in $199.2 million, an increase of $38.4 million over the previous fiscal year. The previous overall scratch sales record was $377.2 million in Fiscal Year 2015 and the jackpot sales record was $197.7 million in Fiscal Year 2013.

- Funds distributed or available for distribution from Fiscal Year 2016 sales were nearly $143.6 million, another record in the Lottery's history, surpassing the previous high fiscal year record of $135.6 million in Fiscal Year 2013. Fiscal Year 2016 distributions included a spill-over of funds to the Public School Capital Construction Assistance Fund of nearly $8.1 million. This spill-over occurred when the Great Outdoors Colorado (GOCO) proceeds cap of $63.7 million in the current fiscal year was reached. The cap for GOCO is the 1992 base year amount of $35 million as adjusted for the annual change in the cost of living increase for the Denver-Boulder area. Since its start in Fiscal Year 2009, the spill-over going to Building Excellent Schools Today (BEST), a capital construction grant program administered by the Public School Capital Construction Assistance Fund has totaled $79.4 million.

- Fiscal Year 2016 gross profit (Lottery product sales minus costs tied directly to those sales) as a percent of sales decreased by 0.7 percent from the previous fiscal year (from 29.0 percent to nearly 28.3 percent).

Costs tied directly to sales include prize expense, retailer commissions and bonuses, scratch ticket costs and vendor fees charged for the use of the jackpot gaming systems provided by the third party vendor IGT. An increase in prize expense as a percentage of sales of 0.7 percent was the chief reason for the drop in the gross profit percentage. The increased prize expense as a percentage of sales seen in Fiscal Year 2016 was mainly due to the introduction of a new $50 scratch ticket which carries a higher prize expense percentage and to the same number of Lotto jackpots won by players as the previous fiscal year, despite a drop in Lotto sales. In addition, the purchase of a $4.9 million annuity for one of these Lotto jackpot winners was at a higher cost than paying out the cash value and, therefore, also increased the prize expense as a percentage of sales. All other costs as a percentage of sales combined for a nearly zero overall change. Slight increases in the costs of retailer bonuses and vendor fees as a percentage of sales were offset by small decreases in the costs of retailer commissions and cost of tickets as a percentage of sales.

- Total prize expense as a percentage of sales for all Lottery products increased from 61.6 percent to 62.3 percent in Fiscal Years 2015 and 2016, respectively, with an increase from 66.5 percent to 68.3 percent for scratch games and a slight increase from 50.2 percent to 50.5 percent for combined jackpot games. The increase in scratch prize expense as a percentage of sales in Fiscal Year 2016 was mainly due to the $50 scratch game introduction as previously mentioned, combined with a $2.4 million drop in the write off of unclaimed scratch prizes in Fiscal Year 2016. The increase in jackpot games prize expense percentage in Fiscal Year 2016 was mainly due to an increase in the Lotto prize expense percentage, with the number of Lotto jackpot wins remaining at eight as in Fiscal Year 2015, but with a drop in Lotto sales of $2.4 million from fiscal year to fiscal year.

- Retailer bonuses as a percentage of sales increased slightly for Fiscal Year 2016 from Fiscal Year 2015 while retailer commissions as a percentage of sales decreased slightly. Combined retailer commission and bonus costs as a percentage of sales in both Fiscal Years 2016 and 2015, however, were virtually the same at 7.4 percent. Cost of tickets sold and vendor fees as a percentage of sales combined to just over 2.0 percent in both Fiscal Years 2016 and 2015, with vendor fees as a percentage of sales increasing and ticket costs decreasing. Vendor fees increased slightly in Fiscal Year 2016 due to the increased use by Lottery players of the self-serving Gemini terminals to purchase their lottery tickets. Gemini terminal sales carry a slightly higher vendor fee rate than sales from the retailer manned terminals. Scratch ticket costs as a percentage of sales have declined in Fiscal Year 2016 due to the mix of scratch games offered and sold as compared to the previous year.

Using this Annual Report

This annual report consists of a series of financial statements. The statements of net position provide information about the Lottery's assets, liabilities and deferred inflows and outflows and reflect the Lottery's financial position as of June 30, 2016 and 2015. The statements of revenues, expenses and changes in net position report the activity of selling the Lottery products and the expenses related to such activity for the years ended June 30, 2016 and 2015. Finally, the statements of cash flows outline the cash inflows and outflows related to the activity of selling the Lottery products for the years ended June 30, 2016 and 2015.

Statements of Net Position

The statements of net position present a financial snapshot of the Lottery at June 30, 2016 and 2015. It presents the fiscal resources of the Lottery (assets), the consumption of net assets that is applicable to a future reporting period (deferred outflows), the claims against those resources (liabilities), the acquisition of net assets that is applicable to a future reporting period (deferred inflows) and the residual available for future operations (net position). Assets and liabilities are classified by liquidity as either current or noncurrent.

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

Condensed Statements of Net Position
June 30, 2016, 2015, and 2014

	2016	2015	2014
Assets			
Current assets	$ 70,565,459	$ 57,985,990	$ 57,706,896
Restricted assets	6,465,986	6,460,543	6,736,352
Capital assets	438,258	549,690	957,567
Total assets	$ 77,469,703	$ 64,996,223	$ 65,400,815
Deferred Outflows - Pensions	$ 2,865,826	$ 1,071,597	$ -
Liabilities			
Current liabilities	$ 73,990,705	$ 61,646,250	$ 61,723,207
Long-term liabilities	782,973	796,373	760,275
Net pension liability	25,257,445	23,627,441	-
Total liabilities	$ 100,031,123	$ 86,070,064	$ 62,483,482
Deferred Inflows - Pensions	$ 1,066,323	$ 136,155	$ -
Net Position			
Net Investment in Capital Assets	$ 438,258	$ 549,690	$ 957,567
Restricted – Licensed Agent Recovery Reserve	424,591	378,903	383,534
Restricted – Operating Reserve	1,500,000	1,500,000	1,400,000
Unrestricted - Unrealized Gain/Loss on Investments	333,176	125,007	176,232
Unrestricted - Unfunded Pension Liability	(23,457,942)	(22,691,999)	-
Total net position	$ (20,761,917)	$ (20,138,399)	$ 2,917,333

The Lottery's total assets at June 30, 2016 were $77.5 million. Assets consisted primarily of cash and investments of $50.1 million, including restricted balances of $1.9 million, receivables from Lottery retailers for the sales of Lottery products of $20.9 million, prepaid prize expense with Multi-State Lottery Association (MUSL) of over $4.5 million, scratch ticket inventory of nearly $1.5 million and a net investment in fixed assets of over $0.4 million.

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

Comparable figures at June 30, 2014 were $65.4 million in total assets, principally including cash and investments of $39.1 million, including restricted balances of $1.8 million, receivables from retailers of $18.9 million, prepaid prize expense with MUSL of over $4.9 million, scratch ticket inventory of $1.3 million and a net investment in fixed assets of nearly $1.0 million.

The Lottery's total assets increased by $12.5 million from Fiscal Year 2015 to Fiscal Year 2016. This increase was primarily made up of the increases in cash and investments of $11.6 million due to the nearly $12.0 million increase in the accrued prizes not yet paid to Lottery players, in receivables from Lottery retailers of nearly $0.7 million and in scratch ticket inventory of over $0.3 million, offset by slight decreases in MUSL prepaid prize and other prepaid expenses and in the net investment in fixed assets for a combined decrease of just over $0.1 million. The Lottery's total assets decreased by $0.4 million from Fiscal Year 2014 to Fiscal Year 2015. This decrease was primarily made up of the decreases in cash and investments of $0.7 million, in prepaid prize expense with MUSL of nearly $0.4 million, in scratch ticket inventory of over $0.1 million and in net investment in fixed assets of over $0.4 million, offset by the increase of $1.3 million in receivable from retailers, with no significant changes in any one other asset category.

The Lottery's total liabilities at June 30, 2016 totaled over $100.0 million, which consisted primarily of net pension liability of nearly $25.3 million recorded in accordance with Governmental Accounting Standards Board (GASB) Statement No. 68, GASB Statement No. 71 and GASB Statement No. 73, prize liability on all the Lottery products of nearly $38.0 million, proceeds distributions due to recipients of $31.9 million, nearly $1.0 million due to Lottery vendors and retailer bonus payments due of over $1.8 million.

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

The Lottery's total liabilities at June 30, 2014 totaled $62.5 million, which consisted primarily of prize liability on all Lottery products of $25.8 million, proceeds distributions due of $30.5 million, Lottery vendor payments due of $2.6 million and retailer bonus payments due of $1.5 million.

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

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

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

The Lottery's total net position decreased $0.6 million from June 30, 2015 to June 30, 2016. This included 1) a decrease in investment in capital assets of $111 thousand due to the depreciation expense of $443 thousand recognized in Fiscal Year 2016 combined with a net loss of $3 thousand on the disposal of fixed assets offset by current year additions of capital assets of $335 thousand; 2) an increase in the Licensed Agent Recovery Reserve (also known as bonding reserve) from $379 thousand to $425 thousand; 3) a net increase in unrealized gain on investments of $208 thousand resulting from a net increase in the adjustments on State Treasury investments, and 4) a net decrease in unfunded pension liability of $766 thousand. The fifth component operating reserve remained the same at $1.5 million.

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

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

The change in net position from June 30, 2014 to June 30, 2015 consisted of a decrease in investment in capital assets of $408 thousand due to depreciation expense of $557 thousand recognized in Fiscal Year 2015 offset by current year additions of capital assets of $149 thousand, a slight decrease in the bonding reserve from $384 thousand to $379 thousand, and increase in the operating reserve from $1.4 million to $1.5 million, a net decrease in unrealized gain on investments of $51 thousand and a net decrease in unfunded pension liability of $22.7 million.

Following is a schedule of net position for Fiscal Years 2015 and 2014:

	2015	2014	Change
Net Investment in Capital Assets	$ 549,690	$ 957,567	$ (407,877)
Restricted - Licensed Agent Recovery Reserve	378,903	383,534	(4,631)
Restricted - Operating Reserve	1,500,000	1,400,000	100,000
Unrestricted - Unrealized Gain or Loss on Investments	125,007	176,232	(51,225)
Unrestricted - Unfunded Pension Liability	(22,691,999)	-	(22,691,999)
Total net position	$ (20,138,399)	$ 2,917,333	$ (23,055,732)

Statements of Revenues, Expenses and Changes in Net Position

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

Condensed Statements of Revenues, Expenses and Changes in Net Position For the Fiscal Years Ended June 30, 2016, 2015, and 2014

	2016	2015	2014
Operating Revenues	$ 594,411,905	$ 538,025,144	$ 545,030,260
Direct Operating Expenses	426,499,528	382,148,410	387,530,205
Gross Profit on Sale of Tickets	167,912,377	155,876,734	157,500,055
Other Operating Expenses			
Marketing and communications	11,295,008	13,823,454	13,629,282
Wages and benefits	9,223,414	9,635,406	9,256,494
Other operating expenses	5,353,196	5,437,874	6,182,913
Total Other Operating Expenses	25,871,618	28,896,734	29,068,689
Other Operating Revenue	858,465	195,041	382,539
Total Operating Income	142,899,224	127,175,041	128,813,905
Nonoperating Revenues (Expenses)			
Investment income	813,205	442,094	554,251
Unfunded pension expense	(765,943)	(660,976)	-
Proceeds distributions	(143,570,004)	(127,980,868)	(130,113,508)
Total Nonoperating Expenses	(143,522,742)	(128,199,750)	(129,559,257)
Change in Net Position	(623,518)	(1,024,709)	(745,352)
Net Position, Beginning of Year	(20,138,399)	(19,113,690)	3,662,685
Net Position, End of Year	$ (20,761,917)	$ (20,138,399)	$ 2,917,333

Sales Activities

Revenues from the sales of Lottery products for the Fiscal Year ended June 30, 2016 were $594.4 million, the highest in the Lottery's thirty plus year history. Up from the previous fiscal year amount of $538.0 million, the $56.4 million increase represented a 10.5 percent increase from Fiscal Year 2015 sales. Overall sales for the Fiscal Year ended June 30, 2015 were down from the previous fiscal year amount of $545.0 million, with the $7.0 million decrease representing a 1.3 percent drop from Fiscal Year 2014 sales.

Continuing the climb from the previous fiscal year, Fiscal Year 2016 scratch sales of $395.2 million represented an $18.0 million or 4.8 percent increase over Fiscal Year 2015 scratch sales of $377.2 million, breaking the previous year's scratch sales record. The increase can be attributed to the introduction of the new $50 priced ticket resulting in $35.7 million sales combined with an increase in sales of $3.0 million and $0.7 million of the $5 and $2 priced tickets, respectively. Sales of the $1, $3, $10 and $20 priced tickets were all down by a combined total of $21.4 million with the biggest drop in the sales of the $20 scratch games by $12.5 million. The decline in sales of the $20 and $10 priced games was most likely a result of the introduction of the $50 game including the replacement of one of the $10 ticket slots with a slot for the new $50 game. The decline in sales of the $1 and $3 priced tickets, however, was due to a shift to the $5 scratch games.

On the rebound, Fiscal Year 2015 scratch sales of $377.2 million represented a $15.1 million or 4.2 percent increase over the prior fiscal year scratch sales of $362.0 million. The increase can be attributed to a $29.4 million jump in the sales of the $5 and $10 priced tickets offset by a $14.3 million drop in sales of the $1, $2, $3 and $20 priced tickets.

Jackpot game sales saw a $38.4 million increase in Fiscal Year 2016 from Fiscal Year 2015 primarily due to the $43.1 million or a 59.9 percent increase in Powerball sales. With a modest increase in Pick 3 sales of $215 thousand or 2.5 percent, all other jackpot games sales dropped by a combined total of just $4.9 million. The $4.9 million decrease in other jackpot games sales in the current fiscal year from the previous fiscal year consisted of a $2.4 million or an 8.1 percent decrease in Lotto sales; a $2.2 million or a 7.3 percent drop in Mega Millions sales and a $272 thousand or 1.4 percent decrease in Cash 5 sales. As previously mentioned in the *Financial Highlights* section, the unprecedented increase in Powerball sales was due to the nearly $1.6 billion Powerball jackpot seen in January 2016, causing a buying frenzy across the nation including in Colorado. The drop in Fiscal Year 2016 Lotto and Mega Millions sales can be attributed to the continued smaller jackpot amounts as seen in the previous year, which, as a rule, generate lower sales. Mega Millions sales, however, received a late boost with a growing jackpot at $390 million at year-end, the highest one of the fiscal year.

The decline in jackpot game sales in Fiscal Year 2015 was primarily due to the $12.5 million or 14.8 percent decrease in Powerball sales. Combined with double digit percentage drops in Mega Millions sales (15.7 percent) and Lotto sales (11.7 percent) for a total of over $9.7 million drop for the two games when compared to the prior fiscal year, total jackpot sales in Fiscal Year 2015 were down $22.1 million for Fiscal Year 2014. The other two jackpot games, Cash 5 and Pick 3, showed modest increases of less than one percent when compared to the prior fiscal year for a combined total of $141 thousand gain in sales.

The following tables compare Lottery product sales between fiscal years.

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

Product Sales	2015	2014	Difference	Change
Scratch	$ 377,164,257	$ 362,045,443	$ 15,118,814	4.2 %
Powerball	72,009,314	84,518,786	(12,509,472)	(14.8)
Lotto	29,837,628	33,809,181	(3,971,553)	(11.7)
Mega Millions	31,015,743	36,799,903	(5,784,160)	(15.7)
Cash 5	19,263,308	19,173,636	89,672	0.5
Pick 3	8,734,894	8,683,311	51,583	0.6
Total	$ 538,025,144	$ 545,030,260	$ (7,005,116)	

Other Operating Revenues

Other operating revenues for the Fiscal Years ended June 30, 2016 and June 30, 2015 totaled $0.9 million and $0.2 million, respectively. The major reason for the nearly $0.7 million increase seen in Fiscal Year 2016 was the increase in liquidated damages charged to Scientific Games for failure to satisfy or perform the duties and obligations as outlined in the Scratch ticket contract between the Lottery and Scientific Games.

Nonoperating Revenues

Nonoperating revenues for the years ended June 30, 2016 and June 30, 2015 totaled $0.8 million and $0.4 million, respectively. The major reason for the increase was the GASB Statement No. 31 adjustment recording the Lottery's share of the unrealized gains and losses on investments held by the Treasury which resulted in an increase in revenue of $259 thousand as a result of the change from a net loss of $51 thousand in Fiscal Year 2015 to a net gain of $208 thousand in Fiscal Year 2016. In addition, an increase in the average cash balances held offset by only a slight decrease in interest rates paid on investments in Fiscal Year 2016 contributed to the increase in revenues by $112 thousand in nonoperating interest revenue.

Total Revenues

Total revenues were $596.1 million and $538.7 million for the years ended June 30, 2016 and 2015, respectively. The major contributing factor to the increase in total revenues of approximately $57.4 million was primarily due to the 23.9 percent increase in total jackpot game sales combined with the 4.8 percent increase in scratch game sales for a total increase of $56.4 million in game sales in the current fiscal year. In addition, other operating revenue increased by nearly $0.7 million and investment income increase by $0.4 million as outlined above.

Major Expenses

Approximately $426.5 million of the Lottery's total expenses of $452.4 million for the Fiscal Year ended June 30, 2016 were incurred in direct support of the Lottery games. These expenses include prize expense, retailer compensation, money spent to purchase scratch tickets and compensation to the vendor who maintains and supports the jackpot gaming system. Of the $426.5 million spent in Fiscal Year 2016 for the direct support of the Lottery games, $370.5 million was for prize expense associated with those games.

In comparison, approximately $382.1 million of the Lottery's total expenses of $411.0 million for the Fiscal Year ended June 30, 2015 were game-related expenses. Of the $382.1 million spent in Fiscal Year 2015 for direct support of the Lottery games, $331.5 million was spent for prize expense associated with those games.

Total prize expense in Fiscal Year 2016 increased $39.0 million from Fiscal Year 2015. Based on the overall prize expense as a percentage of sales of 61.6 percent in Fiscal Year 2015 and on the overall sales increase of $56.4 million in Fiscal Year 2016, a $34.7 million increase in prize expense would have been expected. The additional $4.3 million increase in prize expense can be attributed to several factors. The new $50 scratch game, introduced in Fiscal Year 2016, had sales of $35.7 million; it also carried an 83.4 percent prize expense (partially up due to the accrual to prize expense of $3 million for the second chance drawing to be awarded at the end of the game). Using the scratch prize expense percentage of 66.5 percent of Fiscal Year 2015; this increased scratch prize expense by $6.0 million for these sales. The prize expense for all other scratch games was up slightly by 0.3 percent from Fiscal Year 2015 to Fiscal Year 2016 due to the $2.4 million drop in the amount of unclaimed tickets written off which ultimately reduces prize expense offset by the decrease in the average prize expense percentage due to a change of the scratch product mix of the remaining price points. Overall, the prize expense associated with the existing non-$50 scratch games rose by $1.1 million. On the jackpot game side, overall prize expense for all jackpot games was up slightly by 0.3 percent from Fiscal Year 2015 to Fiscal Year 2016 (50.2 percent to 50.5 percent) resulting in an increase to prize expense of $0.7 million based on sales of $199.2 million.

These increases for scratch and jackpot games all totaled $7.8 million. A 3.6 percent product shift, however, from scratch sales (70.1 percent of total sales to 66.5 percent) to jackpot sales (29.9 percent of sales to 33.5 percent) from Fiscal Year 2015 to Fiscal Year 2016 resulted in a decrease in prize expense of approximately $3.4 million due to the fact that jackpot games carry lower prize expense percentages than do scratch games. The end result was the $4.3 million increase in the expected prize expense.

Total prize expense in Fiscal Year 2015 decreased $5.0 million from Fiscal Year 2014. Generally, a decrease would be expected with an associated decrease in product sales as was seen in Fiscal Year 2015. As a percentage of sales, however, overall prize expense went down for 61.7 percent in Fiscal Year 2014 to 61.6 percent in Fiscal Year 2015. The decrease in the prize percentage was equivalent to a $0.7 million reduction in prize expense.

Overall scratch prize expense as a percentage of sales increased by 1.8 percent in Fiscal Year 2016 over the previous fiscal year. As mentioned directly above, the increase can be attributed mostly to the introduction of the $50 priced ticket and to a lesser degree to the $2.4 million drop in unclaimed prizes from Fiscal Year 2015 to Fiscal Year 2016. The increase was slightly offset by the change in the product mix of the existing price point games (the $1, $2, $3, $5, $10 and $20 games) resulting in a 0.3 percent drop in the prize expense percentage of sale for these games. Jackpot game prize expense as a percentage of sales experienced a small overall increase of 0.3 percent in Fiscal Year 2016 compared to Fiscal Year 2015.

This resulted in a $0.7 million increase in jackpot game prize expense from what was expected with the $20.0 million increase in jackpot sales based on the prior year's prize expense percentage of sales. The main reason for the jackpot prize expense increase was due to the over 4.0 percent increase in the Lotto prize expense percentage. With Lotto jackpot hits at eight in both Fiscal Year 2015 and 2016, the extra cost of $0.9 million to the Lottery to purchase the annuity for a $5.0 million jackpot was the reason for the increase. An increase in the write off of unclaimed jackpot prizes of $0.2 million slightly offset the increase in the jackpot prize expense percentage.

Scratch prize expense as a percentage of sales decreased by over 1.8 percent in Fiscal Year 2015 from Fiscal Year 2014. Over one half of this decrease was due to the $3.4 million increase in unclaimed prizes from the previous fiscal year. Starting in Fiscal Year 2012, Lottery management issued a directive to introduce scratch games with lower overall prize payouts, in order to increase the distributions to our proceeds recipients. In Fiscal Year 2015 a 1.0 percent drop in prize expense percentage compared to Fiscal Year 2014 was seen due to this directive. These decreases, however, were offset in Fiscal Year 2015 by a 0.2 percent increase in prize expense percentage due to the change in scratch ticket product mix. Overall jackpot game prize expense as a percentage of sales increased by an overall 1.5 percent in Fiscal Year 2015 compared to Fiscal Year 2014. The main reason for the increase was due to the nearly 5.0 percent increase in the Lotto prize expense percentage due to the increase in jackpot hits from five in Fiscal Year 2014 to eight in Fiscal Year 2015. Each Lotto jackpot hit increases the jackpot prize expense by $0.5 million. A decrease in the write off of unclaimed jackpot prizes of $0.9 million in Fiscal Year 2015 from Fiscal Year 2014 also contributed to the overall increase.

As a percentage of sales, the overall other game-related expenses other than prize expense were virtually the same at 9.4 percent for both Fiscal Year 2016 and Fiscal Year 2015. A slight increase in the vendor fees cost percentage was offset by a similar decrease in the cost of scratch tickets percentage.

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

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

Following are tables comparing the game-related expenses between Fiscal Years 2015 and 2014:

Game-Related Expenses	2015	% of Sales		2014	% of Sales		Difference	Change in % of Sales	
Prize Expense									
Scratch	$ 250,776,391	66.5	%	$ 247,349,989	68.3	%	$ 3,426,402	(1.8)	%
Powerball	34,701,513	48.2		40,130,951	47.5		(5,429,438)	0.7	
Lotto	16,356,901	54.8		16,846,382	49.8		(489,481)	5.0	
Mega Millions	14,827,976	47.8		17,627,121	47.9		(2,799,145)	(0.1)	
Cash 5	10,446,120	54.2		10,398,485	54.2		47,635	-	
Raffle	-	N/A		(40,120)	N/A		40,120	N/A	
Pick 3	4,390,086	50.3		4,198,685	48.3		191,401	2.0	
Total prize expense	331,498,987	61.6		336,511,493	61.7		(5,012,506)	(0.1)	
Retailer compensation									
Commissions	35,964,041	6.7		36,249,056	6.6		(285,015)	0.1	
Bonuses	3,851,251	0.7		3,963,926	0.7		(112,675)	-	
Ticket costs	2,480,847	0.5		2,601,233	0.5		(120,386)	-	
Vendor fees	8,353,284	1.5		8,204,497	1.5		148,787	-	
Total	$ 382,148,410	71.0	%	$ 387,530,205	71.1	%	$ (5,381,795)	(0.1)	%

Non game-related expenses totaled $25.9 million in Fiscal Year 2016 compared to $28.9 million in Fiscal Year 2015, a 10.5 percent or $3.0 million decrease. Of the $25.9 million expenses that were non game-related in Fiscal Year 2016, nearly $11.3 million, a $2.5 million drop from the previous fiscal year's amount of $13.8 million, was for marketing agency fees, promotions and institutional and product advertising. The decline was chiefly due to a nearly $2.6 million drop in specific product and proceeds advertising costs. Approximately $9.2 million, a $411,992 or 4.3 percent decrease from Fiscal Year 2015, was for wages and benefits. The decrease in wages and benefits in Fiscal Year 2016 was mainly the result of an over $403 thousand decline in wages due to vacancy savings associated with employee turnover and the timing of hiring replacements combined with an associated decline of $67 thousand in accrued annual and sick leave benefits. These decreases were partially offset by increases of $24 thousand in other employee benefits, namely in health insurance benefits and $34 thousand in purchased services for temporary help. The remainder of the changes to non-game-related expenses was mainly made up of an increase in equipment purchases offset by decreases to indirect cost allocations (the Lottery's share of Department of Revenue overhead) and depreciation.

Non game-related expenses totaled $28.9 million in Fiscal Year 2015 compared to $29.1 million in Fiscal Year 2014, a 0.6 percent or $172 thousand decrease. Of the $28.9 million expenses that were non game-related in Fiscal Year 2015, more than $13.8 million, slightly higher than the previous fiscal year's amount, was for promotions and institutional and product advertising. Approximately $9.6 million, a $379 thousand or 4.1 percent increase over Fiscal Year 2014, was for wages and benefits to Lottery employees. $1.6 million was paid to other state agencies, including indirect cost allocations paid to the Department of Revenue and to the Office of Information Technology. Additionally, deliver expense for scratch games made up $1.0 million of non-related expenses with building rental expense at over $0.7 million.

Nonoperating Expenses

Nonoperating expenses were $766 thousand in Fiscal Year 2016 for unfunded pension expense, tied to the requirements of GASB Statement No. 68, GASB Statement No. 71, and GASB Statement No. 73. Fiscal Year 2015 unfunded pension expense was $661 thousand.

Distributions to the Proceeds Recipients

The Lottery's proceeds distribution for Fiscal Year 2016 totaled $143.6 million, an increase of $15.6 million or 12.2 percent from Fiscal Year 2015's proceeds amount of nearly $128.0 million, and a record high in the Lottery's history. As a percentage of total revenue the Lottery returned 24.1 percent in Fiscal Year 2016, an increase of over 0.3 percent over the previous fiscal year. Of these total proceeds, $63.7 million, the cap amount, was allocated to the Great Outdoors Colorado Trust Fund, over $57.4 million to the Conservation Trust Fund and nearly $14.4 million to the Division of Parks and Outdoor Recreation per the distribution formula stated in Colorado Revised Statutes (C.R.S.) 24-35-210. Due to the fact that the maximum distribution to Great Outdoors Colorado of $63.7 million, pursuant to C.R.S. 33-60-104(1)(c) and 33-60-104(2), was reached, nearly $8.1 million spilled over into the Public School Capital Construction Assistance Fund pursuant to C.R.S. 22-43.7-104 (2)(b)(III).

Capital Assets

The Lottery's investment in net capital assets at June 30, 2016 and 2015 amounted to $0.4 million and $0.5 million, respectively. The investment in capital assets as of June 30, 2016 and 2015 included computer equipment, servers, back office computer system, drawing equipment, modular furniture, cameras, recorders and leasehold improvements net of accumulated depreciation. The asset values of equipment decreased by $60,190 from Fiscal Year 2015 to Fiscal Year 2016.

The decrease in equipment from Fiscal Year 2015 to Fiscal Year 2016 was due to the purchase and capitalization of a telephone server for $166 thousand, a digital draw system for $108 thousand and a back-up power server for $61 thousand, which was more than offset by the write off of miscellaneous computer equipment for $206 thousand, the old phone system for $69 thousand, mobile radios for $43 thousand, video conferencing equipment for $41 thousand, and miscellaneous other equipment for $36 thousand. The increase in asset values of equipment from Fiscal Year 2014 to Fiscal Year 2015 was due to the purchase and capitalization of miscellaneous computer equipment for $77 thousand and video conferencing equipment for $72 thousand. Capital assets are shown on the Statement of Net Position at the cost on the day of acquisition.

Analysis of changes in capital assets is as follows:

Capital Assets as of
June 30, 2016, 2015, and 2014

	2016	2015	2014
Capital Assets			
Equipment	$ 6,011,671	$ 6,071,861	$ 5,922,293
Leasehold Improvements	64,711	64,711	64,711
Less: Accumulated Depreciation	(5,638,124)	(5,586,882)	(5,029,437)
Net capital assets	$ 438,258	$ 549,690	$ 957,567

Budgetary Highlights

The Lottery's budget is determined by a variety of methods. The majority of the budget is set by the annual appropriations bill (the Long Bill), which determines budgets for every agency within the State. Many of the appropriation lines in the Long Bill are at the Department of Revenue (department) level, and the department has the discretion to allocate them among each agency within the department. The Long Bill and department level allocations are approved shortly before the start of each fiscal year. Agencies may also request a supplemental appropriation during the fiscal year to cover unexpected expenses (or a negative supplemental for less than expected expenses), as well as year-end transfers of spending authority, if needed. Department level re-allocations were approved in employee benefits, variable vehicle, legal services and vehicle lease payments. The final method of funding is special legislation. There was no special legislation affecting the Lottery's budget in Fiscal Year 2016.

The approved Lottery budget at the beginning of Fiscal Year 2016 was over $525.6 million. Department level reallocations approved throughout the fiscal year increased the budget slightly by $86,600 to an amended total of $525.7 million. Total expenditures and roll-forwards for Fiscal Year 2016 on a budget basis came to $453.0 million, resulting in excess appropriations (or savings) of nearly $72.7 million.

Economic Outlook

According to the June, 2016 Colorado Economic Outlook published by the Governor's Office of State Planning and Budgeting, "Colorado's economy continues to perform solidly overall". The only problem seen in our state is tight labor market conditions that are stifling business.

In spite of increased unemployment in the mining sector and the ongoing challenges faced by the oil and gas industry, employment for the state is forecast to grow 2.5 percent in 2017, which is the same as 2016. The unemployment rate in Colorado is expected to be 3.6% in 2017 compared to 3.3% in 2016. Housing construction is on the rise again, along with higher rent charges and home values, which is expected to stimulate employment and spending.

Building on the state's success, the Colorado Lottery is projecting sales of $589.9 million and proceeds to recipients of $132.4 million. Although spillover proceeds to the Building Excellent Schools Today (BEST) program will not be as high as Fiscal Year 2016, we are expecting to exceed the statutory capped amount that is distributed to Great Outdoors Colorado, resulting in spillover to the BEST program of $1.7 million.

The Lottery expects to achieve these goals by continuing to introduce new and different games in Fiscal Year 2017 and by enhancing existing products. The Lottery plans to launch at least two new licensed product scratch games in Fiscal Year 2017--a Frogger game based on the arcade game Frogger and a NASCAR game. Frogger will offer players the chance to enter a code off the ticket to play free an electronic version of Frogger on their computer or phone. This game will also be supported on our web site where players can play the actual Frogger video game. In the NASCAR game, players will be able to enter a drawing to win a trip to Las Vegas, which includes VIP passes to the 2017 NASACAR Awards Ceremony. Already reaping the rewards of the newly launched Lucky for Life jackpot game which started the summer of 2016, we are planning to introduce a second daily draw for the Pick 3 game in the fall and an enhancement to our Cash 5 game called EZ Match. EZ Match allows players a chance for an instant win in the game for an additional one dollar wager. It creates an additional play area displaying a series of five numbers and associated prizes. If any of those numbers match the numbers played in the Cash 5 base game, the player instantly wins the prize associated with that number. These both new and enhanced games are expected to increase sales in Fiscal Year 2017.

The Lottery also plans to introduce new sales channels such as Play at the Pump (PATP). PATP is tentatively scheduled to launch the summer of 2017 and would allow players to purchase Powerball, Mega Millions, and Lotto quick pick tickets at the gas pump in selected retail locations while still providing a commission to the Lottery retailers. Not only do we expect this new sales channel to enhance sales; but by offering Lottery products at the pump, we hope to reach a different demographic-- the people that do not go into convenience stores to purchase food, drinks, tobacco, and Lottery.

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

Contacting the Lottery's Financial Management

This management discussion and analysis report is designed to provide Colorado citizens, Colorado government officials, our players, retailers and other interested parties with a general overview of the Lottery's financial activity for Fiscal Year 2016 and to demonstrate the Lottery's accountability for the money generated from the sale of the Lottery products. If you have questions about this report or need additional information, contact John Caligaris, the Colorado Lottery's Controller, 225 North Main Street, Pueblo, CO 81003.

COLORADO LOTTERY
Statements of Net Position
June 30, 2016 and 2015

	2016	2015
ASSETS		
Current Assets:		
Cash and Investments	$ 48,143,610	$ 36,567,210
Accounts Receivable, net of the allowance for doubtful accounts of $203,463 in 2016 and $192,396 in 2015	20,877,979	20,217,923
Consignment Inventory, at Cost	95,370	97,796
Warehouse Inventory, at Cost	1,376,545	1,027,328
Prepaid Expenses	71,955	75,733
Total Current Assets	70,565,459	57,985,990
Reserved and Restricted Assets:		
Cash and Investments-Operating Reserve	1,500,000	1,500,000
Cash and Investments-Licensed Agent Recovery Reserve Receipts	424,591	378,903
Prepaid Prize Expense with MUSL	4,541,395	4,581,640
Total Reserved and Restricted Assets	6,465,986	6,460,543
Capital Assets:		
Equipment	6,011,671	6,071,861
Leasehold Improvements	64,711	64,711
Less Accumulated Depreciation and Amortization	(5,638,124)	(5,586,882)
Total Capital Assets	438,258	549,690
TOTAL ASSETS	77,469,703	64,996,223
DEFERRED OUTFLOWS - PENSIONS	2,865,826	1,071,597
TOTAL ASSETS AND DEFERRED OUTFLOWS	$ 80,335,529	$ 66,067,820

COLORADO LOTTERY
Statements of Net Position
June 30, 2016 and 2015

	2016	2015
LIABILITIES		
Current Liabilities:		
Accounts Payable	$ 963,432	$ 1,580,911
Prize Liability	37,970,798	26,019,403
Payable to MUSL	569,030	84,015
Accrued Annual and Sick Leave	-	36,427
Wages and Benefits	750,542	765,035
Retailer Bonus Liability	1,821,535	1,340,842
Funds Available for Distribution	31,915,368	31,819,617
Total Current Liabilities	73,990,705	61,646,250
Long-Term Liabilities:		
Accrued Annual and Sick Leave	747,820	756,884
Expired Warrants Liability	35,153	39,488
Net Pension Liability	25,257,445	23,627,442
Total Long-Term Liabilities	26,040,418	24,423,814
TOTAL LIABILITIES	100,031,123	86,070,064
DEFERRED INFLOWS - PENSIONS	1,066,323	136,155
NET POSITION		
Net Investment in Capital Assets	438,258	549,690
Restricted-Licensed Agent Recovery Reserve	424,591	378,903
Restricted-Operating Reserve	1,500,000	1,500,000
Unrestricted-Unrealized Gain/Loss on Investments	333,176	125,007
Unrestricted-Unfunded Pension Liability	(23,457,942)	(22,691,999)
TOTAL NET POSITION	(20,761,917)	(20,138,399)
TOTAL LIABILITIES AND NET POSITION	$ 80,335,529	$ 66,067,820

COLORADO LOTTERY
Statements of Revenues, Expenses, and Changes in Fund Net Position
For the Years Ended June 30, 2016 and 2015

	2016	2015
OPERATING REVENUES		
Gross Ticket Sales	$ 594,411,905	$ 538,025,144
DIRECT OPERATING EXPENSES		
Prize Expense	370,513,550	331,498,987
Retailer Commissions and Bonuses	43,922,306	39,815,292
Cost of Tickets and Vendor Fees	12,063,672	10,834,131
Total Direct Operating Expenses	426,499,528	382,148,410
GROSS PROFIT ON SALE OF TICKETS	167,912,377	155,876,734
OTHER OPERATING EXPENSES		
Marketing and Communications	11,295,008	13,823,454
Administration Fees Paid to MUSL	111,812	127,709
Wages and Benefits	9,223,414	9,635,406
Professional Services	255,983	308,721
State Agencies Services	745,102	724,982
Department of Revenue Services	434,425	529,826
Travel	103,110	103,739
Equipment (including loss on disposition of equipment of $3749 and $0, respectively)	458,148	104,848
Depreciation	442,583	557,445
Space Rental	790,701	775,080
Rents for Equipment	29,720	29,076
Motor Pool Leasing	292,821	311,069
Materials and Supplies	143,339	117,657
Telephone	240,517	307,533
On-Line Telecommunications	-	57,368
Data Processing Supplies and Services	-	35,657
Equipment Maintenance	202,905	208,613
Printing	18,128	18,227
Delivery Expense	923,863	961,753
Other	160,039	158,571
Total Other Operating Expenses	25,871,618	28,896,734
OTHER OPERATING REVENUE	858,465	195,041

COLORADO LOTTERY
Statements of Revenues, Expenses, and Changes in Fund Net Position
(Continued)
For the Years Ended June 30, 2016 and 2015

	2016	2015
TOTAL OPERATING INCOME	$ 142,899,224	$ 127,175,041
NONOPERATING REVENUES (EXPENSES)		
Investment Income	813,205	442,094
Unfunded Pension Expense	(765,943)	(660,976)
Funds Distributed for Current Year	(111,654,636)	(96,161,251)
Funds Available for Distribution for Current Year	(31,915,368)	(31,819,617)
Total Nonoperating Revenues (Expenses)	(143,522,742)	(128,199,750)
NET INCOME(LOSS)	$ (623,518)	$ (1,024,709)
NET POSITION, BEGINNING OF YEAR	(20,138,399)	(19,113,690)
Net Change in Net Position	(623,518)	(1,024,709)
NET POSITION, END OF YEAR	$ (20,761,917)	$ (20,138,399)

COLORADO LOTTERY
Statements of Cash Flows
For the Years Ended June 30, 2016 and 2015

	2016	2015
Cash Flows from Operating Activities		
Cash received from retailers	$ 595,446,771	$ 536,875,049
Cash paid in prizes	(358,758,960)	(331,401,331)
Cash paid in retailer commissions	(39,527,758)	(35,964,041)
Cash payments to suppliers	(29,343,208)	(30,212,388)
Cash payments to employees for services	(9,283,398)	(9,556,749)
Cash paid in retailer bonus	(3,915,411)	(4,044,768)
Net cash provided by operating activities	154,618,036	125,695,772
Cash Flows from Noncapital Financing Activities		
Distribution of net proceeds	(143,474,253)	(126,669,758)
Net cash used by noncapital financing activities	(143,474,253)	(126,669,758)
Cash Flows from Capital and Related Financing Activities		
Acquisition of capital assets	(334,900)	(149,568)
Net cash used by capital and related financing activities	(334,900)	(149,568)
Cash Flows from Investing Activities		
Interest received	605,036	493,319
Change in fair market value of investments	208,169	(51,225)
Net cash provided by investing activities	813,205	442,094
Increase (Decrease) in Cash and Investments	11,622,088	(681,460)
Cash and Investments, Beginning of Year (including $1,878,903 and $1,783,534, respectively, in restricted accounts)	38,446,113	39,127,573
Cash and Investments, End of Year, (including $1,924,591 and $1,878,903, respectively, in restricted accounts)	$ 50,068,201	$ 38,446,113

COLORADO LOTTERY
Statements of Cash Flows
(Continued)
For the Years Ended June 30, 2016 and 2015

		2016		2015
Reconciliation of Operating Income to Net Cash Provided by Operating Activities				
Operating income	$	142,899,224	$	127,175,041
Adjustments of reconcile operating income to net cash provided by operating activities				
Depreciation		442,583		557,445
Loss (gain) on disposition of equipment		3,749		-
Change in:				
Accounts Receivable		(660,056)		(1,294,395)
Warehouse and Consignment Inventory		(346,791)		130,541
Prepaid Expenses		3,778		107,931
Prepaid Prize Expense with MUSL		40,245		371,178
Liabilities (excluding funds available for distribution)		12,235,304		(1,351,969)
Net cash provided by operating activities	$	154,618,036	$	125,695,772
Reconciliation of Cash and Investments				
Cash and investments	$	48,143,610	$	36,567,210
Restricted cash and investments- Licensed Agent Recovery Reserve		424,591		378,903
Restricted cash and investments- Operating Reserve		1,500,000		1,500,000
Cash and Investments, End of Year	$	50,068,201	$	38,446,113

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

Nature of Operations

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

The financial statements reflect activities of the Lottery, an enterprise fund of the State of Colorado, for the Fiscal Years ended June 30, 2016 and 2015. The Lottery is an agency of the State of Colorado. The financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of Colorado that is attributable to the transactions of the Lottery in accordance with accounting principles generally accepted in the United States of America.

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

Use of Estimates

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

Fund Accounting

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

Enterprise Fund

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

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

Pensions

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

Basis of Accounting

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

Budget

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

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

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

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

Accounts Receivable and Allowance for Doubtful Accounts

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

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

The Lottery uses the specific identification method to determine expected uncollectibles. Under the provisions of Section 24-35-219, C.R.S., licensed agent recovery reserve receipts are collected from the retailers to cover uncollectible accounts. The accounts receivable and the licensed agent recovery reserve are shown net of estimated uncollectible receivables of $203,463 and $192,396 as of June 30, 2016 and 2015, respectively.

Warehouse Inventory

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

Consignment Inventory

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

Supplies Inventory

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

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

Prepaid Prize Expense

As part of the Lottery's agreement with MUSL, for both the Powerball and Mega Millions games, a certain percentage of sales must be paid to MUSL, when required, to bring the set prize and grand prize reserves up to the reserve requirement amounts as determined by MUSL. No payments were required to be made to the Powerball or Mega Millions reserves in Fiscal Years 2016 or 2015. However, during Fiscal Year 2016 a total of $36,063 was transferred from the Mega Millions Prize Reserve to cover the payment of lower-tier prizes causing a decrease in the prepaid prize expense with MUSL. In Fiscal Year 2015, effective October 1, 2014 and April 1, 2015, MUSL rebalanced both the Powerball and Mega Millions reserves and new reserve ceilings were determined for each member state. With the addition of Maryland, Wyoming and Puerto Rico as new MUSL members, the Colorado Lottery's reserve requirements were lowered. This resulted in refunds to the Lottery of $227,430 of the Powerball reserves and $133,396 of the Mega Million reserve causing a decrease in the prepaid prize expense with MUSL. In addition, with the Lottery's approval, MUSL holds small amounts in an unreserved account to be used to pay miscellaneous, unforeseen expenses. The unreserved account included in prepaid prize expense at June 30, 2016 was $0, a reduction of $4,182 from June 30, 2015.

Capital Assets

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

Deferred Outflows/Inflows of Resources

In addition to assets, the Statements of Net Position includes a separate section for deferred outflows of resources. This separate element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Lottery's Deferred Outflows – Pensions represents the amount of pension contributions made to the State pension plan subsequent to the December 31, 2015 measurement date, the deferred variance in expected to actual investment earnings and the deferred experience gains and losses.

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

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

Accrued Wages and Benefits

At the end of each fiscal year, the state shifts the pay date for the month of June for employees paid on a monthly basis, deferring the date from the last working day of June to the first working day of July. For the Lottery, along with other minor payroll accruals, this created a liability for accrued wages and benefits at June 30, 2016 and 2015 of $750,542 and $765,035, respectively.

Prize Liability and Prize Expense

Under the provisions of Section 24-35-210 (9), C.R.S., the Lottery must pay no less than fifty percent (50%) of total ticket sales as prizes. In the aggregate, the Lottery continues to meet this requirement. Additional prize expense and corresponding liability may be incurred as a result of market fluctuations in the cost of annuities used to pay Lotto jackpots (see Note 10).

All scratch, jackpot game and special drawing prizes are accounted for using the accrual basis of accounting. Scratch prize liability and expense are recognized at the point of ticket pack activation. The liability and expense for jackpot game prizes are recognized at the point of retail sale and are adjusted as the jackpot game draws occur and actual prize liability is determined. The liability for special drawing prizes is accrued on the first day of sales of the associated game. Prize liability for all games is reduced as prizes are paid to winners. The net prize liability at June 30, 2016 and 2015 was $37,970,798 and $26,019,403, respectively.

Payments of scratch prize amounts of $150 or less may be made at the Lottery or at the retail outlet; payment of scratch prize amounts of $151 to $599 may be made at the retailer level at the option of the retailer or at the Lottery. Scratch prizes of $600 or more are paid by the Lottery. Retailer accounts are credited for any prize payments retailers make on a daily basis. Prizes may be claimed up to 180 days after game-end. After the final claim date, any unclaimed scratch prizes accrued as a liability will result in a decrease to prize expense and any prizes claimed in excess of the liability accrued will result in an increase to prize expense. Net unclaimed scratch prizes resulted in a decrease to prize expense of $6,542,002 for Fiscal Year ended June 30, 2016 and $8,949,258 for the Fiscal Year ended June 30, 2015.

Payments of cumulative jackpot game prize amounts of $150 or less on a single ticket may be made at the Lottery or at the retail outlet; payment of cumulative prize amounts of $151 to $599 on a single ticket may be made at the retailer level at the option of the retailer or at the Lottery. Payment of cumulative prize amounts of $600 or more on a single ticket must be made at the Lottery. Retailer accounts are credited for any prize payments retailers make on a daily basis. Jackpot game prizes may be claimed up to 180 days after the date of the drawing. After the final claim date, unclaimed jackpot game prizes will result in a decrease to prize expense so long as the aggregate prize expense of all games exceeds or equals the statutory 50% of sales. In the event that the expiration of an unclaimed prize would result in the aggregate prize expense of all games to fall below the statutory 50% level, the unclaimed prize amount would remain in prize expense and be paid out to players as a guaranteed additional prize. Unclaimed jackpot game prizes resulted in a decrease to prize expense of $3,005,052 for the Fiscal Year ended June 30, 2016 and $2,815,686 for the Fiscal Year ended June 30, 2015.

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

Retailer Bonus Liability

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

The cashing bonus is accrued as tickets are sold and paid as winning tickets are redeemed. The write off of the accrued cashing bonus liability tied to unclaimed prizes at the end of the 180 day claim period in Fiscal Years 2016 and 2015 is recorded as a reduction of bonus expense.

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

Licensed Agent Recovery Reserve

Under the provisions of Section 24-35-219, C.R.S., a Licensed Agent Recovery Reserve, established on January 1, 1988, is used to maintain surety bond receipts collected from Lottery retailers. Billing rates are established by the Executive Director of the Department of Revenue and are reviewed on an annual basis. Retailers have the option to obtain private surety bond coverage at a rate of $2,000 surety coverage per outlet at their discretion. As of June 30, 2016 and June 30, 2015, the Lottery had reserved $424,591 and $378,903, respectively. The Lottery utilizes restricted net assets before using unrestricted net assets for bad debts.

Lottery Fund Net Position

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

In June 2002 the Lottery Commission approved a balance in net assets "equal to the net value of the Lottery's capital assets". As of June 30, 2016 and June 30, 2015, the Lottery had reserved $438,258 and $549,690, respectively.

In April 2005, the Lottery set up a separate operating reserve independent of the net capital asset reserve in the amount of $1.7 million. The amount held in this operating reserve is reviewed annually and adjusted accordingly. The annual reviews were completed in January 2015 and October 2014. The reserve remained at $1.5 million in Fiscal Year 2016 as in Fiscal Year 2015, in accordance with the reviews.

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

Equipment Expense

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

Compensated Leave

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

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

	June 30, 2014	Increases	Decreases	June 30, 2015
Annual leave	$ 595,033	$ 514,798	$ (431,861)	$ 677,970
Sick leave	113,004	37,676	(35,861)	114,819
Total annual and sick leave	708,037	552,474	(467,722)	792,789
Compensatory time	818	13,482	(13,778)	522
Total compensated leave	$ 708,855	$ 565,956	$ (481,500)	$ 793,311

The short-term portion of the above accrued annual and sick leave at June 30, 2016 and June 30, 2015 is $0 and $36,427, respectively. This represents the amount to be paid out to known current employees planning to retire and cash in their leave balances within the next twelve months.

Expired Warrants Liability

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

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

The Lottery must request reimbursement from the Unclaimed Property Fund for any warrants presented for payment that expired after June 30, 2003. No request for reimbursement was made for Fiscal Years ending June 30, 2016 and June 30, 2015 from the Unclaimed Property Fund.

Promotional Activity

The Lottery engages in three types of promotional activities in an attempt to enhance sales, to increase player awareness and to increase the player base: special promotions and drawings, direct give-aways, and buy x-get-y. The number and amount of promotional activities can and do vary year over year due to such factors as budget availability, retailer and special events participation, and new product introductions. Specific promotional coupons/tickets are distributed/awarded to players through special promotions and drawings and can be redeemed/claimed at any lottery office for a specified Lottery product. Specific promotional coupons/tickets with a total face value of $0 and $112 were redeemed in Fiscal Years ended June 30, 2016 and June 30, 2015, respectively.

Scratch and jackpot game tickets for specific games are given away as a more direct approach to introduce players to lottery games. During the Fiscal Years ended June 30, 2016 and 2015, scratch tickets with a total face value of $182,982 and $137,460, respectively, were given away. No free jackpot tickets were given away in Fiscal Year 2016 or Fiscal Year 2015.

For the “buy x-get-y” promotions, players are given the opportunity to receive a “free” jackpot ticket when a qualifying purchase is made, for instance buy five Lotto tickets receive a free Pick 3 ticket. During the Fiscal Year ended June 30, 2016, jackpot games tickets with a total face value of $239,160 were given away through this method. During the Fiscal Year ended June 30, 2015, jackpot games tickets with a total face value of $14,876 were given away. The increase in Fiscal Year 2016 over the previous fiscal year was mostly due to the introduction of a new “Sampler” promotion where players were given the opportunity to purchase a sample of all of the Lottery’s jackpot games while receiving one of the tickets for free.

Scratch and jackpot game tickets and coupon promotions are valued at cost. For the Fiscal Years ended June 30, 2016 and 2015, $281,220 and $117,713, respectively, were recorded as costs related to free tickets and coupons. These costs were included in Marketing and Communications expense in the statements of revenues, expenses and changes in fund net position for coupons redeemed and scratch and jackpot game tickets given away.

Reclassifications

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

Subsequent Events

The Lottery has evaluated subsequent events through January 3, 2017, the date which the financial statements were available to be issued.

NOTE 2 – Change in Accounting Policy

Implementation of GASB Statement No. 68, GASB Statement No. 71 and GASB Statement No. 73

Effective July 1, 2014 for Fiscal Year 2015, the Lottery adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. The implementation of these standards requires governments to calculate and report the costs and obligations associated with pensions in their basic financial statements. Employers are required to recognize pension amounts for all benefits provided through the plan which include the net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense.

NOTE 3 – Correction of an Error

Evaluation of implementation of GASB Statement No. 72, Fair Value Measurements and Application

As of July 1, 2015, the Lottery evaluated the applicability of guidance in GASB Statement No. 72, Fair Value Measurement and Application (Statement). This Statement provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements, as well as defines what constitutes an investment. Adoption of this Statement requires retroactive application by restating the financial statements in all prior periods presented.

As a result of the evaluation of the applicability of this standard, the Lottery determined that the assets and liabilities previously reported in the Powerball Annuity Winners Trust Fund did not represent assets or liabilities of the Colorado Lottery. The result of this determination is that the statements of fiduciary net position and statements of changes in fiduciary net position are no longer presented with the financial statements of the Colorado Lottery. The Colorado Lottery has made this determination as management believes this presentation more accurately reflects the assets and liabilities of the Colorado Lottery. Note 12 describes the Lottery's relationship with the Multi-State Lottery Association and additional information regarding the Powerball annuity.

NOTE 4 – CASH AND INVESTMENTS

Cash

Cash includes petty cash funds, change funds, an imprest account, a depository account and cash on deposit with the State Treasurer. A detail of cash at June 30, 2016 and 2015 is as follows:

	2016	2015
Petty cash	$ 1,100	$ 1,100
Change funds	72,000	72,000
Imprest account	180,000	190,000
Depository accounts	50,000	30,000
Cash on deposit with State Treasurer	47,840,510	36,274,110
Total unrestricted cash and investments	48,143,610	36,567,210
Restricted cash and investments - Licensed Agent		
Recovery Reserve Receipts on deposit with State Treasurer	424,591	378,903
Operating Reserve on deposit with State Treasurer	1,500,000	1,500,000
Total restricted cash and investments	1,924,591	1,878,903
Total cash and investments	$ 50,068,201	$ 38,446,113

Cash on Deposit with State Treasurer

Under the provisions of Section 24-35-210 (6), C.R.S., the State Treasurer shall invest the monies of the Lottery in excess of operating and prize payment expenses and all authorized transfers. Interest or any other return on investments is paid to the Lottery Fund account on a monthly basis. Actual interest payments are determined by the State Treasurer. The actual allocated interest rate for Fiscal Years 2016 and 2015 was 0.97% and 1.01%, respectively.

In addition, the State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1, C.R.S. Moneys deposited in the Treasury are invested until the cash is needed. As of June 30, 2016, the Lottery had cash on deposit with the State Treasurer of $49,765,101, which represented approximately 0.7 percent of the total $7,408.5 million fair value of deposits in the State Treasurer's Pool (Pool).

Effective July 1, 1997, with the Lottery's initial adoption of Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, all of the Treasurer's investments, which include the net Licensed Agent Recovery Reserve Receipts are reported at fair value, which is determined based on quoted prices in active markets for identical assets ($230 million) and significant other observable inputs ($7,178.5 million) at the fiscal year end. The State Treasurer does not invest any of the pool resources in any external investment pool, and there is no assignment of income related to participation in the Pool. Additional information on the Treasurer's Pool may be obtained in the State of Colorado's Comprehensive Annual Financial Report.

NOTE 4 – CASH AND INVESTMENTS (CONTINUED)

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

Deposits

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

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

Statements of Cash Flows

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

NOTE 5 – SCHEDULE OF CHANGES IN CAPITAL ASSETS

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

	June 30, 2014	Increases	Decreases	June 30, 2015
Capital assets being depreciated:				
Equipment and software	$ 5,922,293	$ 149,568	$ -	$ 6,071,861
Leasehold improvements	64,711	-	-	64,711
Total historical costs	5,987,004	149,568	-	6,136,572
Less accumulated depreciation for equipment	(4,990,611)	(544,538)	-	(5,535,149)
Less accumulated depreciation for leasehold improvements	(38,826)	(12,907)	-	(51,733)
Total accumulated depreciation	(5,029,437)	(557,445)	-	(5,586,882)
Total capital assets, being depreciated, net	$ 957,567	$ (407,877)	$ -	$ 549,690

NOTE 6 – OPERATING LEASES

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

Pueblo

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

Warehouse – The Lottery leases primary warehouse space from Santa Fe 250 LLC. The Lottery entered into a lease agreement, which began July 1, 2011 and expires June 30, 2016. A lease amendment was signed August 8, 2012 to reduce monthly rent payments on the warehouse loft space. The Lottery entered into a new lease agreement with Santa Fe 250 LLC which was signed by the State Controller's Office on June 10, 2016 and became effective July 1, 2016 and expires June 30, 2019. The warehouse loft space was eliminated from the agreement along with physical access to the loft. The lease contains an option to renew for two additional three-year term commencing on July 1, 2019. The lease also contains a holdover clause where the Lottery will become a month-to-month tenant if the Lottery fails to vacate the premises upon expiration or sooner termination of this lease. The rent to be paid by the Lottery during such continued occupancy shall be the same being paid by the Lottery as of the date of expiration or sooner termination. Landlord and the Lottery each hereby agree to give the other party at least thirty days written notice prior to termination of any holdover tenancy.

Denver

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

Warehouse – On December 11, 2009, the Lottery entered into a lease agreement with Valley Business Corp., Inc. beginning on December 11, 2009 and expiring on June 30, 2015. The lease contains an option to renew the lease for two (2) consecutive additional periods of five years each. The lease also contains a holdover provision, whereby if the Lottery fails to vacate the premises upon the expiration or sooner termination of the lease, the Lottery will continue making the same monthly rent payment in effect pursuant to the lease agreement as of the date of expiration or sooner termination of the lease. Valley Business Corp. Inc. and the Lottery both agree to give each other thirty (30) days written notice prior to the termination of a holdover tenancy period.

NOTE 6 – OPERATING LEASES (CONTINUED)

The Lottery executed Amendment #1 to the lease with Valley Business Corp. effective July 23, 2015, which extended the term of the lease from June 30, 2015 through June 30, 2020, and made certain modifications to the existing premises.

Fort Collins

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

Grand Junction

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

Wireless Jackpot Signage

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

			FUTURE MINIMUM LEASE PAYMENTS					
LOCATION	**FY 2015**	**FY2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**Later Years**
Pueblo Office	$ 263,854	$ 271,769	$ 273,238	$ 353,206	$ 363,685	$ 374,592	$ 385,713	$ 397,261
Pueblo Warehouse	163,895	163,341	168,805	168,805	168,805	-	-	-
Denver	203,509	214,073	211,608	217,589	223,570	-	-	-
Denver Warehouse	108,424	108,079	110,943	113,718	116,577	119,522	-	-
Fort Collins Office	26,888	25,611	-	-	-	-	-	-
Grand Jct Office	6,465	5,947	-	-	-	-	-	-
Parking	2,045	1,881	-	-	-	-	-	-
In-store signage	-	-	91,616	259,616	373,016	431,424	481,824	-
	$ 775,080	$ 790,701	$ 764,594	$ 853,318	$ 872,637	$ 494,114	$ 385,713	$ 397,261

NOTE 7 – OTHER REVENUE

A schedule of other revenue for the Fiscal Years ended June 30, 2016 and 2015 follows:

	2016	2015
License fees	$ 64,239	$ 65,898
Fines and penalties	738,404	32,687
Assignment fees	1,200	300
Net licensed agent recovery reserve receipts	45,688	(4,631)
Other	8,934	100,787
Total	$ 858,465	$ 195,041

NOTE 8 – DISTRIBUTION OF NET PROCEEDS

In accordance with Section 33-60-104, C.R.S., distributions of net proceeds shall be made on a quarterly basis. The State Treasurer shall distribute net lottery proceeds as follows: forty percent (40%) to the Conservation Trust Fund, ten percent (10%) to the Division of Parks and Wildlife and all the remaining net lottery proceeds in trust to the State Board of the Great Outdoors Colorado Trust Fund up to the statutory limit. Under Section 33-60-104(2), C.R.S., the limit is $35 million as adjusted annually based on the consumer price index, which was calculated to be $63.7 million for the year ended June 30, 2016. Any excess over the limit shall be transferred to the State Public School Capital Construction Assistance Fund.

Income available for distribution at June 30:

	2016	2015
Operating income	$ 142,899,224	$ 127,175,041
Plus: Investment income	813,205	442,094
Less: Unfunded pension expense	(765,943)	(660,976)
Income before distributions	142,946,486	126,956,159
Change in licensed agent recovery reserve	(45,688)	4,631
Change in fair market value of investments	(208,169)	51,225
Change in operating reserve	-	(100,000)
Change in investment in capital assets	111,432	407,877
Less: Unfunded pension expense not included in distribution calculation	765,943	660,976
Income available for distribution	143,570,004	127,980,868
Less distributions prior to year-end	(111,654,636)	(96,161,251)
Income available for distribution	$ 31,915,368	$ 31,819,617

NOTE 8 – DISTRIBUTION OF NET PROCEEDS (CONTINUED)

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

	Accrued at June 30, 2014	Proceed Distribution Expenses	Distributions Paid	Accrued at June 30, 2015
Great Outdoors Colorado	$ 10,518,911	$ 61,992,978	$ (58,599,537)	$ 13,912,352
Public School Capital Construction Assistance Fund	4,735,342	1,997,456	(4,735,342)	1,997,456
Conservation Trust Fund	12,203,403	51,192,347	(50,667,903)	12,727,847
Division of Parks and Outdoor Recreation	3,050,851	12,798,087	(12,666,976)	3,181,962
	$ 30,508,507	$ 127,980,868	$ (126,669,758)	$ 31,819,617

NOTE 9 – PENSION PLANS

Defined Benefit Pension Plan

Plan Description

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

NOTE 9 – PENSION PLANS (CONTINUED)

Benefits Provided

PERA provides retirement, disability, and survivor benefits. Retirement benefits are determined by the amount of service credit earned and/or purchased, highest average salary, the benefit structure(s) under which the member retires, the benefit option selected at retirement, and age at retirement.

Retirement eligibility is specified in tables set forth at C.R.S. § 24-51-602, 604, 1713, and 1714.

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

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

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

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

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

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

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

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

NOTE 9 – PENSION PLANS (CONTINUED)

Contributions

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

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

	Fiscal Year 2014		**Fiscal Year 2015**		**Fiscal Year 2016**	
	CY2013	*CY2014*	*CY2014*	*CY 2015*	*CY2015*	*CY 2016*
	7/1/13 - 12/31/13	1/1/14 - 6/30/14	7/1/14 - 12/31/14	1/1/15 - 6/30/15	7/1/15 - 12/31/15	1/1/16 - 6/30/16
Employer Contribution Rate	10.15%	10.15%	10.15%	10.15%	10.15%	10.15%
Amount of Employer Contribution Apportioned to the Heath Care Trust Fund as specified in C.R.S. Section 24-51-208(1)(f)	-1.02%	-1.02%	-1.02%	-1.02%	-1.02%	-1.02%
Amount Apportioned to the SDTF	9.13%	9.13%	9.13%	9.13%	9.13%	9.13%
Amortization Equalization Disbursement (AED) as specified in C.R.S. Section 24-51-411*	3.40%	3.80%	3.80%	4.20%	4.20%	4.60%
Supplemental Amortization Equalization Disbursement (SAED) as specified in C.R.S., Section 24-51-411	3.00%	3.50%	3.50%	4.00%	4.00%	4.50%
Total Employer Contribution Rate to the SDTF	15.53%	16.43%	16.43%	17.33%	17.33%	18.23%

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

Employer contributions are recognized by the SDTF in the period in which the compensation becomes payable to the member, which is when the Lottery is statutorily committed to pay the contributions to the SDTF. Employer contributions recognized by the SDTF from the Lottery were $1,142,872, $1,150,328 and $1,070,065 for the Fiscal Years ended June 30, 2016, 2015, 2014, respectively and represented 100% of the total required contributions for each year.

NOTE 9 – PENSION PLANS (CONTINUED)

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

At June 30, 2016, the Lottery reported a liability of $25,257,445 for its proportionate share of the net pension liability. The net pension liability was measured as of December 31, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2014. Standard update procedures were used to roll forward the total pension liability to December 31, 2015. The Lottery proportion of the net pension liability was based on the Lottery contributions to the SDTF for the calendar year 2015 relative to the total contributions of participating employers to the SDTF.

At December 31, 2015, the Lottery proportion was 0.2398382458 percent, which was a decrease of .0113434537 percent from its proportion of .2511816995 percent measured as of December 31, 2014. For the Fiscal Year ended June 30, 2016 and Fiscal Year ended June 30, 2015, the Lottery recognized pension expense of $1,974,400 and $1,880,856, respectively. At June 30, 2016, the Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Year ended June 30, 2016		Year ended June 30, 2015	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between actual and expected experience	$ 367,791	$ 816	$ -	$ 1,751
Changes of assumptions or other inputs	-	298,976	-	-
Net difference between projected and actual earnings on pension plan investments	1,919,444	-	481,766	-
Changes in proportion and differences between contributions recognized and proportionate share of contributions	-	766,531	-	134,404
Contributions subsequent to the measurement date	578,591	-	589,831	-
Total	$ 2,865,826	$ 1,066,323	$ 1,071,597	$ 136,155

The amount of $578,591 reported as deferred outflows of resources related to pensions, resulting from contributions subsequent to the measurement date, will be recognized as a reduction of the net pension liability in the Fiscal Year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Year Ending June 30,	
2017	$ 99,529
2018	221,882
2019	509,972
2020	389,530

NOTE 9 – PENSION PLANS (CONTINUED)

Actuarial assumptions

The total pension liability in the December 31, 2014 actuarial valuation was determined using the following actuarial assumptions and other inputs:

Actuarial cost method	Entry age
Price inflation	2.80 percent
Real wage growth	1.10 percent
Wage inflation	3.90 percent
Salary increases, including wage inflation	3.90 – 9.57 percent
Long-term investment Rate of Return, net of pension plan investment expenses, including price inflation	7.50 percent *
Future post-retirement benefit increases:	

*In setting the long-term expected rate of return, projections employed to model future returns provide a range of expected long-term results that, including expected inflation, ultimately support a long-term expected rate of return assumption of 7.50%.

PERA Benefit Structure hired prior to 1/1/07; and DPS Benefit Structure (automatic)	2.00 percent
PERA Benefit Structure hired after 12/31/06 (ad hoc, substantively automatic)	Financed by the Annual Increase Reserve

Mortality rates were based on the RP-2000 Combined Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements based on a projection of Scale AA to 2020 with Males set back 1 year, and Females set back 2 years.

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

Changes to assumptions or other inputs since the December 31, 2013 actuarial valuation are as follows:

- The following programming changes were made:
    - Valuation of the full survivor benefit without any reduction for possible remarriage.
    - Reflection of the employer match on separation benefits for all eligible years.
    - Reflection of one year of service eligibility for survivor annuity benefit.
    - Refinement of the 18 month annual increase timing.
    - Refinements to directly value certain and life, modified cash refund and pop-up benefit forms.

NOTE 9 – PENSION PLANS (CONTINUED)

- The following methodology changes were made:
  - Recognition of merit salary increases in the first projection year.
  - Elimination of the assumption that 35% of future disabled members elect to receive a refund.
  - Removal of the negative value adjustment for liabilities associated with refunds of future terminating members.
  - Adjustments to the timing of the normal cost and unfunded actuarial accrued liability payment calculations to reflect contributions throughout the year.

The SDTF's long-term expected rate of return on pension plan investments was determined using a log-normal distribution analysis in which best estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation.

As of the November 15, 2013 adoption of the long-term expected rate of return by the PERA Board, the target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	10 Year Expected Geometric Real Rate of Return*
U.S. Equity - Large Cap	26.76%	5.00%
U.S. Equity - Small Cap	4.40%	5.19%
Non U.S. Equity - Developed	22.06%	5.29%
Non U.S. Equity - Emerging	6.24%	6.76%
Core Fixed Income	24.05%	0.98%
High Yield	1.53%	2.64%
Long Duration Gov't/Credit	0.53%	1.57%
Emerging Market Bonds	0.43%	3.04%
Real Estate	7.00%	5.09%
Private Equity	7.00%	7.15%
Total	100.00%	

* In setting the long-term expected rate of return, projections employed to model future returns provide a range of expected long-term results that, including expected inflation, ultimately support a long-term expected rate of return assumption of 7.50%.

NOTE 9 – PENSION PLANS (CONTINUED)

Discount rate

The discount rate used to measure the total pension liability was 7.50 percent. The projection of cash flows used to determine the discount rate applied the actuarial cost method and assumptions shown above. In addition, the following methods and assumptions were used in the projection of cash flows:

- Total covered payroll for the initial projection year consists of the covered payroll of the active membership present on the valuation date and the covered payroll of future plan members assumed to be hired during the year. In subsequent projection years, total covered payroll was assumed to increase annually at a rate of 3.90%.

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

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

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

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

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

Based on the above actuarial cost method and assumptions, the SDTF's fiduciary net position was projected to be available to make all projected future benefit payments of current members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability. The discount rate determination does not use the Municipal Bond Index Rate. There was no change in the discount rate from the prior measurement date.

NOTE 9 – PENSION PLANS (CONTINUED)

Sensitivity of the Lottery proportionate share of the net pension liability to changes in the discount rate

The following presents the proportionate share of the net pension liability calculated using the discount rate of 7.50 percent, as well as what the proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.50 percent) or 1-percentage-point higher (8.50 percent) than the current rate:

	1% Decrease (6.50%)	Current Discount Rate	1% Increase (8.50%)
Proportionate share of the net pension liability	$ 31,909,231	$ 25,257,445	$ 19,693,447

Pension plan fiduciary net position

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

NOTE 10 – OTHER RETIREMENT PLANS

Defined Contribution Plan (DC Plan)

Plan Description

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

Funding Policy

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

NOTE 10 – OTHER RETIREMENT PLANS (CONTINUED)

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

	Fiscal Year 2014		**Fiscal Year 2015**		**Fiscal Year 2016**	
	CY2013	*CY2014*	*CY2014*	*CY 2015*	*CY2015*	*CY 2016*
	7/1/13 - 12/31/13	1/1/14 - 6/30/14	7/1/14 - 12/31/14	1/1/15 - 6/30/15	7/1/15 - 12/31/15	1/1/16 - 6/30/16
Amortization Equalization Disbursement (AED) as specified in C.R.S. Section 24-51-411	3.40%	3.80%	3.80%	4.20%	4.20%	4.60%
Supplemental Amortization Equalization Disbursement (SAED) as specified in C.R.S., Section 24-51-411*	3.00%	3.50%	3.50%	4.00%	4.00%	4.50%
Total Additional Employer Contribution Rate to the SDTF	6.40%	7.30%	7.30%	8.20%	8.20%	9.10%

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

Contribution requirements are established under Title 24, Article 51, Section 1505 of the C.R.S., as amended. Participating employees of the PERA DC Plan are immediately vested in their own contributions and investment earnings and are immediately 50 percent vested in the amount of employer contributions made on their behalf. For each full year of participation, vesting of employer contributions increases by 10 percent. Forfeitures are used to pay expenses of the PERA DC Plan in accordance with PERA Rule 16.08 as adopted by the PERA Board of Trustees in accordance with Title 24, Article 51, Section 204 of the C.R.S. As a result, forfeitures do not reduce pension expense.

401(k) Defined Contribution Plan

Plan Description

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

Funding Policy

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

NOTE 10 – OTHER RETIREMENT PLANS (CONTINUED)

457 Deferred Compensation Plan

The PERA Deferred Compensation Plan (457) was established July 1, 2009, as a continuation of the State's deferred compensation plan which was established for state and local government employees in 1981. At July 1, 2009, the State's administrative functions for the 457 plan were transferred to PERA, where all costs of administration and funding are borne by the plan participants. In calendar year 2015, participants were allowed to make contributions of up to 100 percent of their annual gross salary (reduced by their 8 percent PERA contribution) to a maximum of $18,000. Participants who are age 50 and older, and contributing the maximum amount allowable, were allowed to make an additional $6,000 contribution in 2015, for total contributions of $24,000. Contributions and earnings are tax deferred. At December 31, 2015, the plan had 17,814 participants.

The Lottery made contributions to other retirement plans totaling $16,978 during Fiscal Year 2016.

NOTE 11 – OTHER POSTEMPLOYMENT BENEFITS AND LIFE INSURANCE

Health Care Trust Fund

Plan Description

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

Funding Policy

The Lottery is required to contribute at a rate of 1.02 percent of PERA-includable salary for all PERA members as set by statute. No member contributions are required. The contribution requirements for the Lottery are established under Title 24, Article 51, Part 4 of the C.R.S., as amended. The apportionment of the contributions to the HCTF is established under Title 24, Article 51, Section 208(1)(f) of the C.R.S., as amended. For the Fiscal Years ending June 30, 2016, 2015 and 2014, the Lottery contributions to the HCTF were $64,484, $68,405 and $68,312, respectively, equal to their required contributions for each year.

NOTE 12 – CONTINGENCIES AND COMMITMENTS

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

The Lottery remains liable for the payment of the guaranteed prizes in the event the insurance companies issuing the annuity contracts default. The following estimated prize payments for which annuity contracts have been purchased are due in varying amounts and are estimated to continue through September 5, 2062 based on updated life expectancy tables.

Specified prize payments	$151,755,069
Lifetime prize payments	29,845,000
Total guaranteed prize payments	$181,600,069

Prize Commitment – The Lottery also acts as a transfer agent for the single Powerball Jackpot Winner on October 10, 2007. These funds are held in trust at the MUSL in securities deemed appropriate by the Grand Prize Trust Agreement. The future value of this prize was $16,226,000 as of June 30, 2016.

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

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

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

NOTE 12 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

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

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

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

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

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

Gaming Operations Commitments – The Lottery entered into long-term contracts with certain significant vendors related to providing jackpot data processing services and scratch tickets in support of the Lottery's gaming operations. The jackpot data processing contract with Scientific Games International (SGI) expired on October 31, 2014; however, the Lottery entered into a new contract with SGI effective January 17, 2014 extending the contract through November 1, 2014 considered the Conversion Period (no compensation period) due to the selection of and conversion to a new jackpot data processing vendor. The Lottery entered into a new contract with IGT formally GTECH, effective November 9, 2014 through June 30, 2021. The contract contains an Option to Extend for continued performance for up to a maximum of two (2) two-year extensions. Additionally, upon written notice the Lottery may unilaterally extend the term of the contract beyond the initial term or renewal term for a period not to exceed two months. Effective June 21, 2016 the Lottery amended the IGT contract to include the lease of new in-store wireless jackpot signs, as well as to provide service and replacement of existing in-store wireless jackpot signage. The Lottery also exercised the option to purchase 25 additional Lottery ticket vending machines. The maximum amount payable under the contract, excluding renewal terms if any, is $75,403,000. Payments for the jackpot data processing contracts were $10,254,260 for Fiscal Year ended June 30, 2016 and $9,182,393 for Fiscal Year ended June 30, 2015.

NOTE 12 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

The Lottery exercised the option to extend the contracts for three additional periods of 12 months with its three scratch ticket vendors beginning July 1, 2014 and ending on June 30, 2017. There are no other provisions for extension or renewal. The total costs of the three extended contracts are not to exceed a total of $11,566,320. Payments under the initial contracts were $2,811,440 and $2,350,306 for the Fiscal Years ended June 30, 2016 and 2015, respectively.

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

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

The total amount contributed by the Lottery to the Powerball prize reserves as of June 30, 2016 was $3,457,858 and is based on a percentage of sales. This amount is shown as prepaid prize expense – MUSL on the statements of net position. MUSL reserves the right to hold funds which do not exceed 110% of the required balance. If the actual balance in the reserves should exceed 110% of the required balance, MUSL will refund any funds in excess of the 110% threshold. As of June 30, 2016 the excess funds held by MUSL over Colorado's required reserves balance of $3,211,400 was $246,458, $74,682 less than the maximum allowable excess amount of $321,140.

In 2009, the Powerball and Mega Millions governing bodies entered discussions regarding cross-selling the Powerball and Mega Millions games, whereby each state currently selling Mega Millions tickets would also sell Powerball tickets and those states currently selling Powerball tickets would also sell Mega Million tickets. On March 10, 2010, the Lottery commission voted to allow the Colorado Lottery to participate in the cross-selling of the Mega Millions game. The rule became effective as of April 30, 2010 and the first day of ticket sales was May 16, 2010. MUSL agreed to undertake the administrative functions associated with the Mega Millions game for the states currently participating in their Powerball game. MUSL immediately began collecting a percentage of sales to fund the newly formed Mega Millions prize reserve fund. On March 22, 2013, the MUSL Mega Millions Game Group set the maximum prize reserve fund at $45 million. The Colorado Lottery's balance in the reserve as of June 30, 2016 was $1,083,537. For the Mega Millions reserve, MUSL also reserves the right to hold funds not to exceed 110% of the required balance. As of June 30, 2016 the excess funds held by MUSL over Colorado's required Mega Millions reserve balance of $1,015,316 was $68,221, $33,311 less than the maximum allowable excess amount of $101,532.

In addition, MUSL may deposit and hold any Unreserved Account Funds in trust for the benefit of member lotteries. These funds will not be comingled with any other funds held in trust and can be used only for authorized uses of the unreserved funds. MUSL held no amount in the unreserved fund as of June 30, 2016.

NOTE 12 – CONTINGENCIES AND COMMITMENTS (CONTINUED)

Other Major Vendor Commitments –The Lottery entered into a long-term contract with an advertising agency to provide advertising services to promote the Lottery's products beginning on July 1, 2012 and expiring on June 30, 2015. On June 22, 2015 the Lottery exercised the option for an additional term beginning July 1, 2015 and ending on June 30, 2016 and on May 11, 2016 exercised the option for the final twelve-month term beginning July 1, 2016 and ending on June 30, 2017. The total compensation allowed for services performed under the first Option Letter was $14,950,000, with payments totaling $10,595,661 for the Fiscal Year ended June 30, 2016. Payments under the final year of the original contract were $12,730,316 for the Fiscal Year ended June 30, 2015.

Litigation – Currently, there is no reportable outstanding litigation.

NOTE 13 – TAX, SPENDING AND DEBT LIMITATIONS

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

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

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

NOTE 14 – RELATED PARTY TRANSACTIONS

The Lottery, as an agency of the State of Colorado, paid fees to other agencies of the state for auditing, legal and other services and vehicle and office rent. The Lottery also pays fees to the Department of Revenue for indirect costs and the Governor's Office of Information Technology for information and communications technology (ICT) services. Interagency charges were $1,530,473 and $1,634,921 for the Fiscal Years ended June 30, 2016 and 2015, respectively.

REQUIRED SUPPLEMENTARY INFORMATION

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

Last 10 Fiscal Years*

	2015	2014
Lottery's proportion of the net pension liability	0.2398382458%	0.2511816995%
Lottery's proportionate share of the net pension liability	$ 25,257,445	$ 23,627,442
Lottery's covered-employee payroll	$ 6,590,924	$ 6,673,901
Lottery's proportionate share of the net pension liability as a percentage of its covered-employee payroll	383.22%	354.03%
Plan fiduciary net position as a percentage of the total pension liability	56.10%	59.80%

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

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

Last 10 Fiscal Years*

	2016	2015
Contractually required contribution	$ 1,142,872	$ 1,150,328
Contributions in relation to the contractually required contribution	(1,142,872)	(1,150,328)
Contribution deficiency (excess)	$ -	$ -
Lottery's covered-employee payroll	$ 6,353,094	$ 6,739,389
Contributions as a percentage of covered-employee payroll	17.99%	17.07%

* The amounts presented for each fiscal year were determined as of 6/30.
* Fiscal year 2015 was the 1st year of implementation, therefore only two years are shown.

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

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

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

SUPPLEMENTARY INFORMATION

COLORADO LOTTERY
Schedule of Revenue and Costs for Scratch and Jackpot Games
For the Fiscal Year Ended June 30, 2016

	Scratch	Jackpot Games: Lotto	Jackpot Games: Powerball	Jackpot Games: Cash 5	Jackpot Games: Mega Millions	Jackpot Games: Pick 3	FY 2016 Total	FY 2015 Scratch and Jackpot Games
TICKET SALES	$ 395,162,447	$ 27,422,320	$ 115,122,117	$ 18,991,636	$ 28,763,801	$ 8,949,584	$ 594,411,905	$ 538,025,144
PRIZE EXPENSE	(269,831,938)	(16,170,096)	(55,934,400)	(10,399,581)	(13,838,464)	(4,339,071)	(370,513,550)	(331,498,987)
NET REVENUE AFTER PRIZES	125,330,509	11,252,224	59,187,717	8,592,055	14,925,337	4,610,513	223,898,355	206,526,157
COMMISSIONS, BONUSES, TICKET COSTS & VENDOR FEES (Note 1)								
Retailer Commission	(27,600,712)	(1,642,108)	(6,891,639)	(1,136,863)	(1,721,132)	(535,304)	(39,527,758)	(35,964,041)
Retailer Bonus	(3,459,263)	(155,517)	(441,983)	(153,718)	(123,225)	(60,842)	(4,394,548)	(3,851,251)
Cost of Tickets Sold	(2,486,931)	N/A	N/A	N/A	N/A	N/A	(2,486,931)	(2,480,847)
Telecomm Reimbursements	512,418	35,559	149,282	24,627	37,299	11,605	770,790	777,190
On-Line Vendor Fees	(6,910,871)	(479,115)	(1,962,576)	(332,083)	(503,988)	(158,898)	(10,347,531)	(9,130,474)
TOTAL	(39,945,359)	(2,241,181)	(9,146,916)	(1,598,037)	(2,311,046)	(743,439)	(55,985,978)	(50,649,423)
GROSS PROFIT ON SALE OF TICKETS	$ 85,385,150	$ 9,011,043	$ 50,040,801	$ 6,994,018	$ 12,614,291	$ 3,867,074	$ 167,912,377	$ 155,876,734
AVERAGE DAILY TICKET SALES	$ 1,079,679	$ 74,924	$ 314,541	$ 51,890	$ 78,590	$ 24,452	$ 1,624,076	$ 1,474,041

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

COLORADO LOTTERY
Schedule of Percent of Prize Expense to Gross Ticket Sales
For the Fiscal Year Ended June 30, 2016

		Jackpot Games					FY 2016	FY 2015
	Scratch	Lotto	Powerball	Cash 5	Mega Millions	Pick 3	Total	Total
Prize Expense	$ 269,831,938	$ 16,170,096	$ 55,934,400	$ 10,399,581	$ 13,838,464	$ 4,339,071	$ 370,513,550	$ 331,498,987
(/)Ticket Sales	$ 395,162,447	$ 27,422,320	$ 115,122,117	$ 18,991,636	$ 28,763,801	$ 8,949,584	$ 594,411,905	$ 538,025,144
Prize %	68.28%	58.97%	48.59%	54.76%	48.11%	48.48%	62.33%	61.61%

COLORADO LOTTERY
Budgetary Comparison
For the Fiscal Year Ended June 30, 2016

	Fiscal Year 2016 Original Budget	Supplemental Allocations & Internal Transfers	Fiscal Year 2016 Final Budget	Fiscal Year 2016 Actual Expenditures	Under Expended	Percent Under Expended
Personal Services	$ 9,500,081	$ -	$ 9,500,081	$ 7,850,149	$ 1,649,932	17.37%
Amortization Equalization	324,547	-	324,547	286,721	37,826	11.66%
Supplemental Amort. Equal.	313,483	-	313,483	276,897	36,586	11.67%
Workmen's Compensation	93,111	-	93,111	93,111	-	0.00%
Health and Life	1,031,570	-	1,031,570	961,867	69,703	6.76%
Short Term Disability	16,059	-	16,059	12,754	3,305	20.58%
Operating	1,203,156	-	1,203,156	1,056,396	146,760	12.20%
Variable Vehicle	163,062	-	163,062	158,070	4,992	N/A
Leased Space	748,017	34,100	782,117	782,874	(757)	-0.10%
Leased Space-Grand Junctior	5,947	-	5,947	5,947	-	0.00%
Risk Management	27,896	-	27,896	27,896	-	0.00%
Vehicle Lease Payments	153,061	-	153,061	133,576	19,485	12.73%
Travel	113,498	-	113,498	103,110	10,388	9.15%
Marketing, Communications & Sales	14,700,000	-	14,700,000	11,138,537	3,561,463	24.23%
Payments to Other Agencies	239,410	-	239,410	92,338	147,072	61.43%
Legal Services	28,408	52,500	80,908	83,753	(2,845)	-3.52%
Indirect Costs	460,259	-	460,259	434,425	25,834	5.61%
Ticket Costs-Scratch	6,578,000	-	6,578,000	3,477,220	3,100,780	47.14%
Research	250,000	-	250,000	156,225	93,775	37.51%
Vendor Fees	12,571,504	-	12,571,504	10,764,406	1,807,098	14.37%
Prize Payments	424,104,016	-	424,104,016	370,513,550	53,590,466	12.64%
Retailer Compensation	52,241,350	-	52,241,350	43,922,306	8,319,044	15.92%
Multi-State Lottery Fund	177,433	-	177,433	111,812	65,621	36.98%
CORE Conversion	26,567	-	26,567	26,567	-	0.00%
OIT Payments	569,011	-	569,011	569,011	-	0.00%
TOTAL	$ 525,639,446	$ 86,600	$ 525,726,046	$ 453,039,518	$ 72,686,528	13.83%

FY16 Staffing-FTE-Note 1	117.1	(Appropriated)	112.5	(Actual)

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

Expenses Per Statement of Revenues, Expenses and Changes in Net Position

Prize Expense	$ 370,513,550
Commissions and Bonuses	43,922,306
Cost of Tickets & Vendor Fees	12,063,672
Operating Expenses	25,871,618
Total Expenses per Statement of Revenues, Expenses and Changes in Net Position	452,371,146
Telecommunications offset classified as revenue	770,790
Less: Non-Appropriated Expenses	
Depreciation	(442,583)
Accrued Annual and Sick Leave	9,014
Book Value of Assets Written Off	(3,749)
Sub-Total	452,704,618
Plus: Capitalized Purchases	334,900
	$ 453,039,518

Note 1 - The Governor's budget office has informed the departments that the appropriated FTE can be exceeded by 10% for FY 2016.

EideBailly
CPAs & BUSINESS ADVISORS

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Colorado Lottery, an enterprise fund of the State of Colorado as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Colorado Lottery's basic financial statements, and have issued our report thereon dated January 3, 2017.

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

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

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

440 Indiana St., Ste. 200 | Golden, CO 80401-5021 | TF 877.882.7929 | T 303.986.2454 | F 303.980.5029 | EOE

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

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

Eide Bailly LLP

Golden, Colorado
January 3, 2017

January 3, 2017

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

We have audited the basic financial statements of the Colorado Lottery, an enterprise fund of the State of Colorado, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated June 9, 2016. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Colorado Lottery are described in Note 1 to the financial statements.

During 2016, the Colorado Lottery evaluated the applicability of guidance in GASB Statement No. 72, *Fair Value Measurement and Application.* As a result of the evaluation of this new standard effective for the year ended June 30, 2016, management determined that amounts previously reported in the Powerball Annuity Winners Trust Fund did not represent assets or liabilities of the Colorado Lottery. As such, the statements of fiduciary net position and statements of changes in fiduciary net position have been removed from the Colorado Lottery's financial statements. This has been reported as a correction of an error in Note 3 of the financial statements.

We noted no transactions entered into by the Colorado Lottery during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the Colorado Lottery's financial statements were:

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

440 Indiana St., Ste. 200 | Golden, CO 80401-5021 | TF 877.882.7929 | T 303.986.2454 | F 303.980.5029 | EOE

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

The disclosure of Correction of an Error in Note 3, as this disclosure presents information regarding the determination that the Powerball Annuity Winners Trust Fund be removed from the Colorado Lottery's financial statements.

The disclosure of Distributions of Net Proceeds in Note 8, as this disclosure presents information regarding performance of the Lottery's commitment to funding beneficiaries throughout the State of Colorado.

The disclosure of Pension Plans in Note 9, which presents the Colorado Lottery's deferred inflows and outflows of resources related to the defined benefit pension plan, as well as summarizes actuarial assumptions used in determining the Colorado Lottery's estimated total pension liability.

The disclosure of Contingencies and Commitments in Note 12, which summarize the Colorado Lottery's commitments to pay annuities to prior Lotto jackpot winners, as well as gaming operations and major vendor commitments.

The disclosure of Tax, Spending, and Debt Limitations in Note 13, which discloses that the net proceeds from the Colorado Lottery are excluded from the scope of TABOR.

The disclosure of Related Party Transactions in Note 14, which discloses the nature of the Colorado Lottery's relationship with the State of Colorado and interdepartmental fees paid as a result of this relationship.

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

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. There were no corrected or uncorrected misstatements during Fiscal Year 2016.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated January 3, 2017.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations.
If a consultation involves application of an accounting principle to the Colorado Lottery’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Colorado Lottery’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We applied certain limited procedures to management’s discussion and analysis, the schedule of the Colorado Lottery’s proportionate share of the net pension liability, and the schedule of the Colorado Lottery’s contributions for the Colorado Lottery’s defined benefit pension plan, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding 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 did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the Schedule of Revenues and Costs for Scratch and Jackpot Games, the Schedule of Percent of Prize Expense to Gross Ticket Sales, and the Budgetary Comparison, which accompany the financial statements but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

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

Very truly yours,

Eide Bailly LLP

Golden, Colorado