

**MINNESOTA STATE LOTTERY**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGE IN NET POSITION**  
**YEARS ENDED JUNE 30, 2016 and 2015**

|  | <b>2016</b>           | <b>2015</b>            |
|--|-----------------------|------------------------|
| <b>Operating Revenues:</b>                                 |                       |                        |
| Scratch Ticket Sales                                       | \$ 394,761,644        | \$ 376,195,747         |
| Online Ticket Sales  | 198,091,164           | 170,672,222            |
| Other Income   | <u>14,783</u>         | <u>26,970</u>          |
| Total Operating Revenues                                   | 592,867,591           | 546,894,939            |
| Less: In-Lieu-of-Sales Tax                                 | <u>38,535,433</u>     | <u>35,546,418</u>      |
| Gross Receipts   | <u>554,332,158</u>    | <u>511,348,521</u>     |
| <b>Direct Costs:</b>                                       |                       |                        |
| Scratch Ticket Prizes                                      | 264,542,148           | 249,885,363            |
| Online Ticket Prizes                                       | 101,358,067           | 85,313,450             |
| Online Vendor Expense                                      | 13,951,066            | 10,404,691             |
| Ticket Costs   | 5,977,756             | 6,064,450              |
| Retailer Commissions and Incentives (Note 11)              | <u>35,636,934</u>     | <u>32,873,107</u>      |
| Total Direct Costs   | <u>421,465,971</u>    | <u>384,541,061</u>     |
| Gross Profit   | <u>132,866,187</u>    | <u>126,807,460</u>     |
| <b>Operating Expenses: (Note 12)</b>                       |                       |                        |
| Advertising (Note 12)                                      | 5,969,027             | 6,970,958              |
| Salaries and Benefits (Note 13)                            | 10,968,961            | 11,259,768             |
| Promotion  | 2,278,754             | 1,304,480              |
| Purchased Services   | 1,657,079             | 1,696,587              |
| Communication  | 590,146               | 556,632                |
| Occupancy Costs (Note 9)                                   | 1,567,685             | 1,469,382              |
| Supplies and Materials                                     | 962,875               | 878,946                |
| Computer and Omnipoint Maintenance                         | 466,069               | 437,347                |
| Depreciation   | 598,425               | 659,856                |
| Other Expense  | <u>335,136</u>        | <u>461,714</u>         |
| Total Operating Expenses                                   | <u>25,394,157</u>     | <u>25,695,670</u>      |
| <b>Operating Income</b>                                    | <u>107,472,030</u>    | <u>101,111,790</u>     |
| <b>Nonoperating Revenue (Expense)</b>                      |                       |                        |
| Interest Earned on Investments                             | 253,532               | 168,997                |
| Compulsive Gambling Contribution from Prize Fund (Note 10) | (1,617,462)           | (1,922,954)            |
| Unclaimed Prizes to State (Note 6)                         | (8,769,064)           | (11,698,224)           |
| Net Proceeds to State (Note 8)                             | <u>(95,758,036)</u>   | <u>(86,376,609)</u>    |
| Total Nonoperating Revenue (Expense)                       | <u>(105,891,030)</u>  | <u>(99,828,790)</u>    |
| <b>Change in Net Position</b>                              | 1,581,000             | 1,283,000              |
| <b>Net Position at Beginning of Year (Note 8)</b>          | <u>(11,332,000)</u>   | <u>(12,615,000)</u>    |
| <b>Net Position at End of Year (Note 8)</b>                | <u>\$ (9,751,000)</u> | <u>\$ (11,332,000)</u> |

See Accompanying Notes to Financial Statements

**MINNESOTA STATE LOTTERY  
STATEMENTS OF CASH FLOWS  
YEARS ENDED JUNE 30, 2016 and 2015**

|   | <b>2016</b>           | <b>2015</b>           |
|---|-----------------------|-----------------------|
| <b>Cash Flows from Operating Activities:</b>  |                       |                       |
| Cash Received from Customers  | \$ 594,585,251        | \$ 545,973,185        |
| Cash Received from Other Income   | 14,783                | 26,970                |
| Payments to State (In-Lieu-of-Sales Tax)  | (38,408,482)          | (35,443,944)          |
| Payments to Employees   | (12,391,042)          | (12,402,373)          |
| Payments to Suppliers   | (31,810,134)          | (28,251,798)          |
| Payments to Retailers   | (35,636,934)          | (32,873,107)          |
| Payments to Prize Winners   | (362,751,676)         | (336,925,609)         |
| Net Cash Provided by Operating Activities   | <u>113,601,766</u>    | <u>100,103,324</u>    |
| <b>Cash Flows from Non-Capital Financing Activities:</b>                                |                       |                       |
| Net Proceeds Paid to State  | (95,005,401)          | (85,417,373)          |
| Compulsive Gambling Contribution Transfer   | (1,617,462)           | (1,922,954)           |
| Unclaimed Prizes Transfer   | (11,698,224)          | (9,589,418)           |
| Net Cash Used by Non-Capital Financing Activities                                       | <u>(108,321,087)</u>  | <u>(96,929,745)</u>   |
| <b>Cash Flows from Capital and Related Financing Activities:</b>                        |                       |                       |
| Purchases of Capital Assets   | (684,752)             | (517,421)             |
| Proceeds on sale of Capital Assets  | 59,509                | 83,158                |
| Net Cash Used by Capital Financing Activities   | <u>(625,243)</u>      | <u>(434,263)</u>      |
| <b>Cash Flows from Investing Activities:</b>  |                       |                       |
| Investment Income   | <u>244,812</u>        | <u>166,353</u>        |
| Net Cash Provided by Investing Activities   | <u>244,812</u>        | <u>166,353</u>        |
| <b>Net Increase in Cash and Cash Equivalents</b>  | 4,900,248             | 2,905,669             |
| <b>Beginning of Year Cash and Cash Equivalents</b>                                      | <u>24,906,193</u>     | <u>22,000,524</u>     |
| <b>End of Year Cash and Cash Equivalents</b>  | <u>\$ 29,806,441</u>  | <u>\$ 24,906,193</u>  |
| <b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b> |                       |                       |
| Operating Income  | \$ 107,472,030        | \$ 101,111,790        |
| Adjustments to Reconcile Operating Income to Net Cash provided by Operating Activities: |                       |                       |
| Depreciation  | 598,425               | 659,856               |
| Gain on the disposal of capital assets  | (51,228)              | (78,729)              |
| Change in pension activity  | (1,581,000)           | (1,283,000)           |
| Net Change in Assets and Liabilities:   |                       |                       |
| Account Receivable  | 1,690,731             | (988,279)             |
| Inventory   | (65,856)              | (272,900)             |
| Prepaid Expenses  | 197,415               | (167,146)             |
| Accounts payable  | 1,802,569             | 2,412,828             |
| Accrued salaries and benefits payable   | 158,919               | 140,395               |
| Deferred rent   | 62,559                | 99,336                |
| Other current liabilities   | 168,663               | 195,969               |
| Prize Liability   | <u>3,148,539</u>      | <u>(1,726,796)</u>    |
| Net Cash Provided by Operating Activities   | <u>\$ 113,601,766</u> | <u>\$ 100,103,324</u> |

See Accompanying Notes to Financial Statements.

| <u>Year Ending June 30</u> | <u>Lease<br/>Amount</u>   |
|----------------------------|---------------------------|
| 2017                       | \$ 1,497,202              |
| 2018                       | 1,412,655                 |
| 2019                       | 1,234,600                 |
| 2020                       | 1,269,057                 |
| 2021                       | 1,294,412                 |
| 2022 to 2023               | <u>2,484,280</u>          |
| <b>Total</b>               | <u><b>\$9,192,206</b></u> |

The total amount of lease payments is being charged to Occupancy Costs on a straight-line basis over the terms of the leases. The difference between the lease expense and amount paid is recorded as accrued rent.

**10. COMPULSIVE GAMBLING TREATMENT CONTRIBUTION PROVIDED FROM PRIZE FUND**

Minnesota Laws 1998, Chapter 407, Article 8, Section 11 directed the Lottery to pay \$340,000 annually from the prize fund to a special Indian Gaming account in the State Treasury. Funds in this account are transferred to the Department of Human Services for compulsive gambling treatment programs.

Minnesota Laws 2013, Chapter 108, Article 14, section 2, subdivision 1 appropriated \$1,890,000 for fiscal years 2016 and 2015 from the Lottery Prize Fund of the Department of Human Services for statewide compulsive gambling treatment programs. The Department of Human Services utilized \$1,617,462 and \$1,922,954 for 2016 and 2015 for compulsive gambling programs of the allowable appropriated amount of \$2,230,000 for each year. The programs' services are designed to increase public awareness of problem gamblers and their families, and research relating to problem gambling.

**11. RETAILER COMMISSIONS AND INCENTIVES**

Retailer commission is set by Minnesota Rule 7856.4030, subpart 1 as 5.5% of the price of each lottery ticket sold by a retailer and 1% of the amount of each winning lottery ticket cashed by a retailer. Lottery retailers were paid \$35,636,934 in 2016 and \$32,873,107 in 2015.

**12. STATUTORY LIMITATION ON OPERATING AND ADVERTISING EXPENSES**

Gross revenue is defined in law as ticket sales and all other income less in-lieu-of-sales tax. Direct costs are expenses that are a direct function of lottery sales, which include all prize payouts, retailer commissions and incentives, amounts paid to produce and deliver

scratch lottery tickets, and amounts paid to an outside vendor to operate and maintain an on-line gaming system. Operating costs include all other expenses of the Lottery.

Minnesota Statutes, Section 349A.10, subdivision 3 limits the Lottery's advertising costs to 2.75 percent and operating costs to 9 percent of gross revenue. Minnesota Laws 2013, Chapter 142, Article 1, section 17 provides that notwithstanding Minnesota Statutes, section 349A.10, subdivision 3, the operating budget must not exceed \$30,500,000 in fiscal year 2016 and 2015.

The Lottery is in compliance with the statutory limits on advertising and operating costs. Advertising costs as a percentage of gross revenue were 1.08 percent for fiscal year 2016 and 1.36 percent for fiscal year 2015. Operating costs as a percentage of gross revenue were 4.58 percent and 5.02 percent for the year ended June 30, 2016 and 2015 respectively.

### **13. RETIREMENT PLANS AND POST RETIREMENT BENEFITS**

#### **(a) Plan Description**

The State Employees Retirement Fund (SERF) is administered by the Minnesota State Retirement System (MSRS), and is established and administered in accordance with Minnesota Statutes, Chapters 352 and 356. SERF includes the General Employees Retirement Plan (General Plan), a multiple-employer, cost-sharing defined benefit plan, and three single-employer defined benefit plans: the Military Affairs Plan, the Transportation Pilots Plan, and the Fire Marshals Plan. Only certain employees of the Department of Military Affairs, the Department of Transportation, and the State Fire Marshal's Division are eligible to be members of those plans, but all state of Minnesota employees who are not members of another plan are covered by the General Plan. The Transportation Pilots Plan has been closed to new entrants since July 1, 2008.

MSRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained at [www.msrs.state.mn.us/financial-information](http://www.msrs.state.mn.us/financial-information); by writing to MSRS at 60 Empire Drive, #300, St. Paul, Minnesota, 55103; or by calling (651) 296-2761 or 1-800-657-5757.

#### **(b) Benefits Provided**

MSRS provides retirement, disability, and death benefits through the State Employees Retirement Fund. Benefit provisions are established by state statute and can only be modified by the state legislature. Benefits are based on a member's age, years of credit, and the highest average salary for any sixty successive months of allowable service at termination of service. Benefit increases are provided to benefit recipients each January, and are related to the funded ratio of the plan. Annuitants receive benefit increases of 2.0 percent each year. When the fund reaches a 90 percent

funded status for two consecutive years, annuitants will receive a 2.5 percent increase.

Retirement benefits can be computed using one of two methods: the Step formula and the Level formula. Members hired before July 1, 1989, may use the Step or Level formula, whichever is greater. Members hired on or after July 1, 1989, must use the Level formula. Each formula converts years and months of service to a certain percentage. Under the Step formula, members receive 1.2 percent of the high-five average salary for each of the first 10 years of covered service, plus 1.7 percent for each year thereafter. It also includes full benefits under the Rule of 90 (age plus years of allowable service equals 90). In contrast, the Level formula does not include the Rule of 90. Under the Level formula, members receive 1.7 percent of the high-five average salary for all years of covered service, and full benefits are available at normal retirement age.

(c) Contributions

Minnesota Statutes Chapter 352 sets the rates for employer and employee contributions. Eligible General Plan members and participating employers were required to contribute 5.0 percent of their annual covered salary in fiscal year 2014. Effective July 1, 2014, member and employer rates increased to 5.5 percent of total compensation. The Lottery's contributions to MSRS for the year ending June 30, 2016, 2015, and 2014 were as follows:

Classified Plan

|      | <u>2016</u> | <u>2015</u> | <u>2014</u> |
|------|-------------|-------------|-------------|
| MSRS | \$480,931   | \$488,541   | \$424,617   |

Unclassified Plan

|      | <u>2016</u> | <u>2015</u> | <u>2014</u> |
|------|-------------|-------------|-------------|
| MSRS | \$36,755    | \$37,847    | \$32,908    |

These contributions were equal to the contractually required contributions for each year as set by state statute.

(d) Actuarial Assumptions

The Minnesota State Lottery's net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The total pension liability was determined using the following actuarial assumptions, applied to all periods included in the measurement:

|                              |                       |
|------------------------------|-----------------------|
| Inflation                    | 2.75 percent per year |
| Active Member Payroll Growth | 3.50 percent per year |
| Investment Rate of Return    | 7.90 percent          |

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors and disabilitants were based on RP-2000 generational mortality tables projected with mortality improvement scale AA, white collar adjustment. Benefit increases for retirees are assumed to be 2.0 percent every January 1st through 2043 and 2.5 percent thereafter.

Actuarial assumptions used in the June 30, 2015, valuation were based on the results of actuarial experience studies for the period July 1, 2004, through June 30, 2008, with an update of economic assumptions in 2014.

There were no changes in actuarial assumptions in 2015.

The long-term expected rate of return on pension plan investments is 7.9 percent. The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness of the long-term expected rate of return on a regular basis of building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

| <b>Asset Class</b>   | <b>Target Allocation</b> | <b>SBI's Long-Term Expected Real Rate of Return (Geometric Mean)</b> |
|----------------------|--------------------------|--|
| Domestic Stocks      | 45%                      | 5.50%  |
| International Stocks | 15%                      | 6.00%  |
| Bonds                | 18%                      | 1.45%  |
| Alternative Assets   | 20%                      | 6.40%  |
| Cash                 | 2%                       | 0.50%  |

(e) Discount Rate

The discount rate used to measure the total pension liability as of June 30, 2015 and 2014, was 7.90 percent. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rate specified in statute. Based on that assumption, the pension plan's fiduciary net position at June 30, 2015 and 2014, was projected to be available to make all projected future benefit payments of current active and inactive employees. 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. A long-term expected rate of return of 7.90 percent for June 30, 2015 and

2014 and a municipal bond rate of 3.80 percent as of June 30, 2015 and 4.63 percent as of June 30, 2014. The projection showed that assets would be available to pay benefits only through 2045, with a resulting single discount rate of 7.90 percent for 2015 and 6.63 percent for 2014, and an increase of 1.27 percent between the beginning and the end of the measurement period.

(f) Net Pension Liability

At June 30, 2016, the Minnesota State Lottery reported a liability of \$5,054,000 for its proportionate share of MSRS' net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Minnesota State Lottery's proportion of the net pension liability was based on the Minnesota State Lottery's contributions received by MSRS during the measurement period July 1, 2014, through June 30, 2015, relative to the total employer contributions received from all of MSRS's participating employers. At June 30, 2015, the Minnesota State Lottery's proportion was 0.4399 percent.

For comparison purposes at June 30, 2015, the Minnesota State Lottery reported a liability of \$5,250,000 for its proportionate share of MSRS' net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Minnesota State Lottery's proportion of the net pension liability was based on the Minnesota State Lottery's contributions received by MSRS during the measurement period July 1, 2013, through June 30, 2014, relative to the total employer contributions received from all of MSRS's participating employers. At June 30, 2014, the Minnesota State Lottery's proportion was 0.4371 percent.

Two changes in benefit provisions affected the measurement of the total pension liability since the prior measurement date. Member and employer contribution rates increased from 5 percent to 5.5 percent of pay effective the first day of the first full pay period beginning after July 1, 2014. Beginning July 1, 2014, the funding ratio threshold that must be attained to pay a 2.5 percent post-retirement benefit increase to benefit recipients was changed from 90 percent for one year to 90 percent for two consecutive years.

Two changes in assumptions affected the measurement of the total pension liability since the prior measurement date. The single discount rate changed from 6.63 percent to 7.90 percent. The post-retirement benefit increase changed from 2 percent indefinitely, to 2 percent through 2043, and 2.5 percent thereafter.

(g) Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in the MSRS Comprehensive Annual Financial Report, available on the MSRS website ([www.msrs.state.mn.us/financial-information](http://www.msrs.state.mn.us/financial-information)).

(h) Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the year ended June 30, 2016 and June 30, 2015, the Minnesota State Lottery recognized a pension adjustment of \$(1,581,000) and \$(808,000) respectively.

At June 30, 2016, the Minnesota State Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

|   | <b>Deferred Outflows<br/>of Resources</b> | <b>Deferred<br/>Inflows of<br/>Resources</b> |
|---|---|--|
| Differences between expected and actual experience  | -0-                                       | \$1,381,000                                  |
| Changes of assumptions  | -0-                                       | \$2,888,000                                  |
| Net difference between projected and actual earnings on investments   | \$1,032,000                               | \$2,055,000                                  |
| Changes in proportion and differences between actual contributions and proportionate share of contributions | \$154,000                                 | \$51,000                                     |
| Contributions paid to MSRS subsequent to the measurement date   | \$492,000                                 | -0-  |
| Total   | \$1,678,000                               | \$6,375,000                                  |

Amounts reported as deferred outflows of resources related to pensions resulting from Minnesota State Lottery contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016.



At June 30, 2015, the Minnesota State Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

|   | <b>Deferred Outflows<br/>of Resources</b> | <b>Deferred<br/>Inflows of<br/>Resources</b> |
|---|---|--|
| Differences between expected and actual experience  | -0-                                       | \$114,000                                    |
| Changes of assumptions  | -0-                                       | \$3,827,000                                  |
| Net difference between projected and actual earnings on investments   | -0-                                       | \$2,723,000                                  |
| Changes in proportion and differences between actual contributions and proportionate share of contributions | \$107,000                                 | -0-  |
| Contributions paid to MSRS subsequent to the measurement date   | \$475,000                                 | -0-  |
| <b>Total</b>  | <b>\$582,000</b>                          | <b>\$6,664,000</b>                           |

Amounts reported as deferred outflows of resources related to pensions resulting from Minnesota State Lottery contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2015.

(i) Postemployment Benefits

The Lottery provides other postemployment benefits (OPEB) as part of its total employee compensation package. GASB statement No. 45 “Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions” requires the Lottery to report OPEB on the face of its financial statements. The Lottery implemented GASB Statement No. 45 in Fiscal Year 2008. Total adjustments related to the OPEB Liability for fiscal years 2016 and 2015 were \$30,000 and \$34,000, respectively.

**Schedules of Required Supplementary Information**

**Schedule of the Minnesota State Lottery's Share of Net Pension Liability  
State Employees Retirement Fund  
Last 10 years\***

Schedule of the Minnesota State Lottery's Share of Net Pension Liability  
State Employee Retirement Fund

| Plan Year | Employer's Portion (Percentage) of the Net Pension Liability | Employer's Proportionate Share of the Net Pension Liability (a) | Employer's Covered Payroll (b) | Employer's Proportionate Share of the Net Pension Liability as a Percentage of its Covered Payroll (a/b) | Plan Fiduciary Net Position as a Percentage of the Total Pension Liability |
|-----------|--|---|--------------------------------|--|--|
| 2015      | 0.4399%  | \$5,054,000   | \$9,353,603                    | 54.03%   | 88.32%   |
| 2014      | 0.4371%  | \$5,250,000   | \$9,336,162                    | 56.23%   | 87.64%   |

Schedule of the Minnesota State Lottery's Contributions  
State Employee Retirement Fund

| Plan Year | Contractually Required Contributions | Actual Contributions Made | Contribution Deficiency | Minnesota State Lottery's Covered-Employee Payroll | Contributions as a Percentage of Covered-Employee Payroll |
|-----------|--------------------------------------|---------------------------|-------------------------|--|---|
| 2015      | \$517,686                            | \$517,686                 | \$0                     | \$9,353,603  | 5.535%  |
| 2014      | \$526,388                            | \$526,388                 | \$0                     | \$9,336,162  | 5.638%  |

\* This schedule is intended to show information for 10 years prospectively beginning in fiscal year ended June 30, 2015. Additional years will be displayed as they become available.

\*\*For purposes of this schedule, covered payroll is defined pensionable wages.