



MARYLAND LOTTERY AND GAMING CONTROL AGENCY
an agency of the State of Maryland

FINANCIAL STATEMENTS
For the Years Ended June 30, 2018 and 2017

MARYLAND LOTTERY AND GAMING CONTROL AGENCY

**FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2018 AND 2017**

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INDEPENDENT AUDITORS' REPORT

To the Maryland Lottery and Gaming Control Agency:

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Maryland Lottery and Gaming Control Agency (an agency of the State of Maryland) (Agency), as of and for the years ended June 30, 2018 and 2017, and the related notes to the 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.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Maryland Lottery and Gaming Control Agency as of June 30, 2018 and 2017 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

As discussed in Note 1, the financial statements of the Agency are intended to present the financial position and the changes in financial position and cash flows, where applicable, of the Agency. They do not purport to, and do not, present fairly the financial position of the State of Maryland as of June 30, 2018 and 2017, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion, analysis and budgetary comparison and changes in net pension liability contributions and related ratios information on pages 3 through 18 and 46 through 50, respectively, be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board (GASB), 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 September 27, 2018, on our consideration of the Maryland Lottery and Gaming Control Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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 Maryland Lottery and Gaming Control Agency's internal control over financial reporting and compliance.

SC+M Affect Services, P.C.

September 27, 2018

Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
For the Years Ended June 30, 2018 and 2017

The following Management's Discussion and Analysis (MD&A) provides an overview of the Maryland Lottery and Gaming Control Agency's (Agency) performance for the fiscal years ended June 30, 2018 and 2017. As you read the MD&A, 2018 refers to the fiscal year ended June 30, 2018, 2017 refers to the fiscal year ended June 30, 2017 and 2016 refers to the fiscal year ended June 30, 2016. The information contained in the MD&A should be read in conjunction with the information contained in the financial statements and notes to the financial statements, which begins on page 19.

FINANCIAL HIGHLIGHTS

- Net lottery sales were \$2.04 billion in 2018, an increase of \$111.25 million or 5.76% compared to 2017, which increased by \$26.0 million or 1.36% as compared to 2016.
- Gross video lottery terminal (VLT) revenue was \$1.047 billion in 2018, an increase of \$160.81 million or 18.15% as compared to 2017, which increased by \$144.17 million or 19.44% as compared to 2016.
- Table game revenue was \$632.29 million in 2018, an increase of \$97.22 million or 18.17% compared to 2017, which increased \$132.80 million, or 33.01% compared to 2016.
- Cost of sales increased by \$238.42 million or 10.85% in 2018 compared to 2017, which increased \$263.97 million, or 13.65% compared to 2016.
- Operating expenses decreased by \$11.54 million or 17.58% in 2018 compared to 2017 which increased by \$7.06 million or 12.05% compared to 2016.
- Transfers from lottery proceeds to the State of Maryland, the Stadium Authority, the International Racing Fund and the Veterans Trust Fund in 2018 were \$575.67 million, an increase of \$50.77 million or 9.67% compared to 2017 which decreased by \$44.91 million or 7.88% as compared to 2016.
- Transfers to Other Governmental Funds/Agencies totaled \$ 680.21 million in 2018, an increase of \$80.58 million or 13.44% compared to 2017, which increased \$85.47 million or 16.62% compared to 2016.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Maryland Lottery and Gaming Control Agency is an independent agency of the State of Maryland (the State) that was created to generate revenue through the operation of a lottery. On November 4, 2008, a constitutional amendment was approved by voters which set up broad parameters for the operations of VLTs and the establishment of five casinos in the State. During the 2012 Second Special Session of the Maryland General Assembly, legislation passed, subject to voter referendum, that allowed, among other things, the implementation of table games as well as a sixth casino. During the November 2012 election, voters approved both table games and the sixth casino. The Agency is responsible for regulating the operations of the casinos. As of June 30, 2018, there were six casinos operating in the State with 11,535 VLTs and 594 table games.

The Agency is accounted for as a proprietary-type enterprise fund using the accrual basis of accounting, similar to a private business entity.

Maryland Lottery and Gaming Control Agency
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OVERVIEW OF THE FINANCIAL STATEMENTS – (continued)

Financial Statements

The financial statements included in this report are: the statements of net position; statements of revenues, expenses, and changes in net position; and statements of cash flows. The statements of net position present the assets and deferred outflows of resources, and liabilities and deferred inflows of resources of the Agency with the difference being reported as net position. The statements of revenues, expenses, and changes in net position report the revenues and expenses of the Agency and are used to measure the success of its operations for a given period of time as it relates to contributions to the State of Maryland and other government agencies. The statements of cash flows reconcile the changes in cash and cash equivalents with the activities of the Agency for the periods presented. The activities are classified as operating, noncapital financing, capital and related financing, and investing.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to the full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 23 to 45 of this report.

Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
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FINANCIAL ANALYSIS

Table 1 is a summarized version of the statements of net position as of June 30, 2018, 2017 and 2016. The table reflects the Agency's overall change in financial resources and claims on those resources. The majority of the assets consist of cash held by the State Treasury, investments, accounts receivable and net capital assets. The Agency's investments and the majority of accounts receivable, as well as the majority of cash held by the State Treasury, are used to pay lottery winners or are transferred as income to the State of Maryland and other government agencies. Most liabilities represent prize awards payables, annuities payable, amounts due to the State of Maryland, amounts due to other government agencies and capital lease obligations.

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Current Assets	\$ 226,625	\$ 171,954	\$ 209,910
Other Non-Current Assets	34,503	29,024	30,292
Capital Assets, net	400	35,735	48,717
Total Assets	<u>\$ 261,528</u>	<u>\$ 236,713</u>	<u>\$ 288,919</u>
Deferred Outflows of Resources	\$ 11,100	\$ 13,879	\$ 11,394
Total Assets and Deferred Outflows	<u>\$ 272,628</u>	<u>\$ 250,592</u>	<u>\$ 300,313</u>
Current Liabilities	\$ 219,809	\$ 175,137	\$ 210,685
Non-Current Liabilities	35,102	52,126	63,384
Net Pension Liability	27,646	27,137	22,831
Total Liabilities	<u>\$ 282,557</u>	<u>\$ 254,400</u>	<u>\$ 296,900</u>
Deferred Inflows of Resources	\$ 2,859	\$ 1,104	\$ 1,436
Total Liabilities and Deferred Inflows	<u>\$ 285,416</u>	<u>\$ 255,504</u>	<u>\$ 298,336</u>
Net Position			
Net Investment in capital assets	\$ 400	\$ 67	\$ 433
Restricted	(1,762)	(3,542)	(5,650)
Unrestricted	(11,425)	(1,435)	7,194
Total Net Position	<u>\$ (12,787)</u>	<u>\$ (4,910)</u>	<u>\$ 1,977</u>

Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
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FINANCIAL ANALYSIS – (continued)

Current Assets

The Agency's current assets increased by \$54.67 million or 31.79% in 2018 compared to 2017 which decreased by \$37.96 million or 18.08% compared to 2016.

Cash held with the State Treasury increased by \$45.68 million or 40.55% in 2018 compared to 2017 which decreased by \$43.71 million or 27.95% compared to 2016. At the end of 2018, there was two months of lottery income waiting to be transferred to the General Fund versus one month of income in 2017. At the end of 2017, there was one month of lottery income waiting to be transferred to the General Fund versus two months of income in 2016.

Accounts receivable increased by \$11.01 million or 22.51% in 2018 compared to 2017 which increased by \$6.35 million or 14.92% compared to 2016. Accounts receivable is primarily comprised of amounts due from lottery retailers from the sale of lottery tickets and revenue due from the casino operators. Accounts receivable from lottery retailers increased by \$7.01 million or 16.87% in 2018 compared to 2017 which increased by \$4.32 million or 11.58% compared to 2016. On a weekly basis, amounts due from retailers are collected electronically from the retailers' bank accounts. In 2018, seven days' worth of sales activity was waiting to be collected compared to five days in 2017 and four days in 2016.

Accounts receivable from casino operators increased by \$4.00 million or 54.66% in 2018 compared to 2017 which increased by \$2.05 million or 38.93% compared to 2016. Gross terminal revenue is electronically transferred to the Agency on a daily basis and table game revenue is electronically transferred to the Agency every two days. Corresponding increases and decreases in accounts receivables from casino operators is a function of the change in gaming revenue for the last days of the fiscal year and timing of when the revenue is received.

The current portion of investments for annuity payments increased by \$554 thousand or 16.11% in 2018 compared to 2017 which increased by \$1.28 million or 27.08% compared to 2016. The increases during these years resulted from more jackpot winners electing to receive their prize in the form of an annuity compared to the number of annuities that expired.

Non-Current Assets

The Agency's non-current assets consist of investments for annuity payments, net of current portion and capital assets, net of depreciation. Non-current assets decreased by \$29.86 million or 46.10% in 2018 compared to 2017 which decreased by \$14.25 million or 18.04% compared to 2016.

Capital assets, net of depreciation, decreased by \$35.34 million or 98.88% in 2018 compared to 2017 which decreased by \$12.98 million or 26.65% compared to 2016. The reduction in both periods was the result of depreciation of existing assets which primarily related to VLTs. In July 2017, the gaming law changed and required the Casino at Ocean Downs and the Rocky Gap Casino and Resort to own their VLTs by March 31, 2020. Both casinos elected to own their VLTs in July 2017, which eliminated the majority of the Agency's capital assets. The decrease between 2016 and 2017 was for a similar reason in that the gaming law required all casinos with the exception of the Casino and Ocean Downs and the Rocky Gap Casino and Resort to own their VLTs. These VLTs were leased by the Agency under agreements, which included purchase options at the end of their five-year terms and, as such, were treated as capital leases and were being amortized over the five-year life of the related leases.

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Non-Current Assets (continued)

The Agency's investments for annuity payments, net of current portion, increased by \$5.48 million or 18.88% in 2018 compared to 2017 which decreased by \$1.27 million or 4.18% compared to 2016. The increase in 2018 resulted from more jackpot winners electing to receive their prize in the form of an annuity compared to the number of annuities that have expired, while the decrease in 2017 resulted from fewer jackpot winners electing to receive their prize in the form of an annuity compared to the number of annuities that have expired.

Deferred Outflows of Resources

In 2015, the Agency recognized deferred pension outflows as a result of the implementation of GASB Statement No. 68 - *Accounting and Financial Reporting for Pensions - An Amendment of GASB Statement No. 27*. The amount recognized represents the Agency's contributions subsequent to the measurement date and the changes in the Agency's proportionate share of the State Retirement and Pension Funds total pension liability and the changes in actuarial assumptions as described in Note 9 to the financial statements. Deferred outflows decreased by \$2.78 million or 20.02% in 2018 compared to 2017 which increased by \$2.49 million or 21.81% compared to 2016. The changes between years is attributed to the changes in the Agency's proportionate share of the overall pension liability.

Current Liabilities

Current liabilities increased by \$44.67 million or 25.51% in 2018 compared to 2017 which decreased by \$35.55 million or 16.87% compared to 2016. The majority of the increase between 2018 and 2017 is related to amount of lottery income due to the General Fund at year-end. At the end of 2018, two months of lottery income was waiting to be transferred to the General Fund compared to one month in 2017. Conversely, at the end of 2017, there was one month of lottery income waiting to be transferred, in comparison to two months in 2016. Amounts due to other governmental agencies – gaming also increased between 2018 and 2017. Amounts due to other governmental agencies – gaming increased by \$7.81 million or 14.09% in 2018 compared to 2017 which increased by \$12.47 million or 29.03% in 2017 in comparison to 2016. The increase between 2018 and 2017 is related to an overall increase in gaming revenue and a full year of operations at the MGM National Harbor Casino. The increase between 2017 and 2016 was related to the opening of the MGM National Harbor casino.

The increases in current liabilities in 2018 was offset by a decrease in the current portion of the capital lease obligation. As previously noted, the Casino at Ocean Downs and the Rocky Gap Casino and Resort acquired all of their VLTs in July 2017 thus eliminating the capital lease obligations.

Non-Current Liabilities

Non-current liabilities decreased by \$17.02 million or 32.66% in 2018 compared to 2017 which decreased by \$11.26 million or 17.76% compared to 2016. The decrease between 2018 and 2017 is related to the elimination of the capital leases when the Casino at Ocean Downs and the Rocky Gap Casino and Resort acquired their VLTs in July 2017. The decrease between 2017 and 2016 is the result of payments made on the capital leases for the VLTs at these casinos.

Maryland Lottery and Gaming Control Agency
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Net Pension Liability

Net pension liability increased by \$509 thousand or 1.87% in 2018 compared to 2017 which increased by \$4.31 million or 18.86% compared to 2016. The Agency began recognizing net pension liability in 2015 as a result of implementing GASB Statement No. 68 - *Accounting and Financial Reporting for Pensions - An Amendment of GASB Statement No. 27*. The total pension liability represents the Agency's proportionate share of the State of Maryland's total net pension liability. The changes between the years is primarily the result of the changes in the Agency's proportionate share of the State Retirement and Pension Funds overall pension liability.

Deferred Inflows of Resources

Deferred inflows increased by \$1.76 million or 159.0% in 2018 compared to 2017 which decreased by \$332,000 or 23.10% in 2017 compared to 2016. In 2015, the Agency began recognizing deferred pension inflows as a result of the implementation of GASB Statement No. 68 - *Accounting and Financial Reporting for Pensions - An Amendment of GASB Statement No. 27*. The amount recognized represents the Agency's contributions subsequent to the measurement date and the change in actuarial assumptions as described in Note 9 to the financial statements.

Net Position

Net position decreased by \$7.88 million or 160.4% in 2018 compared to 2017 which decreased by \$6.89 million or 348.43% compared to 2016. Because the Agency is required by law to transfer its entire budgetary basis net position to the State of Maryland and its gaming revenue to government agencies, changes in net position do not reflect the results of the Agency's operating activities. Rather, changes in net position reflect differences between budgetary basis net income and net income in accordance with accounting principles generally accepted in the United States and the unclaimed prize fund.

The decreases in both 2018 and 2017 is related to the recognition of pension expense and deferred inflows.

Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
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Results of Operations

Table 2 is a summarized version of the statements of revenues, expenses, and changes in net position for the years ended June 30, 2018, 2017 and 2016.

Table 2
Revenues, Expenses, and Changes in Net Position
(in thousands)

	2018	2017	2016
Revenue			
Draw games	\$ 1,282,785	\$ 1,246,420	\$ 1,287,323
Instant games	750,888	676,753	611,286
ITLMs	9,121	8,373	6,934
Total sales	\$ 2,042,794	\$ 1,931,546	\$ 1,905,543
Gaming revenue – gross terminal revenue	1,046,677	885,868	741,694
Gaming revenue – state grant	7,475	20,706	20,275
Gaming revenue – table games	632,290	535,074	402,279
Gaming revenue – facility applicants	2,130	2,957	1,921
Gaming revenue – machine assessments	5,358	4,650	3,845
ITLM lease revenue	3,807	3,495	2,894
Total revenue	\$ 3,740,531	\$ 3,384,296	\$ 3,078,451
Cost of sales	\$ 2,436,693	\$ 2,198,274	\$ 1,934,303
Gross profit	\$ 1,303,838	\$ 1,186,022	\$ 1,144,148
Operating expenses	54,130	65,674	58,609
Income from operations	\$ 1,249,708	\$ 1,120,348	\$ 1,085,539
Non-operating revenues (expenses)			
Investment in loss and amortization of discount for annuity prize liabilities	(1,780)	(2,108)	394
Voluntary exclusion program	79	38	76
Interest expense	-	(633)	(820)
Payments to State of Maryland General Fund, Stadium Authority and Veterans Trust Fund	(575,672)	(524,903)	(569,814)
Payments to Other Government Funds/Agencies- Gaming	(680,212)	(599,628)	(514,154)
Total non-operating expenses	\$ (1,257,585)	\$ (1,127,234)	\$ (1,084,318)
Change in net position	\$ (7,877)	\$ (6,886)	\$ 1,221
Total net position – beginning of year	(4,910)	1,976	755
Total net position – end of year	\$ (12,787)	\$ (4,910)	\$ 1,976

Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
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Sales

Net lottery sales were \$2.04 billion in 2018, an increase of \$111.25 million or 5.76% compared to 2017, which increased by \$26.0 million or 1.36% as compared to 2016.

Lottery sales are categorized as jackpot games, draw games, monitor games, instant ticket games and instant ticket lottery machine sales (ITLMs).

Table 3
Net Sales
(in thousands)

	2018	2017	2016
Jackpot	\$ 241,877	\$ 206,691	\$ 259,796
Draw	556,913	556,086	548,879
Monitor	483,994	483,643	478,648
Instant	750,889	676,753	611,286
ITLM	9,121	8,373	6,934
Total	\$ 2,042,794	\$ 1,931,546	\$ 1,905,543

Sales for Jackpot games, which includes Powerball, Powerplay (referred to as Powerball), Mega Millions, Megaplier (referred to as Mega Millions), Multi-Match, and Cash 4 Life increased by \$35.19 million or 17.02% in 2018 compared to 2017 which decreased by \$53.11 million or 20.44% compared to 2016. The increase in 2018 is mostly attributed to an increase in both Powerball and Mega Millions sales. Powerball sales increased by \$11.06 million or 11.05% and Mega Millions sales increased by \$22.21 million or 33.48%. During 2018, both games had three jackpots in excess of \$450 million. As jackpots grow, sales grow.

The decrease in Jackpot games between 2017 and 2016 is attributed mostly to Powerball. Powerball sales decreased by \$43.39 million or 30.23% in 2017 compared to 2016. In 2016, Powerball set a world record jackpot of \$1.6 billion. 2017 did not experience a jackpot anywhere near \$1.6 billion resulting in lower sales for the year. Sales for Mega Millions and Multi-Match also decreased between 2017 and 2016. Mega Millions sales decreased by \$6.87 million or 9.39% in 2017 compared to 2016 and Multi-Match sales decreased by \$7.08 million or 22.76% in 2017 compared to 2016. Sales for these games are jackpot dependent.

Sales for Draw games, which are Pick 3, Pick 4, Bonus Match 5 and 5 Card Cash increased by \$827 thousand or 0.15% in 2018 compared to 2017 which increased by \$7.21 million or 1.31% compared to 2016. Pick 4 sales increased in years 2018, 2017 and 2016 over the previous years by \$4.62 million or 1.58%, \$10.81 million or 3.85% and \$3.83 million or 1.38% respectively. Pick 4 has increased over the past several years as players who enjoy playing their daily numbers chose Pick 4 over Pick 3 as it has a top prize of \$5,000 compared to the top prize of Pick 3 of \$500. The 2017 increase in Pick 4 sales is attributed to the game paying out more than both the theoretical payout and the payout in 2016. In 2017, Pick 4 paid out 55% of sales, which is higher than the theoretical payout of 50% and more than the 45% payout in 2016. As payouts increase, players tend to reinvest their winnings generating additional sales.

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Management's Discussion and Analysis
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Sales (continued)

Pick 3 sales decreased \$3.75 million or 1.57% in 2018 compared to 2017, which decreased \$2.42 million, or 1.00% compared to 2016. Pick 3 sales continue to slowly decline as the top prize of \$500 is no longer attractive to players.

Sales for Bonus Match 5 and 5 Card Cash remained relatively flat between 2016 and 2018. Bonus Match 5 sales decreased by \$141 thousand or 0.71% in 2018 compared to 2017 which decreased by \$812,000 or 3.94% compared to 2016. 5 Card Cash sales increased by \$101 thousand or 1.82% in 2018 compared to 2017 which decreased by \$369 thousand or 6.24% compared to 2016.

Sales for the Monitor games, which includes Racetrax® and Keno increased by \$351 thousand or 0.07% in 2018 compared to 2017, which increased \$5.0 million or 1.04% compared to 2016. Racetrax® sales increased by \$12.19 million or 6.75% in 2018 compared to 2017 which increased by \$13.31 million or 7.96% compared to 2016. Racetrax® continues to grow as players find the HD graphics appealing. It is further believed that players have traded Pick 3 play for Racetrax® play as Racetrax® plays much like Pick 3 and has a higher top prize.

The increase in Racetrax® sales in both 2018 and 2017 was offset by a decrease in Keno sales for these years. Keno sales decreased by \$11.83 million or 3.90% in 2018 compared to 2017 which decreased by \$8.31 million or 2.67% compared to 2016.

Instant ticket games continue to be a growth product for the Agency. Instant ticket game sales increased by \$74.14 million or 10.95% in 2018 compared to 2017 which increased by \$65.47 million or 10.71% compared to 2016.

Maryland Lottery and Gaming Control Agency
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Sales (continued)

Table 4
Net Sales of Instant Games
by Price Point
(in thousands)

	2018	2017	2016
\$1	\$30,555	\$31,569	\$30,761
\$2	46,761	51,468	41,263
\$3	35,153	41,999	38,609
\$5	243,443	231,118	240,356
\$10	219,328	182,396	161,362
\$20	93,221	106,020	98,935
\$30	82,427	32,183	-
Total	\$750,889	\$676,753	\$611,286

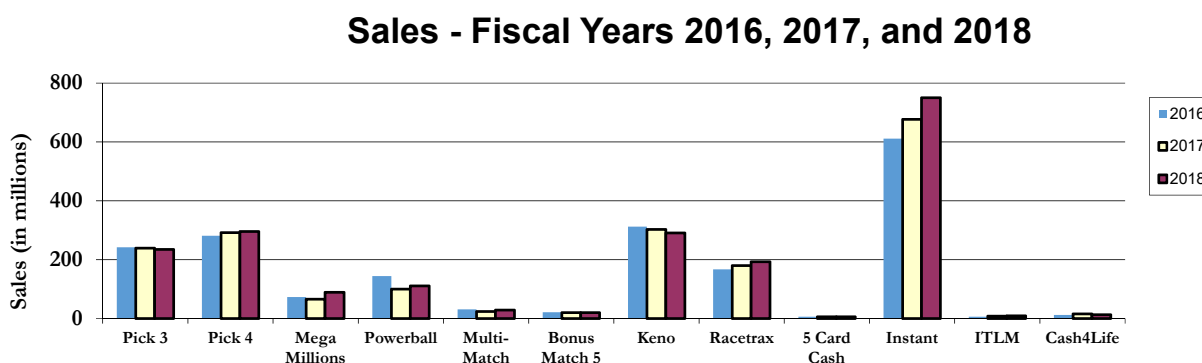
Instant ticket sales growth in 2018 was fueled by the continued growth of the \$30 tickets and continued growth of the \$10 tickets. The first \$30 ticket was launched in March 2017; therefore, 2018 was the first full year of sales for this price point. Players gravitate towards higher price point tickets as the payouts are more rewarding. Instant ticket sales growth has continued over the past several years due to key components in place: inventory management, an aggressive planning and development schedule and increased advertising. By closing older games and replenishing inventory with newer games, retailer and player interest and enthusiasm remained high throughout the past years. In addition, a strategic approach to invest more advertising money towards the Instant ticket product category has been essential to the sales growth.

Instant ticket lottery machines (ITLMs) is the last category of lottery games offered. Instant ticket lottery machines were first introduced in September 2014 and under law are allowed only in veterans' organizations in certain counties in Maryland. An ITLM is an electronic device that dispenses pre-printed instant scratch tickets and utilizes a touch screen monitor. The device accumulates winnings and prints out a voucher at the conclusion of play. ITLM sales (which are accounted for as amount bet less amount won) increased by \$748,000 or 8.94% in 2018 compared to 2017 which increased by \$1.44 million or 20.75% compared to 2016. The continued increases can be attributed to a further rollout of the product and a gain in popularity.

Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
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Sales (continued)

The following graph depicts sales for 2016, 2017, and 2018.



Gaming Revenue – Gross Terminal Revenue, Table Games, State Grant, Facility Applicants, Machine Assessments and ITLM Lease Revenue

Gaming revenue – gross terminal revenue (GTR) represents the revenue generated by the VLTs net of total prize payouts. Gross terminal revenue in 2018 totaled \$1,046.68 million, an increase of \$160.8 million or 18.15% compared to 2017, which increased \$144.17 million, or 19.44% compared to 2016. The increase in 2018 is primarily related to a full year of operations for the MGM National Harbor casino. Gross terminal revenue at all other casinos remained relatively consistent with a slight increase at the Casino at Ocean Downs and a slight decrease at the Horseshoe Casino Baltimore. The increase in 2017 is attributed to the opening of the MGM National Harbor casino in December 2016. During the first seven months of operations, MGM National Harbor generated \$177.46 million in gross terminal revenue. This increase was offset by a decrease in gross terminal revenue at Live! Casino. Gross terminal revenue decreased by \$36.88 million or 9.02% in 2017 compared to 2016. Live! Casino is the closest casino to MGM National Harbor and lost some play to them. Gross terminal revenue at all of the other casinos remained relatively consistent.

Table 5
Gross Terminal Revenue Statistics

Casino	Date Opened	Number of Machines as of June 30, 2018	2018 GTR (in millions)	2017 GTR (in millions)	2016 GTR (in millions)
Hollywood Casino Perryville	September 27, 2010	822	\$ 64.9	\$ 63.1	\$ 65.7
Casino at Ocean Downs	January 4, 2011	888	64.2	59.6	57.6
Live! Casino	June 6, 2012	3,997	369.5	371.9	408.8
Rocky Gap Casino and Resort	May 22, 2013	665	46.5	45.1	41.3
Horseshoe Casino Baltimore	August 24, 2014	2,202	156.3	168.7	168.3
MGM National Harbor Casino	December 8, 2017	2,961	345.3	177.5	-
Total		11,535	\$ 1,046.7	\$ 885.9	\$ 741.7

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For the Years Ended June 30, 2018 and 2017

Gaming Revenue – Gross Terminal Revenue, Table Games, State Grant, Facility Applicants, Machine Assessments and ITLM Lease Revenue– (continued)

Gaming revenue – table games revenue generated in 2018 increased by \$97.2 million or 18.17% over 2017 which increased by \$132.80 million or 33.01% compared to 2016. The increase in table game revenue in 2018 is primarily attributed to a full year of operations at the MGM National Harbor casino. Table game revenue at MGM National Harbor casino increased by \$149.07 million or 92.62% in 2018 compared to 2017. In addition to the increase at MGM National Harbor casino, \$3.35 million of the overall increase is attributed to the Casino at Ocean Downs opening table games in December 2017. These increases were offset by decreases in table game revenue at the Horseshoe Casino Baltimore and Live! Casino. Table game revenue at Horseshoe Casino Baltimore decreased by \$24.55 million or 18.14% in 2018 and table game revenue at the Live! Casino decreased by \$29.70 million or 13.51% in 2018. Table game revenue at all other casinos remained relatively consistent. The overall increase in 2017 is attributed to the opening of the MGM National Harbor casino in December 2016. In its first seven months of operations, MGM National Harbor casino generated \$160.95 million in table game revenue. This increase was offset by a decline in table game revenue at Maryland Live! Casino and Horseshoe Casino Baltimore as players shifted their play from these casinos to the MGM National Harbor casino. Table game revenue at Live! Casino decreased by \$22.17 million or 9.16% in 2017 compared to 2016 and decreased by \$6.78 million or 4.77% at Horseshoe Casino Baltimore. Table game revenue at the other two casinos remained relatively consistent between 2016 and 2017. Table 6 shows the table game revenue statistics for each casino.

Table 6
Table Game Revenue Statistics

Casino	Date Table Games Debuted	Number of Tables as of June 30, 2018	2018 Table Game Revenue (in millions)	2017 Table Game Revenue (in millions)	2016 Table Game Revenue (in millions)
Hollywood Casino - Perryville	March 6, 2013	22	\$ 10.4	\$ 11.3	\$ 11.6
Live! Casino	April 11, 2013	198	190.1	219.8	242.0
Rocky Gap Casino Resort	May 22, 2013	17	7.6	7.6	6.6
Casino at Ocean Downs	N/A	10	3.3	-	-
Horseshoe Casino Baltimore	August 24, 2014	167	110.8	135.3	142.1
MGM National Harbor Casino	December 8, 2016	180	310.0	160.9	-
Total		594	\$632.3	\$ 535.1	\$ 402.3

For the gaming operations, the gross terminal revenue and table game revenue (gaming revenue) is required to be transferred to specified Government agencies to be used for certain purposes or is retained by the casinos and the Agency to assist in covering the costs of the operations. Changes in the distribution of gaming proceeds occurred in both 2018 and 2017. Effective for 2018, the proceeds that were previously allocated to the Small, Minority and Woman-Owned Business were redirected to the General Fund. The only proceeds that are still allocated to the Small, Minority and Woman-Owned Business are a portion of expired gaming vouchers. Effective with the opening of MGM National Harbor casino in December 2016, five percent of the table game proceeds were redirected from the Education Trust Fund to the local jurisdictions in which the casino is located. Table 7 below shows the overall disbursements and allocations.

Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
For the Years Ended June 30, 2018 and 2017

Gaming Revenue – Gross Terminal Revenue, Table Games, State Grant, Facility Applicants, Machine Assessments and ITLM Lease Revenue– (continued)

Table 7
Gaming Revenue Disbursements/Allocations

Fund	2018 Disbursements (in millions)	2017 Disbursements (in millions)	2016 Disbursements (in millions)
Maryland Education Trust Fund	\$ 496.7	\$ 451.2	\$ 402.5
Casino Operators	996.9	819.4	626.1
Horse Racing	71.2	63.0	57.1
Local Impact Grants	56.8	47.5	39.7
Maryland Lottery and Gaming Control Agency	10.5	9.3	7.8
Small, Minority and Women-Owned Business	0.024	12.9	10.8
Local Jurisdictions	31.6	17.6	-
General Fund	15.3	-	-
Total	\$ 1,679.0	\$ 1,420.9	\$ 1,144.0

Gaming revenue – state grant represents funds received from the State of Maryland to help pay for the costs of the gaming operations. Gaming revenue - state grant decreased by \$13.23 million or 63.90% in 2018 compared to 2017 which increased by \$432,000 or 2.13% compared to 2016. The decrease in 2018 is the result of a change in the gaming law that required the Casino at Ocean Downs and the Rocky Gap Casino and Resort to own their VLTs by March 15, 2020. Both casinos elected to own their machines in July 2017 eliminating the need for the Agency to continue to pay lease costs. The increase in 2017 was related to a change in the mix of VLTs on the casino floors.

Gaming revenue - facility applicants represents money received to perform background investigations on applicants who have applied for a gaming license. Gaming revenue - facility applicants decreased by \$827,000 or 27.97% in 2018 compared to 2017 which increased by \$1.03 million or 53.91% compared to 2016. This account fluctuates based on the number of license applications received. The decrease in 2018 is attributed to no major casino openings. The increase in 2017 is a result of the opening of MGM National Harbor casino.

Gaming revenue - machine assessments represents assessments made to casino operators based on the maximum number of VLTs and table games on the floor during the fiscal year. In accordance with the law, casino operators are assessed a yearly fee of \$425 per VLT and \$500 per table. These funds are collected by the Agency and subsequently remitted to the Department of Health and Mental Hygiene's Problem Gambling Fund. Machine assessments increased by \$709,000 or 15.24% in 2018 compared to 2017 which increased by \$805 thousand or 20.94% compared to 2016. Assessments fluctuate based on the number of VLTs and table games that are on the casino floor during the year.

Gaming revenue – ITLM lease revenue increased by \$312,000 or 8.93% in 2018 compared to 2017 which increased by \$601,000 or 20.75% compared to 2016. ITLM lease revenue represents the amount collected from the veterans' organizations that is used to pay the machine fees to the ITLM vendor.

Maryland Lottery and Gaming Control Agency
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Cost of Sales

Cost of sales consists of lottery prize expense, lottery retailer commissions, casino operator commissions, costs paid to vendors to operate and maintain the lottery and gaming systems, and costs paid for the printing and delivery of instant ticket games. Cost of sales increased by \$238.42 million or 10.85% in 2018 compared to 2017 which increased by \$263.97 million or 13.65% compared to 2016.

Commission paid to casino operators increased by \$177.47 million or 21.66% in 2018 compared to 2017 which increased by \$193.29 million or 30.87% compared to 2016. The increase in commissions paid in 2018 is the result of higher overall gaming revenue and the increase in the commissions paid to the Casino at Ocean Downs and the Rocky Gap Casino and Resort as a result of them owning/leasing their own VLTs. The VLT commissions paid to the Casino at Ocean Downs increased from 43% to 53% of the gross terminal revenue. The VLT commissions paid to the Rocky Gap Casino and Resort increased from 50% to 60% of the gross terminal revenue. The increase in commissions in 2017 was the result of overall higher gaming revenue due to the opening of the MGM National Harbor casino and an increase in commission rates for the Live! Casino and the Horseshoe Casino Baltimore. In accordance with the law, in order to compensate Live! Casino and Horseshoe Casino Baltimore for lost revenue due to the opening of the MGM National Harbor casino, the commission rates for these two casinos increased by 8% and 7%, respectively.

Commissions paid to lottery retailers increased by \$7.84 million or 5.38% in 2018 compared to 2017 which increased by \$4.73 million or 3.35% compared to 2016. Typically, increases and decreases in commission are a function of sales as retailers receive a percentage of all tickets sold and cashed at their location. Sales in both 2018 and 2017 increased resulting in an increase in commission paid to retailers.

Prize expense increased by \$52.21 million or 4.36% in 2018 compared to 2017 which increased by \$63.21 million or 5.58% compared to 2016. There is a direct correlation between prize expense and sales. As such, the increase in both 2018 and 2017 was the result of an increase in sales.

Operating Expenses

Operating expenses decreased by \$11.54 million or 17.58% in 2018 compared to 2017 which increased by \$7.06 million or 12.05% compared to 2016.

Salaries, wages and benefits remained relatively constant increasing by \$92,000 or 0.34% in 2018 compared to 2017, which increased by \$2.3 million or 9.43%, compared to 2016. Increases in 2017 are due to promotions, cost of living increases and an increase in number of employees due to growth of Agency activity. Advertising and promotions decreased by \$2.84 million or 15.47% in 2018 compared to 2017 which increased by \$2.73 million or 17.47% compared to 2016. Fluctuations between advertising expenses are related to changes in the advertising budget and encumbrances.

Depreciation and amortization decreased by \$12.77 million or 98.39% in 2018 compared to 2017 which remained relatively constant with 2016. The decrease in 2018 is related to the termination of the VLT leases in July 2017.

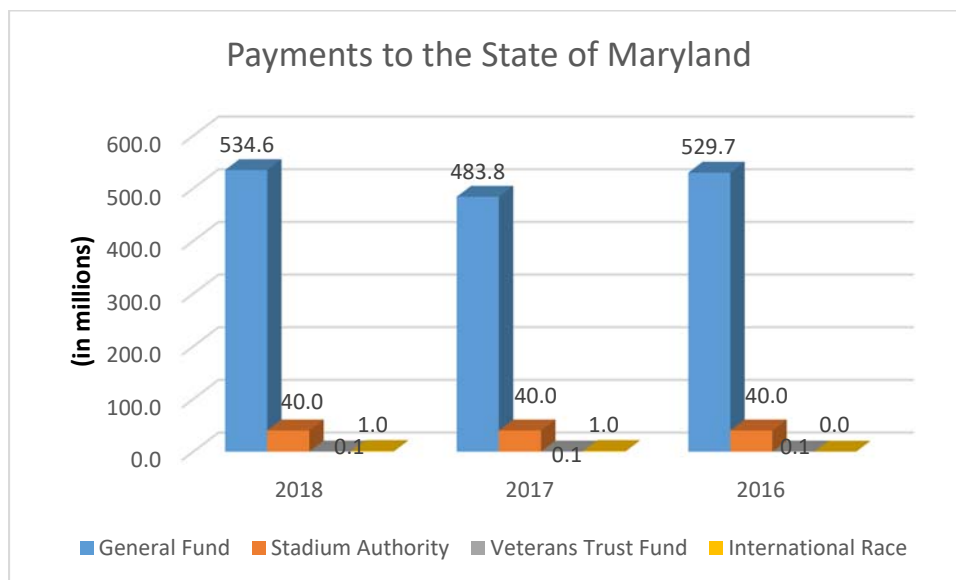
Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
For the Years Ended June 30, 2018 and 2017

Non-operating Revenue (Expenses)

Non-operating expenses increased by \$130.35 million or 11.56% in 2018 compared to 2017 which increased by \$42.92 million or 3.96% compared to 2016. Non-operating expenses primarily consist of unrealized gains or losses on investments held to fund obligations to annuitants and payments to the State of Maryland General Fund, the Stadium Authority, the Veterans Trust Fund and other government funds/agencies. The Agency expects to realize the face value of its investments, since it intends to hold these investments until maturity. Therefore, any interim unrealized gains or losses on investments will reverse. The change in fair value of the investments held by the Agency is discussed in more detail on page 33.

The increase in 2018 is attributed to the increase in payments to the State of Maryland General Fund and Other Governmental Funds/Agencies. Payments to the State of Maryland increased by \$50.77 million or 9.69% in 2018 compared to 2017 which decreased by \$45.92 million or 8.67% compared to 2016. As previously mentioned, the increase in 2018 is related to a higher profitability in Pick 4, Powerball, Mega Millions and instant tickets. In 2017, lower profitability in Powerball and Pick 4 led to the decline in transfers to the General Fund. Payments to Other Governmental Funds/Agencies increased by \$80.58 million or 13.44% in 2018 compared to 2017 which increased by \$85.47 million or 16.62% compared to 2016. The increase in 2018 is related to higher overall gaming revenues as well as a full year of operations at MGM National Harbor casino. The increase in 2017 is attributed to the opening of the MGM National Harbor casino in December 2016.

The Agency is required by State law to transfer its budgetary basis net income to the State of Maryland (General Fund, Stadium Authority, the Veterans Trust Fund and beginning in 2017, the International Race Fund) from its lottery operations. Furthermore, it is required to transfer revenue from its gaming operations to various government agencies. Accordingly, the Agency's success can be measured by the income it transfers.



Maryland Lottery and Gaming Control Agency
Management's Discussion and Analysis
For the Years Ended June 30, 2018 and 2017

Non-operating Revenue (Expenses) – (continued)

Transfers to other government funds/agencies increased by \$80.58 million or 13.44% in 2018 compared to 2017 which increased by \$85.47 million or 16.62% compared to 2016. Table 7 on page 14 provides a breakdown of the various accounts. The increase in 2018 is the result of higher overall gaming revenue, due in part to a full year of operations at MGM National Harbor casino. The increase in 2017 is the result of the opening of the MGM National Harbor casino.

Contacting the Agency's Financial Management

The financial report is designed to provide a general overview of the Agency's financial activity for those interested in the Agency's operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to: Gina M. Smith, Deputy Director/CFO, Maryland Lottery and Gaming Control Agency, 1800 Washington Boulevard, Suite 330, Baltimore, Maryland 21230.

Maryland Lottery and Gaming Control Agency
Statements of Net Position
As of June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 2,479,106	\$ 1,982,789
Cash and cash equivalents - gaming	40,751	40,747
Cash and cash equivalents - gaming licensing deposits	1,626,629	1,304,822
Cash and cash equivalents - agent	189,053	224,051
Cash held with State Treasury	158,344,255	112,662,276
Accounts receivable - lottery	48,603,813	41,589,506
Accounts receivable - casino operators	11,300,537	7,306,496
Prepaid commissions	48,629	58,728
Current portion of investments for annuity payments	3,991,948	3,437,992
MUSL reserves	-	3,346,866
Total current assets	226,624,721	171,954,273
Non-current assets:		
Capital assets, net of accumulated depreciation	399,970	35,735,318
Investments for annuity payments, net of current portion	34,503,880	29,024,020
Total non-current assets	34,903,850	64,759,338
Total assets	261,528,571	236,713,611
Deferred Outflows of Resources:		
Deferred pension outflows	11,100,541	13,879,612
Total deferred outflows of resources	11,100,541	13,879,612
Total assets and deferred outflows of resources	\$ 272,629,112	\$ 250,593,223
Liabilities:		
Current liabilities:		
Current portion of annuity prizes payable	\$ 3,939,051	\$ 3,352,069
Current portion of employee related payables	1,863,533	2,098,414
Current portion of capital lease obligation	-	13,249,883
Transfer due to State of Maryland General Fund	92,335,706	45,241,525
Transfer due to other government agencies - gaming	63,217,601	55,412,571
Transfer due to local jurisdictions	2,759,996	2,485,917
Prize awards payable	45,501,553	45,198,987
Accounts payable and accrued expenses	6,985,273	4,196,666
Gaming licensing deposits	1,437,914	1,146,411
Gaming payable	40,751	40,747
Agent payable	189,053	344,051
Unearned revenue	1,684,818	2,236,563
Taxes and other liabilities	657,216	132,978
Total current liabilities	220,612,465	175,136,782
Non-current liabilities:		
Annuity prizes payable, net of current portion	32,794,850	25,567,763
Employee related payables, net of current portion	1,504,053	793,040
Capital lease obligation, net of current portion	-	22,418,085
Pension liability	27,645,653	27,137,095
MUSL reserves	-	3,346,866
Total non-current liabilities	61,944,556	79,262,849
Total liabilities	282,557,021	254,399,631
Deferred Inflows of Resources:		
Deferred pension inflows	2,859,040	1,104,003
Total deferred inflows of resources	2,859,040	1,104,003
Total liabilities and deferred inflows of resources	285,416,061	255,503,634
Commitments and contingencies (Note 7)		
Net Position:		
Net investment in capital assets	399,970	67,350
Restricted	(1,761,928)	(3,542,180)
Unrestricted	(11,424,991)	(1,435,581)
Total net position	(12,786,949)	(4,910,411)
Total liabilities, deferred inflows of resources and net position	\$ 272,629,112	\$ 250,593,223

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

Maryland Lottery and Gaming Control Agency
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Revenue:		
Draw Games	\$ 1,282,784,608	\$ 1,246,420,103
Instant Games	750,888,512	676,752,574
ITLMs	9,121,217	8,372,989
Total Sales	2,042,794,337	1,931,545,666
Gaming revenue - gross terminal revenue	1,046,676,783	885,867,966
Gaming revenue - state grant	7,474,980	20,706,322
Gaming revenue - table games	632,289,627	535,074,397
Gaming revenue - facility applicants	2,209,398	2,957,020
Gaming revenue - machine assessments	5,278,854	4,649,746
ITLM lease revenue	3,807,152	3,494,887
Total revenue	3,740,531,131	3,384,296,004
Cost of sales:		
Prize expense	1,248,722,984	1,196,511,295
Retailer commissions	153,725,963	145,883,312
Casino commissions	996,857,938	819,389,044
Gaming vendor and data processing fees	30,748,701	29,026,085
Instant ticket printing and delivery	6,637,518	7,464,342
Total cost of sales	2,436,693,104	2,198,274,078
Gross profit	1,303,838,027	1,186,021,926
Operating expenses:		
Salaries, wages and benefits	26,966,333	26,873,983
Advertising and promotions	15,536,795	18,379,694
Depreciation and amortization	208,680	12,982,014
Other general and administrative expenses	11,417,957	7,438,231
Total operating expenses	54,129,765	65,673,922
Income from operations	1,249,708,262	1,120,348,004
Non-operating revenues (expenses):		
Investment loss	(356,891)	(699,524)
Amortization of discount for annuity prize liabilities	(1,423,362)	(1,408,770)
Voluntary exclusion program	79,444	37,603
Interest expense	-	(633,426)
Payments to State of Maryland General Fund	(534,595,837)	(483,832,419)
Payments to State of Maryland Stadium Authority and Veterans Trust	(40,076,575)	(40,070,173)
Payments to International Racing Fund	(1,000,000)	(1,000,000)
Payments to Other Governmental Funds/Agencies - Gaming	(680,211,579)	(599,628,305)
Total non-operating revenues (expenses)	(1,257,584,800)	(1,127,235,014)
Change in net position	(7,876,538)	(6,887,010)
Total net position - beginning of year,	(4,910,411)	1,976,599
Total net position - end of year	\$ (12,786,949)	\$ (4,910,411)

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

Maryland Lottery and Gaming Control Agency
Statements of Cash Flows
For the Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Receipts from customers	\$ 3,733,354,183	\$ 3,378,929,602
Payments to suppliers	(55,654,970)	(63,756,879)
Payments to employees	(31,532,865)	(23,794,464)
Payments to agents	(1,150,573,802)	(965,244,344)
Prize payments/awards to players	(1,238,038,480)	(1,191,358,003)
	1,257,554,066	1,134,775,912
Net cash and cash equivalents provided by operating activities	1,257,554,066	1,134,775,912
Cash flows from noncapital financing activities:		
Transfers to the State of Maryland General Fund and Stadium Authority	(528,501,656)	(577,572,799)
Transfers to DHMH	(4,720,937)	(3,879,818)
Transfers to Other Government Funds/Agencies-Gaming	(668,008,664)	(580,827,216)
Prize payments/awards	(3,466,992)	(4,714,992)
	(1,204,698,249)	(1,166,994,825)
Net cash and cash equivalents used in noncapital financing activities	(1,204,698,249)	(1,166,994,825)
Cash flows from capital and related financing activities:		
Payments of capital lease obligations	-	(12,616,457)
Interest payments	-	(633,426)
	-	(13,249,883)
Net cash and cash equivalents used in capital and related financing activities	-	(13,249,883)
Cash flows from investing activities:		
Coupon bonds purchased	(9,857,700)	(2,869,931)
Proceeds from matured annuities and bonds	3,466,992	4,714,992
	(6,390,708)	1,845,061
Net cash and cash equivalents (used in) provided by investing activities	(6,390,708)	1,845,061
Net increase (decrease) in cash and cash equivalents	46,465,109	(43,623,735)
Cash and cash equivalents, beginning of year	116,214,685	159,838,420
Cash and cash equivalents, end of year	\$ 162,679,794	\$ 116,214,685
Noncash investing and financing activities:		
Change in fair value of investments	\$ (1,780,253)	\$ (2,109,294)

Maryland Lottery and Gaming Control Agency
Statements of Cash Flows - (continued)
For the Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Reconciliation of operating income to net cash and cash equivalents provided by operating activities:		
Operating income	\$ 1,249,708,262	\$ 1,120,348,004
Adjustments to reconcile operating income to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	208,680	12,982,014
Deferred prize payments	9,857,700	2,869,930
Deferred inflows pension	1,755,037	(332,192)
Deferred outflows pension	2,779,071	(2,485,512)
Effect of changes in operating assets and liabilities:		
Accounts receivable	(11,008,348)	(6,348,246)
Prepaid commissions	10,099	28,011
Accounts payable and accrued expenses	2,925,116	1,557,288
Employee related payables	534,832	155,035
Taxes and other liabilities	524,238	(106,705)
Prize awards payable	302,566	2,390,066
Unearned revenue	(551,745)	(587,774)
Pension liability	508,558	4,305,993
Net cash and cash equivalents provided by operating activities	<u>\$ 1,257,554,066</u>	<u>\$ 1,134,775,912</u>

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

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Legislative Enactment

The Maryland Lottery and Gaming Control Agency (Agency) was established by the Maryland General Assembly enactment of Chapter 365 of Laws of Maryland of 1972, and the voters' approval that same year of a constitutional amendment to allow the lottery. The amendment was ratified on November 7, 1972, and the Agency commenced operations on January 2, 1973.

The mandate of the law was to establish a State-operated lottery, under the immediate supervision of a Director and the guidance of a Commission, for the purpose of producing revenue for the State. The Governor, with the advice and consent of the Senate of Maryland, appoints the Director and the Commission members.

During the 2007 special session of the Maryland General Assembly, Chapter 4 was enacted relating to the legalization of video lottery terminals (VLTs) in the State subject to the passage of a voters' constitutional referendum. In 2008, voters approved the installation of up to 15,000 VLTs at five privately owned casinos at specified locations throughout the State.

On August 14, 2012, Senate Bill 1 – Gaming Expansion – Video Lottery Terminals and Table Games passed the 2012 Second Special Session of the Maryland General Assembly. This bill contained many provisions concerning gaming operations and certain provisions that were subject to voter referendum. The provisions which were subject to voter referendum passed during the November 6, 2012 election and allowed for a sixth casino at a site in Prince George's County, increased the maximum number of VLTs allowed in the State from 15,000 to 16,500, established table games and allowed for 24-7 operations at the casinos. A gaming license to operate a casino at National Harbor in southern Prince George's County was awarded to MGM Resorts International on December 20, 2013. The casino opened in December 2016.

Effective October 1, 2012, the bill also authorized the Agency to issue certain veterans' organizations a license for up to five instant ticket lottery machines. Veterans' organizations in counties on the Eastern Shore and in Montgomery County are not eligible. After deductions for commissions and prize payouts, 10% of the proceeds are distributed to the Maryland Veterans Trust Fund and the remainder goes to the General Fund. An ITLM is an electronic device that dispenses pre-printed instant scratch tickets and utilizes a touchscreen monitor. The device scans and validates the barcode on the instant ticket as it is dispensed and displays the result of the ticket on the touchscreen monitor. The device accumulates winnings for the player and prints out a voucher at the conclusion of play that can be redeemed for cash or inserted into another ITLM for continued play.

Pursuant to § 9-1A-01 of the Maryland State Government Article, under certain circumstances, if a casino returns to successful players more than the amount of money bet through VLTs or table games on a given day, the casino may subtract that amount from the proceeds of the following 2 days for purposes of the calculation of the amount of revenue due to the Agency. This change became effective in July 2017. Effective July 1, 2018, the casino may carryforward losses up to 7 days.

Pursuant to § 9-1A-26 of the Maryland State Government Article, the jackpot proceeds won at a video lottery terminal that are not claimed by the winner within 182 days after the jackpot shall become the property of the State. The proceeds shall be allocated as follows: 2.5% to the Small, Minority, and Women-Owned Business Account, 9.5% to Local Impact Grants, 10% to Purse Dedication, 1.5% to the Racetrack Facility Renewal Account and the remainder to the Education Trust Fund. This change became effective in October 2017.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Legislative Enactment – (continued)

Pursuant to § 9-1A-27(d) of the Maryland State Government Article, the proceeds of table games include a 5% allocation to Local Jurisdictions, in which the casino is located. The casino share of the proceeds remains at 80%, but the Maryland Education Trust Fund has been reduced from 20% to 15%. This change became effective in December 2016.

The Agency, in conjunction with its Commission, serves as the regulator of the Gaming program and is responsible for regulating the casinos, licensing the casino operators and all other entities and individuals requiring a gaming license and the collection and disbursement of VLT gross terminal revenue and table game revenue in accordance with the law.

The Agency is a part of the primary government of the State of Maryland and is reported as a proprietary fund and business-type activity within the State of Maryland's financial statements. The State of Maryland prepares a comprehensive annual financial report (CAFR). The Agency is an enterprise fund of the State of Maryland and is included in the basic financial statements of the CAFR of the State of Maryland.

Basis of Accounting and Presentation

The Agency is accounted for as a proprietary special purpose government fund engaged in business-type activities. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and with accounting principles generally accepted in the United States of America, the financial statements are prepared on the accrual basis of accounting which requires recognition of revenue when earned and expenses when incurred. As permitted by GASB No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Units That Use Proprietary Fund Accounting*, the Agency has elected to not adopt Financial Accounting Standard Board (FASB) statements and interpretations issued after November 30, 1989, unless the GASB specifically adopts such FASB statements or interpretations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates.

Lottery Games – Revenue Recognition and Prize Obligations

Revenue from lottery games originates from three product lines: draw games, instant games and instant ticket lottery machines (ITLMs). The Agency develops multiple game themes and prize structures to comply with its enabling legislation and customer demand. Independent and corporate retailers comprised principally of grocery and convenience stores, package goods stores, and restaurants serve as the primary distribution channel for draw and instant lottery sales. Veterans' organizations are the only distribution channel for ITLMs. Retailers receive a sales commission of 5.5% of net sales and a cashing commission of 3% of prizes redeemed. Veterans' organizations earn an additional ½% sales commission on ITLM sales.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Lottery Games – Revenue Recognition and Prize Obligations – (continued)

Licensed lottery retailers sell draw game lottery tickets to the public through the use of computerized terminals. Draw games are categorized as: Numbers (Pick 3 and Pick 4), Matrix (Multi-Match, Mega Millions/Megaplier, Powerball/Powerplay, Bonus Match 5, 5 Card Cash, and Cash4Life) and Monitors (Keno, Keno Bonus®, Keno Super Bonus, Racetrax®, and Racetrax® Bonus). Draw revenue is recognized in the month in which the related drawings are held. Revenue from the sale of tickets and commissions paid for future drawings are deferred until the drawings are held. Revenue from instant games is recognized when the retailer activates the book of tickets. Licensed veterans' organizations offer ITLMs to their customers. The Agency recognizes ITLM revenue as "gross terminal revenue" equivalent to all wagers, net of related prizes.

Prize obligations for draw games are determined and recognized after each drawing is held. For all draw games, winners are paid a certain amount depending upon the number of winners and the order of the winning numbers drawn. The Multi-Match, Mega Millions, Powerball and Cash4Life jackpots are calculated as a percentage of total game revenue. If there is no jackpot winner, the prize pool is carried forward until there is a winner. The remaining Multi-Match, Mega Millions, Powerball and Cash4Life prize levels are based on a predetermined set amount. Prize obligations are recognized monthly for instant games based on the books activated by retailers and the related prize expense based on the specific game's prize structure. Prize expense for ITLM is recorded as amounts are won and is used in determining the "gross terminal revenue" for ITLM.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Gaming Operations (VLTs and Table Games) - Revenue Recognition and Prize Obligations

As of the end of fiscal year 2018, six casinos were in operation with a total of 11,535 VLTs. VLTs are a self-activated video version of lottery games which allow for a player to place bets for the chance to be awarded credits which can either be redeemed for cash or be replayed as additional bets. The prize structures of these VLTs are designed to award prizes, or credits, at a stipulated rate of total bets played, and prize expenses are netted against total video credits played. The Agency recognizes VLT revenue as “gross terminal revenue” equivalent to all wagers, net of related prizes.

In accordance with the law, the casino operators receive a specified percentage of gross terminal revenue to operate their casinos. The percentage varies by casino. In fiscal year 2018, two of the casinos received a 10% increase in their commissions in exchange for purchasing their VLTs. Commissions during fiscal year 2018 ranged from 39% to 60%. In fiscal year 2017, one casino received a 7% increase in their commissions and another casino received an 8% increase in their commissions due to the opening of the State’s sixth casino. After the increase, commissions ranged from 39% to 50%.

To help fund its operations, the Agency retains 1% of the gross terminal revenue from all of the casinos. The enabling legislation requires the Agency to disburse the remainder of the gross terminal revenue to other Government agencies, which in turn are responsible for making further distributions. Prior to fiscal year 2018, enabling legislation required a specified percentage to be transferred to the Small, Minority, Women-Owned Business fund. Effective July 1, 2017, this percentage was redirected to the General Fund.

As of the end of fiscal year 2018, there were 594 table games in operation at the casinos. Table games include blackjack, roulette, craps, baccarat, big six wheel and various poker games. Table game revenue is equivalent to all wagers, net of related prizes. Casino operators receive 80% of the table game revenue to operate their casino. Prior to December 8, 2016 the remaining 20% was remitted to the Agency who in turn transferred it to the Education Trust Fund in accordance with the enabling legislation. Effective December 8, 2016, with the opening of the sixth casino, enabling legislation required the Agency to transfer 15% to the Education Trust Fund and the remaining 5% to a Local Jurisdiction Fund. Any table games loss for any given day are carried forward to offset gains in the next 2 days with any remaining losses absorbed by the casino. Effective July 1, 2018 the casino may carryforward losses up to 7 days.

The casino operators’ share of the revenue from both VLT and table games is recorded as a cost of sales.

To further help fund the operations of the Gaming program, the State provided grants to the Agency during fiscal years 2018 and 2017 in the amount of \$7,474,980 and \$20,706,322 respectively.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Gaming Operations (VLTs and Table Games) - Revenue Recognition and Prize Obligations – (continued)

License related revenues (application, license, fingerprint, principal applicant background investigation, and vendor fees) are recorded as licensing deposits until the receipt is identified as being for a specific applicant and type of fee which usually occurs in the same month that the deposit is received. After the specific applicant and fee type is ascertained, the related deposit amount is recognized as revenue, except for principal applicant investigation fees which are recognized as revenue when the background investigation is completed and the applicant is either invoiced for any investigation costs in excess of the deposit received or the portion of the deposit in excess of investigation costs is returned to the applicant.

Administrative expenses for the Gaming program are recognized as they are incurred. Prior to fiscal year 2018, the majority of the expenses incurred for the gaming program were for the lease of the VLTs and salaries. All of these leases met the criteria for capital leases and are treated as such for financial statement purposes. In July 2017, the two casinos which had not purchased their VLTs took over ownership; therefore, eliminating all leases. Consequently, the majority of the expenses incurred for the gaming program in fiscal year 2018 are for salaries.

Operating and Non-Operating Revenues and Expenses

Operating revenues and expenses for proprietary funds such as the Agency, are revenues and expenses that result from providing services and producing and delivering goods and/or services. Operating revenues for the Agency are derived from providing various types of lottery games, various VLTs and table games. Operating expenses for lottery games include the costs to operate the various games, to pay prize winners, and administrative expenses. Operating expenses for gaming include the costs to operate the various games and administrative expenses. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Cash and Cash Equivalents

Cash and cash equivalents include cash deposited with financial institutions, deposits with the Maryland State Treasury and overnight investment repurchase agreements.

Cash and Cash Equivalents – Gaming License Deposits

Cash and cash equivalents – gaming license deposits account is used to record the receipt of license related fees and investigation deposits that are received from applicants wanting to obtain a gaming license. For the majority of applicants, fees are recorded as revenue after the specific applicant and type of fee received is determined. At the end of each month, these fees are transferred to the Gaming Special Fund account.

For principal employee applicants, in addition to the aforementioned fees, the Agency also receives a background investigation deposit which is used to pay the investigation costs for the principal employee applicant. These deposit amounts remain in cash and cash equivalents – gaming license deposits and are recorded as a licensing deposit liability until the investigation is completed. To the extent that the investigation deposit is greater than the costs incurred for the investigation, the monies are refunded to the applicant. To the extent that the investigation deposit is less than the costs incurred for the investigation, the applicant is billed for the deficit. After the investigation is completed, the deposit is recorded as revenue and is transferred to the Gaming Special Fund account.

1. SUMMARY OF SIGNIFICANT OF ACCOUNTING POLICIES – (continued)

Cash and Cash Equivalents – Agent

Cash and cash equivalents – agent consists of lottery agency funds deposited with a financial institution and the related interest earned. Monies deposited into the accounts were received from select retailers who deposited monies with the Agency in lieu of obtaining a bond.

Accounts Receivable – Lottery

Accounts receivable – lottery represents the amounts due from lottery retailers from the sale of lottery tickets and ITLM amounts played. The Agency utilizes the allowance method to provide for doubtful accounts based on management’s evaluation of the collectability of accounts receivable. The Agency determines accounts receivable to be delinquent when greater than 10 days past due. Receivables are written off when it is determined that amounts are uncollectible. As of June 30, 2018 and 2017, management believes all accounts receivable are collectible, and, as such, no allowance for doubtful accounts has been recorded.

Accounts Receivable – Gaming

Accounts receivable – gaming represents outstanding amounts due that have been billed to applicants for completed background investigations.

Accounts Receivable – Casino Operators

Accounts receivable – casino operators represents the amount of gross terminal revenue and table games revenue due from the casino operators. Gross terminal revenue is collected on a daily basis. Table game revenue is collected every two days. Also included in the June 2018 and 2017 balances are the amount due from the casino operators for the \$425 per VLT assessment and the \$500 per table game assessment that is due to the Problem Gambling Fund. Management believes that all accounts receivable are collectible, and as such, no allowance for doubtful accounts has been recorded as of June 30, 2018 and 2017.

Capital Assets and Leasehold Improvements

The Agency has adopted a policy of capitalizing assets with individual amounts exceeding \$25,000 and all leased assets. These assets are comprised principally of VLTs. The purchased assets are recorded at cost and depreciation is computed using the straight-line method over three-to-five year useful lives. Assets acquired through capital leases are initially recorded at the net present value of the minimum lease payments. Assets acquired under capital leases are amortized over the lesser of the lease term or the estimated useful life of the leased asset. In July 2017, all leases were terminated when the two remaining casinos purchased their own VLTs.

Investments

Investments consist of United States Government Treasury Bonds and annuity contracts. The investments in United States Government Treasury Bonds are purchased in the name of the Agency and stated at fair value based on quoted market prices. Investments in annuity contracts are purchased in the name of the Agency and stated at present value, which approximates fair value.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Compensated Absences

The Agency accrues compensated absences in accordance with GASB No. 16, *Accounting for Compensated Absences*. All full-time permanent Agency employees accrue annual leave at variable rates based on the number of years employed by the State of Maryland. The maximum annual leave an employee can earn per calendar year is 25 days. At the end of each calendar year, an employee’s accrued annual leave may not exceed 75 days. Accrued annual leave is included in the employee related payables in the accompanying statements of net position. Agency employees also accrue sick pay benefits. However, the Agency does not record a liability for accrued sick pay benefits as neither the State of Maryland nor the Agency has a policy to pay unused sick leave when employees terminate from State service.

Payments to the State of Maryland

The law requires the Agency to transfer its lottery revenue in excess of funds allocated to prize awards and operating expenses to the State of Maryland General Fund and to a lesser extent the Maryland Stadium Authority, the Veteran’s Trust Fund and, beginning in fiscal year 2017, the International Race Fund. These payments are recorded as a non-operating expense in the accompanying statements of revenues, expenses, and changes in net position.

The law further requires the Agency to transfer its gaming revenue to various governmental agencies. On a monthly basis, in accordance with percentages specified in the law, the Agency transfers funds to the State’s Department of Education into the Maryland Education Trust Fund; the State’s Racing Commission into accounts for Local Impact Grants, Purse Dedication, Racetracks Facility Renewal and Local Jurisdictions. Prior to July 1, 2017, the Agency transferred a specified percentage to the State’s Board of Public Works into the Small, Minority, and Women-Owned Business Account. Beginning in July 2017, these funds were redirected into the State’s General Fund. All transfers are recorded as non-operating expenses in the accompanying statements of revenues, expenses and changes in net position.

A summary of the total game revenue and the distributions for the years ended June 30, 2018 and 2017, respectively, follows:

Fund	2018	2017
Education Trust Fund	\$ 496,663,611	\$ 451,206,896
Local Impact Grants	56,792,606	47,481,444
Horse Purse Dedication	61,212,583	54,641,341
Racetracks Facility Renewal	10,006,816	8,407,300
Small, Minority and Women Owned Businesses	24,300	12,949,485
Local Jurisdictions	31,614,481	17,556,796
General Fund	15,336,944	-
Maryland Lottery and Gaming Control Agency	10,457,130	9,310,058
Casino Operators	996,857,938	819,389,044
Total	\$ 1,678,966,409	\$ 1,420,942,364

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Net Position

Net position is presented as either restricted, unrestricted or invested in capital assets, net of related debt. Net position invested in capital assets, net of related debt, represents the difference between capital assets net of accumulated depreciation and the related capital lease obligations. Unrestricted net position represents the net position available for future operations including outstanding encumbrances as of year-end and unrealized gains or losses on investments. Market gains or losses represent temporary fluctuations and are not recognized in the calculation of the amount due to the Maryland Stadium Authority, State of Maryland General Fund or payments to Other Governmental Agencies. Restricted net position represents investments for annuity payments, which are stated at fair value, less the annuity prize obligations, which are carried at present value.

New Accounting Pronouncements

The Agency implemented GASB Statement No. 75 (GASB No. 75), *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, for fiscal year ended June 30, 2018 with no effect to the Agency.

GASB has also issued GASB Statement No. 85 (GASB No. 85) *Omnibus 2017* and GASB Statement No. 86 (GASB No 86) – *Certain Debt Extinguishment Issues* effective for fiscal years beginning after June 15, 2017. These statements have no effect on the Agency.

GASB has also issued GASB Statement No. 83 (GASB No 83), *Certain Asset Retirement Obligations* and GASB Statement No. 88 (GASB No 88), *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements* effective for reporting periods beginning after June 15, 2018, GASB Statement No 84 (GASB No 84), *Fiduciary Activities* and GASB Statement No 90 (GASB No 90), *Majority Equity Interests-an amendment of GASB Statements No. 14 and No. 61* for reporting periods beginning after December 15, 2018, GASB Statement No 87 (GASB No 87), *Leases*, and GASB Statement No. 89 (GASB No. 89), *Accounting for Indirect Cost Incurred before the End of a Construction Period* for reporting periods beginning after December 15, 2019. The Agency is in the process of assessing the impact of these statements and will implement them as of the effective date, if appropriate.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

2. CASH AND CASH EQUIVALENTS

As of June 30, 2018 and June 30, 2017, the carrying amounts of deposits with financial institutions were \$4,335,539 and \$3,552,409, respectively. The corresponding bank balances were \$3,824,356 and \$3,528,737 as of June 30, 2018 and June 30, 2017, respectively.

As of June 30, 2018 and June 30, 2017, the amount on deposit with the Maryland State Treasury (State Treasury) was \$158,344,255 and \$112,662,276, respectively. The corresponding State Treasury balances were \$6,002,182 and \$16,171,679, respectively. The State Treasury has statutory responsibility for the daily cash management activities of the State's agencies, departments, boards, and commissions. The deposits with the State Treasury are part of the State of Maryland's internal investment pool and are not separately identifiable as to specific types of securities. The State Treasury maintains these and other Maryland State agency funds on a pooled basis in accordance with State statute. The Agency does not obtain interest on funds deposited with the State Treasury. As of June 30, 2018 and 2017, the Agency's deposits with the State Treasury were 2.4% and 1.8% of the total deposits with the State Treasury, respectively.

Custodial credit risk – Custodial credit risk is the risk that in the event of a bank failure, the Agency's deposits will not be returned to it. The Agency's deposit policy requires that it comply with the State law that governs the State Treasury deposits. Specifically, unexpended or surplus money may be deposited in a financial institution in the State, if the deposit is interest bearing; the financial institution provides collateral that has a market value that exceeds the amount by which a deposit exceeds the deposit insurance; and the custodian holds the collateral.

Interest rate risk – The State Treasury investment policy states that to the extent possible, it will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the State Treasury will not directly invest in securities maturing more than five years from the date of purchase.

Credit risk – State law requires that the State Treasury investments in repurchase agreements be collateralized by United States Treasury and Agency Obligations. In addition, investments may be made directly in United States Agency Obligations. State law also requires that money market mutual funds receive the highest possible rating from at least one nationally recognized statistical rating organization.

Concentration of credit risk – The State Treasury's investment policy limits the amount of repurchase agreements to be invested with a particular institution to 30% of the portfolio. There is no other limit on the amount that may be invested in any one issuer. More than 5% of government fund investments are in the FNMA and the Federal Home Loan Mortgage Corporation. As of June 30, 2018, these investments are 9.64% and 50.17% of the State of Maryland's internal investment pool total investments, respectively. As of June 30, 2017, these investments were 14.20% and 45.57% of the State of Maryland's internal investment pool total investments, respectively.

3. INVESTMENTS

United States Government Treasury Bonds

It is the Agency's policy to fund jackpot and lifetime prize awards through the purchase of United States Government Treasury Bonds. Furthermore, it is the policy of the Agency to hold these investments to maturity. The investment maturities approximate the annuity prizes payable installment due dates.

The Agency has purchased long-term investments to fund jackpot and lifetime prize awards. The majority of these investments are United States Government Treasury Bonds, which carry yields to maturity of 0.739% to 6.942%. As of June 30, 2018 and June 30, 2017, the Agency's United States Government Treasury Bonds totaled \$38,422,425 and \$32,366,349 respectively. The investments in United States Government Treasury Bonds are carried at fair value based on quoted market prices on the accompanying statements of net position and the related unrealized gains (losses) and interest income are recorded as investment revenue (loss) on the accompanying statements of revenues, expenses, and changes in net position.

Annuity Contracts

As of June 30, 2018 and June 30, 2017, the annuity contracts totaled \$73,403 and \$95,663, respectively. The annuity contracts were purchased in 1976 to satisfy the Agency's obligation for certain lifetime prizes. The value of the annuity contracts and related annuity prizes payable were adjusted in fiscal year 2005 based on revised actuarial life expectancy tables.

Investment Risk

Interest rate risk is the risk that an investment's fair value decreases as market interest rates increase. Typically, this risk is higher in debt securities with longer maturities. The Agency is not subject to interest rate risk because it is the Agency's policy to hold the investments until maturity, unless an annuitant through a court order forces the sale of an investment to settle the Agency's obligation to the annuitant at which time the annuitant would be paid the proceeds received from the sale of the investments.

For an investment, custodial risk is the risk that in the event of the failure of the counterparty, the Agency will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Agency is not subject to custodial risk because the United States Government Treasury Bonds are held in the Agency's name by its custodian and annuity contracts are not evidenced by securities that exist in physical or book entry form.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

3. INVESTMENTS – (continued)

United States Government Treasury Bonds and Annuity Contracts

As of June 30, 2018, the Agency had the following investments:

Investment Type	Fair Value	Credit Quality Rating	% of Investments	Investment Maturities (In Years)				
				Less than 1	1-5	6-10	11-20	21-30
<u>Investments in prize annuities:</u>								
United States Treasury Bonds	\$38,422,425	1	99.8%	\$3,966,387	\$16,412,710	\$10,444,019	\$6,605,755	\$ 993,554
Annuity Contracts	73,403	2	.2%	25,561	24,813	19,380	3,649	-
Total Investments	\$38,495,828		100.0%	\$3,991,948	\$16,437,523	\$10,463,399	\$6,609,404	\$ 993,554

- 1 Credit quality ratings not required for U.S. government and agency securities that are explicitly guaranteed by the U.S. government.
2 Annuity contracts not rated.

As of June 30, 2017, the Agency had the following investments:

Investment Type	Fair Value	Credit Quality Rating	% of Investments	Investment Maturities (In Years)				
				Less than 1	1-5	6-10	11-20	21-30
<u>Investments in prize annuities:</u>								
United States Treasury Bonds	\$32,366,349	1	99.7%	\$3,393,507	\$14,927,630	\$9,820,023	\$3,943,344	\$ 281,845
Annuity Contracts	95,663	2	.3%	25,534	44,410	18,983	6,736	-
Total Investments	\$32,462,012		100.0%	\$3,419,041	\$14,972,040	\$9,839,006	\$3,950,080	\$ 281,845

- 1 Credit quality ratings not required for U.S. government and agency securities that are explicitly guaranteed by the U.S. government.
2 Annuity contracts not rated.

Investments are measured and reported at fair value and are classified and disclosed in one of the following categories:

- Level I – Quoted prices are available in active markets for identical investments as of the reporting date.
- Level II – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies.
- Level III – Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

3. INVESTMENTS – (continued)

United States Government Treasury Bonds and Annuity Contracts – (continued)

The following table sets forth by level, within the fair value hierarchy, the Agency’s investments at fair value as of June 30, 2018:

	Level 1	Level 2	Level 3	Total
<u>Investments by fair value level</u>				
U.S. treasury obligations	\$ 38,422,425	\$ -	\$ -	\$ 38,422,425
Annuities	-	73,403	-	73,403
Total	\$ 38,422,425	\$ 73,403	\$ -	\$ 38,495,828

The following table sets forth by level, within the fair value hierarchy, the Agency’s investments at fair value as of June 30, 2017:

	Level 1	Level 2	Level 3	Total
<u>Investments by fair value level</u>				
U.S. treasury obligations	\$ 32,366,349	\$ -	\$ -	\$ 32,366,349
Annuities	-	95,663	-	95,663
Total	\$ 32,366,349	\$ 95,663	\$ -	\$ 32,462,012

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

4. CAPITAL ASSETS

A summary of capital asset activity for the year ended June 30, 2018 is as follows:

	2017	Increases	Decreases	2018
Capital Assets				
Machinery and Equipment	\$ 94,438,354	\$ -	\$ (85,902,162)	\$ 8,536,192
Leasehold Improvements	613,240	-	-	613,240
Total Capital Assets	95,051,594	-	(85,902,162)	9,149,432
Less Accumulated Depreciation and Amortization				
Machinery and Equipment	58,703,036	208,680	(50,775,494)	8,136,222
Leasehold Improvements	613,240	-	-	613,240
Total Accumulated Depreciation and Amortization	59,316,276	208,680	(50,775,494)	8,749,462
Net Capital Assets	\$ 35,735,318	\$ 208,680	\$ (35,126,668)	\$ 399,970

A summary of capital asset activity for the year ended June 30, 2017 is as follows:

	2016	Increases	Decreases	2017
Capital Assets				
Machinery and Equipment	\$ 94,438,354	\$ -	\$ -	\$ 94,438,354
Leasehold Improvements	613,240	-	-	613,240
Total Capital Assets	95,051,594	-	-	95,051,594
Less Accumulated Depreciation and Amortization				
Machinery and Equipment	45,721,022	12,982,014	-	58,703,036
Leasehold Improvements	613,240	-	-	613,240
Total Accumulated Depreciation and Amortization	46,334,262	12,982,014	-	59,316,276
Net Capital Assets	\$ 48,717,332	\$ 12,982,014	\$ -	\$ 35,735,318

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

5. ANNUITY PRIZE OBLIGATIONS

The Agency carries long-term annuity prize obligations at present value. Presented below is a summary of long-term annuity prize payment requirements for annuities payable to maturity:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 3,939,051	\$ 92,941	\$ 4,031,992
2020	4,914,752	436,177	5,350,929
2021	3,410,978	408,218	3,819,196
2022	4,146,230	764,966	4,911,196
2023	2,965,323	669,873	3,635,196
2024-2028	9,581,142	3,280,838	12,861,980
2029-2033	4,181,098	1,775,727	5,956,825
2034-2038	2,557,818	1,572,182	4,130,000
2039-2042	1,037,509	866,491	1,904,000
Total	<u>\$ 36,733,901</u>	<u>\$ 9,867,413</u>	<u>\$46,601,314</u>

This debt represents annual payments owed to jackpot and lifetime winners. Annuity prizes are paid over a period of time ranging from 20 to 25 years depending on the time period in which the prize was won. The Agency has purchased United States Government Treasury Bonds or annuity contracts that fully fund these obligations.

Long-term liability activity of annuity prize payments for the years ended June 30, 2018 and 2017 was as follows:

<u>Fiscal Year</u>	<u>Beginning</u>			<u>Ending</u>	<u>Due Within</u>
<u>Ending</u>	<u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u>	<u>One Year</u>
June 30, 2018	\$28,919,832	\$11,281,061	\$3,466,992	\$36,733,901	\$3,939,051
June 30, 2017	\$29,356,123	\$4,278,701	\$4,714,992	\$ 28,919,832	\$3,352,069

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

6. EMPLOYEE RELATED PAYABLES

The employee related payables due within one year are included in the current portion of the employee related payables on the accompanying statements of net position, which also includes salaries payable in the amount of \$803,233 and \$751,914 as of June 30, 2018 and 2017, respectively. Changes in long-term employee related payables were as follows for the years ended June 30, 2018 and 2017:

	2018		
	Compensated Absences	Workers' Compensation	Combined
Beginning Balance	\$ 1,829,540	\$ 310,000	\$ 2,139,540
Additions	1,282,965	219,576	1,502,541
Reductions	(950,152)	(127,576)	(1,077,728)
Ending Balance	\$ 2,162,353	\$ 402,000	\$ 2,564,353
Amount Due Within One Year	\$ 1,000,000	\$ 60,300	\$ 1,060,300
Non-Current Portion	1,162,353	341,700	1,504,053
	\$ 2,162,353	\$ 402,000	\$ 2,564,353
	2017		
	Compensated Absences	Workers' Compensation	Combined
Beginning Balance	\$ 1,685,843	\$ 429,000	\$ 2,114,843
Additions	1,229,333	(39,560)	1,189,773
Reductions	(1,085,636)	(79,440)	(1,165,076)
Ending Balance	\$ 1,829,540	\$ 310,000	\$ 2,139,540
Amount Due Within One Year	\$ 1,300,000	\$ 46,500	\$ 1,346,500
Non-Current Portion	529,540	263,500	793,040
	\$ 1,829,540	\$ 310,000	\$ 2,139,540

7. COMMITMENTS AND CONTINGENCIES

Leases

The Agency leases office space, warehouse facilities, and draw and instant product equipment over periods extending through July 2023. Rent expense for the years ended June 30, 2018 and 2017 totaled \$1,175,341 and \$1,132,041, respectively. Certain leases contain a bargain purchase option and are accounted for as capital leases.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

7. COMMITMENTS AND CONTINGENCIES – (continued)

Leases – (continued)

The assets acquired under capital leases include:

	<u>June 30, 2018</u>	<u>June 30, 2017</u>
Machinery and Equipment	\$ -	\$91,983,613
Accumulated Amortization	-	(56,856,945)
	<u>\$ -</u>	<u>\$35,126,668</u>

The following is a schedule of future minimum lease payments under these leases:

<u>Years Ending June 30,:</u>	<u>Operating Lease</u>
2019	\$ 1,220,473
2020	1,267,252
2021	1,316,013
2022	1,366,697
2023	703,049
Total	\$ 5,873,484

Liability activity for capital leases was as follows for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Beginning Balance	\$35,667,968	\$48,284,425
Acquisition	-	-
Disposals	(35,667,968)	-
Payments	-	(12,616,457)
Ending Balance	<u>\$ -</u>	<u>\$35,667,968</u>

8. PARTICIPATION IN THE MULTI-STATE LOTTERY

In July 2014, the Agency became a member of the Multi-State Lottery (MUSL), which operates several jackpot lottery games on behalf of other participating lotteries. The Agency participates in two of these games: Mega Millions and Powerball. MUSL is managed by a Board of Directors, which is comprised of lottery directors or their designee from each of the party states. The Board of Directors' responsibilities to administer these multi-state games are performed by advisory committees or panels staffed by officers and independent contractors appointed by the board. These officers and independent contractors serve at the pleasure of the board and the board prescribes their powers, duties and qualifications. The Executive Committee carries out the budgeting and financing of MUSL, while the board contracts the independent audit.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

8. PARTICIPATION IN MULTI-STATE LOTTERY – (continued)

Each MUSL member sells game tickets through its lottery retailers and makes weekly wire transfers to MUSL in an amount equivalent to the total prize pool less the amount of prizes won in each state. Lesser prizes are paid directly to the winners by each member lottery. The prize pool for Powerball and Mega Millions is 50% of each drawing period’s sales, within minimum jackpot levels.

MUSL places a percentage of game sales from each game in separate prize reserve funds that serve as a contingency reserve to protect from unforeseen liabilities. Once the prize reserve funds exceed the designated limit, the excess becomes part of that particular prize pool. Prize reserve fund monies are refundable to the members if MUSL disbands or, after one year, if a member leaves MUSL.

The Agency’s share of the prize reserve fund balances with MUSL as of June 30, 2017 was as follows (in thousands):

	<u>Total Prize Reserve</u>	<u>Agency Share</u>
Powerball	\$ 114,888	\$ 2,125
Mega Millions	<u>35,962</u>	<u>1,222</u>
	\$ 150,850	\$ 3,347

Lottery prize reserves held by MUSL are invested according to a Trust agreement the participating lotteries have with MUSL outlining investment policies. The policies restrict investments to direct obligations of the United States Government, perfected repurchase agreements, and obligations issued or guaranteed as to the payment of principal and interest by agencies or instrumentalities of the United States Government, and mutual funds of approved investments. The average portfolio is never more than one year, except that up to one third of the portfolio may have an average maturity of up to two years. The maximum maturity for any one security does not exceed five years.

On October 31, 2016, the Agency withdrew from MUSL and joined the Mega Millions consortium. The Mega Millions consortium is made up of lottery directors from member party states. Unlike MUSL, the consortium does not require reserves. Instead, settlements between states occur after each jackpot win and annually for all other prizes unless non-jackpot prize settlements exceed a specified amount. The Agency received its MUSL reserve balances on October 31, 2017.

9. RETIREMENT BENEFITS

The Agency and its employees contribute to the State Retirement and Pension System (the System). The System is a cost sharing multiple-employer public employee retirement system established by the State to provide pension benefits for State employees. The Agency’s only obligation to the System is its required annual contribution. The System is administered by a Board of Trustees in accordance with State Personnel and the Pension Article of the Annotated Code of Maryland. The System prepares a separately audited CAFR, which can be obtained from the State Retirement and Pension System of Maryland, 120 East Baltimore Street, Baltimore, Maryland 21202 or located at <http://www.sra.state.md.us/Agency/Downloads/CAFR/>.

9. RETIREMENT BENEFITS – (continued)

Plan Descriptions

Agency employees are members of the Employees' Retirement and Pension Systems (two of several systems managed by the System's Board of Trustees). The Employees' Retirement System (the Retirement Plan) includes those employees hired prior to January 1, 1980 who have not elected to transfer to the Employees' Pension System (the Pension Plan). Conversely, members of the Pension Plan include those employees hired after January 1, 1980 and prior employees who have elected to transfer from the Retirement Plan.

The Retirement Plan provides retirement, death, and disability benefits to its members. Members of the Retirement Plan are generally eligible for full retirement benefits upon the earlier of attaining age 60 or accumulating 30 years of eligible service regardless of age. The annual retirement allowance equals $1/55$ (1.8%) of the member's highest three-year average final salary (AFS) multiplied by the number of years of accumulated creditable service. A member may retire with reduced benefits after completing 25 years of eligible service. Benefits are reduced by 0.5% per month for each month remaining until the retiree either attains age 60 or would have accumulated 30 years of eligible service, whichever is less. The maximum reduction for a member is 30%. Any member who terminates employment before attaining retirement age but after accumulating five years of eligible service is eligible for a vested retirement allowance.

The Pension Plan provides retirement, death and disability benefits to its members. Certain aspects of eligibility and benefit calculations are different for employee's hired on or after July 1, 2011. Those differences are explained below.

Members of the Pension Plan who were active participants prior to July 1, 2011 are generally eligible for full retirement benefits upon the earlier of attaining age 62, with specified years of eligibility service, or accumulating 30 years of eligibility service regardless of age. Generally, the annual pension allowance for a member equals $1/55$ (1.8%) of the member's AFS, multiplied by the number of years of creditable service. A member may retire with reduced benefits upon attaining age 55 with at least 15 years of eligible service. Any member who terminates employment before attaining retirement age but after accumulating five years of eligible service is eligible for a vested retirement allowance.

Employees hired on or after July 1, 2011 (New Hires) are generally eligible for full retirement benefits based upon the "Rule of 90" which states that the sum of the employee's age plus eligible service must equal 90 or the employee must be age 65 with 10 years of service. The annual pension allowance for New Hires equals 1.5% of the member's AFS, multiplied by the number of years of creditable service. AFS for New Hires is calculated using the highest 5 consecutive years. A New Hire may retire with reduced benefits upon attaining age 60 with at least 15 years of eligible service. A New Hire who terminates employment before attaining retirement age but after accumulating ten years of eligible service is eligible for a vested retirement allowance.

Funding Policy

Active members and the employers of the members are required to contribute to the Employees' Retirement and Pension Systems. The Agency's required contribution is established by annual actuarial valuations using the entry age normal cost method with projection and other actuarial assumptions adopted by the Board of Trustees. For service earned after July 1, 2011, members of the Employees' Retirement System and the Employee's Pension System are required to contribute 7% of earnable compensation.

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

9. RETIREMENT BENEFITS – (continued)

Funding Policy – (continued)

The Agency contributions, which equal 100% of the required contributions, for the years ended June 30, 2018 and 2017 are as follows:

	2018	2017
Agency contribution	\$3,196	\$3,115,271
Percentage of payroll	0.012%	11.60%

GASB No. 68 – Pension Disclosures

In June 2012, GASB issued Statement No. 68, “*Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No 27.*” GASB Statement No. 68 requires the Agency to recognize the long-term obligations for pension benefits as a liability for the first time on the Statements of Net Position and to more comprehensively and comparatively measure the annual cost of pension benefits.

As of June 30, 2018 and 2017, the Agency reported a liability of \$27,645,653 and \$27,137,095 for its proportionate share of the State of Maryland’s pension liability.

On June 30, 2018 and 2017, the Agency’s proportion of the State of Maryland’s net pension liability of \$20,390,203,712 and \$22,173,456,403, respectively (State pool only) was \$27,645,653 and \$27,137,095 or 0.136% and 0.122%, respectively of the total State’s pension liability.

The Agency reported deferred outflows of resources and deferred inflows of resources related to the pensions from the following sources as of June 30, 2018:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Agency's contributions during the year	\$ (3,115,271)	\$ -
Amortization of prior year deferred outflows and inflows	(2,729,971)	(688,987)
Net difference between projected and actual earnings on pension plan investments	-	1,104,512
Change of assumptions	137,628	-
Change of proportionate share of contributions	2,925,347	-
Net difference between projected and actual experience	-	1,339,512
Agency’s contributions subsequent to the measurement date	3,196	-
Total	\$ (2,779,071)	\$ 1,755,037

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

9. RETIREMENT BENEFITS – (continued)

GASB No. 68 – Pension Disclosures – (continued)

The Agency’s contributions of \$3,196 reported as deferred outflows of resources resulted from contributions subsequent to the measurement date. This amount will be recognize as a reduction in the net pension liability for the year ended June 30, 2019.

The Agency reported deferred outflows of resources and deferred inflows of resources related to the pensions from the following sources as of June 30, 2017:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Agency's contributions during the year	\$ (2,424,201)	\$ -
Amortization of prior year deferred outflows and inflows	(1,975,902)	(629,522)
Change of proportionate share of contributions	1,078,536	-
Net difference between projected and actual earnings on pension plan investments	2,691,808	-
Net difference between projected and actual experience	-	297,330
Agency’s contributions subsequent to the measurement date	3,115,271	-
Total	\$ 2,485,512	\$ (332,192)

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

9. RETIREMENT BENEFITS – (continued)

GASB No. 68 – Pension Disclosures – (continued)

Other amounts reported as deferred outflows of resources and deferred inflows of resources related to the pensions will be recognized in pension expense as follows:

Year End June 30,	2018 Balance Amortization				2017 Balance Amortization			
	Deferred Outflows		Deferred Inflows		Deferred Outflows		Deferred Inflows	
	Change in Assumptions	Change in Proportionate Share of Contributions	Net Difference in Investment Earnings	Projected and Actual Experience	Net Difference in Investment Earnings	Change in Proportionate Share of Contributions	Projected and Actual Experience	
2019	\$ 27,526	\$ 585,069	\$ 220,902	\$ 267,902	\$ 538,362	\$ 215,707	\$ (59,466)	
2020	27,526	585,069	220,902	267,902	538,362	215,707	(59,466)	
2021	27,526	585,069	220,902	267,902	538,362	215,707	(59,466)	
2022	27,526	585,069	220,902	267,902	538,361	215,707	(59,466)	
2023	27,524	585,071	220,904	267,904	-	-	-	
Total	\$137,628	\$2,925,347	\$1,104,512	\$1,339,512	\$ 2,153,447	\$ 862,828	\$ (237,864)	

Year End June 30,	2016 Balance Amortization				2015 Balance Amortization	
	Deferred Outflows			Deferred Inflows	Deferred Outflows	Deferred Inflows
	Net Difference in Investment Earnings	Change in Assumptions	Change in Proportionate Share of Contributions	Projected and Actual Experience	Change in Assumptions	Net Difference in Investment Earnings
2019	\$ 502,736	\$ 234,677	\$ 1,167,980	\$ (96,008)	\$ 70,509	\$ (533,513)
2020	502,738	234,677	1,167,980	(96,008)	-	-
2021	-	204,169	1,016,141	(83,529)	-	-
2022	-	-	-	-	-	-
2023	-	-	-	-	-	-
Total	\$ 1,005,473	\$ 673,523	\$ 3,352,101	\$ (275,545)	\$ 70,509	\$ (533,513)

Maryland Lottery and Gaming Control Agency
Notes to the Financial Statements
For the Years Ended June 30, 2018 and 2017

9. RETIREMENT BENEFITS – (continued)

GASB No. 68 – Pension Disclosures – (continued)

Assumptions and Other Inputs:

Valuation method.....	Individual Entry Age Normal Cost Method
Amortization method.....	Level Percentage of Payroll, Closed
Salary increases.....	3.15% to 9.15% including inflation
Inflation.....	2.65% general, 3.15% wage
Investment rate of return.....	7.50%
Discount rate.....	7.50%
Retirement age.....	Experienced-based table of rates that are specific to the type of eligibility condition. Last updated for the 2015 valuation pursuant to an experience study of the period 2010-2014.
Mortality.....	RP-2014 Mortality Tables with generational mortality projections using scale MP-2014, calibrated to MSRPS experience.

Discount Rate

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

10. OTHER POSTEMPLOYMENT BENEFITS

Members of the State Retirement and Pension Systems and their dependents are provided postemployment health care benefits through the State Employee and Retiree Health and Welfare Benefits Program (Plan). The Plan is a single-employer defined benefit health care plan established by the State Personnel and Pensions Article, Section 2-501 through 2-516 of the Annotated Code of Maryland. The Plan is self-insured to provide medical, hospitalization, prescription drug and dental insurance benefits to eligible state employees, retirees, and their dependents. A separate valuation is not performed for the Agency. The Agency’s only obligation to the Plan is its required annual contribution.

10. OTHER POSTEMPLOYMENT BENEFITS – (continued)

Effective June 1, 2004, the State established the Postretirement Health Benefits Trust Fund (OPEB Trust) to receive appropriated funds and contributions to assist the Plan in financing the State's post-employment health insurance subsidy. The OPEB Trust is established in accordance with the State Personnel and Pensions Article, Section 34-101 of the Annotated Code of Maryland and is administered by the Board of Trustees for the State Retirement and Pension System. The Board of Trustees prepares a financial report for the OPEB Trust, which can be obtained from the State Retirement and Pension System of Maryland, 120 E. Baltimore Street, Suite 1600, Baltimore, Maryland 21202.

Plan Description

Agency employees are members of the Plan. Members, generally, may enroll and participate in the health benefit options upon retirement if the retiree ended State service with at least 10 years of creditable service and within five years before the age at which a vested retirement allowance normally would begin or if the retiree ended State service with at least 16 years of creditable service.

Funding Policy

Based on current practice, the State subsidizes approximately 50% to 85% of covered medical, dental, prescription, and hospitalization costs, depending on the type of insurance plan. The State assesses a surcharge for postemployment health care benefits, which is based on health care insurance charges for current employees. Costs for post retirement benefits are for State of Maryland retirees. The State does not distinguish employees by employer/State agency. Instead, the State allocates the postemployment health care costs to all participating employers. The cost of these benefits is expensed when paid. For the years ended June 30, 2018 and June 30, 2017, the State did not allocate postemployment health care costs to participating employers and as a result no contribution was made by the Agency.

11. RISK MANAGEMENT

The Agency is exposed to various risks associated with the theft, damage, or destruction of assets, torts, and game liability. To manage the related risks, the Agency participates in the State's insurance program, which provides general liability, personal and casualty, and workers' compensation insurance. The program requires all agencies to submit premiums based upon proportionate payroll costs and/or claim history. This insurance covers related losses up to a maximum of \$1,000,000 per event. Settlements have not exceeded coverage for any of the past three fiscal years. The activity related to accrued workers' compensation costs is included in the schedule exhibited in Note 6.

To minimize risks associated with lottery game liabilities, the Agency has established aggregate payout limits for each game type. This approach discontinues sales of the daily numbers games once the potential liability limit is reached for a specific player selection. A maximum payout limit is established for those games with a first-tier prize, which requires multiple first-tier winners to split the related prize.

Risk is minimized for gaming operations as the law requires a VLT to have an average payout of 87% or more but does not exceed 100%. A casino's gaming floor is to be configured to collectively achieve, at all times, an average payout of 87% and which does not exceed 95%. For table games, an overall loss for a day is spread over a maximum of three days. Any excess loss due over the 3 day period are absorbed by the Casino and do not impact the Agency.

SUPPLEMENTAL INFORMATION

Maryland Lottery and Gaming Control Agency
Schedule of Revenues, Expenses and Changes in Net Position - Budget and Actual
For the Year Ended June 30, 2018

	Original Budget	Final Amended Budget	Actual Amounts	Variance with Budget over (under)
Revenues				
Cash revenue receipts from all sources	\$ 2,197,477,000	\$ 2,197,447,000	\$ 3,740,531,131	\$ 1,543,084,131
Expenditures and encumbrances				
Gaming vendor and information technology fees	33,014,554	33,014,554	30,748,701	\$ (2,265,853)
Instant ticket printing and delivery	8,200,000	8,200,000	6,637,518	(1,562,482)
Salaries, wages, and benefits	26,207,704	26,207,704	26,966,333	758,629
Advertising and promotions	15,423,987	15,423,987	15,536,795	112,808
Other general and administrative expenses	8,103,816	8,103,816	11,417,957	3,314,141
Reversions VLT general fund	-	(2,413,562)	-	2,413,562
Reversions-lottery	-	(1,081,878)	-	1,081,878
Total expenditures and encumbrances	<u>90,950,061</u>	<u>87,454,621</u>	<u>91,307,304</u>	<u>3,852,683</u>
Excess of revenues over expenditures	<u>2,106,526,939</u>	<u>2,109,992,379</u>	<u>3,649,223,827</u>	<u>1,539,231,448</u>
Other uses of financial resources				
Transfers in (out)				
State of Maryland Stadium Authority and Veterans Trust and				
International Racing Fund	(41,074,000)	(41,074,000)	(41,076,575)	(2,575)
State of Maryland General Fund	(519,500,000)	(521,207,000)	(534,595,837)	(13,388,837)
Other government agencies/funds-VLT	(643,599,000)	(651,356,000)	(680,211,579)	(28,855,579)
Excess of revenues over expenditures and other sources of financial resources	<u>\$ 902,353,939</u>	<u>\$ 896,355,379</u>	<u>\$ 2,393,339,836</u>	<u>\$ 1,496,984,457</u>
Reconciliation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures				
Change in net position	\$ (7,876,538)			
Non-budgetary expenditures:				
Prize expense	1,248,722,984			
Retailer and casino commissions	1,150,583,901			
Depreciation	208,680			
Decrease in fair value of investments	356,891			
Amortization of discount prize liabilities	1,423,362			
Voluntary exclusion program	(79,444)			
Excess of revenues over expenses	<u>\$ 2,393,339,836</u>			

Maryland Lottery and Gaming Control Agency
Notes to the Schedule of Revenues, Expenses, and
Changes in Net Position – Budget and Actual
For the Year Ended June 30, 2018

1. BUDGETING AND BUDGETARY CONTROL

The Maryland Constitution requires the Governor to submit to the General Assembly an annual balanced budget for the following fiscal year. Each year the Agency prepares its annual budget and submits it to the Governor. The Governor then presents the State's annual budget (including the Agency's) to the General Assembly in accordance with Constitutional requirements. The General Assembly is required to then enact a balanced budget.

The Agency's official budget, as adopted by the Legislature, is based upon accounting for certain transactions on the basis of cash receipts and disbursements. Encumbrance accounting, under which purchase orders, contracts, and other commitments for expenditures are recorded as expenditures when the purchase commitment is made, is employed for budgetary purposes. Unliquidated encumbrances are canceled at year-end if it is determined the funds will not be utilized in the future. Unencumbered appropriations lapse at the end of the fiscal year for which they were appropriated. The major differences between the budget basis and the Accounting Principles Generally Accepted in the United States of America (GAAP) basis of accounting are:

- Lottery player prize payments are not budgeted;
- Lottery retailer commissions are not budgeted;
- Casino operator commissions are not budgeted;
- Revenues are recorded when received in cash (budget) as opposed to when earned (GAAP);
- Expenses (including deferred prizes) are recorded when paid or encumbered (budget) as opposed to when the liability is incurred (GAAP);
- The budget basis excludes depreciation and amortization.

The Agency maintains budgetary control by not permitting the total expenditures to exceed appropriations without executive and legislative branch approval.

Maryland Lottery and Gaming Control Agency
Schedule of Changes in Net Pension Liability
Contributions and Related Ratios*
For the Year Ended June 30,

Schedule of Changes in Net Pension Liability

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Agency's proportion of the collective NPL	0.13%	0.12%	0.11%	0.08%
Agency's proportionate share of the collective NPL	\$ 27,645,652	\$ 27,137,095	\$ 22,831,103	\$ 13,723,698
Agency's covered payroll	17,438,842	16,262,945	14,459,261	13,597,365
Proportionate share of the collective NPL as a percentage of covered payroll	158.53%	166.86%	157.90%	100.93%
Plan fiduciary net position as a percentage of total pension liability	69.38%	65.79%	68.78%	71.87%

Schedule of Contributions

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Actuarially determined contributions	\$ 3,196	\$ 3,115,271	\$ 2,424,201	\$ 2,315,584
Contributions in relation to the actuarially determined contribution	<u>3,196</u>	<u>3,115,271</u>	<u>2,424,201</u>	<u>2,315,584</u>
Contribution deficiency (excess)	\$ -	\$ -	\$ -	\$ -
Covered payroll	17,438,842	16,262,945	14,459,261	13,597,365
Contributions as a percentage of covered-employee payroll	0.02%	19.16%	16.77%	17.03%

Maryland Lottery and Gaming Control Agency
Schedule of Changes in Net Pension Liability
Contributions and Related Ratios*
For the Year Ended June 30,

Notes to Required Schedules

Assumptions and Other Inputs:

Valuation Date.....	June 30 Actuarially determined contribution rates are calculated as of June 30, which is 12 months prior to the beginning of the fiscal year in which the contributions are reported.
Valuation method.....	Individual Entry Age Normal Cost Method
Amortization method.....	Level Percentage of Payroll, Closed
Asset Valuation Method.....	5-years smoothed market; 20% collar
Salary increases.....	3.15% to 9.15% including inflation
Inflation.....	2.65% general, 3.15% wage
Investment rate of return.....	7.50%
Discount rate.....	7.50%
Retirement age.....	Experienced-based table of rates that are specific to the type of eligibility condition. Last updated for the 2015 valuation pursuant to an experience study of the period 2010-2014.
Mortality.....	RP-2014 Mortality Tables with generational mortality projections using scale MP-2014, calibrated to MSRPS experience.
Notes.....	There were no benefit changes during the year. Adjustments to the roll-forward liabilities were made to reflect the inflation assumption change in the 2017 valuation from 2.90% to 2.65%

*Schedules are intended to show information for 10 years. Additional years will be displayed as they become available.



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

To the Maryland Lottery and Gaming Control Agency:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities, of the Maryland Lottery and Gaming Control Agency (an agency of the State of Maryland) (Agency), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Maryland Lottery and Gaming Control Agency's basic financial statements, and have issued our report thereon dated September 27, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Maryland Lottery and Gaming Control Agency's internal control over financial reporting (internal control) to determine the 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 Maryland Lottery and Gaming Control Agency's internal control. Accordingly, we do not express an opinion on the effectiveness of the Maryland Lottery and Gaming Control Agency's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit 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 Maryland Lottery and Gaming Control Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

SC + H Architect Services, P.C.

September 27, 2018