



NEW YORK STATE LOTTERY

Basic Financial Statements

March 31, 2015 and 2014

(With Independent Auditors' Report Thereon)

NEW YORK STATE LOTTERY

Basic Financial Statements

March 31, 2015 and 2014

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KPMG LLP
515 Broadway
Albany, NY 12207-2974

Independent Auditors' Report

The New York State Gaming Commission:

We have audited the accompanying statements of net position of the New York State Lottery (the Lottery), an enterprise fund of the State of New York, as of March 31, 2015 and 2014, and the related statements of revenue, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; 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.

Auditors' 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 auditors' 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 New York State Lottery as of March 31, 2015 and 2014, and the changes in its financial position and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of a Matter

As discussed in note 1, the Lottery's financial statements present only the New York State Lottery enterprise fund of the State of New York and do not purport to, and do not, present fairly the financial position of the



State of New York, as of March 31, 2015 and 2014, the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 9 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.

KPMG LLP

Albany, New York
July 17, 2015

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Management's Discussion and Analysis (Unaudited)

March 31, 2015 and 2014

The management of the New York State Lottery (New York Lottery or Lottery) offers readers the following general overview and analysis of the New York Lottery's financial position and activities for the fiscal years ending March 31, 2015 and 2014. We encourage readers to consider this information in conjunction with the detailed financial statements and explanatory notes that follow. The New York Lottery's basic financial statements for the fiscal years ending March 31, 2015 and 2014 have been prepared in accordance with U.S. generally accepted accounting principles.

Financial Highlights

- New York Lottery revenues totaled \$9.156 billion, while net proceeds earned for Lottery Aid to Education reached \$3.111 billion for fiscal year 2015.
- New York Lottery revenues in fiscal year 2015 were less than the revenues of 2014 by \$70.2 million or 0.8%. In fiscal year 2014, the annual revenue increase was \$292.2 million or 3.3%.
- Net proceeds earned for Lottery Aid to Education in fiscal year 2015 were less than the net proceeds of 2014 by \$62.4 million or 2.0%. Comparatively, the annual earnings for education in fiscal year 2014 were more than the net proceeds of 2013 by \$127.2 million or 4.2%.
- Prize expense decreased by \$11.0 million or 0.2% during fiscal year 2015. Prize expense increased by \$188.9 million or 4.5% during fiscal year 2014. Prize expense generally follows the changes occurring in sales of the corresponding games.
- Operating income decreased by \$36.8 million or 1.2% during fiscal year 2015. Operating income increased by \$46.4 million or 1.5% during fiscal year 2014.
- Nonoperating income increased by \$200.3 million during fiscal year 2015 after decreasing by \$143.5 million during fiscal year 2014. The changes in this category are generally the result of unrealized gains/losses on investments which can change by large amounts in either direction from year to year.
- Working Capital (current assets minus current liabilities) decreased by \$22.8 million in fiscal year 2015 after decreasing by \$23.1 million in fiscal year 2014.

Overview of Financial Statements

The New York Lottery presents its financial statements using the accrual basis of accounting, which is comparable to the method used by many private sector businesses. The accrual basis recognizes revenues when earned, not when received. Likewise, expenses are recognized when incurred, not when paid. The Lottery prepares the following three financial statements for fiscal years 2015 and 2014:

Statements of Net Position

The statement on page 10 provides information on the nature and amount of the Lottery's assets, liabilities and net position at the close of fiscal years 2015 and 2014. The relationship of assets to liabilities and resulting net position is one indicator of the financial condition of the Lottery and can also be a reflection of changes within the Lottery.

Statements of Revenue, Expenses, and Changes in Net Position

The statement on page 11 reflects the Lottery's operating and nonoperating revenues and expenses and the change in net position for the year.

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Management's Discussion and Analysis (Unaudited)

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Statements of Cash Flows

The statement on page 12 is presented on the direct method of reporting and reflects cash flows from operating activities as well as capital and noncapital financing and investing activities. Cash collections and payments are reflected in this statement to arrive at the net increase or decrease in cash and cash equivalents for the year.

The above mentioned financial statements, the notes to the financial statements and this management's discussion and analysis provide information about the Lottery's overall financial condition.

This management's discussion and analysis is meant to be an introduction to the financial statements and to assist readers in understanding the results of the operations and the financial condition of the New York Lottery. The notes to the financial statements are an integral part of the statements and include additional data and explanations which are to be used in concert with the financial statements.

The New York Lottery deposits its net proceeds into six accounts held in joint custody by the Commissioner of Taxation and Finance and the State Comptroller. These six accounts and the purpose of the funds are as follows:

- Lottery Education Account – Accumulates the required deposits for Aid to Education from revenues, not including video gaming revenues.
- Prize Pending Account – Consists of Lottery prizes that have not yet been paid from revenues, excluding video gaming revenues.
- Administration Account – Utilized to pay for the Lottery's administrative costs that are not related to or funded by video gaming revenues.
- Video Gaming Education Account – Accumulates the required deposits for Aid to Education from video gaming operations.
- Video Gaming Prize Pending Account – Consists of video gaming prizes awarded that have not yet been claimed.
- Video Gaming Administration Account – Utilized to pay the administrative costs of video gaming.

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Management's Discussion and Analysis (Unaudited)

March 31, 2015 and 2014

Financial Analysis

Summary of Net Position

The comparative summary of net position represents the Lottery's financial position as of the fiscal years 2015, 2014, and 2013 (in millions):

	FY 2015	FY 2014	FY 2013	FY 2015 vs. FY 2014		FY 2014 vs. FY 2013	
				Increase/(decrease) In \$	In %	Increase/(decrease) In \$	In %
Capital assets	\$ —	—	—	—	—%	\$ —	—%
Other assets	2,637	2,544	2,589	93	3.7	(45)	(1.7)
Total assets	2,637	2,544	2,589	93	3.7	(45)	(1.7)
Current liabilities	967	935	811	32	3.4	124	15.3
Noncurrent liabilities	1,277	1,299	1,325	(22)	(1.7)	(26)	(2.0)
Total liabilities	2,244	2,234	2,136	10	0.4	98	4.6
Restricted net position	139	150	185	(11)	(7.3)	(35)	(18.9)
Unrestricted net position	254	160	268	94	58.8	(108)	(40.3)
Total net position	\$ 393	310	453	83	26.8	\$ (143)	(31.6)

Capital Assets

Capital assets consist of equipment and leasehold improvements. During fiscal year 2015 and 2014, there were no significant changes in capital assets other than disposal of fully depreciated assets. Activity was primarily limited to yearly depreciation. Additional information about the Lottery's capital assets can be found in note 1i of the notes to the basic financial statements.

Other Assets

Other assets consist of cash and cash equivalents, accounts receivable, instant ticket inventory, and investments. During fiscal year 2015, other assets increased by \$93.6 million which represented an increase of 3.7% from the previous year. This increase was primarily a result of an increase in long-term investments. In fiscal year 2014, other assets decreased by \$45.3 million, which represented a decrease of 1.7% from the previous year.

Current Liabilities

Current liabilities consist of prizes awarded in the past year that remain unclaimed, amounts due to education, accrued expenses, accounts payable, the value of Lottery tickets purchased in advance of game drawings (unearned ticket sales), and the short-term portion of long-term prizes payable and amounts due to employees for unused vacation leave. In total, these accounts increased by \$31.7 million during fiscal year 2015. This change can be compared to the fiscal year ended March 31, 2014 when there was a \$123.9 million annual increase in total current liabilities.

Noncurrent Liabilities

Noncurrent liabilities consist of amounts due to be paid more than one year after the close of the fiscal year for installment prizes and unused employee vacation leave. During fiscal year 2015, noncurrent liabilities decreased by \$21.3 million, with the decrease occurring primarily in the category of long-term prizes payable. During fiscal

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Management's Discussion and Analysis (Unaudited)

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year 2014, noncurrent liabilities decreased by \$26.4 million, with the decrease occurring primarily in the category of long-term prizes payable. Additional information about the Lottery's noncurrent liabilities can be found in note 5 of the notes to the basic financial statements.

Net Position

Restricted net position for future prizes consists of prize funds that are in excess of prizes actually claimed at the fiscal year-end, but which are necessary to ensure future prize payments. For example, prize funds from past sales are utilized to pay an accumulating or future New York Lotto, Powerball, Mega millions or Cash 4 Life jackpot or contribute toward a created but unclaimed instant ticket prize. These amounts are available by statute for this purpose.

Unrestricted net position listed on the statement of net position is largely the cumulative result of increased fair market value of the investments held by the Lottery to pay annuity prizes. Since the full maturity value of the investments is needed to pay the annuity prizes, the Lottery does not expect to realize any permanent gain on these investments.

Summary of Revenue, Expenses, and Changes in Net Position

The following summary compares the Lottery's revenues, expenses and changes in net position for the fiscal years 2015, 2014 and 2013 (in millions).

	FY 2015	FY 2014	FY 2013	FY 2015 vs. FY 2014		FY 2014 vs. FY 2013	
				Increase/(decrease) In \$	In %	Increase/(decrease) In \$	In %
Operating revenue:							
Lottery revenue, net	\$ 9,156	9,226	8,934	(70)	(0.8)%	\$ 292	3.3%
Operating expenses:							
Direct expenses	(5,938)	(5,958)	(5,708)	(20)	0.3	250	4.4
Indirect expenses	(120)	(133)	(138)	(13)	9.8	(5)	(3.6)
Total operating expenses	(6,058)	(6,091)	(5,846)	(33)	0.5	245	(4.2)
Operating income	3,098	3,135	3,088	(37)	(1.2)	47	1.5
Nonoperating income (expenses):							
Nonoperating income	158	(34)	108	192	564.7	(142)	(131.5)
Nonoperating expenses	(62)	(71)	(68)	(9)	12.7	3	(4.4)
Total nonoperating income (expenses)	96	(105)	40	201	191.4	(145)	(362.5)
Income before required allocation	3,194	3,030	3,128	164	5.4	(98)	(3.1)
Required allocation – contribution for aid to education	(3,111)	(3,173)	(3,046)	(62)	2.0	127	(4.2)
Change in net position	83	(143)	82	226	158.0	(225)	(274.4)
Net position beginning of year	310	453	371	(143)	(31.6)	82	22.1
Net position end of year	\$ 393	310	453	83	26.8	\$ (143)	(31.6)

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Management's Discussion and Analysis (Unaudited)

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Revenues

The New York Lottery exists for the sole purpose of raising revenue to help support Aid to Education. The Lottery achieves its mission through the sale of Lottery tickets at approximately 18,000 licensed retail locations across the state. The Lottery also achieves its mission through nine licensed video lottery gaming facilities located in Saratoga, Monticello, Farmington, Hamburg, Batavia, Tioga, Vernon, Yonkers, and New York City.

During fiscal year 2015, the Lottery achieved \$3.491 billion in draw sales, \$3.760 billion in instant sales, and \$1.905 billion in video lottery gaming net machine income for a total of \$9.156 billion, a decrease of \$70.2 million or 0.8% over the previous fiscal year. During fiscal year 2014, the Lottery achieved \$3.637 billion in draw sales, \$3.677 billion in instant sales, and \$1.912 billion in video lottery gaming net machine income for a total of \$9.226 billion, an increase of \$292.2 million or 3.3% over the previous fiscal year. The most significant growth was generated in instant sales during fiscal year 2015 while draw sales generated the most significant growth in fiscal year 2014.

The following compares the Lottery's revenues by game and the percentage of total revenues by game for the fiscal years 2015, 2014, and 2013 (in millions).

Game	FY 2015		FY 2014		FY 2013	
	Revenue	Percent of total revenues	Revenue	Percent of total revenues	Revenue	Percent of total revenues
Mega Millions	\$ 288	3.1%	\$ 400	4.3%	\$ 255	2.9%
Lotto	84	0.9	95	1.0	110	1.2
Take 5	239	2.6	256	2.8	266	3.0
Numbers	870	9.5	874	9.5	847	9.5
Win 4	852	9.3	831	9.0	794	8.9
Quick Draw	694	7.6	654	7.1	580	6.5
Pick 10	28	0.3	29	0.3	30	0.3
Sweet Million	6	0.1	33	0.4	35	0.4
Powerball	305	3.3	463	5.0	468	5.2
Other Multi-State Draw Games *	125	1.4	—	—	—	—
Promo game	—	—	2	—	—	—
Instant	3,760	41.1	3,677	39.9	3,724	41.7
Subtotal traditional lottery	7,251	79.2	7,314	79.3	7,109	79.6
Video Gaming, net **	1,905	20.8	1,912	20.7	1,825	20.4
Total revenues	\$ 9,156	100.0%	\$ 9,226	100.0%	\$ 8,934	100.0%

* Other Multi-State Draw Games include Cash 4 Life and Monopoly Millionaires' Club.

** Video gaming revenue represents net machine income after awarding prizes. Video gaming credits played and won were as follows:

	FY 2015	FY 2014	FY 2013
Credits played	\$ 33,971	32,348	28,672
Credits won	(32,066)	(30,436)	(26,847)
Net machine income	\$ 1,905	1,912	1,825

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March 31, 2015 and 2014

Direct Expenses

Direct expenses consist of prize expense for traditional Lottery games, commissions to Lottery retailers and video lottery gaming facilities, fees to gaming contractors, expenses of providing instant tickets to players, and telecommunications. The largest expenditure in this category is prize expense which made up approximately 75% of direct expenses during each of the three years being discussed. Prizes decreased by \$11.0 million to \$4.397 billion in fiscal year 2015. At the same time, retailer commissions decreased by \$7.6 million to \$1.283 billion and gaming contractor fees remained flat.

Prizes increased by \$188.9 million to \$4.408 billion in fiscal year 2014. At the same time, retailer commissions increased by \$53.6 million to \$1.290 billion and gaming contractor fees increased by \$10.4 million to \$219.7 million.

Other Operating Expenses

Other operating expenses include marketing, state agency charges, personal services, fringe benefits and other administrative costs. These costs were \$120.6 million during fiscal year 2015 which was 9.8% lower than the prior year. Corresponding costs in fiscal year 2014 were \$133.4 million which was 3.6% lower than in fiscal year 2013.

Nonoperating Revenues (Expenses)

Nonoperating revenues and expenses consist of miscellaneous income plus the net growth or decline in the fair market value of investments used to fund long-term prizes. Investment income of \$148.9 million in 2015, \$(35.4) million in 2014 and \$107.7 million in 2013 consists of both the fair value adjustments of investments plus the normal growth of the value of Lottery investments as the securities move closer to maturity. The market-driven fair value adjustment, which is subject to considerable variance over time, is the primary factor in causing any large differences from year to year. Investment expense is a reflection of the Lottery expending the investment income to increase the valuation of the long-term prizes payable to winners. The annual fair value adjustment of investments flows to the unrestricted net position balance on the statement of net position.

Income Before Required Allocation and Change in Net Position

The revenues and expenses for fiscal year 2015 resulted in income before required allocation totaling \$3.194 billion. This amount consists of a required allocation for Aid to Education of \$3.111 billion that transfers out as a contribution for Aid to Education and an \$83.1 million increase in net position for the year. The \$83.1 million increase in net position is a combination of an \$11.2 million decrease in net position restricted for prizes and a \$94.3 million increase in unrestricted net position. The revenues and expenses for fiscal year 2014 resulted in income before required allocation totaling \$3.030 billion. This amount consists of a required allocation for Aid to Education of \$3.173 billion that transfers out as a contribution for Aid to Education and a \$142.9 million decrease in net position for the year. The \$142.9 million decrease in net position is a combination of a \$34.7 million decrease in net position restricted for prizes and a \$108.2 million decrease in unrestricted net position.

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Management's Discussion and Analysis (Unaudited)

March 31, 2015 and 2014

Summary and Outlook

As a mature business entity, the New York Lottery generally anticipates only moderate but steady growth from year to year. An opportunity to move beyond normal growth occurred in October 2011 with the opening of a new video gaming facility in Queens, NY at the Aqueduct Racetrack. As a result, video lottery revenue grew from \$1.427 billion in 2012 to \$1.825 billion in 2013 to \$1.912 billion in 2014, then decreased to \$1.905 billion in 2015.

Contacting New York Lottery's Financial Management

This financial report is designed to provide the State of New York, the public, and other interested parties with an overview of the financial results of the New York State Lottery and an explanation of the Lottery's financial condition. If you have any questions about this report or require additional information, email info@gaming.ny.gov or write to The New York State Gaming Commission Communications Office, One Broadway Center, P.O. Box 7500, Schenectady, NY 12301-7500.

NEW YORK STATE LOTTERY

Statements of Net Position

March 31, 2015 and 2014

(In thousands)

Assets	2015	2014
Current assets:		
Cash and cash equivalents	\$ 490,819	515,992
Accounts receivable	526,292	479,000
Instant ticket inventory	10,704	9,141
Investments	112,255	126,915
Total current assets	<u>1,140,070</u>	<u>1,131,048</u>
Noncurrent assets:		
Long-term investments, net	1,497,026	1,412,495
Capital assets	—	—
Total noncurrent assets	<u>1,497,026</u>	<u>1,412,495</u>
Total assets	<u>\$ 2,637,096</u>	<u>2,543,543</u>
Liabilities		
Current liabilities:		
Prizes payable	\$ 138,019	159,746
Unclaimed prizes	577,253	471,181
Due to education fund	213,309	251,558
Accounts payable and accrued liabilities	26,978	41,501
Unearned ticket sales	9,714	9,487
Compensated absences	1,464	1,487
Total current liabilities	<u>966,737</u>	<u>934,960</u>
Noncurrent liabilities:		
Compensated absences	120	314
Long-term prizes payable	1,277,256	1,298,381
Total noncurrent liabilities	<u>1,277,376</u>	<u>1,298,695</u>
Total liabilities	<u>\$ 2,244,113</u>	<u>2,233,655</u>
Net Position		
Restricted for future prizes	\$ 138,995	150,194
Unrestricted	253,988	159,694
Total net position	<u>\$ 392,983</u>	<u>309,888</u>

See accompanying notes to basic financial statements.

NEW YORK STATE LOTTERY

Statements of Revenue, Expenses, and Changes in Net Position

Years ended March 31, 2015 and 2014

(In thousands)

	2015	2014
Operating revenue:		
Lottery revenue, net	\$ 9,156,336	9,226,490
Operating expenses:		
Prize expense	(4,396,853)	(4,407,924)
Retailer commissions	(1,282,568)	(1,290,202)
Gaming contractor fees	(219,731)	(219,745)
Instant ticket direct expenses	(20,566)	(18,871)
Telecommunications	(17,827)	(21,357)
Total direct expenses	(5,937,545)	(5,958,099)
Marketing and advertising expense	(75,812)	(89,779)
Personal service and fringe benefits	(28,883)	(32,343)
Other administrative costs	(11,443)	(8,465)
State agency charges	(4,441)	(2,784)
Depreciation	—	(5)
Total indirect expenses	(120,579)	(133,376)
Total operating expenses	(6,058,124)	(6,091,475)
Operating income	3,098,212	3,135,015
Nonoperating revenue (expenses):		
Investment (loss) income	148,914	(35,364)
Other revenue, net	8,982	1,340
Investment expense	(62,443)	(70,893)
Total nonoperating revenue (expense)	95,453	(104,917)
Income before required allocation	3,193,665	3,030,098
Required allocation for aid to education	(3,110,570)	(3,172,958)
Change in net position	83,095	(142,860)
Net position beginning of year	309,888	452,748
Net position end of year	\$ 392,983	309,888

See accompanying notes to basic financial statements.

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Statements of Cash Flows
Years ended March 31, 2015 and 2014
(In thousands)

	<u>2015</u>	<u>2014</u>
Operating activities:		
Cash received from net lottery revenue	\$ 9,137,343	9,220,869
Cash payments for prizes	(4,432,987)	(4,405,534)
Cash payments for commissions	(1,282,577)	(1,290,265)
Cash payments for contractor fees	(219,238)	(219,410)
Cash payments for telecommunications	(17,827)	(21,357)
Cash payments for instant ticket direct expenses	(22,052)	(19,020)
Cash payments for other operating expenses	(127,041)	(133,144)
Other cash receipts	8,982	1,340
Net cash provided by operating activities	<u>3,044,603</u>	<u>3,133,479</u>
Investing activities:		
Proceeds from investment maturities	127,118	135,965
Purchases of investments	(84,265)	(114,693)
Proceeds from investment sales	11,804	73,317
Interest on cash and cash equivalents and investments	24,386	24,868
Net cash provided by investing activities	<u>79,043</u>	<u>119,457</u>
Noncapital financing activities:		
Cash transfer to State for Aid to Education	(3,215,584)	(3,181,781)
Cash received from State General Fund for Lottery Aid Guarantee	66,765	—
Net cash used in noncapital financing activities	<u>(3,148,819)</u>	<u>(3,181,781)</u>
Net increase (decrease) in cash and cash equivalents	(25,173)	71,155
Cash and cash equivalents, beginning of year	<u>515,992</u>	<u>444,837</u>
Cash and cash equivalents, end of year	<u>\$ 490,819</u>	<u>515,992</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 3,098,212	3,135,015
Adjustments to reconcile operating income to net cash provided by operating activities:		
Other cash receipts	8,982	1,340
Depreciation	—	5
Change in operating assets and liabilities:		
Increase in accounts receivable, net	(47,292)	(37,561)
Increase in ticket inventory	(1,563)	(763)
Decrease in prizes payable	(105,295)	(107,321)
Increase in unclaimed prizes	106,072	126,066
Decrease in compensated absences	(217)	(94)
Increase (decrease) in accounts payable and accrued liabilities	(14,523)	15,657
Increase in unearned ticket sales	227	1,135
Net cash provided by operating activities	<u>\$ 3,044,603</u>	<u>3,133,479</u>
Noncash investing activities:		
Increase (decrease) in unrealized gains on investments	\$ 85,313	(108,230)
Amortization of investment discount	37,382	41,259

See accompanying notes to basic financial statements.

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Notes to Basic Financial Statements

March 31, 2015 and 2014

(1) Summary of Significant Accounting Policies

The New York State Lottery (Lottery) was established in 1967. In 1976, the Lottery was placed under the Division of the Lottery, an independent unit of the New York State Department of Taxation and Finance, which operates in accordance with the provisions of the New York State Lottery for Education Law (Tax Law Article 34). On February 1, 2013, the Division of Lottery was merged with the New York State Racing and Wagering Board into a single oversight entity called the New York State Gaming Commission, which was given responsibility to administer traditional and video lottery games as part of its overall responsibility for regulation and enforcement of gaming activity in New York. The purpose of the Lottery is to raise revenue for education in the State of New York (State) through the administration of lottery games.

These financial statements present only the Lottery and do not present the financial position of the State nor changes in the State's financial position and cash flows. However, the Lottery is included in the State of New York's basic financial statements as an enterprise fund.

The Lottery applies all applicable Governmental Accounting Standards Board (GASB) pronouncements and prepares its financial statements under the economic resources measurement focus, whereby all inflows, outflows and balances affecting net position are reported, and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The primary operating revenue of the Lottery is ticket sales from games. Nonoperating income consists mostly of investment income and unrealized gains on investments. Operating expenses consist of direct expenses for prizes, commissions to Lottery retailers, fees to gaming contractors, expenses for providing instant tickets to players, and telecommunications. Other operating expenses that are indirect to the results of each game include marketing, state agency charges, personal services, and fringe benefits. Nonoperating expense includes the amortization of the discount on long-term prizes payable.

The more significant accounting policies of the Lottery are described below:

(a) Revenue Recognition

(i) Draw Games

Revenue from ticket sales for Lotto, Sweet million, Quick Draw, Take 5, Pick 10, Mega millions, Powerball, Cash 4 Life, Monopoly millionaires' Club, Numbers and Win-4 games, and promotional games (draw games) is recognized when the related drawing takes place. Receipts from subscription sales and other ticket sales for future drawings are recorded as unearned revenue and will not be recognized as revenue until the related drawings take place.

(ii) Instant Games

Revenue from Instant Games is recognized based on the dollar value of the total number of tickets available for sale. Tickets are available for sale upon being activated on the Lottery Validation System at the retailer locations.

(iii) Video Gaming

Revenue from video lottery gaming is recognized based on net machine income, which is defined as amounts played less prizes won.

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Notes to Basic Financial Statements

March 31, 2015 and 2014

(b) Prize Expense

The Lottery recognizes prize expense for draw games equivalent to the actual prize liability incurred for each drawing. Prize expense for instant games is recognized when instant books are activated by retailers and is based on the percentage of sales allocated to prizes for each game. Video lottery revenue is reported net of prizes, so prize expense is not recognized on these games. Prize expense is adjusted accordingly for any prizes unclaimed within the time period allowed by law.

(c) Commissions and Fees

Retailers selling draw and instant game tickets receive a commission of 6% based on the total tickets sold. Video gaming facilities receive a varying percent of incremental annual net machine income according to provisions of Section 1612 of the Tax Law. The particular percent applied to a range of net machine income can vary depending on the facility's number of video gaming machines, geographical area of the state, population level, or proximity to Native American gaming facilities. The draw game contractor and the video gaming central processing contractor receive fees equal to a contractual percentage of the sales generated through the network maintained by the respective contractor. The instant game contractor is paid a fee equal to a contractual percentage of instant sales. Video lottery terminal contractors receive a fee equal to a contractual percentage of revenue, adjusted for the units of service provided. All other gaming contractors are paid fees based on the units of service provided (see note 13).

(d) Accounts Receivable

Accounts receivable primarily represents amounts due from retailers through a Lottery gaming contractor and amounts due from video lottery gaming facilities, net of commissions and fees, as well as amounts due from agents for Instant Game tickets which have been activated, but not yet settled. Instant ticket settlements occur within 45 days after a book of tickets is activated. Video lottery gaming receivables are received two business days after each sales day and draw games are collected within four business days after the close of each sales week.

(e) Allocation of Revenue from Ticket Sales

The allocation of ticket sales is made in accordance with the provisions of the New York State Lottery for Education Law which requires:

- Allocations of ticket sales revenue to New York for educational purposes are to be at least 20% for the New York State Lottery Instant Games, 30% for multi-state games such as Mega millions, Powerball, Cash 4 Life and Monopoly millionaires' Club, 35% for Take 5, Numbers, Win-4, and Pick 10, 45% for Lotto, Sweet million, and promotional games, and 25% for Quick Draw. In addition, the Lottery has statutory authority to issue up to five Instant Games per year with at least 10% for educational purposes. For video lottery, the required allocation to education is a varying percent of each facility's annual incremental net machine income, depending on factors such as the facility's number of video gaming machines, geographical area of the state, population level, and proximity to Native American gaming facilities.
- Allocations of ticket sales revenue for the payment of lottery prizes are not to exceed 65% for the New York State Lottery Instant Games, 55% for multi-state games such as Mega millions,

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Powerball, Cash 4 Life and Monopoly millionaires' Club, 50% for Take 5, Numbers, Win-4, and Pick 10, 40% for Lotto, Sweet million, and promotional games, and 60% for Quick Draw. In addition, the Lottery has statutory authority to issue up to five Instant Games per year with up to 75% allocated to prizes. Video lottery is required to pay prizes that average no less than 90% of gross sales.

- Allocations of ticket sales revenue from all traditional games for the payment of Lottery administrative expenses (including agent commissions and contractor fees) are not to exceed 15%. For video lottery, 10% of net revenue (the total revenue wagered after payout for prizes) is allocated for Lottery Administration. Unlike traditional games, the video lottery administrative allocation does not include commissions and fees which are described separately in note 1c. Any excess of the maximum allocation over actual administrative expenses is allocated to education. Such allocations amounted to approximately \$464,791,000 and \$455,696,000 for fiscal years 2015 and 2014, respectively. Administrative expenses incurred by the Lottery represent telecommunications, advertising, salary and other operating costs.

(f) Cash and Cash Equivalents

For purposes of the statements of cash flows, the Lottery considers cash equivalents to be amounts held with banks and amounts held under the joint custody of the Commissioner of Taxation and Finance and the Comptroller of the State of New York through the Short-Term Investment Pool, which is used for the temporary investment of funds not required for immediate payments.

(g) Investments

Investments, consisting of U.S. Government-backed obligations (zero coupon bonds and stripped Government securities) and New York City Transitional Finance Authority municipal bonds, are carried at fair value. Investment income represents amortization of bond discount, interest on bonds and deposits, and the change in fair value of investments.

(h) Inventory

Instant game tickets are purchased from printing vendors. Tickets not activated for sale are held in inventory and are valued at cost by game. Tickets are charged to instant ticket direct expense under the first-in, first-out (FIFO) accounting method when activated for sale by the lottery retailers. At the conclusion of an instant game, unused inventory is charged to instant ticket direct expense.

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(i) **Capital Assets**

Capital assets consist of equipment and leasehold improvements which are carried at historical cost. Equipment is capitalized when it has cost in excess of \$40,000 and a useful life of two years or more. Leasehold improvements are capitalized when they have a cost of \$100,000 or more. Depreciation of equipment is computed using the straight-line method over five years, the estimated useful lives of the assets. Leasehold improvements and equipment acquired under capital leases are amortized using the straight-line method over ten and five years, respectively, which is the lesser of their useful lives or the term of the leases. Changes in capital assets and related accumulated depreciation are shown below, by major class of asset, for the years ended March 31, 2015 and 2014 (in thousands).

	2013	Additions	Deletions	2014	Additions	Deletions	2015
Leasehold improvements:							
Cost	\$ 4,526	—	—	4,526	—	—	4,526
Accumulated depreciation	(4,526)	—	—	(4,526)	—	—	(4,526)
Net value	—	—	—	—	—	—	—
Equipment:							
Cost	2,022	—	(111)	1,911	—	—	1,911
Accumulated depreciation	(2,017)	(5)	111	(1,911)	—	—	(1,911)
Net value	5	(5)	—	—	—	—	—
Total	\$ 5	(5)	—	—	—	—	—

When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is reflected in other revenues, net in the period of disposal.

(j) **Prizes Payable**

Lotto, Powerball, Mega millions and Cash 4 Life jackpot players have the option of selecting a lump sum payment or a long-term annuity payment. Some instant games also have jackpot prizes that are long-term annuity payments. Prizes payable represents the liability for those prizes which are payable in annual installments. Such prize payments are funded by the Lottery's investments. The amortization of the long-term annuity payment discount is recorded as investment expense in these financial statements. Any excess of investment maturities over related annuity prize payments are recorded in restricted net position and made available for future prizes.

(k) **Unclaimed Prizes**

Unclaimed prizes at March 31, 2015 and 2014 were \$577,253,000 and \$471,181,000, respectively. Prizes unclaimed for one year after the drawing date (lapsed) are forfeited by the ticket holder. Total prizes lapsed amounted to approximately \$64,647,000 and \$67,543,000 for fiscal years 2015 and 2014, respectively. These forfeited prizes are netted against prize expense in the Statements of Revenue, Expense, and Changes in Net Position.

Under State Tax Law Section 1614, the Lottery retains forfeited prizes for supplemental prizes in subsequent lottery games. During the fiscal years 2015 and 2014, these supplemental prizes were used

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for Mega millions, Powerball, Cash 4 Life, Lotto, Quick Draw, Sweet million, Take 5, Monopoly millionaires' Club, Numbers, Win 4, and various Instant Games.

(l) Restricted Net Position

Restricted net position for prizes includes forfeited prizes and other prize assets that are restricted under State Tax Law Sections 1612 and 1614 for the purpose of meeting future prize expense.

(m) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and related notes. Actual results could differ from those estimates.

(2) Cash and Cash Equivalents

Lottery deposits of cash and cash equivalents are made in accordance with State Finance Law Sections 92c and 98a and State Tax Law Sections 1611 and 1612. Lottery sales receipts are allocated and deposited in separate fund accounts for prizes, education, and administration under the joint custody of the Commissioner of Taxation and Finance and the Comptroller of the State of New York. Per Section 98a of the State Finance Law, the accounts for prizes and administration earn interest through participation in a short-term investment pool administered by the Office of the State Comptroller of the State of New York. The prize account interest is used for future lottery prizes. The carrying amount of the joint custody accounts included in cash and cash equivalents were \$460,129,000 and \$504,781,000 at March 31, 2015 and 2014, respectively.

The Lottery also maintains sole custody accounts which are used for daily cash management purposes. The Lottery manages the investment of its cash balances to minimize its uninvested funds. At March 31, 2015 and 2014, the amount of sole custody accounts included in cash and cash equivalents related to the sole custody accounts were \$30,690,000 and \$11,211,000, respectively.

The Lottery's deposits are collateralized under a program administered by the Office of the State Comptroller of the State of New York. To manage custodial credit risk, the State requires that its depository banks pledge collateral based on available bank balances. All securities pledged as collateral are held by the State's fiscal agent in the name of the State. The Lottery's deposits with financial institutions were fully collateralized at fiscal year-end. The Lottery manages custodial credit risk by using several financial institutions and by minimizing balances in the sole custody accounts.

(3) Investments

The Lottery is authorized by the Office of the State Comptroller per State statute to invest prize funds which will provide for the payment of prizes payable (see note 4). The Lottery invests these funds in U.S. Government-backed obligations, New York City Transitional Finance Authority municipal bonds, and Agency for International Development Bonds that are guaranteed by the full faith and credit of the United States. The fair value of these investments at March 31, 2015 and 2014 was \$1,609,281,000 and \$1,539,410,000, respectively. During fiscal years 2015 and 2014, approximately \$37,382,000 and \$41,259,000, respectively, of amortized discount was included in investment income.

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The amortized costs of these investments consisted of the following at March 31 (in thousands):

		<u>2015</u>	<u>2014</u>
Maturity value	\$	1,748,794	1,769,887
Unamortized discount		<u>(369,846)</u>	<u>(375,496)</u>
Total at amortized cost		1,378,948	1,394,391
Less investments, maturing within one year, at amortized cost		<u>110,175</u>	<u>123,974</u>
Long-term investments, at amortized cost	\$	<u><u>1,268,773</u></u>	<u><u>1,270,417</u></u>

Maturities of the investments in each of the five fiscal years following March 31, 2015, and five year incremental totals thereafter, are as follows (in thousands):

		<u>Maturities</u>	<u>Interest due</u>	<u>Total</u>
2016	\$	112,478	23,622	136,100
2017		99,565	23,622	123,187
2018		100,336	23,063	123,399
2019		100,206	22,432	122,638
2020		104,806	21,738	126,544
2021–2025		474,666	94,957	569,623
2026–2030		259,072	72,164	331,236
2031–2035		125,423	60,684	186,107
2036–2040		237,661	36,718	274,379
2041–2045		134,581	380	134,961
	\$	<u><u>1,748,794</u></u>	<u><u>379,380</u></u>	<u><u>2,128,174</u></u>

Credit risk is the risk that an issuer will not fulfill its obligations. The Lottery's policy is to follow State law which limits the investments that the Lottery can make and generally limit the Lottery's exposure to credit risk. The Lottery has generally limited its investments to obligations backed by the full faith of the U.S. government. Beginning in 2011, the Lottery held similarly rated New York City Transitional Finance Authority municipal bonds. The credit ratings of the Lottery's investments as published by Moody and Standard & Poors are included on the next page for those investments where credit ratings were available.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Lottery's policy for managing this risk is generally to hold investment securities to maturity, at which time the fair value of the investment is equal to its stated maturity value.

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As of March 31, 2015 and 2014, the Lottery had the following investments and maturities (amounts in thousands):

Investment type	2015 Fair value	Moody Credit rating	S&P Credit rating	2015		
				Investment maturities		
				Less than five years	5 years to 10 years	More than 10 years
U.S. Treasury Strips	\$ 670,230	Aaa	N/A	235,562	165,857	268,811
New York City Transitional Finance Authority Bonds	538,036	Aa1	AAA	66,974	115,913	355,149
Agency for International Development Bonds	<u>401,015</u>	Aaa	AA+	<u>208,340</u>	<u>155,992</u>	<u>36,683</u>
Total	<u>\$ 1,609,281</u>			<u>510,876</u>	<u>437,762</u>	<u>660,643</u>

Investment type	2014 Fair value	Moody Credit rating	S&P Credit rating	2014		
				Investment maturities		
				Less than five years	5 years to 10 years	More than 10 years
U.S. Treasury Strips	\$ 595,898	Aaa	N/A	\$ 225,284	148,651	221,963
New York City Transitional Finance Authority Bonds	501,712	Aa1	AAA	47,437	106,527	347,748
Agency for International Development Bonds	<u>441,800</u>	Aaa	AA+	<u>243,721</u>	<u>159,725</u>	<u>38,354</u>
Total	<u>\$ 1,539,410</u>			<u>\$ 516,442</u>	<u>414,903</u>	<u>608,065</u>

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to perform on a transaction, the Lottery will not be able to recover the value of investment securities that are in the possession of an outside party. In order to manage this risk, all of the Lottery's investments are insured or registered securities held by the Lottery or its agent in the Lottery's name.

(4) Prizes Payable

Prizes payable consisted of the following at March 31 (in thousands):

	2015	2014
Total obligation	\$ 2,169,576	2,229,061
Unamortized discount	<u>(754,301)</u>	<u>(770,934)</u>
Total carrying amount	1,415,275	1,458,127
Less prizes payable within one year	<u>138,019</u>	<u>159,746</u>
Long-term prizes payable	<u>\$ 1,277,256</u>	<u>1,298,381</u>

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The amortized discount on the prizes payable is based on interest rates which range from 0.07% to 8.49% and reflect the interest rates earned by the investments held to fund the related liabilities. The amortization of discount is recorded as investment expense in the Statements of Revenues, Expenses, and Changes in Net Position and amounted to \$62,443,000 and \$70,893,000 for fiscal years 2015 and 2014, respectively.

The aggregate amount of prizes payable due in each of the five fiscal years following March 31, 2015, and the five year incremental totals thereafter, is as follows (in thousands):

2016	\$	138,019
2017		122,226
2018		122,916
2019		123,565
2020		124,105
2021–2025		558,366
2026–2030		356,895
2031–2035		195,177
2036–2040		120,578
2041–2045		102,155
2046–2050		78,434
2051–2055		54,444
Thereafter		72,696
	\$	<u>2,169,576</u>

(5) Long-Term Liabilities

The Lottery's long-term liabilities as of March 31, 2015 and 2014 are comprised of the following (in thousands):

	<u>Balance at March 31, 2014</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at March 31, 2015</u>	<u>Current portion</u>
Compensated absences (note 11)	\$ 1,801	1,448	(1,665)	1,584	1,464
Prizes payable (note 4)	1,458,127	108,034	(150,886)	1,415,275	138,019

	<u>Balance at March 31, 2013</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance at March 31, 2014</u>	<u>Current portion</u>
Compensated absences (note 11)	\$ 1,895	1,470	(1,564)	1,801	1,487
Prizes payable (note 4)	1,494,555	123,927	(160,355)	1,458,127	159,746

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(6) Aid to Education

The required allocation and contribution transferred out for aid to education during the fiscal years ended March 31, 2015 and 2014 are as follows (in thousands):

	2015	2014
Cash transferred to education	\$ 3,215,584	3,181,781
Amount received from the State General Fund for Lottery aid guarantee	(66,765)	—
Net cash transferred to education	3,148,819	3,181,781
Prior year payable	(251,558)	(260,381)
Current year payable	213,309	251,558
Required allocation to education	\$ 3,110,570	3,172,958

(7) Pension Benefits

Substantially all employees of the Lottery are members of the State and Local Employees' Retirement System (ERS) and the Public Employees' Group Life Insurance Plan (GLIP). The two programs are part of the State and Local Retirement System (System) which is a cost-sharing, multiple employer public employee retirement system. The Comptroller of the State of New York is sole trustee and administrative head of the System. The System issues a publicly available financial report that includes financial statements and required supplementary information which may be obtained by writing to New York State and Local Employees' Retirement Systems, 110 State Street, Albany, New York 12244.

The System provides retirement benefits as well as death and disability benefits. Retirement benefits are established by the New York State Retirement and Social Security Law. Vesting, retirement benefits, and contributory requirements depend upon the point in time at which an employee last joined the System. Most members of the System who joined before July 27, 1976 are enrolled in a noncontributory plan; the Lottery contributes the entire amount determined to be payable to the System. Personnel who joined the System on or after July 27, 1976 are required by law to contribute some percent of their gross salary for a specified number of years of employment; the Lottery withholds and contributes the balance payable to the System for these employees.

The Lottery paid to the Office of the State Comptroller of the State of New York \$3,213,000 for 2015, \$3,132,000 for 2014, \$2,649,000 for 2013, to cover required employer contributions for retirement benefits and equaled 100% of the required contribution in each of the respective years. These payments made represent 17.52%, 15.59%, and 13.14% of covered payroll for each of the years, respectively.

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(8) Operating Income

Composition of operating income for fiscal 2015 and 2014 by type of lottery game is as follows (in thousands):

	2015					
	Expenses					
	Revenue	Prizes**	Commissions	Fees	Instant Direct Expense	Net
Mega Millions	\$ 287,809	(130,844)	(16,942)	(3,003)	—	137,020
Lotto	83,960	(22,644)	(4,578)	(1,047)	—	55,691
Take 5	239,022	(117,605)	(14,341)	(2,145)	—	104,931
Pick 10	27,983	(12,192)	(1,679)	(251)	—	13,861
Numbers	870,505	(419,064)	(52,230)	(8,029)	—	391,182
Win 4	852,017	(430,108)	(51,121)	(7,863)	—	362,925
Sweet Million	6,305	(3,727)	(378)	(57)	—	2,143
Powerball	304,540	(146,098)	(18,273)	(2,941)	—	137,228
Other Multi-State Draw Games**	124,989	(87,661)	(7,499)	(1,122)	—	28,707
Instants	3,760,139	(2,572,353)	(226,024)	(41,341)	(20,566)	899,855
Quick Draw	693,758	(454,677)	(41,626)	(7,883)	—	189,572
Total traditional lottery	7,251,027	(4,396,973)	(434,691)	(75,682)	(20,566)	2,323,115
Video gaming	1,905,309 *	120	(847,877)	(144,049)	—	913,503
	<u>\$ 9,156,336</u>	<u>(4,396,853)</u>	<u>(1,282,568)</u>	<u>(219,731)</u>	<u>(20,566)</u>	3,236,618
Telecommunications						(17,827)
Other operating expenses						<u>(120,579)</u>
Total operating income						<u>\$ 3,098,212</u>

* Video gaming revenue represents net machine income after awarding prizes. Video gaming credits played and won were as follows:

Credits played	\$ 33,970,899
Credits won	<u>(32,065,590)</u>
Net machine inc	<u>\$ 1,905,309</u>

** Prizes unclaimed after one year are forfeited and are netted against prizes.

*** Other Multi-State Draw Games include Cash 4 Life and Monopoly Millionaires' Club.

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2014						
Expenses						
	Revenue	Prizes**	Commissions	Fees	Instant direct expense	Net
Mega Millions	\$ 400,480	(203,464)	(23,720)	(4,113)	—	169,183
Lotto	94,563	(57,075)	(5,185)	(1,160)	—	31,143
Take 5	256,071	(127,364)	(15,364)	(2,309)	—	111,034
Pick 10	29,393	(15,140)	(1,764)	(265)	—	12,224
Numbers	873,845	(444,830)	(52,431)	(8,131)	—	368,453
Win 4	831,156	(401,267)	(49,869)	(7,746)	—	372,274
Sweet Million	32,565	(10,751)	(1,954)	(294)	—	19,566
Powerball	462,974	(214,803)	(27,778)	(4,484)	—	215,909
Promo Game	1,832	(768)	(110)	(16)	—	938
Instants	3,677,133	(2,511,112)	(221,886)	(41,064)	(18,871)	884,200
Quick Draw	654,158	(422,691)	(39,250)	(7,634)	—	184,583
Total traditional lottery	7,314,170	(4,409,265)	(439,311)	(77,216)	(18,871)	2,369,507
Video gaming	1,912,320 *	1,341	(850,891)	(142,529)	—	920,241
Telecommunications	\$ 9,226,490	(4,407,924)	(1,290,202)	(219,745)	(18,871)	3,289,748
Other operating expenses						(133,376)
Total operating income						\$ <u>3,135,015</u>

* Video gaming revenue represents net machine income after awarding prizes. Video gaming credits played and won were as follows:

Credits played	\$ 32,348,056
Credits won	<u>(30,435,736)</u>
Net machine income	\$ <u>1,912,320</u>

** Prizes unclaimed after one year are forfeited and are netted against prizes.

(9) Deferred Compensation

The State offers its employees, including Lottery employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the plan are placed in trust for the participants and their beneficiaries.

(10) Postretirement Benefits

As a New York State (State) agency, the Lottery participates in the New York State Health Insurance Program (NYSHIP), which is administered by the State as an agent multiple employer defined benefit plan. Under the plan, the State provides certain healthcare for eligible retired employees and their dependents. In order to qualify, retirees must meet certain age requirements and minimum service periods that vary based on the time they last entered benefits-eligible service. Retirees generally contribute a percent of the cost of

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single and dependent coverage for health insurance benefits. The percent varies based on when the employee retired. The percent also varies based on salary grade for those retiring on or after January 1, 2012. The State covers 100% of the cost of single coverage for employees retired prior to January 1, 1983 who are enrolled in the Empire Plan or another plan of equal or lower cost. NYSHIP does not issue a stand-alone financial report and NYSHIP's agent activities are included within the financial statements of the State.

During the fiscal years ended March 31, 2015 and 2014 NYSHIP provided health insurance coverage through the Empire Plan, an indemnity health insurance plan with managed care components; various Health Maintenance Organizations (HMOs); and through the Student Employee Health Plan (SEHP). Generally, these include hospital, medical, mental health and substance abuse benefits, and prescription drug benefits.

The Lottery's policy regarding retiree healthcare benefits is to pay the amounts billed through the State's fringe benefit rate on a pay-as-you-go basis. The Lottery has no obligation beyond the payment of the State's fringe benefit rate for retiree healthcare benefits. The State's policy is that the State is responsible for recording the annual required contribution and the actuarial accrued liability under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* for the Lottery's retiree health care benefits in the State's governmental-wide financial statements.

At March 31, 2015 and 2014, the Lottery had between 191 and 170 retired and/or spouses of retired employees receiving these benefits with an annual pay-as-you-go cost of approximately \$1,810,000 and \$1,622,000, respectively. Employee costs were approximately \$382,000 and \$278,000 as of March 31, 2015 and 2014, respectively.

(11) Employees' Compensated Absences

Under the terms of the Lottery's personnel policies and its union agreements, vacation pay benefits may be paid upon termination up to a maximum of 225 hours. The Lottery recognizes employees' compensated absence benefits when earned. The liability for employees' compensated absences was approximately \$1,584,000 and \$1,801,000 as of March 31, 2015 and 2014, respectively, and is recorded as a liability in the statements of net position.

(12) Leases

The Lottery has entered into operating leases for equipment and building space. Rental expense was approximately \$2,554,000 and \$2,458,000 in 2015 and 2014, respectively.

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Future minimum lease payments under all noncancelable leases having initial or remaining terms in excess of one year as of March 31, 2015 are as follows (in thousands):

	Operating leases
2016	\$ 1,993
2017	1,235
2018	1,233
2019	1,019
2020	213
2021 and thereafter	583
Total minimum payments required	\$ <u>6,276</u>

(13) Commitments and Contingencies

(a) Contractual Arrangements

The Lottery maintains a gaming network of approximately 18,000 retailer locations where all traditional lottery games are sold. Instant Game tickets are also sold through approximately 5,000 self-service terminals. GTECH Corporation (GTECH) is responsible for operating all traditional Lottery games, including maintenance of terminals and related communication services, under a contract expiring on August 5, 2017.

Instant Game sales are also supported by services provided under additional contracts:

- (1) Under a contract that expires August 14, 2018, Scientific Games International is the primary supplier of Instant Game tickets.
- (2) Under a contract expiring August 23, 2018, Pollard Banknote Limited is an alternate supplier of Instant Game tickets.
- (3) Under a contract that expires on August 21, 2018, GTECH Printing Corporation is an alternate supplier of Instant Game tickets.

Video lottery games are offered on approximately 18,000 video gaming machines spread over nine video lottery gaming facilities. MGAM Systems, Inc. provides a central processing system for the operation of video lottery games under a contract expiring on December 31, 2017. Video lottery gaming machines are provided under contracts expiring December 31, 2017 with three different companies (Bally Gaming Inc., International Game Technology, and Spielo International USA, Inc.). These contracts are paid based on a contractual percentage of revenue, adjusted for units of service provided.

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(b) *Litigation*

The Lottery has been named as a defendant in several lawsuits. While the ultimate outcome of these lawsuits cannot be predicted at this time, it is the opinion of management and in-house counsel that the disposition of any litigation in which the Lottery is involved will not have a material adverse effect on the financial position of the Lottery.