

NORTH CAROLINA EDUCATION LOTTERY

FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2020 and 2019

(And Report of Independent Auditor)

Financial Statement Audit Report of the
North Carolina Education Lottery
For the Years Ended June 30, 2020 and 2019

Performed under contract with the
North Carolina Office of the State Auditor
Beth A. Wood, CPA

NORTH CAROLINA EDUCATION LOTTERY

Table of Contents

	<u>Page</u>
Report of Independent Auditor	1 - 2
Management's Discussion and Analysis.....	3 - 12
Statements of Net Position	13
Statements of Revenues, Expenses, and Changes in Net Position	14
Statements of Cash Flows	15
Notes to Financial Statements	16 - 49
Required Supplementary Information – Schedule of the Proportionate Share of Net Pension Liability – Teachers' and State Employees' Retirement System	50
Required Supplementary Information – Schedule of Contributions – Teachers' and State Employees' Retirement System	51
Required Supplementary Information – Schedule of Proportionate Share of Net OPEB Liability and Schedule of Contributions – Retirement Health Benefit Fund	52 - 53
Required Supplementary Information – Schedule of Proportionate Share of Net OPEB Liability and Schedule of Contributions – Disability Income Plan of NC.....	54 - 55
Report of Independent Auditor on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	56 - 57

Report of Independent Auditor

To the Commissioners
North Carolina Education Lottery
Raleigh, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of the North Carolina Education Lottery (the “NCEL”), a major enterprise fund of the State of North Carolina, which comprise of statements of net position as of June 30, 2020 and 2019, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to financial statements, which collectively comprise the NCEL’s basic financial statements as listed in the table of contents.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 audits 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 NCEL’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 financial statement presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the NCEL as of June 30, 2020 and 2019, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Nature of Reporting Entity

As discussed in Note 2, the financial statements present only the NCEL and do not purport to and do not present fairly the financial position of the State of North Carolina as of June 30, 2020 and 2019, and the changes in its financial position and its cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and the Required Supplementary Information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a required 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 Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 16, 2020, on our consideration of the NCEL's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the NCEL's internal control over financial reporting and compliance.

Cherry Roubert LLP

Raleigh, North Carolina
October 16, 2020

NORTH CAROLINA EDUCATION LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

The following is a discussion and analysis of the financial performance of the North Carolina Lottery Commission [aka, North Carolina Education Lottery (NCEL)] for the fiscal years ended June 30, 2020, 2019, and 2018 and should be read in conjunction with the financial statements, including the footnotes. This report consists of three parts: management's discussion and analysis, the basic financial statements, and the notes to the financial statements. Included below and on the following pages are the financial highlights, summary of contributions to the State, and summary results of operations for the fiscal years ended June 30, 2020, 2019, and 2018.

Financial Highlights

For fiscal year 2020, gross ticket sales totaled \$3.016 billion representing a \$156 million increase over fiscal year 2019. Total operating income was \$731 million, which represented an increase of \$20 million over fiscal year 2019. Other significant financial highlights included the following:

- North Carolina General Statute Section 18C-164(a) requires the NCEL to transfer net proceeds from operations and any prior year surplus to the State of North Carolina at least four times a year. In fiscal year 2020, the sum total of these cash transfers was \$745.3 million. Total cash transfers for fiscal years 2019 and 2018 were \$665.6 million and \$645.8 million, respectively.
- Awarded \$1 million or more to an NCEL player for the 537th time.
- Provided customer service to our 7,015 retailers on a regular basis.
- Released 54 new instant scratch-off games into the marketplace generating gross instant ticket sales of \$2.1 billion.

Overview of the Financial Statements

This financial report is designed to inform the public and other interested parties of the financial results of the NCEL and show its accountability in meeting the legislated mandate to generate funds to further the goal of providing enhanced educational opportunities. Accordingly, the focus of the financial statements is to determine funds available for payment to the State's Education Lottery Fund. It is important to note that most financial statement balances have a direct or indirect relationship to revenue. As lottery sales increase, the amount paid to the State's Education Lottery Fund also increases. Similarly, increases in revenues generally result in direct increases to cost of sales including, but not limited to, prize expense, retailer commission expense and gaming system vendor charges.

The NCEL is a major enterprise fund of the primary government of the State of North Carolina. The financial statements were prepared on the accrual basis of accounting in a manner similar to a private business entity. The principal operating revenues of NCEL are sales of lottery products, by contracted retailers, to the general playing public. Operating expenses include the cost of prizes, retailer commissions, gaming system vendor charges, personnel, and other administrative expenses.

Included in this report are the Statements of Net Position as of June 30, 2020 and 2019, the Statements of Revenues, Expenses, and Changes in Net Position for the years ended June 30, 2020 and 2019, and the Statements of Cash Flows for the years ended June 30, 2020 and 2019.

NCEL transfers its net revenues to the Office of State Budget and Management (OSBM) for credit to the Education Lottery Fund. Education Lottery funds are distributed by OSBM based on the budgeted distribution of lottery net revenue as recommended by the General Assembly.

NORTH CAROLINA EDUCATION LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

Total Assets

Total assets at the end of fiscal year 2020 were \$140 million compared to \$135 million at the end of fiscal year 2019, representing an increase of \$5 million.

Current assets decreased from \$58.4 million as of June 30, 2019 to \$57.9 million as of June 30, 2020, representing a decrease of \$0.5 million. This decrease resulted from a decrease in Accounts Receivable that stemmed directly from the timing and frequency of funds transfers.

Current assets were also affected by a \$16.3 million decrease in retailer accounts receivable. Retailer accounts receivable primarily represents amounts due from retailer for ticket sales less commissions and prizes paid by the collections from lottery retailers at fiscal year-end.

Pooled cash consists of deposits held by the State Treasurer in the State Treasurer's Short-Term Investment Fund (STIF). The STIF has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and may withdraw cash at any time without prior notice or penalty. All deposits are combined with other state agencies and invested by the State Treasurer until needed to cover disbursements. Investments are limited to those authorized for the State's General Fund, pursuant to NC General Statute 147-69.1. Interest earned of \$1.16 million on these balances is recorded as nonoperating revenue. Earnings on the accounts are credited on a monthly basis. The allocable share of the revenues arising from State Treasurer's Securities Lending Collateral program transactions are also included as nonoperating revenue.

The NCEL's investment in capital assets, net of accumulated depreciation in 2020 was \$2.5 million representing a \$0.5 million decrease from 2019. The investment in capital assets includes game equipment, data processing equipment, telephone equipment, software and fixtures. The capitalization of all items including equipment, computers, and furniture follows the Office of the State Controller's (OSC) policy. NCEL defines capital assets as assets with an initial unit cost of \$5,000 or greater and an estimated useful life of two or more years – except in the case of software where the initial unit cost threshold is \$100,000. Capital assets are carried at cost less accumulated depreciation.

Additional information on the NCEL's capital assets can be found in Notes 2F and 5D to the financial statements.

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

The activity for capital assets for the year ended June 30, 2020 was (in thousands):

<u>Category</u>	<u>Balance June 30, 2019</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2020</u>
Capital assets, depreciable				
Furniture	\$ 49	\$ -	\$ -	\$ 49
Equipment	5,058	758	800	5,016
Motorized equipment	80	-	-	80
Computer software	1,010	-	-	1,010
Total capital assets, depreciable	<u>6,197</u>	<u>758</u>	<u>800</u>	<u>6,155</u>
Less accumulated depreciation for:				
Furniture	29	-	-	29
Equipment	2,607	400	110	2,897
Motorized equipment	81	-	-	81
Computer software	480	127	-	607
Total accumulated depreciation	<u>3,197</u>	<u>527</u>	<u>110</u>	<u>3,614</u>
Total capital assets, depreciable, net	<u>3,000</u>	<u>231</u>	<u>690</u>	<u>2,541</u>
Capital assets, net	<u>\$ 3,000</u>	<u>\$ 231</u>	<u>\$ 690</u>	<u>\$ 2,541</u>

Deferred Outflows of Resources

The NCEL recognized deferred outflows of resources as related to pensions and retiree medical insurance during fiscal year 2020, fiscal year 2019, and fiscal year 2018. More information on deferred outflows can be found in Notes 9 and 10 of the notes to the financial statements.

Total Liabilities

Total current liabilities for the NCEL were \$64 million as of June 30, 2020 increasing by \$2 million from 2019. The increase in current liabilities mainly resulted from an increase in accounts payable. This increase can be attributed to the timing of transactions encountered in the normal course of business.

Noncurrent liabilities include Accrued Paid Time Off or Compensated Absences. A liability is recorded to reflect the balances for unpaid Paid Time Off (PTO) earned, which is provided to employees for use whenever vacation, sick leave, personal leave or bereavement leave is requested and approved. Current and noncurrent liability for Accrued Paid Time Off is shown below in thousands.

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long-Term Portion</u>
<u>\$ 2,042</u>	<u>\$ 2,101</u>	<u>\$ 1,661</u>	<u>\$ 2,482</u>	<u>\$ 105</u>	<u>\$ 2,377</u>

Noncurrent liabilities also includes the present value of the annuity contracts that fund the long-term installment prizes that are due to NCEL annuity prize winners that will be paid after June 30, 2021.

NORTH CAROLINA EDUCATION LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

Deferred Inflows of Resources

The NCEL recognized deferred inflows of resources as related to pensions and retiree medical insurance during fiscal year 2020, fiscal year 2019, and fiscal year 2018. More information on deferred inflows can be found in Notes 9 and 10 of the Notes to the Financial Statements.

Net Position and Changes in Net Position

As required in the North Carolina State Lottery Act, each month, twenty percent of the previous month's lottery sales is transferred to the NC Education Lottery Fund at the Office of State Budget and Management. Additional quarterly transfers are made to move any additional net income to the Office of State Budget Management. At year-end, net position is (\$44,698) for the NCEL. This represented no change from fiscal year 2019. Current net position of (\$44,698) resulted from a previous adjustment to net pension liability and the recognition of other post-employment benefits (OPEB) liabilities. More information about these changes can be found in Notes 9 and 10 of the Notes to the Financial Statements.

Condensed Statement of Net Position (in thousands)

	2020	2019	2018
ASSETS			
Total Current Assets	\$ 57,873	\$ 58,420	\$ 70,053
Noncurrent Assets	79,825	74,017	71,938
Capital Assets, Depreciable (Net)	2,541	3,000	2,063
Total Assets	<u>140,239</u>	<u>135,437</u>	<u>144,054</u>
Deferred Outflows of Resources	<u>8,080</u>	<u>7,861</u>	<u>6,743</u>
Liabilities			
Total Current Liabilities	64,189	62,234	69,830
Noncurrent Liabilities	117,257	110,886	114,129
Total Liabilities	<u>181,446</u>	<u>173,120</u>	<u>183,959</u>
Deferred Inflows of Resources	<u>11,571</u>	<u>14,876</u>	<u>11,536</u>
Net Position			
Investment in Capital Assets	2,541	3,000	2,063
Restricted	36	27	108
Unrestricted	<u>(47,275)</u>	<u>(47,725)</u>	<u>(46,869)</u>
Total Net Position	<u>\$ (44,698)</u>	<u>\$ (44,698)</u>	<u>\$ (44,698)</u>

NORTH CAROLINA EDUCATION LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

Current liabilities consist of "Due to the State" in the amount of \$27.7 million. This amount represents the remaining amount of the "Net Revenues" and "50% of Unclaimed Prizes" for fiscal year 2020 not yet transferred to the State of North Carolina as of June 30, 2020. These funds will be transferred to the State during fiscal year 2021. Additional information on "Due to the State" is found in Note 6C to the financial statements.

Revenues

Operating revenues consist of gross sales (net of bad debt), fees, and licenses.

Sales

The gross lottery ticket sales for fiscal year 2020 totaled \$3.016 billion as compared to \$2.860 billion for fiscal year 2019 and \$2.605 billion for fiscal year 2018. This represents an increase of \$157 million from 2019 and \$255 million from 2018.

Gross instant ticket sales were \$2.089 billion for fiscal year 2020 compared with \$1.909 billion for fiscal year 2019 and \$1.783 billion for fiscal year 2018, an increase of approximately \$180 million from fiscal year 2019 and approximately \$306 million from fiscal year 2018. The increase in instant ticket sales in fiscal year 2020 was driven by growth at the \$5, \$10 and \$20 price points, which combined, experienced 12% increases over the previous year. The introduction of the first \$25 game, Extreme Cash in March, was also a significant contributor to the instant ticket growth. The first-of-its-kind \$25 game featured prizes that started at \$40 and resulted in sales of \$88 million in the four months that it was on sale in FY20. The best-selling game of the year was the \$30 game \$300 Million Supreme Riches, which accounted for \$192 million in sales. The \$5 price point was the top selling price point in FY20 accounting for \$452 million in sales with a growth rate of 15% year over year. This growth can be attributed to a strong lineup of games throughout the year led by the Big Spin, \$500 Loaded and 20X the Cash.

Draw game sales were \$927 million for fiscal year 2020 compared to \$951 million for fiscal year 2019 and \$829 million for fiscal year 2018, representing a \$24 million decrease compared to fiscal year 2019 and a \$98 million increase over fiscal year 2018. The decline in sales was driven by the multi-state jackpot games, Mega Millions and Powerball. Combined these two games were down 41% year over year. This loss can be attributed to lower than average jackpots for both games. Mega Millions loss was due to the high performance the previous year which included a record setting \$1.5 billion jackpot. Our in-state rolling jackpot game, Cash 5 grew at a healthy rate of 6% year over year due to a full year of sales following a game change that was made back in November of 2018.

The numbers games, Pick 3 and Pick 4 continued their recent trend of strong performance, recording 14% growth year over year. The two games combined added \$585 million in sales and are by far the top performing draw games, accounting for over 63% of draw game sales in the state.

The NCEL's newest draw game, Keno, continued to grow at a significant rate in its second full year of sales. A number of updates were made to the Keno game and to its distribution over the course of the year. Those updates resulted in growth of 56% year over year, and sales of \$66 million. Some of that contributed to Keno's strong performance included shortening draw times, increasing the number of outlets that sell the game and implementing a Multiplier add-on.

The remaining draw game in the portfolio, Lucky for Life recorded sales that were flat year over year. This is partially attributed to the lack of promotions or Marketing / Advertising support that were dedicated to the game throughout the year.

NORTH CAROLINA EDUCATION LOTTERY

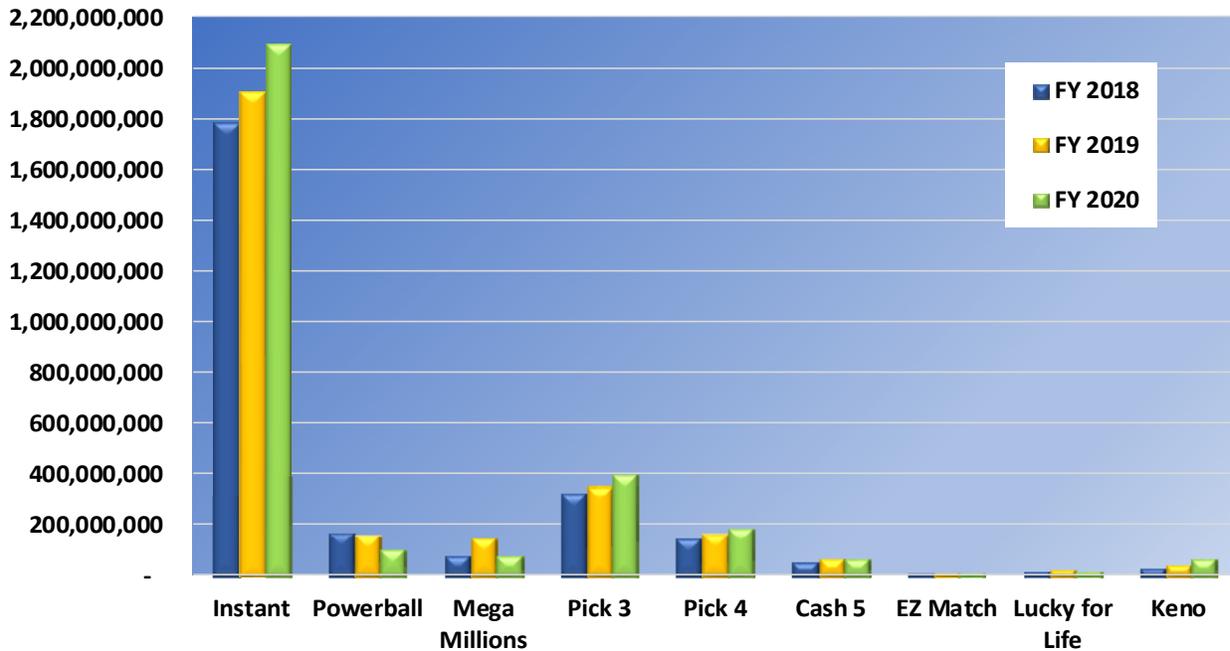
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

The sales of draw games via the Online Play channel grew significantly year over year. Sales of the four draw games offered online, Powerball, Mega Millions, Cash 5 and Lucky for Life, grew by 83% year over year to \$25.3 million or 9.1% of sales for those particular games. Sales accelerated through the end of the fiscal year as more and more players took advantage of the platform to purchase tickets during the pandemic.

The following chart depicts the distribution of sales by product for the fiscal years ended June 30, 2020, 2019, and 2018.

SALES BY GAME FY 2018 TO FY 2020 COMPARISON



Nonoperating Revenues mainly consist of investment earnings on Short-Term Investment Fund (STIF) accounts and security lending transactions.

Expenses

Section 18C-162, NC General Statute stipulates that no more than 8% of the total annual revenues shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed 1% of the total annual revenues.

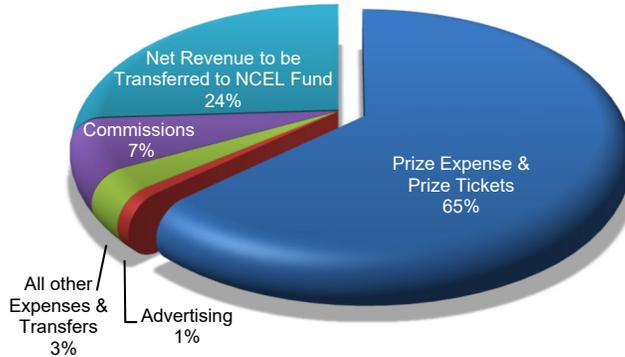
NORTH CAROLINA EDUCATION LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

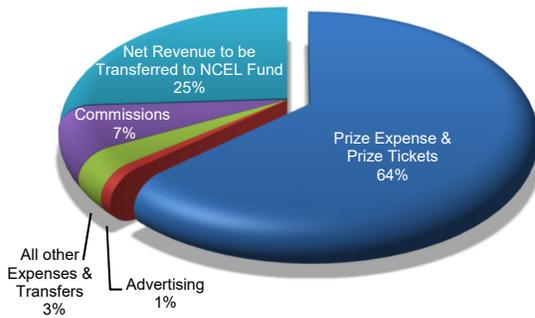
June 30, 2020 and 2019

The following charts show the major components of NCEL operating expenses and transfers as a percentage of total revenues for the fiscal years ended June 30, 2020, 2019, and 2018.

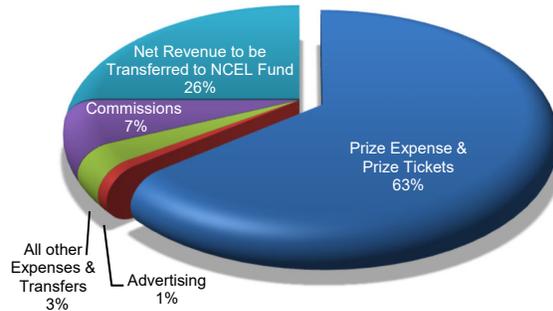
DISTRIBUTION OF REVENUES FY 2020



DISTRIBUTION OF REVENUES FY 2019



DISTRIBUTION OF REVENUES FY 2018



Prizes, commissions, and gaming vendor charges all directly relate to sales. As expected, as sales have increased so have these expenses. In fiscal year 2020, total gaming expenses which consist of prizes, retailer commissions, and gaming vendor charges (gaming system services), totaled \$2,221 million as compared to \$2,090 million and \$1,874 million for fiscal years 2019 and 2018, respectively. Other operating expenses, which consist of advertising and marketing, salary and benefits, professional fees, rent, maintenance, depreciation, and general administrative expenses increased to \$70.1 million in fiscal year 2020, as compared with \$64.1 million and \$64.2 million for fiscal years 2019 and 2018, respectively. Other operating expenses represented 2.3%, 2.2%, and 2.5% of total operating revenues in fiscal years 2020, 2019, and 2018, respectively.

NORTH CAROLINA EDUCATION LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

Condensed Statements of Revenues, Expenses, and Changes in Net Position (in thousands)

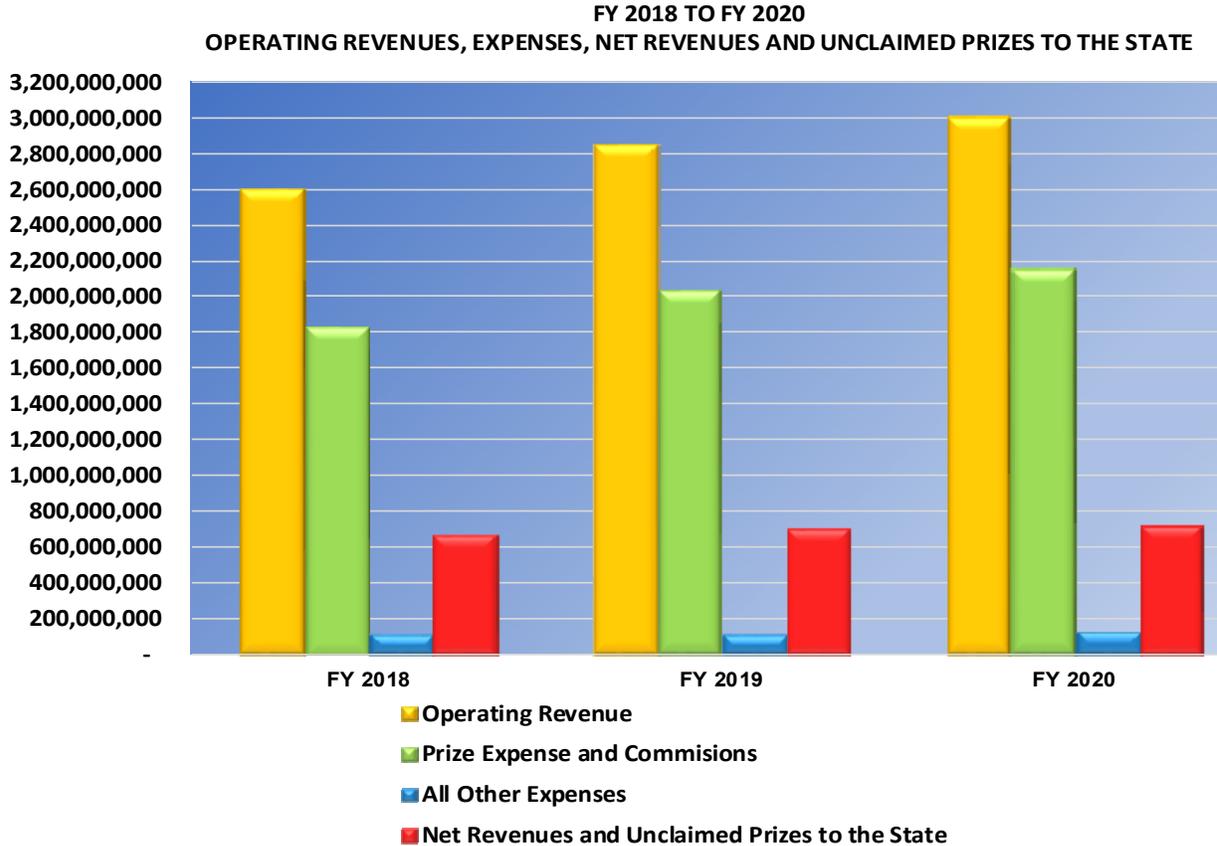
	<u>2020</u>	<u>2019</u>	<u>2018</u>
Operating Revenues:			
Gross Sales:	\$ 3,016,205	\$ 2,859,624	\$ 2,605,313
Sales/Service Bad Debt/Bad Debt Recoveries	(2)	(14)	(294)
Fees and Licenses	<u>5,399</u>	<u>5,335</u>	<u>5,399</u>
Total Operating Revenues	<u>3,021,602</u>	<u>2,864,945</u>	<u>2,610,418</u>
Operating Expenses:			
Gaming Expenses:			
Lottery Prizes	1,957,588	1,845,287	1,647,828
Retailer Commissions	209,187	198,924	181,571
Gaming Systems Services	<u>53,883</u>	<u>45,586</u>	<u>44,257</u>
Total Gaming Expenses	2,220,658	2,089,797	1,876,465
Other Operating Expenses	<u>70,063</u>	<u>64,108</u>	<u>64,158</u>
Total Operating Expenses	<u>2,290,721</u>	<u>2,153,905</u>	<u>1,937,814</u>
Operating Income	<u>730,881</u>	<u>711,040</u>	<u>672,604</u>
Nonoperating Revenues (Expenses):			
Investment Earnings, Nonoperating Revenues (Expenses) and Compulsive Gambling Contribution & ALE	(1,482)	(1,845)	(2,342)
Net Revenues and Unclaimed prizes to the State	<u>(729,400)</u>	<u>(709,195)</u>	<u>(675,470)</u>
Total Nonoperating Revenues (Expenses)	<u>(730,881)</u>	<u>(711,040)</u>	<u>(677,812)</u>
Change in Net Position	<u>-</u>	<u>-</u>	<u>(5,208)</u>
Net Position, Beginning July 1	<u>(44,698)</u>	<u>(44,698)</u>	<u>-</u>
Cumulative Effect From Change in Accounting Principle	<u>-</u>	<u>-</u>	<u>(39,490)</u>
Net Position, Beginning July 1 (Restated)	<u>-</u>	<u>-</u>	<u>(39,490)</u>
Net Position, Ending June 30	<u>\$ (44,698)</u>	<u>\$ (44,698)</u>	<u>\$ (44,698)</u>

NORTH CAROLINA EDUCATION LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

From fiscal year 2018 to fiscal year 2020, the NCEL has achieved annual increases in operating revenues. The following graph depicts revenue and expense trends.



Budget and Economic Outlook

On June 23, 2020, the NCEL Commission approved the Fiscal Year 2021 budget for the NCEL to provide a projected \$703.4 million to the State's Education Lottery Fund. This projected budget is a 1% increase over the fiscal year 2020 budget that reflected a \$694.1 million transfer to the State's Education Lottery Fund. The NCEL continues to monitor the current economic conditions in the State, and their impact upon lottery ticket sales. A recent Barings/UNC Charlotte economic forecast adds that after the modest growth of the North Carolina economy in 2019, the COVID-19 fueled downturn is projected to result in a loss of 300,000 net jobs. Additionally, Gross Product in the state dropped by 4.4% from 2019 levels. The forecast notes that during the previous, 10-year long, expansion, North Carolina's rate of growth lagged behind the national rate of growth. This lagging economic recovery rate may be a factor as the economy begins to rebound. Full recovery, back to 2019 levels, may not happen until mid to late 2022.

A focus of the NCEL Commission is to ensure sound operations. The existence of this focus is apparent in the opinions issued by external audit firms. For the twelfth consecutive year, the State Auditor contracted with an outside CPA firm to conduct the fiscal year financial audit, which resulted in an unmodified opinion.

NORTH CAROLINA EDUCATION LOTTERY

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2020 and 2019

Requests for Information

Any request for information about this report should be sent to the Public Information Officer at the North Carolina Education Lottery, 2728 Capital Boulevard, Suite 144, Raleigh, NC 27604.

NORTH CAROLINA EDUCATION LOTTERY

Statements of Net Position (in thousands)
June 30, 2020 and 2019

	2020	2019
ASSETS		
Current Assets:		
Cash and Cash Equivalents:		
Cash	\$ 42	\$ 129
Pooled Cash	37,719	21,181
Receivables:		
Accounts Receivable	12,589	28,975
Interest Receivable	48	89
Investment in Annuity Contracts and Treasury Strips	6,656	6,581
State Treasurer's Security Lending Collateral	819	1,465
Total Current Assets	57,873	58,420
Noncurrent Assets:		
Investment in Annuity Contracts	74,072	71,774
Prepaid Items	5,713	2,214
Net OPEB Asset	40	29
Capital Assets, Depreciable (Net):		
Furniture and Equipment	6,155	6,197
Accumulated Depreciation	(3,614)	(3,197)
Total Capital Assets, Depreciable (Net)	2,541	3,000
Total Noncurrent Assets	82,366	77,017
Total Assets	140,239	135,437
DEFERRED OUTFLOWS OF RESOURCES	8,080	7,861
LIABILITIES		
Current Liabilities:		
Accounts Payable	27,585	8,588
Accrued Payroll	1,350	1,706
Annuity Prize Award Payable - Current	6,656	6,581
Accrued Paid Time Off - Current	105	289
Due to the State	27,652	43,587
Obligation for Workers' Compensation	22	18
Obligations Under State Treasurer's Security Lending Agreements	819	1,465
Total Current Liabilities	64,189	62,234
Noncurrent Liabilities:		
Annuity Prize Award Payable	74,072	71,775
Accrued Paid Time Off	2,377	1,753
Net Pension Liability	11,063	10,752
Net OPEB Liability	29,745	26,606
Total Noncurrent Liabilities	117,257	110,886
Total Liabilities	181,446	173,120
DEFERRED INFLOWS OF RESOURCES	11,571	14,876
NET POSITION		
Investment in Capital Assets	2,541	3,000
Restricted	36	27
Unrestricted	(47,275)	(47,725)
Total Net Position	\$ (44,698)	\$ (44,698)

See Notes to the Financial Statements.

NORTH CAROLINA EDUCATION LOTTERY

Statements of Revenues, Expenses, and Changes in Net Position (in thousands)
Years Ended June 30, 2020 and 2019

	2020	2019
Operating Revenues:		
Gross Sales:	\$ 3,016,205	\$ 2,859,624
Sales/Service Bad Debt/Bad Debt Recoveries	(2)	(14)
Fees and Licenses	5,399	5,335
Total Operating Revenues	3,021,602	2,864,945
Operating Expenses:		
Salaries, Wages, and Benefits	25,478	22,259
Lottery Prizes	1,957,588	1,845,287
Retailer Commissions	209,187	198,924
Retailer Incentives	1,256	1,120
Gaming Systems Services	53,883	45,586
Advertising	21,729	25,367
Marketing	4,535	4,448
Other Services	10,948	5,388
Furniture, Fixtures, and Equipment	1,469	944
Depreciation	527	564
Other General and Administrative Expenses	4,121	4,018
Total Operating Expenses	2,290,721	2,153,905
Operating Income	730,881	711,040
Nonoperating Revenues (Expenses):		
Investment Earnings	1,156	1,450
Compulsive Gambling Contribution	(1,000)	(1,000)
ALE Gaming Enforcement	(2,100)	(2,100)
Unclaimed Prizes to NC Education Lottery Fund	(13,617)	(16,206)
Net Revenues to the State of NC	(715,782)	(692,989)
Miscellaneous Nonoperating Revenues (Expenses)	462	(195)
Total Nonoperating Expenses	(730,881)	(711,040)
Change in Net Position	-	-
Net Position, Beginning July 1	(44,698)	(44,698)
Net Position, Ending June 30	\$ (44,698)	\$ (44,698)

See Notes to the Financial Statements.

NORTH CAROLINA EDUCATION LOTTERY

Statements of Cash Flows (in thousands)
Years Ended June 30, 2020 and 2019

	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Customers	\$ 2,828,780	\$ 2,662,089
Payments to Employees and Fringe Benefits	(25,119)	(22,850)
Payments for Prizes, Benefits, and Claims	(1,946,517)	(1,864,033)
Payments to Vendors and Suppliers	(93,516)	(93,011)
Other Receipts	335	96
Net Cash Flows From Operating Activities	763,963	682,291
CASH FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers to State	(745,335)	(695,255)
Transfers to Other State Agencies	(3,100)	(3,100)
Net Cash From Noncapital Financing Activities	(748,435)	(698,355)
CASH FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and Construction of Capital Assets	(758)	(2,185)
Proceeds from Sale of Capital Assets	525	523
Net Cash From Capital and Related Financing Activities	(233)	(1,662)
CASH FROM INVESTING ACTIVITIES		
Investment Earnings	1,156	1,408
Net Cash from Investing Activities	1,158	1,408
Net Increase/(Decrease) in Cash and Cash Equivalents	16,451	(16,318)
Cash and Cash Equivalents at Beginning of Year	21,310	37,628
Cash and Cash Equivalents at End of Year	\$ 37,761	\$ 21,310
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating Income	\$ 730,881	\$ 711,040
Adjustments to Reconcile Operating Income to Net Cash From Operating Activities:		
Depreciation Expense	527	564
Other Nonoperating Income	668	17
(Increase) Decrease in Assets:		
Accounts Receivable	16,386	(3,852)
Prepaid Items	(3,499)	(2,173)
Net OPEB Asset	(11)	30
Deferred Outflows for Pensions	1,323	(1,340)
Deferred Outflows for OPEB	(1,542)	222
Increase (Decrease) in Liabilities:		
Accounts Payable	18,998	(22,718)
Accrued Payroll and Related Liabilities	(356)	(119)
Workers' Compensation	4	18
Compensated Absences	440	252
Net Pension Liability	311	2,104
Net OPEB Liability	3,139	(5,095)
Deferred Inflows for OPEB	(3,143)	3,544
Deferred Inflows for Pensions	(163)	(203)
Total Cash Provided by Operating Activities	\$ 763,963	\$ 682,291
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Capital Asset Write-off	\$ (110)	\$ 684
Change in Securities Lending Collateral	\$ (646)	\$ 1,418

See Notes to the Financial Statements.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 1 – ORGANIZATION

The North Carolina State Lottery Commission [aka, North Carolina Education Lottery (NCEL)] was created with the enactment of House Bill 1023, effective August 31, 2005, as an independent, self-supporting, and revenue-raising agency of the State of North Carolina (the State). The NCEL commenced operations on March 30, 2006 with the sale of instant scratch-off tickets. In March 2006, the NCEL joined the Multi-State Lottery Association (MUSL), a group of U.S. lotteries that combine jointly to sell POWERBALL lottery tickets. POWERBALL sales began on May 30, 2006. The current sales portfolio consists of additional draw games introduced as follows:

- Carolina Pick 3 on October 6, 2006
- Carolina Cash 5 on October 27, 2006
- Carolina Pick 3 second daily draw (Monday through Saturday) on March 31, 2008
- Carolina Pick 4 on April 17, 2009
- Mega Millions on January 31, 2010
- Carolina Pick 4 second daily draw and Carolina Pick 3 second Sunday draw on February 27, 2011
- EZ Match on March 30, 2014
- Lucky for Life on February 8, 2016
- Keno on October 29, 2017

The purpose of the NCEL is to generate funds to further the goal of providing enhanced educational opportunities, supporting school construction, and funding college and university scholarships. The operations of the NCEL are overseen by a nine-member commission, five of whom are appointed by the Governor and four of whom are appointed by the General Assembly.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity:

For financial reporting purposes, the North Carolina Education Lottery is a major enterprise fund of the primary government of the State of North Carolina and is reported as such in the *Comprehensive Annual Financial Report* (CAFR) of the State. These financial statements for the NCEL are separate and apart from those of the State of North Carolina and do not present the financial position of the State nor changes in the State's financial position and cash flows.

B. Basis of Presentation:

The financial statements are prepared on the accrual basis of accounting in a manner similar to a private enterprise. The NCEL elected to apply all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as Accounting Principles Board (APB) opinions. GASB Statement No. 62 incorporates into the GASB's authoritative literature the applicable guidance previously presented in the following pronouncements issued before November 30, 1989: 1) Financial Accounting Standards Board (FASB) Statements and Interpretations, 2) Accounting Principles Board Opinions, and 3) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. The guidance generally has been taken "as-is" from the original FASB and AICPA pronouncements, except a few provisions that have been modified where necessary to relate specifically to the governmental environment.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. Basis of Presentation (continued):

As an enterprise fund, the NCEL is accounted for using the “economic resources” measurement focus. This means that all the assets and liabilities related to its operations are included on its statement of net position, and its operating statement includes all revenues (increases) and expenses (decreases) in net position. The NCEL distinguishes operating from nonoperating revenues and expenses. Operating revenues and expenses generally relate to the NCEL’s primary ongoing operations of selling lottery tickets and redeeming prizes; all revenues and expenses not meeting this definition are reported as nonoperating. The principal operating revenues of the NCEL are for the sales of lottery products. The significant operating expenses include the cost of prizes, commissions, gaming system vendor charges, personnel, advertising and other administrative expenses.

C. Cash and Cash Equivalents:

Cash and cash equivalents include regional office deposited operating funds, imprest funds, and deposits held by the State Treasurer in the State Treasurer’s Short-Term Investment Fund. The Short-Term Investment Fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without prior notice or penalty.

D. State Treasurer’s Securities Lending Collateral:

While the NCEL does not directly engage in securities lending transactions, it deposits certain funds with the State Treasurer’s Short-Term Investment Fund which participates in securities lending activities. Based on the State Treasurer’s allocation of these transactions, the NCEL recognizes its allocable share of the assets and liabilities related to these transactions on the accompanying financial statements as “State Treasurer’s Securities Lending Collateral” and “Obligations Under State Treasurer’s Securities Lending Agreements.” The NCEL’s allocable share of these assets and liabilities is based on the NCEL’s year-end deposit balance per the State Treasurer’s records.

Based on the authority provided in NC General Statute 147-69.3(e), the State Treasurer lends securities from its investment pool to brokers-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer’s securities custodian manages the securities lending program. The Treasurer’s custodian lent U.S. government and agency securities, FNMA’s, corporate bonds and notes for collateral. The Treasurer’s custodian is permitted to receive cash, U.S. government and agency securities, or irrevocable letters of credit as collateral for the securities lent.

The collateral is initially pledged at 102 percent of the market value of the securities lent, and additional collateral is required if its value falls to less than 100 percent of the market value of the securities lent. There are no restrictions on the amount of loans that can be made. Substantially all security loans can be terminated on demand by either the State Treasurer or the borrower.

Additional details on the State Treasurer’s securities lending program are included in the State of North Carolina’s *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller’s Internet home page <http://www.osc.nc.gov/> and clicking on “Public Information”, or by calling the State Controller’s Financial Reporting Section at (919) 707-0500.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

E. Allowance for Doubtful Accounts:

An allowance for doubtful accounts has not been established because there are no indications of significant delinquencies from the collection of retailer accounts as of June 30, 2020 and 2019.

F. Capital Assets:

The NCEL defines capital assets as assets with an initial unit cost of \$5,000 or greater and an estimated useful life of two or more years – except in the case of software where the initial unit cost threshold is \$100,000. This definition conforms to the policy of the NC Office of State Controller. Depreciation is computed using the straight-line method over the estimated lives of the assets. The NCEL uses the half year convention. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation will be removed from the books and any resulting gain or loss reflected in operations of the period of disposal. Capital assets are carried at cost less accumulated depreciation. The estimated useful lives by general category are as follows:

<u>Category</u>	<u>Years</u>
Equipment	5-7
Furniture	5
Computers and Software	3-5

G. Deferred Outflows/Inflows of Resources:

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized until then. The NCEL has two items that meet this criterion - pension related deferrals and other postemployment benefits (OPEB). In addition to liabilities, the statement of net position also reports a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period and so will not be recognized until then. The NCEL has two items that meets this criterion - pension related deferrals and OPEB related deferrals.

H. Game Revenue Recognition:

For the NCEL's draw games, POWERBALL, Mega Millions, Carolina Cash 5, Carolina Pick 4, Carolina Pick 3, EZ Match, Lucky for Life, and Keno, revenue is recognized at the time of sale on a daily basis. For instant games, revenue is recognized at the time a pack of tickets is settled (See Note 3A.1).

I. Lottery Prize Expense Recognition:

For POWERBALL, Mega Millions, Carolina Cash 5, Carolina Pick 4, and Carolina Pick 3, and Lucky for Life, prize expense is recorded at 50 percent of sales on a daily basis. EZ Match is recorded at 63.3571 percent of sales on a daily basis. Keno is recorded at 65.73 percent of sales on a daily basis. For instant games, prize expense is accrued based on the final production prize structure percentage provided by the gaming vendor for each game and recorded daily on the value of packs settled. For the instant games with prize tickets, the final prize structure percentage used is adjusted to eliminate the value of the prize tickets. Prize expense for merchandise prizes is recognized as prizes are fulfilled.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

J. Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

K. Retirement Plans:

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 Teachers' and State Employees' Retirement System (TSERS) and additions to/deductions from TSERS' fiduciary net position have been determined on the same basis as they are reported by TSERS. For this purpose, plan member contributions are recognized in the period in which the contributions are due. The NCEL's employer contributions are recognized when due and the NCEL has a legal requirement to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of TSERS. The TSERS investments are reported at fair value.

L. Other Postemployment Benefits:

The net OPEB liability represents the NCEL's proportionate share of the collective net OPEB liability reported in the State of North Carolina's 2019 Comprehensive Annual Financial Report. This liability represents the NCEL's portion of the collective total OPEB liability less the fiduciary net position of the Retiree Health Benefit Fund. See Note 10 for further information regarding the NCEL's policies for recognizing liabilities, expenses, deferred outflows of resources, and deferred inflows of resources related to OPEB.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 3 – REVENUE

A. Operating Revenue:

1. Game Revenue:

Instant packs are settled using the following methodology:

- Manually by the retailer initiating a settlement transaction via the gaming terminal.
- Automatically by the gaming system - twenty-one (21) days after pack activation.
- Automatically by the gaming system - once the fifth (5th) pack in a specific game is activated by a retailer, the oldest active pack is settled.

Operating revenues are reduced by the value of prize tickets validated during a period.

Game Revenue	2020	2019
Instant	\$ 2,089,212	\$ 1,908,862
Draw	926,993	950,762
Bad debt write off	2	(3)
Damaged tickets, sales services	(4)	(11)
Total	<u>\$ 3,016,203</u>	<u>\$ 2,859,610</u>

2. Fees and Licenses:

The majority of Fees and Licenses represent a weekly retailer communication fee charged to active retailers for terminal satellite communications and an application fee for new retailers and changes in ownership. Total Fees and Licenses for fiscal year 2020 and 2019 were \$5,399 and \$5,335 respectively.

B. Nonoperating Revenue:

The cash accounts of the NCEL are Short-Term Investment Fund (STIF) accounts which are interest-bearing accounts held with the State Treasurer. Investments are limited to those authorized for the State's General Fund, pursuant to NC General Statute 147-69.1. The investment earnings on these accounts and the related security lending collateral transactions were \$1,156 and \$1,450 for the years ended June 30, 2020 and 2019, respectively.

The NCEL, on occasion, will also have miscellaneous nonoperating revenue related to dividends received from MUSL. There were however, no dividends to report the years ended June 30, 2020 and 2019, respectively.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 4 – EXPENSES

A. Operating Expenses:

1. Lottery Prize Expense:

Prize Expense	2020	2019
Instant	\$ 1,479,690	\$ 1,348,383
Draw	464,281	480,698
50% of unclaimed prizes	13,617	16,206
Total	\$ 1,957,588	\$ 1,845,287

2. Retailer Commissions:

Commissions	2020	2019
Instant	\$ 146,099	\$ 133,430
Draw	63,088	65,494
Total	\$ 209,187	\$ 198,924

3. Retailer Incentives:

In fiscal year 2010, the State Lottery Commission approved a retailer incentive program where retailers would receive compensation for selling a top/second tier prize in the Multi-State games POWERBALL and Mega Millions and a top tier prize in Carolina Cash 5. As of December 2011, the retailer incentive program was expanded to include instant ticket prizes of over \$1 million as well. As of February 8, 2016, the program was again expanded to include Lucky for Life. The total payments issued for the retailer incentive program for fiscal years 2020 and 2019 were \$1,256 and \$1,120, respectively.

4. Other Services:

The principal expenses included are: security services, communications, legal services, travel, financial audit services, network support, and costs for temporary employees.

	2020	2019
Security services	\$ 3	\$ 8
Communications, including wiring	788	724
Legal services	70	36
Travel	213	259
Other	9,874	4,361
Total	\$ 10,948	\$ 5,388

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 4 – EXPENSES (continued)

A. Operating Expenses (continued):

5. Furniture, Fixtures, and Equipment:

To operate a lottery, numerous units of equipment, furniture, and ticket dispensers are required. Most of these items were one-time purchases to be replaced as needed at various points in the future. These items were also below our threshold for capitalization (See Note 2F) and therefore expensed. The total expenses for fiscal years 2020 and 2019 were \$1,469 and \$944, respectively.

6. Leases – Buildings, Offices, and Other Equipment:

The NCEL has entered into various operating leases through the North Carolina State Department of Administration for building and office facilities. These leases are for initial terms of seven to ten years.

Projected lease payments for these facilities are:

<u>Year Ending</u>	<u>Amount</u>
2021	\$ 2,041
2022	2,110
2023	2,164
2024	2,072
2025	2,106
2025-2030	444
Total	<u>\$ 10,937</u>

The total space rental costs for the fiscal years 2020 and 2019 were \$1,974 and \$1,924, respectively. The NCEL also has several contracts for various equipment leases including instant ticket vending machines (ITVM's).

B. Non-operating Expenses:

The allocable share of the expenses arising from State Treasurer's Securities Lending Collateral program transactions, totaling \$39 and \$49 for the years ended June 30, 2020 and 2019, respectively, are included as non-operating expense.

C. Transfers Out:

There were four significant transfers from the NCEL. One million dollars was transferred to the NC Department of Health and Human Services for a gambling addiction education and treatment program, as stipulated in the North Carolina State Lottery Act, for the years ended June 30, 2020 and 2019 (See Note 7D).

The second transfer was to the Department of Public Safety's Division of Alcohol and Law Enforcement (ALE) in the amount of \$2,100 in both fiscal years 2020 and 2019.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 4 – EXPENSES (continued)

C. Transfers Out (continued)

The Third transfer was \$13,617 and \$16,206 for the years ended June 30, 2020 and 2019, respectively, from unclaimed prizes during the year. The North Carolina State Lottery Act requires the NCEL to transfer “Fifty percent (50%)” of unclaimed prizes to the NC Education Lottery Fund each year (See Note 7C). As part of the state legislature’s response to the COVID-19 pandemic, lottery tickets that would have expired between March 10th of 2020 and August 1st of 2020 will now expire on November 1st of 2020. This extension of ticket expiration dates means that any would-be unclaimed prize monies to be transferred for April, May, or June of 2020, will not be available for transfer until November of 2020.

The fourth transfer was in compliance with the North Carolina State Lottery Act. This Act requires all “Net Revenues” of the NCEL to be transferred to the NC Education Lottery Fund for educational purposes set forth in the legislation. “Net Revenues” were \$715,782 for fiscal year 2020 compared to \$692,989 for fiscal year 2019 (See Note 12). However, \$745,335 was transferred to the NC Education Lottery Fund for fiscal year 2020 compared with \$665,608 for fiscal year 2019. The balances remaining \$27,652 and \$43,587 for fiscal years 2020 and 2019, respectively, were recorded as a payable to the State for both fiscal years and were transferred subsequent to fiscal year end. NC General Statute 18C-162 states: “The funds remaining in the North Carolina State Lottery Fund after receipt of all revenues to the Lottery Fund and after accrual of all obligations of the Commission for prizes and expenses shall be considered to be the net revenues of the North Carolina State Lottery Fund.”

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 5 – ASSETS

A. Cash:

The cash and cash equivalents balances as of June 30, 2020 and 2019 include no undeposited receipts on hand.

Unless specifically exempt, the NCEL is required by NC General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. Except as noted above, all NCEL funds are deposited with the State Treasurer. The NCEL has no deposit policy concerning credit risk, as all deposits are held by the State Treasurer.

Ownership interest of the STIF is determined on a fair market valuation basis as of fiscal year end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the custodian.

At June 30, 2020 and 2019, \$37,719 and \$21,181, respectively, of the amounts shown on the Statement of Net Position as cash and cash equivalents represents the NCEL's equity position in the STIF. The STIF (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission or subject to any other regulatory oversight and does not have a credit rating) had a weighted average maturity of 1.3 and 1.3 years, as of June 30, 2020 and 2019, respectively. Ownership interests of the STIF are determined on a fair market valuation basis as of fiscal year end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the custodian. Pool investments are measured at fair value in accordance with GASB 72. The NCEL's position in the pool is measured and reported at fair value and the STIF is not required to be categorized within the fair value hierarchy.

Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Public Information", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 5 – ASSETS (continued)

B. Accounts Receivable:

Accounts Receivable primarily represents amounts due from retailer's ticket sales less commissions and prizes paid by the retailers. Electronic Funds Transfer is used to collect receivables weekly from retailer bank accounts that were set up in trust for the NCEL.

C. Investment in Annuity Contracts and Treasury Strips:

Investments in Annuity Contracts and Treasury Strips represent the present value of the annuity contracts that fund the long-term installment prizes contracted through insurance company annuities (See Note 7B) and the market value of treasury strips that fund the long-term installment prizes. The current and long-term balances are \$6,656 and \$74,072 for fiscal year 2020 and \$6,581 and \$71,774 for fiscal year 2019.

The policies of the NCEL only allow for direct purchase of annuity contracts and treasury strips from which the proceeds are used to fund long term installment prizes. As the NCEL is not pursuing other forms of investments, they are not currently anticipated under the policy. As a means of limiting exposure to interest rate risk, the policy only allows for direct purchase of annuity contracts and treasury strips which future value payments are pre-negotiated with the providers of the contracts. These contracts are not subject to foreign currency risk because the provider is required by contract to pay the full annuities. Accordingly, the NCEL does not have a policy regarding foreign currency risk since investments in products subject to this risk are not applicable to the NCEL.

The policy of the NCEL restricts direct purchase of annuity contracts to those with companies that hold minimum ratings as follows: AA by Fitch, AA by Moody's, or AA by Standard & Poor's. As of June 30, 2020 and 2019, all annuities carried a rating of Aa/AA.

Maturities for investments in annuity contracts and treasury strips are as follows:

<u>Maturities</u>	<u>2020</u>	<u>2019</u>
Less than 1 year	\$ 6,656	\$ 6,581
1 to 5 years	26,624	26,324
6 to 10 years	26,624	26,324
More than 10 years	20,824	19,126
Total	<u>\$ 80,728</u>	<u>\$ 78,355</u>

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 5 – ASSETS (continued)

D. Capital Assets:

The activity for capital assets for the year ended June 30, 2020 was:

<u>Category</u>	<u>Balance June 30, 2019</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2020</u>
Capital assets, depreciable				
Furniture	\$ 49	\$ -	\$ -	\$ 49
Equipment	5,058	758	800	5,016
Motorized equipment	80	-	-	80
Computer software	1,010	-	-	1,010
Total capital assets, depreciable	<u>6,197</u>	<u>758</u>	<u>800</u>	<u>6,155</u>
Less accumulated depreciation for:				
Furniture	29	-	-	29
Equipment	2,607	400	110	2,897
Motorized equipment	81	-	-	81
Computer software	480	127	-	607
Total accumulated depreciation	<u>3,197</u>	<u>527</u>	<u>110</u>	<u>3,614</u>
Total capital assets, depreciable, net	<u>3,000</u>	<u>231</u>	<u>690</u>	<u>2,541</u>
Capital assets, net	<u>\$ 3,000</u>	<u>\$ 231</u>	<u>\$ 690</u>	<u>\$ 2,541</u>

The activity for capital assets for the year ended June 30, 2019 was:

<u>Category</u>	<u>Balance June 30, 2018</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2019</u>
Capital assets, depreciable				
Furniture	\$ 49	\$ -	\$ -	\$ 49
Equipment	4,246	2,185	1,373	5,058
Motorized equipment	80	-	-	80
Computer software	1,010	-	-	1,010
Total capital assets, depreciable	<u>5,385</u>	<u>2,185</u>	<u>1,373</u>	<u>6,197</u>
Less accumulated depreciation for:				
Furniture	28	-	-	29
Equipment	2,862	435	689	2,608
Motorized equipment	78	3	-	81
Computer software	354	126	-	480
Total accumulated depreciation	<u>3,322</u>	<u>564</u>	<u>689</u>	<u>3,198</u>
Total capital assets, depreciable, net	<u>2,063</u>	<u>1,621</u>	<u>684</u>	<u>2,999</u>
Capital assets, net	<u>\$ 2,063</u>	<u>\$ 1,621</u>	<u>\$ 684</u>	<u>\$ 2,999</u>

Equipment expenditures for 2020 mainly consisted of printer and computer equipment. In 2019, equipment expenditures mainly consisted of items needed to complete a server upgrade.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 6 – LIABILITIES

A. Accounts Payable:

This primarily represents trade payables to vendors, prize liabilities, and multi-state game low-tier liability. At year end, June 30, 2020 and 2019, the balances were:

<u>Account Type</u>	<u>2020</u>	<u>2019</u>
Prize Liability, Trade payables to vendors and other	\$ 27,585	\$ 8,588
Total Accounts Payable	<u>\$ 27,585</u>	<u>\$ 8,588</u>

B. Annuity Prize Awards Payable:

Annuity prize awards payable represents the present value of the contracts and fair value of the treasury strips that fund the long-term installment prizes that are due to NCEL annuity prize winners (See Note 7B). The current and long-term balances are \$6,656 and \$74,072 for fiscal year 2020 and \$6,581 and \$71,775 for fiscal year 2019, respectively.

Annual activity for both short and long-term accounts during fiscal year 2020 are as follows:

	<u>Beginning Balance</u>	<u>Purchases</u>	<u>Appreciation</u>	<u>Disbursements</u>	<u>Reclass to Short-Term</u>	<u>Ending Balance</u>
Short-Term	\$ 6,581	\$ -	\$ -	\$ (6,455)	\$ 6,503	\$ 6,656
Long-Term	71,775	1,624	7,203	-	(6,503)	74,072
Total	<u>\$ 78,356</u>	<u>\$ 1,624</u>	<u>\$ 7,203</u>	<u>\$ (6,455)</u>	<u>\$ -</u>	<u>\$ 78,356</u>

Annual activity for both short and long-term accounts during fiscal year 2019 are as follows:

	<u>Beginning Balance</u>	<u>Purchases</u>	<u>Appreciation</u>	<u>Disbursements</u>	<u>Reclass to Short-Term</u>	<u>Ending Balance</u>
Short-Term	\$ 6,556	\$ -	\$ -	\$ (6,380)	\$ 6,405	\$ 6,581
Long-Term	72,440	725	5,015	-	(6,405)	71,775
Total	<u>\$ 78,996</u>	<u>\$ 725</u>	<u>\$ 5,015</u>	<u>\$ (6,380)</u>	<u>\$ -</u>	<u>\$ 78,356</u>

C. Due to the State:

As explained in Note 4C, \$27,652 and \$43,587 for the years ended June 30, 2020 and 2019, respectively, represent the amounts of the "Net Revenues" for the year not yet transferred to the State as of June 30, but will be transferred to the State subsequent to fiscal year-end.

D. Accrued Paid Time Off:

Paid time off (PTO) is provided to employees for use whenever vacation, sick leave, personal leave, or bereavement leave is requested and approved. Under this policy, every calendar year, on January 1st, a specific amount of PTO will be credited to Directors' and above PTO accounts. All other employees' PTO accounts will be credited on a monthly basis as earned. Employees must be employed at least one year to receive pay for accrued leave balances. Directors and above will be paid their accrued leave balances upon separation provided they have attained one (1) year of service as of the date of separation. PTO payouts will be prorated based on length of service if tenure is less than one (1) year.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 6 – LIABILITIES (continued)

D. Accrued Paid Time Off (continued):

Activity for the year ended June 30, 2020:

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long-Term Portion</u>
\$ 2,042	\$ 2,101	\$ 1,661	\$ 2,482	\$ 105	\$ 2,377

Activity for the year ended June 30, 2019:

<u>Beginning</u>	<u>Earned</u>	<u>Used</u>	<u>Ending</u>	<u>Current Liability</u>	<u>Long-Term Portion</u>
\$ 1,789	\$ 2,042	\$ 1,789	\$ 2,042	\$ 289	\$ 1,753

E. Changes in Net Pension Liabilities:

The changes in Net Pension Liability and OPEB Liability during fiscal year 2020 are as follows:

	June 30, 2019			June 30, 2020
	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
Net Pension Liability	\$ 10,752	\$ 311	\$ -	\$ 11,063
Net OPEB Liability	26,606	3,139	-	29,745

The changes in Net Pension Liability and OPEB Liability during fiscal year 2019 are as follows:

	June 30, 2018			June 30, 2019
	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u>
Net Pension Liability	\$ 8,647	\$ 2,105	\$ -	\$ 10,752
Net OPEB Liability	31,701	-	5,095	26,606

For more information on Net Pension Liability and Net OPEB Liability see Notes 9 and 10, respectively.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 7 – OTHER IMPORTANT ITEMS

A. Deposits with Multi-State Lottery Association (MUSL):

MUSL is a voluntary association created for the purpose of administering joint, multi-jurisdictional lottery games, such as POWERBALL and Mega Millions. As of June 30, 2020, MUSL included 35 state lotteries, the District of Columbia, Loteria Electronica de Puerto Rico, and the U.S. Virgin Islands. The chief executive officer of each member lottery serves on the MUSL board of directors.

As a member of MUSL, the NCEL is required to contribute to various prize reserve funds maintained by MUSL. These contributions are included in the 50% prize expense calculated on POWERBALL and Mega Millions sales. The net amount of the 50% prize expense less the amount required to pay low-tier prizes within the State is paid to MUSL. This payment is to cover the NCEL's share of current jackpot prizes based on the NCEL's percent of sales for each drawing and the NCEL's share of the prize reserve fund. The prize reserve fund serves as a contingency reserve to protect all MUSL members including the NCEL from unforeseen prize liabilities. All prize reserve funds remitted, and the related interest earnings, will be returned to the NCEL upon leaving MUSL, less any portion of unanticipated prize claims which may have been paid from the fund. As of June 30, 2020 and 2019, the NCEL had been credited with \$10,213 and \$10,144, respectively, in the MUSL prize reserve funds.

B. Annuity Installment Prizes:

The NCEL funds long-term installment prizes through the purchase of insurance company annuities and treasury strips. The contract holders will fund the future value of the installment prize awards over the life of the prize awarded to the player. The NCEL currently holds contracts with Met Life Insurance Company, Prudential Life Insurance Company, and Wells Fargo Bank to provide these future prize installment payments. The future value of the annuity prizes awarded as of June 30, 2020 and 2019 were \$82,275 and \$86,531, respectively.

To the extent available, the NCEL's treasury strips are recorded at fair value as of June 30, 2020 and 2019. 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. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques should maximize the use of observable inputs to the extent available.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 7 – OTHER IMPORTANT ITEMS (continued)

B. Annuity Installment Prizes (continued):

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

Level 1: Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.

Level 2: Investments with inputs – other than quoted prices included within Level 1 – that are observable for an asset either directly or indirectly.

Level 3: Investments classified as Level 3 have unobservable inputs for an asset and may require a degree of professional judgment.

At year-end, June 30, 2020 and 2019, the NCEL's treasury strips had recurring fair value measurements of \$36,701 and \$31,664, respectively, and inputs used to measure fair market value were categorized as Level 1 inputs. The remaining annuity investment balances are composed of Insurance company annuity contracts that are recorded at present value as of June 30, 2020 and 2019.

C. Unclaimed Prizes:

As of June 30, 2020 and 2019, the NCEL had unclaimed prizes from both online and instant games. The first POWERBALL draw after the NCEL started selling tickets was on May 31, 2006 and, subsequently, the NCEL began recognizing unclaimed prizes on November 27, 2006 (180 days after the first draw). The first Carolina Pick 3 unclaimed prizes were recorded on April 4, 2007 and the first unclaimed prizes for Carolina Cash 5 were recorded on April 25, 2007. Unclaimed prizes for Carolina Pick 4 were recorded on November 14, 2009. Unclaimed prizes for Mega Millions were recorded on August 1, 2010. Unclaimed prizes for EZ Match were recorded on September 26, 2014. Unclaimed prizes for All or Nothing were recorded on March 6, 2015. Unclaimed prizes for Lucky for Life were recorded on August 6, 2016. The first unclaimed prizes for Keno were recorded on April 27, 2018. The NCEL closed forty-three (43) instant games during fiscal year 2020 resulting in \$17,924 in unclaimed prizes. In 2019, the NCEL closed fifty-four (54) instant games resulting in \$20,171 in unclaimed prizes. As discussed in note 4, the state legislature's response to the COVID-19 pandemic included a provision that lottery tickets that would have expired between March 10, 2020 and August 1, 2020 will now expire on November 1, 2020. This extension of ticket expiration dates means that any would-be unclaimed prize monies to be transferred for April, May, or June 2020, will not be available for transfer until November 2020.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 7 – OTHER IMPORTANT ITEMS (continued)

C. Unclaimed Prizes (continued):

<u>Game Type</u>	<u>2020</u>	<u>2019</u>
Instant	\$ 17,924	\$ 20,171
Powerball	2,031	3,302
Mega Millions	875	2,715
Carolina Cash 5	1,513	1,091
Carolina Pick 4	1,536	1,801
Carolina Pick 3	2,048	2,227
EZ Match	233	227
Lucky for Life	845	564
Keno	230	314
Total Unclaimed Prizes	<u>\$ 27,235</u>	<u>\$ 32,412</u>

D. Compulsive Gambling Contribution:

The NC General Statute states, the NCEL must make “a transfer of \$1,000 annually to the North Carolina Department of Health and Human Services (DHHS) for gambling addiction education and treatment programs.” (See Note 4C)

E. Limitations on Operating and Advertising Expenses:

As established in NC General Statute 18C-162(a)(3); “No more than eight percent (8%) of the total annual revenues, as described in this Chapter, shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed one percent (1%) of the total annual revenues.” The one percent for advertising expenses is included in the eight percent maximum for Lottery expenses. Total annual revenues include proceeds from the sale of lottery tickets, interest earned by the NCEL, and all other funds credited to the Lottery from any source.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 8 – RISK MANAGEMENT

The NCEL is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The NCEL participates in the State's Risk Management Program for property, liability, crime, and automobile coverage, and pays an annual premium for this coverage. The Lottery has not experienced any losses during the year ended June 30, 2020.

The types of coverage, limits, and deductibles as of June 30, 2020 are described below (the following chart is not shown in thousands).

Coverage Type	Limits (\$)	Deductible (\$)	Comments
Public officers and employee liability	1,000,000 /10,000,000		1,000,000 per person/ 10,000 per accident limits
All risk – property contents	7,260,147	5,000	
Auto – liability	1,000,000 per person/ 10,000,000 per accident		
Hired Auto - Physical Damage	40,000 60,000 if GVW > 10,000 lbs.	100 500	Comp. deductible Collision deductible
Theft, disappearance, destruction	500,000	1,000	Inside premises
Theft, disappearance, destruction	500,000	1,000	Outside premises
Computer fraud	5,000,000	100,000	
Funds transfer fraud	5,000,000	250,000	
Employee dishonesty	5,000,000	100,000	+10% over \$100,000
Cyber and breach response	3,000,000	150,000	
Forgery and alteration	100,000	2,500	

Employees and retirees are provided health care coverage by the State of North Carolina's Comprehensive Major Medical Plan. This employee benefit plan is funded by employer and employee contributions.

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State are included in the program. When an employee is injured, the NCEL's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The State is self-insured for workers' compensation. A third-party administrator processes workers' compensation claims. State agencies, including the NCEL, contribute to a fund administered by the Office of the State Controller to cover their workers' compensation claims. The third-party administrator receives a per case administration fee and draws down State funds to make medical and indemnity payments on behalf of the State in accordance with the North Carolina Workers' Compensation Act. The NCEL recognized a future liability based on current workers' compensation expense in the amount of \$22 and \$18 for the years ended June 30, 2020 and 2019, respectively.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 8 – RISK MANAGEMENT (continued)

Term life insurance of \$25 to \$50 is provided to eligible employees. This self-insured death benefit program is administered by the North Carolina Department of the State Treasurer and funded via employer contributions. The employer contribution rate was .1886% of covered payroll for the current fiscal year.

Additional details on State-administered risk management programs are disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Public Information", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

NOTE 9 – PENSION AND DEFERRED COMPENSATION PLANS

A. Retirement Plan:

Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System (TSERS) and is automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by a 13-member Board of Trustees, with the State Treasurer serving as Chairman of the Board.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Public Information", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

B. Benefits Provided:

TSERS provides retirement and survivor benefits. Retirement benefits are determined as 1.82% of the member's average final compensation times the member's years of creditable service. A member's average final compensation is calculated as the average of a member's four highest consecutive years of compensation. General employee plan members are eligible to retire with full retirement benefits at age 65 with five years of membership service, at age 60 with 25 years of creditable service, or at any age with 30 years of creditable service. General employee plan members are eligible to retire with partial retirement benefits at age 50 with 20 years of creditable service or at age 60 with five years of membership. Survivor benefits are available to eligible beneficiaries of members who die while in active service or within 180 days of their last day of service and who have either completed 20 years of creditable service regardless of age or have completed five years of service and have reached age. Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions. The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 9 – PENSION AND DEFERRED COMPENSATION PLANS (continued)

B. Benefits Provided (continued):

Funding policy. Plan members are required to contribute 6% of their annual covered salary, and the NCEL is required to contribute at an actuarially determined rate. The fiscal year 2020 rate is 12.97% of the annual covered payroll. The contribution requirements of plan members and the NCEL are established and may be amended by the General Assembly. The following table represents the three-year trend of the annual contributions made by the NCEL to the State retirement system. The NCEL made 100% of its required contributions for the years ended June 30, 2020, 2019, and 2018:

	2020	2019	2018
Retirement Contribution	\$ 2,160	\$ 1,832	\$ 1,696
Percentage of Covered Payroll	12.97%	12.29%	10.78%

Net pension liability. At June 30, 2020, the NCEL reported a liability of \$11,063 for its proportionate share of the net pension liability. The total pension liability used to calculate the net pension was determined by an actuarial valuation as of December 31, 2018. The total pension liability was then rolled forward to the measurement date of June 30, 2019 utilizing update procedures incorporating the actuarial assumptions. The NCEL's proportion of the net pension liability was based on a projection of the NCEL's long-term share of future payroll covered by the pension plan, relative to the projected future payroll covered by the pension plan of all participating TSERS employers, actuarially determined. At June 30, 2019 and at June 30, 2018, the NCEL's proportion was 0.10671% and 0.10799%, respectively.

Deferred inflows of resources and deferred outflows of resources related to pensions. For the years ended June 30, 2020 and 2019, the NCEL recognized pension expense of \$3,864 and \$2,390 respectively.

At June 30, 2020, the NCEL reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between actual and expected experience	\$ 925	\$ 21
Changes of Assumptions	1,179	-
Net difference between projected and actual earnings on pension plan investments (see note below)	212	-
Change in proportion and differences between the NCEL's contributions and proportionate share of contributions	-	131
Contributions subsequent to the measurement date	2,160	-
Total	\$ 4,476	\$ 152

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 9 – PENSION AND DEFERRED COMPENSATION PLANS (continued)

B. Benefits Provided (continued):

At June 30, 2019, the NCEL reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between actual and expected experience	\$ 785	\$ 108
Changes of Assumptions	2,158	-
Net difference between projected and actual earnings on pension plan investments (see note below)	1,025	-
Change in proportion and differences between the NCEL's contributions and proportionate share of contributions	-	208
Contributions subsequent to the measurement date	<u>1,832</u>	<u>-</u>
Total	<u>\$ 5,800</u>	<u>\$ 316</u>

For fiscal year 2020, there were \$2,160 in Deferred Outflows of Resources related to pensions resulting from the NCEL's contributions subsequent to the measurement date. Contributions subsequent to the measurement date for fiscal year 2019 were \$1,832. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year ending June 30:</u>	
2021	\$ 1,535
2022	365
2023	189
2024	74
2025	-
Total	<u>\$ 2,163</u>

Note: negative amounts indicate amortization of pension deferrals that will decrease pension expense.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 9 – PENSION AND DEFERRED COMPENSATION PLANS (continued)

B. Benefits Provided (continued):

Actuarial assumptions. The total pension liability was determined by an actuarial valuation performed as of December 31, 2018. The total pension liability was calculated through the use of update procedures to roll forward from the actuarial valuation date to the measurement date of June 30, 2019. The update procedures incorporated the actuarial assumptions used in the valuation. The entry age normal actuarial cost method was utilized. Inflation is assumed to be 3% and salary increases range 3.50% to 8.10% which includes 3.5% inflation and productivity factor. The discount rate used was 7.00% and is net of pension plan investment expense, including inflation.

TSERS currently uses mortality tables that vary by age, gender, employee group (i.e. teacher, general, law enforcement officer) and health status (i.e. disabled and healthy). The current mortality rates are based on published tables and studies that cover significant portions of the U.S. population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The actuarial assumptions used in the December 31, 2018 valuations were based on the results of an actuarial experience study that was prepared as of December 31, 2014.

Future ad hoc Cost of Living Adjustment (COLA) amounts are not considered to be substantively automatic and are therefore not included in the measurement.

The projected long-term investment returns and inflation assumptions are developed through review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projections are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class as of June 30, 2019 are summarized in the following table:

<u>Asset Class</u>	<u>Long-Term Expected Real Rate of Return</u>
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Opportunistic Fixed Income	6.0%
Inflation Sensitive	4.0%

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 9 – PENSION AND DEFERRED COMPENSATION PLANS (continued)

B. Benefits Provided (continued):

The information above is based on 30-year expectations developed with the consulting actuary and is part of the asset, liability, and investment policy of the North Carolina Retirement Systems. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.05%. Return projections do not include any excess return expectations over benchmark averages. All rates of return and inflation are annualized. The long-term expected real rate of return for the Bond Index Pool as of June 30, 2019 was 1.4%.

Discount rate. The discount rate used to measure the total pension liability was 7.00%. The discount rate is in line with the long-term nominal expected return on pension plan investments. The calculation of the net pension liability is a present value calculation of the future net pension payments. These net pension payments assume that contributions from plan members will be made at the current statutory contribution rate and that contributions from employers will be made at the contractually required rates, actuarially determined. Based on these assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability to changes in the discount rate. The following presents the NCEL’s proportionate share of the net pension liability calculated using the discount rate of 7%, as well as, what the NCEL’s proportionate share of the net pension asset or net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6%) or one percentage-point higher (8%) than the current rate:

	1% Decrease (6%)	Discount Rate (7%)	1% Increase (8%)
NCEL's proportionate share of the net pension liability (asset)	\$ 21,055	\$ 11,063	\$ 2,680

Pension plan fiduciary net position. Detailed information about the TSERS fiduciary net position is included in the State of North Carolina’s Comprehensive Annual Financial Report. An electronic version of this report is available by accessing the North Carolina Office of the State Controller’s Internet home page <http://www.osc.nc.gov/> and clicking on “Public Information”, or by calling the State Controller’s Financial Reporting Section at (919) 707-0500.

C. Supplemental Retirement Income Plan:

IRC Section 401(k) Plan – All full-time employees are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of the plan participants. The Plan is provided by Prudential Retirement, administered by the NC Department of the State Treasurer and sponsored by the State of North Carolina. The effective date of participation was January 30, 2006. The voluntary contributions by employees amounted to \$543, \$403, and \$309 for the years ended June 30, 2020, 2019, and 2018, respectively.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 9 – PENSION AND DEFERRED COMPENSATION PLANS (continued)

D. Deferred Compensation Plan:

IRC Section 457 Plan – The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Plan's Board of Trustees. The Board, a part of the North Carolina Department of State Treasurer, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. The effective date of participation was January 30, 2006. The voluntary contributions by employees amounted to \$137, \$111, and \$108, for the years ended June 30, 2020, 2019, and 2018, respectively.

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long Term Disability Beneficiaries and Retirees:

The NCEL participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System. Coverage eligibility varies depending on years of contributory membership service in the retirement system prior to disability or retirement.

The Plan's benefit and contribution provisions are established by Chapter 135, Article 3B, of the NC General Statutes, and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

The NC General Statute states that a Retiree Health Benefit Fund (RHBF) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. The NC General Statute states that the RHBF is administered by the Board of Trustees Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the RHBF. Contribution rates to the RHBF, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are established by the General Assembly.

For the period July 1, 2019 through June 30, 2020, the NCEL contributed 6.47% of the covered payroll under the Teachers' and State Employees' Retirement System. Required contribution rates for the years ended June 30, 2019 and 2018 were 6.27% and 6.27%, respectively. The NCEL made 100% of its annual required contributions to the RHBF for the years ended June 30, 2020, 2019, and 2018, which were \$1,077, \$935, and \$952, respectively.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (continued)

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Public Information", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

B. Long Term Disability:

The NCEL participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System. Benefit and contribution provisions are established by Chapter 135, Article 6, of the NC General Statute, and may be amended only by the North Carolina General Assembly. The plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the North Carolina General Assembly. For the fiscal year ended June 30, 2020, the NCEL made a statutory contribution of .10% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2020, 2019, and 2018 were .10%, .14%, and .14%, respectively. The NCEL made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2020, 2019, and 2018, which were \$17, \$21, and \$22, respectively. The NCEL assumes no liability for long-term disability benefits under the Plan other than its contribution.

Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Public Information", or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

C. Net OPEB Liability (Asset):

Net OPEB Liability: At June 30, 2020, the NCEL reported a liability of \$29,745 for its proportionate share of the collective net OPEB liability for RHBF. The net OPEB liability was measured as of June 30, 2019. The total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of December 31, 2018, and update procedures were used to roll forward the total OPEB liability to June 30, 2019. The NCEL's proportion of the net OPEB liability was based on the present value of future salaries for the NCEL relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2020, the NCEL's proportion was .09401%.

Net OPEB Asset: At June 30, 2020, the NCEL reported an asset of \$40 for its proportionate share of the collective net OPEB asset for DIPNC. The net OPEB asset was measured as of June 30, 2019. The total OPEB asset used to calculate the net OPEB asset was determined by an actuarial valuation as of December 31, 2018, and update procedures were used to roll forward the total OPEB asset to June 30, 2019. The NCEL's proportion of the net OPEB asset was based on the present value of future salaries for the NCEL relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2020, the NCEL's proportion was .09333%.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (continued)

C. Net OPEB Liability (Asset) (continued):

Actuarial Assumptions: The total OPEB liabilities (assets) for RHBF and DIPNC were determined by actuarial valuations as of December 31, 2018, using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified. The total OPEB liabilities (assets) were then rolled forward to June 30, 2019 utilizing update procedures incorporating the actuarial assumptions.

	Retiree Health Benefit Fund <u>(1)</u>	Disability Income Plan in N.C. <u>(1)</u>
Valuation Date	12/31/2018	12/31/2018
Inflation	3.00%	3.00%
Salary Increases	8.10% grading down to 3.50% depending on employee class	3.50% - 8.10%
Investment Rate of Return (2)	7.00%	3.75%
Healthcare Cost Trend Rate - Medical	6.50% grading down to 5.00% by 2024	6.50% grading down to 5.00% by 2024
Healthcare Cost Trend Rate - Prescription Drug	9.5% grading down to 5.00% by 2028	9.5% grading down to 5.00% by 2028
Healthcare Cost Trend Rate - Medicare Advantage	6.50% grading down to 5.00% by 2024	N/A
Healthcare Cost Trend Rate - Administrative	3%	N/A

(1) - Salary increase include 3.5% inflation and productivity factor

(2) - Investment rate of return is net of pension plan investment expense, including inflation.

N/A - Note Applicable

The OPEB plans currently use mortality tables that vary by age, gender, employee group (i.e. teacher, general, law enforcement officer) and health status (i.e. disabled and healthy). The current mortality rates are based on published tables and studies that cover significant portions of the U.S. population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The projected long-term investment returns and inflation assumptions are developed through a review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the U.S. Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projects are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. DIPNC is primarily invested in the Bond Index Investment Pool as of June 30, 2019.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (continued)

C. Net OPEB Liability (Asset) (continued):

Best estimates of real rates of return for each major asset class included in RHBF's target asset allocation as of December 31, 2018 (the valuation date) are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Opportunistic Fixed Income	6.0%
Inflation Sensitive	4.0%

The information in the preceding table is based on 30-year expectations developed with the consulting actuary and is part of the asset, liability, and investment policy of the North Carolina Retirement Systems. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.05%. Return projections do not include any excess return expectations over benchmark averages. All rates of return and inflation are annualized. The long-term expected real rate of return for the Bond Index Investment Pool as of June 30, 2019 is 1.4%.

Actuarial valuations of the plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. The results of the valuations fluctuate from year to year as actual experience differs from assumptions. This includes demographic experiences (i.e., mortality and retirement) that differ from expected. This also includes financial experiences (i.e., member medical costs and contributions) that vary from expected trends. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The actuarial assumptions used for RHBF are consistent with those used to value the pension benefits of the TSERS where appropriate. These assumptions are based on the most recent pension valuations available. The discount rate used for RHBF reflects a pay-as-you-go approach.

Projections of benefits for financial reporting purposes of the plans are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and historical pattern of sharing of benefit costs between the employer and plan members to that point. Historically, the benefits funded solely by employer contributions applied equally to all retirees. Currently, as described earlier in the note, benefits are dependent on membership requirements.

The actuarial methods and assumptions used for DIPNC include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (continued)

C. Net OPEB Liability (Asset) (continued):

The actuarial assumptions used in the December 31, 2018 valuations were based on the results of an actuarial experience study prepared as of December 31, 2014.

Discount Rate: The discount rate used to measure the total OPEB liability for RHBF was 3.5%. The projection of cash flows used to determine the discount rate assumed that contributions from employers will be made at the current statutorily determined contribution rate. Based on the above assumptions, the plan's fiduciary net position was not projected to be available to make projected future benefit payments of current plan members. As a result, a municipal bond rate of 3.5% was used as the discount rate used to measure the total OPEB liability. The 3.5% rate is based on the Bond Buyer 20-year General Obligation Index as of June 30, 2019.

The discount rate used to measure the total OPEB liability for DIPNC was 3.75%. The projection of cash flow used to determine the discount rate assumed that contributions from plan members would be made at the current contribution rate and that contributions from employers would be made at statutorily required rates, actuarially determined. Based on those assumptions, the plan's fiduciary net position was projected to be available to make all projected future benefit payments to the current plan members. Therefore, the long-term expected rate of return on plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

Sensitivity of the Net OPEB Liability (Asset) to Changes in the Discount Rate: The following presents the NCEL's proportionate share of the net OPEB liability (asset) of the plans, as well as what the plans' net OPEB liability (asset) would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current discount rate:

Net OPEB Liability (Asset)					
		<u>1% Decrease (2.5%)</u>	<u>Current Discount Rate (3.5%)</u>		<u>1% Increase (4.5%)</u>
	RHBF	\$ 35,347	\$	29,745	\$ 25,258
		<u>1% Decrease (2.75%)</u>	<u>Current Discount Rate (3.75%)</u>		<u>1% Increase (4.75%)</u>
	DIPNC	\$ (34)	\$	(40)	\$ (46)

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (continued)

C. Net OPEB Liability (Asset) (continued):

Sensitivity of the Net OPEB Liability (Asset) to Changes in the Healthcare Cost Trend Rates: The following presents the net OPEB liability (asset) of the plans, as well as what the plans' net OPEB liability (asset) would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower or 1-percentage-point higher than the current discount rate (dollars in thousands):

	1% Decrease (Medical - 4.00 - 5.50% Pharmacy - 4.00 - 8.50% Med. Advantage - 4.00 - 5.50% Administrative - 2.00%)	Current healthcare Cost Trend Rates (Medical - 5.00 - 6.50% Pharmacy - 5.00 - 9.50% Med. Advantage - 5.00 - 6.50% Administrative - 3.00%)	1% Increase (Medical - 6.00 - 7.50% Pharmacy - 6.00 - 10.25% Med. Advantage - 6.00 - 7.5% Administrative - 4.00%)
RHBF Net OPEB Liability	\$ 35,347	\$ 29,745	\$ 25,258
DIPNC Net OPEB Asset	\$ (34)	\$ (40)	\$ (46)

Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB: For the year ended June 30, 2020, the NCEL recognized OPEB expense of \$(378) for RHBF and \$38 for DIPNC, resulting in a total OPEB expense of \$(340).

At June 30, 2020 and 2019, the NCEL reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

Employer Balances of Deferred Outflows of Resources
Related to OPEB by Classification
For the Year Ended June 30, 2020

	<u>RHBF</u>	<u>DIPNC</u>	<u>Total</u>
Difference between actual and expected experience	\$ -	\$ 41	\$ 41
Changes of assumptions	1,430	4	1,434
Net difference between projected and actual earnings on pension plan investments	20	8	28
Change in proportion and differences between the NCEL's contributions and proportionate share of contributions	1,004	3	1,007
Contributions subsequent to the measurement date	1,077	17	1,094
Total	<u>\$ 3,531</u>	<u>\$ 73</u>	<u>\$ 3,604</u>

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (continued)

C. Net OPEB Liability (Asset) (continued):

Employer Balances of Deferred Outflows of Resources
Related to OPEB by Classification
For the Year Ended June 30, 2019

	<u>RHBF</u>	<u>DIPNC</u>	<u>Total</u>
Difference between actual and expected experience	\$ -	\$ 50	\$ 50
Changes of assumptions	-	5	5
Net difference between projected and actual earnings on pension plan investments	3	22	25
Change in proportion and differences between the NCEL's contributions and proportionate share of contributions	1,025	1	1,026
Contributions subsequent to the measurement date	<u>934</u>	<u>21</u>	<u>955</u>
Total	<u>\$ 1,962</u>	<u>\$ 99</u>	<u>\$ 2,061</u>

Employer Balances of Deferred Inflows of Resources
Related to OPEB by Classification
For the Year Ended June 30, 2020

	<u>RHBF</u>	<u>DIPNC</u>	<u>Total</u>
Difference between actual and expected experience	\$ 1,500	\$ -	\$ 1,500
Changes of assumptions	8,943	4	8,947
Net difference between projected and actual earnings on pension plan investments	-	-	-
Change in proportion and differences between the NCEL's contributions and proportionate share of contributions	971	1	972
Contributions subsequent to the measurement date	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 11,414</u>	<u>\$ 5</u>	<u>\$ 11,419</u>

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 10 – OTHER POSTEMPLOYMENT BENEFITS (continued)

C. Net OPEB Liability (Asset) (continued):

	<u>RHBF</u>	<u>DIPNC</u>	<u>Total</u>
Difference between actual and expected experience	\$ 1,819	\$ -	\$ 1,819
Changes of assumptions	11,526	-	11,526
Net difference between projected and actual earnings on pension plan investments	-	-	-
Change in proportion and differences between the NCEL's contributions and proportionate share of contributions	1,214	1	1,215
Contributions subsequent to the measurement date	-	-	-
Total	<u>\$ 14,559</u>	<u>\$ 1</u>	<u>\$ 14,560</u>

Amounts reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability related to RHBF and an increase of the net OPEB asset related to DIPNC in the fiscal year ended June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Outflows of resources and deferred inflows of resources that will be recognized in OPEB expense:

<u>Year Ended June 30:</u>	<u>RHBF</u>	<u>DIPNC</u>
2021	\$ (2,789)	\$ 17
2022	(2,789)	12
2023	(2,785)	9
2024	(905)	5
2025	309	8
Thereafter	-	-
Total	<u>\$ (8,959)</u>	<u>51</u>

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 11 – LITIGATION

NC Citizens for Free Enterprise, Inc., et al. v. The State of North Carolina, et al. – The NC Attorney General’s Office notified the NCEL that their office was officially served the Amended Complaint on behalf of the NCEL, among other defendants. The gist of the complaint, filed on December 29, 2016, alleged that the named defendants worked together to aggressively “shut down” the sweepstakes industry in order to promote the NCEL. The Amended Complaint, filed February 8, 2017 added another plaintiff. The counts have been transferred to a 3-judge panel in Wake County Superior Court where the case is on hold. The NCEL does not anticipate paying any monetary damages associated with this case.

Watkins v Stephenson, et al. – This case involves a prize dispute between two players involving a 2nd-tier prize from the Lucky for Life game. The plaintiff included the NCEL as a party because the NCEL is delaying the prize payout until the case is resolved. A Motion to Dismiss has been filed. The NCEL does not anticipate paying any monetary damages associated with this case.

Charles Quick v. NCEL, et al. - Mr. Charles Quick, a South Carolina resident, alleged that he should have won the Powerball jackpot of \$182 Million from 2007, even though the jackpot was won in Oregon. Mr. Quick has been in regular contact with various NCEL staff since 2007 to the present and subsequently filed a formal hand-written complaint against the NCEL in Richmond County. Mr. Quick is representing himself. The AAG has filed for Motion to Dismiss for several reasons. A hearing was scheduled for March 16, 2020. Mr. Quick’s offer to settle for \$20 Million, was rejected by the NCEL. The NCEL’s Motion to Dismiss was granted on August 4, 2020.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 12 – ALLOCATION OF TOTAL NET REVENUES/TRANSFERS TO NC EDUCATION LOTTERY FUND

	2020	
Lottery Ticket Sales	\$ 3,016,203	
Fees and Licenses	5,399	
Investment Earnings and Other Revenues	1,618	
Total Annual Revenue	3,023,220	
Prize Expense	(1,957,588)	65% of Total Annual Revenue
Advertising	(21,729)	1% of Total Annual Revenue
All Other Expenses and Transfers	(105,317)	
Total Section 18C-162.a.3	(127,046)	3% of Total Annual Revenue
Commissions (per Section 18C-142)	(209,187)	7% of Lottery Ticket Sales
Unclaimed Prizes to the State of North Carolina	13,617	
Net Revenues to the State of North Carolina	715,782	
Total Revenues to the State of North Carolina	\$ 729,399	24% of Total Annual Revenue

	2019	
Lottery Ticket Sales	\$ 2,859,610	
Fees and Licenses	5,335	
Investment Earnings and Other Revenues	1,255	
Total Annual Revenue	2,866,200	
Prize Expense	(1,845,287)	64% of Total Annual Revenue
Advertising	(25,367)	1% of Total Annual Revenue
All Other Expenses and Transfers	(87,428)	
Total Section 18C-162.a.3	(112,794)	3% of Total Annual Revenue
Commissions (per Section 18C-142)	(198,924)	7% of Lottery Ticket Sales
Unclaimed Prizes to the State of North Carolina	16,206	
Net Revenues to the State of North Carolina	692,989	
Total Revenues to the State of North Carolina	\$ 709,195	25% of Total Annual Revenue

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 12 – ALLOCATION OF TOTAL NET REVENUES/TRANSFERS TO NC EDUCATION LOTTERY FUND (continued)

In accordance with Section 18C-162 of the North Carolina State Lottery Act: Allocation of revenues.

- (a) The Commission shall allocate revenues to the North Carolina State Lottery Fund in order to increase and maximize the available revenues for education purposes, and to the extent practicable, shall adhere to the following guidelines:
- (1) At least fifty percent (50%) of the total annual revenues, as described in this Chapter, shall be returned to the public in the form of prizes.
 - (2) At least thirty-five percent (35%) of the total annual revenues, as described in this chapter, shall be transferred as provide in G.S. 18C-164.
 - (3) No more than eight percent (8%) of the total annual revenues, as described in this Chapter, shall be allocated for payment of expenses of the Lottery. Advertising expenses shall not exceed one percent (1%) of the total annual revenues.
 - (4) No more than seven percent (7%) of the face value of tickets or shares, as described in this chapter shall be allocated for compensation paid to lottery game retailers.
- (b) *To the extent that the expenses of the Commission are less than eight percent (8%) of total annual revenues, the Commission may allocate any surplus funds:*
- (1) To increase prize payments; or
 - (2) To the benefit of the public purposes as described in this chapter.
- (c) Unclaimed prize money shall be held separate and apart from the other revenues and allocated as follows:
- (1) Fifty percent (50%) to enhance prizes under subdivision (a) (1) of this section.
 - (2) Fifty percent (50%) to the Education Lottery Fund to be allocated in accordance with G.S.18C-164(c) (2005-344, s. 1; 2005-276, s. 31.1(r); 2007-323, s.5.2(c)).

Additionally, in accordance with Section 18C-142 of the North Carolina State Lottery Act, Compensation for lottery game retailers, “The amount of compensation paid to lottery game retailers for their sales of lottery tickets or shares shall be seven percent (7%) of the retail price of the tickets or shares sold for each lottery game.”

Section 18C-161. Types of income to the North Carolina State Lottery Fund.

- (1) All proceeds from the sale of lottery tickets or shares.
- (2) The funds for initial start-up costs provided by the State.
- (3) All other funds credited or appropriated to the Commission from any sources.
- (4) Interest earned by the North Carolina Lottery Fund.

The NCEL transferred \$701.7 million to the NC Education Lottery Fund for fiscal year 2020 compared with \$665.6 million for fiscal year 2019. As explained in Note 4C, \$27.7 million and \$43.6 million for fiscal years ended June 30, 2020 and 2019, respectively, were the amounts of the “Net Revenues” and “50% of Unclaimed Prizes” that were transferred to the State subsequent to the end of the respective fiscal year.

NORTH CAROLINA EDUCATION LOTTERY

NOTES TO FINANCIAL STATEMENTS (in thousands)

June 30, 2020 and 2019

NOTE 13 – CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2020, the NCEL implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*. The Statement is intended to provide relief to governments and other stakeholders in light of the COVID-19 pandemic.

The guidance postpones by one year the effective dates of certain provisions in the following pronouncements:

- Statement No. 83, *Certain Asset Retirement Obligations*
- Statement No. 84, *Fiduciary Activities*
- Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*
- Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*
- Statement No. 90, *Majority Equity Interests*
- Statement No. 91, *Conduit Debt Obligations*
- Statement No. 92, *Omnibus 2020*
- Statement No. 93, *Replacement of Interbank Offered Rates*
- Implementation Guide No. 2017-3, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan Reporting)*
- Implementation Guide No. 2018-1, *Implementation Guidance Update—2018*
- Implementation Guide No. 2019-1, *Implementation Guidance Update—2019*
- Implementation Guide No. 2019-2, *Fiduciary Activities*.

The Statement postpones the effective dates of the following pronouncements by 18 months:

- Statement No. 87, *Leases*
- Implementation Guide No. 2019-3, *Leases*.

The provisions of Statement 95 are effective immediately. Statement 95 does not postpone the effective date of Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, because the pandemic was factored into Statement 94's effective date.

[Statement 95](http://www.gasb.org) is available on the GASB website, www.gasb.org.

NOTE 14 – CONTINGENCIES

During 2020, an outbreak of a novel strain of coronavirus ("COVID-19") emerged globally. As a result of the spread of COVID-19, economic uncertainties have arisen that could negatively impact the Lottery's revenue and operations for an indeterminable period of time. Other financial impacts could occur that are unknown at this time.

NOTE 15 – SUBSEQUENT EVENTS

The Commission of the NCEL has evaluated all subsequent events for potential recognition and disclosure through October 16, 2020, the date these financial statements will be available.

REQUIRED SUPPLEMENTARY INFORMATION

NORTH CAROLINA EDUCATION LOTTERY

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF THE PROPORTIONATE SHARE OF NET PENSION LIABILITY
TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM

LAST SEVEN FISCAL YEARS

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
(1) Proportionate share percentage of collective net pension liability	0.10671%	0.10799%	0.10898%	0.11054%
(2) Proportionate share of TSERS collective net pension liability	\$ 11,063	\$ 10,752	\$ 8,647	\$ 10,160
(3) Covered payroll	\$ 14,907	\$ 15,733	\$ 14,093	\$ 13,989
(4) Net pension liability as a percentage of covered payroll	74%	68%	61%	73%
(5) Plan fiduciary net position as a percentage of the total pension liability	87.56%	87.61%	89.51%	87.32%
	<u>2016</u>	<u>2015</u>	<u>2014</u>	
(1) Proportionate share percentage of collective net pension liability	0.11096%	0.11096%	0.10540%	
(2) Proportionate share of TSERS collective net pension liability	\$ 1,301	\$ 1,301	\$ 6,399	
(3) Covered payroll	\$ 13,989	\$ 13,706	\$ 13,139	
(4) Net pension liability as a percentage of covered payroll	9%	9%	49%	
(5) Plan fiduciary net position as a percentage of the total pension liability	94.64	98.24%	90.60%	

Information is not available for preceding years, to the extent 10 years of information is not presented.

NORTH CAROLINA EDUCATION LOTTERY

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF CONTRIBUTIONS TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM

Last Ten Fiscal Years

	2020	2019	2018	2017	2016
(1) Contractually required contribution	\$ 2,160	\$ 1,832	\$ 1,696	\$ 1,405	\$ 1,190
(2) Contributions in relation to the contractually determined contribution	2,160	1,832	1,696	1,405	1,190
(3) Contribution deficiency (excess)	<u>\$ -</u>				
(4) Covered-employee payroll	\$ 16,653	\$ 14,907	\$ 15,733	\$ 14,093	\$ 13,006
(5) Contributions as a percentage of covered-employee payroll	12.97%	12.29%	10.78%	9.98%	9.15%

	2015	2014	2013	2012	2011
(1) Contractually required contribution	\$ 1,279	\$ 1,191	\$ 1,094	\$ 955	\$ 592
(2) Contributions in relation to the contractually determined contribution	1,279	1,191	1,094	955	592
(3) Contribution deficiency (excess)	<u>\$ -</u>				
(4) Covered-employee payroll	\$ 13,989	\$ 13,706	\$ 13,139	\$ 12,839	\$ 12,018
(5) Contributions as a percentage of covered-employee payroll	9.15%	8.69%	8.33%	7.44%	4.93%

Notes to Schedule

Valuation date.

The total pension liability was determined by actuarial valuations as of December 31, 2018. The total pension liability was then rolled forward to June 30, 2019 utilizing update procedures incorporating the actuarial assumptions. The actuarial assumptions used in the December 31, 2018 valuations were based on the results of an actuarial experience study for the period January 1, 2010 through December 31, 2014.

Methods and assumptions used to determine contribution rates.

- The Entry Age Normal actuarial cost method was used to determine liabilities and funding requirements.
- Change in discount rate from 7.20% to 7.00% as of December 31, 2018, with direct-rate smoothing of the change in the employer contributions rate over a three-year period.
- Salary increases are assumed to be 3.50%-8.10% which includes 3.5% inflation and productivity factor.
- Investment expected rate of return is 7.00% net of pension plan investment expense, including inflation.
- No cost-of-living adjustments granted.
- Mortality tables vary by age, gender, employee group, and health status. The current mortality rates are based on published tables and based on studies that cover significant portions of the U.S. population. The mortality rates also contain a provision to reflect future mortality improvements.

NORTH CAROLINA EDUCATION LOTTERY

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF PROPORTIONATE SHARE OF NET OPEB LIABILITY
AND SCHEDULE OF CONTRIBUTIONS
RETIREMENT HEALTH BENEFIT FUND

LAST THREE FISCAL YEARS

	<u>2020</u>	<u>2019</u>	<u>2018</u>
(1) Proportionate share percentage of collective net pension liability	0.09401%	0.09339%	0.09669%
(2) Proportionate share of RHBF collective net pension liability	\$ 29,745	\$ 26,606	\$ 31,701
(3) Covered payroll	\$ 14,907	\$ 15,733	\$ 14,093
(4) Net pension liability as a percentage of covered payroll	200%	169%	225%
(5) Plan fiduciary net position as a percentage of the total pension liability	4.40%	4.40%	3.52%

LAST THREE FISCAL YEARS

	<u>2020</u>	<u>2019</u>	<u>2018</u>
(1) Contractually required contributions	\$ 1,077	\$ 935	\$ 952
(2) Contributions in relation to the contractually determined contributions	<u>1,077</u>	<u>935</u>	<u>952</u>
(3) Contributions deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
(4) Covered payroll	\$ 16,653	\$ 14,907	\$ 15,733
(5) Contributions as a percentage of covered payroll	6.47%	6.27%	6.05%

NORTH CAROLINA EDUCATION LOTTERY

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF PROPORTIONATE SHARE OF NET OPEB LIABILITY AND SCHEDULE OF CONTRIBUTIONS RETIREMENT HEALTH BENEFIT FUND

Notes to Schedule

Valuation date.

The total pension liability was determined by actuarial valuations as of December 31, 2018. The total pension liability was then rolled forward to June 30, 2019 utilizing update procedures incorporating the actuarial assumptions.

Methods and assumptions used to determine contribution rates.

- The discount rate used to measure total OPEB liability for RHBF was 3.5%, mirroring the municipal bond rate. The rate is based on the Bond-Buyer 20-year General Obligation index as of June 30, 2019.
- Salary increases are assumed to be 3.50%-8.10% which includes 3.5% inflation and productivity factor.
- Investment expected rate of return is 7.00% net of pension plan investment expense, including inflation.
- General inflation is assumed to be 3%
- Mortality tables vary by age, gender, employee group and health status. The current mortality rates are based on published tables and based on studies that cover significant portions of the U.S. population. The mortality rates also contain a provision to reflect future mortality improvements.

NORTH CAROLINA EDUCATION LOTTERY

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF PROPORTIONATE SHARE OF NET OPEB LIABILITY
AND SCHEDULE OF CONTRIBUTIONS
DISABILITY INCOME PLAN OF NORTH CAROLINA

LAST THREE FISCAL YEARS

	<u>2020</u>	<u>2019</u>	<u>2018</u>
(1) Proportionate share percentage of collective net pension liability	0.09333%	0.09435%	0.09603%
(2) Proportionate share of DIPNC collective net pension liability	\$ (40)	\$ (29)	\$ (59)
(3) Covered payroll	\$ 14,907	\$ 15,733	\$ 14,093
(4) Net pension liability as a percentage of covered payroll	0%	0%	0%
(5) Plan fiduciary net position as a percentage of the total pension liability	113%	108.47%	116.23%

LAST THREE FISCAL YEARS

	<u>2020</u>	<u>2019</u>	<u>2018</u>
(1) Contractually required contributions	\$ 17	\$ 21	\$ 22
(2) Contributions in relation to the contractually determined contributions	17	21	22
(3) Contributions deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
(4) Covered payroll	\$ 16,653	\$ 14,907	\$ 15,733
(5) Contributions as a percentage of covered payroll	0.10%	0.14%	0.14%

NORTH CAROLINA EDUCATION LOTTERY

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF PROPORTIONATE SHARE OF NET OPEB LIABILITY AND SCHEDULE OF CONTRIBUTIONS DISABILITY INCOME PLAN OF NORTH CAROLINA

Notes to Schedule

Valuation date.

The total pension liability was determined by actuarial valuations as of December 31, 2018. The total pension liability was then rolled forward to June 30, 2019 utilizing update procedures incorporating the actuarial assumptions. The actuarial assumptions used in the December 31, 2018 valuations were based on an investigation of demographic and economic experience over the five-year period from January 1, 2010 to December 31, 2014.

Methods and assumptions used to determine contribution rates.

- The discount rate used to measure total OPEB liability for DIPNC was 3.75%.
- The long-term expected real rate of return on plan investments was used on all periods for projecting benefit payments and determining the total liability.
- Salary increases are assumed to be 3.50%-8.10% which includes 3.5% inflation and productivity factor.
- Investment expected rate of return is 3.75% net of pension plan investment expense, including inflation.
- General inflation is assumed to be 3%
- Mortality tables vary by age, gender, employee group, and health status. The current mortality rates are based on published tables and based on studies that cover significant portions of the U.S. population. The mortality rates also contain a provision to reflect future mortality improvements.

**Report of Independent Auditor 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***

To the Commissioners
North Carolina Education Lottery
Raleigh, North Carolina

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the North Carolina Education Lottery (the "NCEL"), a major enterprise fund of the State of North Carolina, as of and for the years ended June 30, 2020 and 2019, and the related notes to the financial statements, which collectively comprise the NCEL's basic financial statements as listed in the table of contents, and have issued our report thereon dated October 16, 2020.

The financial statements present only the NCEL and do not purport to and do not present fairly the financial position of the State of North Carolina, as of June 30, 2020 and 2019, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Internal Control over Financial Reporting

In planning and performing our audits of the financial statements, we considered the NCEL'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 NCEL's internal control. Accordingly, we do not express an opinion on the effectiveness of the NCEL'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 NCEL'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. Given these limitations, during our audits, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the NCEL's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audits, 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 NCEL'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 NCEL's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Cherry Baskin LLP

Raleigh, North Carolina
October 16, 2020

The audit report required 415 audit hours at a cost of \$56,500.