

Georgia Lottery Corporation

*Management's Discussion and Analysis for the
Years Ended June 30, 2018 and 2017, Financial
Statements as of and for the Years Ended June 30,
2018 and 2017, and Independent Auditor's Report*

GEORGIA LOTTERY CORPORATION

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INDEPENDENT AUDITOR'S REPORT

**The Board of Directors
of the Georgia Lottery Corporation:**

Report on the Financial Statements

We have audited the accompanying financial statements of the **Georgia Lottery Corporation** (the "GLC"), a component unit of the State of Georgia, as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the GLC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Georgia Lottery Corporation as of June 30, 2018 and 2017, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of Proportionate Share of the Net Pension Liability, and Schedule of Contributions on pages 3 through 17, 41, and 42, respectively, 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.

Mauldin & Jenkins, LLC

Atlanta, Georgia
October 24, 2018

Management's Discussion and Analysis

As management of the Georgia Lottery Corporation (the "GLC"), we offer readers of the GLC's financial statements this narrative overview and analysis of the financial activities for the fiscal years ended June 30, 2018 and June 30, 2017. We encourage readers to consider the information presented here in conjunction with the financial statements, which begin on page 18.

Financial Highlights

The GLC had another record year of profits in fiscal year 2018, returning \$1.143 billion for education. This represents an increase of \$42.5 million compared to the prior year. For fiscal year 2017, net proceeds were \$1.101 billion, which represented an increase of \$3.5 million compared to fiscal year 2016. Gross ticket sales were \$4.598 billion in fiscal year 2018 compared to \$4.529 billion in 2017. Other significant financial highlights include the following:

- For fiscal year 2018, gross tickets sales increased by \$68.8 million, or 1.52 % as compared to 2017. For fiscal year 2017, gross tickets sales decreased by \$26.9 million, or 0.6 % as compared to 2016.
- Prize expense increased \$31.0 million, or 1.1% during fiscal year 2018 and decreased \$8.0 million, or 0.3% during fiscal year 2017. This expense usually increases or decreases in direct proportion to ticket sales and represented approximately 60% of gross ticket sales in fiscal years 2018 and 2017.
- Direct gaming expenses, which include retailer commissions, contractor fees, advertising, retailer merchandising and marketing, and gaming equipment increased \$1.0 million in fiscal year 2018, from \$401.3 million to \$402.3 million. These expenses also fluctuate in proportion to ticket sales and represented approximately 8.7% of gross ticket sales in 2018. For fiscal year 2017, direct gaming expenses decreased \$7.6 million from \$408.9 million to \$401.3 million. These expenses represented approximately 8.9% of gross ticket sales in 2017.
- Fiscal year 2018 operating expenses increased \$2.6 million above 2017 expenses, from \$45.9 million to \$48.5 million. Fiscal year 2017 operating expenses decreased \$1.4 million below 2016 expenses, from \$47.3 million to \$45.9 million. Operating expenses remained at approximately 1% of gross ticket sales for fiscal years 2018 and 2017.
- Nonoperating expenses, net of revenues, increased \$36.5 million in 2018 as compared to 2017. This increase is attributable to the increase in payments due to Lottery for Education Account over the prior fiscal year of \$42.5 million, an increase in interest revenue of \$0.9 million offset by the change in the fair value of grand prize investments held by the GLC for funding future grand prize payments. Nonoperating expenses, net of revenues, increased \$26.3 million in 2017 as compared to 2016. This increase is attributable to the increase in payments due to Lottery for Education Account over the prior fiscal year, offset by the change in the fair value of grand prize investments held by the GLC for funding future grand prize payments, an increase in interest revenue.
- In fiscal year 2018, the Coin Operated Amusement Machines (COAM) line of business contributed \$75.0 million in revenues from centralized monitoring operations, licensing fees, fines, penalties, processing fees and revenue generated from auctioning additional master license privileges. This represents an increase of \$12.5 million or 20.1% over 2017. COAM returned \$58.2 million to the Lottery for Education Account in fiscal year 2018, an increase of \$10.7 million or 22.4% over 2017. In fiscal year 2017, COAM contributed \$62.4 million in revenues from centralized monitoring operations, licensing fees, fines, penalties, processing fees and revenue generated from auctioning additional master license privileges. This represents an increase of \$15.3 million or 32.5% over 2016. COAM returned \$47.5 million to the Lottery for Education Account in fiscal year 2017, an increase of \$14.1 million or 42.1% over 2016.

Overview of the Financial Statements

The GLC is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the GLC's basic financial statements, along with the notes to the financial statements. The statements of net position on page 18, the statements of revenues, expenses, and changes in net position on page 19, and the statements of cash flows on pages 20 and 21 report the GLC's net position and changes therein. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements begin on page 22 of this report.

The GLC pays its net proceeds each fiscal year to the General Fund of the state treasury for credit to the Lottery for Education Account. As a result, the GLC's net position consist of funds invested in capital assets and unrestricted net position. Unrestricted net position normally results from the inclusion of capital costs in the determination of net proceeds (as required by the Georgia Lottery for Education Act) and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments which are held to fund future grand prizes payments. The GLC expects to hold these investments to maturity to meet our future grand prize winner obligations and, therefore, will not realize any gains or losses related to the current value of these investments for distribution as net proceeds. The reader of these financial statements should review the assets and liabilities in the statements of net position and the operating revenues and expenses and the payment to and due to Lottery for Education Account in the statements of revenues, expenses, and changes in net position to assess the GLC's financial position as of June 30, 2018 and 2017, and the results of its operations for the years then ended.

Financial Analysis

Assets

At the end of fiscal year 2018, total assets were \$636.7 million compared to \$636.5 million at the end of fiscal year 2017, representing an increase of \$0.2 million. Total assets at the end of fiscal year 2017 were \$636.5 million compared to \$642.9 million at the end of fiscal year 2016, representing a decrease of \$6.4 million.

Current assets increased from \$422.7 million in 2017 to \$432.6 million in 2018, representing an increase of \$9.9 million. This increase was due to increases of \$6.2 million in retailer receivables, \$2.9 million in cash and cash equivalents and \$2.1 million in retailer escrow holdings, offset by a decrease of \$1.4 million in prepaid expenses and other assets. The changes in cash and cash equivalents and retailer receivables are due to the timing of weekly retailer collections.

Current assets decreased from \$423.4 million in 2016 to \$422.7 million in 2017, representing a decrease of \$0.7 million. This decrease was due to a \$14.2 million decrease in cash and cash equivalents, offset by an increase of \$12.2 million in retailer accounts receivable, and \$1.2 million increase in prepaid and other assets. The decrease in cash and cash equivalents was due to the timing of weekly retailer collections.

In fiscal year 2018, noncurrent assets decreased from \$213.9 million in 2017 to \$204.1 million in 2018, representing a decrease of \$9.8 million. This decrease is primarily due to grand prize investments decreasing from \$208.5 million in 2017 to \$193.0 million in 2018, a decrease of \$15.5 million. The decrease represents the net effect of from maturities used to fund prize payments of \$18.7 million, net purchases to fund new prize payments of \$5.1 million, accreted interest earned on current-year maturities of \$6.9 million and a decrease of \$8.8 million in the fair value of investments. Net capital assets increased from \$5.3 million in 2017 to \$11.1 million in 2018. The increase resulted from capital procurements of \$8.4 million less depreciation expense of \$2.6 million. Capital procurements in fiscal year 2018 were comprised primarily of \$7.2 million in computer and communications equipment purchases required as a part of the gaming system contract extension signed in FY2017. The remaining capital purchases were \$0.6 million in other computer and communications equipment, \$0.5 million for vehicle procurements and \$0.1 million in leasehold improvement projects.

In fiscal year 2017, noncurrent assets decreased from \$219.5 million in 2016 to \$213.9 million in 2017, representing a decrease of \$5.6 million. This decrease is primarily due to grand prize investments decreasing from \$213.6 million in 2016 to \$208.5 million in 2017, a decrease of \$5.1 million. The decrease resulted from maturities used to fund prize payments of \$21.1 million offset by accreted interest earned on current-year maturities of \$7.3 million and a decrease of \$13.9 million in the fair value of investments. Net capital assets decreased from \$5.9 million in 2016 to \$5.3 million in 2017. The decrease resulted from capital procurements of \$1.6 million less depreciation expense of \$2.1 million. Capital procurements in fiscal year 2017 were comprised primarily of \$0.6 million for vehicle procurements, \$0.4 million for Gemini units (self-service merchandising machines), \$0.2 million for software, \$0.2 million to build-out New Airport Concourses and \$0.2 million in other projects.

Liabilities

Total liabilities at the end of fiscal year 2018 were \$623.6 million compared to \$614.0 million at the end of fiscal year 2017 representing an increase of \$9.6 million. Total liabilities at the end of fiscal year 2017 were \$614.0 million compared to \$606.7 million at the end of fiscal year 2016 representing an increase of \$7.3 million.

Current liabilities increased from \$413.6 million in 2017 to \$429.8 million in 2018, an increase of \$16.2 million. The increase is primarily attributable to an increase of \$8.6 million in accounts payable and accrued liabilities, an increase of \$7.9 million for prizes won and due to winners not yet claimed and a \$2.1 million increase in the retailer escrow fund, offset by a decrease of \$2.2 million in funds due to the Lottery for Education. The change in prizes payable is due to increases of \$4.0 million in the prize reserves, \$3.2 million in prizes won but not yet claimed, \$0.9 million in expired prizes due to the *Mega Millions* and *Cash 4 Life* games offset by a \$0.2 million reduction in miscellaneous account changes. Unearned COAM revenue associated with receipt of 2019 renewal fees in advance of the licensing period was \$7.1 million for 2018 compared to \$8.4 million in 2017. This amount is classified as a non-exchange transaction in fiscal year 2018 and thus is being reported as a deferred inflow of resources.

Current liabilities decreased from \$415.1 million in 2016 to \$413.6 million in 2017, a decrease of \$1.6 million. The decrease is primarily attributable to a \$19.0 million increase in funds due to the Lottery for Education and a \$2.9 million increase in retailer escrow fund, offset by a decrease of \$20.2 million in liabilities for prizes won and due to winners not yet claimed and a decrease in accounts payable and accrued liabilities of \$3.5 million. The increase in the balance due to the Lottery for Education Account is consistent with the record sales and net proceeds for 2017. The decrease in prizes payable is due to investments purchased to fund annuity prize payments shifting the noncurrent portion of these liabilities to grand prize payables. Unearned COAM revenue associated with receipt of 2018 renewal fees in advance of the licensing period was \$8.5 million for 2017 compared to \$8.2 million in 2016. This amount is classified as a non-exchange transaction in fiscal year 2017 and thus is being reported as a deferred inflow of resources.

Noncurrent liabilities decreased \$6.6 million from \$200.4 million in 2017 to \$193.8 million in 2018. Noncurrent liabilities principally consist of grand prizes payable, which represent the amount to be paid to grand prize winners over future years. In fiscal year 2018, grand prizes payable decreased \$6.3 million from \$195.0 million to \$188.7 million. The decrease was attributable to net payments made to annuity winners of \$11.8 million in excess of net purchases of \$5.1 million to fund new grand prize liabilities. Noncurrent liabilities increased \$8.8 million from \$191.6 million in 2016 to \$200.4 million in 2017. Grand prizes payable increased \$8.9 million from \$186.1 million to \$195.0 million in 2017. The increase was attributable to an investment purchase of \$22.6 million in 2017 to fund long term prize liabilities, offset by the settlement of \$21.1 million in annuity liabilities net of \$7.3 million in interest earned that became due and payable in 2017.

Net Position and Changes in Net Position

Net position decreased \$8.2 million in 2018 from \$14.0 million in fiscal year 2017, to an end of year balance of \$5.8 million. This change resulted from a decrease in the unrealized loss in the fair market value of grand prize investments held by the GLC for the funding of future grand prize payments. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value, and the change in the fair value is recorded as non-operating revenue (expense) annually. The GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations. Inclusion of capital costs in the determination of net proceeds is required by the Georgia Lottery for Education Act.

Net position decreased \$13.9 million in 2017 from \$27.9 million in fiscal year 2016, to an end of year balance of \$ 14.0 million. This change resulted from a decrease of \$13.9 million unrealized change in the fair market value of grand prize investments held by the GLC for the funding of future grand prize payments. Accounting principles generally accepted in the United States of America require the GLC to record its grand prize investments at fair value, and the change in the fair value is recorded as non-operating revenue (expense) annually. The GLC classifies the decreases and increases in fair value as unrealized, due to the investments generally being held to maturity to fund future prize obligations. Inclusion of capital costs in the determination of net proceeds is required by the Georgia Lottery for Education Act.

Sales

Total lottery ticket sales for fiscal year 2018 were \$4.598 billion as compared to \$4.529 billion in 2017. This represents an increase of \$68.8 million. Scratcher game sales increased by \$35.2 million, Diggi (e-Instant) game sales increased by \$11.0 million and sales of draw games increased by \$22.6 million. Product distribution on the mobile platform continues to grow, contributing \$35.7 million, or 71% of interactive sales in 2018. The scratcher sales increase was primarily attributable to growth in our \$10 and \$20 games plus the introduction of four \$25 games. Draw game sales performance was driven by increases in *Mega Millions* and *Powerball* of \$35.2 million and \$28.5 million, respectively. The game matrix for *Mega Millions* was changed during the year as well as an add-on game, *Just the Jackpot*, was introduced. Average weekly gross ticket sales for fiscal year 2018 were \$88.4 million versus \$87.1 million in 2017.

Gross scratcher ticket sales increased \$35.2 million during fiscal year 2018, from \$3.107 billion in 2017 to \$3.142 billion. The GLC's administration of a sound marketing strategy, continuous development and introduction of new scratcher games, and effective management of the scratcher portfolio and product mix led to the 1.1% increase in ticket sales for 2018 versus 2017.

Scratcher tickets at the \$1, \$2, and \$3 price points generated approximately \$149 million, \$371 million, and \$179 million in sales, respectively in fiscal year 2018 for a net decrease of \$53.2 million compared to 2017. Some of our most successful scratcher games at the lower price points, included *\$1 5X The Money*, *\$1 Junior Jumbo Bucks*, *\$2 Jumbo Bucks Classic*, *\$2 10X The Money*, *\$2 10X The Money Exclusive*, *\$3 15X The Money*

Exclusive, \$3 Cherry, Orange, Lemon Tripler Crossword, and \$3 Jumbo Bucks CROSSWORD. \$2 Jumbo Bucks Classic was the top selling game in this group, contributing \$89.9 million.

Ticket sales at the \$5 price point totaled \$612 million in fiscal year 2018 making it the second largest scratcher game segment. This represents an increase of \$7.5 million above 2017. The most successful \$5 scratcher games during the period included *20X The Money, Giant Jumbo Bucks, The Atlanta Falcons* and the *25th Anniversary* which totaled \$180.5 million or 30% of sales collectively at this price point. The two top selling \$5 scratchers games in fiscal year 2018 were *20X The Money* and *Giant Jumbo Bucks*, which contributed \$52 million and \$49 million in revenue, respectively.

Scratcher games at the \$10 price point provided approximately \$659 million in revenue, continuing to be the largest scratcher game segment. This represents a \$49.1 million increase over 2017. The top games at this price point included *50X The Money, Win Either \$50 or \$100, \$100 Million Cash Extreme, Lucky No.7* and *\$1,000,000 Jackpot*. Additionally, 11 new games collectively contributed \$390 million. The most popular games in this segment were *50X the Money* and *Win Either \$50 or \$100*, generating \$109 million and \$50 million in sales respectively.

The \$20 price point category contributed \$506 million in ticket revenue, an increase of \$47.3 million or 10.3% in 2018, making it the third largest segment in terms of overall scratcher sales. During fiscal year 2018, the category was led by the *100X The Money, \$100 or \$200, the \$3 Million Royale* and *Millionaire Jumbo Bucks* games which contributed \$114 million, \$69 million, \$53 million and \$51 million respectively. New games contributed \$144 million during the period.

In fiscal year 2018, the \$25 category grew by \$21.2 million or 12.6% to \$190.2 million compared to 2017. The top selling game was *25th Anniversary*, contributing \$63 million in gross sales. Additionally, three other new games were launched during the year, *Break the Bank, Georgia Lottery Exclusive* and *Money Tree!*, which contributed \$38 million, \$36 million and \$30 million respectively.

In fiscal year 2018, the GLC offered four \$30 scratcher games which generated \$475 million in sales. This represents a decrease of \$37 million or 7.2% over the previous year. The *Billionaire Club* game was the leading seller in the overall scratcher category, generating \$281 million in sales. No new games were launched during the fiscal year.

The GLC continues to offer popular families of scratcher games in fiscal year 2018. Each of these families demonstrated strong player appeal. The *X The Money* family includes \$1 *5X The Money*, \$2 *10X The Money*, \$3 *15X The Money*, \$5 *20X The Money*, \$10 *50X The Money* and \$20 *100X The Money* games and contributed approximately \$405 million in 2018. The *Jumbo Bucks* family includes \$1 *Jr. Jumbo Bucks*, \$2 *Jumbo Bucks Classic*, \$3 *Lady Jumbo Bucks*, \$3 *Jumbo Bucks Crossword*, \$5 *Giant Jumbo Bucks*, \$10 *Jumbo Jumbo Bucks*, and \$20 *Millionaire Jumbo Bucks* games contributed approximately \$264 million in 2018. The *Payout* family includes the \$1 *\$7,000,000 Payout!*, the \$2 *\$17,000,000 Payout!*, the \$5 *\$37,000,000 Payout!* and the \$20 *\$77,000,000 Payout!* games and contributed \$38 million.

Gross scratcher ticket sales increased \$10.9 million during fiscal year 2017, from \$3.096 billion in 2016 to \$3.107 billion. The GLC's administration of a sound marketing strategy, continuous development and introduction of new scratcher games, and effective management of the scratcher portfolio and product mix led to the 0.4% increase in ticket sales for 2017 versus 2016.

Scratcher tickets at the \$1, \$2, and \$3 price points generated approximately \$152 million, \$392 million, and \$209 million in sales, respectively in fiscal year 2017 for a net decrease of \$38 million compared to 2016. Some of our most successful scratcher games at the lower price points, included *\$1 Junior Jumbo Bucks*, *\$1 5X The Money*, *\$2 Jumbo Bucks Classic*, *\$2 10X The Money*, *\$2 10X The Money Exclusive*, *\$3 Cherry, Orange, Lemon Tripler Crossword*, *\$3 15X The Money Exclusive* and *\$3 Jumbo Bucks CROSSWORD*. *\$2 Jumbo Bucks Classic* was the top selling game in this group, contributing \$93.7 million.

Ticket sales at the \$5 price point totaled \$605 million in fiscal year 2017 making it the second largest scratcher game segment. This represents a decrease of \$58 million below 2016. The most successful \$5 scratcher games during the period included *Giant Jumbo Bucks*, *20X The Money, Gold*, the *Big Money Maker* and the *\$37,000,000 Cash Payout!* games, which totaled \$241.2 million or 40% of sales collectively at this price point. The two top selling \$5 scratchers games in fiscal year 2017 were *Giant Jumbo Bucks* and *20X The Money*, which contributed \$78 million and \$61 million in revenue, respectively.

Scratcher games at the \$10 price point provided approximately \$610 million in revenue, becoming the largest scratcher game segment. This represents a \$54 million increase over 2016. The top games at this price point included *50X The Money*, *Win Either \$50 or \$100*, *\$100 Million Cash Out* and *Jumbo Jumbo Bucks*. Additionally, 6 new games - *Winner Green*, *2017 Super Star*, *Silver Peach*, *Ca\$h-tastic*, *The Golden Ticket* and *Lucky 10* - collectively contributed \$237 million. The most popular games in this segment were *50X the Money* and *Win Either \$50 or \$100*, generating \$150 million and \$100 million in sales respectively.

The \$20 price point category contributed \$458 million in ticket revenue, a decrease of \$22 million or 4.6% in 2017, making it the fourth largest segment in terms of overall scratcher sales. During fiscal year 2017, the category was led by the *100X The Money*, *Millionaire Jumbo Bucks*, the *\$77,000,000 Cash Payout!*, *\$100 or \$200 and \$7,500 A Week For Life* games which contributed over \$298 million in ticket sales. The top selling game was *100X The Money* generating \$114 million or 25% of sales for the total category during the period.

In fiscal year 2017, the \$25 category grew by \$46 million or 37% to \$169 million compared to 2016. The top selling game was *Mighty Jumbo Bucks*, contributing \$72 million in gross sales. Additionally, two new games were launched during the year, *Jingle Jumbo Bucks* and *Georgia's Super Hit!*, which contributed \$56 million and \$41 million respectively.

In fiscal year 2017, the GLC offered four \$30 scratcher games which generated \$511 million in sales. This represents an increase of \$35 million or 7.4% over the previous year making it the third largest scratcher game segment. The new *Billionaire Club* game was the leading seller in the category, generating \$181 million in sales. *Super Max the Money* and the *\$10,000,000 Cash Spectacular* games contributed \$162 million and \$127 million, respectively. A second new game, *The New Super Max the Money* game contributed \$41 million.

The GLC continues to offer popular families of scratcher games in fiscal year 2017. Each of these families demonstrated strong player appeal. The *X The Money* family includes *\$1 5X The Money*, *\$2 10X The Money*, *\$3 15X The Money*, *\$5 20X The Money*, *\$10 50X* and *\$20 100X The Money* games and contributed approximately \$394 million in 2017. The *Jumbo Bucks* family includes *\$1 Jr. Jumbo Bucks*, *\$2 Jumbo Bucks Classic*, *\$3 Jumbo Bucks Crossword*, *\$5 Giant Jumbo Bucks*, *\$10 Jumbo Jumbo Bucks*, and *\$20 Millionaire Jumbo Bucks* games contributed approximately \$307 million in 2017. The *Payout* family includes the *\$1 \$7,000,000 Payout!*, the *\$2 \$17,000,000 Payout!*, the *\$5 \$37,000,000 Payout!* and the *\$20 \$77,000,000 Payout!* games and contributed \$106 million.

For fiscal year 2018, Diggi (e-Instant) game sales were \$21.6 million, an increase of \$11.0 million or 104.3% over 2017. Diggi games are interactive games that can be played on internet or mobile platforms and exhibit the same characteristics as traditional scratcher games, including grids and game reveal data. Players can place wagers using their registered iHope cards or other debit cards associated with their ilottery accounts. All transactions up to \$600 are cashless. Prizes greater than \$601 must be claimed at a lottery office. The games are sold at price points ranging from \$0.50 to \$10 with prizes up to \$100,000. The GLC has currently 38 active games. 2017 Diggi game sales were \$10.6 million, an increase of \$5.6 million or 110.4% over 2016.

For fiscal year 2018, draw game sales were \$1.434 billion, an increase of \$22.6 million, or 1.6% above the 2017 draw sales of \$1.412 billion. For fiscal year 2017, draw game sales were \$1.412 billion, a decrease of \$43.4 million, or 3.0% below the 2016 draw sales of \$1.455 billion. .

Cash 3 sales decreased by \$28.3 million to \$525.4 million in 2018 compared to \$553.7 million in 2017. *Cash 3* experienced 15 high payout (>\$1 million) draws during the year. *Cash 3* is a thrice-daily drawing game whereby the player chooses a three-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. A “1-Off” add-on feature was added as part of the base game. The feature allows players to win fixed prizes for being one off from one or more of the draw numbers (e.g. 1-6-3 or 2-7-2 rather than the 1-6-2 draw number) for an additional wager. This has created another opportunity to refresh an already popular game.

Cash 3 sales increased by \$6.9 million to \$553.7 million in 2017 compared to \$546.8 million in 2016. The actual prize payout experienced was approximately 46% for fiscal year 2018 and 49% for 2017. Historically, as the prize amount won for this game increases above or decreases below the industry average of 50% of sales, a corresponding increase or decrease in sales will occur.

In fiscal year 2018, *Mega Millions* sales increased \$35.2 million or approximately 39.0% to \$125.6 million compared to \$90.4 million in 2017. The size and frequency of jackpots are the primary drivers for *Mega Millions* sales. The game matrix was changed in advance of the October 28, 2017 draw. The *Mega Millions* jackpot exceeded \$250 million on three occasions during the year, reaching \$393 million in August 2017, \$451 million in January 2018 and a high value of \$533 million in March 2018. *Mega Millions* is a multi-state lottery game operated with ten other states—California, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Virginia, and Washington. Through an agreement between the Mega Millions Consortium (MMC) and the Multi-State Lottery Association (MUSL), MUSL members are allowed to cross-sell tickets for the *Mega Millions* game. Drawings are held twice weekly on Tuesday and Friday. Under the new game matrix, players win the *Mega Millions* jackpot by matching 5 numbers from a set of 70 white balls plus 1 number from a set of 25 gold balls. Matching the five white balls automatically wins \$1 million. The price of a base wager increased from \$1 to \$2 and the starting jackpot raised to \$40 million. Additionally, the GLC added another feature to the *Mega Millions* game as part of the matrix change. *Just the Jackpot* (JTJ) is an add-on that permits players to place wagers for jackpot wins only (i.e. no opportunity to win any fixed prize). The price of JTJ is \$3 for two wagers. Four members of the MMC elected to add this feature during the year. In November 2010, the GLC added the *Megaplier* feature to *Mega Millions*. *Megaplier* remains as an add-on feature that increases players’ non-jackpot prizes for an additional \$1 per play. Depending on the *Megaplier* number selected during the draw, players have the opportunity to multiply their winnings by two, three, four, or five times. The multiplier also applies to matching the five white balls.

In fiscal year 2017, *Mega Millions* sales decreased \$6.0 million or approximately 6.2% to \$90.3 million compared to \$96.3 million in 2016.

Powerball sales increased by \$28.5 million, or 22.4% to \$155.9 million in 2018 compared to \$127.4 million in 2017. The size and frequency of jackpots are the primary drivers for *Powerball* sales. The *Powerball* jackpot exceeded \$250 million on three occasions during the year, reaching \$758 million in August 2017, \$559 million in January 2018 and \$456 million in March 2018. *Powerball* is a multi-state lottery draw game operated by the Multi-State Lottery Association (MUSL). Through a cross-sell agreement between MUSL and participating *Mega Millions* states, the GLC began selling tickets for the *Powerball* draw game during fiscal year 2010, on January 30, 2010. Drawings are held twice weekly on Wednesday and Saturday. The game matrix was changed in advance of the October 7, 2015 draw. The five winning numbers are now drawn from a set of 69 balls rather than 59 white balls. The one number is now drawn from a second set of 26 red balls versus 35 red balls. The new starting jackpot is \$40 million. This change was intended to increase the size of jackpots. Additionally, the *Power Play* option was changed to increase non-jackpot prizes for an additional \$1 per play, per draw. Non-jackpot prize tiers are now fixed at multiples of two, three, four, five, and sometimes ten from the base prize depending on the specific tier level. Additionally, a jackpot management system was introduced in fiscal year 2016. The process works by reducing the jackpot contribution when the jackpot reaches an annuity value of \$120 million. The intent of the change is to increase the size of the early incremental jackpot increases and to slow down the increments at the higher jackpot levels.

Powerball sales decreased by \$74.0 million, or 36.7% to \$127.4 million in 2017 compared to \$201.4 million in 2016. The decrease was directly attributable to the historic jackpot of \$1.6 billion experienced in January 2016.

In fiscal year 2018, *Cash 4* sales increased \$4.2 million or 1.5%, from \$278.4 million in 2017 to \$282.6 million. The increase was attributable to excitement generated by 12 high payout (>\$1 million) draws and the continued synergy with *Cash 3*. *Cash 4* is a thrice-daily drawing game whereby the player chooses a four-digit number and wins a specified fixed amount if his or her numbers are selected in the draw. The aggregate prize amount per draw varies based on the number of winners. A “1-Off” add-on feature was added as part of the base game. The feature allows players to win fixed prizes for being one off from one or more of the draw digits (e.g. 1-6-3-5 or 2-7-2-5 rather than the 1-6-2-5 draw) for an additional wager. This has created another opportunity to refresh an already popular game.

In fiscal year 2017, *Cash 4* sales increased \$18.2 million or 7.0%, from \$260.2 million in 2016 to \$278.4 million. Actual prize payouts in fiscal years 2018 and 2017 were approximately 52% and 48%, respectively.

Fantasy 5 sales decreased by \$10.0 million to \$90.9 million in fiscal year 2018 compared to \$100.9 million in 2017. Sales for the add-on feature, *Cash Match* decreased \$0.5 million in fiscal year 2018 to \$4.5 million from \$5.0 in fiscal year 2017. *Fantasy 5* is a pari-mutuel draw game where players have the option to add *Cash Match* for an additional \$1, where matching their *Fantasy 5* numbers to any of the *Cash Match* numbers can win players up to 5 times on each ticket with instant cash prizes from \$4 to \$500. On October 4, 2015, the game matrix for *Fantasy 5* changed from a field of 39 balls to a field of 42 balls. Additionally, the starting jackpot was raised from a guaranteed minimum of \$100,000 and \$120,000 for the first two draws to \$125,000 and \$150,000. The net effect of the change was to increase the size of the jackpots for the game by reducing the odds on the front end. There were 117 jackpot winners and 7 jackpots exceeded \$1 million in 2018.

Fantasy 5 sales increased by \$2.8 million to \$100.9 million in fiscal year 2017 compared to \$98.1 million in 2016. Sales for the add-on feature, *Cash Match* decreased \$1.1 million in fiscal year 2017 to \$5.0 million from \$6.1 in fiscal year 2016.

Georgia FIVE sales increased by \$0.1 million, from \$7.3 million in fiscal year 2018 to \$7.4 million in fiscal year 2018. *Georgia FIVE* is a fixed prize draw game where players pick their own five numbers, in a single PLAY area - one from each vertical column of 0 to 9 or have their numbers randomly selected through the terminal by requesting a Quik Pik lottery ticket. Players win by matching their numbers to the winning number(s) drawn in the exact order and position in a single play. By matching all five of your numbers in exact order to the winning numbers, players win the top prize of \$10,000. Other opportunities to win prizes are available by matching one or more numbers in a specific order and position sequence/order, with prizes ranging from \$1 to \$225.

Georgia FIVE sales decreased by \$0.7 million, from \$8.0 million in fiscal year 2016 to \$7.3 million in fiscal year 2017.

Keno! sales increased by \$1.2 million to \$190.9 million in fiscal year 2018, compared to \$189.7 million in fiscal year 2017. *Keno!* is a local draw game where players choose the number of spots they wish to play (1-10), the numbers they wish to play from 1-80 or Quik Pik selections, the dollar amount they wish to wager per draw (\$1, \$2, \$3, \$5, or \$10), an optional multiplier (up to 10X), and the number of consecutive draws they wish to play (up to 20). Winners are based on the total numbers matched per game spot per \$1 played. For example, a 10 spot game where the player matches all 10 spots for a \$2 wager wins \$200,000. The odds are based on the number of spots played. The game is played every 3 ½ minutes, or approximately 350 times per day.

Keno! sales declined by \$3.2 million to \$189.7 million in fiscal year 2017, compared to \$192.9 million in fiscal year 2016.

All or Nothing sales decreased \$0.4 million in fiscal year 2018 from \$6.2 million in 2017 to \$5.8 million in 2017. *All or Nothing* is a fixed prize payout draw game where players select their own 12 numbers from a population of 1 to 24, or have their numbers randomly selected through the terminal by requesting a Quik Pik lottery ticket. Each play is \$2. Players win a top prize of \$250,000 by matching all twelve numbers or none of the twelve numbers, hence *All or Nothing*. Other opportunities to win prizes are available by matching one, two, three, four, eight, nine, ten, or eleven numbers. Drawings are held four times daily.

All or Nothing sales decreased \$1.8 million in fiscal year 2017 from \$8.0 million in 2016 to \$6.2 million in 2017.

Jumbo Bucks Lotto sales decreased by \$0.1 million in fiscal year 2018, from \$19.1 million in 2017 to \$19.0 million. *Cash Match* sales decreased by \$0.1 million from \$2.8 million in 2017 to \$2.7 million. *Jumbo Bucks Lotto* is a local draw game that was launched in February 2015. The base game also includes an add-on feature, *Cash Match* that contains features similar to a scratcher game. Drawings are held on Monday and Thursday. Six numbers between one and forty seven are selected by the player with a starting jackpot of \$1 million. Lottery players can play the base game for \$1, or purchase the *Cash Match* add-on feature for an additional \$1. Players have overall odds of 1 in 2.94 of winning a prize for a combined play. There was one jackpot winner during the year. *Jumbo Bucks Lotto* experienced its largest jackpot ever, reaching \$10.8 million in June 2018.

Jumbo Bucks Lotto sales decreased by \$6.6 million in fiscal year 2017, from \$25.7 million in 2016 to \$19.1 million. *Cash Match* sales decreased by \$2.8 million from \$5.6 million in 2016 to \$2.8 million in 2017.

5 Card Cash sales decreased \$4.5 million in 2018 to \$4.2 million from \$8.7 million in 2017. The game possesses characteristics of a draw game and a scratcher game and is based on the poker game *Texas Holdem*. Players wager \$2 for a Quik Pik poker hand containing five cards from a standard deck of 52 cards. The player wins the instant component if he/she matches one of nine Poker hands (e.g. Royal Flush, 4 of a Kind, Straight, etc.). The player wins the draw component of the game by matching two or more of the cards, including suit. The top prize for the instant component is \$5,000 for a Royal Flush match. The top prize for the draw component is \$150,000 for matching all five cards in the drawing.

5 Card Cash sales increased \$2.7 million in FY2017 to \$8.7 million from \$6.0 million in 2016. *5 Card Cash* was launched in 2016.

Cash 4 Life sales decreased \$1.4 million in 2018 from \$11.2 million in 2017 to \$9.8 million. On August 28, 2016, the Georgia Lottery launched the online game, *Cash 4 Life*. The game contributed \$11.2 million in fiscal year 2017. *Cash 4 Life* is a multi-state lottery game that originated with the New Jersey and New York Lotteries and currently includes Florida, Georgia, Indiana, Maryland, New Jersey, New York, Pennsylvania, Tennessee and Virginia. Drawings are held on Monday and Thursday nights. The game matrix consists of selecting five numbers from a pool of numbers from one (1) to sixty (60) and a single number from a second pool of numbers from one (1) to four (4). The number from the second pool is referred to as the “Cash Ball” and can be the same as one of the five numbers selected in the first pool. Players wager \$2 per play and can purchase up to ten consecutive advance plays. The prize structure contains nine tiers of which the top two are considered grand prizes and are pari-mutuel under certain circumstances. The remaining tiers are fixed. The tier one prize is \$1,000 per day (\$365,000 per year) for the life of the winner with a maximum cash option of \$7 million for any single draw. The second tier prize is \$1,000 per week (\$52,000 per year) for the life of the winner with a maximum cash option of \$5 million for any single draw. In the case of multiple winners for a particular draw, the “Measuring Life” is considered to be twenty (20) years.

Print N Play sales decreased \$1.6 million in 2018 from \$11.1 million in 2017 to \$9.5 million. On November 20, 2016, the Georgia Lottery launched the online game, *Print N Play*. The game contributed \$11.1 million in fiscal year 2017. *Print N Play* is composed of a series of games that allow players to place wagers of \$1, \$2, \$3 or \$5. Players win by matching numbers and/or symbols in a reveal area. Prizes are determined by specific prize structures associated with each game. The game possesses characteristics of a draw game and a scratcher game. A player receives a ticket similar to what is provided for a draw game wager and each game contains a grid. However, the numbers and/or symbols are already revealed on the draw ticket, i.e. the player does not have to scratch off overprint ink to uncover the reveal section. The winning experience mimics a scratcher game with respect to reveal sections. No playslips are used for *Print N Play*. The individual games are concept driven (e.g. Cold Hard Ca\$hword, Chilly Cash Blast or Winter Bucks for winter launches). Consequently, the same grids can be “reskinned” to create new games without the need for changing the underlying game specifications. This is another concept adopted from scratcher games and applied to the draw portfolio. There are currently eight active games with a top prize of \$25,000.

COAM Revenue

COAM revenue includes licensing renewal revenue, commissions from net revenue generated by Class B COAM machines, fines and penalties, and other miscellaneous revenue. GLC launched the COAM centralized accounting system in January 2015. Its purpose is to collect net daily revenues generated by Class B COAM machines throughout the state on behalf of the machine owners (Masters). Class B machines are defined as line-up or match-up video games requiring some skill where the points carry over. GLC received 8% of total net revenues generated as a fee for providing this oversight service in 2018. The percentage will continue to increase by 1% each year until it reaches 10% in 2020. COAM revenue increased by \$12.6 million in fiscal year 2018, totaling \$75.0 million versus \$62.4 million in 2017. The increase is due primarily to an increase in the GLC revenue share of \$11.6 million, complemented by increases of \$2.8 million in fines and penalties, \$1.5 million in licensing application fees and \$0.9 million in revenue recognized from auctioning one additional Master License Holder privilege in May.

COAM revenue increased by \$15.3 million in fiscal year 2017, totaling \$62.4 million versus \$47.1 million in 2016.

Other Operating Revenue

Other operating revenue (which includes interest revenue) increased by \$0.8 million in fiscal year 2018, totaling \$5.6 million versus \$4.8 million in 2017. The change is primarily due to an increase in interest revenue.

Other operating revenue increased by \$0.5 million in fiscal year 2017, totaling \$4.8 million versus \$4.3 million in 2016.

Prize Expense

Gross prize expense for scratcher games increased by \$21 million to \$2.060 billion in fiscal year 2018 compared to 2017. Gross prize expense for scratcher games was flat at \$2.039 billion in fiscal year 2017 compared to 2016. The increase is directly proportional to the increase in gross sales of scratcher products and the change in the sales mix of scratcher products. Scratcher games prize expense is managed through the number of tickets printed for each game and value of prizes at each price point, as determined prior to ticket production. Prize expense is recognized based on an established prize structure and related percentage of sales for each game introduced and is recognized when products are made available for sale to the public.

Scratcher game prize expense is reduced by applying unclaimed prizes recognized during the fiscal year. For fiscal year 2018, prize expense, net of unclaimed prizes for scratcher games, totaled \$2.014 billion as compared to \$2.002 billion in 2017. For fiscal year 2017, prize expense, net of unclaimed prizes for scratcher games, totaled \$2.002 billion as compared to \$1.995 billion in 2016. Unclaimed prize expense was \$45.5 million, \$36.7 million and \$43.0 million in 2018, 2017, and 2016 respectively.

Prize expense for draw games generally increases or decreases each year in direct proportion to ticket sales of the related game. For games with pari-mutuel jackpot prizes (*Mega Millions, Powerball, Fantasy 5, Jumbo Bucks Lotto* and *Cash 4 Life* under certain circumstances), actual prize expense is recognized as a percentage of ticket sales. For games with fixed prizes (*Cash 3, Cash 4, Print N Play, Georgia FIVE, Cash Match games, Keno!, All or Nothing, 5 Card Cash* and secondary tier prizes for *Mega Millions, Powerball, Jumbo Bucks Lotto* and *Cash 4 Life*), actual prize expense is recognized based on the number and prize value of winning tickets. To recognize prize expense on a consistent basis for these games, the GLC recognizes prize expense based on the greater of actual prizes paid, the estimated payout experience over the life of the game or industry averages. The GLC has established prize liability limits per draw for certain games.

Total draw prize expense increased by \$11.1 million in 2018 to \$739.2 million compared to \$728.1 million in 2017. Total draw prize expense decreased by \$22.7 million in 2017 to \$728.1 million compared to \$750.9 million in 2016. The net increases are comprised of the following increases and decreases by game as follows:

- Prize expense for *Cash 3* decreased \$13.8 million in fiscal year 2018 as compared to 2017. This is consistent with the 5.1% decrease in gross sales over prior year. Prize expense for *Cash 3* increased \$3.4 million in fiscal year 2017 as compared to 2016. This is consistent with the 1.3% increase in gross sales over prior year. The actual prize payout experienced was approximately 46% and 49% for fiscal years 2018 and 2017 respectively.
- Prize expense for *Mega Millions* increased \$17.6 million in 2018 versus 2017, in direct proportion to the 39.0% increase in sales. Prize expense for *Mega Millions* decreased \$3.0 million in 2017 versus 2016, in direct proportion to the 6.2% decrease in sales.
- Prize expense for *Powerball* increased \$14.3 million in fiscal year 2018 as compared to 2017, in direct proportion to the 22.4% increase in sales. Prize expense for *Powerball* decreased \$37.0 million in fiscal year 2017 as compared to 2016, in direct proportion to the 36.7% decrease in sales.
- Prize expense for *Cash 4* increased \$2.0 million in 2018 over 2017, consistent with the increase in gross sales of 1.5%. Prize expense for *Cash 4* increased \$8.6 million in 2017 over 2016, consistent with the increase in gross sales of 7.0%. The recognized expense percentage was adjusted from 47.25% to 47.00% in 2016 in conjunction with an analysis of actual prize payouts since liability caps were implemented. This adjustment partially offset the increase in prize expense for 2016. Actual prize payouts in fiscal years 2018 and 2017 were approximately 52% and 48%, respectively.
- Prize expense for *Fantasy 5* decreased by \$4.7 million in 2018 versus 2017, in direct proportion to the decrease in gross sales of 9.9%. Prize expense for *Fantasy 5* increased by \$1.1 million in 2017 versus 2016, in direct proportion to the increase in gross sales of 2.8%. Additional liability of 1.25% above the prize structure has been recorded beginning in 2015 to account for actual liability experienced from unfunded jackpots. Cash Match prize expense decreased by \$0.3 million in fiscal year 2018 as compared to 2017 consistent with a 9.5% decrease in gross sales. Cash Match prize expense decreased \$0.9 million in fiscal year 2017 as compared to 2016 consistent with a 18.8% decrease in gross sales.
- Prize expense for *Georgia FIVE* was flat compared to 2017, consistent with the modest growth in gross sales. Prize expense for *Georgia FIVE* decreased \$0.4 million in 2017 compared to 2016, consistent with an 8.6% decrease in gross sales.
- Prize expense for *Keno!* increased by \$0.9 million in 2018 as compared to 2017. This is consistent with an increase of 0.7% in gross sales. Prize expense for *Keno!* decreased by \$3.2 million in 2017 as compared to 2016. This is consistent with a decrease of 1.7% in gross sales. An analysis of actual prize liability over the three prior years resulted in a decision to reduce recognized prize expense from 68.5% to 68.0% in fiscal year 2017 to more accurately reflect actual payout. Keno experienced actual payout of 67.6% in 2018.
- Prize expense for *All or Nothing* decreased \$0.2 million in 2018 compared to 2017. This is consistent with the decrease in gross sales of 7.0%. Prize expense for *All or Nothing* decreased \$1.0 million in 2017 compared to 2016. This is consistent with the decrease in gross sales of 22.5%.
- Prize expense for *Jumbo Bucks Lotto* was flat compared to 2017. This was consistent with flat year over year gross sales. Prize expense for *Cash Match* decreased \$0.1 million in 2018 compared to 2017. Prize expense for *Jumbo Bucks Lotto* decreased \$3.3 million in 2017 compared to 2016. This was consistent with a decrease in gross sales of 25.6%. Prize expense for *Cash Match* decreased \$2.1 million in 2017 compared to 2016. This was consistent with a decrease in gross sales of 49.7%.

- Prize expense for *5 Card Cash* decreased by \$2.9 million in 2018 compared to 2017. This is consistent with the 105.1% decrease in gross sales. Prize expense for *5 Card Cash* increased by \$1.8 million in 2017 compared to 2016. The increase in prize expense was due to the first full year of sales occurring in 2017. The game launched April 3, 2016.
- Prize expense for *Cash 4 Life* decreased by \$0.8 million in 2018 compared to 2017. This is consistent with the 12.3% decline in gross sales. Prize expense for *Cash 4 Life* was \$6.1 million in the first year of sales. The game launched August 28, 2016.
- Prize expense for *Print N Play* decreased by \$0.8 million in 2018 compared to 2017. This is consistent with the 16.5% decline in gross sales. Prize expense for *Print N Play* was \$7.2 million in the first year of sales. The game launched November 20, 2016.

Direct Gaming and Operating Expenses

Direct gaming expenses usually change in proportion with changes in ticket sales. For fiscal year 2018, increased ticket sales resulted in a corresponding increase in contractor (vendor) fees and retailer commissions and a slight increase in retailer merchandising and marketing as compared to 2017. For fiscal year 2017, decreased ticket sales resulted in corresponding decreases in contractor (vendor) fees and retailer commissions and a slight increase in retailer merchandising and marketing as compared to 2016. Retailer commissions for fiscal year 2018 were \$271.6 million compared to \$268.5 million in 2017, and \$270.7 million in 2016. This represents a \$3.1 million increase in fiscal year 2018 versus 2017, and \$2.2 million decrease in fiscal year 2017 versus 2016. For fiscal year 2018, the GLC paid its retailers a set 6% commission percentage for selling lottery tickets. Due to legislative changes with the passing of House Bill 326 in March of fiscal year 2011, the GLC began compensating its retailers at a fixed commission percentage of 6% for selling tickets. Cashing bonuses for validating and paying winning prizes up to \$600 and winning ticket jackpot incentives on certain draw games were discontinued.

Contractor (vendor) fees primarily represent payments made to our three major suppliers of the gaming products, systems, and services, and three other suppliers of scratcher ticket printing, website development, and property licensing. The payments made to our two major suppliers of lottery products and services are determined based on a percentage of sales formula. Contracts with our major vendors for Online Gaming Systems and Services and Scratch Ticket Printing and Associated Services were extended until September 2025. The contract extension will provide lower vendor fees resulting from the reduction in the charges for services provided to the GLC. Payments to our COAM vendor are based on a percentage of net daily revenues collected from the COAM's. The contract with our vendor for the centralized COAM accounting system is in effect until 2022. Payments made to the other suppliers are based on contract terms. In fiscal year 2018, contractor (vendor) fees were \$97.2 million as compared to \$95.2 million in 2017, representing an increase of \$2.0 million. The increase was primarily attributable to increased ticket sales in fiscal year 2018 offset by realization of nearly a full year savings associated with contract extensions signed in 2017. In fiscal year 2017, contractor (vendor) fees were \$95.2 million as compared to \$99.6 million in 2016, representing a decrease of \$4.4 million. The decrease was primarily attributable to decreased ticket sales in fiscal year 2017.

In fiscal year 2018, advertising expense decreased by \$2.3 million to \$25.3 million from \$27.6 million in 2017. The GLC's advertising agency, BBDO, provided marketing services including creative conception, production and shipment of television and radio advertising, point-of-sale materials, digital and print advertising, premium giveaway items, website creative, and the placement of media for various lottery games and marketing initiatives during fiscal year 2018. Additionally, BBDO provided marketing, planning and execution of several experiential sponsorships, including the Atlanta Falcons Halftime Event, the Atlanta Hawks Halftime Event, the July 4th WSB-TV Salute to America media sponsorship, and various other executions. BBDO also

employed Images USA to provide production and translation for radio advertising, point-of-sale and scratcher games.

In fiscal year 2017, several accounts were identified as reflecting advertising costs rather than other gaming. As a result, the accounts were reclassified in 2016 and 2015 was restated to reflect the change. The impact of the change is that advertising expense was increased from \$21.1 million in 2015 to \$31.9 million and gaming expense (Retailer merchandising and marketing) was reduced from \$17.2 million to \$6.4 million as reflected in the 2015 audit report. Advertising expense decreased by \$2.5 million to \$27.6 million in 2017 from \$30.1 million in 2016.

In fiscal year 2018, retailer merchandising and marketing expenses decreased by \$1.2 million from \$8.8 million in 2017 to \$7.6 million in 2018. In fiscal year 2017, retailer merchandising and marketing expenses increased \$0.8 million from \$8.0 million in 2016 to \$8.8 million in 2017. Retailer and marketing expenses are associated with marketing campaigns supporting new lottery games and features including retailer refreshes (Sales maker initiative), promotional point of sale, sponsorships of Georgia collegiate and professional sports teams, retailer partnerships, and various second chance drawings.

Gaming equipment expenses include purchases of *Keno!* monitors, jackpot signs, and Express Point Plus (EPP) ticket checkers. In 2018, the GLC invested \$0.6 million in new *Keno!* monitors to emphasize our commitment to growing *Keno!* into a core game. The GLC invested \$1.1 million in new gaming equipment in fiscal year 2017 to enhance our point-of-sale presence in major corporate retailers, to support merchandising and new scratcher ticket introduced during the year. The GLC invested \$0.5 million in ticket dispensers, jackpot signs, acquisition of draw balls, and Express Point Plus ticket checkers in fiscal year 2016 to enhance our point-of-sale presence in major corporate retailers and television draw graphics.

Operating expenses increased by \$2.3 million to \$48.2 million in 2018 from \$45.9 million in 2017. The increase in operating expenses resulted primarily from increases in personnel services of \$2.4 million and net increases of \$0.2 million in all other categories. Operating expenses decreased by \$1.4 million to \$45.9 million in 2017 from \$47.3 million in 2016. The GLC continually looks for opportunities to improve productivity in conducting its operations.

Nonoperating Revenues (Net of Expenses)

Nonoperating revenues, net of expenses, consist primarily of payments due to Lottery for Education Account, interest revenue, and the change in the fair value of grand prize investments held by the GLC for funding of future grand prize payments. The increases or decreases in the fair value of grand prize investments are the result of current period market fluctuations. For fiscal year 2018, nonoperating expenses, net of revenues, increased \$36.5 million from \$1.114 billion in 2017 to \$1.151 billion in 2018. The increase in nonoperating expenses, net of revenues is attributable to a \$42.5 million increase in payments due to Lottery for Education Account offset by a \$0.9 million increase in interest revenue and \$5.1 million decrease in the change in fair value of grand prize investments held by the GLC for funding of future grand prize payments.

For fiscal year 2017, nonoperating expenses, net of revenues, increased \$26.2 million from \$1.088 billion in 2016 to \$1.114 billion in 2017. The increase in nonoperating expenses, net of revenues is attributable to a \$23.2 million increase in the change in fair value of grand prize investments held by the GLC for funding of future grand prize payments, as well as a \$3.5 million increase in payments due to Lottery for Education Account.

Significant Factors Impacting Next Year

The GLC strives to stay relevant in the marketplace by providing lottery products and regulatory oversight of COAMs that align with our mission of maximizing revenues for the State of Georgia and its specific education programs funded through our proceeds. During the upcoming fiscal year, the GLC emphasis will be on replacing our existing Enterprise Series gaming system with the new Aurora gaming system. This represents the first full refresh in 15 years. The Aurora conversion will necessitate a freeze in new draw games. Go Live is scheduled for September 2018. The GLC will continue to examine creative ways to enhance current draw games and expand our distribution channels during this period.

In April 2013, Georgia House Bill 487 was signed into law and transferred responsibility for administration, enforcement, and licensing of coin-operated amusement machines to the GLC. On June 12, 2014, the GLC awarded a vendor contract to INTRALOT Inc. for the development and implementation of a centralized accounting and communications network that was connected to all Class B machines. In January 2015, the onboarding of Class B machines began, allowing the GLC to begin revenue sharing. The GLC share is scheduled to increase by 1% to 9% in 2019 until reaching 10% in 2020.

Contacting the GLC's Financial Management

This financial report is designed to provide the state of Georgia, the public, and other interested parties with an overview of the financial results of the GLC's activities and to show the GLC's accountability for conducting business in a fiscally responsible manner. If you have questions about this report or require additional financial information, contact the GLC's Corporate Affairs Division at the Georgia Lottery.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF NET POSITION

AS OF JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 237,745,000	\$ 234,877,000
Restricted fidelity fund cash	369,000	229,000
Restricted retailers' escrow fund cash	16,249,000	14,184,000
Retailer accounts receivable—net	175,038,000	168,805,000
Prepaid expenses and other assets	3,202,000	4,561,000
	<u>432,603,000</u>	<u>422,656,000</u>
NONCURRENT ASSETS:		
Grand prize investments	192,983,000	208,510,000
Capital assets - net	11,068,000	5,340,000
	<u>204,051,000</u>	<u>213,850,000</u>
TOTAL ASSETS	<u>636,654,000</u>	<u>636,506,000</u>
Deferred Outflows of Resources		
Deferred outflows of resources related to pensions	37,000	124,000
LIABILITIES		
CURRENT LIABILITIES:		
Due to Lottery for Education Account	280,665,000	283,061,000
Prizes payable	100,962,000	93,098,000
Accounts payable and accrued liabilities	31,576,000	22,986,000
Restricted fidelity fund	369,000	229,000
Restricted retailers' escrow fund	16,249,000	14,184,000
	<u>429,821,000</u>	<u>413,558,000</u>
NONCURRENT LIABILITIES:		
Grand prizes payable	188,720,000	194,980,000
Noncurrent portion of other long-term liabilities	4,692,000	4,820,000
Net pension liability	383,000	608,000
	<u>193,795,000</u>	<u>200,408,000</u>
Total liabilities	<u>623,616,000</u>	<u>613,966,000</u>
Deferred Inflows of Resources		
Deferred inflows of resources related to pensions	122,000	191,000
Deferred inflows related to unearned COAM revenue	7,149,000	8,484,000
Total deferred inflows of resources	<u>7,271,000</u>	<u>8,675,000</u>
NET POSITION		
Invested in capital assets	11,068,000	5,340,000
Unrestricted	(5,264,000)	8,649,000
Total net position	<u>\$ 5,804,000</u>	<u>\$ 13,989,000</u>

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
OPERATING REVENUES:		
Ticket sales	\$ 4,597,783,000	\$ 4,528,950,000
Less tickets provided as prizes	<u>(315,288,000)</u>	<u>(310,523,000)</u>
Net ticket sales	4,282,495,000	4,218,427,000
Online fees	3,851,000	3,894,000
COAM fees	74,970,000	62,442,000
Other	<u>86,000</u>	<u>131,000</u>
Net operating revenues	<u>4,361,402,000</u>	<u>4,284,894,000</u>
OPERATING EXPENSES:		
Prizes	2,768,522,000	2,737,542,000
Retailer commissions	271,581,000	268,528,000
Contractor fees	97,170,000	95,188,000
Advertising	25,318,000	27,606,000
Salaries and benefits	32,789,000	30,266,000
Retailer merchandising and marketing	7,588,000	8,836,000
Rent, utilities, and maintenance	5,490,000	5,371,000
Depreciation	2,648,000	2,149,000
Professional fees	4,299,000	2,279,000
Gaming Equipment	637,000	1,138,000
Other	<u>2,938,000</u>	<u>5,744,000</u>
Total operating expenses	<u>3,218,980,000</u>	<u>3,184,647,000</u>
Operating income	<u>1,142,422,000</u>	<u>1,100,247,000</u>
NONOPERATING REVENUES (EXPENSES):		
Payments to and due to Lottery for Education Account	(1,143,513,000)	(1,101,063,000)
Interest revenue	1,685,000	816,000
Net increase (decrease) in fair value of grand prize investments	<u>(8,779,000)</u>	<u>(13,867,000)</u>
Total nonoperating revenues (expenses)	<u>(1,150,607,000)</u>	<u>(1,114,114,000)</u>
Change in net position	(8,185,000)	(13,867,000)
NET POSITION — Beginning of year	<u>13,989,000</u>	<u>27,856,000</u>
NET POSITION — End of year	<u>\$ 5,804,000</u>	<u>\$ 13,989,000</u>

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
OPERATING ACTIVITIES:		
Cash received from customers	\$ 4,274,998,000	\$ 4,205,685,000
Other operational cash received	3,937,000	4,025,000
COAM cash received	74,970,000	62,442,000
Cash paid to prize winners	(2,766,913,000)	(2,748,624,000)
Cash paid to retailers	(271,581,000)	(268,528,000)
Cash paid to contractors and employees	(155,866,000)	(156,875,000)
Other operating payments	(8,422,000)	(20,511,000)
	<u>1,151,123,000</u>	<u>1,077,614,000</u>
NONCAPITAL FINANCING ACTIVITIES:		
Payments to Lottery for Education Account	(1,145,909,000)	(1,082,016,000)
Payments to DHBDD	(200,000)	(200,000)
	<u>(1,146,109,000)</u>	<u>(1,082,216,000)</u>
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchases of property and equipment	(8,411,000)	(1,638,000)
Proceeds from disposals of property and equipment	37,000	8,000
	<u>(8,374,000)</u>	<u>(1,630,000)</u>
INVESTING ACTIVITIES:		
Interest received	1,685,000	816,000
Purchase of grand prize investments	(5,059,000)	(22,585,000)
Maturities of grand prize investments	11,807,000	13,819,000
	<u>8,433,000</u>	<u>(7,950,000)</u>
NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	5,073,000	(14,182,000)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—Beginning of year	<u>249,290,000</u>	<u>263,472,000</u>
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH—End of year	<u>\$ 254,363,000</u>	<u>\$ 249,290,000</u>

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION

(A Component Unit of the State of Georgia)

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:

	<u>2018</u>	<u>2017</u>
Operating income	\$ 1,142,422,000	\$ 1,100,247,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,648,000	2,149,000
Provision for doubtful retailer accounts	(71,000)	780,000
Gains (Losses) on disposals of property and equipment	(2,000)	26,000
Changes in assets and liabilities:		
Retailer accounts receivable	(6,162,000)	(13,005,000)
Prepaid expenses and other assets	1,359,000	(1,188,000)
Accounts payable and accrued liabilities	8,589,000	(3,458,000)
Prizes payable	8,064,000	(19,972,000)
Grand prizes payable	(6,260,000)	8,890,000
Restricted fidelity fund	140,000	99,000
Restricted Retailer Escrow	2,066,000	2,929,000
Unearned COAM Revenue	(1,335,000)	263,000
Net pension liability and related deferred inflows and outflows	(207,000)	(195,000)
Other liabilities	(128,000)	49,000
	<u>\$ 1,151,123,000</u>	<u>\$ 1,077,614,000</u>
Net cash provided by operating activities		
	<u>\$ 1,151,123,000</u>	<u>\$ 1,077,614,000</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES:		
Increase (decrease) in fair value of investments	\$ (8,779,000)	\$ (13,867,000)
Accretion of grand prizes payable	<u>6,852,000</u>	<u>7,308,000</u>
Total noncash investing, capital, and related financing activities	<u>\$ (1,927,000)</u>	<u>\$ (6,559,000)</u>

See Notes to financial statements.

GEORGIA LOTTERY CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED JUNE 30, 2018 AND 2017

1. REPORTING ENTITY

The Georgia Lottery Corporation (the “GLC”) was established as an instrumentality of the state with the enactment of the Georgia Lottery for Education Act (the “Act”) on November 2, 1992. The GLC is responsible for the provision of lotteries on behalf of the State of Georgia in accordance with the Act and is a component unit of the State of Georgia.

Additionally, House Bill 487 was signed into law in April, 2013 which transferred oversight responsibility for licensing and regulating coin operated amusement machines (COAMs) across the state of Georgia from the Georgia Department of Revenue to the GLC. The COAM industry is comprised of masters (machine owners) and locations (machine operators). A COAM is any machine that requires some sort of payment (cash, tickets, tokens, etc.) and whose operation depends in whole or in part on the skill of the player. COAM’s are classified as Class A or Class B machines. The distinguishing characteristic between the two classes is that Class B machines afford the player an award, e.g. a free play or redemption coupon. Cash awards are prohibited.

The GLC’s ticket sales include scratcher ticket sales, Diggi games and draw ticket sales for *Cash 3*, *Cash 4*, *Georgia FIVE*, *Fantasy 5*, *Cash Match*, *Keno!*, *Mega Millions*, *Powerball*, *All or Nothing*, *Jumbo Bucks Lotto* with *Cash Match*, *5 Card Cash*, *Cash 4 Life* and *Print N Play*.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation—The GLC is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises: (1) where the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or (2) where the periodic determination of net income is considered appropriate.

Basis of Accounting—The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”). Under this method, revenues are recognized when earned and expenses are recognized and recorded when a liability is incurred, regardless of the timing of cash flows. The Governmental Accounting Standards Board (“GASB”) establishes generally accepted accounting principles for governmental entities and pronouncements of the GASB are followed by the GLC.

Use of Estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities, deferred inflows of resources, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition—Lottery games are sold to the public by contracted retailers. Revenue is recognized for draw games when tickets are sold to players and the related draw has occurred. Revenue is recognized for scratcher games when the product is made available for sale to the public, which is based on ticket activations by the retailers. Certain games include free tickets in the prize structure, which entitle the holder to receive one ticket of equal value. The selling price of tickets provided as prizes reduces gross ticket revenue when the prize is claimed by a player. Centralized accounting system revenue is recognized for COAM based the GLC percentage of the net daily revenues collected from individual Class B machines throughout the state. GLC also receives revenue from COAM owners and operators for renewing existing licenses and obtaining additional licenses. During fiscal year 2014 and prior, these licenses were considered an exchange transaction as the amounts were going to pay for the GLC’s establishment of the monitoring system related to COAM. Beginning in fiscal year 2015 as the system has been established, the amount of the license significantly exceeds the cost of monitoring and thus the license revenue is a non-exchange transaction. As a non-exchange transaction, this revenue is treated as a deferred inflow of resources until the applicable licensing period is reached. Licenses are currently granted on a fiscal year basis.

Revenue and Expenses—Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues generally result from providing services in connection with a proprietary fund’s principal ongoing operations. The principal operating revenues of the Georgia Lottery Corporation’s enterprise fund are primarily revenues from ticket sales, COAM licensing fees, and online fees. “Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.” All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal nonoperating revenues and expenses of the Georgia Lottery Corporation’s enterprise fund are primarily interest income revenue, payments to and due to the Lottery for Education Account (an expense), and the net increase (revenue) or decrease (expense) in the fair value of grand prize investments.

Commissions and Bonuses— During fiscal years 2018 and 2017, retailers received a sales commission of 6% on all games. On March 15, 2011, Georgia House Bill 326 was enacted into law, which effectively eliminated all cashing bonuses and retailer incentive payments, and provided for sales commissions at a rate of 6% for all games.

Contractor Fees—The GLC has contracted with two vendors for the majority of the gaming systems and supplies. Additionally, the GLC has contracted with one vendor for operation and maintenance of the centralized COAM accounting system.

For fiscal year 2018, the IGT Corporation (“IGT”) rate was unchanged compared to 2017 at 0.99% of net sales. The IGT vendor rate decreased from 1.15% to 0.99% of net sales, or 13.9% in fiscal year 2017. Additionally, the contract with IGT was amended through September 11, 2025. The amended contract provides for further savings based on a rate reduction from 0.99% to 0.8477%, or 14.4% beginning in September 2018 in addition to retailer equipment.

For fiscal 2018, the Scientific Games, Inc. (“SGI”) rate was unchanged compared to 2017 at 0.99% of scratcher game tickets distributed to retailers, net of returns. Additionally, the contract with SGI for the printing and distribution of scratcher game tickets was amended through September 10, 2025. Under the amended contract, SGI has agreed to provide an additional 10,000 scratcher ticket dispenser facings per contract year. The GLC will realize a reduction in fees from 0.99% to 0.793%, or 19.9% and SGI’s annual sales incentive bonus will be discontinued beginning in September 2018.

The GLC entered into an eight-year vendor contract effective June 12, 2014, with Intralot, Inc. for the development, implementation, and maintenance of a centralized COAM accounting system. Under the current contract, Intralot receives a fee of 1.2489% of net daily revenues generated by COAM machines. This rate remains fixed throughout the life of the agreement. The contract ends December 31, 2022.

Prizes—In accordance with the Act, as nearly as practical, at least 45% of ticket sales must be returned to the public in the form of prizes. Prize expense for scratcher games is recognized based on the predetermined prize structure for each game. Generally, prize expense for *Cash 3*, *Cash 4*, *Georgia FIVE*, *Cash Match*, *Kenol*, *All or Nothing*, *5 Card Cash* and *Print N Play* draw games is recognized based on the estimated payout experience over the life of the games, theoretical game payout or the industry averages. Prize expense for *Fantasy 5* and *Jumbo Bucks Lotto* is recorded on a pari-mutuel basis according to the game structure based on a percentage of revenue recognized.

Cash 4 Life and *Mega Millions*, are multi-state lottery games operated by member lotteries. Prizes costs are shared based on contributions to the prize pools by the member lotteries. Grand prize investments for jackpot winners who purchased tickets in Georgia are held by the GLC.

The *Powerball* grand prize is a shared prize from contributions to the prize pool by all member lotteries of the Multi-State Lottery Association (“MUSL”) and certain Mega Millions states including Georgia which sell *Powerball* tickets without being a member of MUSL. All *Powerball* grand prizes won by players who purchased tickets in Georgia are funded by investments purchased by MUSL. The investments are held by MUSL in trust for the GLC and are paid in 20 annual installments. No investments were held in trust by MUSL in the statement of net position at June 30, 2018. The GLC withdrew from MUSL on August 31, 1996. During fiscal year 2010, the GLC, along with the other participating Mega Millions states, entered into an agreement with the MUSL authorizing the cross-sell of tickets for the *Powerball* game. Ticket sales under the cross-sell agreement began on January 31, 2010, and the first *Powerball* drawing including participating Mega Millions states was held on February 1, 2010.

Unclaimed Prizes—Prizes must be claimed no later than 90 days after game-end for scratcher games and within 180 days after the draw date for draw games. An estimate of the unclaimed prizes is based upon the historical experience rate as a percentage of ticket sales. In accordance with the Act, \$200,000 of unclaimed prizes must be transferred to the Department of Behavioral Health and Developmental Disabilities for the treatment of compulsive gambling and related educational programs. Transfers for this purpose for each fiscal year have been \$200,000. The remainder of unclaimed prizes is used to fund future prizes or special prize promotions, as defined by the statute. The GLC also transferred \$200,000 on behalf of the COAM business unit as part of their operating expenses.

Net Position—Net position represents cumulative revenues less expenses in excess of net proceeds transferred to the Lottery for Education Account, as defined under the Act (see Note 7). Net position includes funds invested in capital assets and unrestricted net position. Unrestricted net position normally results from the inclusion of capital costs in the determination of net proceeds as required by the Act and the cumulative effect of periodic adjustments to recognize the fair value of grand prize investments held to fund grand prizes payable. Grand prize investments are purchased to finance future payments to *Jumbo Bucks Lotto*, *Mega Millions*, *Powerball*, *Decades of Dollars*, and certain scratcher game grand prize winners. Any increases or decreases in the fair value of these investments are determined to be unrealized and will not affect (i) the future ability to hold these investments or (ii) the amount of funds available for distribution to the Lottery for Education Account. Unrealized gains on grand prize investments at June 30, 2018 and 2017 were \$6,100,000 and \$14,879,000, respectively, resulting in a net change of \$8,779,000 in the fair value of grand prize investments.

Cash and Cash Equivalents—The GLC considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash, and balances on account in Georgia Fund 1.

Accounts Receivable—Accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions and prizes paid by the retailers and from COAM operators (Locations) for net revenues collected from COAM machines. Lottery proceeds are collected weekly from retailer and COAM operator bank accounts held in trust for the GLC. An allowance for doubtful accounts is established based on management’s estimate of retailer and COAM operator receivables that will not be collected. At June 30, 2018 and 2017, the allowance for uncollectible retailer receivables was \$3,952,000 and \$4,607,000, respectively.

Capital Assets—Capital assets are stated at cost less accumulated depreciation. Depreciation on capital assets is computed using the straight-line method over the estimated useful lives of three to ten years. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal.

Fidelity Fund—In accordance with the Act, retailers and COAM locations contribute a fee to a fidelity fund upon acceptance as a GLC retailer or COAM operator. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers or COAM locations. At the end of each year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the GLC subject to transfer to the Lottery for Education Account. There were no fidelity funds available for transfer as net proceeds for the years ended June 30, 2018 and 2017. The fidelity fund proceeds are held in a separate account and are presented in the statements of net position as restricted fidelity fund cash and in liabilities as restricted fidelity funds.

Escrow Fund—Retailers and COAM locations pledge cash deposits to an escrow funds management service offered by a commercial bank selected by the GLC. This is one of the acceptable forms of Financial Security Deposits from Retailers pursuant to Section 19 of the Georgia Lottery for Education Act, Chapter 2 of the GLC Policies entitled ‘Retailer Rules and Regulations,’ and Chapter 8.2 of the GLC Policies entitled ‘Retailer Credit and Financial Security Policy,’ and appropriate Executive Orders. The GLC is reimbursed from available funds for any losses incurred as a result of the misfeasance or malfeasance of GLC retailers or COAM operators. The retailers’ escrow funds are not subject to transfer to the Lottery for Education Account. The retailer escrow fund proceeds are held in a separate account and are presented in the statements of net position as restricted retailer escrow fund cash and in liabilities as restricted retailer escrow funds.

Coin Operated Amusement Machines (COAM)

The GLC deployed an internally developed licensing application system in May 2014. The GLC granted 310 Class A and 192 Class B master licenses in fiscal year 2018. COAM Operations also issued 19,597 Class A decals for 19,382 active machines and 26,937 Class B decals for 26,582 active machines. During fiscal year 2018, COAM contributed \$58.8 million in COAM revenue sharing, \$11.0 million in licensing fees, \$4.3 million in fines, penalties and miscellaneous other income and \$0.9 million in incremental revenue from auctioning additional master license holder privileges.

COAM collected an additional \$7.1 million in renewal fees received in advance of the fiscal year 2019 licensing period, a decrease of \$1.3 million below the 2018 licensing period.

Compensated Absences—Employees earn the right to be compensated during absences for vacation and illness. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and vested sick leave benefits is accrued in the period in which it was earned. In March 2005, the GLC adopted a new policy concerning payments of accrued sick leave upon termination. Sick leave accrued by employees prior to March 1, 2005, and not used prior to termination is paid at a 50% rate upon termination. No payments will be made for sick leave accrued after March 1, 2005, and not used by the employee before termination.

Pensions—For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Employees' Retirement System (ERS) and additions to/deductions from ERS's fiduciary net position have been determined on the same basis as they are reported by ERS. 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.

Budget—Georgia Statute requires the GLC to submit to the Office of Planning and Budget (“OPB”) and the State Auditor, annually by June 30, a proposed operating budget for the next fiscal year. Additionally, the GLC is required to submit to the OPB annually, on September 1, a proposed operating budget for the GLC and an estimate of net proceeds for the succeeding fiscal year. The GLC complied with these requirements in 2018 and 2017.

3. CASH, CASH EQUIVALENTS, AND GRAND PRIZE INVESTMENTS

During the year ended June 30, 2005, the GLC adopted the provisions of SGAS No. 40, *Deposit and Investment Risk Disclosures*, which amends SGAS No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, which recognizes that deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This statement establishes and modifies disclosure requirements related to investment and deposit risks; accordingly, the GLC's note disclosures on cash, cash equivalents, and investments are in conformity with the provisions of SGAS No. 40. Following “exception-based reporting,” the GLC is not required to disclose risks that do not apply to it. Additionally, in 2016 the Georgia Lottery changed banking service providers from Bank of America to SunTrust Bank. This change was effective January 1, 2016 and included a nine-month transition period. The escrow accounts were transferred in September 2016 and the Safekeeping account transferred in November 2016 in sync with the quarterly annuity payments.

Cash—Cash is primarily held in demand deposits at SunTrust Bank. The GLC’s daily operating cash and other cash accounts for accounts payable, prizes payable, retailer return items, district offices, promotions, payroll, escrow, merchant processor transactions and petty cash are held in accounts with SunTrust. At June 30, 2018, the Master Operating Account had a book balance of \$37,981,000 and a bank balance of \$37,690,000. This includes COAM cash consisting of a book balance of \$27,427,000 and a bank balance of \$27,472,000. At June 30, 2018, the other miscellaneous accounts had a net book balance of (\$1,773,000) which was primarily due to outstanding checks for the accounts payable and prize check zero balance cash accounts and a bank balance of \$349,000. The net carrying value and bank balance of all GLC cash accounts as of June 30, 2018 was \$36,208,000 and \$38,039,000 respectively. These deposits were entirely insured by FDIC insurance or collateralized by investment securities held by the GLC’s agent in the GLC’s name.

At June 30, 2017, the Master Operating Account had a book balance of \$31,110,000 and a bank balance of \$31,087,000. This includes COAM cash consisting of a book balance of \$27,025,000 and a bank balance of \$27,614,000. At June 30, 2017, the other miscellaneous accounts had a net book balance of (\$1,607,000) which was primarily due to outstanding checks for the accounts payable and prize check zero balance cash accounts and a bank balance of \$305,000. The net carrying value and bank balance of all GLC cash accounts as of June 30, 2017 was \$29,503,000 and \$31,392,000 respectively. These deposits were entirely insured by FDIC insurance or collateralized by investment securities held by the GLC’s agent in the GLC’s name.

Cash Equivalents—Cash equivalents represent surplus cash invested in Georgia Fund 1 administered by the State of Georgia’s Office of the State Treasurer. The voluntary fund is a short-term investment vehicle that is available for use by state entities and local governments. Georgia Fund 1 invests its assets in U.S. Treasury bills, U.S. Treasury notes, securities issued by federal agencies and instrumentalities, banker’s acceptances, and repurchase agreements.

The Georgia Fund 1 is an external investment pool managed by the Office of the State Treasurer in accordance with policies and procedures established by state law and the State Depository Board, the oversight Board for the Office of the State Treasurer. This investment is valued at fair value. The Georgia Fund 1 is an AA Af rated investment pool by Standard & Poor’s, and the portfolio’s weighted average maturity is ten (10) days at June 30, 2018 Under SGAS No. 40, since these funds represent an externally managed pool it is not exposed to custodial credit risk, and therefore, no custodial credit risk disclosures are required. The GLC’s investment in Georgia Fund 1 was approximately \$201,537,000 and \$205,374,000 at June 30, 2018 and 2017, respectively. Interest earned on the GLC’s investments was approximately \$1,685,000 and \$816,000 for the years ended June 30, 2018 and 2017, respectively.

Other Deposits—Cash maintained in the Retailer Escrow Fund bank account had bank and book balances of \$16,695,000 and \$16,249,000 respectively, as of June 30, 2018. Cash maintained in the Fidelity Fund bank account has bank and book balances of \$334,000 and \$369,000, respectively, as of June 30, 2018. The Fidelity Fund account was moved from Carver State Bank to SunTrust during fiscal year 2018 to consolidate all GLC cash accounts. All accounts continue to be entirely insured by FDIC insurance or collateralized by investment securities held by the GLC’s agent in the GLC’s name.

Cash maintained in the Retailer Escrow Fund bank account had bank and book balances of \$14,476,000 and \$14,184,000 respectively, as of June 30, 2017. Cash maintained in the Fidelity Fund bank account has bank and book balances of \$224,000 and \$229,000, respectively, as of June 30, 2017. The Retailer Escrow Fund and the restricted COAM fund accounts were maintained with SunTrust and the Fidelity Fund account was maintained with Carver State Bank and each account was entirely insured by FDIC insurance or collateralized by investment securities held by the GLC’s agent in the GLC’s name.

Grand Prize Investments—All grand prize investments represent funds held to pay grand prize winners who are entitled to multiyear payments. Grand prize investments at June 30, 2018 and 2017, consist of the following:

	Fair Value	
	2018	2017
U.S. Treasury securities	\$ 192,983,000	\$ 208,510,000
	<u>\$ 192,983,000</u>	<u>\$ 208,510,000</u>

Grand prize investments are not presented as current assets, as they are not part of the GLC's current operations. Changes in grand prize investments for the years ended June 30, 2018 and 2017 consisted of the following:

Fair value—June 30, 2016	\$ 213,611,000
Purchases	22,585,000
Payments to grand prize winners	(21,127,000)
Interest earned on current-year maturities	7,308,000
Change in fair value	<u>(13,867,000)</u>
Fair value—June 30, 2017	<u>208,510,000</u>
Purchases	5,059,000
Payments to grand prize winners	(18,659,000)
Interest earned on current-year maturities	6,852,000
Change in fair value	<u>(8,779,000)</u>
Fair value—June 30, 2018	<u>\$ 192,983,000</u>

Grand prize investments are recorded at their fair values. Increases or decreases in the fair value of these investments are recorded as nonoperating revenue (expense). The GLC categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs. The GLC has the following recurring fair value measurements as of June 30, 2018 and 2017:

<u>Investment</u>	<u>2018</u>		<u>2017</u>	
	<u>Level 2</u>	<u>Fair Value</u>	<u>Level 2</u>	<u>Fair Value</u>
United States Treasuries	\$ 192,983,000	\$ 192,983,000	\$ 208,510,000	\$ 208,510,000
Total Investments at fair value	<u>\$ 192,983,000</u>	192,983,000	<u>\$ 208,510,000</u>	208,510,000
Investments not subjected to level disclosure:				
Georgia Fund 1		<u>201,537,000</u>		<u>205,374,000</u>
Total Investments		<u>\$ 394,520,000</u>		<u>\$ 413,884,000</u>

The investment in United States Treasuries classified as Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

The Georgia Fund 1 is an investment pool which does not meet the criteria of GASB Statement No. 79 and is thus valued at fair value in accordance with GASB Statement No. 31. As a result, the GLC does not disclose investment in the Georgia Fund 1 within the fair value hierarchy.

Custodial credit risk for Deposits—Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. State statutes require all deposits and investments (other than federal or state government instruments) to be collateralized by depository insurance, obligations of the U.S. government, or bonds of public authorities, counties, or municipalities. As of June 30, 2018, all deposits are considered insured.

Investments—In November 2016, the GLC transferred safekeeping responsibilities from Bank of America to SunTrust, completing the banking transition begun in FY 2016. The GLC’s investments consist of U.S. Treasury Strips (principal and interest) that are held to maturity to fund grand prize winners for several draw games, including *Lotto Georgia*, *The Big Game*, *Mega Millions*, *Lotto South*, and *Win For Life*, and various Scratcher Games with annuity prizes such as *Georgia’s \$500 Million Club*, *Georgia Lottery Black*, *Super Millions*, and *Maximum Green*. At June 30, 2018 and 2017, the GLC’s investment balances consisted of:

<u>Investment Type</u>	<u>2018 Fair Value</u>	<u>2018 Maturity</u>
U.S Treasury Strips	\$ <u>192,983,000</u>	Weighted average maturity of 6.4 years
Total	\$ <u>192,983,000</u>	
<u>Investment Type</u>	<u>2017 Fair Value</u>	<u>2017 Maturity</u>
U.S Treasury Strips	\$ <u>208,510,000</u>	Weighted average maturity of 6.8 years
Total	\$ <u>208,510,000</u>	

U.S Treasury Strips held by the GLC are AAA-rated and current holdings mature quarterly beginning August 2018 through February 2041.

Interest Rate Risk—The GLC’s deposits in the master operating account with SunTrust are subject to fluctuations in short-term interest rates. The GLC purchases investments to fund future prize payments at fixed amounts for grand prize winner obligations, as detailed in Note 5, Grand Prizes Payable. Periodic market fluctuations affect the fair value of grand prize investments. The GLC expects to hold grand prize investments to maturity to meet future grand prize payments and, therefore, will not realize any gains or losses related to the changes in the market. The only exposure that the GLC has in regards to interest rate sensitivity is for the GLC’s master operating account, since there is no investment related impact on the GLC resulting from the effect of interest rate changes on grand prize investments.

Credit Risk—State laws limit the investment sources available to the GLC to United States Treasury securities, federal agency securities, state of Georgia securities, repurchase or reverse repurchase agreements, bank certificates of deposits, Georgia Fund 1, life insurance annuity contracts, and investments that would be permissible for the legal reserves of domestic life insurance companies under the laws of the state of Georgia.

Custodial Credit Risk—For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the GLC will not be able to recover the value of its investments in the possession of an outside party. The GLC entered into a Collateral pool agreement with SunTrust on January 26, 2016. Effective July 1, 2017, banks with \$50 billion or more will be required to participate in the Secure Deposit Program per Senate Bill 283. SunTrust falls into this category. The program will be administered by the State Treasurer for the State Depository Board. Collateralization of public deposits will no longer be permitted. Custodial risk will be mitigated by FDIC insurance, liquidation of collateral pledged to the State Treasurer by the Covered Depository and assessments made by the State Treasurer on remaining Covered Depositories to the extent necessary to cover any shortfall.

4. CAPITAL ASSETS

Capital assets at June 30, 2018 and 2017 consisted of the following:

	Balance at June 30, 2017	Increases	Decreases	Balance at June 30, 2018
Capital assets:				
Furniture and fixtures	\$ 2,947,000	\$ -	\$ -	\$ 2,947,000
Computer and communications equipment	13,035,000	7,824,000	-	20,859,000
Vehicles	3,664,000	410,000	(330,000)	3,744,000
COAM Vehicles	406,000	64,000	(50,000)	420,000
Leasehold improvements	5,376,000	106,000	-	5,482,000
COAM improvements	405,000	-	-	405,000
Software	3,887,000	-	-	3,887,000
COAM Software	875,000	-	-	875,000
Other assets	1,747,000	-	-	1,747,000
Gaming Equipment	2,415,000	7,000	-	2,422,000
	<u>34,757,000</u>	<u>8,411,000</u>	<u>(380,000)</u>	<u>42,788,000</u>
Total capital assets at historical cost				
	34,757,000	8,411,000	(380,000)	42,788,000
Less accumulated depreciation	<u>(29,417,000)</u>	<u>(2,648,000)</u>	<u>345,000</u>	<u>(31,720,000)</u>
Capital assets—net	<u>\$ 5,340,000</u>	<u>\$ 5,763,000</u>	<u>\$ (35,000)</u>	<u>\$ 11,068,000</u>
	June 30, 2016	Increases	Decreases	June 30, 2017
Capital assets:				
Furniture and fixtures	\$ 2,983,000	\$ -	\$ (36,000)	\$ 2,947,000
Computer and communications equipment	13,139,000	153,000	(257,000)	13,035,000
Vehicles	3,465,000	608,000	(409,000)	3,664,000
COAM Vehicles	296,000	110,000	-	406,000
Leasehold improvements	5,179,000	197,000	-	5,376,000
COAM improvements	405,000	-	-	405,000
Software	3,680,000	207,000	-	3,887,000
COAM Software	875,000	-	-	875,000
Other assets	1,747,000	-	-	1,747,000
Gaming Equipment	2,052,000	363,000	-	2,415,000
	<u>33,821,000</u>	<u>1,638,000</u>	<u>(702,000)</u>	<u>34,757,000</u>
Total capital assets at historical cost				
	33,821,000	1,638,000	(702,000)	34,757,000
Less accumulated depreciation	<u>(27,936,000)</u>	<u>(2,149,000)</u>	<u>668,000</u>	<u>(29,417,000)</u>
Capital assets—net	<u>\$ 5,885,000</u>	<u>\$ (511,000)</u>	<u>\$ (34,000)</u>	<u>\$ 5,340,000</u>

5. GRAND PRIZES PAYABLE

Grand prizes payable is recorded at the net present value of the U.S. Treasury securities purchased for each jackpot winner. Grand prizes payable was accreted by approximately \$6,852,000 and \$7,308,000 for the years ended June 30, 2018 and 2017, respectively. Grand prizes payable are not presented as current liabilities, as they are not part of the GLC's current operations.

Future payments of grand prizes payable at June 30, 2018, are scheduled as follows:

2019	\$ 18,612,000
2020	18,612,000
2021	18,612,000
2022	18,612,000
2023	18,612,000
2024-2028	76,326,000
2029-2033	42,688,000
2034-2038	16,609,000
2039-2043	<u>7,383,000</u>
	236,066,000
Less imputed interest	<u>(47,346,000)</u>
Net present value of grand prizes payable	<u>\$ 188,720,000</u>

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (the "Omnibus Act") was enacted into federal law on October 21, 1998. Included in this Omnibus Act is a Special Rule for Cash Options for Receipt of Qualified Prizes ("Special Rule"). Pursuant to the Special Rule, the GLC may extend to recipients of "qualified prizes" the opportunity, within a certain period after the drawing, to select a lump-sum payment equivalent to the cash value of an annuitized prize. Qualified prizes, as defined in the Omnibus Act, include multiple-year payments of a minimum of ten years.

Claimants of qualified prizes, as defined in the GLC Rules and Regulations, on or after the date of enactment of the Omnibus Act, can make an irrevocable election to receive a lump-sum cash payment equivalent of the annuitized prize within 60 days of the claim date. Grand prizes payable at June 30, 2018, consist of no qualified prizes under this provision of the Special Rule.

6. OPERATING LEASES

The GLC has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the GLC.

Future minimum rental payments on non-cancellable leases with original terms of one year or more are scheduled as follows:

<u>Year Ending June 30,</u>	<u>Operating Leases</u>
2019	\$ 2,800,000
2020	2,803,000
2021	2,586,000
2022	2,781,000
2023	2,620,000
	<u>13,590,000</u>
Less sublease revenues	<u>(3,320,000)</u>
Total	<u>\$10,270,000</u>

Rental expense under all operating leases totaled approximately \$3,179,000 and \$2,879,000 for the years ended June 30, 2018 and 2017, respectively.

7. DUE TO LOTTERY FOR EDUCATION ACCOUNT

In accordance with the Act, all net proceeds of the GLC are due to the Lottery for Education Account within the state of Georgia Treasury. Net proceeds is defined under the Act as “all revenue derived from the sale of lottery tickets or shares and all other monies derived from the GLC less operating expenses.” Any unrealized gain or loss resulting from changes in fair value of grand prize investments does not represent funds received from GLC operations and is excluded from determination of “net proceeds.”

“Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to retailers, advertising and marketing costs, personnel costs, capital costs, depreciation of property and equipment, funds for compulsive gambling education and treatment, amounts held in or paid from a fidelity fund, and other operating costs.”

Net proceeds and operating expenses for the years ended June 30, 2018 and 2017, are summarized as follows:

	<u>2018</u>	<u>2017</u>
Operating revenues:		
Ticket sales	\$ 4,597,783,000	\$ 4,528,950,000
Less tickets provided as prizes	(315,288,000)	(310,523,000)
Net ticket sales	4,282,495,000	4,218,427,000
Online fees and other revenues	3,937,000	4,025,000
COAM fees	74,970,000	62,442,000
Interest revenue and other	1,685,000	816,000
GLC proceeds	4,363,087,000	4,285,710,000
Operating expenses—as defined:		
Gaming	3,170,816,000	3,138,838,000
Operating	48,163,000	45,809,000
Other	9,206,000	1,838,000
Total operating expenses—as defined	3,228,185,000	3,186,485,000
Net proceeds before distribution of unrestricted net position	1,134,902,000	1,099,225,000
Other:		
Funds resulting from current year capital purchases	8,411,000	1,638,000
Funds for current year compulsive gambling education and treatment	200,000	200,000
Total other	8,611,000	1,838,000
Net proceeds subject to transfer	\$ 1,143,513,000	\$ 1,101,063,000
Amount due to Lottery for Education Account for year	\$ 1,143,513,000	\$ 1,101,063,000
Amount paid during year	(862,848,000)	(818,002,000)
Amount due to Lottery for Education Account for year	\$ 280,665,000	\$ 283,061,000

8. EMPLOYEE BENEFITS

401(k) Defined Contribution Plan—Effective July 1, 1998, House Bill 441 was enacted into law, allowing the Georgia Lottery Corporation to participate in the Deferred Compensation Plan offered by the state of Georgia for public employees pursuant to Section 401(k) of the Internal Revenue Code.

There were 363 GLC employees participating in the 401(k) plan at June 30, 2018. For the years ended June 30, 2018 and 2017, GLC contributed \$1,733,000 and \$1,635,000 to the plan, respectively. Contributions by plan participants during fiscal years ended June 30, 2018 and 2017 were \$1,247,000 and \$866,000, respectively.

457 Deferred Compensation Plan—Beginning in December 1994, the GLC offered its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all full-time employees at their option, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency.

Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Service Code to provide that all assets and income under a Section 457(b) plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. In September, 2013, the GLC transferred custodianship of the plan's assets from Nationwide Retirement Services to Great-West Financial. As of June 30, 2018 and 2017, the fair value of the plan's assets was \$4,294,000 and \$3,950,000, respectively. Contributions by participants during the years ended June 30, 2018 and 2017 were \$198,000 and \$245,000, respectively.

Compensated Absences— At June 30, 2018 and 2017, the balance for compensated absences was \$3,596,000 and \$3,504,000, respectively. The year-end balances are comprised of earned and unused vacation and sick leave hours. At separation, employees are compensated for all earned vacation and any remaining sick leave hours accrued prior to March 1, 2005. Increases to the compensated absences balance represent vacation and sick leave hours earned by employees and decreases represent their usage of leave.

During the year ended June 30, 2018, employees earned and used leave totaling \$1,706,000 and \$1,614,000 respectively. During the year ended June 30, 2017, employees earned and used leave totaling \$1,605,000 and \$1,592,000 respectively. The current portion of the compensated absence liability, expected to be due within one year of the statement date, June 30, 2018, is estimated using historical trends. At June 30, 2018 and 2017, the estimated current portion of the compensated absences liability was \$222,000 and \$201,000, respectively.

Defined Benefit Plan – Employees' Retirement System

General Information

Plan description: ERS is a cost-sharing multiple-employer defined benefit pension plan established by the Georgia General Assembly during the 1949 Legislative Session for the purpose of providing retirement allowances for employees of the State of Georgia and its political subdivisions. ERS is directed by a Board of Trustees. Title 47 of the O.C.G.A. assigns the authority to establish and amend the benefit provisions to the State Legislature. ERS issues a publicly available financial report that can be obtained at www.ers.ga.gov/financials.

Benefits provided: The ERS Plan supports three benefit tiers: Old Plan, New Plan, and Georgia State Employees' Pension and Savings Plan (GSEPS). Employees under the old plan started membership prior to July 1, 1982 and are subject to plan provisions in effect prior to July 1, 1982. Members hired on or after July 1, 1982 but prior to January 1, 2009 are new plan members subject to modified plan provisions. Effective January 1, 2009, new state employees and rehired state employees who did not retain membership rights under the Old or New Plans are members of GSEPS. ERS members hired prior to January 1, 2009 also have the option to irrevocably change their membership to GSEPS. The GLC has five employees that participate in this plan.

Under the old plan, the new plan, and GSEPS, a member may retire and receive normal retirement benefits after completion of 10 years of creditable service and attainment of age 60 or 30 years of creditable service regardless of age. Additionally, there are some provisions allowing for early retirement after 25 years of creditable service for members under age 60.

Retirement benefits paid to members are based upon the monthly average of the member's highest 24 consecutive calendar months, multiplied by the number of years of creditable service, multiplied by the applicable benefit factor. Annually, postretirement cost-of-living adjustments may also be made to members' benefits, provided the members were hired prior to July 1, 2009. The normal retirement pension is payable monthly for life; however, options are available for distribution of the member's monthly pension, at reduced rates, to a designated beneficiary upon the member's death. Death and disability benefits are also available through ERS.

Contributions: Member contributions under the old plan are 4% of annual compensation, up to \$4,200, plus 6% of annual compensation in excess of \$4,200. Under the old plan, the state pays member contributions in excess of 1.25% of annual compensation. Under the old plan, these state contributions are included in the members' accounts for refund purposes and are used in the computation of the members' earnable compensation for the purpose of computing retirement benefits. Member contributions under the new plan and GSEPS are 1.25% of annual compensation. The GLC's total required contribution rate for the year ended June 30, 2018 was 24.81% of annual covered payroll for old and new plan members and 21.78% for GSEPS members. The rates include the annual actuarially determined employer contribution rate of 24.69% of annual covered payroll for old and new plan members and 21.66% for GSEPS members, plus a 0.12% adjustment for HB751 one-time benefit adjustment of 3% to retired state employees. The GLC's contributions to ERS totaled \$32,000 for the year ended June 30, 2018. Contributions are expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability.

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

At June 30, 2018, the GLC reported a liability for its proportionate share of the net pension liability in the amount of \$383,000. The net pension liability was measured as of June 30, 2017. The total pension liability used to calculate the net pension liability was based on an actuarial valuation as of June 30, 2016. An expected total pension liability as of June 30, 2017 was determined using standard roll-forward techniques. The GLC's proportion of the net pension liability was based on contributions to ERS during the fiscal year ended June 30, 2017. At June 30 2017 the Employer's proportion was 0.009434%, which was a decrease of 0.003426 % from its proportion measured as of June 30, 2016 of 0.012860%.

At June 30, 2017, the GLC reported a liability for its proportionate share of the net pension liability in the amount of \$608,000. The net pension liability was measured as of June 30, 2016. The total pension liability used to calculate the net pension liability was based on an actuarial valuation as of June 30, 2015. An expected total pension liability as of June 30, 2016 was determined using standard roll-forward techniques. The GLC's proportion of the net pension liability was based on contributions to ERS during the fiscal year ended June 30, 2016. At June 30 2016 the Employer's proportion was 0.012860%, which was a decrease of 0.005540 % from its proportion measured as of June 30, 2015 of 0.018400%.

For the years ended June 30, 2018 and 2017, the GLC recognized pension expense of (\$175,000) and (\$140,000), respectively. At June 30, 2018, the GLC reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 4,000	\$ -
Changes to assumptions	1,000	-
Net difference between projected and actual earnings on pension plan investments	-	1,000
Changes in proportion and differences between Employer contributions and proportionate share of contributions	-	121,000
Employer contributions subsequent to the measurement date	<u>32,000</u>	<u>-</u>
Total	<u>\$ 37,000</u>	<u>\$ 122,000</u>

GLC contributions subsequent to the measurement date of \$32,000 are reported as deferred outflows of resources and will be recognized as a reduction of the net pension liability in the year ended June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended June 30:

2019	\$ (92,000)
2020	(18,000)
2021	4,000
2022	(11,000)

At June 30, 2017, the GLC reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ -	\$ 2,000
Changes to assumptions	5,000	-
Net difference between projected and actual earnings on pension plan investments	62,000	-
Changes in proportion and differences between Employer contributions and proportionate share of contributions	-	189,000
Employer contributions subsequent to the measurement date	<u>57,000</u>	<u>-</u>
Total	<u>\$ 124,000</u>	<u>\$ 191,000</u>

Actuarial assumptions: The total pension liability as of June 30, 2017 was determined by an actuarial valuation as of June 30, 2016 using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.75%
Salary increases	3.25 – 7.00%, including inflation
Investment rate of return	7.50%, net of pension plan investment expense, including inflation

Postretirement mortality rates were based on the RP-2000 Combined Mortality Table with future mortality improvement projected to 2025 with the Society of Actuaries' projection scale BB and set forward 2 years for both males and females for service retirements and dependent beneficiaries. The RP-2000 Disabled Mortality Table with future mortality improvement projected to 2025 with Society of Actuaries' projection scale BB and set back 7 years for males and set forward 3 years for females was used for death after disability retirement. There is a margin for future mortality improvement in the tables used by the System. Based on the results of the most recent experience study adopted by the Board on December 17, 2015, the numbers of expected future deaths are 9-12% less than the actual number of deaths that occurred during the study period for service retirements and beneficiaries and for disability retirements. Rates of mortality in active service were based on the RP-2000 Employee Mortality Table projected to 2025 with projection scale BB.

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

The 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 nominal returns, net of pension plan investment expense and the assumed rate of inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target asset allocation and best estimates of arithmetic real rates of return for each major asset class based on the most recent experience study are summarized in the following table:

Asset class	Target allocation	Long-term expected real rate of return*
Fixed income	30.0%	-0.5%
Domestic large equities	37.2	9.0
Domestic mid equities	3.4	12.0
Domestic small equities	1.4	13.5
International developed market equities	17.8	8.0
International emerging market equities	5.2	12.0
Alternatives	5.0	10.5
Total	100.00%	

* Net of inflation

Discount rate: The discount rate used to measure the total pension liability was 7.50 %. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that employer and State of Georgia contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the GLC’s proportionate share of the net pension liability to changes in the discount rate:

The following presents the GLC’s proportionate share of the net pension liability, reported as of June 30, 2018, calculated using the discount rate of 7.50 %, as well as what the GLC’s 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 %) or 1-percentage-point higher (8.50 %) than the current rate:

	1% Decrease (6.50%)	Current discount rate (7.50%)	1% Increase (8.50%)
Employer's proportionate share of the net pension liability	\$ 541,000	\$ 383,000	\$ 249,000

The following presents the same analysis of the GLC’s proportionate share of the net pension liability reported as of June 30, 2017:

	<u>Decrease (6.50%)</u>	<u>discount rate (7.50%)</u>	<u>Increase (8.50%)</u>
Employer's proportionate share of the net pension liability	\$ 824,000	\$ 608,000	\$ 424,000

Pension plan fiduciary net position: Detailed information about the pension plan’s fiduciary net position is available in the separately issued ERS financial report which is publically available at www.ers.ga.gov/financials.

9. CONTINGENCIES

The GLC is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the GLC.

10. RISK MANAGEMENT

The GLC is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and injuries to employees. The GLC obtains umbrella insurance coverage for property, liability, vehicle fleet, workers’ compensation, and unemployment compensation through the State of Georgia’s Department of Administrative Services (“DOAS”). The GLC purchased additional commercial insurance for certain company-owned vehicles. DOAS, as a component of the State of Georgia, utilizes self-insurance programs established by individual agreement, statute or administrative action to provide property insurance covering fire and extended coverage and automobile insurance and to pay losses that might occur from such causes; liability insurance for employees against personal liability for damages arising out of performance of their duties; survivors’ benefits for eligible members of the Employees’ Retirement System; consolidating processing of unemployment compensation claims against state agencies and the payment of sums due to the Department of Labor; and workers’ compensation statutes of the State of Georgia. These self-insurance funds are accounted for as internal service funds of the State of Georgia where assets are set aside for claim settlements. The majority of the risk management programs are funded by assessments charged to participating organizations. A limited amount of commercial insurance is purchased by the self-insurance funds applicable to property, employee and automobile liability, fidelity, and certain other risks to limit the exposure to catastrophic losses. Otherwise, the risk management programs service all claims against the state for injuries and property damage.

Financial information relative to self-insurance funds is presented in the financial reports of the Department of Administrative Services and the Employees’ Retirement System for the years ended June 30, 2018 and 2017.

The GLC negotiated a service contract with Blue Cross Blue Shield of Georgia to provide its employee health insurance, dental and vision coverage effective January 1, 2017. GLC utilized Cigna for its health insurance and Guardian for its dental and vision coverage from July 1, 2016 through December 31, 2016. Unum is the provider for short-term disability, long-term disability, and term life insurance coverage. The GLC’s health, dental, and vision insurance plans are funded by contributions from plan participants and by GLC employer contributions.

Georgia Lottery Corporation
Required Supplementary Information
Schedule of Proportionate Share of the Net Pension Liability
Employees' Retirement System
For the Year Ended June 30
(Dollar amounts in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
GLC's proportion of the net pension liability	0.009434%	0.012860%	0.018400%	0.023993%
GLC's proportionate share of the net pension liability	\$ 383,000	608,000	746,000	900,000
GLC's covered payroll	\$ 232,000	303,000	472,000	534,000
GLC's proportionate share of the net pension liability as a percentage of its covered payroll	165.09%	200.67%	158.05%	168.54%
Plan fiduciary net position as a percentage of the total pension liability	76.33%	72.34%	76.20%	77.99%

Note: Schedule is intended to show information for the last 10 fiscal years. Additional years will be displayed as they become available.

Georgia Lottery Corporation
Required Supplementary Information
Schedule of Contributions
Employees' Retirement System
For the Year Ended June 30:
(Dollar amounts in thousands)

	2018	2017	2016	2015	2014	2013
Contractually required contribution	\$32,000	57,000	77,000	101,000	100,000	78,000
Contribution in relation to the Contractually requires contribution	<u>\$32,000</u>	<u>57,000</u>	<u>77,000</u>	<u>101,000</u>	<u>100,000</u>	<u>78,000</u>
Contribution deficiency (excess)	\$0	0	0	0	0	0
GLC's covered payroll	\$130,000	232,000	303,000	472,000	534,000	529,000
Contribution as a percentages Of covered payroll	24.62%	24.57%	25.41%	21.50%	18.67%	14.76%

Note: Schedule is intended to show information for the last 10 fiscal years. Additional years will be displayed as they become available.

Georgia Lottery Corporation
Notes to Required Supplementary Information
For the Year Ended June 30, 2018
(Dollar amounts in thousands)

Changes of assumptions: On December 17, 2015, the Board adopted recommended changes to the economic and demographic assumptions utilized by the System. Primary among the changes were the updates to rates of mortality, retirement, withdrawal and salary increases.

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