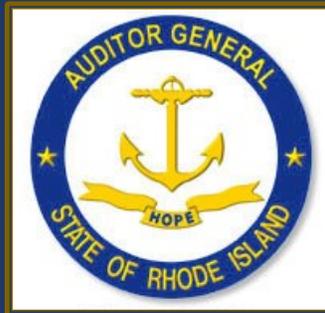


RHODE ISLAND LOTTERY

(AN ENTERPRISE FUND OF THE
STATE OF RHODE ISLAND)

FISCAL YEAR ENDED JUNE 30, 2020



Dennis E. Hoyle, CPA, Auditor General

Office of the Auditor General

General Assembly

State of Rhode Island



Office of the Auditor General

State of Rhode Island - General Assembly
Dennis E. Hoyle, CPA - Auditor General

oag.ri.gov

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October 30, 2020

JOINT COMMITTEE ON LEGISLATIVE SERVICES:

SPEAKER Nicholas A. Mattiello, Chairman

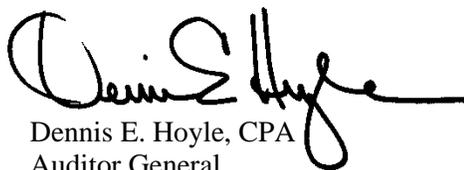
Senator Dominick J. Ruggerio
Senator Dennis L. Algieri
Representative K. Joseph Shekarchi
Representative Blake A. Filippi

We have completed our audit of the financial statements of the Rhode Island Lottery for the year ended June 30, 2020 and have issued our *Independent Auditor's Report* thereon.

Section III of this report includes our *Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*.

Section IV contains a finding and management comments which include recommendations intended to enhance internal control or result in other operational efficiencies.

Sincerely,

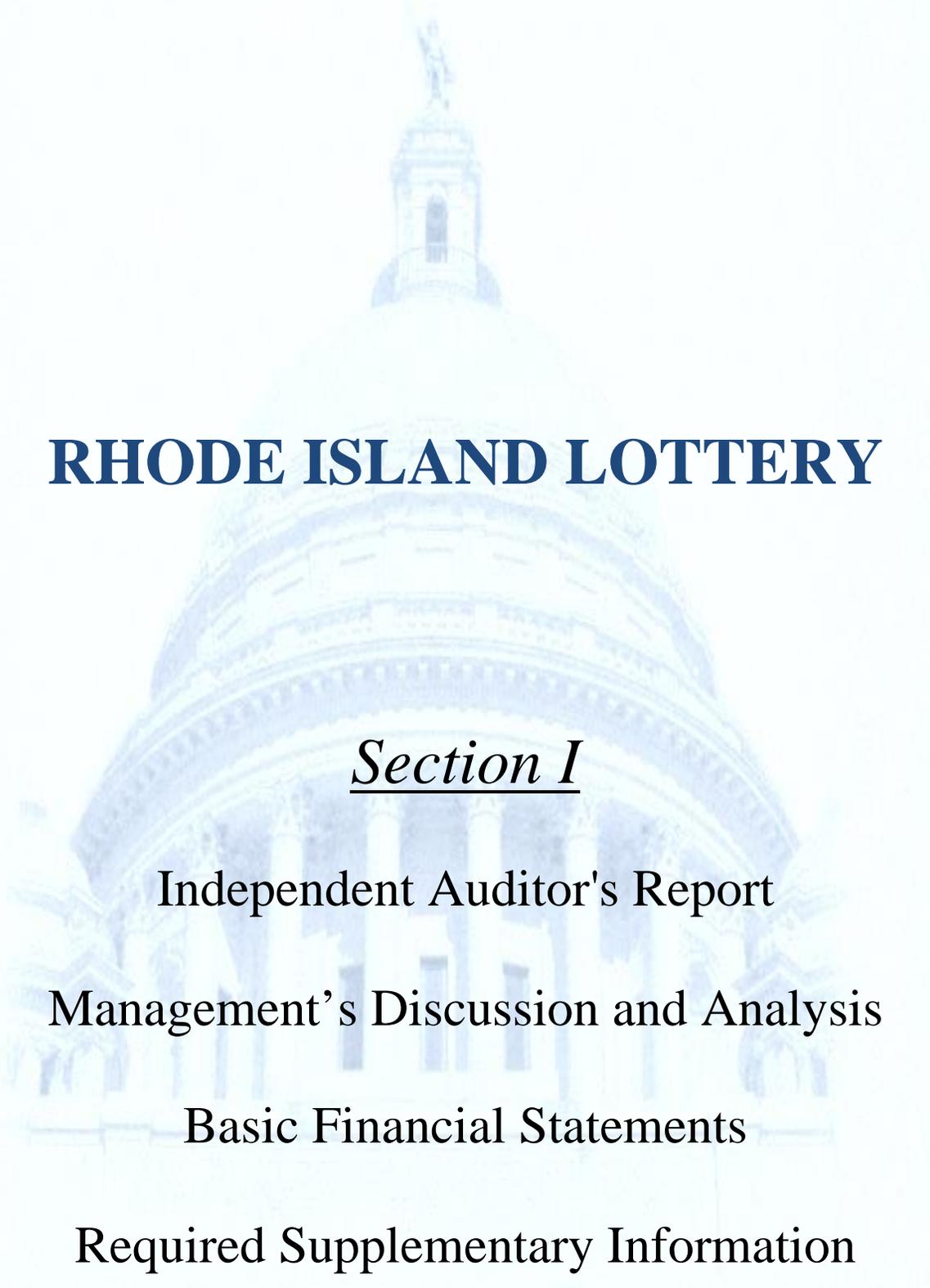


Dennis E. Hoyle, CPA
Auditor General

RHODE ISLAND LOTTERY
 (AN ENTERPRISE FUND OF THE STATE OF RHODE ISLAND)
FISCAL YEAR ENDED JUNE 30, 2020

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RHODE ISLAND LOTTERY

Section I

Independent Auditor's Report

Management's Discussion and Analysis

Basic Financial Statements

Required Supplementary Information



Office of the Auditor General

State of Rhode Island - General Assembly
Dennis E. Hoyle, CPA - Auditor General

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INDEPENDENT AUDITOR'S REPORT

Joint Committee on Legislative Services, General Assembly, State of Rhode Island:

Report on the Financial Statements

We have audited the accompanying financial statements of the Rhode Island Lottery (Lottery), an enterprise fund of the State of Rhode Island, as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express 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 control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Joint Committee on Legislative Services, General Assembly, State of Rhode Island

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2020, and the changes in financial position and its cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 2(b), the financial statements present only the Lottery enterprise fund and do not purport to, and do not, present fairly the financial position of the State of Rhode Island, as of June 30, 2020, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 – Contingencies - the Lottery’s fiscal year 2020 revenues were materially affected by the global COVID-19 pandemic with impacts expected to continue in fiscal 2021. Additionally, the Lottery’s ability to generate income for transfer to the State’s General Fund could be adversely affected by competitor gaming activities in neighboring states.

Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management’s Discussion and Analysis on pages 4 through 16, Schedule of the Lottery’s Proportionate Share of the Net Pension Liability – Employees’ Retirement System Plan on page 50, the Schedule of the Lottery’s Contributions – Employees’ Retirement System Plan on page 51, the Schedule of the Lottery’s Proportionate Share of the Net OPEB Liability – State Employees’ OPEB Plan on page 52, and the Schedule of the Lottery’s Contributions – State Employees’ OPEB Plan on page 53 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

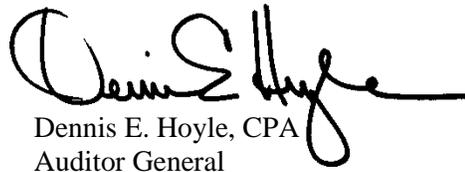
Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Lottery’s basic financial statements. The supplementary information included in Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

Joint Committee on Legislative Services, General Assembly, State of Rhode Island

Schedule 1 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, Schedule 1 is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 23, 2020 on our consideration of the Lottery’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is solely 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 the effectiveness of the Lottery’s 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 Lottery’s internal control over financial reporting and compliance.



Dennis E. Hoyle, CPA
Auditor General

October 23, 2020

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

Management of the Lottery provides this *Management's Discussion and Analysis* of their financial performance for the readers of the Lottery's financial statements. This narrative provides an overview of the Lottery's financial activity for the fiscal year ended June 30, 2020. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Lottery's financial activities based on facts, decisions, and conditions currently facing management.

Understanding the Lottery's Financial Statements

The Lottery, a division of the Department of Revenue of the State of Rhode Island (State), is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with notes to the financial statements and a supplementary schedule detailing operating revenue and the cost of gaming operations for each lottery game. The financial statements immediately follow this *Management's Discussion and Analysis* and are designed to highlight the Lottery's net position and changes in net position resulting from Lottery operations.

The most important relationship demonstrated within the Lottery's financial statements is the requirement that the Lottery transfer net income to the State's General Fund. Accordingly, the primary focus of these financial statements is determining net income available for payment to the State's General Fund rather than the change in net position of the Lottery. It is also important to note that most financial statement balances have a direct relationship to revenue. Generally, as lottery revenues increase for a particular game, the related amount paid to the State's General Fund also increases. Similarly, increases in revenue for a particular lottery game result in direct increases to the related prize awards and commissions expense.

Most assets included on the Statement of Net Position represent current amounts such as cash and accounts receivable from Lottery retailers. Most current liabilities represent prize awards owed, vendor commission payments, and amounts due to the State's General Fund. Current assets approximate the amounts required to satisfy current liabilities at year-end.

The deficit in net position of \$20.4 million reported at June 30, 2020 relates to (a) the Lottery's previous sale of its exclusive rights to operate its gaming systems and (b) the Lottery's proportionate share of the net pension and OPEB liabilities. In fiscal 2003, the Lottery sold the exclusive right to operate its current gaming systems for a 20-year period at a cost of \$12.5 million and immediately paid the proceeds to the State's General Fund. According to the terms of the agreement, if for any reason, this contract is voided prior to its completed term; the Lottery will be required to refund a pro-rata share of the sales price to the gaming system provider. In accordance with generally accepted accounting principles, the Lottery recognizes the revenue related to this transaction over the 20-year life of the contract. The deficit in net position at June 30, 2020 includes the remaining balance of \$1.9 million representing unearned contract revenue. The remaining net position (deficit) of \$18.5 million represents the Lottery's recognition of its proportionate share of the net pension liability and net OPEB liability (inclusive of related deferred inflows and outflows) as of June 30, 2020, as a participating employer in the Employees' Retirement System Pension Plan (Pension Plan) and the State Employees' OPEB Plan (OPEB Plan). Further details of the Lottery's net pension liability and net OPEB liability can be found in the notes to the financial statements.

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

Financial Highlights

The Lottery's fiscal year 2020 revenues were materially affected by the global COVID-19 pandemic. Closure of the State's two licensed casinos, many Lottery retailers, restaurants and bars, the canceling and elimination of professional and college sporting events, and stay at home regulations had a significant impact on revenues for all Lottery lines of business, and have reduced expected revenues in the new fiscal year beginning July 1, 2020. The Lottery transferred \$283.9 million to the State's General Fund in fiscal 2020, an amount significantly reduced from the prior year due to the following results of operations:

- On-line games revenue through March 2020 (pre-pandemic) decreased by approximately 14% when compared to the first nine months of fiscal 2019. The impact of the global pandemic ultimately resulted in a decrease in on-line games revenue for fiscal 2020 by more than 17% compared to fiscal 2019. In addition, the overall annual decrease in PowerBall and Mega Millions of approximately 40% was attributable to fewer large jackpots accumulating in fiscal 2020 compared to 2019. Keno experienced a 12.5% decline in sales, largely due to the closure in March of Keno retailers – notably bars and restaurants.
- Instant games revenue through March 2020 (pre-pandemic) increased by 5% when compared to the first nine months of fiscal 2019. Instant games were less impacted by the pandemic than other Lottery games during fiscal 2020 experiencing an overall increase in revenue of more than 9% over the prior fiscal year.
- Video lottery games net revenue at the Lottery's two casinos through March 2020 (pre-pandemic) had decreased by slightly more than 12% when compared to the first nine months of fiscal 2019. The net revenue decrease during fiscal 2020 was largely attributable to the opening of a new casino in Massachusetts. The impact of the global pandemic worsened the overall decline in fiscal 2020 and resulted in a 32% decrease in revenue for fiscal 2020 compared to fiscal 2019. The Lottery's gaming facilities were closed for most of the final quarter of the fiscal year.
- Table games net revenue at the Lottery's two casinos through March 2020 (pre-pandemic) had also decreased by 32% when compared to the first nine months of fiscal 2019. As was the case for video lottery, the net revenue decrease during fiscal 2020 was largely attributable to the opening of a new casino in Massachusetts. The impact of the global pandemic worsened the overall decline in fiscal 2020 and resulted in a 49% decrease in revenue for fiscal 2020 compared to fiscal 2019. The Lottery's gaming facilities were closed for most of the final quarter of the fiscal year.
- Sportsbook revenue increased 172% for fiscal 2020 compared to fiscal 2019; however, sportsbook was only operational for seven months in fiscal 2019. Fiscal 2020 sportsbook revenue was limited by the impact of the global pandemic due to reduced betting options for patrons from the cancellation of sporting events. Mobile sportsbook wagering, which began in fiscal 2020, contributed to the fiscal 2020 increase and offset the negative impact on in-person sportsbook wagering due to the temporary casino shutdowns.

In addition to the highlights of financial results above, the Lottery successfully launched the following gaming initiatives to enhance revenue in their existing game offerings:

- Sportsbook mobile and computer applications launched in September 2019 enabling wagers on sporting events within the State of Rhode Island. Mobile and online sports betting revenue through June 30, 2020 totaled \$3.8 million.

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

- iLottery mobile application launched in April 2020 enabling iKeno and eInstant games. Total iLottery revenue through June 30, 2020 was \$1.3 million.

Analysis of Comparative Financial Position

The Lottery's net position (deficit) at June 30, 2020 and June 30, 2019 is summarized below:

| | <u>June 30, 2020</u> | <u>June 30, 2019</u> |
|--|------------------------|------------------------|
| Assets: | | |
| Current assets | | |
| Cash and cash equivalents | \$ 21,692,915 | \$ 27,664,723 |
| Accounts receivable, net | 5,002,874 | 10,650,307 |
| Due from State's General Fund | 66,147 | - |
| Other | 1,435,924 | 1,181,849 |
| Total current assets | <u>28,197,860</u> | <u>39,496,879</u> |
| Long-term assets | | |
| Capital assets, net | 472,462 | 353,299 |
| Total assets | <u>28,670,322</u> | <u>39,850,178</u> |
| Deferred outflows of resources - pension | 5,892,724 | 3,452,985 |
| Deferred outflows of resources - OPEB | 1,425,416 | 678,777 |
| Deferred outflows of resources | <u>7,318,140</u> | <u>4,131,762</u> |
| Liabilities: | | |
| Current liabilities | | |
| Due to State's General Fund - net income from operations | \$ 2,863,337 | \$ 2,048,319 |
| Due to State's General Fund - operating expenses | - | 39,381 |
| Accounts payable | 6,724,474 | 18,398,496 |
| Prize obligations | 12,632,701 | 11,639,227 |
| Compensated absences | 337,733 | 325,212 |
| Other liabilities | 6,306,007 | 7,578,886 |
| Total current liabilities | <u>28,864,252</u> | <u>40,029,521</u> |
| Long-term liabilities | | |
| Compensated absences | 431,071 | 445,658 |
| Net pension liability | 20,850,027 | 17,142,457 |
| Net OPEB liability | 3,990,380 | 3,876,354 |
| Unearned contract revenue | 1,250,000 | 1,875,000 |
| Total long-term liabilities | <u>26,521,478</u> | <u>23,339,469</u> |
| Total liabilities | 55,385,730 | 63,368,990 |
| Deferred inflows of resources - pension | 302,051 | 458,812 |
| Deferred inflows of resources - OPEB | 666,159 | 267,284 |
| Deferred inflows of resources | <u>968,210</u> | <u>726,096</u> |
| Net position (deficit): | | |
| Net investment in capital assets | 472,462 | 353,299 |
| Unrestricted | (20,837,940) | (20,466,445) |
| Total net position (deficit) | <u>\$ (20,365,478)</u> | <u>\$ (20,113,146)</u> |

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

The majority of the Lottery's assets represent current resources necessary to pay the current liabilities owed to vendors, prize winners, video lottery participants, and ultimately the State's General Fund. At June 30, 2020, the Lottery's assets included \$21.7 million in cash and cash equivalents as compared with \$27.7 million at June 30, 2019. The Lottery's accounts receivable approximated \$5.0 million and \$10.7 million, respectively, at June 30, 2020 and 2019.

The Lottery's current liabilities at the balance sheet date are amounts owed for vendor payables, prize obligations and a residual amount owed to the State's General Fund for June 2020 net operations and June 2019 operating expenses. The amount owed to the General Fund for June net operations approximated \$2.9 million at June 30, 2020. At June 30, 2020, vendor payables, made up largely of commissions due to video lottery and sports book participants, and prize obligations, attributable mostly to instant ticket games were \$6.7 million and \$12.6 million, respectively. In comparison, vendor payables and prize obligations at June 30, 2019 were \$18.4 million and \$11.6 million, respectively.

Deferred outflows of resources related to pension and OPEB increased in fiscal 2020 compared to fiscal 2019 primarily due to increases in contributions made subsequent to the measurement date and increases in the Lottery's proportionate share of the net pension liability which is deferred and recognized over the remaining service life of members.

Deferred inflows of resources related to pension decreased in fiscal 2020 compared to fiscal 2019, whereas deferred inflows of resources related to OPEB increased in fiscal 2020 compared to fiscal 2019, principally due to the expected recognition in pension and OPEB expense of amounts previously deferred.

The deficit in net position reported at June 30, 2020, as previously explained, relates to the Lottery's immediate transfer, in a prior fiscal year, to the State's General Fund, of all proceeds received from the sale of its exclusive rights over the operation of its gaming systems and the recognition of the Lottery's pension and OPEB liabilities. At June 30, 2020, a deficit balance of \$1.9 million remains relating to deferred contract revenue to be recognized proportionately over the remaining term of the Master Contract with its gaming systems provider. The Lottery recognizes its proportionate share of the net pension liability and net OPEB liability as a participating employer in the Pension Plan and the OPEB Plan. As required by RI General Laws, the Lottery's transfer to the State's General Fund is based on net income reflecting the actuarially determined employer contribution to the Pension Plan and OPEB Plan. Net income reported in the Lottery's financial statements reflects the recognition of pension expense and OPEB expense in accordance with generally accepted accounting principles.

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

Lottery Operations

| | June 30, 2020 | June 30, 2019 |
|--|-----------------|-----------------|
| Operating revenue: | | |
| Games reported - gross revenue | | |
| On-line games | \$ 132,443,543 | \$ 160,361,098 |
| Instant games | 112,643,821 | 102,914,666 |
| iLottery | 1,305,682 | - |
| Sport book | 200,188,405 | 127,587,809 |
| Games reported - revenue net of related prize awards | | |
| Video lottery | 352,833,794 | 522,754,625 |
| Table games | 83,257,074 | 163,442,908 |
| Total operating revenue | 882,672,319 | 1,077,061,106 |
| Cost of gaming operations: | | |
| Commissions | 245,258,955 | 375,395,649 |
| Prize awards expense (on-line, instant, and sports book) | 338,205,556 | 285,987,368 |
| Incentive programs, video lottery | 3,990,072 | 6,053,466 |
| Marketing/advertising expense | 2,602,043 | 3,554,740 |
| Unclaimed prize recovery | (3,776,164) | (3,300,542) |
| Cost of tickets | 972,986 | 925,570 |
| Total cost of gaming operations | 587,253,448 | 668,616,251 |
| Gross Profit | 295,418,871 | 408,444,855 |
| Operating expenses: | | |
| Salaries and benefits | 12,550,219 | 10,855,702 |
| Contract services | 16,486 | 48,538 |
| Depreciation and amortization | 133,808 | 132,628 |
| Other | 900,222 | 702,151 |
| Total operating expenses | 13,600,735 | 11,739,019 |
| Operating Income | 281,818,136 | 396,705,836 |
| Non-operating income (expenses): | | |
| Investment income | 702,358 | 553,497 |
| Other income (expenses) - net | 1,097,720 | 892,330 |
| Income before transfers | 283,618,214 | 398,151,663 |
| Transfers to State's General Fund | (283,870,546) | (397,320,920) |
| Increase (decrease) in net position | (252,332) | 830,743 |
| Total net position (deficit), beginning of year | (20,113,146) | (20,943,889) |
| Total net position (deficit), end of year | \$ (20,365,478) | \$ (20,113,146) |

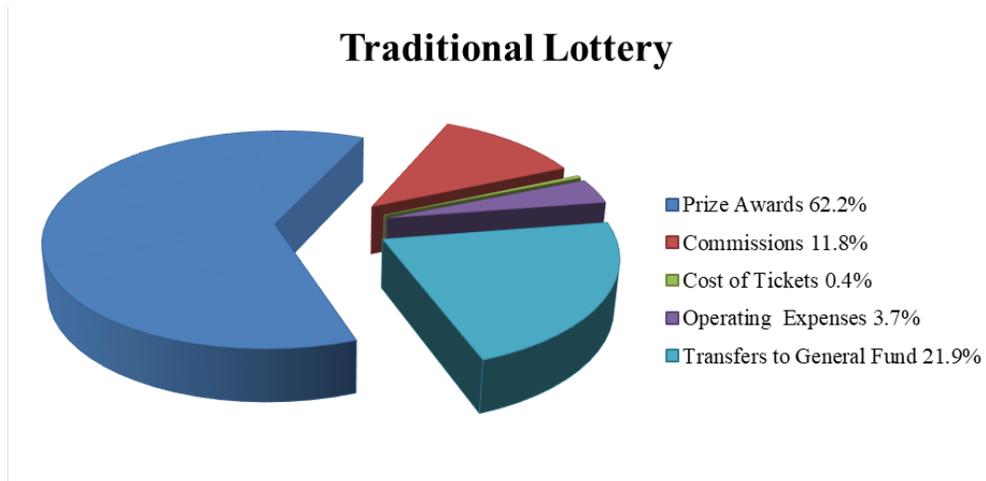
RHODE ISLAND LOTTERY

Management's Discussion and Analysis

Revenue

Traditional Lottery

- Traditional Lottery games consist of on-line, instant ticket games, with the addition in April 2020 of iLottery. Distribution of the year's traditional lottery revenue was as follows:



- On-line games offered were PowerBall®, Mega Millions®, Keno, Bingo, Daily Numbers, Wild Money and Lucky for Life® during fiscal 2020. In total, traditional on-line revenue decreased by \$28.0 million. Traditional on-line games were materially affected by the COVID-19 pandemic. Significant changes in traditional on-line game revenue from prior year included:
 - Revenue from Bingo, Daily Numbers, Wild Money and Lucky for Life®, experienced slight decreases during the fiscal year.
 - Revenue from Keno experienced a 12.6% decrease compared to prior year fiscal year 2019.
 - Revenue from jackpot driven games PowerBall® and Mega Millions® experienced 34.1% and 41.0% decreases over prior year. As a result of the COVID-19 pandemic, for PowerBall® and Mega Millions®, jackpots (annuities) are now based on current game sales with no minimum fixed amounts.
- Instant ticket revenue for fiscal 2020 increased \$9.7 million over fiscal year 2019. During fiscal year 2020, the Lottery continued with its successful family of games and its holiday game offerings. The Lottery also continued to introduce various high-price point tickets including the \$25 Royal Riches, \$10 Aces High, and \$5 Lucky Loot.
- iLottery was launched at the end of April 2020. Current offerings include eInstant games and iKeno with plans of offering all Lottery on-line games in the future. iLottery revenue for fiscal year 2020 totaled \$1.3 million.

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

The following graph depicts the Lottery's on-line sales for the fiscal years ended June 30, 2020 and 2019.

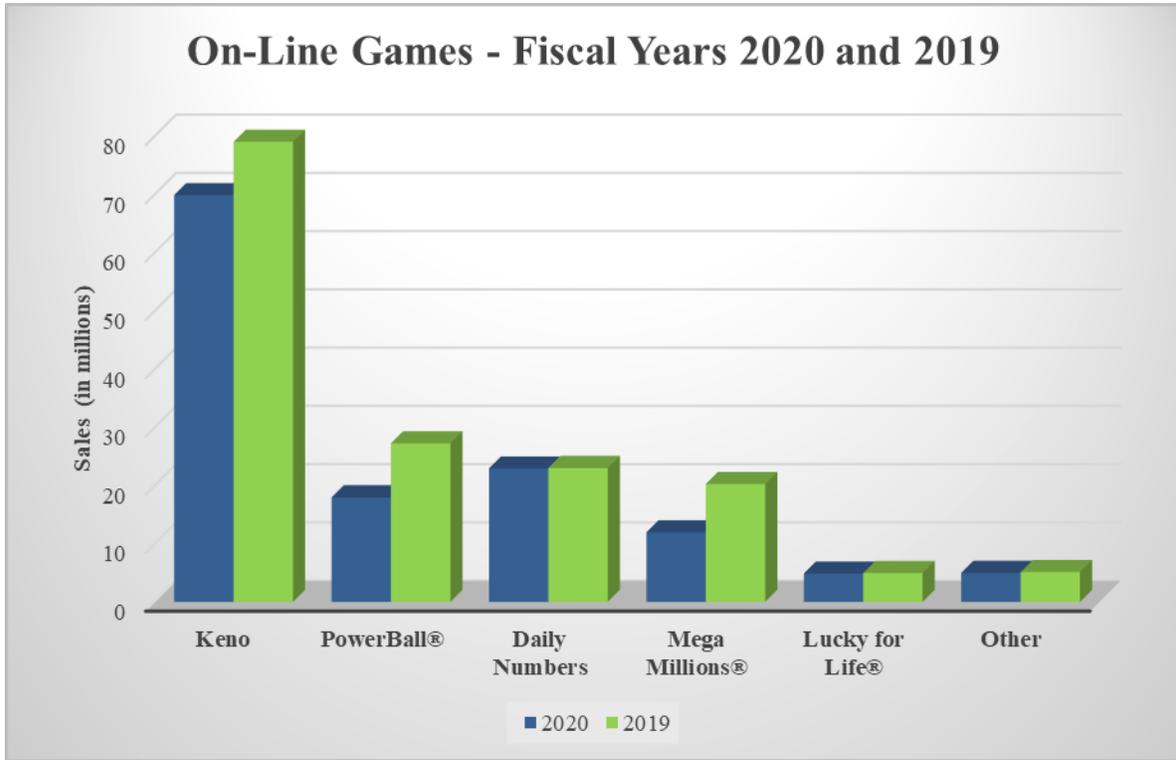
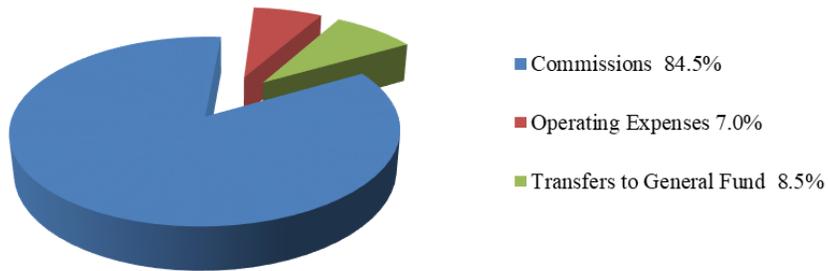


Table Games

For the fiscal year ended June 30, 2020, net table games revenue was \$83.3 million, a decrease of 49.1% compared to the prior year. Due to the COVID-19 pandemic, both Twin River Casino Hotel and Tiverton Casino Hotel were closed on March 14, 2020, thereby suspending all table games activity until June 30, 2020 when the casinos were reopened, at a limited capacity, per State and Health Department guidelines.

Distribution of the year's net table game revenue was as follows:

Table Games - Net Revenue Distribution



RHODE ISLAND LOTTERY

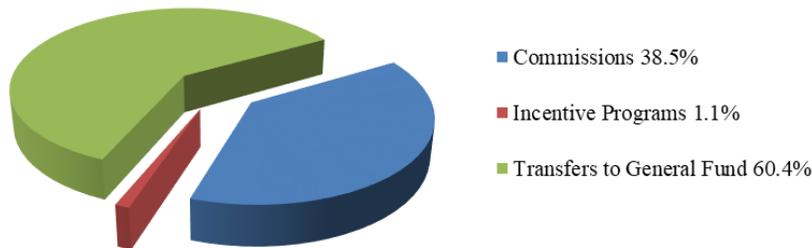
Management's Discussion and Analysis

Video Lottery

Video lottery net revenue decreased \$170.0 million or 32.5% from the prior fiscal year. Due to the COVID-19 pandemic, both Twin River Casino Hotel and Tiverton Casino Hotel were closed on March 14, 2020, thereby suspending all video lottery gaming until June 8, 2020, when the casinos were reopened, at a limited capacity, per State guidelines. Twin River Casino Hotel reopened offering 1,577 video lottery terminal (VLT) machines and Tiverton Casino Hotel reopened offering, 378 VLT machines.

Distribution of the year's video lottery net revenue was as follows:

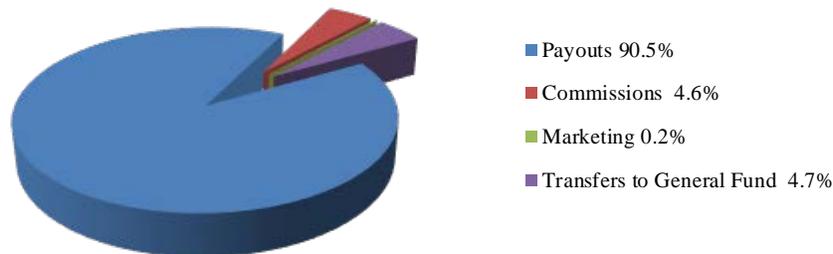
Video Lottery - Net Revenue Distribution



Sportsbook

The sportsbook online application began on September 4, 2019 offering players the option of placing wagers and receiving payouts via their mobile device and/or their computer provided they are gambling within the State boundaries. Total sportsbook revenues through June 30, 2020 totaled \$200.2 million. Gross profit transferred to the State General Fund from sportsbook, after deducting payouts, commissions and marketing expenses was \$9.5 million. Due to the COVID-19 pandemic, beginning on March 11, 2020, major sporting events were cancelled or postponed. Also, on March 14, 2020, the on-premise Sportsbook at both Twin River Casino Hotels were closed. Beginning on June 8, 2020, the casinos began a phased opening under State and Health Department guidelines. The two casinos reopened the on-premise Sportsbook on July 22, 2020.

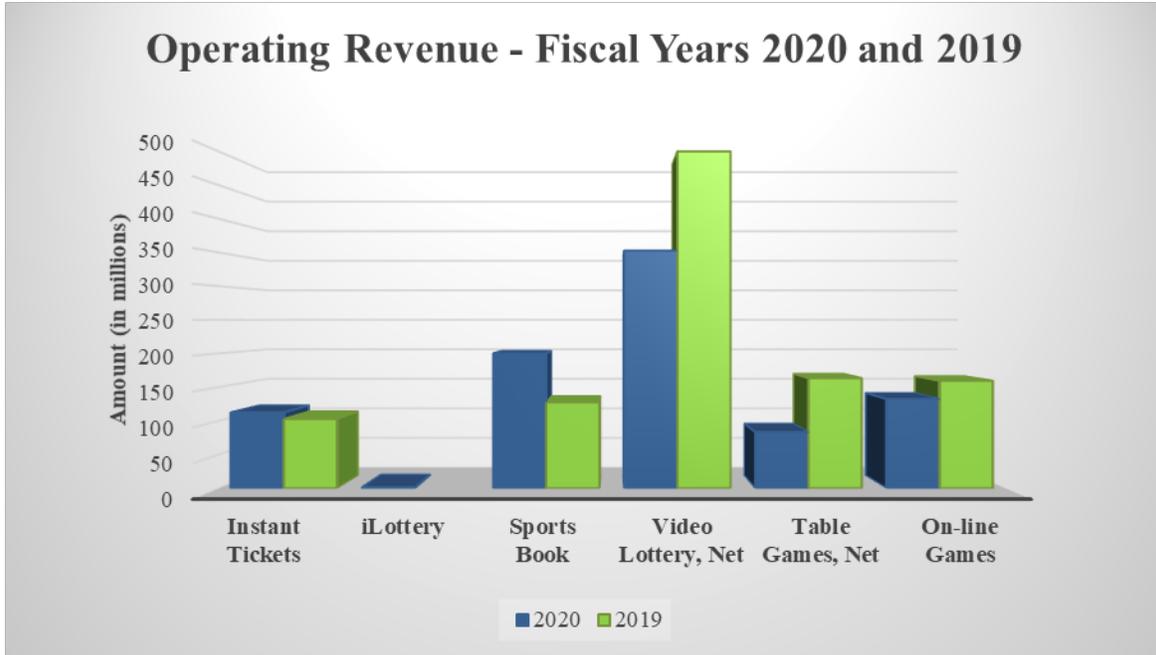
Sportsbook



RHODE ISLAND LOTTERY

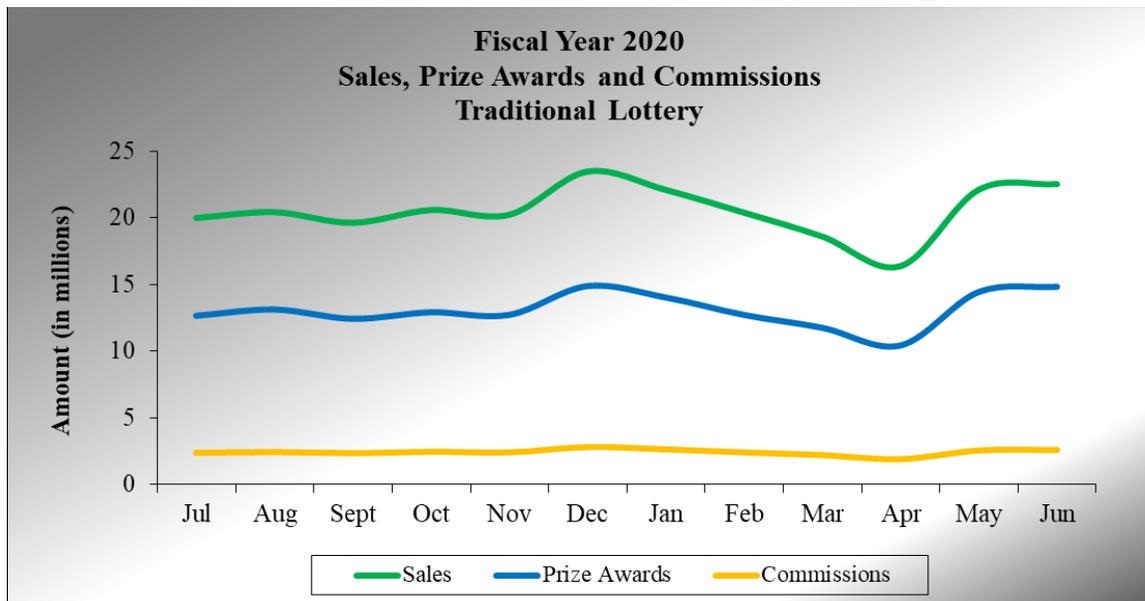
Management's Discussion and Analysis

The following graph depicts the Lottery's operating revenue for instant tickets, iLottery, video lottery, table games, sports betting and on-line games for the fiscal year ended June 30, 2020 in comparison to fiscal year ended June 30, 2019.



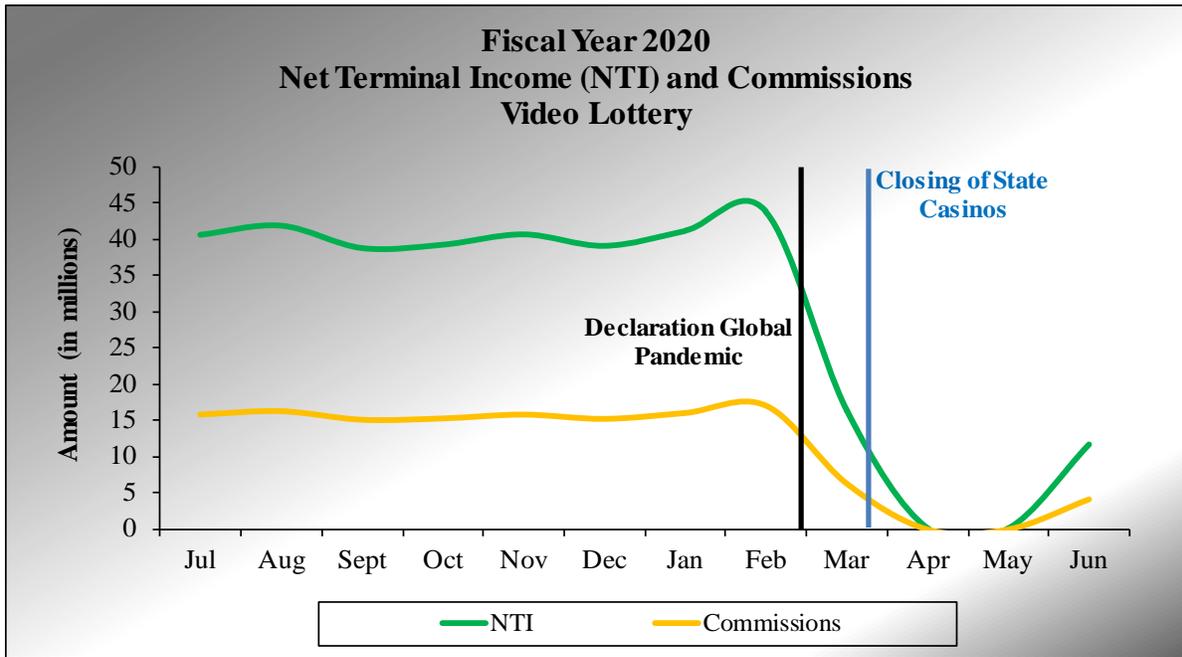
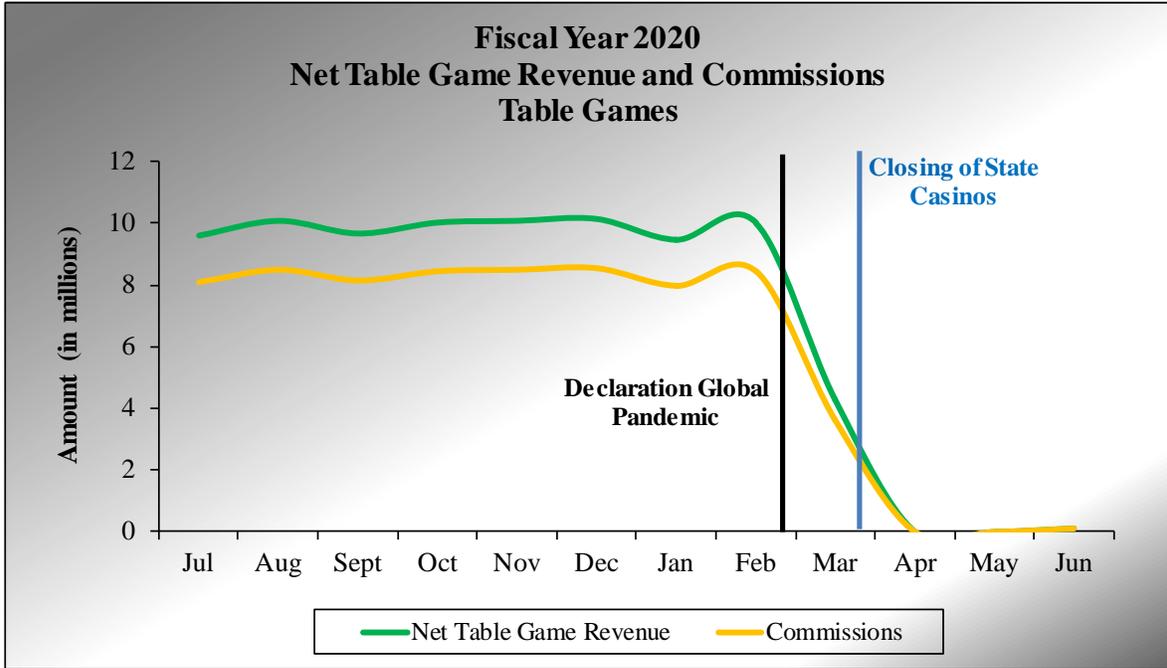
Commissions and Prize Awards Expense

As the following graphs depict, the Lottery's most significant expenses (commissions and prize awards) are predictable because they have a direct correlation to sales. As lottery revenues increase, so do the related prizes and commissions paid by the Lottery. While each Lottery game has a designed prize payout structure, the overall amount paid as prize awards expense is consistent in relation to sales. The second, third, and fourth graphs compare table game net revenue, video lottery net revenue, and sports book revenue and prizes to their related commissions.



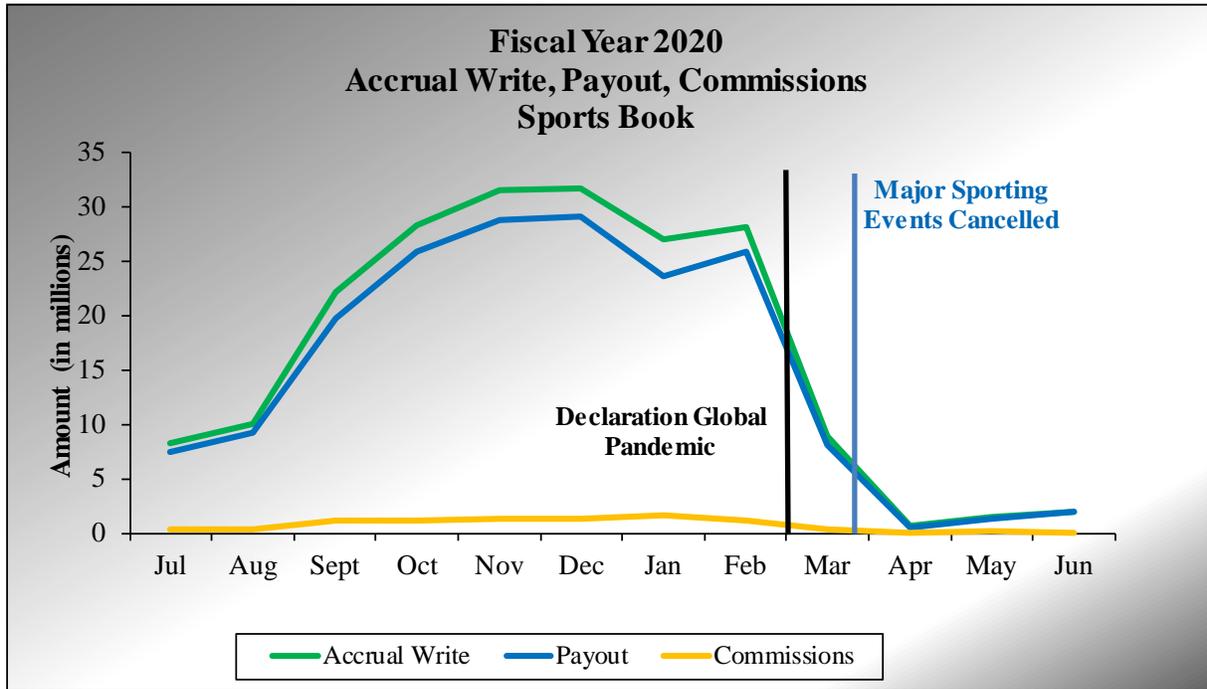
RHODE ISLAND LOTTERY

Management's Discussion and Analysis



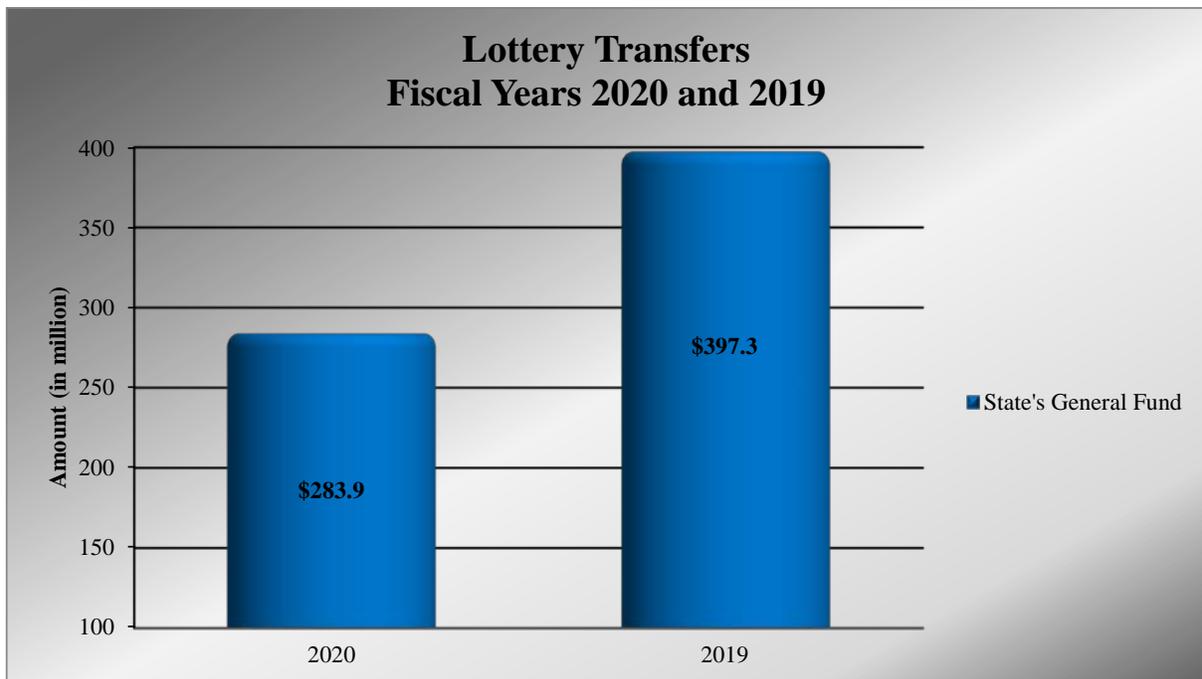
RHODE ISLAND LOTTERY

Management's Discussion and Analysis



Lottery Transfers

Due to the COVID-19 global pandemic, net income transferred by the Lottery for the fiscal years ended June 30, 2020 and June 30, 2019 was \$283.9 million and \$397.3 million, respectively. All fiscal 2020 transfers were made by the Lottery directly to the State’s General Fund, as required by the General Laws.



RHODE ISLAND LOTTERY

Management's Discussion and Analysis

Debt Administration

Jackpot prizes awarded under PowerBall® and Mega Millions® are satisfied through investments purchased by the Multi-State Lottery Association (MUSL). MUSL purchases U.S. government obligations, which are held in irrevocable trusts established by MUSL for the benefit of participating state lotteries. Accordingly, the Lottery does not record an obligation for PowerBall® and Mega Millions® jackpot awards which are payable in installments from funds provided by MUSL. Following the April 8, 2020 drawing, guaranteed starting PowerBall® jackpots and minimum jackpot increases were eliminated, and future jackpots are based on game sales and interest rates effective at the time. Following the April 3, 2020 drawing, Mega Millions® jackpots and minimum jackpot increases were eliminated, and future jackpots and increases are based on game sales and interest rates.

The Lucky for Life® game offers top and second prize winners an annuity or cash option payment. If the annuity option is selected by the winner, the Lucky for Life® game requires each selling lottery to purchase an insurance annuity to fully fund the top and second prizes won in that state. All participating lotteries share in the cost of the insurance annuity or cash option; however, the selling lottery is responsible for settling the top and second prize liabilities. Annuities shall be purchased in accordance with the applicable laws of the state purchasing the annuity. Qualified insurance companies must meet the minimum rating requirements established by each participating state. Rhode Island plans to purchase its annuities for any future top prize winners selecting this option through MUSL from an insurance company with an AM Best rating of A or better. Rhode Island has purchased its second prize winners' annuities through MUSL in accordance with insurance company rating requirements.

Capital Assets

The Lottery purchases and maintains property and equipment necessary to sell lottery products, pay prizes and perform other lottery operations.

For further information, refer to Notes to Financial Statements, Note 4.

Potential Factors Impacting Future Operations

The Lottery's mission is to generate revenues for the purpose of maximizing payments to the State's General Fund. A continuous assessment of the State's financial environment and the Lottery's own product lines and operations are essential to accomplish this mission. The following considerations have been presented to inform those interested in the Lottery's operations about potential factors that could affect future operations:

- The Lottery's fiscal year 2020 revenues were materially affected by the global COVID-19 pandemic. Closure of the State's two licensed casinos, many Lottery retailers, restaurants and bars, the canceling and elimination of professional and college sporting events, and stay at home regulations had a significant impact on revenues for all Lottery lines of business, and have reduced expected revenues in the fiscal year beginning July 1, 2020.
- Expansion of traditional Lottery products offered via mobile and/or internet devices commenced in April 2020. Initial product offerings included eInstant games and iKeno with plans to offer all on-line Lottery drawing games by the fall of 2021.

RHODE ISLAND LOTTERY

Management's Discussion and Analysis

- Further expansion of sportsbook began in September 2019 with the roll-out of mobile sports betting to players within the geographical limits of Rhode Island. Players may create and register a mobile account and then place wagers online for sporting events authorized by the Lottery Division.
- The facilities face increasing competition from surrounding casinos including Massachusetts casinos expanding in the region. In June 2019, a third Massachusetts casino, offering slot and table games, opened in Everett Massachusetts which significantly increased gaming options within the New England region. The Lottery and the State continually monitor the risk to gaming operations and assess and expand important revenue generating marketing and promotional programs to best enable competitive positions.
- Master contracts with its licensed gaming facilities, Twin River Casino Hotel (Twin River – Lincoln) and Tiverton Casino Hotel (Twin River – Tiverton), include provisions for promotional play programs (free video terminal play) up to authorized amounts. These agreements also require the Lottery to reimburse the facilities for its net terminal income share of certain qualified marketing and promotional expenses thereby incentivizing the facilities to continue to invest appropriately in the promotion of their facilities and the Lottery's gaming activities. See Note 12 to the financial statements for details regarding these agreements.
- Each facility continues to offer a full complement of gaming options including slots, table games, and sports betting and operates a hotel for the convenience of players and guests. This allows each facility to compete more effectively with gaming venues in nearby states.

Contacting the Lottery's Financial Management

This financial report is designed to provide a general overview of the Lottery's financial activity for all those interested in the Lottery's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Finance Administrator, Rhode Island Lottery, 1425 Pontiac Avenue, Cranston, RI, 02920.

RHODE ISLAND LOTTERY

Statement of Net Position

June 30, 2020

Assets

| | |
|--|------------------|
| Current assets: | |
| Cash and cash equivalents (note 3) | \$ 21,692,915 |
| Accounts receivable-less allowance for doubtful accounts of \$189,340 | 5,002,874 |
| Ticket inventory | 951,504 |
| Deposits with Multi-State Lottery Association (MUSL) (note 1) | 44,916 |
| Due from State's General Fund - operating expenses (note 5) | 66,147 |
| Other current assets | 439,504 |
| | <hr/> |
| Total current assets | 28,197,860 |
| Long-term assets: | |
| Capital assets, net (note 4) | 472,462 |
| | <hr/> |
| Total assets | 28,670,322 |
| Deferred outflows of resources - pension (note 9) | 5,892,724 |
| Deferred outflows of resources - OPEB (note 10) | 1,425,416 |
| | <hr/> |
| Deferred outflows of resources | 7,318,140 |

Liabilities

| | |
|---|----------------|
| Current liabilities: | |
| Due to State's General Fund - net income from operations (note 5) | \$ 2,863,337 |
| Accounts payable | 6,724,474 |
| Obligation for unpaid prize awards | 12,632,701 |
| Accrued expenses | 5,011,470 |
| Compensated absences (note 7) | 337,733 |
| Advances for future drawings and events | 669,537 |
| Unearned contract revenue (note 8) | 625,000 |
| | <hr/> |
| Total current liabilities | 28,864,252 |
| Long-term liabilities: | |
| Compensated absences (note 7) | 431,071 |
| Net pension liability (note 9) | 20,850,027 |
| Net OPEB liability (note 10) | 3,990,380 |
| Unearned contract revenue (note 8) | 1,250,000 |
| | <hr/> |
| Total long-term liabilities | 26,521,478 |
| | <hr/> |
| Total liabilities | 55,385,730 |
| Deferred inflows of resources - pension (note 9) | 302,051 |
| Deferred inflows of resources - OPEB (note 10) | 666,159 |
| | <hr/> |
| Deferred inflows of resources | 968,210 |

Net position (deficit)

| | |
|---|------------------------|
| Net investment in capital assets (note 8) | 472,462 |
| Unrestricted (deficit) (note 8) | (20,837,940) |
| | <hr/> |
| Total net position (deficit) | <u>\$ (20,365,478)</u> |

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Statement of Revenue, Expenses and Changes in Net Position

Year Ended June 30, 2020

Operating revenue (schedule 1):

| | |
|--|--------------------|
| Games reported - gross revenue | |
| On-line games | \$ 132,443,543 |
| Instant games | 112,643,821 |
| iLottery | 1,305,682 |
| Sports book | 200,188,405 |
| Games reported - revenue net of related prize awards | |
| Video lottery (note 2) | 352,833,794 |
| Table games (note 2) | 83,257,074 |
| Total operating revenue | <u>882,672,319</u> |

Cost of gaming operations (schedule 1):

| | |
|--|--------------------|
| Commissions (note 6) | 245,258,955 |
| Prize awards expense (on-line, instant, and sports book) | 338,205,556 |
| Incentive programs, video lottery | 3,990,072 |
| Marketing/advertising expense | 2,602,043 |
| Unclaimed prize recovery | (3,776,164) |
| Cost of tickets | 972,986 |
| Total cost of gaming operations | <u>587,253,448</u> |
| Gross profit | <u>295,418,871</u> |

Operating expenses:

| | |
|-------------------------------|-------------------|
| Salaries and benefits | 12,550,219 |
| Contract services | 16,486 |
| Depreciation and amortization | 133,808 |
| Other | 900,222 |
| Total operating expenses | <u>13,600,735</u> |
| Operating income | 281,818,136 |

Non-operating income (expenses):

| | |
|-------------------------------|--------------------|
| Investment income | 702,358 |
| Other income (expenses) - net | 1,097,720 |
| Income before transfers | <u>283,618,214</u> |

Transfer to State's General Fund (note 5)

(283,870,546)

Decrease in net position (252,332)

Total net position (deficit), beginning of year (20,113,146)

Total net position (deficit), end of year (note 8) \$ (20,365,478)

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Statement of Cash Flows

Year Ended June 30, 2020

| | |
|--|----------------------|
| Cash flows from operating activities: | |
| Receipts from lottery sales, online and instant games | \$ 244,907,135 |
| Receipts from iLottery sales | 813,748 |
| Receipts from video lottery operations (net of prizes) | 357,288,264 |
| Receipts from sports book | 200,568,793 |
| Receipts from table games (net of prizes) | 84,821,270 |
| Receipts from MUSL for grand prize winners | 948,389 |
| Receipts from problem gambling program | 201,000 |
| Other receipts | 466,616 |
| Payments for on-line and instant ticket prizes | (152,346,638) |
| Payments for iLottery prizes | (854,438) |
| Sports book payouts | (180,234,835) |
| Payments to MUSL grand prize winners | (948,389) |
| Payments for commissions - retailers | (12,026,875) |
| Payments for commissions - video lottery | (143,156,480) |
| Payments for commissions - sports book | (10,720,367) |
| Payments for commissions - table games | (73,836,729) |
| Payments for commissions - on-line games contractor | (17,215,929) |
| Payments to facilities - video lottery incentive program | (5,263,216) |
| Payments to suppliers for goods and services | (5,134,200) |
| Payments to employees for services | (11,642,786) |
| Net cash provided by operating activities | <u>276,634,333</u> |
| Cash flows from noncapital financing activities: | |
| Transfers to State's General Fund | <u>(283,055,528)</u> |
| Net cash used for noncapital financing activities | <u>(283,055,528)</u> |
| Cash flows from capital and related financing activities: | |
| Purchase of capital assets | <u>(252,971)</u> |
| Net cash used for capital and related financing activities | <u>(252,971)</u> |
| Cash flows from investing activities: | |
| Interest income | <u>702,358</u> |
| Net cash provided by investing activities | <u>702,358</u> |
| Net decrease in cash and cash equivalents | (5,971,808) |
| Cash and cash equivalents at July 1, 2019 | <u>27,664,723</u> |
| Cash and cash equivalents at June 30, 2020 | <u>\$ 21,692,915</u> |
| See accompanying notes to financial statements. | |

*

Continued.

RHODE ISLAND LOTTERY

Statement of Cash Flows (Continued)

Year Ended June 30, 2020

| | |
|--|-----------------------|
| Reconciliation of operating income to net cash provided by operating activities: | |
| Operating income | \$ 281,818,136 |
| Adjustments to reconcile operating income to net cash provided by (used for) operating activities: | |
| Depreciation and amortization | 133,808 |
| Miscellaneous receipts classified as operating activities | 28,226 |
| Rental income and other receipts | 444,494 |
| (Increase) decrease in assets and deferred outflows of resources: | |
| Accounts receivable | 5,647,433 |
| Deposits with MUSL | (853) |
| Inventory | 176,282 |
| Prepaid expense | (41,862) |
| Deferred outflows of resources - pension | (2,439,739) |
| Deferred outflows of resources - OPEB | (746,639) |
| Increase (decrease) in liabilities and deferred inflows of resources: | |
| Due to State's General Fund - operating expenses | (105,528) |
| Accounts payable | (11,674,023) |
| Obligation for unpaid prize awards | 993,474 |
| Accrued expenses and other | (1,737,844) |
| Net pension liability | 3,707,570 |
| Net OPEB liability | 114,026 |
| Advances for future drawings and events | 75,258 |
| Deferred inflows of resources - pension | (156,761) |
| Deferred inflows of resources - OPEB | 398,875 |
| Total adjustments | <u>(5,183,803)</u> |
| Net cash provided by operating activities | <u>\$ 276,634,333</u> |

See accompanying notes to financial statements.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(1) Organization

The Lottery was created in 1974 under the General Laws of the State of Rhode Island (General Laws) to establish and operate lottery games for the purpose of generating resources for the State's General Fund. The Lottery is a division of the Department of Revenue of the State of Rhode Island (the State).

The Lottery's fiscal year 2020 revenues were materially affected by the global COVID-19 pandemic. Closure of the State's two licensed casinos, many Lottery retailers, restaurants and bars, the canceling and elimination of professional and college sporting events, and stay at home regulations had a significant impact on revenues for all Lottery lines of business, and have reduced expected revenues in the new fiscal year beginning July 1, 2020.

The Lottery offers the following games to the public:

(A) On-line (lottery drawing) games that include:

- i) Traditional in-state drawing games including Daily Numbers – Midday and Evening, Keno, Bingo, and Wild Money. The drawings for these games are administered by the Rhode Island Lottery and offer patrons set prize amounts or smaller progressive jackpots. Keno and Bingo are considered monitor games where drawings are held every 4 and 8 minutes, respectively, on “monitors” in sales locations across the State.
- ii) Multi-state games, which include Powerball[®] and Mega Millions[®], are operated in accordance with rules and agreements established by the Multi-State Lottery Association (MUSL). These games offer jackpot prize awards to patrons in participating states. Specific details regarding the operations of these games are as follows:

(a) *PowerBall*[®]

PowerBall[®] is a Multi-State Lottery Association game offered in forty-five states (including Rhode Island), plus the District of Columbia, Puerto Rico, and U.S. Virgin Islands. The Lottery sells PowerBall[®] tickets, collects all revenues, and remits prize funds to MUSL net of low-tier prize awards. Jackpot prizes are payable in either a lump-sum cash distribution or annual installments. Annual installments are satisfied through investments purchased by MUSL. MUSL purchases U.S. government obligations, which are held in irrevocable trusts established by MUSL for the benefit of participating state lotteries. Accordingly, the Lottery does not record an obligation for jackpot awards which are payable in installments from funds provided by MUSL.

The prize pool for PowerBall[®] is 50% of each drawing period's ticket sales. MUSL may place up to 5% of each drawing period's ticket sales for PowerBall[®], included as part of each member's prize liability, in prize reserve funds. The prize reserve deduction begins at 2% when an annuity jackpot exceeds \$120 million and 4% when an annuity jackpot exceeds \$250 million. The maximum balance on the prize reserve funds for PowerBall[®] is \$140 million. Once the prize reserve funds exceed this designated amount, the excess becomes part of the prize pool. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities, and these reserve funds are to be used at the discretion of the MUSL Board of Directors. The prize reserve funds are refundable to MUSL members if MUSL disbands or if a member leaves MUSL. Members leaving MUSL must wait one year before receiving their remaining share, if any, of prize reserve funds.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(1) *Organization* - (Continued)

Effective with the drawing held on July 2, 2016, at any time that the Grand Prize Carry Forward Pool (GPCFP) is below forty-five million dollars (\$45,000,000) prior to a drawing, the GPCFP deduction from a Party Lottery's Grand Prize Pool (GPP) contribution for that drawing shall be equal to a maximum of four percent (4%) of a Party Lottery's sales when the annuity Grand Prize exceeds one hundred twenty million dollars (\$120,000,000). The GPCFP percentage shall be reduced by the percentage of sales being actually contributed to the Set-Aside Pool (SAP), Set Prize Reserve Account (SPRA) or the Prize Reserve Account (PRA). At any time that the GPCFP exceeds forty-five million dollars (\$45,000,000) prior to a drawing, there shall be no GPCFP deduction for that drawing.

Due to the COVID-19 pandemic, following the April 8, 2020 drawing, guaranteed jackpot amounts and minimum jackpot increases were eliminated, and jackpots (annuities) are based on current game sales.

At June 30, 2020, the prize reserve funds for the PowerBall® game reported a balance of \$87.1 million of which the Lottery's share was \$1.0 million. The Lottery records amounts, which are placed into the prize reserve funds, as prize awards expense when the related sales occur.

All investment earnings relating to the prize reserve funds are credited to an unreserved account for each member state. This account can be utilized to offset operating costs or for the promotion of any MUSL game as approved by the MUSL Board of Directors. The Lottery has recorded all income and operating expenses related to its unreserved account and has reported the balance of \$44,916 at June 30, 2020 on the Statement of Net Position as "Deposits with MUSL".

(b) *Mega Millions*®

MUSL participates as a member (or party) lottery of the Mega Millions® Product Group (a group of lotteries participating under an agreement between the Mega Millions® lotteries and MUSL to offer the Mega Millions® game within their State jurisdictions). Mega Millions® is offered in forty-five states, plus the District of Columbia, and the U.S. Virgin Islands. The Rhode Island Lottery participates as a member of MUSL, in the sale of tickets, payment of prizes, and associated activities related to the Mega Millions® lottery game. As such, the Lottery sells Mega Millions® tickets, collects all revenues, and remits prize funds to MUSL net of low-tier prizes. Jackpot prizes are payable either in a lump-sum cash distribution or annual installments. Annual installments are satisfied through investments purchased by MUSL. MUSL purchases U.S. government obligations, which are held in irrevocable trusts established by MUSL for the benefit of participating lotteries. Accordingly, the Lottery does not record an obligation for jackpot awards which are payable in installments from funds provided by MUSL.

The prize pool for Mega Millions® shall consist of up to 52% of each drawing period's ticket sales. An amount of up to 2% of each drawing period's ticket sales may be placed in one or more prize pool reserve accounts. The maximum prize reserve account is \$100 million.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(1) Organization - (Continued)

At June 30, 2020, the prize reserve account for the Mega Millions[®] game reported a balance of \$89.6 million of which the Lottery's share was \$797,263. The Lottery records amounts, which are placed into the prize reserve funds, as prize awards expense when the related sales occur.

Due to the COVID-19 pandemic, following the April 3, 2020 drawing, guaranteed jackpot amounts and minimum jackpot increases were eliminated, and jackpots (annuities) are based on current game sales.

iii) Lucky for Life[®], which is offered in twenty-six lotteries, operates under an agreement between the six New England states ("New England Lotteries") and the Arkansas Scholarship Lottery, the Colorado Lottery Commission, the Delaware Lottery, the Office of Lottery & Charitable Games, the Idaho Lottery, the Iowa Lottery Authority, the Kansas Lottery, the Kentucky Lottery Corporation, the Michigan Lottery, the Minnesota State Lottery, the Missouri Lottery, the Montana Lottery, the Nebraska Lottery, the North Carolina Lottery, the North Dakota Lottery, the Oklahoma Lottery Commission, the Ohio Lottery Commission, the South Carolina Education Lottery, the South Dakota Lottery, and the Wyoming Lottery Corporation (collectively referred to as the "Licensee Lotteries") to offer the Lucky for Life[®] game with a top prize of \$1,000 per day for life. The Lottery sells Lucky for Life[®] tickets, collects all revenues, and pays prizes based on its share of total sales, as a party lottery operating the game. The party lotteries have entered into an agreement with MUSL to administer certain aspects of the game. MUSL communicates and collects the share of prize amounts owed by each party lottery. The top prize and second prize are paid in accordance with official game rules and is shared based on each state's percentage of sales in proportion to the total top prize liability. Total low-tier prizes are shared based on a percentage of sales in proportion to the total low-tier prize liability.

Top Prize Settlement

All top prizes are funded through the purchase of insurance annuities with an alternative cash option. For the annuity option, top prizes are based on a \$365,000 deferred annuity paid annually based on the winner's natural life with a minimum payment period of 20 years. If there is more than one top prize winner, up to 14 winners, the annuitized prize will be split equally, including the number of top prize winners exercising the cash option, with a minimum value of \$500 per week to each winner exercising the annuity option.

For top prizes claimed in Rhode Island, the Lottery will utilize MUSL to purchase insurance annuities to satisfy the prize liability. The Lottery has adopted the following minimum qualification requirements for insurance companies providing insurance annuities for top prize winners:

- An AM Best rating of A or better;
- At least \$100 million in capital and surplus;
- At least \$1 billion in assets per the balance sheet of the company's most recently audited financial statements prepared by an independent certified public accountant; and
- A National Association of Insurance Commissioners' (NAIC) risk-based capital (RBC) rating of 200% or greater.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(1) Organization - (Continued)

In the event of default on an insurance annuity for a Rhode Island winner, the Lottery may be contingently liable for any remaining prize amounts due the winner.

As an alternative to the annuitized payment option, the top prize winner may request the top prize cash option payment of \$5,750,000. If there is more than one top prize winner, the top prize cash option will be divided by the total number of prize winners, including top prize winners selecting the annuitized payment option.

If more than 14 top prize winners, the top prize liability will be split equally among all top prize winners and paid in one lump sum cash payment, without an annuitized option.

Second Tier Prize Settlement

For up to 20 second prize winners, including those who exercise the cash option, the annuity payment option will be \$25,000 per year for life to second prize winners exercising the annuity option. For up to 20 second prize winners, including those who exercise the annuity option, the cash option will be \$390,000 to each second prize winner exercising the cash option.

If more than 20 second prize winners, the second prize liability is capped and will be split equally among all second prize winners and paid in one lump sum cash payment, without an annuitized option.

All low-tier prizes (all levels except the top prize and second prizes) are paid in one lump sum cash payment through the Selling Lottery. There is a reconciliation by the Game Administrator for both low-tier and unclaimed expired prizes (prize levels 2-10) when a party lottery varies from its projected prize liabilities and its unclaimed expired prizes.

- (B) Instant (or scratch) ticket offerings sold through licensed lottery retailers include a wide array of themed games where patrons must match two or three of a kind, get like symbols or bonus features, or meet other game requirements to win the prize shown.
- (C) iLottery mobile and online offerings currently include eInstants and iKeno. Players who successfully create an eWallet account and whose personal identification is verified, are then able to fund their player accounts and play iLottery offerings within geographical boundaries of the State of Rhode Island.
- (D) Video lottery games are generally operated through 5,073 video lottery terminals (VLTs) at two licensed facilities, Twin River Casino Hotel and Tiverton Casino Hotel. Due to the global COVID-19 pandemic, closure of the State's two licensed casinos occurred on March 14, 2020 thereby suspending all video game play until June 8, 2020. At June 30, 2020, there were 1,957 VLTs in operation, effectively using less than 39% of the available terminals. Both licensed facilities are owned by Twin River Worldwide Holdings, Inc. Video lottery offers various virtual and multi-layer display games, hosting a wide array of card and theme games to the public.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(1) Organization - (Continued)

- (E) Table games are operated at Twin River Casino Hotel and Tiverton Casino Hotel. Chapter 42-61.2 of the General Laws authorizes the State to operate casino gaming, and the Lottery Division to promulgate rules and regulations and set policy for table gaming. This chapter stipulates the allocation of net table game revenue. Consistent with the General Laws, net table game revenue is deposited in the State Lottery Fund for administrative purposes with commissions distributed to Twin River Casino Hotel, Tiverton Casino Hotel, and the Towns of Lincoln and Tiverton with and the balance remitted to the General Fund.
- (F) Sportsbook wagering is offered at both Twin River Casino Hotel and at the Tiverton Casino Hotel. In September 2019, mobile and online sportsbook wagering commenced, enabling players to place wagers and receive payouts through their computer or mobile devices provided they wager within the State boundaries. The sportsbook offers multiple wagering opportunities for professional and college events (excluding Rhode Island university and college events), Olympic or international sporting events, etc. in line with industry standards. Chapter 42-61.2 of the General Laws authorizes the State through the Lottery Division to implement, operate, conduct and control sports wagering at Twin River Casino Hotel and Tiverton Casino Hotel gaming facilities. The State, through the Division of Lottery, has full operational control, as defined by the statute.
- (G) Prize payout percentages and amounts required to be paid to the State's General Fund as stipulated in the General Laws are summarized below for the various games operated by the Lottery.

| Game | Prize Payout | Mandated Payments to the State |
|--|---|---|
| Daily Numbers Instant Ticket Games eInstants PowerBall® Mega Millions® Wild Money Lucky for Life® Bingo | Not less than 45% or more than 65% of sales | Payments to the General Fund – net of prizes, commissions, administrative and operating expenses. |
| Keno and iKeno | Not less than 45% or more than 72% of sales | Payments to the General Fund – net of prizes, commissions, administrative and operating expenses. |
| Video Lottery | Prize payout not established by law | Payments to the General Fund - net terminal income (video lottery credits purchased less credits redeemed or redeemable, including prize contributions to multi-state video lottery progressive jackpots) minus commission payments and incentive program reimbursements. |
| Table Games and Stadium Gaming | Prize payout not established by law | Payments to the General Fund - net table game revenue minus commission payments and table game administrative and operating expenses. |
| Sportsbook | Prize payout not established by law | Payments to the General Fund – book revenue (accrual write less accrual payout) minus commission payments net of statutory host Town fees and approved marketing expenses. |

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(2) Summary of Significant Accounting Policies

(a) *Basis of Accounting*

The financial records of the Lottery, an enterprise fund, are accounted for using the economic resources measurement focus and are maintained on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time the related liabilities are incurred. The Governmental Accounting Standards Board (GASB) has the responsibility for establishing generally accepted accounting principles for governmental proprietary fund type activities.

(b) *Reporting Entity*

The Lottery, a division of the Department of Revenue of the State of Rhode Island (State), is accounted for as an enterprise fund for financial reporting purposes.

Accordingly, its annual financial statements are included in the State's Comprehensive Annual Financial Report (CAFR). The accompanying financial statements are not intended to present the financial position and results of operations of the State.

(c) *Revenues and Expenses*

The Lottery defines all revenues and expenses deriving from on-line, including mobile and computer, instant ticket, video lottery, table games, and sports betting including mobile and computer as operating. The Lottery accrues for the maximum prizes payable. Prize obligations, other than those relating to prizes payable in installments, that remain unclaimed one year after the drawing date are reported as a reduction to cost of sales.

Revenue from the sale of lottery tickets, video lottery, table games, and sports betting and expenses for prizes and commissions are recognized as follows:

1. On-line lottery games with specific drawing dates - when the related drawings are held. For the Mega Millions[®] and Powerball[®], prize awards expense is recorded equal to the required contributions to the jackpot pool and low-tier prizes won. For the Lucky for Life[®] game, prize awards expense is recorded equal to the estimated cost of actual prizes won. Prize awards expense is subsequently adjusted based on the Lottery's share of purchased annuities for the top prize and a settlement for actual low tier prizes won in all participating states.
2. Traditional instant ticket lottery games - when ticket packets are charged to retailers. Prize expense is recognized in proportion to the number of tickets sold based on the stated prize structure for a specific traditional instant ticket game.
3. iLottery games are recognized at the time the specific games are played, and prize expense when the specific games are won.
4. Video lottery games - are reported on a net basis. Gross revenue is recognized when game credits are purchased via cash or credit redemption at the terminal (gross terminal inputs). Related prizes are recognized when game credits are issued by a video lottery terminal making them redeemable as credits in another video terminal or for cash by a patron (gross terminal outputs).

The gross video lottery terminal inputs and outputs for fiscal 2020 and reported video lottery net revenue are detailed in the following schedule:

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(2) Summary of Significant Accounting Policies – (Continued)

| Video Lottery Net Revenue - For the Year Ended June 30, 2020 | |
|---|-----------------------|
| Video Terminal Cash-In (Gross Terminal Inputs): | |
| Cash collected from video lottery terminals | \$ 1,106,981,655 |
| Plus: Credit vouchers redeemed for play in video lottery terminals | 1,574,763,425 |
| Total cash in reported by video lottery terminals | 2,681,745,080 |
| Less: Video Terminal Cash-out (Gross Terminal Outputs): | |
| Video lottery credit vouchers issued by video lottery terminals | 2,328,911,286 |
| Video lottery revenue, net | \$ 352,833,794 |

5. Table games, with the exception of poker, are reported on a net table game (win) basis from the Twin River Casino Hotel and Tiverton Casino Hotel facilities. Net table game revenue, calculated daily at each table, is cash in the drop box, plus front money (patron funds left on deposit with the facility that are drawn for chips at a table), plus markers (credit extended at a table to patrons in exchange for chips), less fills, plus credits, less beginning chip inventory, plus ending chip inventory, plus one-half of match play and free bet coupons redeemed. Poker games revenue is reported on a gross fee basis, referred to as poker rake, from the Twin River Casino Hotel facility. Poker rake calculated daily at each table is based upon a percentage of each poker pot or a direct fee charged to each player in proportion to the time spent playing at the poker table.
6. Hybrid stadium gaming is reported on a net table game (win) basis from the facilities. Net table game revenue, calculated daily at each table, is tickets in, plus cash in, less tickets issued and less token (dealer gratuities).

The State, through the Division of State Lottery, has operational control and regulating authority to collect casino gaming gross receipts, allocate receipts according to statute, define and limit the rules of play and odds of authorized games including minimum and maximum wagers and payouts for each game. Amounts required by statute to be paid to the two state gaming facilities are reported as commissions. The statute further stipulates that the Division of State Lottery establish rules and regulations and set policy for table games. These policies and regulations (promulgated in accordance with the Lottery's established minimum control standards and federal and State statute) stipulate that the table games retailers (Twin River Casino Hotel and Tiverton Casino Hotel) be responsible for obtaining approved equipment (tables, dice, cards, etc.) and bearing all risk for the management, security, and monitoring of authorized table games. The retailers are also responsible for marketing table games and all related expenses. The Lottery Division incurs operating and administrative costs relating to the oversight and regulation of casino operations which are netted against the State's statutory share of net table game revenue prior to transferring the balance to the State's General Fund.

7. Sports betting is reported on an accrual book revenue basis as of the completion of each sporting event. Book revenue is derived by event by calculating accrual write minus accrual payout. The State, through the Division of State Lottery, has authority to implement, operate, conduct and control sports wagering at the State's two licensed facilities. The statute further stipulates the Division Director promulgates rules and regulations related to sports wagering and sets policy including approving standards, rules and regulations to govern the conduct of sports wagering and the associated sports wagering system. Amounts required by statute to be paid to the facilities and

RHODE ISLAND LOTTERY

Notes to Financial Statements

Year Ended June 30, 2020

(2) Summary of Significant Accounting Policies – (Continued)

the system operator, after deducting statutory payments to host Towns and agreed upon marketing expenses, are reported as commissions. Allocation of book revenue from sports wagering after payments to host Towns and approved marketing expenses, are at statutory percentages.

All expenses directly attributable to providing or promoting lottery games to the public are considered costs of gaming operations and are reported as such on the Lottery's Statement of Revenue, Expenses, and Changes in Net Position. These expenses predominantly include commissions to lottery retailers, gaming facilities, video lottery terminal providers, gaming system operators, and the cities/towns that host the Lottery's gaming facilities, in addition to advertising, marketing and promotional expenses.

Other expenses directly attributable to the Lottery's support and oversight of gaming activities are reported as operating expenses. Operating expenses mostly consist of personnel costs, contract services, depreciation/amortization expenses, and other expenses associated with the maintenance of the Lottery's headquarters and internal computer network.

All other revenues and expenses are defined as non-operating. Non-operating revenues include income from pull tab tickets (the Lottery is not responsible for prizes won), rental income, and refunds from the Multi-State Lottery Association.

(d) *Capital Assets*

Capital assets are stated at historical cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the assets. Asset and useful lives are as follows:

| <u>Asset Category</u> | <u>Useful Life</u> | <u>Threshold</u> |
|-------------------------|--------------------|------------------|
| Buildings | 50 years | \$1,000,000 |
| Building Improvements | 20 years | \$1,000,000 |
| Computer Equipment | 5 years | \$5,000 |
| Furniture and Equipment | 5 years | \$5,000 |
| Automobiles | 5 years | \$5,000 |

In addition, the Lottery capitalizes certain intangible assets and amortizes those assets over their expected benefit period. The Lottery adheres to the State's capitalization thresholds and estimated useful lives for capital asset categories.

(e) *Cash Equivalents*

Cash equivalents consist of highly liquid investments with a maturity date of three months or less at the time of purchase and are stated at cost plus accrued interest which approximates fair value.

(f) *Investments*

Investments are recorded at fair value except for certain money market investments that have a remaining maturity at the time of purchase of one year or less, which are recorded at a net asset value reflective of amortized cost which approximates fair value. Fair value is defined by GASB Statement No. 72, *Fair Value Measurement and Application (GASB 72)*, as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. The hierarchy has three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(2) *Summary of Significant Accounting Policies* – (Continued)

2 inputs are inputs that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs, such as management's assumptions.

(g) *Ticket Inventory*

Inventory consists of the cost of tickets for the instant games, which is expensed as a percentage of sales from instant ticket games.

(h) *Advances for Future Drawings/Events*

Tickets can be purchased in advance of scheduled drawing dates. Revenue from advance ticket sales is recognized during the period in which the related drawing is held. Sports wagers may be made in advance for future athletic events (futures) and revenue is recognized at the time the athletic event is completed.

(i) *Unearned Contract Revenue*

Unearned contract revenue relates to the sale of the exclusive rights to the operation of the Lottery's gaming systems. The revenue is recognized ratably over the life of the contract.

(j) *Incentive Programs – Video Lottery*

The Lottery reimburses the gaming facilities for the State's share (net terminal income percentage) of certain marketing and promotional expenses incurred by the facilities, in relation to video lottery games. Complete details of the Lottery's reimbursement are disclosed in Note 12, Commitments.

(k) *Compulsive and Problem Gambling Program*

Pursuant to section 42-61.2-14 of the Rhode Island General Laws, the Lottery is required to establish a program for compulsive and problem gamblers in conjunction with Twin River Casino Hotel and Tiverton Casino Hotel to include awareness, player self-exclusion, and promotion of a problem gambling hotline. The program is funded through aggregate reimbursements made by Twin River Casino Hotel and Tiverton Casino Hotel totaling not less than \$125,000 annually. The Lottery received \$201,000 from gaming facility providers toward the operation of its compulsive and problem gambling program. At June 30, 2020, the Lottery advanced \$387,642 for program expenditures in excess of amounts received from the gaming facility providers at June 30, 2020. The Lottery's advance will be repaid through subsequent receipts from the gaming facility providers for the compulsive and problem gambling program. This program is not included within the operating revenue and related expenses of the Lottery.

(l) *Pensions*

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Employees' Retirement System ("ERS") and the additions to/deductions from ERS' fiduciary net position have been determined on the same basis as they are reported by ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(2) Summary of Significant Accounting Policies – (Continued)

(m) *Postemployment Benefits Other Than Pensions (OPEB)*

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the State Employees' and Electing Teachers OPEB System of the State of Rhode Island (the System) and additions to/deductions from the System's fiduciary net position have been determined on the same basis as they are reported by the System. For this purpose, the System recognizes benefit payments when due and payable in accordance with the benefit terms. Investments are reported at fair value, except for money market investments that have a maturity at the time of purchase of one year or less, which are reported at cost.

(n) *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual amounts could differ from those amounts.

(o) *New Accounting Pronouncements*

The Lottery evaluates the impact of all new accounting pronouncements issued by the Governmental Accounting Standards Board (GASB). For fiscal 2020, no newly effective statements required implementation by the Lottery. In subsequent years, the Lottery will consider the impact, if any, of GASB Statement No. 84, *Fiduciary Activities*, and GASB Statement No. 87, *Leases*. Lottery management has not yet determined the effect that these statements will have on the financial statements for future periods.

(3) Deposits and Investment Risk

(a) *Deposits*

The Lottery's cash deposit balances at June 30, 2020 totaled \$21,684,222, with corresponding bank balances totaling \$21,717,498. The bank balances consisted of \$404,116 in demand deposit accounts and \$21,313,382 in collateralized deposit investment accounts. The book and bank balances include \$548,722 of mobile sportsbook eWallet deposits at June 30, 2020. These amounts are reflected as other liabilities until wagered or withdrawn by patrons.

All deposits were in the custody of the State General Treasurer. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the Lottery's (or State's) name.

In accordance with Chapter 35-10.1 of the General Laws, depository institutions holding deposits of the State, its agencies or governmental subdivisions of the State, shall at a minimum, insure or pledge eligible collateral equal to one hundred percent of time deposits with maturities greater than 60 days. Any of these institutions which do not meet capital standards prescribed by federal regulators shall insure or pledge eligible collateral equal to 100% of deposits, regardless of maturity. None of the cash deposits of the Lottery were required to be collateralized at June 30, 2020 pursuant to Chapter 35-10.1 of the General Laws. However, the State Investment Commission has adopted a collateralization requirement for institutions holding the State's deposits. Financial institutions are required to pledge collateral equal to

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(3) Deposits and Investment Risk – (Continued)

102% of the uninsured deposit amounts. Of the total bank deposit balance totaling \$21,717,498 at year end, the entire amount was either covered by federal depository insurance or collateralized by securities held by an independent third-party custodian.

(b) Investments - Fair Value Measurements

All investments, principally cash equivalent type investments, are made by the State General Treasurer in accordance with guidelines established by the State Investment Commission (SIC), which is responsible for the investment of all State funds. Pursuant to Chapter 35-10 of the General Laws, the SIC may, in general, “invest in securities as would be acquired by prudent persons of discretion and intelligence in these matters who are seeking a reasonable income and the preservation of their capital.”

The Lottery categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. GASB Statement No. 72, *Fair Value Measurement and Application*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The hierarchy is based on the valuation inputs used to measure the fair value of the assets. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

At June 30, 2020, the Lottery had a single investment consisting of \$8,693 in the Ocean State Investment Pool Trust (OSIP), an investment pool established by the State General Treasurer. The Lottery’s OSIP investment represented less than 1% of the total OSIP Pool Trust at June 30, 2020. Agencies, authorities, commissions, boards, municipalities, political subdivisions, and other public units of the State may invest in OSIP. OSIP issues a publicly available financial report that can be obtained by writing to the Office of the General Treasurer, Finance Department, 50 Service Avenue - 2nd Floor, Warwick, RI 02886.

OSIP has met the criteria outlined in GASB Statement No. 79 – Certain External Investment Pools and Pool Participants to permit election to report its investments at amortized cost which approximates fair value. The OSIP is not rated and the weighted average maturity of investments held in the pool, by policy, is not to exceed 60 days. OSIP’s investments are high quality and liquid and include U.S. government and government agency obligations, U.S. dollar-denominated money market securities of domestic and foreign issuers such as short-term certificates of deposits, commercial paper, corporate bonds and notes, time deposits, municipal securities, asset-backed securities and repurchase agreements. OSIP transacts with its participants at a stable net asset value (NAV) per share. Investments reported at the NAV are not subject to the leveling categorization as described above. There are no participant withdrawal limitations.

Custodial Credit Risk: Investment securities are exposed to custodial risk if the securities are uninsured, are not registered in the name of the government and are held by either: a) the counterparty or b) the counterparty’s trust department or agent but not in the government’s name. Pursuant to guidelines established by the SIC, securities purchased, or underlying collateral, are required to be delivered to an independent third-party custodian.

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Based on SIC policy, the State’s short-term investment portfolio, whenever possible, will be structured to minimize interest rate risk, by matching the maturities of investments with the requirements for funds disbursement. The Lottery’s investments are typically money market mutual funds or investments with maturities less than 30 days thereby minimizing the Lottery’s exposure to interest rate risk.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(3) Deposits and Investment Risk – (Continued)

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The SIC has adopted policies regarding acceptable short-term investment types. Credit risk is mitigated by the SIC's minimum rating criteria policy, collateralization requirements, and limiting the maximum participation by any one issuer to 35% of the State's total short-term investment portfolio. Credit risk policies have been developed for investments in commercial paper.

Concentration of Credit Risk: The SIC has adopted limitations as to the maximum percentages of the State's total short-term investment portfolio that may be invested in a specific investment type or with any one issuer of securities.

| | |
|---|---------------|
| Cash deposits, including interest-bearing investment deposit accounts | \$ 21,684,222 |
| Investments classified as cash equivalents | 8,693 |
| Cash and cash equivalents | \$ 21,692,915 |

(4) Capital Assets

Lottery headquarters are situated on land owned by the State of Rhode Island. The State has assigned custody, control and supervision of the land to the Lottery at no cost. However, since title to such land remains vested in the State, it is not recorded in the statement of net position.

A summary of capital assets follows:

| | Estimated Useful Life | Balance at June 30, 2019 | 2020 Additions | 2020 Disposals | Balance at June 30, 2020 |
|--|--------------------------|-----------------------------|-------------------|-------------------|-----------------------------|
| <u>Cost</u> | | | | | |
| Building | 50 | \$ 1,437,912 | | | \$ 1,437,912 |
| Building improvements | 20 | 1,937,228 | | | 1,937,228 |
| Ticket production equipment | 5 | 11,486 | | | 11,486 |
| Office equipment | 5 | 113,250 | 5,130 | | 118,380 |
| Furniture and fixtures | 5 | 109,093 | | | 109,093 |
| Lottery drawing equipment | 5 | 96,935 | 231,875 | | 328,810 |
| Automobiles | 5 | 475,020 | | | 475,020 |
| Computer equipment | 5 | 118,678 | 15,966 | | 134,644 |
| Intangible Assets | 7 | 175,424 | | | 175,424 |
| Total | | \$ 4,475,026 | \$ 252,971 | \$ - | \$ 4,727,997 |
| <u>Less: Accumulated Depreciation and Amortization</u> | | | | | |
| Building | | \$ 1,437,912 | | | \$ 1,437,912 |
| Building improvements | | 1,875,392 | 7,950 | | 1,883,342 |
| Ticket production equipment | | 11,486 | | | 11,486 |
| Office equipment | | 93,004 | 5,807 | | 98,811 |
| Furniture and fixtures | | 92,575 | 6,607 | | 99,182 |
| Lottery drawing equipment | | 95,126 | 24,907 | | 120,033 |
| Automobiles | | 273,473 | 61,252 | | 334,725 |
| Computer equipment | | 77,779 | 16,841 | | 94,620 |
| Intangible Assets | | 164,980 | 10,444 | | 175,424 |
| Total | | \$ 4,121,727 | \$ 133,808 | \$ - | \$ 4,255,535 |
| Capital assets, net | | \$ 353,299 | \$ 119,163 | \$ - | \$ 472,462 |

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(5) Transfers to the State

- (a) The Lottery is required to transfer net proceeds from the Lottery’s games in accordance with RI General Laws sections 42-61-15 and 42-61.2-7. Transfers to the State’s General Fund for fiscal 2020 are reported as follows in the Lottery’s financial statements:

| | |
|--|---------------------|
| Due to State's General Fund, beginning of year | \$ 2,048,319 |
| Transfers to State's General Fund | 283,870,546 |
| Cash paid during fiscal year | (283,055,528) |
| Due to State's General Fund, end of year | <u>\$ 2,863,337</u> |

In accordance with the Rhode Island General Laws, the Lottery transfers net income to the State’s General Fund based on the Lottery’s actual pension and OPEB contributions (which are the actuarially determined contributions required by law) to the State’s pension plan and OPEB plan. Pension and OPEB expense reported in the Lottery’s financial statements in accordance with GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, is a different amount reflecting the change in the net pension and OPEB liabilities during the fiscal year. The table below details the amount transferred to the General Fund as required by RI General Laws:

| <u>Description</u> | <u>Amount</u> |
|--|-----------------------|
| Income before Transfers | \$ 283,618,214 |
| Add: Pension expense in accordance with GASB Statement No. 68 | 3,010,839 |
| Less: Pension contributions made subsequent to measurement date | (1,899,769) |
| Add: OPEB expense in accordance with GASB Statement No. 75 | 243,903 |
| Less: OPEB contributions made subsequent to measurement date | (477,641) |
| Less: Contract revenue recognized in 2019 transferred to the General Fund in prior period | (625,000) |
| Transfers to State's General Fund | <u>\$ 283,870,546</u> |

- (b) The Lottery also reimburses the State’s General Fund for certain operating expenses associated with personnel costs, information technology resources, utilities, etc. As a result of COVID-19, certain Lottery employees were deployed to different state agencies for their services, therefore amounts owed from the General Fund at year-end for operating expenses totaled \$66,147.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(6) Commissions

The Lottery pays commissions to ticket retailers and its on-line games contractor based on a percentage of gross ticket sales. Video lottery commissions, as specified in the General Laws, are paid to the facility operators, technology providers (video lottery terminal providers), the central communications provider and others based on various percentages of net terminal income (video lottery credits purchased less credits redeemed or redeemable plus progressive jackpots). Table games commissions, as specified in the General Laws, are paid to Twin River Casino Hotel and Tiverton Casino Hotel and the Towns of Lincoln, RI and Tiverton, RI. Sports book commissions, as specified in the General Laws, are paid to the facility operators and the system operator after flat fees to the Town of Lincoln, RI and Tiverton, RI and after approved marketing expenses.

The General Laws provide for reductions of certain video lottery commissions. The amount reduced is to be credited to the State’s Distressed Communities Relief Fund, which is part of the State’s General Fund. The Lottery has reflected the actual video commissions paid as an expense. The amount to be credited to the Distressed Communities Relief Fund is included in the payments to the State’s General Fund.

(7) Compensated Absences

The Lottery accrues an estimated liability for vested benefits relating to future compensated absences. This includes an expected obligation in connection with vacation credits, pay reduction credits, and accumulated vested sick pay for those employees eligible for retirement. The liability for compensated absences was approximately \$768,804 as of June 30, 2020 and is recorded as a liability in the Statement of Net Position. The current portion of \$337,733, as reported, was estimated based on a four-year average of employee utilization.

Changes in the reported liability for compensated absences for fiscal 2020 are as follows:

| | Balance at July 1, 2019 | Increase | Decrease | Balance at June 30, 2020 |
|--|----------------------------|-----------|-----------|-----------------------------|
| Liability for Compensated Absences | \$770,870 | \$494,505 | \$496,571 | \$768,804 |

(8) Net Position - (Deficit)

Components of Unrestricted (Deficit):

- o *Balance of prior year advance to the General Fund prior to contract revenue recognition* - On May 12, 2003, the Lottery entered into a 20-year contract, effective July 1, 2003, with its gaming system provider. The contract granted the provider the right to be the Lottery’s exclusive vendor of hardware and software, together with the related services necessary for the operation of the Lottery’s computerized games, through June 30, 2023. In return, the provider made a one-time payment of \$12.5 million to the Lottery as consideration for this exclusive contract right. The Lottery recorded unearned contract revenue in the amount of \$12.5 million and transferred the cash to the State’s General Fund on June 30, 2003. This prior year transfer of unearned contract revenue resulted in a deficit in net position at June 30, 2020 of \$1.9 million. As the contract revenue is recognized over the twenty-year life of the contract, the deficit in net position will be reduced by \$625,000 per year. Accordingly, the Lottery has recognized \$625,000 as the current portion of unearned revenue as of June 30, 2020.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(8) Net Position - (Deficit) – (Continued)

- *Proportionate share of Net Pension Liability in accordance with GASB Statement No. 68, Accounting and Financial Reporting for Pensions* – the Lottery recognizes its proportionate share of the State’s net pension liability for the Pension Plan. The Lottery’s net pension liability at June 30, 2020 was \$20,850,027, which constitutes a significant portion of the unrestricted deficit reported on the Statement of Net Position at June 30, 2020. As required by RI General Laws, the Lottery’s transfer to the State’s General Fund is based on net income reflecting the actuarially determined employer contribution to the Employees’ Retirement System. Net income reported in the Lottery’s financial statements reflects the recognition of pension expense in accordance with generally accepted accounting principles.
- *Proportionate share of Net OPEB Liability in accordance with GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* – the Lottery recognizes its proportionate share of the State’s net OPEB liability for the OPEB Plan. The Lottery’s net OPEB liability at June 30, 2020 was \$3,990,380, which constitutes a portion of the unrestricted deficit reported on the Statement of Net Position at June 30, 2020. As required by RI General Laws, the Lottery’s transfer to the State’s General Fund is based on net income reflecting the actuarially determined employer contribution to the OPEB Plan. Net income reported in the Lottery’s financial statements reflects the recognition of OPEB expense in accordance with generally accepted accounting principles.

Net investment in capital assets:

- The Lottery’s net position (deficit) at June 30, 2020 also includes its net investment in capital assets. The Lottery had no debt related to capital assets at June 30, 2020.

(9) Retirement Plans

Plan description - Employees of the Lottery participate in a cost-sharing multiple-employer defined benefit pension plan – the Employees’ Retirement System Plan - administered by the Employees’ Retirement System of the State of Rhode Island (the “System”). Under a cost sharing plan, pension obligations for employees of all employers are pooled and plan assets are available to pay the benefits of the employees of any participating employer providing pension benefits through the plan, regardless of the status of the employers’ payment of its pension obligation to the plan. The plan provides retirement and disability benefits and death benefits to plan members and beneficiaries.

The System issues a publicly available financial report that includes financial statements and required supplementary information for the plans. The report may be obtained at <http://www.ersri.org>.

Benefit provisions - The level of benefits provided to participants is established by Chapter 36-10 of the General Laws, which is subject to amendment by the General Assembly. Member benefit provisions vary based on service credits accumulated at dates specified in various amendments to the General Laws outlining minimum retirement age, benefit accrual rates and maximum benefit provisions. In general, members accumulate service credits for each year of service subject to maximum benefit accruals of 80% or 75%. For those hired after June 30, 2012, the benefit accrual rate is 1% per year with a maximum benefit accrual of 40%. Members eligible to retire at September 30, 2009 may retire with 10 years of service at age 60 or after 28 years of service at any age. The retirement eligibility age increases proportionately for other members reflecting years of service and other factors until it aligns with the Social Security Normal Retirement Age, which applies to any member with less than 5 years of service as of July 1, 2012. Members are vested after 5 years of service.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(9) *Retirement Plans*- (Continued)

The plan provides for survivor's benefits for service-connected death and certain lump sum death benefits. Joint and survivor benefit provision options are available to members.

Cost of living adjustments are provided but are currently suspended until the collective plans covering state employees and teachers reach a funded status of 80%. Until the plans reach an 80% funded status, interim cost of living adjustments are provided at four-year intervals.

The plan also provides nonservice-connected disability benefits after five years of service, and service-connected disability benefits with no minimum service requirement.

Contributions – The funding policy, as set forth in the General Laws, Section 36-10-2, provides for actuarially determined periodic contributions to the plan. For fiscal 2020, Lottery employees, with less than 20 years of service as of 7/1/2012, were required to contribute 3.75% of their annual covered salary. Employees with more than 20 years of service as of 7/1/2012 were required to contribute 11% of their annual covered salary. The Lottery is required to contribute at an actuarially determined rate; the rate was 26.39% of annual covered payroll for the fiscal year ended June 30, 2020. The Lottery contributed \$1,899,769, \$1,737,836 and \$1,320,896 for the fiscal years ended June 30, 2020, 2019 and 2018, respectively, equal to 100% of the required contributions for each year.

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

At June 30, 2020, the Lottery reported a liability of \$20,850,027 for its proportionate share of the net pension liability related to its participation in ERS. The net pension liability was measured as of June 30, 2019, the measurement date, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2018, rolled forward to the June 30, 2019 measurement date. The Lottery's proportion of the net pension liability was based on its share of contributions to the ERS for fiscal year 2019 relative to the total contributions of all participating employers for that fiscal year. At the June 30, 2019 measurement date, the Lottery's proportion was 0.91995341%.

For the year ended June 30, 2020, the Lottery recognized pension expense of \$3,010,839. At June 30, 2020, the Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(9) Retirement Plans - (Continued)

Deferred Outflows of Resources

| | | |
|---|-----------|------------------|
| Change of assumptions | \$ | 911,907 |
| Difference between expected and actual experience | | 219,581 |
| Changes in proportion and differences between employer and proportionate share of contributions | | 2,861,467 |
| Contributions subsequent to measurement date | | 1,899,769 |
| Total Deferred Outflows of Resources | \$ | 5,892,724 |

Deferred Inflows of Resources

| | | |
|---|-----------|----------------|
| Difference between expected and actual experience | \$ | 108,681 |
| Net difference between projected and actual investment earnings | | 38,696 |
| Changes in proportion and differences between employer and proportionate share of contributions | | 154,674 |
| Total Deferred Inflows of Resources | \$ | 302,051 |

Contributions of \$1,899,769 are reported as deferred outflows of resources related to pensions resulting from the Lottery's contributions in fiscal year 2020 subsequent to the measurement date and will be recognized as a reduction of the net pension liability determined in the subsequent period. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

| <u>Year ended June 30:</u> | <u>Net Deferred Outflows (Inflows) of Resources:</u> | |
|----------------------------|--|------------------|
| 2021 | \$ | 1,186,734 |
| 2022 | | 910,018 |
| 2023 | | 804,939 |
| 2024 | | 712,074 |
| 2025 | | 77,139 |
| Thereafter | | - |
| | \$ | 3,690,904 |

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(9) Retirement Plans - (Continued)

Actuarial Methods and Assumptions

The total pension liability was determined using the following actuarial methods and assumptions, applied to all periods included in the measurement:

| Actuarial Cost Method | Entry Age Actuarial Cost methodology is used |
|---------------------------|--|
| Amortization Method | Level Percent of Payroll - Closed |
| Inflation | 2.50% |
| Salary increases | 3.25% to 6.25% |
| Investment rate of return | 7.00% |

Mortality rates for male plan members were based on the RP-2014 Combined Healthy for Males with Blue Collar adjustments, projected with the ultimate values of the MP scale. Mortality rates for female plan members were based on the RP-2014 Combined Healthy for Females, projected with the ultimate values of the MP scale.

The actuarial methods and assumptions used in the June 30, 2018 valuation rolled forward to June 30, 2019 and the calculation of the total pension liability at June 30, 2019 were consistent with the results of an actuarial experience investigation study performed as of June 30, 2016.

The long-term expected rate of return best-estimate on pension plan investments was determined by the actuary using a building-block method. The actuary started by calculating best-estimate future expected real rates of return (expected returns net of pension plan investment expense and inflation) for each major asset class, based on a collective summary of capital market expectations from 34 sources. These return assumptions are then weighted by the target asset allocation percentage, factoring in correlation effects, to develop the overall long-term expected rate of return best-estimate on an arithmetic basis. The June 30, 2019 expected arithmetic returns over the long-term (20 years) by asset class are summarized in the following table:

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(9) Retirement Plans - (Continued)

| Asset Class | Target Asset Allocation | Long-Term Expected Arithmetic Real Rate of Return |
|--------------------------------|----------------------------|---|
| GROWTH | | |
| Global Equity | | |
| U.S. Equity | 22.10% | 6.16% |
| International Developed Equity | 13.20% | 6.83% |
| Emerging Markets Equity | 4.70% | 8.90% |
| Private Growth | | |
| Private Equity | 11.25% | 9.81% |
| Non-Core RE | 2.25% | 5.51% |
| Opportunistic Private Credit | 1.50% | 9.81% |
| INCOME | | |
| High Yield Infrastructure | 1.00% | 3.98% |
| REITS | 1.00% | 5.51% |
| Liquid Credit | 2.80% | 3.98% |
| Private Credit | 3.20% | 3.98% |
| STABILITY | | |
| Crisis Protection Class | | |
| Treasury Duration | 4.00% | 0.77% |
| Systematic Trend | 4.00% | 4.20% |
| Inflation Protection | | |
| Core Real Estate | 3.60% | 5.51% |
| Private Infrastructure | 2.40% | 5.85% |
| TIPs | 1.00% | 1.37% |
| Natural Resources | 1.00% | 3.76% |
| Volatility Protection | | |
| IG Fixed Income | 11.50% | 2.15% |
| Absolute Return | 6.50% | 4.20% |
| Cash | 3.00% | 0.77% |
| | 100.00% | |

These return assumptions are then weighted by the target asset allocation percentage, factoring in correlation effects, to develop the overall long-term expected rate of return best-estimate on an arithmetic basis.

Discount rate

The discount rate used to measure the total pension liability was 7.0 percent. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from the employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(9) *Retirement Plans* - (Continued)

Sensitivity of the net pension liability (asset) to changes in the discount rate

| | | Net Pension Liability | | | |
|--|------------|------------------------------|------------|--|------------|
| 1.00% Decrease (6.0% Discount Rate) | | (7.0% Discount Rate) | | 1.00% Increase (8.0% Discount Rate) | |
| \$ | 25,591,523 | \$ | 20,850,027 | \$ | 16,968,556 |

Pension Plan Fiduciary Net Position:

As noted earlier, ERS issues a publicly available financial report that includes financial statements and required supplementary information for the plans. The report may be obtained at <http://www.ersri.org>. The report contains detailed information about the pension plan’s fiduciary net position.

Defined Contribution Plan:

Plan Description – Certain employees participating in the defined benefit plan (those with less than 20 years of service as of 7/1/2012), as described above, also participate in a defined contribution plan of the Employees’ Retirement System as authorized by General Law Chapter 36-10.3. The defined contribution plan is established under IRS section 401(a) and is administered by TIAA-CREF. The Retirement Board is the plan administrator and plan trustee. The Employees may choose among various investment options available to plan participants. The State Investment Commission is responsible for implementing the investment policy of the plan and selecting the investment options available to members.

Plan contributions – Certain employees (those with less than 20 years of service as of 7/1/2012) contribute 5% of their annual covered salary and employers contribute at the following percentages of annual covered salary for these employees based on their years of service as of July 1, 2012:

| Years of Service As of July 1, 2012 | Employer Contribution Rate |
|--|---------------------------------------|
| 15-20 Years | 1.5% |
| 10-15 Years | 1.25% |
| 0-10 Years | 1.00% |

Employee contributions are immediately vested while employer contributions are vested after three years of contributory service. Contributions required under the plan by both the employee and employer are established by the General Laws of the State of Rhode Island, which are subject to amendment by the General Assembly.

The Lottery contributed and recognized as pension expense \$72,627 for the fiscal year ended June 30, 2020, equal to 100% of the required contributions for the fiscal year.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(9) Retirement Plans - (Continued)

Plan vesting and contribution forfeiture provisions – The total amount contributed by the member, including associated investment gains and losses, shall immediately vest in the member’s account and is non-forfeitable. The total amount contributed by the employer, including associated investment gains and losses, vests with the member and is non-forfeitable upon completion of three (3) years of contributory service. Non-vested employer contributions are forfeited upon termination of employment. Such forfeitures can be used by employers to offset future remittances to the plan.

Retirement benefits – Benefits may be paid to a member after severance from employment, death, plan termination, or upon a deemed severance from employment for participants performing qualified military service. At a minimum, retirement benefits must begin no later than April 1 of the calendar year following the year in which the member attains age 70½ or terminates employment, if later.

The System issues a publicly available financial report that includes financial statements and required supplementary information for plans administered by the system. The report may be obtained at <http://www.ersri.org>.

(10) Postemployment Healthcare

Plan description - Employees of the Lottery participate in a cost-sharing multiple-employer defined benefit other post-employment benefits (OPEB) plan included within the Rhode Island State Employees’ and Electing Teachers OPEB System (the “System”). The Lottery participates in the State Employees plan within the System.

Under a cost sharing plan, OPEB obligations for employees of all employers are pooled and plan assets are available to pay the benefits of the employees of any participating employer providing OPEB benefits through the plan, regardless of the status of the employers’ payment of its OPEB obligation to the plan. The plan provides health care benefits to plan members.

The System is administered by the OPEB Board and was authorized, created, and established under Chapter 36-12.1 of the RI General Laws. The Board was established under Chapter 36-12.1 as an independent board to hold and administer, in trust, the funds of the OPEB system. The four members of the OPEB Board are: the State Controller, the State Budget Officer, the State Personnel Administrator and the General Treasurer, or their designees.

The System issues a publicly available financial report that includes financial statements and required supplementary information for the plans. The report may be obtained at <http://www.oag.ri.gov/reports.html>.

Membership and Benefit provisions – The plans within the System generally provide healthcare coverage to pre-Medicare eligible retirees and health reimbursement account contributions or Medicare supplement coverage for members who are Medicare eligible. Members may purchase coverage for spouses and dependents. Dental and vision coverage may be purchased by these groups with no state subsidy.

Members of the System must meet the eligibility and services requirements set forth in the RI General Laws or other governing documents. RIGL Sections 16-17.1-1 and 2, 36-10-2, 36-12.1, 36-12-2.2 and 36-12-4 govern the provisions of the System, and they may be amended in the future by action of the General Assembly.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(10) *Postemployment Healthcare Plan*- (Continued)

Contributions – The funding policy, as set forth in the General Laws and which may be amended at any time, provides for actuarially determined periodic contributions to the plans. The Lottery is required to contribute at an actuarially determined rate; the rate was 6.65% of annual covered payroll for the fiscal year ended June 30, 2020. The Lottery contributed \$477,641, \$400,960 and \$317,442 for the fiscal years ended June 30, 2020, 2019 and 2018, respectively, equal to 100% of the required contributions for each year.

Active employees do not make contributions to the plan. Retired member contributions consist of the required retiree share of coverage based on the time of retirement and years of service.

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

At June 30, 2020, the Lottery reported a liability of \$3,990,380 for its proportionate share of the net OPEB liability related to its participation in the System. The net OPEB liability was measured as of June 30, 2019, the measurement date, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of June 30, 2018 rolled forward to the June 30, 2019 measurement date. The Lottery's proportion of the net OPEB liability was based on its share of contributions to the System for fiscal year 2019 relative to the total contributions of all participating employers for that fiscal year. At the June 30, 2019 measurement date, the Lottery's proportion was 0.91422568%.

For the year ended June 30, 2020, the Lottery recognized OPEB expense of \$243,903. At June 30, 2020, the Lottery reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

Deferred Outflows of Resources

| | | |
|---|-----------|--------------------------------|
| Change of assumptions | \$ | 195,419 |
| Changes in proportion and differences between employer and proportionate share of contributions | | 752,356 |
| Contributions subsequent to measurement date | | <u>477,641</u> |
| Total Deferred Outflows of Resources | \$ | <u><u>1,425,416</u></u> |

Deferred Inflows of Resources

| | | |
|---|-----------|------------------------------|
| Difference between expected and actual experience | \$ | 504,108 |
| Change of assumptions | | 35,045 |
| Net difference between projected and actual investment earnings | | <u>127,006</u> |
| Total Deferred Inflows of Resources | \$ | <u><u>666,159</u></u> |

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(10) Postemployment Healthcare Plan- (Continued)

Contributions of \$477,641 are reported as deferred outflows of resources related to OPEB expense resulting from the Lottery’s contributions in fiscal year 2020 subsequent to the measurement date and will be recognized as a reduction of the net OPEB liability in the subsequent period. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

| <u>Year ended June 30:</u> | <u>Net Deferred Outflows (Inflows) of Resources:</u> |
|----------------------------|--|
| 2021 | \$ 25,161 |
| 2022 | 25,161 |
| 2023 | 39,711 |
| 2024 | 50,321 |
| 2025 | 63,125 |
| Thereafter | 78,136 |
| | <hr/> \$ 281,615 <hr/> |

Actuarial Methods and Assumptions

The total OPEB liability was determined using the following significant actuarial methods and assumptions:

| | |
|-----------------------------|--|
| Actuarial Cost Method | Entry Age Normal - the Individual Entry Age Actuarial Cost methodology is used |
| Amortization Method | Level Percent of Payroll - Closed |
| Inflation | 2.50% |
| Salary increases | 3.00% to 6.00% |
| Investment rate of return | 5.00% |
| Health Care Cost Trend Rate | 8.25% in fiscal 2019 decreasing annually to 3.5% in fiscal year 2031 and later |

Mortality rates for male plan members were based on the RP-2014 Combined Healthy for Males with Blue Collar adjustments, projected with the MP-2016 ultimate rates. Mortality rates for female plan members were based on the RP-2014 Combined Healthy for Females, projected with the MP-2016 ultimate rates.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(10) Postemployment Healthcare Plan- (Continued)

The long-term expected rate of return best-estimate on OPEB plan investments was determined by the actuary using a building-block method. The actuary started by calculating best-estimate future expected real rates of return (expected returns net of OPEB plan investment expense and inflation) for each major asset class, based on a collective summary of capital market expectations from 34 nationally recognized investment consulting firms. The June 30, 2019 expected arithmetic returns over the long-term (20 years) by asset class are summarized in the following table:

| Asset Class | Target Asset Allocation | Long-Term Expected Arithmetic Real Rate of Return |
|--------------------|--------------------------------|--|
| Domestic Equity | 65.00% | 6.05% |
| Fixed Income | 35.00% | 1.48% |

These return assumptions are then weighted by the target asset allocation percentage, factoring in correlation effects, to develop the overall long-term expected rate of return best-estimate on an arithmetic basis.

Discount rate

The discount rate used to measure the total OPEB liability was 5 percent. The projection of cash flows used to determine the discount rate assumed that contributions from plan members, if any, will be made at the current contribution rate and that contributions from the employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the OPEB plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

Sensitivity of the net OPEB liability to changes in the discount rate

The following presents the net OPEB liability calculated using the discount rate of 5 percent as well as what the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current rate.

| Net OPEB Liability | | |
|--|---|--|
| 1.00% Decrease (4.0% Discount Rate) | Discount Rate Sensitivity (5.0% Discount Rate) | 1.00% Increase (6.0% Discount Rate) |
| \$ 4,506,429 | \$ 3,990,380 | \$ 3,098,613 |

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(10) Postemployment Healthcare Plan- (Continued)

Sensitivity of the net OPEB liability to changes in the healthcare cost trend rate

The following table presents the net OPEB liability calculated using the healthcare cost trend rate of 8.25% and gradually decreasing to an ultimate rate of 3.5%, as well as what the employers' net OPEB liability would be if it were calculated using a trend rate that is 1 percentage point lower or 1 percentage point higher than the current rate (expressed in thousands).

| Net OPEB Liability | | | | | |
|---|-----------|-----------------|-----------|------------------|-----------|
| Health Care Trend Rate Sensitivity | | | | | |
| 1% Lower | | Baseline | | 1% Higher | |
| \$ | 2,921,724 | \$ | 3,990,380 | \$ | 4,760,059 |

OPEB Plan Fiduciary Net Position:

The System issues a publicly available financial report that includes financial statements and required supplementary information for the plans. The report may be obtained at <http://www.oag.ri.gov/reports.html>. The report contains detailed information about the OPEB plan's fiduciary net position.

(11) Deferred Compensation

Employees of the Lottery may participate in a deferred compensation plan offered by the State. Required disclosures are reported in the State's CAFR.

(12) Commitments

(a) Gaming Systems Provider – International Game Technology (IGT)

The Lottery entered into a 20-year master contract with its gaming systems provider granting them the right to be the exclusive provider of information technology hardware, software, and related services for all lottery games. This contract is effective from July 1, 2003 through June 30, 2023 and amends all previous agreements between the parties.

As consideration for this exclusive right, the gaming systems provider paid the Lottery \$12.5 million. In the event that the contract term is not fulfilled, the Lottery will be obligated to refund a pro-rata share of this amount to the gaming systems provider (\$1.9 million at June 30, 2020).

The contract mandates commission percentages as detailed in the following chart.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(12) Commitments- (Continued)

| Commission Percentages | |
|---|------------------------|
| On-Line and Instant Tickets | |
| Total Lottery Sales in the Year | Percent Thereof |
| \$0 - \$275 Million | 5.00% |
| Over \$275 Million - \$400 Million | 1.00% |
| Over \$400 Million | 5.00% |
| Video Lottery Central System | |
| Total Net Terminal Income for the Year | Percent Thereof |
| \$0 - \$500 Million | 2.50% |
| Over \$500 Million - \$1 Billion | 1.00% |
| Over \$1 Billion | 2.50% |

The Lottery also leases to the gaming systems provider a portion of its headquarters to house the computer hardware and office space necessary for the operation of the Lottery’s games. The original term of the lease was for five (5) years, commencing October 19, 2012 and the square footage leased is 5,101 square feet. The annual lease amount for the first year approximated \$117,000 and the four (4) remaining years will increase by four percent (4%) per annum, effective October 19th. The tenant exercised the one, four (4) year term renewal option for the office space. The base rate for the renewal options is an increase of four percent (4%) per annum unless a mutually acceptable rate is negotiated.

(b) Video Lottery Terminal Provider - International Game Technology (IGT)

IGT is also a provider of video lottery terminals and receives compensation equal to 7% of net terminal income. The Master Contract (as amended) also includes provisions related to premium IGT video lottery terminals and responsibility for related license fees (IGT) as well as concurrence on agreement on the promotional points program with the casinos and the Lottery.

(c) Sportsbook - International Game Technology (IGT)

The Lottery also executed a Sports Betting Agreement with IGT to provide, along with its subcontractor, American Wagering, Inc., D/B/A William Hill US (William Hill), a proprietary sports betting solution for all sports betting at the Twin River Casino Hotel and the Tiverton Casino Hotel facilities. The initial term of the software license is five years from launch date (November 26, 2018), and upon mutual agreement of the parties, there are two successive five-year renewal options. In exchange, IGT has allocated its revenue share in accordance with RI General Laws 42-61.2-7. In the event of a loss of sports wagering revenue in a quarterly period, IGT will cover the State’s share of said loss interest free until a subsequent invoicing period is sufficient to cover said prior period loss.

During July 2019, the Lottery executed the first amendment to the Sports Betting Agreement authorizing IGT to supply the equipment, software, and services for online sports wagering using mobile devices. This is in accordance with authorized sports wagering legislation enacted in June 2019. Effective April 30, 2020 the Division is responsible for payment of all transaction processing fees.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(12) Commitments- (Continued)

The Sports Betting Agreement was further amended in January 2020 to authorize IGT additional responsibilities for the provision of certain fraud and security services, as well as, cash fund management services in connection with the online sports wagering agreement executed in July 2019. In consideration of these additional services, the Division invoices Twin River Casino Hotel and remits payment to IGT a fixed monthly fee of \$20,000 since the launch of online sports wagering, with the initial month pro-rated.

(d) Licensed Gaming Facilities (Twin River Casinos)

The Lottery's licensed gaming facilities are owned and operated by Twin River Worldwide Holdings, Inc. and operate as Twin River – Lincoln (Twin River Casino Hotel) and Twin River – Tiverton (Tiverton Casino Hotel)

Both licensed facilities operate under a common Master Contract with options to extend the agreement for two additional five (5) year terms commencing on July 18, 2020 and July 17, 2025 and continuing until July 17, 2030. Certain extensions are contingent on the owners' compliance with full-time employment mandates. The contract entitles the owners to compensation ranging from 26% to 28.85% of video lottery net terminal income at the facility.

The Master Contract reflects the statutory authorization of a promotional points program at the licensed gaming facilities. For fiscal year 2020, each facility's allowable promotional points are 20% of prior year net terminal income plus \$750,000. In fiscal 2020, Twin River – Lincoln and Twin River – Tiverton were authorized and issued approximately \$52.0 million and \$13.2 million, respectively, in promotional points to facility patrons.

The Master Contract also reflects the statutory requirement that the Lottery reimburse the owner for certain allowable marketing expenses as follows:

| <u>Marketing Expense Level</u> | <u>Lottery Reimbursement Percentage</u> |
|---------------------------------------|--|
| <u>Twin River – Lincoln:</u> | |
| \$1 up to \$4,000,000 | 0% |
| \$4,000,001 up to \$10,000,000 | State Share of NTI |
| \$10,000,001 up to \$14,000,000 | 0% |
| \$14,000,001 up to \$17,000,000 | State Share of NTI |
| <u>Twin River – Tiverton:</u> | |
| \$1 up to \$560,000 | 0% |
| \$560,001 up to \$1,400,000 | State Share of NTI |

The Lottery is required to reimburse the Twin River casinos for allowable marketing expenses incurred at the same percentage as the Lottery's share of net terminal income for the fiscal year 2020 (60.78% for Twin River -Lincoln and 60.94% for Twin River - Tiverton). For fiscal 2020, the Lottery accrued \$3,646,800 and \$511,896 in reimbursable marketing expenses for Twin River – Lincoln and Twin River – Tiverton, respectively.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(12) Commitments- (Continued)

Table games are operated at the Twin River Casino Hotel and Tiverton Casino Hotel. Commissions for both casino facilities and the respective host community were 83.5% and 1%.

The Lottery also entered into a Sports Wagering Hosting Agreement with Twin River to host in-person and on-premises sports betting. The agreement entitles the owners to compensation of 17% of sports wagering revenue generated at the facilities. The agreement can be extended for two five-year periods so long as there is a master video lottery terminal contract between the relevant parties.

On September 4, 2019, subsequent to legislation in March 2019 authorizing online sports wagering, the Lottery entered in the first amendment to the sports wagering hosting agreement to enable Twin River to host, manage and enable players to participate in online sports wagering including validation and registration of players.

During the term of the first amendment, Twin River remits to the Division \$20,000 per month for fraud, security, and cash fund management services (performed by IGT). Twin River has the option, upon approval by the Division, to assume any or all of these services. As of August 12, 2020, the fraud and security services were assumed by Twin River. The monthly fees collected by the Lottery and remitted to IGT have been reduced to \$12,000 per month in the aggregate to reflect Twin River's assumption of these responsibilities.

(13) Contingencies

- (a) The Lottery's fiscal year 2020 revenues were materially affected by the global COVID-19 pandemic. Closure of the State's two licensed casinos, many Lottery retailers, restaurants and bars, the canceling and elimination of professional and college sporting events, and stay at home regulations had a significant impact on revenues for all Lottery lines of business, and have reduced expected revenues in the new fiscal year beginning July 1, 2020.
- (b) The Lottery's master contracts with its video lottery facilities contain revenue protection provisions in the event that existing video lottery facilities incur revenue losses caused by new gaming ventures within the State.
- (c) The Lottery's gaming operations currently compete with casinos in nearby Connecticut and Massachusetts. The Lottery and the State continually monitor the risk to gaming operations resulting from competition in nearby states.
- (d) The Narragansett Indian Tribe filed a complaint against the State of Rhode Island in the Rhode Island Superior Court on or about September 28, 2011, challenging, inter alia, the constitutionality of the Rhode Island Casino Gaming Act ("Act") on the grounds that it would not be "state-operated" and the Act "delegates unconstitutional authority to a private corporation". On or about June 29, 2012, the Rhode Island Superior Court found that the Narragansett Indian Tribe had not sustained their burden of proof beyond a reasonable doubt that the Act is facially unconstitutional. The Narragansett Indian Tribe filed a notice of appeal of that decision with the Rhode Island Supreme Court. On or about March 4, 2015, the Rhode Island Supreme Court issued a decision upholding the Superior Court's decision. The remaining issue in the case relating to whether the State "operates" the Twin River – Lincoln and Twin River – Tiverton facilities remains pending in the Superior Court.

RHODE ISLAND LOTTERY

Notes to Financial Statements
Year Ended June 30, 2020

(13) Contingencies

- (e) A plaintiff has filed suit against the Division of Lottery and Department of Administration challenging the constitutionality of sports betting in Rhode Island. The complaint asserts that the conduct of State operated sports betting in Tiverton and Lincoln violates the express constitutional requirement of voter approval and must be declared unconstitutional and enjoined until and unless the voters of Rhode Island approve sports gambling at duly authorized statewide and local elections. The complaint was dismissed once by the Rhode Island Superior Court due to a lack of standing by the Plaintiff, but subsequently the Court permitted the Plaintiff to refile an amended complaint. The parties then filed summary judgement motions. On June 1, 2020, the Rhode Island Superior Court issued a decision where it found that the legislation enabling sports betting did not impermissibly expand the location of gambling and that the acts are constitutional. The case has been appealed to the Rhode Island Supreme Court.
- (f) In the event of default on an insurance annuity contract for a Rhode Island winner of the Lucky for Life® jackpot prize award, the Lottery may be contingently liable for any remaining prize amounts due the winner.

(14) Risk Management

The Lottery is exposed to various types of risk related to its operations. These risks can result in losses incurred from property damage or destruction, inability to operate gaming activities and worker compensation claims. The Lottery manages these risks through the purchase of commercial insurance. During fiscal 2020, the Lottery maintained its amount of purchased insurance coverage. Claims and settlements incurred for fiscal years 2020, 2019 and 2018 have not exceeded the Lottery's insurance coverage.

The Lottery participates in the health insurance program for all State employees.

The Lottery also manages a variety of operational risks which could impact the continuity of business operations. These include the risk of cyber-attacks, property damages, or employee strikes which could adversely impact Lottery operations and have an effect on the State's share of net revenues. To mitigate these risks, Lottery contractors and facility operators procure business interruption insurance, cyber liability insurance, and other property insurance, in conjunction with managing employment issues in a manner that safeguards the continuity of the Lottery's business operations.

(15) Subsequent Events

On July 12, 2020, the traditional online draw game, Wild Money, changed from three (3) drawings per week to a daily drawing. This planned change occurred in an effort to increase Lottery profits.

Additionally, as of July 28, 2020, enacted legislation resulted in players being able to register online to use the mobile application, thereby eliminating the requirement to register in person at the casinos.

RHODE ISLAND LOTTERY

Required Supplementary Information

RI Lottery
Schedule of the Lottery's Proportionate Share of the Net Pension Liability
Employees' Retirement System Plan

| Year Ended | June 30, 2020 | June 30, 2019 | June 30, 2018 | June 30, 2017 | June 30, 2016 | June 30, 2015 |
|---|---------------|---------------|---------------|---------------|---------------|---------------|
| Lottery's proportion of the net pension liability | 0.91995341% | 0.76161477% | 0.74815308% | 0.76619002% | 0.75882900% | 0.74724193% |
| Lottery's proportionate share of the net pension liability | \$ 20,850,027 | \$ 17,142,457 | \$ 16,869,023 | \$ 16,260,567 | \$ 15,073,593 | \$ 13,315,141 |
| Lottery's covered payroll (at measurement date) | \$ 6,612,770 | \$ 5,311,202 | \$ 5,185,935 | \$ 5,155,796 | \$ 5,070,849 | \$ 4,891,380 |
| Lottery's proportionate share of the net pension liability as a percentage of its covered payroll | 315.30% | 322.76% | 325.28% | 315.38% | 297.26% | 272.22% |
| Plan fiduciary net position as a percentage of the total pension liability | 52.8% | 52.5% | 51.8% | 51.9% | 55.0% | 58.6% |

Notes:

1.) The amounts presented for each fiscal year were determined as of June 30 measurement date prior to the fiscal year-end.

2.) Schedule is intended to show information for 10 years - additional years will be displayed as they become available.

RI Lottery
Schedule of the Lottery's Contributions
Employees' Retirement System Plan

| | <u>2020</u> | <u>2019</u> | <u>2018</u> | <u>2017</u> | <u>2016</u> | <u>2015</u> |
|--|--------------|--------------|--------------|--------------|--------------|-----------------|
| Statutorily determined contribution | \$ 1,899,769 | \$ 1,737,836 | \$ 1,320,896 | \$ 1,314,116 | \$ 1,219,209 | \$ \$ 1,183,029 |
| Contributions in relation to the statutorily determined contribution | 1,899,769 | 1,737,836 | 1,320,896 | 1,314,116 | 1,219,209 | 1,183,029 |
| Contribution deficiency (excess) | <u>\$ -</u> |
| Lottery's covered payroll | \$ 7,198,822 | \$ 6,612,770 | \$ 5,311,202 | \$ 5,185,935 | \$ 5,155,796 | \$ 5,070,849 |
| Contributions as a percentage of covered payroll | 26.39% | 26.28% | 24.87% | 25.34% | 23.65% | 23.33% |

Notes:

1.) Employers participating in the State Employee's Retirement System are required by RI General Laws, Section 36-10-2, to contribute an actuarially determined contribution rate each year.

2.) Schedule is intended to show information for 10 years - additional years will be displayed as they become available.

RI Lottery
Schedule of the Lottery's Proportionate Share of the Net OPEB Liability
State Employees' OPEB Plan

| Year Ended | June 30, 2020 | June 30, 2019 | June 30, 2018 |
|---|---------------|---------------|---------------|
| | | | |
| Measurement Date | June 30, 2019 | June 30, 2018 | June 30, 2017 |
| Lottery's proportion of the net OPEB liability | 0.91422568% | 0.76106927% | 0.74378532% |
| Lottery's proportionate share share of the net OPEB liability | \$ 3,990,381 | \$ 3,876,354 | \$ 3,863,547 |
| Lottery's covered payroll (at measurement date) | \$ 6,705,017 | \$ 5,308,395 | \$ 5,185,930 |
| Lottery's proportionate share of the net OPEB liability as a percentage of its covered payroll | 59.51% | 73.02% | 74.50% |
| Plan fiduciary net position as a percentage of the total OPEB liability | 33.57% | 26.25% | 22.38% |

Notes:

- 1.) The amounts presented for each fiscal year were determined as of June 30 measurement date prior to the fiscal year-end.**
- 2.) Schedule is intended to show information for 10 years - additional years will be displayed as they become available.**

RI Lottery
Schedule of the Lottery's Contributions
State Employees' OPEB Plan

| | <u>2020</u> | <u>2019</u> | <u>2018</u> |
|--|------------------|------------------|------------------|
| Statutorily determined contribution | \$ 477,641 | \$ 400,960 | \$ 317,442 |
| Contributions in relation to the statutorily determined contribution | 477,641 | 400,960 | 317,442 |
| Contribution deficiency (excess) | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> |
| (Component Unit's) covered payroll | \$ 7,182,571 | \$ 6,705,017 | \$ 5,308,395 |
| Contributions as a percentage of covered payroll | 6.65% | 5.98% | 5.98% |

Notes:

1.) Employers participating in the State Employee's Retirement System are required by RI General Laws, Section 36-10-2, to contribute an actuarially determined contribution rate each year.

2.) Schedule is intended to show information for 10 years - additional years will be displayed as they become available.

RHODE ISLAND LOTTERY
Notes to Required Supplementary Information
Year Ended June 30, 2020

Pension – Required Supplementary Information:

- **Schedule of the Lottery’s Proportionate Share of the Net Pension Liability – Employees’ Retirement System Plan**
- **Schedule of the Lottery’s Contributions – Employees’ Retirement System Plan**

The schedules are intended to present ten years of data. Additional years of data will be presented as they become available.

1. Actuarial methods and assumptions used to calculate the net pension liability of the participating employers

The actuarial methods and assumptions used to calculate the net pension liability of the participating employers are described in Note 9 to the financial statements. The following information is presented about factors that significantly affect trends in the amounts reported between years.

June 30, 2019 measurement date:

There were no changes in actuarial methods or assumptions reflected in the calculation of the net pension liability (asset) of the plans as of the June 30, 2019 measurement date compared to the June 30, 2018 measurement date.

June 30, 2018 measurement date:

There were no changes in actuarial methods or assumptions reflected in the calculation of the net pension liability (asset) of the plan as of the June 30, 2018 measurement date compared to the June 30, 2017 measurement date.

June 30, 2017 measurement date:

- Decreased the general inflation assumption from 2.75% to 2.50%;
- Decreased the nominal investment return assumption from 7.50% to 7.00%;
- Decreased the general wage growth assumption from 3.25% to 3.00%;
- Decreased salary increase assumptions; and
- Updated the post-retirement mortality tables to variants of the RP-2014 table. For the improvement scale, update to the ultimate rates of the MP-2016 projection scale.

June 30, 2016 measurement date:

There were no changes in actuarial methods or assumptions reflected in the calculation of the net pension liability of the plans as of the June 30, 2016 measurement date compared to the June 30, 2015 measurement date.

June 30, 2015 measurement date:

There were no changes in actuarial methods or assumptions reflected in the calculation of the net pension liability of the plans as of the June 30, 2015 measurement date compared to the June 30, 2014 measurement date.

RHODE ISLAND LOTTERY
Notes to Required Supplementary Information
Year Ended June 30, 2020

1. Actuarial methods and assumptions used to calculate the net pension liability (asset) of the participating employers (continued)

Benefit changes are reflected in the calculation of the net pension liability at the June 30, 2015 measurement date. The following is a summary of those benefit changes that resulted from the settlement of the pension litigation and the subsequent enactment of those settlement provisions by the General Assembly.

- Employees with more than 20 years of service at July 1, 2012 will increase their employee contribution rates to 11% for state employees and municipal general employees will contribute 8.25% (9.25% for units with a COLA provision) and participate solely in the defined benefit plan going forward – service credit accruals will increase from 1% to 2% per year.
- Members are eligible to retire upon the attainment of: age 65 with 30 years of service, 64 with 31 years of service, 63 with 32 years of service, or 62 with 33 years of service. Members may retire earlier if their RIRSA date is earlier or are eligible under a transition rule.
- Employees with more than 10 but less than 20 years of service at July 1, 2012 will receive an increased employer contribution to the defined contribution plan. Also, members who earn less than \$35,000 per year will not be required to pay the administrative fees to the defined contribution plan.
- Members who retired from a COLA eligible plan before July 1, 2012 will received a one-time cost of living adjustment of 2% of the first \$25,000 paid as soon as administratively possible.
- Retirees as of June 30, 2015 will receive two \$500 stipends; the interim cost of living increases will occur at 4 year rather than 5-year intervals.
- The COLA formula was adjusted to: 50% of the COLA is calculated by taking the previous 5-year average investment return, less 5.5% (5yr Return - 5.5%, with a max of 4%) and 50% calculated using previous year's CPI-U (max of 3%) for a total max COLA of 3.5%. This COLA is calculated on the first \$25,855, effective 01/01/16, and indexed as of that date as well. (The indexing formula is run annually regardless of funding level each year.)
- Minor adjustments were made to the actuarial reduction for employees choosing to retire early.

2. Actuarially determined contributions

Actuarially determined contributions are calculated as of June 30, three years prior to the fiscal year in which the contributions are reported. For example, the contribution rate for fiscal 2019 for the plan was based on a valuation performed as of June 30, 2016.

RHODE ISLAND LOTTERY
Notes to Required Supplementary Information
Year Ended June 30, 2020

Other Postemployment Benefits (OPEB) Plan – Required Supplementary Information:

- **Schedule of the Lottery’s Proportionate Share of the Net OPEB Liability – State Employees’ OPEB Plan**
- **Schedule of the Lottery’s Contributions – State Employees’ OPEB Plan**

1. Actuarial assumptions and methods used to calculate the net OPEB liability of the participating employers

The actuarial methods and assumptions used to calculate the net OPEB liability of the participating employers are described in Note 10 to the financial statements. The following information is presented about factors that significantly affect trends in the amounts reported between years.

June 30, 2019 measurement date:

The June 30, 2018 actuarial valuation rolled forward to the June 30, 2019 measurement date reflected a change in Excise Tax load on pre-65 liabilities from 11.0% to 9.5%.

June 30, 2018 Measurement date:

There were no changes in actuarial methods or assumptions reflected in the calculation of the net OPEB liability of the plan as of the June 30, 2018 measurement date compared to the June 30, 2017 measurement date.

June 30, 2017 Measurement Date:

Certain actuarial assumptions for State Employees were updated to match the assumptions used for State Employees in the pension valuation for the Employees’ Retirement System of Rhode Island (ERSRI) and the results of an actuarial experience investigation performed for ERSRI at June 30, 2016. Changes were made to the following assumptions:

- Merit and longevity portion of the salary increase assumption
- Rates of separation from active membership
- Rates of retirement
- Rates of disability
- The rate of wage inflation
- The mortality assumption
- The trend assumption
- Aging factors and health and inflation trends

The excise tax load on pre-65 liabilities was changed from 13.8% to 11.0%. The Patient Protection and Affordable Care Act includes an excise tax on high cost health plans beginning in 2022. The excise tax is 40% of costs above a threshold. The actual actuarial assumptions used in the most recent valuations assume that the plans will be subject to the excise tax in 2022.

2. Actuarially determined contributions

The annual required contributions for fiscal year 2020 were determined based on the June 30, 2017 valuation of the State Employees’ OPEB Plan.

RHODE ISLAND LOTTERY

Section II

Supplementary Information

Schedule 1 – Operating Revenue and Cost of Gaming Operations

RHODE ISLAND LOTTERY
Operating Revenue and Cost of Gaming Operations
Year Ended June 30, 2020

Schedule 1

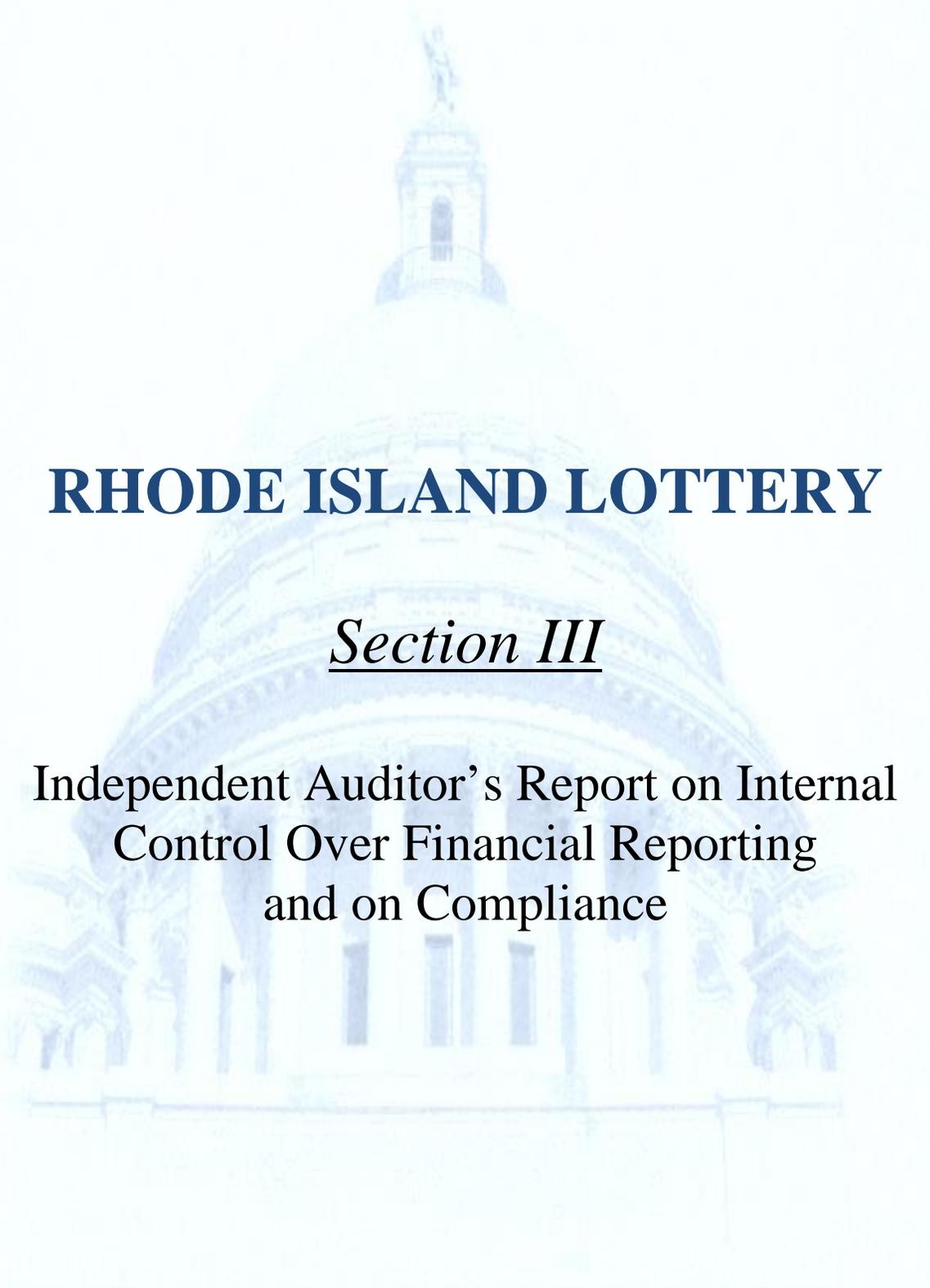
| | Revenue ⁽¹⁾ | Commissions | Prize Awards Expense | Unclaimed Prize Recovery | Cost of Tickets | Marketing/Advertising | Incentive Programs | Cost of Gaming Operations | Gross Profit |
|--|------------------------|-----------------------|-----------------------|--------------------------|-------------------|------------------------|---------------------|---------------------------|-----------------------|
| Games reported -- gross revenue | | | | | | | | | |
| On-line Games | | | | | | | | | |
| Keno | \$ 69,826,851 | \$ 9,077,909 | \$ 45,946,963 | \$ (288,454) | \$ - | \$ 399,132 | \$ - | \$ 55,135,550 | \$ 14,691,301 |
| Bingo | 1,155,938 | 149,988 | 823,120 | (6,733) | - | 969 | - | 967,344 | 188,594 |
| PowerBall [®] | 17,945,735 | 2,333,137 | 8,976,381 | (598,935) | - | 215,469 | - | 10,926,052 | 7,019,683 |
| Daily Numbers | 22,900,222 | 2,978,236 | 11,800,681 | (232,268) | - | 20,827 | - | 14,567,476 | 8,332,746 |
| Mega Millions [®] | 11,943,934 | 1,553,017 | 5,974,003 | (257,040) | - | 398,550 | - | 7,668,530 | 4,275,404 |
| Wild Money | 3,816,929 | 496,031 | 2,099,192 | (84,961) | - | 23,722 | - | 2,533,984 | 1,282,945 |
| Lucky for Life [®] | 4,853,934 | 630,535 | 2,635,881 | (148,465) | - | 81,757 | - | 3,199,708 | 1,654,226 |
| | <u>132,443,543</u> | <u>17,218,853</u> | <u>78,256,221</u> | <u>(1,616,856)</u> | <u>-</u> | <u>1,140,426</u> | <u>-</u> | <u>94,998,644</u> | <u>37,444,899</u> |
| Instant Tickets | 112,643,821 | 12,026,875 | 77,609,050 | (1,179,729) | 972,986 | 977,418 | - | 90,406,600 | 22,237,221 |
| iLottery ⁽⁴⁾ | 1,305,682 | 65,285 | 858,338 | - | - | 162,777 | - | 1,086,400 | 219,282 |
| Sports Book | 200,188,405 | 9,110,668 | 181,481,947 | (224,660) | - | 321,422 ⁽³⁾ | - | 190,689,377 | 9,499,028 |
| Games reported -- revenue net of related prize awards | | | | | | | | | |
| Video Lottery ⁽²⁾ | 352,833,794 | 136,485,046 | - | (750,054) | - | - | 3,990,072 | 139,725,064 | 213,108,730 |
| Table Games | 83,257,074 | 70,352,228 | - | (4,865) | - | - | - | 70,347,363 | 12,909,711 |
| Totals | <u>\$ 882,672,319</u> | <u>\$ 245,258,955</u> | <u>\$ 338,205,556</u> | <u>\$ (3,776,164)</u> | <u>\$ 972,986</u> | <u>\$ 2,602,043</u> | <u>\$ 3,990,072</u> | <u>\$ 587,253,448</u> | <u>\$ 295,418,871</u> |
| <u>Lottery games commissions - detail by game</u> | | | | | | | | | |
| | | <u>Video</u> | <u>Table Games</u> | <u>Sports Book</u> | | | | | |
| Facilities | \$ | 98,029,764 | \$ 69,519,657 | \$ 3,091,457 | | | | | |
| Technology Providers | | 24,048,757 | - | 5,819,211 | | | | | |
| Central Communications Provider | | 8,820,845 | - | - | | | | | |
| Towns | | 5,116,090 | 832,571 | 200,000 | | | | | |
| Narragansett Indian Tribe | | 469,590 | - | - | | | | | |
| Total | \$ | <u>136,485,046</u> | <u>\$ 70,352,228</u> | <u>\$ 9,110,668</u> | | | | | |

(1) See note 2 (c) for details of revenue accounting policy.

(2) See note 2 (c) (3) for detail of gross video lottery terminal activity.

(3) Marketing expenses specifically for Sports Book are allocated as part of the overall allocation of revenue to the State and casino facilities.

(4) iLottery consisted of eInstants and iKeno at June 30, 2020.



RHODE ISLAND LOTTERY

Section III

**Independent Auditor's Report on Internal
Control Over Financial Reporting
and on Compliance**



Office of the Auditor General

State of Rhode Island - General Assembly
Dennis E. Hoyle, CPA - Auditor General

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

Joint Committee on Legislative Services, General Assembly, State of Rhode Island:

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Rhode Island Lottery (Lottery), an enterprise fund of the State of Rhode Island, as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, and have issued our report thereon dated October 23, 2020.

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 (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control.

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

Our consideration of internal control 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 a deficiency in internal control described in the accompanying Section IV – *Findings and Management Comments*, as Finding 2020-1 that we consider to be a significant deficiency.

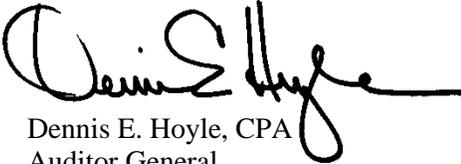
Joint Committee on Legislative Services, General Assembly, State of Rhode Island

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, and contracts, noncompliance with which could have a direct and material effect on the financial statements. 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*.

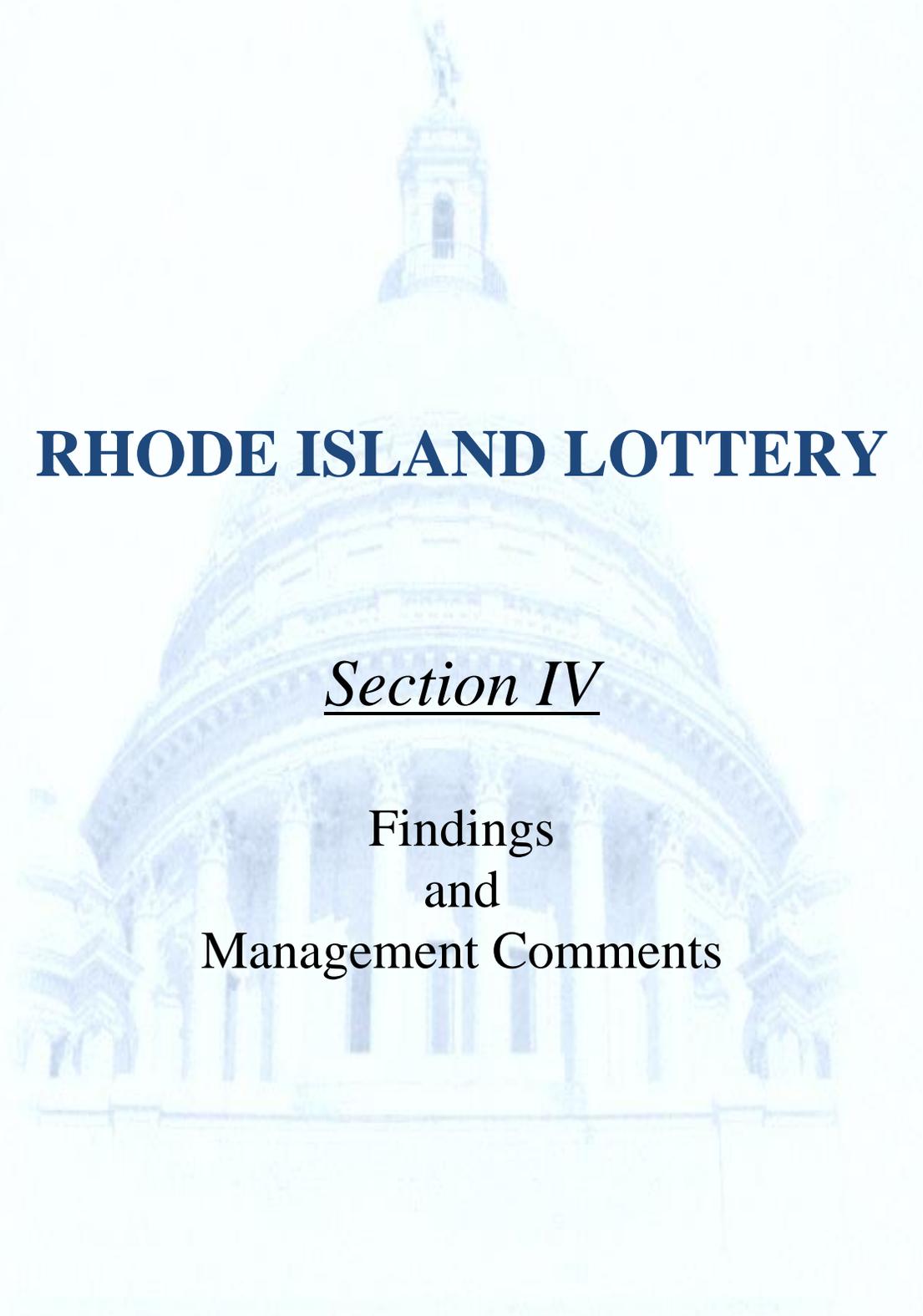
Purpose of this Report

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.



Dennis E. Hoyle, CPA
Auditor General

October 23, 2020



RHODE ISLAND LOTTERY

Section IV

Findings
and
Management Comments

CONTROLS OVER MOBILE SPORTS BETTING AND iLOTTERY GAMING ACTIVITY

Background: The Lottery implemented mobile sports betting in September 2019 allowing patrons to wager in RI Sportsbook (“sportsbook”) from anywhere in the State. Previously, only in-person sportsbook wagering was permitted at the Twin River casinos. In April 2020, the Lottery implemented iLottery which currently allows both mobile and on-line wagering for iKENO and eInstant games by registered patrons within the State borders.

The Lottery obtained pre-implementation certifications of these new gaming options to ensure that they would function as designed upon introduction to the public. The Lottery also implemented reconciliation controls to ensure the completeness of reported financial activity. Review of the gaming system contractor’s IT security policies and procedures over the new systems continues.

Criteria: Sportsbook, including mobile wagering, and iLottery are more technology advanced gaming options. Multiple third parties are utilized by the gaming system provider to administer the overall game functionality (i.e., “book-maker”, patron eWallet cash settlement intermediary). The Lottery only has a contractual relationship with the system technology provider; however, controls provided by the subcontractors are integral to the overall control structure for Sportsbook and iLottery games. Gaming functionalities performed by other third parties outside of the Lottery’s direct contract with the technology provider and gaming facility host require further consideration of the operational and technological risks of these games. This consideration may identify additional control assurances or specific reporting needed from contractors involved with the operation of these games.

As its gaming environment becomes more complex, the Lottery must continue to implement comprehensive controls and monitoring processes to address the unique operational characteristics and related risks of these gaming options. The Lottery now needs to continue implementation of a comprehensive “internal audit” functionality for these games which focuses on operational controls and game monitoring procedures.

This process will involve identifying all data, information, and control assurances (from all parties involved in the operation of these new games and wagering functionality) needed to implement the necessary monitoring and audit procedures to ensure the reliability of financial reporting information.

Condition: The Lottery’s controls and monitoring processes to address the unique operational characteristics and related risks of the mobile sportsbook and iLottery gaming options need further enhancement. Upon inquiry, the Lottery obtained Service Organization Control (SOC) reports for the vendors that support the “wallet” and cash settlement functionality of the gaming applications. Those reports referenced the involvement of various “sub-service” organizations which also must be considered in evaluating and administering a comprehensive control structure for Sportsbook and iLottery. Additionally, an independent review of the controls over the “book-making” operations of the sports gaming system was not available for our audit period. We were informed that a contractually required SOC report of sports gaming operations by the technology provider is expected in the future, however, no such review of the system technology provider’s controls was available for the fiscal 2020 period. These are critical control points of the sportsbook operations that require additional consideration by the Lottery.

For both mobile sports betting and iLottery, risks are increased through external devices (phones and computers) accessing the gaming platforms. The Lottery’s challenges in monitoring diverse gaming activities include the overall cyber-security threats common to all information technology as well as the more specific risks associated with rapid technology deployments that provide new gaming options.

For all Lottery gaming activities prior to 2020, the cash collection and reconciliation functions were separate from the technology provider that operated the system. The cash settlement functions for mobile

Sportsbook and iLottery are substantially different from other games and involves the technology provider as well as other external vendors. The Lottery is the custodian of patron eWallets for mobile sportsbook; however, this requires a significant amount of manual reconciliation for the Lottery. The Lottery intends to transfer this function to the sportsbook host (Twin River), as was initially envisioned, so that the cash settlement process can be managed with other sportsbook activity at the casinos. We concur that this would strengthen controls over the daily cash settlement and financial reporting functions for mobile sportsbook activity.

In addition, periodic random sampling of sportsbook odds and final event results recorded within the sports gaming system should be tested and compared to other external sources. This data becomes the basis for revenue and expense activity recorded within the Lottery's financial statements.

Cause: Both mobile sports betting and iLottery are operationally different and incorporate new technologies compared to other Lottery gaming options. Additionally, implementation of mobile gaming soon after sportsbook significantly increased the pace of technological and operational challenges being managed by the Lottery in recent years.

It may be appropriate for the Lottery to engage a consultant with specific experience to guide the development of a comprehensive "internal audit" functionality appropriate for sportsbook and iLottery gaming activities. This may include building automated and independent data accumulation and matching processes which would enhance the reliability of data used for financial reporting purposes and facilitate other monitoring efforts.

Effect: Weaknesses in controls and monitoring processes exist for the mobile sportsbook and iLottery gaming options.

RECOMMENDATIONS

- | | |
|-----------|---|
| 2020-1(a) | Develop a comprehensive "internal audit" functionality appropriate for sportsbook gaming and iLottery activities. Consider engaging a consultant to guide the development of this process. |
| 2020-1(b) | Continue with the planned transition of the custodianship of sportsbook eWallets to the sportsbook host, Twin River, to streamline and enhance controls over the mobile sportsbook cash settlement process. |

Auditee Views and Corrective Action Plan:

The Lottery strongly disagrees with the finding of "significant deficiency" related to mobile sports betting and iLottery. More pointedly, there are no specific examples or incidents referenced in Finding 2020-1 where Lottery's reporting was incorrect or inaccurate.

Over the last fiscal year, the Lottery has made substantial enhancements with internal controls in response to the introduction of mobile and online service delivery channels. The Lottery agrees that mobile applications and digital technology require modifications to the control environment to address technological advances and changes related to the mobile environment, and the Lottery has made it a priority to develop these monitoring and oversight procedures as these new systems are operationalized. Further, the Lottery continues to review, modify, and expand such monitoring and oversight as needed based on the evolution of these delivery channels. The operational environment for mobile applications requires procedures different than other Lottery lines of business whereby operational systems, cash collections, reconciliations, and regulatory oversight are performed by separate entities. The traditional model for such functions simply does not translate from an operational standpoint. For example, with iLottery, the fraud, funding, and

customer service procedures handled by the systems provider are based on the provider's resources and expertise in the industry, as well as the technological development and deployment of this specific delivery channel. Moreover, all ewallet deposits and withdrawals are through independent, experienced companies with trustworthy reputations.

More importantly, the iLottery and sports betting systems (as well as all of the Lottery's systems) have been—and continue to be—audited from an IT security, system functionality, and financial reporting standpoint internally by the Lottery and externally using industry-leading gaming and IT security auditing firms. Likewise, the Lottery conducts—and monitors compliance through—internal reviews to identify and manage risks, including comprehensive reviews of system controls related to mobile sports betting and iLottery. These internal and external reviews occur on a scheduled basis and utilize industry standards. The Lottery also continuously monitors the gaming contractor's internal and external assessments as these pertain to IT security reviews and assessments.

Given the current fiscal uncertainty with the state budget, it would be unrealistic to believe that the Auditor General's suggestion with respect to additional resources for the internal audit functions will be allocated in the next fiscal year. Nonetheless, the Lottery will continue to adjust and tighten its oversight processes.

In reference to SOC (Service Organization Control) reports, the Lottery provided SOC reports from the major independent companies through which all ewallet deposits and withdrawals are made. The Lottery also provided a SOC report for its gaming system provider for its shared services systems for iLottery. To the extent possible, the Lottery has, and will continue to, pursue service entity reports through the Lottery's contracted sports betting system provider, and any integral entities, but it should be noted that the Lottery does not have contractual relationships with third-party vendors providing services to the system provider, and holds the system provider responsible for the subcontracted services.

With respect to the Auditor General's suggestion that the Lottery should conduct "periodic random sampling of sportsbook odds and final event results," the Lottery does, in fact, conduct such reviews. In particular, with retail, the Lottery tests paid tickets over \$10,000, as well as randomly selected tickets, and odds and final event results are the same throughout the system.

Additionally, the Lottery has worked diligently since inception of both sports betting and iLottery to provide complete, accurate, and timely financial reporting from system implementation deadlines and implemented procedures related to system reports and cash reconciliation procedures.

Lastly, the sports betting funding and cash custodial procedures were anticipated to be assumed by Twin River Casinos as of March 2020. However, due to the global COVID-19 pandemic, the Casinos closed and transfer of this function from the Lottery was delayed. The Casinos were shuttered for three (3) months and now are operating at approximately fifty (50%) capacity, with a reduced workforce. The transfer process currently is in progress, and additional procedures will be implemented for mobile sports betting to address daily cash reconciliation to system reports as needed.

Auditor response:

We acknowledge that these mobile/remote gaming options are new and related control procedures continue to evolve. Despite the contracted nature of the Sportsbook and iLottery gaming functions (including subcontracts), the Lottery ultimately remains responsible for maintaining a comprehensive monitoring process over gaming operations and financial reporting information. The focus of our finding is on the

design and implementation of appropriate control procedures rather than a known financial statement misstatement. Our recommendations are reflective of the likely growth in these modes of gaming over the next few years and the need for controls and monitoring procedures that are specific to the unique and complex operational aspects of the games. As a point of reference, the Lottery made a substantial investment in monitoring and oversight procedures with the advent of table games a few years ago, which was in response to the unique operational aspects of those games.

Management Comment 2020-1

(repeat comment)

INFORMATION TECHNOLOGY VENDOR CONTRACTING

The Lottery has a long-term contract with its gaming systems contractor to support multiple aspects of the Lottery's overall gaming activities including on-line games operation and the central communications network for video lottery as well as other functionalities. While the gaming systems contractor is required to maintain and support the systems to the satisfaction of the Lottery, the contract is not sufficiently explicit regarding specifications for systems security. Since the inception of the Lottery, the gaming systems contracts have specified system replacements (new hardware and application) at defined dates. At times, addressing certain identified issues was deferred until implementation of the next scheduled system upgrade.

The Lottery should seek to strengthen contract language to enhance its ability to ensure continued security over critical Lottery technology supporting its gaming activities. The Lottery's objective is to ensure that all the IT infrastructure supporting gaming activities meets industry best practices from an IT operations and system security perspective. With rapid changes in information technology, contract terms should be strengthened to more specifically require that the vendor maintain the systems to meet continually evolving industry best practices including IT security standards and requirements.

As seen in the recent implementation of sports betting, the system provider utilizes subcontractors to provide essential components of the overall gaming functionality. These circumstances require that the Lottery be able to obtain certain assurances regarding the operating effectiveness of controls within these subcontracted entities. The Lottery's contract with its gaming systems provider should include provisions that permit and facilitate all required assurances.

In a long-term contract, anticipating the appropriate pace and schedule of desired or required technology updates is difficult, particularly with both technology and related risks moving at a near exponential rate. As the Lottery and the State's leaders entertain a potential contract extension, enhanced consideration should be given to ensuring, through specific contract terms, continued system performance and adherence to continually evolving system security standards.

RECOMMENDATION

MC-2020-1 Strengthen contract terms to enhance the Lottery's ability to ensure the gaming systems contractor maintains critical technology supporting its gaming activities to meet continually evolving industry best practices and IT security standards and requirements.

Auditee Views and Corrective Action Plan:

The Lottery has previously addressed this concern with the gaming system provider supporting the central system via the Second Letter Agreement dated August 20, 2018. Additionally, the gaming system provider has been addressing issues and patching the systems where possible. The Lottery anticipates that older Legacy systems issues will be addressed in the new gaming system provider agreement, currently under consideration before the Legislature. Lastly, sports betting and iLottery systems have also been receiving patches and updates from the vendor.

Management Comment 2020-2

(repeat comment)

DISASTER RECOVERY

During fiscal 2020, the Lottery's gaming systems contractor reviewed its disaster recovery process including the likely response time to restore operations in the event of a service interruption. This was in follow-up to an incident which occurred during fiscal 2019 at the Lottery's Data Center when the gaming systems were out of service for approximately two hours affecting both on-line games and video lottery terminal activity. In the event of an incident, the system is designed to shift processing to a back-up facility to avoid or minimize any interruption of service. Another incident occurred during December 2019 where the Sportsbook system was unavailable for six hours due to a data storage configuration issue which idled the system.

The Lottery has been advised by the gaming systems contractor of the likely required response time to restore operations at the alternate site. The Lottery should evaluate whether that response timeline is sufficient to meet its operational needs. With the advent of sports gaming, iLottery and other time sensitive applications, service disruptions are potentially more significant from an operations, revenue loss, and customer experience/satisfaction perspective. The Lottery should ensure that future contracts are specific to disaster recovery expectations deemed satisfactory for the industry.

RECOMMENDATION

MC-2020-2 Evaluate the sufficiency of the disaster recovery timeline capabilities of the gaming systems contractor from an operations sustainability perspective.

Auditee Views and Corrective Action Plan:

The incident that occurred during fiscal year 2019 was a rare, emergency event involving a UPS (uninterruptable power supply) fire.

Since that incident, the Lottery has investigated the issue and ensured that its gaming system contractor made improvements to its system takeover process and procedures to minimize downtime, where possible. Likewise, the Lottery continues to monitor and request further improvements, if available. Further, the gaming system provider has system uptime requirements that it must meet in its contract or it can be subject to liquidated damages. As a result, the gaming system contractor has made improvements to its takeover process and performs regularly scheduled takeover tests throughout the year. The Lottery engaged external firms to review the recovery plans. The gaming system contractor has also performed various takeover tests on all the systems. The Lottery has made additional requests to its central system contractor to continue to make improvements to the takeover process for the sports betting system. The Lottery continues to monitor the gaming system provider with regards to disaster recovery and will continue to ensure that the gaming system provider meets its contractual obligations.

COMPULSIVE AND PROBLEM GAMBLING PROGRAM

The Lottery has established a Compulsive and Problem Gambling Program (the Program) pursuant to General Law Section 42-61.2-14. The program is financially supported by a mandated minimum contribution of not less than \$125,000 per year from the licensed casino facilities with the Lottery determining the actual required contribution amount annually. Total costs for the program in fiscal 2020 approximated \$490,000 and were reimbursed by the Twin River casinos.

The Lottery's accounting policy for this program has been to reflect it as pass-through activity - any amounts pending disbursement and reimbursement are recorded on the balance sheet as a liability and an asset, respectively, but program activity is not reflected as expenses and other non-operating revenue on the Lottery's operating statement. Part of the problem gambling program expenses include a full-time state employee who administers the program and whose salary and related benefit costs are reimbursed by Twin River Casinos. Other program expenditures include contract expenditures for compulsive gambling hotline, specific counseling activities for uninsured or underinsured individuals in need of assistance, and program advertising.

We believe the Lottery should record the problem gambling program activity (program expenses and non-operating revenue reimbursements from the casino operator) on the Lottery's operating statement since it provides the administrative function of the program. This would enhance transparency and more appropriately reflect all the Lottery's operating costs on its financial statements. Since program costs are fully reimbursed by the casino operator, there is no effect on net income and the amount transferred to the State's General Fund.

RECOMMENDATION

MC-2020-3 Include all problem gambling program activity (expenses and non-operating revenue reimbursement) on the Lottery's annual operating statement.

Auditee Views and Corrective Action Plan:

Based on the Auditor General's comment, there does not appear to be an issue with the current practices, but, rather, that there is an opportunity to increase transparency with the Compulsive and Problem Gambling Program financial reporting. While the Lottery agrees that its current practices are adequate, the Lottery will report problem gambling expenses and Twin River Casinos' non-operating revenue reimbursements in accordance with the proposed methodology in Management Comment 2020-3. Prior accounting through the balance sheet for these pass-through expenses ended with this report.