



A REPORT  
TO THE  
MONTANA  
LEGISLATURE

FINANCIAL AUDIT

# *Montana State Lottery*

*For the Two Fiscal Years Ended  
June 30, 2020*

APRIL 2021

LEGISLATIVE AUDIT  
DIVISION

*19-30B*

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**FINANCIAL AUDITS**

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting and many staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2019, was issued March 30, 2020. The Single Audit Report for the two fiscal years ended June 30, 2021, will be issued by March 31, 2022.

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**AUDIT STAFF**

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ALEXA O'DELL

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# LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
William Soller

April 2021

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial audit report of the Montana State Lottery (lottery) for the two fiscal years ended June 30, 2020. Our audit consisted of reviewing revenues, expenses, and account balances primarily related to online and scratch ticket sales. We reviewed the lottery's control systems and compliance with applicable state laws. The report resulted in three recommendations related to internal controls in the non-treasury cash account and compliance with state policies. We issued an unmodified opinion, meaning the reader can rely on the information presented in the financial statements and notes.

The lottery's response to the audit is included on C-1 of the audit report. We thank the Director and his staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

*/s/ Angus Maciver*

Angus Maciver  
Legislative Auditor



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## APPOINTED AND ADMINISTRATIVE OFFICIALS

			<u>Term Expires</u>
<b>Montana State Lottery Commission</b>	John Tarr, Chair (effective March 2021)	Helena	1/1/2022
	Wilbur Rehmann, Chair (through January 2021)	Helena	1/1/2021
	Steve Morris, Public Member	Helena	1/1/2025
	Tony Harbaugh, Law Enforcement	Miles City	1/1/2025
	Thomas M. Keegan, Attorney	Helena	1/1/2022
	Leo Prigge, CPA	Butte	1/1/2023

### **Administrative Officials**

Angela Wong, Montana State Lottery Director (through December 2020)

Bryan Costigan, Montana State Lottery Director of Security and Acting  
Director (beginning January 2021)

Armond Sergeant, Director of Financial Services

For additional information concerning the Montana State Lottery, contact:

Armond Sergeant, Director of Financial Services  
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APRIL 2021

FINANCIAL AUDIT

19-30B



## MONTANA LEGISLATIVE AUDIT DIVISION

## Montana State Lottery

FOR THE TWO FISCAL YEARS ENDED JUNE 30, 2020

**BACKGROUND**

The Montana State Lottery (lottery) offers both online and scratch games. Online games currently on sale include multi-state games such as Powerball, Mega Millions, Lucky for Life, and Lotto America, as well as state-specific games such as Montana Cash and Montana Millionaire. The lottery also markets an assortment of scratch games, as well as Treasure Play games, that are instant win games. Sports Bet Montana was added in fiscal year 2020. Sports Bet revenue is reported as part of “on-line ticket revenue” on lottery’s financial statements. In fiscal year 2020, sales from on-line and scratch games were approximately \$59.9 million, and direct costs associated with the sales were approximately \$46.9 million. The lottery recorded operating transfers to the state’s General Fund and the STEM scholarship fund in fiscal year 2020 totaling \$8.5 million. The lottery’s operating expense, funded from the net proceeds from ticket sales, totaled \$4.5 million in fiscal year 2020.

The Montana State Lottery had a mixed year for revenue in fiscal year 2020. The Coronavirus pandemic led to a large increase in scratch sales, with a decrease in lottery’s other games. Overall, lottery’s net revenue decreased by approximately \$3.7 million. Lottery also implemented two laws from the fiscal year 2019 session: lottery transferred the first \$500,000 of net revenue to the Montana STEM scholarship program administered by the Office of Commissioner of Higher Education, and lottery started a Sports Betting program. Our audit resulted in three recommendations to the lottery, including enhancing internal controls and complying with state policy regarding loans from the General Fund and telework agreements.

**AUDITOR’S OPINION (page A-1): UNMODIFIED**

This means you can rely on the financial statements and notes in this report in all material respects.

For the full context of the Montana State Lottery’s financial activity, see the financial schedules and notes beginning on page A-3.

**RECOMMENDATIONS:**

In this report, we issued the following recommendations:

To the lottery: 3

To the legislature: 0

The prior audit report contained no recommendations.

**RECOMMENDATION #1 (page 5):***Internal Controls and Compliance*

Improvement can be made in the control processes and compliance with state policy related to the movement of cash between the treasury and non-treasury accounts.

**Lottery response: Concur**

**RECOMMENDATION #2 (page 6):***Compliance*

Montana State Lottery did not comply with state policy regarding loans from the General Fund.

**Lottery response: Concur**

(continued on back)

For the full report or more information, contact the Legislative Audit Division.

[leg.mt.gov/lad](http://leg.mt.gov/lad)

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Call  
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(800) 222-4446 or  
(Helena)  
(406) 444-4446

Text  
(704) 430-3930

**RECOMMENDATION #3 (page 7):**

*Compliance*

Montana State Lottery did not comply with state policy regarding telework agreements.

**Lottery response: Concur**

**REPORT ON INTERNAL CONTROL AND COMPLIANCE**

**(page B-1):**

In this report, we identified the following:

Material Weaknesses in Internal Control: 0

Significant Deficiencies in Internal Control: 1

Material Non-Compliance: 0

Other Matters: 0

For the full context of this information, including the distinction between the types of items reported, see the report beginning on page B-1.



# Chapter I – Introduction and Background

## **Introduction**

We performed a financial audit of the Montana State Lottery (lottery) for the fiscal year ended June 30, 2020, with comparative statements for the fiscal year ended June 30, 2019. The audit addresses the requirements of §23-7-410, MCA, for the legislative auditor to conduct, or have conducted, an annual audit of the Montana State Lottery. The objectives of the audit were to:

1. Obtain an understanding of the lottery's control systems to the extent necessary to support our audit of the financial statements and, if appropriate, make recommendations for improvements in management and internal controls for the lottery.
2. Determine whether the lottery's financial statements present fairly the financial position, results of operations, and cash flows for the fiscal year ended June 30, 2020, with comparative financial statements amounts for the fiscal year ended June 30, 2019.
3. Determine compliance with state laws and regulations which have a direct and material impact on determining amounts in the financial statements.

We addressed these objectives by focusing our audit efforts on the review of revenues, expenses, and account balances resulting from ticket sales. We specifically reviewed: scratch and online ticket revenues; direct game costs such as scratch and online ticket prize expenses, retailer commissions, and vendor fees; the estimated prize liability related to winning tickets sold but not claimed by fiscal year-end; accounts receivables associated with ticket sales at retailer locations; cash and cash equivalents; and transfer activity required under state law. We also reviewed the lottery's personal services expenses including the net pension liability.

## **Background**

The lottery is established in state law, and governed by a five-member Lottery Commission (commission). Members of the commission are appointed by the governor to serve four-year staggered terms. The director of the lottery is also appointed by the governor. The commission is responsible for overseeing lottery operations and maximizing the net revenue earned by the lottery and paid to the state. The commission also sets the price of tickets and the number and size of prizes awarded for Montana specific lottery games. The commission is attached to the Department of Administration (department) for administrative purposes. As such, the financial activity of the lottery is also included in the states' Comprehensive Annual Financial Report and the department's audited financial schedules.

The lottery is a member of the Multi-State Lottery Association (MUSL), a nonprofit, government-benefit association. MUSL is owned and operated by member lotteries, and each state member lottery has a representative on the MUSL Board of Directors. The MUSL Board develops rules and regulations for all member state lotteries regarding games operated by MUSL. The lottery must comply with these regulations as a condition of offering MUSL games, such as Powerball.

During fiscal year 2020, the lottery offered scratch tickets, Powerball, Mega Millions, Lucky for Life, Lotto America, Montana Millionaire, Montana Cash, Treasure Play, Fantasy Football, Fantasy Racing, Big Sky Bonus, and added Sports Bet Montana. State law requires a minimum of 45 percent of money paid for tickets and chances on lottery games be used for prizes. Games sold in fiscal year 2020 had a composite prize payout of 61.43 percent. Sports Bet revenue is reported as part of “on-line ticket revenue” on lottery’s financial statements. Sports Bet Montana is the newest game implemented in March 2020 with the ability to bet on a variety of sports, such as football, soccer, and darts, at a kiosk installed in an authorized location or wager on a phone application. Bets range from \$2 to \$1,000. During fiscal year 2020, Sports Bet Montana brought in revenue of \$476,518. Sports Bet revenue is reported as part of “on-line ticket revenue” on the lottery’s financial statements.

The lottery accounts for its operations in an enterprise fund, which means that the operations are financed and operated similar to a private business enterprise where the intent is to finance or recover all costs through user charges. Funding for lottery operations come from sales of lottery games.

## **Transfers Determination**

Section 23-7-402(3), MCA, outlines the transfers of lottery net revenue. Lottery transfers the first \$500,000 of net revenue to the Montana STEM scholarship program administered by the Office of Commissioner of Higher Education. The remaining net revenue is transferred to the General Fund. The lottery has a negative net position resulting from its pension and Other Post-Employment Benefits expenses. These accounts do not result in a cash outflow, so are excluded from the calculation of the net revenue transfer amounts.

## Chapter II – Findings and Recommendations

### Improvements in Internal Control Related to Non-Treasury Cash Account Management

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**Reconciliations for the non-treasury cash account were not completed timely and the reasons for adjustments were not documented.**

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In addition to its treasury cash account, Montana State Lottery (lottery) holds cash in a non-treasury account used to pay lottery winners when they request a check. Lottery needs this account because checks written out of the treasury account would not be available the same day. Lottery transfers money from the treasury account to the non-treasury account weekly or when there are winners over \$5,000. State policy addresses requirements and procedures for handling money outside the State Treasury, including internal controls. The policy states that a deposit cannot be made to a revolving cash account that would cause the book balance to exceed the authorized balance. During the audit we noted a variety of control deficiencies and compliance issues related to these accounts.

The lottery's internal control procedures include a reconciliation of the non-treasury cash account. The reconciliation process compares the authorized balance of \$10,000 to the actual bank balance at the end of the month. Lottery staff completing the reconciliation make sure all checks written to winners are appropriate and document any adjustments caused by bank errors or timing differences. The reconciliations for the months of February through June of 2020 were not completed until August of 2020, which is after the state's accounting system had closed for fiscal year 2020. In addition, there were adjustments exceeding \$1,000 in six of the twelve monthly reconciliations and three instances where lottery staff did not document an explanation for the adjustments. If reconciliations are not completed timely, misstatements to the cash accounts or improper use of the accounts could go undetected at fiscal year-end. If adjustments are not resolved, errors in the accounting records can remain uncorrected. Based on our review, it appears a \$1,000 adjustment was unresolved from April through June of 2020 with no documented explanation. There was evidence all the reconciliations were completed in August and no improper payments were found.

We also noted areas where lottery can improve its reconciliation process:

- ♦ Lottery has a contractor for the gaming system that tracks all sales and winners. At the time of our audit, lottery did not have a process to remove uncashed or "stale checks" from the gaming system. There are stale checks in the gaming system from as far back as 2006, totaling \$6,000. This amounts to 60 percent of the authorized limit of the revolving cash account.

Under the current process, lottery staff must consider the stale checks in their reconciliation process every month. State policy for treasury accounts defines stale checks as those remaining uncashed past 180 days. If a check is in stale status for 180 days, the lottery is required to reclassify it as unclaimed property and transfer the funds to the Department of Revenue. Keeping stale checks in the system and having an authorized amount much smaller than needed makes the non-treasury account reconciliation process unnecessarily complex.

- ◆ Prize checks are regularly written from the revolving cash account that exceed the authorized balance for the account because the balance is too low. Lottery is authorized for \$10,000, but they write checks for hundreds of thousands of dollars every month. When a winner comes to collect, lottery makes a simultaneous transfer to cover the prize payout. In June 2020, there were 19 transfers from the treasury above the authorized amount of \$10,000. They were all to cover checks written for prize winnings. The largest transfer in June 2020 was \$493,499. Lottery should work with the Department of Administration to determine an authorized amount high enough for lottery to write checks without creating a negative cash balance. This would allow them to comply with state policy and would make the replenishment process easier.

We noted a variety of reasons for the internal control and compliance issues discussed above. New employees started completing the reconciliations in fiscal year 2020. In addition, we noted the transition to remote work due to the Coronavirus pandemic affected the timeliness of reconciliations and made maintaining established internal controls and improving controls systems and processes difficult. However, the need to work remotely has continued into fiscal year 2021, and the lottery should consider how it can reestablish and improve its non-treasury banking process to ensure protection and safeguarding of state resources. We consider the absence of complete and timely reconciliations to be a significant deficiency in internal control.

Lottery has been aware of the stale checks causing problems with the reconciliations, but at the time of our audit, they had not been able to find a solution to remove them from the gaming system. They agree it is in the best interest to get them removed and plan to work with the gaming system to address in the future.

We communicated the need to increase the account's balance in the prior audit, but lottery staff have not yet identified the appropriate amount to request, so no changes were made. They agree an increased authorized balance would be helpful and plan to make the change going forward.

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**RECOMMENDATION #1**

We recommend the Montana State Lottery:

- A. Reestablish control processes to ensure non-treasury account reconciliations are done completely and timely.
  - B. Comply with state accounting policy by submitting unclaimed property to Department of Revenue.
  - C. Work with the Department of Administration to establish a revolving account balance for the non-treasury account that meets the business needs.
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## **Lottery Loan With the General Fund**

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**Contrary to state accounting policy, lottery executed an unnecessary \$80,000 General Fund loan at fiscal year-end 2020.**

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State accounting policy requires all funds to have a positive cash balance at fiscal year-end. Lottery's cash balance in the treasury was negative by approximately \$56,000 at the end of fiscal year 2020, so it took a loan of \$80,000 from the General Fund. Although the cash account was negative, lottery had plenty of resources to meet its obligations, but had not converted its resources to cash prior to June 30. Lottery had over \$1.5 million in Short Term Investment Program (STIP) funds at June 30. A portion should have been liquidated to avoid the need for a General Fund loan. State accounting policy specifies, "Any fund requesting an interfund loan must liquidate Short-term Investment Pool (STIP) investments related to that fund prior to requesting an interfund loan."

Lottery staff noted they could no longer sell STIP by the time they realized the treasury account was going to be negative at June 30, 2020, because the buy-sell process was closed for fiscal year-end. Lottery staff noted they will liquidate a portion of its STIP balance to ensure cash is sufficient for year-end in the future. While the loan was paid off in early July 2020, executing the loan instead of selling STIP resulted in noncompliance with state accounting policy.

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**RECOMMENDATION #2**

*We recommend the Montana State Lottery comply with state accounting policy by liquidating sufficient resources to keep their treasury cash account positive at fiscal year-end to avoid loans from the General Fund.*

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## **Telework Policy**

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### **Telework Agreements were not completed for employees working in alternate locations.**

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Section 2-18-120, MCA, specifies, “The department shall adopt policies to encourage agencies to authorize telework and to provide uniform implementation of this section by agencies.” Montana Telework Policy further specifies, “Agency management and the employee must agree to the terms of telework before an employee can work at an alternate work location. Both the employee and agency management must sign the telework agreement.” The policy further explains the telework agreement should include items such as: duration of the agreement, work schedule, performance plan, equipment provided, data-security procedures, and how communication will be handled between employees, management, and customers. Agencies are required to consider any worker’s compensation liability that may arise from an alternate work site, equipment and materials that must be provided to employees to perform duties effectively, integrity and confidentiality of work information, and any other costs associated with telework.

Lottery’s employees have been working at alternate locations since April of 2020 without telework agreements in place. Lottery staff was managing employees in other ways, however, without a documented agreement containing clear expectations, it is difficult for management to keep employees accountable. Employees may be uncertain if they are required to work certain hours of the day, what performance is expected, or how communication is to be handled with co-employees, customers, or management.

The state’s response to the Coronavirus pandemic began in March 2020 with the governor issuing a stay at home mandate that allowed the lottery’s 32 employees to work from home, including the 7 sales representatives that were already in telework status. Of the 25 employees who historically worked in the office, most continued to work from home through January 2021, after the mandate was lifted, without

a telework agreement. Lottery management was not aware state policy required employees working at an alternative location have telework agreements. Additionally, we reviewed five of the seven telework agreements for the sales representatives and found they have not been updated since May of 2018. State policy requires telework agreements be updated on an annual basis.

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***RECOMMENDATION #3***

*We recommend the Montana State Lottery comply with state policy by completing signed telework agreements prior to authorizing work from an alternate work location, and by updating telework agreements annually.*

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# **Independent Auditor's Report and Lottery Financial Statements**



Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
William Soller

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Statement of Net Position of the Montana State Lottery as of June 30, 2020, and 2019, the related Statement of Revenues, Expenses and Changes in Net Position, and the Statement of Cash Flows for the fiscal years then ended, and the related notes to the 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 accounting principles generally accepted in the United States of America; this responsibility includes designing, implementing, and maintaining internal controls 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the Montana State Lottery's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Montana State Lottery's internal control, and 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 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 Montana State Lottery as of June 30, 2020, and 2019, and the changes in net position and cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

*Emphasis-of-Matter*

As discussed in Note 1 to the financial statements, the financial statements present only the enterprise fund of the Montana State Lottery and do not purport to, and do not, present fairly the financial position of the State of Montana, as of June 30, 2020, and 2019, the changes in its financial position, or its cash flows for each of the two fiscal years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

*Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 28, 2021, on our consideration of the Montana State Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Montana State Lottery's internal control over financial reporting and compliance.

Respectfully submitted,

*/s/ Cindy Jorgenson*

Cindy Jorgenson, CPA  
Deputy Legislative Auditor  
Helena, MT

January 28, 2021

**MONTANA LOTTERY  
STATEMENT OF NET POSITION  
JUNE 30, 2020 AND 2019**

	2020	2019
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 1,555,069	\$ 5,607,581
Receivables (Net)	3,514,044	1,902,504
Multi-State Reserve Fund	65,000	65,000
Inventories	404,674	494,592
Prepaid Expenses	<u>26,922</u>	<u>17,732</u>
<b>TOTAL CURRENT ASSETS</b>	<b>5,565,709</b>	<b>8,087,409</b>
<b>NONCURRENT ASSETS</b>		
Computer, Furniture & Equipment	630,514	605,999
Leasehold Improvements	98,793	98,793
Accumulated Depreciation	(545,566)	(489,423)
Multi-State Reserve Fund	<u>1,038,051</u>	<u>994,498</u>
<b>TOTAL NONCURRENT ASSETS</b>	<b>1,221,792</b>	<b>1,209,867</b>
<b>DEFERRED OUTFLOW OF RESOURCES</b>		
Pension Deferred Outflows	305,769	404,438
OPEB Deferred Outflows	<u>41,414</u>	<u>9,833</u>
<b>TOTAL DEFERRED OUTFLOWS OF RESOURCES</b>	<b>347,183</b>	<b>414,271</b>
<b>COMBINED ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b>	<b>\$ <u>7,134,684</u></b>	<b>\$ <u>9,711,547</u></b>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Accounts Payable	\$ 1,009,869	\$ 626,211
Estimated Prize Liability	2,173,172	2,477,419
Loan Payable	80,000	0
Transfer Obligations	2,078,721	4,922,378
Unearned Revenue	200,685	95,950
Accrued Compensated Absences	<u>110,321</u>	<u>128,589</u>
<b>TOTAL CURRENT LIABILITIES</b>	<b>5,652,768</b>	<b>8,250,547</b>
<b>NONCURRENT LIABILITIES</b>		
Multi-State Prize Liability	979,256	956,870
Accrued Compensated Absences	155,477	89,858
Net Pension Liability	1,772,282	1,762,942
Other Post Employment Benefits	<u>118,213</u>	<u>131,843</u>
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>3,025,228</b>	<b>2,941,513</b>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Pension Deferred Inflows	282,766	361,637
OPEB Deferred Inflows	<u>71,609</u>	<u>10,701</u>
<b>TOTAL DEFERRED INFLOWS OF RESOURCES</b>	<b>354,375</b>	<b>372,338</b>
<b>COMBINED LIABILITIES AND DEFERRED INFLOW OF RESOURCES</b>	<b>9,032,371</b>	<b>11,564,398</b>
<b>NET POSITION</b>		
Net Investment in Capital Assets	183,741	215,369
Unrestricted	<u>(2,081,428)</u>	<u>(2,068,220)</u>
<b>TOTAL NET POSITION</b>	<b>\$ <u>(1,897,687)</u></b>	<b>\$ <u>(1,852,851)</u></b>

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

<b>MONTANA LOTTERY</b> <b>STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION</b> <b>FOR THE YEARS ENDED JUNE 30, 2020 AND 2019</b>
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	2020	2019
<b>OPERATING REVENUES:</b>		
Scratch Ticket Revenue	\$ 24,239,036	\$ 18,531,003
On Line Ticket Revenue	35,615,617	41,723,120
License, Permits, and Misc	<u>36,498</u>	<u>18,723</u>
<b>Total Operating Revenues</b>	<b>59,891,151</b>	<b>60,272,846</b>
<b>DIRECT GAME COSTS:</b>		
Scratch Ticket Prize Expense	15,791,608	11,110,279
On Line Ticket Prize Expense	20,974,612	23,382,132
Retailer Commissions	4,165,531	3,603,642
Cost of Tickets Sold	1,026,103	896,761
Vendor fees	<u>4,926,037</u>	<u>5,053,609</u>
<b>Total Direct Game Costs</b>	<b>46,883,891</b>	<b>44,046,423</b>
<b>Income Before Operating Expenses</b>	<b>13,007,260</b>	<b>16,226,423</b>
<b>OPERATING EXPENSES:</b>		
Advertising	481,174	439,744
Advertising Production	275,730	239,003
Audit Fees	65,675	34,286
Bad Debts Expense	2,136	5,102
Communications	160,174	154,722
Contractual Services	169,718	147,396
Depreciation and Amortization	56,143	51,781
Administrative Service Fee	85,699	80,410
Multi-State Dues	0	31,242
Public Relations	49,972	47,152
Other Expenses	55,726	42,089
Personal Services	2,522,838	2,246,835
Repairs and Maintenance	17,726	16,441
Supplies and Materials	292,086	213,829
Travel	26,400	26,556
Utilities and Rent	<u>239,708</u>	<u>238,990</u>
<b>Total Operating Expense</b>	<b>4,500,905</b>	<b>4,015,578</b>
<b>Operating Income</b>	<b>8,506,355</b>	<b>12,210,845</b>
<b>NONOPERATING REVENUES (EXPENSES):</b>		
Interest Earnings	26,763	36,773
Gain/Loss on Sale of Assets	<u>0</u>	<u>499</u>
<b>Total Nonoperating Revenues(Expenses)</b>	<b><u>26,763</u></b>	<b><u>37,272</u></b>
<b>Income Before Operating Transfers</b>	<b>8,533,118</b>	<b>12,248,117</b>
Operating Transfers Out - General Fund	(8,073,079)	(12,214,709)
Operating Transfers Out - OCHE	(500,000)	0
<b>CHANGE IN NET POSITION</b>	<b>(39,961)</b>	<b>33,408</b>
<b>Total Net Position, Beginning of Period</b>	<b>(1,852,851)</b>	<b>(1,877,524)</b>
Prior Period Adjustment (Note 2)	<u>(4,875)</u>	<u>(8,735)</u>
<b>TOTAL NET POSITION, END OF PERIOD</b>	<b>\$ <u>(1,897,687)</u></b>	<b>\$ <u>(1,852,851)</u></b>

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

<b>MONTANA LOTTERY</b> <b>STATEMENTS OF CASH FLOWS</b> <b>FOR THE YEARS ENDED JUNE 30, 2020 AND 2019</b>
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	2020	2019
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts for Sales & Services	\$ 58,382,210	\$ 60,142,693
Payments for Goods & Services	(11,573,073)	(11,401,101)
Payments to Employees	(2,435,527)	(2,268,932)
Payments for Prizes	(37,048,081)	(34,859,277)
Net Cash Provided by Operating Activities	<u>7,325,529</u>	<u>11,613,383</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Transfer to Other Funds	(11,416,736)	(8,445,862)
Operating Loan Proceeds	80,000	0
Net Cash Used For Noncapital Financing	<u>(11,336,736)</u>	<u>(8,445,862)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition of Fixed Assets	(24,515)	(33,969)
Proceeds from Sale of Fixed Assets	0	1,495
Net Cash Used For Capital Financing	<u>(24,515)</u>	<u>(32,474)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest and Dividends on Investments	26,763	36,773
Received from (Paid to) MUSL Prize Reserve Fund	(43,553)	(173,360)
Net Cash Used by Investing Activities	<u>(16,790)</u>	<u>(136,587)</u>
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(4,052,512)</b>	<b>2,998,460</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b><u>5,607,581</u></b>	<b><u>2,609,121</u></b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ <u>1,555,069</u></b>	<b>\$ <u>5,607,581</u></b>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating Income	\$ 8,506,355	\$ 12,063,937
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	56,143	51,781
Change in Assets and Liabilities:		
Decr (Incr) in Account Receivable	(1,611,540)	(106,016)
Decr (Incr) in Inventories	89,918	(18,935)
Decr (Incr) in Prepaid expenses	(9,190)	16,981
Incr (Decr) in Accounts Payable	383,658	(133,275)
Incr (Decr) in Lottery Prizes Payable	(281,861)	(366,866)
Incr (Decr) in Unearned Income	104,735	(19,035)
Incr (Decr) in Other Post Employment Benefits	10,822	859
Incr (Decr) in Pension Liability	29,138	112,641
Incr (Decr) in Compensated Absences Payable	47,351	11,311
Total Adjustments	<u>(1,180,826)</u>	<u>(450,554)</u>
Net Cash Provided by Operating Activities	<b>\$ <u>7,325,529</u></b>	<b>\$ <u>11,613,383</u></b>

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





**MONTANA LOTTERY**  
Notes to the Financial Statements  
June 30, 2020 and 2019

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and countries, and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

The Montana Lottery is included as an enterprise fund in the State of Montana's Comprehensive Annual Financial Report. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Montana Lottery's financial statements as a reporting entity.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Property and equipment. Property and equipment are recorded at cost. Donated property and equipment are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of property and equipment, the cost and related accumulated depreciation or amortization are removed from the accounts. Gain or loss on disposal is reflected in non-operating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of three to ten years. The Lottery conforms to the State of Montana capitalization threshold for capitalizing property and equipment as well as buildings and building/land improvements. The threshold for capitalizing property and equipment is \$5,000 and the threshold for capitalizing buildings/land improvements is \$25,000.

Revenue Recognition. Lottery scratch ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Ticket sales for lotto games Powerball, Montana Cash, Montana Millionaire, Mega Millions, Lucky for Life, Big Sky Bonus, and Lotto America are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as unearned income until such time as the tickets become valid for the most current drawing.

Treasure Play revenue is recorded on a daily basis as games are played. Treasure Play games are instant chances for wins, so when these games are played the revenue from these games are earned as played.

Ticket sales for Fantasy Sports games are based upon MCA 23-4-302 and an interagency agreement between the Lottery and the Board of Horse Racing. The Lottery is only a facilitator of these games and charges an administrative fee for this service. The actual sales of these games are not reflected on the Lottery's financial statements as they are not income to the Lottery.

Tickets sales for Sports Bet Montana wagers are recorded as revenue when the specific event for the bet has occurred and become official. All other wagers for future events that are placed by players are recorded as unearned revenue until such time the specific event has happened and is official.

Classification of Revenues. The Lottery has classified its revenues as either operating or non-operating according to the following criteria:

Operating revenues – include activities that have characteristics of exchange transactions, including (1) ticket sales, net of returns, and (2) retailer license fees and administrative fees in relation to selling lottery tickets.

Non-Operating revenues – include activities that have the characteristics of non-exchange transactions, such as gifts and other revenue sources that are defined as non-operating revenues by GASB No. 9, “Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,” and GASB No. 34, “Basic Financial Statements and Management Discussion and Analysis for State and Local Governments.” Types of revenue sources that fall into this classification are investment income, and gain or loss on disposition of assets.

Free Tickets. Some Montana Lottery scratch games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free ticket prizes distributed for the year ended June 30, 2020, and 2019 was \$1,009,922, and \$699,099, respectively.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., "Ask for the Sale" or second chance drawings. The Lottery also directly distributes scratch tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the year ended June 30, 2020, promotional credits resulted in a revenue reduction of approximately \$21,949 and an expense reclassification of approximately \$16,221. For the year ended June 30, 2019, promotional credits resulted in a revenue reduction of approximately \$21,334 and an expense reclassification of approximately \$15,686.

Prizes. Expenses for scratch prizes are recorded based on the predetermined prize structure for each game. Expenses for lotto prizes are recorded based on the predetermined prize structure for each individual game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the lotto games must be claimed within six months after the appropriate draw date. Prizes for scratch games must be claimed within six months of the announced end of each game. The unclaimed prize amounts for these games are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The amount of unclaimed prizes for all Montana Lottery games is represented in the table below.

	Quarter Ended 6/30/20	Quarter Ended 6/30/19	Year to Date 6/30/20	Year to Date 6/30/19
Lotto	\$123,897	\$269,277	\$ 488,644	\$ 666,285
Scratch	\$233,574	\$593,487	\$ 636,296	\$1,268,131
<b>TOTALS</b>	\$357,471	\$862,764	\$1,124,940	\$1,934,416

## 2. OTHER ACCOUNTING ISSUES

Prior Period Adjustments. The prior period adjustments for the year ended June 30, 2020 and 2019, respectively, were made by the State Accounting Bureau for changes made to the Lottery's pension accounts. These adjustments were made to account for a change in methodology used to allocate the pension figures amongst multiple funds within a single business unit at the State level. A decrease was made to the Pension Deferred Outflows for \$4,875 and \$8,735, respectively, using this methodology. The result of the above equates to a \$4,875 and \$8,735 reduction to the Lottery's Net Position.

## 3. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool; cash on deposit in a revolving account with an approved non-state financial institution; and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Cash and cash equivalents consist of the following:

	June 30,	
	<u>2020</u>	<u>2019</u>
Short-term investment pool	\$1,521,062	\$1,494,130
Cash on deposit with State Treasurer	23,807	4,103,251
Cash in revolving deposit account	10,000	10,000
Petty Cash & Cash On-Hand	200	200
<b>TOTALS</b>	<b>\$1,555,069</b>	<b>\$5,607,581</b>

The bank balance of the revolving deposit account, not including outstanding deposits or checks, was \$178,973, and \$18,587 as of June 30, 2020 and 2019, respectively, and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. For the year ended June 30, 2020, receivables include \$3,944,776, representing amounts due the Lottery for tickets purchased by retailers. Receivables also include \$675 for interest income due from the Montana Board of Investments short-term investment pool. An allowance for ticket returns is included in the receivables amount. This allowance represents a reduction in receivables as of June 30, 2020, for estimated ticket returns. This is an estimate based on returns received to date, as well as an estimate of tickets unsold by retailers for games that have a public sale end date prior to July 1, 2020. The allowance for ticket returns is \$470,506 as of June 30, 2020. The return of vendor fees related to the allowance for returns is \$39,099.

For the year ended June 30, 2019, receivables included \$2,159,366, representing amounts due the Lottery for tickets purchased by retailers. Receivables also include \$2,992 for interest income due from the Montana Board of Investments short-term investment pool. An allowance for ticket returns is included in the receivables amount. This allowance represents a reduction in receivables as of June 30, 2019, for estimated ticket returns. This is an estimate based on returns received to date, as well as an estimate of tickets unsold by retailers for games that have a public sale end date prior to July 1, 2019. The allowance for ticket returns is \$283,405 as of June 30, 2019. The return of vendor fees related to the allowance for returns is \$23,551.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory for years ended June 30, 2020 and 2019 include scratch tickets valued at \$306,802, and \$414,999, respectively, that are stored in the warehouse, at retailers prior to being activated by the retailer, and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. For the years ended June 30, 2020, and 2019, supplies inventories totaled \$97,872, and \$79,593, respectively. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets include the following:

	June 30,	
	2020	2019
Prepaid Expenses	\$26,922	\$17,732

The prepaid expenses for the year ended June 30, 2020 consisted of \$26,922 for prepaid commissions and vendor fees related to unearned revenue. The prepaid expenses for the year ended June 30, 2019 consisted of \$5,000 for booth fees for upcoming events, and \$12,732 for prepaid commissions and vendor fees related to unearned revenue.

Property and Equipment. A summary of property and equipment for the Lottery for both years is as follows:

	June 30,			June 30,
	2018	Additions	Deletions	2019
Leasehold Improvements	\$ 98,793	\$ -	-	\$ 98,793
Furniture & Equipment	\$ 582,010	\$ 33,969	\$ (9,980)	\$ 605,999
Accumulated Depreciation	\$ (446,626)	\$ (51,781)	\$ 8,984	\$ (489,423)
	June 30,			June 30,
	2019	Additions	Deletions	2020
Leasehold Improvements	\$ 98,793	\$ -	-	\$ 98,793
Furniture & Equipment	\$ 605,999	\$ 24,515	\$ -	\$ 630,514
Accumulated Depreciation	\$ (489,423)	\$ (56,143)	\$ -	\$ (545,566)

Estimated Prize Liability. The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

Obligation to Transfer Funds. The Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. The 2015 Legislature passed HB617 which changed the transfer requirements. Any year forward, the Lottery is to transfer an amount to the General Fund that equals the transfer made by the Lottery for FY2015 which was \$12,363,365. Any amount over and above this threshold will then be transferred to the Office of Commissioner for Higher Education (OCHE) for the Montana STEM scholarship program. The 2019 Legislature passed SB60 which changed the transfer requirements again. Going forward, the Lottery is to transfer a set amount to the STEM scholarship first, and any residual would be transferred to the General Fund. The transfer obligations outstanding at June 30, 2020 were \$1,953,721 to the General Fund and \$125,000 to OCHE. For the year ending June 30, 2019, the obligation outstanding at year end was \$4,922,378 due to the General Fund and \$0 to OCHE.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's liability for compensated absences is detailed below.

<u>Balance</u> <u>June 30, 2018</u> \$207,136	<u>Net Leave</u> <u>Earned/(Used)</u> \$11,311	<u>Balance</u> <u>June 30, 2019</u> \$218,447
<u>Balance</u> <u>June 30, 2019</u> \$218,447	<u>Net Leave</u> <u>Earned/(Used)</u> \$47,351	<u>Balance</u> <u>June 30, 2020</u> \$265,798

Long-Term Liabilities. Following are the changes in non-current liabilities for the years ended June 30, 2020 and 2019:

	<b>Year ended June 30, 2020</b>				
	<u>Balance</u> <u>July 1, 2019</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30,2020</u>	<u>Amounts</u> <u>due within</u> <u>one year</u>
Multi-State Prize Liability	\$ 956,870	\$ 54,448	\$( 32,062)	\$ 979,256	\$ -
Accrued Compensated Absences	\$ 89,858	\$ 92,730	\$( 27,111)	\$ 155,477	\$110,321
Net Pension Liability	\$1,762,942	\$ 9,340	\$ -	\$1,772,282	\$ -
Other Post Employment Benefits	\$ 131,843	\$ -	\$( 13,630)	\$ 118,213	\$ -

## Year ended June 30, 2019

	Balance			Amounts	
	July 1, 2018	Additions	Reductions	Balance	due within
				June 30, 2019	one year
Multi-State Prize Liability	\$ 754,449	\$249,728	\$( 47,307)	\$ 956,870	\$ -
Accrued Compensated Absences	\$ 48,284	\$ 68,115	\$( 26,541)	\$ 89,858	\$128,589
Net Pension Liability	\$2,201,008	\$123,138	\$(561,204)	\$1,762,942	\$ -
Other Post Employment Benefits	\$ 122,589	\$ 9,254	\$ -	\$ 131,843	\$ -

**Commissions.** Section 23-7-301(10), MCA, provides retailers a commission on scratch and lotto tickets or chances sold. The Lottery established this commission at 5% (6% for Sports Betting) of the face value of scratch tickets activated by the retailers and the face value of lotto tickets sold. In addition, retailers can earn bonus commissions on tickets sold based on incremental sales of scratch and Treasure Play tickets. For the years ended June 30, 2020 and 2019, retailers earned bonus commissions of \$1,219,143 and \$553,686, respectively. For the years ended June 30, 2020 and 2019, total commissions were \$4,165,531 and \$3,603,642, respectively.

#### 4. PAYMENTS TO OTHER STATE AGENCIES

The Lottery receives a variety of services, supplies, and materials from other state agencies. These services and materials are detailed below for the fiscal years ended June 30, 2020 and 2019:

Year Ended June 30	2020	2019
Administrative Service Fees	\$ 85,699	\$ 80,410
Audit Fees	65,675	34,286
Computer Fees	97,844	91,209
Insurance	15,538	15,864
Mail Processing Fees	10,109	12,053
Other Expenses	6,046	2,574
Payroll Services	8,185	7,657
Printing	10,627	12,937
Record Retention	1,158	1,018
State Accounting System Support	3,802	3,880
Supplies & Materials	-	-
Telecommunications	-	1,336
Warrant Writing Services	1,561	901
	<u>\$306,244</u>	<u>\$264,125</u>



## **5. PRIZES**

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money". Prize expense is recorded based on the predetermined prize structure percentage for each game less unclaimed prizes. For the year ended June 30, 2020, the prize expense of \$36,766,220 is 61.43% of net Lottery ticket revenue of \$59,854,653. For the year ended June 30, 2019, the prize expense of \$34,492,411 was 57.24% of net Lottery ticket revenue of \$60,254,123.

## **6. TRANSFERS OF NET REVENUE**

Section 23-7-402(3), MCA, states "That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. For FY 2019, revenue must be transferred quarterly from the enterprise fund established by 23-7-401, MCA, to the state general fund. Once the amount of revenue transferred to the general fund during a fiscal year equals the amount transferred to the general fund in FY 2015 (\$12,363,365), any additional net revenue must be transferred to the Montana STEM scholarship program special revenue account established in 20-26-617, MCA. Beginning in FY2020, Section 23-7-402(3)(a-e), MCA states an established amount will be transferred to the STEM scholarship first, then any residual will be transferred to the General Fund. The established amounts to go to the STEM scholarships are \$500,000 for FY 2020, \$1,000,000 for FY 2021, \$1,500,000 for FY 2022, \$2,000,000 for FY 2023, and \$2,250,000 for FY 2024 and all subsequent fiscal years thereafter. For the years ended June 30, 2020 and 2019, the net revenue payable to the State General Fund totaled \$8,073,079, and \$12,214,709, respectively. For the years ended June 30, 2020 and 2019, the net revenue payable to the Montana STEM scholarship totaled \$500,000, and \$0, respectively.

## **7. MULTI-STATE LOTTERY**

In November 1989 the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Powerball, Mega Millions, and Lotto America are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Reserve Fund with a balance of \$1,103,051 and \$1,059,498 as of June 30, 2020, and 2019, respectively, is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). A portion of the Powerball Unreserved Account is classified as a current asset which represents an amount expected to be converted into cash and collected from MUSL within the next fiscal year. The balance of these reserve accounts and investment category is as follows:

	<u>June 30, 2020</u>		
	US Treasury	Federal Agencies	Total
Powerball Prize Reserve Account	\$339,013	\$ 19,238	\$ 358,251
Powerball Set Prize Reserve Account	35,144	127,034	162,178
Powerball Unreserved Account	8,554	115,241	123,795
Lotto America Prize Reserve Account	101,240	21,326	122,566
Mega Millions Prize Reserve Account	<u>303,240</u>	<u>33,021</u>	<u>336,261</u>
Total Reserves	<u>\$787,191</u>	<u>\$315,860</u>	<u>\$1,103,051</u>
Less Current Portion			(65,000)
<b>Non Current Reserves</b>			<u>\$1,038,051</u>

	<u>June 30, 2019</u>		
	US Treasury	Federal Agencies	Total
Powerball Prize Reserve Account	\$316,710	\$ 35,268	\$351,978
Powerball Set Prize Reserve Account	48,006	114,397	162,403
Powerball Unreserved Account	1,817	100,811	102,628
Lotto America Prize Reserve Account	78,866	16,521	95,387
Mega Millions Prize Reserve Account	<u>312,565</u>	<u>34,537</u>	<u>347,102</u>
Total Reserves	<u>\$757,964</u>	<u>\$301,534</u>	<u>\$1,059,498</u>
Less Current Portion			(65,000)
<b>Non Current Reserves</b>			<u>\$994,498</u>

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. Payments made to this fund are considered a portion of prize expense associated with the game.

The Powerball Unreserved Account is a separate account used by a participating Lottery to have MUSL hold funds due to the Lottery. Balances in this account are created when any MUSL jackpot expires and goes unclaimed. Each Lottery is then refunded its pro rata share of the jackpot based on sales during the accumulation of that specific jackpot. This money is then invested in U.S. Treasury securities until withdrawn. Interest earned on the Lottery's share of the fund is added to the Unreserved Account on a quarterly basis. The amount in the Unreserved Account has limited uses and are set and approved by the Board with the stipulation that requests to use the funds are accompanied by certification from the requesting Board Member that the payment is made in conformance with state or jurisdiction law and is related to a MUSL activity.

During fiscal year ended 2020, the Lottery received \$2,148 in interest, and had \$19,019 added into the account due to a Mega Millions redistribution adjustment. During the fiscal year ended 2019, the Lottery received \$2,182 in interest, and had \$31,242 withdrawn for annual MUSL dues and assessments.

The Lotto America Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Lotto America game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

The Mega Millions Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Mega Millions game, assuming that no unanticipated prize claims have been paid. The Lottery contributes to the reserve through the 51% set aside for prizes for Mega Millions plays and 51% for Megaplier plays. Payments made to the reserve are considered a portion of the prize expense related to the game.

## 8. RELATED PARTY TRANSACTIONS

All lotteries that offer multi-state games transact with the Multi-State Lottery Association (MUSL) which requires the directors from each of the states to be on the MUSL board of directors. The Director of the Montana Lottery is on this board along with being the Secretary of the MUSL board of directors. The Director of the Lottery is in a management position for both MUSL and the Montana Lottery who have significant transactions between each other.

As described in Note 7 above, the Lottery has prize reserves with MUSL in the amounts of \$1,103,051 and \$1,059,498 for years ended 2020 and 2019, respectively. These are monies that are assets to the Lottery and would be transferred over if the lottery were to quit any of the multi-state games.

Weekly, MUSL collects each state's share of prize expenses to go towards respective jackpots. If a state has a large enough amount/number of winners for any particular draw, MUSL would then reimburse any state for the excess amount of prizes paid out. In FY2020, the Lottery paid MUSL \$5,415,880 for its share of prizes and received reimbursements for prizes in the amount of \$3,032,382. In FY2019, the Lottery paid MUSL \$9,071,077 for its share of prizes and received reimbursements for prizes in the amount of \$661,225.

## 9. GAMES

Currently, Montana Lottery games are Scratch ticket games and six Lotto games referred to as Powerball, Montana Cash, Lotto America, Mega Millions, Lucky for Life, and Big Sky Bonus. The Lottery also offers Treasure Play, a line of instant terminal-issued games with pre-determined odds, and Montana Millionaire, a limited-edition Lottery game. The Lottery is facilitating Fantasy Sports games on behalf of the Board of Horse Racing. Currently the Lottery is selling Montana Sports Action Fantasy Football and Fantasy Racing games. The Lottery also implemented Sports Bet Montana which is a sports wagering game.

Scratch ticket games provide players the opportunity to win instantly by scratching the latex covering to reveal a prize. The lottery sells tickets for \$1, \$2, \$3, \$5, \$10, and \$20. Cash prizes range from \$1 to \$500,000, plus specialty prizes for certain games.

The Powerball game allows players a chance to win a minimum parimutuel jackpot of \$40 million. A player must match all six numbers to win the jackpot. Players also win prizes ranging from \$4 to \$1 million for matching fewer than all six numbers. Drawings are held twice weekly on Wednesday and Saturday nights. Powerball is offered in 45 lottery jurisdictions including Montana. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing, creating a progressive jackpot. In March 2001, the Lottery added Power Play to the Powerball game. For an additional \$1 per play, Power Play doubles the Match 5 prize from \$1 million to \$2 million and increases other prizes as well. Each Powerball prize (except for the jackpot and the Match 5 prize) increases by 2x, 3x, 4x, 5x, or 10x with Power Play.

The Montana Cash game allows players the chance to win a minimum parimutuel jackpot of \$40,000. Players select five numbers from a field of 45 and must match at least two out of five to win a prize. Matching 2 of 5 wins \$1, 3 of 5 wins \$5, and 4 of 5 wins \$200. The Lottery added a second jackpot for this game called Max Cash. Max Cash is a separate jackpot that grows based on the sales for adding an extra dollar to the normal Montana Cash ticket. It is only hit when a player wins the regular jackpot and purchased the Max Cash add on. The drawings are conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all five numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

Mega Millions is a multi-state game that allows players to win a minimum parimutuel jackpot starting at \$20 million. If no one wins the jackpot, the jackpot continues to grow. Mega Millions went on sale March 1, 2010, in Montana. To win the jackpot, players must match all six numbers drawn; other prizes range from \$2 to \$1,000,000. For an additional \$1 per play, Mega Millions has a Megaplier option which multiplies non-jackpot prizes by two, three, or four. Drawings are held each Tuesday and Friday night.

Lucky for Life debuted January 2015. Lucky for Life is a multi-state game that allows players to win a top prize of \$1,000 a day for life. The second prize is \$25,000 a year for life. This pari-mutuel game has a set top prize and tickets cost \$2 each. Players select five numbers from a field of 48 and must match at least the Lucky Ball to win a prize. The drawings are conducted twice weekly on Monday and Friday nights.

Big Sky Bonus debuted April 2016. Big Sky Bonus is a Montana-only game that allows players to win a progressive jackpot. Players select 4 numbers from a field of 28 and must match at least 2 out of 4 to win a prize unless they hit the bonus number which is a 5th number picked out of a field of 17. Matching the bonus number at any time wins \$10. Matching 2 of 4 wins \$2, 3 of 4 wins \$20, and 4 of 4 wins the jackpot. The drawing is held every day at 7:30 p.m. If no ticket matches all 4 numbers, the jackpot rolls over to the next day to create a progressive jackpot.

Lotto America is the newest on-line game for the Lottery. Lotto America allows players in the 13 participating lotteries a chance to win an all-cash pari-mutuel jackpot with a guaranteed minimum of \$2 million. Each time the jackpot is not won, it grows, thus creating a progressive jackpot. Players choose five numbers from 1 to 52, and one Bonus number from 1 to 10. To win the pari-mutuel jackpot, a player must match all six numbers. Drawings are held twice weekly on Wednesday and Saturday nights. A multiplier called the All Star Bonus can be added to win 2X, 3X, 4X, or 5X to any prize except the jackpot for bigger prizes. Drawings are held every Wednesday and Saturday.

The Treasure Play games are offered on self-serve terminals in taverns and casinos that are licensed to sell Montana Lottery products. Introduced in November 2011, they are a suite of games with a pre-determined prize structure like a Scratch game. Players can tell instantly if they have won a prize. The tickets sell for \$1, \$2, \$3, \$5, and \$10.

Montana Millionaire is a seasonal raffle-type game offering a \$1 million top prize. The first offering went on sale October 1, 2007. The lottery has sold the game every winter since. Tickets are sold sequentially and are sold for \$20 each. Early bird drawings for \$25,000 and \$15,000, respectively, will be offered on Thanksgiving weekend and the second week of December to stimulate early sales. There will also be 550 \$100 instant winners and 750 \$500 instant winners. On December 27, 2019, one \$1 million prize was awarded, one \$250,000 prize, along with three \$100,000 prizes and four \$10,000 prizes.

The Montana Lottery offers a product line called Montana Sports Action on behalf of the Montana Board of Horse Racing. The product line began in August 2008 with a game called Fantasy Football. To play the game, players choose five offensive players and a defensive unit from the official roster of professional football players and teams. The players can also select a bet amount (\$5, \$10, \$20, \$50, or \$100) which determines the shares of the prize pool players are eligible to win should their team have one of the three highest point totals for the week. Tickets are sold weekly through the professional playoffs, excluding the championship game. A second game called Fantasy Racing was

introduced in February 2009 and follows the NASCAR® Sprint Cup Series. Teams are created by selecting a driver from the top nine ranked drivers for the week, three drivers ranked from 10 through 34, and one driver ranked 35 or above. The sixth element in a player's Fantasy Racing team is the number of yellow-flag cautions the player believes might occur in that week's race. Like Fantasy Football, players may also choose to purchase a higher-cost ticket to increase the share of the prize pool in the event their team has one of the three highest point totals for that race.

Sports Bet Montana is the newest of games implemented. In the 2019 legislature, HB725 was passed and set into law sports wagering in the State of Montana. The Lottery implemented the game in March 2020 with ability to bet at a kiosk installed in an authorized location, or wager on a phone application which also has to be done in an authorized location. Players can make plays either on the kiosks or with an account the player has set up. The minimum bet is \$2, the maximum bet is \$1,000, and the maximum prize available is \$100,000. These bets can be for any sports event available through the Lottery and can vary in many types of wagers.

## **10. COMMITMENTS - GAMING SUPPLIER CONTRACTS**

Scratch Tickets. On July 30, 2015 the Montana Lottery Commission approved the award of a five-year contract with Scientific Games International (SGI) for the provision of scratch tickets. The contract is for five years with the option for two additional one-year renewals. The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure.

SGI, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of \$5,000,000. The Lottery may terminate this contract by providing proper notification to Scientific Games.

On-line Services. On February 13, 2015, the Lottery signed a seven-year contract with Intralot, Inc. of Duluth, GA to provide an on-line gaming system and the associated services beginning March 31, 2016. The contract requires Intralot to provide new terminals to all retailers with the associated software and communications. Payment under the contract is based on 8.31% of net weekly Lottery sales of lotto and scratch games. The contract currently has a termination date of March 30, 2023.



## 11. LEASES/INSTALLMENT PURCHASES PAYABLE

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a lease agreement that is effective January 1, 2017 through August 2027. The monthly lease payment is \$18,068.

## 12. INVESTMENTS

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). The applicable investment disclosures are described in the following paragraphs.

Multi-State Lottery Association The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States government, and mutual funds of approved investments".

Short-term Investment Pool The State's Short Term Investment Pool (STIP) is an external investment pool managed and administered under the direction of the Montana Board of Investments as statutorily authorized by the Unified Investment Program. It is a commingled external investment pool and participants may request for redemption on a daily basis. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the investment.

**Credit risk** is defined as the risk that an issuer of an investment will not fulfill its obligation, i.e., not make timely principal and interest payments. The STIP securities have credit risk as measured by major credit rating services, however, the pool is not rated. The Lottery does not have a policy regarding credit risk

Per MUSL, for 2020 the prize reserves held on behalf of the Montana Lottery are invested in the Montana Winners Trust. In this trust, 74% was invested in Federal Agencies; another 5% was invested in the First American Government Obligation Fund which is used for overnight investing and does not have a rating from S&P or Moodys, etc. However, it is a very conservatively managed vehicle, investing exclusively in short-term U.S. government securities. Another 9% was invested in a short-term Treasury Bill, and the other 12% of the prize reserves are invested in Federal Agency



repurchase agreements secured by U.S. government securities. The Lottery does not have any authority or a policy regarding the investment portfolios.

**Custodial credit risk** is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party.

The MUSL prize reserves are held in the Montana Winners Trust using policies set forth by the MUSL board regarding policies for the type of securities, as well as the custody, trading and the use of proceeds of the securities. The Lottery does not have any authority or a policy regarding the investment portfolios.

**Concentration of credit** is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Because STIP is a pooled investment, this risk does not apply. Because the MUSL reserves are also a pooled investment, this risk does not apply to them either.

**Interest rate risk** is the risk that changes in interest rates will adversely affect the fair value of an investment. The Lottery does not have any authority or a policy regarding the investment portfolios.

The MUSL prize reserves are invested through the Montana Winners Trust with daily liquidity, and therefore, have low interest rate risk. The MUSL board's investment policy limits the individual security and the portfolio's maturity. As of June 30, 2020, the duration for the U.S. Government Treasury securities was a blended rate of 1.67 years.

The STIP securities are invested in various bond pools and investment portfolios which are liquid on a daily basis. Therefore, STIP itself, does have low risk. The duration for this pool as of June 30, 2020 is 60 days.

According to the STIP Investment Policy, "the STIP portfolio will minimize interest rate risk by:

- 1) Structuring the investment portfolio so securities mature to meet cash requirements for ongoing operations, thereby normally avoiding the need to sell securities on the open market prior to maturity;
- 2) Maintaining a dollar-weighted average portfolio maturity (WAM) for 60 days or less (for this purpose, the date to the next coupon reset date will be used for all floating or variable rate securities); and
- 3) STIP will maintain a reserve account."

### 13. FAIR VALUE MEASUREMENT

The Lottery categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles as follows:

Level 1 – Quoted prices for identical assets or liabilities in active markets.

Level 2 – Prices determined using inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, either directly or indirectly.

Level 3 – Prices are determined using unobservable inputs.

#### Investments Measured at Net Asset Value

	June 30, 2020	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservab le (Level 3)
<u>Investments by Net Asset Value</u>				
Short Term Investment Pool (STIP)	\$1,521,062			
Total Investments by net asset value level	<u>\$1,521,062</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

#### Investments Measured at Net Asset Value

	June 30, 2019	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservab le (Level 3)
<u>Investments by Net Asset Value</u>				
Short Term Investment Pool (STIP)	\$1,494,130			
Total Investments by net asset value level	<u>\$1,494,130</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The Short Term Investment Pool (STIP) has a daily redemption frequency and a daily redemption notice period. The fair value of this pool has been determined using the Net Asset Value (or its equivalent).

#### **14. SUBSEQUENT EVENTS**

During the Fiscal year end 2020, there was litigation requested by third party businesses for the court to find that the Lottery had exceeded its statutory authority in limiting the issuance of sports wagering licenses to locations that hold an alcohol license.

In October 2020, the state district court in Helena ruled that the Lottery did not have authority to limit the issuance of sports wagering licenses to locations that hold an alcohol license. The Lottery, therefore, began to process and review applications submitted by individuals and businesses who wished to obtain a sports wagering license but did not have an alcohol license. It is concluded that this is a resolved issue and nothing more is expected.

#### **15. OTHER POST EMPLOYMENT BENEFITS**

*General.* The State of Montana and the Montana Lottery provide optional postemployment healthcare benefits in accordance with Section 2-18-704, MCA to the following employees and dependents who elect to continue coverage and pay administratively established contributions: (1) employees and dependents who retire under applicable retirement provisions, and (2) surviving dependents of deceased employees. Medical, dental, and vision benefits are available through this plan. The State and Montana Lottery offer OPEB plans that are not administered through trusts; as such, there are no plan assets accumulated to offset the total OPEB liability.

In accordance with Section 2-18-704, MCA, the State provides post-retirement health insurance benefits to eligible employees who receive retirement benefits from the Public Employees' Retirement System (PERS) or various other State retirement systems, and elect to start medical coverage within 60 days of leaving employment. Retirement eligibility criteria differ by State retirement plan.

*Plan Description.* The State OPEB plans are reported as single employer plans. There are a number of State agencies who are participating employers under this plan. Each participating employer is required to disclose additional information as required per

*GASB No. 75, Accounting and Financial Reporting for Postemployment Benefits Other than Pensions (GASB 75).*

The healthcare OPEB plans allow retirees to participate, as a group, at a rate that does not cover all of the related costs. This results in reporting the total OPEB liability in the related financial statements and note disclosures. Reported contributions are not a result of direct funding to the plans or for associated liabilities, but are a measure of the difference in retiree payments into the plans and actual medical costs associated with those individuals paid for by the plans. The healthcare OPEB plans are reported as agency funds. There are no assets or liabilities as only contributions collected and distributions made are reflected in these funds. See the funding policy that follows.

*Basis of Accounting.* OPEB liability is reported on an accrual basis on proprietary and fiduciary fund financial statements. Plan member contributions are recognized in the period in which the contributions are made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

*Funding Policy.* The State of Montana pays for postemployment healthcare benefits on a pay-as-you-go basis. Montana Code Annotated, Title 2, Chapter 18, Part 8 gives authority for establishing and amending the funding policy to the Department of Administration. As of December 31, 2019, the State OPEB plan's administratively established retiree medical premiums vary between \$448 and \$1,777 per month. Retiree dental premiums vary between \$41.10 and \$70.00 per month while vision premiums vary between \$7.64 and \$22.26, depending on the types and number of dependents enrolled. The plan provides different coinsurance amounts and deductibles depending on whether members use in-network or out-of-network providers. Once retiree members become Medicare eligible, the plan automatically processes claim reimbursement as the secondary insurer, even if the member is not enrolled in Medicare.

*Actuarial Methods and Assumptions.* The total OPEB liability (TOL) measured under GASB 75 is based upon service cost and more standardized reporting assumptions than prior GASB Statements. As a pay-as-you-go public entity, GASB 75 requires a 20-year current municipal bond discount rate to establish an Actuarially Determined

Contribution (ADC). The GASB 75 valuation is further required to show both historical and projected future net changes in TOL, as well as sensitivity to changes in key underlying assumptions. Actuarially determined amounts are subject to continual revisions being actual results are compared with past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term perspective. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost-sharing between the employer and plan members in the future.

The State's OPEB Plan TOL in December 31, 2019, rolled forward to March 31, 2020, actuarial valuation was determined using the following actuarial assumptions and inputs, applied to all periods included in the measurement, unless otherwise specified:

Actuarial valuation date	December 31, 2019
Experience study period	January 1, 2017 through December 31, 2019
Actuarial measurement date (1)	March 31, 2020
Actuarial cost method	Entry age normal funding method
Amortization method	Open basis
Amortization period	20 years
Asset valuation	Not applicable since no assets meet the definition of plan assets under GASB 75
Actuarial assumptions:	
Discount rate	2.75%
Projected payroll increases	2.50%
Participation:	
Future retirees	40.00%
Future eligible spouses	70.00%
Marital status at retirement	70.00%
Mortality – Healthy	Assumed to follow RP-2000 Combined Mortality Table with improvements projected by Scale BB to 2020, set back one year for males.
Mortality – Disabled	Assumed to follow RP-2000 Combined Mortality Table with no projections.
Healthcare cost trend rates	7.5% for both medical and prescription initially, decreasing 0.1% per year to an ultimate rate of 3.8%. Cost increases are assumed to apply at the end of the plan year.

Retiree Contribution Increases      Current year was based on actual trend. For retiree/surviving spouse and spouse the increase is 7.0% in 2019 decreasing between 0.1% and 0.5% per year to an ultimate rate of 3.8%.

(1) Updated procedures were used to roll forward the total OPEB liability measurement date.

*Changes in actuarial assumptions and methods since last measurement date:* Changes in actuarial assumptions include a participation rate reduction from 55% to 40% based on recent experience study, a revision to rates per the Retirement System pension valuations as of July 1, 2019, and the interest/discount rate was based on the average of multiple March 3, 2020 municipal bond rate sources.

*Changes in benefit terms since last measurement date:* None

*Sensitivity of the TOL to changes in discount rate.* The following presents the TOL of the Lottery's plan, as well as what they would be if calculated using a discount rate that is 1-percentage-point lower (1.75%) or 1-percentage-point higher (3.75%) than the current discount rate:

	1.0% Decrease (1.75%)	Current Discount Rate (2.75%)	1.0% Increase (3.75%)
<u>Lottery OPEB</u>			
June 30, 2020	\$153,384	\$118,213	\$92,611

*Sensitivity of the TOL to changes in the healthcare cost trend rates.* The following presents the TOL of the Lottery plan, as well as what they would be if calculated using healthcare cost trends that are 1-percentage-point lower (5.0%) or 1-percentage-point higher (7.0%) that the current healthcare cost trend rates:

	1.0% Decrease (5.0%)	Current Discount Rate (6.0%)	1.0% Increase (7.0%)
<u>Lottery OPEB</u>			
June 30, 2020	\$92,706	\$118,213	\$154,333

*OPEB Expense, Liability and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB.* For the year ended June 30, 2020, the Lottery's plan's OPEB expense is \$6,139. The Lottery's proportionate share of the State's total OPEB liability is \$118,213 which is 0.2563% of the total State's OPEB liability at year end.

At June 30, 2020, the Lottery's OPEB plan deferred outflows and inflows of resources are from the following sources:

**June 30, 2020**

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ -	\$31,292
Changes in Assumptions or other inputs	\$ 41,414	\$40,317
Actual vs. Expected Investment Earnings	\$ -	\$ -
Amounts associated with transactions subsequent to the measurement date of the total OPEB liability	\$ -	\$ -
Total	\$ 41,414	\$71,609

At June 30, 2019, the Lottery's OPEB plan deferred outflows and inflows of resources are from the following sources:

**June 30, 2019**

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ -	\$10,072
Changes in Assumptions or other inputs	\$ 5,223	\$ 629
Actual vs. Expected Investment Earnings	\$ -	\$ -
Amounts associated with transaction subsequent to the measurement date of the total OPEB liability	\$ 4,610	\$ -
Total	\$ 9,833	\$10,701

Amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Year Ended June 30,	Amount Recognized in OPEB expense as an increase or (decrease) to OPEB expense
---------------------	--

2020	\$ (2,709)
2021	\$ (2,709)
2022	\$ (2,709)
2023	\$ (2,709)
2024	\$ (2,709)
Thereafter	\$(16,752)

## 16. EMPLOYEE RETIREMENT PLAN

*Plan Description.* The PERS-Defined Benefit Retirement Plan (DBRP) and Defined Contribution Retirement Plan (DCRP) are administered by the Montana Public Employee Retirement Administration (MPERA), and are a multiple-employer, cost-sharing plans established July 1, 1945, and governed by Title 19, chapters 2 & 3, Montana Code Annotated (MCA). These plans provide retirement benefits to covered State, local governments, certain employees of the Montana University System, and school districts. Benefits are established by state law and can only be amended by the Legislature.

All new members are initially members of the PERS-DBRP and have a 12-month window during which they may choose to remain in the PERS-DBRP or join the PERS-DCRP by filing an irrevocable election. Members may not be participants of both the *defined contribution* and *defined benefit* retirement plans.

The PERS-DBRP provides retirement, disability, and death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service, and highest average compensation. Member rights are vested after five years of service.

### *Summary of Benefits.* **Member's highest average compensation (HAC)**

Hired prior to July 1, 2011 - highest average compensation during any consecutive 36 months;

Hired on or after July 1, 2011 – highest average compensation during any consecutive 60 months;

### **Compensation Cap**

Hired on or after July 1, 2013 – 110% annual cap on compensation considered as part of a member's highest average compensation.

### **Eligibility for benefit**



### Service retirement:

Hired prior to July 1, 2011: Age 60, 5 years of membership service;  
Age 65, regardless of membership service; or  
Any age, 30 years of membership service.

Hired on or after July 1, 2011: Age 65, 5 years of membership service;  
Age 70, regardless of membership service.

### Early retirement, actuarially reduced:

Hired prior to July 1, 2011: Age 50, 5 years of membership service; or  
Any age, 25 years of membership service.

Hired on or after July 1, 2011: Age 55, 5 years of membership service.

Second retirement: (requires returning to PERS-covered employer or PERS service)  
Retired before January 1, 2016 and accumulate less than 2 years additional service credit or retired on or after January 1, 2016 and accumulate less than 5 years additional service credit: A refund of Member's contributions plus return interest (currently 2.02% effective July 1, 2018), no service credit for second employment, start the same benefit amount the month following termination, and Guaranteed Annual Benefit Adjustment (GABA) starts again in the January immediately following the second retirement.

Retired before January 1, 2016 and accumulate at least 2 years of additional service credit: A recalculated retirement benefit based on provisions in effect after the initial retirement, GABA starts on the recalculated benefit in the January after receiving the new benefit for 12 months.

Retired on or after January 1, 2016 and accumulate 5 or more years of service credit: The same retirement as prior to the return to service, a second retirement benefit as prior to the second period of service based on laws in effect upon the rehire date, and GABA starts on both benefits in the January after receiving the original and the new benefit for 12 months.

### Monthly benefit formula

Members hired prior to July 1, 2011:

- Less than 25 years of membership service: 1.785% of HAC per year of service credit;
- 25 years of membership service or more: 2% of HAC per year of service credit.

Members hired on or after July 1, 2011:

- Less than 10 years of membership service: 1.5% of HAC per year of service credit;
- 10 years or more, but less than 30 years of membership service: 1.785% of HAC per year of service credit;
- 30 years or more of membership service: 2% of HAC per year of service credit.

#### **Guaranteed Annual Benefit Adjustment (GABA)**

- 3% for members hired **prior to** July 1, 2007
- 1.5% for members hired **on or after** July 1, 2007
- Members hired on or after July 1, 2013:
  - (a) 1.5% for each year PERS is funded at or above 90%;
  - (b) 1.5% is reduced by 0.1% for each 2% PERS is funded below 90%; and
  - (c) 0% whenever the amortization period for PERS is 40 years or more.

After the member has completed 12 full months of retirement, the member's benefit increases by the applicable percentage each January, **inclusive** of other adjustments to the member's benefit.

#### *Overview of Contributions.*

Rates are specified by state law for periodic employer and employee contributions and are a percentage of the member's compensation. Contributions are deducted from each member's salary and remitted by participating employers. The state Legislature has the authority to establish and amend contribution rates to the plan.

Member contributions to the system: Plan members are required to contribute 7.90% of member's compensation. Contributions are deducted from each member's salary and remitted by participating employers.

Member contributions to the system of 7.9% are temporary and will be decreased to 6.9% on January 1 following actuary valuation results that show the amortization period has dropped below 25 years and would remain below 25 years following the reduction of both the additional employer and additional member contribution rates.

Employer contributions to the system: State and University System employers are required to contribute 8.27% of members' compensation. Following the 2013 Legislative Session, PERS-employer contributions were temporarily increased. Effective July 1, 2013, employer contributions increased 1.0%. Beginning July 1, 2014, employer contributions increased an additional 0.1% a year over 10 years, through 2024. The additional employer additional contributions including the 0.27% added in 2007 and

2009, will terminate on January 1 following actuary valuation results that show the amortization period of the PERS-DBRP has dropped below 25 years and would remain below 25 years following the reductions of both the additional employer and member contributions rates. Effective July 1, 2013, employers are required to make contributions on working retirees' compensation. Member contributions for working retirees are not required.

*Stand-Alone Statements.* The PERS financial information is reported in the Public Employees' Retirement Board's *Comprehensive Annual Financial Report* and the GASB 68 Report for the fiscal year ended. It is available from the PERB at PO Box 200131, Helena MT 59620-0131, 406-444-3154.

CAFR information including the stand alone financial statements can be found at the MPERA's website, <http://mpera.mt.gov/annualReports.shtml>. The latest actuarial valuation and experience study can be found at the MPERA's website, <http://mpera.mt.gov/actuarialValuations.asp>.

*Actuarial Assumptions.* The Total Pension Liability as of June 30, 2019, is based on the results of an actuarial valuation date of June 30, 2016 with update procedures to roll forward the Total Pension Liability to June 30, 2017. There were several significant assumptions and other inputs used to measure the Total Pension Liability. The actuarial assumptions used in the June 30, 2017 valuation were based on the results of the actuarial experience study, dated May 2017 for the six year period ended June 30, 2016. Among those assumptions were the following:

- General Wage Growth 3.50% (includes Inflation at 2.75%)
- Merit Increases 0% to 6.30%
- Investment Return (net of admin expense) 7.65%
- Admin Expense as a % of Payroll 0.26%
- Postretirement Benefit Increases;
  - (a) 3% for members hired **prior** to July 1, 2007,
  - (b) 1.5% for members hired **on or after** July 1, 2007, and for members hired **on or after** July 1, 2013;
    - (a) 1.5% for each year PERS is funded at or above 90%;
    - (b) 1.5% is reduced by 0.1% for each 2% PERS is funded below 90%; and
    - (c) 0% whenever the amortization period for PERS is 40 years or more.

Mortality assumptions among contributing members, terminated vested members, service retired members and beneficiaries based on RP-2000 Combined Employee and Annuitant Mortality Tables projected to 2020 with scale BB. Mortality assumptions

among Disabled Retirees are based on RP-2000 Combined Employee and Annuitant Mortality Tables with no projections. No future mortality improvement is assumed.

*Discount Rate.* The discount rate used to measure the Total Pension Liability was 7.65%. The projection of cash flows used to determine the discount rate assumed that contributions from participating plan members, employers, and non-employer contributing entities will be made based on the Board's funding policy, which established the contractually required rates under Montana Code Annotated. The State contributes 0.10% of salaries paid by local governments and 0.37% paid by school districts. In addition, the state contributed a statutory appropriation from the general fund. Based on those assumptions, the Plan's fiduciary net position was projected to be adequate to make all the projected future benefit payments of current plan members through the year 2122. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the Total Pension Liability. A municipal bond rate was not incorporated in the discount rate.

*Target Allocations.*

<b>Asset Class</b>	<b>Target Asset Allocation</b>	<b>Long-Term Expected Real Rate of Return</b>
Cash Equivalents	3.0%	4.09%
Domestic Equity	36.0%	6.05%
Foreign Equity	18.0%	7.01%
Fixed Income	23.0%	2.17%
Private Equity	12.0%	10.53%
Real Estate	8.0%	5.65%

The long-term expected return on pension plan assets is reviewed as part of the regular experience studies prepared for the System. The most recent analysis, performed for the six year period ended June 30, 2016, is outlined in a report dated May 2017, which can be located on the MPERA website. The long-term expected rate of return on pension plan investments was determined by considering information from various sources, including historical rates of return, rate of return assumptions adopted by similar public pension systems, and by using a building block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment and inflation) are developed for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and then adding expected inflation.

The following presents the employer's sensitivity of the Net Pension Liability to the discount rate in the table below. A small change in the discount rate can create a significant change in the liability. The Net Pension Liability was calculated using the discount rate of 7.65% as well as what the Net Pension Liability would be if it were calculated using a discount rate 1.00% lower or 1.00% higher than the current rate.

*Sensitivity Analysis.*

Employer Net Pension Liability	1.0% Decrease (6.65%)	Current Discount Rate	1.0% Increase (8.65%)
June 30, 2020	\$2,546,264	\$1,772,282	\$1,121,848
June 30, 2019	\$2,549,622	\$1,762,942	\$1,116,952
June 30, 2018	\$3,205,580	\$2,201,008	\$1,357,746

*Summary of Significant Accounting Policies.* The Montana Public Employee Retirement Administration (MPERA) prepares its financial statements using the accrual basis of accounting. For the purposes of measuring the Net Pension Liability, deferred inflows of resources and deferred outflows of resources related to pensions, Pension Expense, information about the fiduciary net position and additions to/deductions from fiduciary net position have been determined on the same accrual basis as they are reported by MPERA. For this purpose, member contributions are recognized in the period in which contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Revenues are recognized in the accounting period they are earned and become measurable. Benefit payments and refunds are recognized in the accounting period when due and payable in accordance with the benefit terms. Expenses are recognized in the period incurred. Investments are reported at fair value. MPERA adheres to all applicable Governmental Accounting Standards Board (GASB) statements.

*Net Pension Liability.* In accordance with GASB Statement 68, Accounting and Financial Reporting for Pensions, employers are required to recognize and report certain amounts associated with their participation in the Public Employees' Retirement System (PERS). Statement 68 became effective for fiscal year ended June 30, 2015 and includes requirements to record and report their proportionate share of the

collective Net Pension Liability, Pension Expense, Deferred Inflows and Deferred Outflows of resources associated with pensions.

Lottery Proportionate Share of Net Pension Liability:

Net Pension Liability as of 6/30/20	Net Pension Liability as of 6/30/19	Percent of Collective NPL as of 6/30/20	Percent of Collective NPL as of 6/30/19	Change in Percent of Collective NPL
\$1,772,282	\$1,762,942	0.084786%	0.084465%	0.000723%

At June 30, 2020, the Lottery recorded a liability of \$1,772,282 for its proportionate share of the Net Pension Liability. The Net Pension Liability was measured as of June 30, 2020, and the Total Pension Liability used to calculate the Net Pension Liability was determined by an actuarial valuation as of June 30, 2016, with roll forward provisions to June 30, 2017. For the fiscal years ended June 30, 2020, and 2019, the employer's proportion of the Net Pension Liability was based on the employer's contributions received by PERS during the measurement periods July 1, 2016 to June 30, 2017. Relative to the total employer contributions received from all of PERS' participating employers, at June 30, 2020, the Lottery's proportion was 0.084786%.

***Changes in actuarial assumptions and methods:***

Effective July 1, 2017, the following assumption changes were used:

- Lowered the interest rate from 7.75% to 7.65%
- Lowered the inflation rate from 3.00% to 2.75%
- Updated non-disabled mortality to the RP-2000 Combined Employee and Annuitant Mortality Table projected to 2020 using scale BB, males set back 1 year
- Increased rates of withdrawal
- Lowered the merit component of the total salary increase
- Lowered the wage base component of the total salary increase from 4.00% to 3.50%
- Decreased the administrative expense load from 0.27% to 0.26%

Effective July 1, 2017, the following method changes were used:

- Administrative expenses are recognized by an additional amount added to the normal cost contribution rate for the System. This amount will vary from year to year based on the prior year's actual administrative expenses.

- To be consistent with the wage base growth change, the payroll growth assumption for amortization as a level percent of pay was reduced from 4.00% to 3.50%

**Changes in benefit terms:**

Effective July 1, 2017, the following benefit changes were:

- The interest rate credited to member accounts increased from 0.25% to 0.77%
- Lump sum payouts in all systems are limited to the member’s accumulated contributions rather than the present value of the member’s benefit

**Changes in proportionate share:** There were no changes between the measurement date of the collective Net Pension Liability and the employer’s reporting date that are expected to have a significant effect on the employer’s proportionate share of the collective net pension liability.

**Recognition of Deferred Inflows and Outflows.** At June 30, 2020 and 2019, the Lottery reported its proportionate share of PERS’ deferred outflows of resources and deferred inflows of resources related to PERS from the following sources:

**June 30, 2020**

	Deferred Outflows of Resources	Deferred Inflows of Resources
Actual vs. Expected Experience	\$ 84,038	\$ 83,393
Changes in Assumptions	\$ 75,239	\$ -
Actual vs. Expected Investment Earnings	\$ 21,488	\$ -
Changes in Proportionate Share and Differences between Employer Contributions and Proportionate Share of Contributions	\$ -	\$199,373
Employer contributions subsequent to the measurement date – FY 2019 contributions	\$125,004	\$ -
Total	\$305,769	\$282,766

**June 30, 2019**

	Deferred Outflows of Resources	Deferred Inflows of Resources
Actual vs. Expected Experience	\$134,060	\$ -

Changes in Assumptions	\$149,912	\$ -
Actual vs. Expected Investment Earnings	\$ -	\$ 27,379
Changes in Proportionate Share and Differences between Employer Contributions and Proportionate Share of Contributions	\$ -	\$334,258
Employer contributions subsequent to the measurement date – FY 2018 contributions	\$120,466	\$ -
Total	\$404,438	\$361,637

Amounts reported as deferred outflows of resources related to pensions resulting from the Lottery's contributions subsequent to the measurement date will be recognized as a reduction of the Net Pension Liability in each year end. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in Pension Expense as follows:

Year Ended June 30,	Amount Recognized in Pension Expense as an Increase or (decrease) to Pension Expense
2020	\$ 3,545
2021	\$(132,825)
2022	\$ 7,994
2023	\$ 19,286
2024	\$ 0
Thereafter	\$ 0



# Report on Internal Control and Compliance



# LEGISLATIVE AUDIT DIVISION

B-1

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
William Soller

## REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Montana State Lottery (lottery), as of and for the years ended June 30, 2020, and 2019, and the related notes to the financial statements, which collectively comprise the lottery's basic financial statements, and have issued our report thereon dated January 28, 2021.

### *Internal Control Over Financial Reporting*

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

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

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

any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described below, that we consider to be significant deficiencies.

As described on pages 3 and 4, reconciliations for the non-treasury cash account were not completed timely and the reasons for adjustments were not documented during fiscal year 2020.

*Compliance and Other Matters*

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

*Purpose of this Report*

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

Respectfully submitted,

*/s/ Cindy Jorgenson*

Cindy Jorgenson, CPA  
Deputy Legislative Auditor  
Helena, MT

January 28, 2021

MONTANA STATE LOTTERY

LOTTERY RESPONSE





April 9, 2021

Mr. Angus Maciver, Legislative Auditor  
Legislative Audit Division  
Room 135, State Capitol  
Helena, MT 59620

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LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver:

I would like to take this opportunity to thank the staff of the Legislative Audit Division for the work performed as part of the Lottery Financial Audit for the two fiscal years ended June 30, 2020. The diligence demonstrated by your staff in reviewing the Lottery's procedures, internal controls, accounting practices and our financial statements should be commended. As always, we feel that the services provided by your agency benefit the Lottery and Montana.

As a result of your work, three recommendations were made, and I would like to take this opportunity to respond.

Recommendation 1:

*We recommend the Montana State Lottery:*

- A. Reestablish control processes to ensure non-treasury account reconciliations are done completely and timely.*
- B. Comply with state accounting policy by submitting unclaimed property to Department of Revenue.*
- C. Work with the Department of Administration to establish a revolving account balance for the non-treasury account that meets the business needs.*

Response:

The Lottery concurs with this recommendation.

The Lottery realizes that bank reconciliations need to be completed timely to identify any unusual activity, errors, or issues. Due to logistics of employees in other departments in the Lottery performing the reconciliations, there was a delay in completing them in a timely manner. We understand the importance of this task and will set dates each month to have them done in an appropriate time frame.

The Lottery also agrees to be compliant with the stale-dated checks, on a monthly basis, as we do have the means to omit the checks and submit the unclaimed property. We will also work

with the Department of Administration to raise the authorized amount in the non-treasury account that will meet our business needs in the future.

Recommendation #2

*We recommend the Montana State Lottery comply with state accounting policy by liquidating sufficient resources to keep their treasury cash account positive at fiscal year-end to avoid loans from the General Fund.*

Response:

The Lottery concurs with this recommendation.

The Lottery realizes that state policy at year end is to ensure that all agencies have a positive cash balance in their Treasury account. This is done through interfund transfers, transfers/sales of STIP funds, or through other resources as available. The Lottery is a one-fund agency, so the only option for us is to sell STIP. This was not done this fiscal year as it was not deemed necessary at June 30<sup>th</sup>. After three weeks of additional transactions in July, the Lottery's account was negative for the first time and a three-day loan was needed to comply. The Lottery will ensure that a large amount of STIP is sold at year end and the cash balance is positive.

Recommendation #3

*We recommend the Montana State Lottery comply with state policy by completing signed telework agreement prior to authorizing work from an alternate work location, and by updating telework agreements annually.*

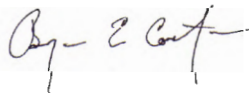
Response:

The Lottery concurs with this recommendation.

We have completed the agreements and instituted a procedure to ensure these agreements are properly maintained.

The Lottery appreciated the opportunity to discuss the Lottery Financial Audit Report with your staff during the exit conference on March 15, 2021. I'd like to thank your staff for their professionalism and the fairness with which they approached issues that arose during the audit period.

Sincerely,



Bryan E. Costigan  
Acting Director  
Montana Lottery