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May 16, 2017

Board of Commissioners  
State Lottery Commission of Indiana  
1302 North Meridian Street  
Indianapolis, IN 46202

We have reviewed the audit report prepared by CliftonLarsonAllen, LLP Independent Public Accountants, for the period July 1, 2015 to June 30, 2016. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Auditors' Report, the financial statements included in the report present fairly the financial condition of the State Lottery Commission of Indiana, as of June 30, 2016 and the results of its operations for the period then ended, on the basis of accounting described in the report.

The audit report is filed with this letter in our office as a matter of public record.

*Paul D. Joyce*  
Paul D. Joyce, CPA  
State Examiner

**THE STATE LOTTERY  
COMMISSION OF INDIANA  
FINANCIAL STATEMENTS  
As of and for the years ended  
JUNE 30, 2016 AND 2015  
(With Independent Auditors' Report)**

**THE STATE LOTTERY COMMISSION OF INDIANA  
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## INDEPENDENT AUDITORS' REPORT

Board of Commissioners  
The State Lottery Commission of Indiana  
Indianapolis, Indiana

### **Report on the Financial Statements**

We have audited the accompanying financial statements of The State Lottery Commission of Indiana (the Commission), a component unit of the State of Indiana, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the component unit's basic financial statements as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

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

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

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

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of June 30, 2016 and 2015, and the changes in its financial position and its 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 present only the Commission and do not purport to, and do not, present fairly the financial position of the State of Indiana, as of June 30, 2016 and 2015, and the changes in its financial position, or where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

During fiscal year ended June 30, 2016, The State Lottery Commission of Indiana adopted Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions* and the related GASB Statement No. 71 *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*. As a result of the implementation of these standards, The State Lottery Commission of Indiana reported a restatement for the change in accounting principle (see Note 11). Our opinion is not modified with respect to the restatement.

***Other Information***

***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the pension information on pages 3 - 11 and 37 - 41, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued a report dated October 10, 2016, on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of 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 Commission's internal control over financial reporting and compliance.



**CliftonLarsonAllen LLP**

Indianapolis, Indiana  
October 10, 2016

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The management of The State Lottery Commission of Indiana (Commission) offers readers of the Commission's annual financial report, a narrative overview of its performance during the fiscal years ended June 30, 2016 and 2015. Please read it in conjunction with the financial statements and related footnote disclosures, which follow this section.

### *Financial Highlights*

- Fiscal year 2016 (FY 16) ticket sales were \$1.208 billion, an increase of approximately \$167 million or 16% from fiscal year 2015 (FY 15). The net increase in sales is primarily attributable to a \$110 million increase in scratch-off sales, a \$45 million increase in Powerball sales, and a \$12 million increase in Fast Play sales. FY 15 ticket sales were \$1.041 billion, an increase of approximately \$22 million or 2% from fiscal year 2014 (FY 14). The net increase in sales is primarily attributable to a \$57 million increase in scratch-off sales, a \$6 million decrease in Hoosier Lotto sales, a \$10 million decrease in Mega Millions sales, and a \$20 million decrease in Powerball sales.
- Prize expenses for FY 16 increased \$101 million from FY 15, or 15%. The increase in prize expense during FY 16 is directly related to the increase in sales mentioned above. Prize expenses for FY 15 increased \$34 million from FY 14, or 5%. The FY 15 increase in prize expense was partially related to the increase in sales mentioned above; however, prize expenses outpaced revenue growth by 3%.
- Indirect gaming expense for FY 16, which includes retailer commissions, advertising and promotions, ticket printing expense, central gaming system expense, miscellaneous lottery expenses, management fees, and other game expenses increased approximately \$13 million from FY 15. This increase is due primarily to an increase in retailer commissions and central gaming system expense, while management fees decreased in FY 16. Indirect gaming expense for FY 15 increased approximately \$9 million from FY 14. This increase is due primarily to an increase in retailer commissions, central gaming system expense, advertising and promotions, ticket printing expense and management fees.
- Other operating expenses in FY 16, which includes salaries, wages and benefits and general and administrative expenses, increased \$276 thousand or 5% compared to that of FY 15 mainly due to salaries, wages, and benefits. Other operating expenses in FY 15 increased \$206 thousand or 4% compared to that of FY 14 which was also mainly due to salaries, wages, and benefits.
- In FY 16, non-operating revenues, net of expenses, decreased approximately \$7 million from FY 15. This decrease was related to no shortfall payment being received from IGT Indiana, LLC, formerly GTECH Indiana, LLC, in FY 16 and an increase in the fair market value of investments in U.S. Treasury securities held by the Commission to fund noncurrent prizes. In FY 15, non-operating revenues, net of expenses, increased approximately \$15 million from FY 14. This increase was related to a shortfall payment received from IGT Indiana, LLC and an increase in other income and the change in fair market value of investments in U.S. Treasury securities held by the Commission to fund noncurrent prizes.
- FY 16 net income of \$290 million represents approximately a \$46 million increase from FY 15. FY 15 net income of \$244 million represents approximately a \$6 million decrease from FY 14.

### ***Overview of the Financial Statements***

The Commission is accounted for as an enterprise fund, reporting transactions using the accrual basis of accounting similar to a business entity. This discussion and analysis is intended to serve as an introduction to the Commission's financial statements. For each fiscal year, the Commission's basic financial statements are comprised of the following:

- Statements of Net Position
- Statements of Revenues, Expenses and Changes in Net Position
- Statements of Cash Flows
- Notes to the Financial Statements

The Statements of Net Position present information on all of the Commission's assets, deferred outflows, liabilities, and deferred inflows, with the difference between these items reported as net position.

The Statements of Revenues, Expenses, and Changes in Net Position present revenue and expense information and the change in the Commission's net position during the measurement period as a result of these transactions.

The Statements of Cash Flows present sources and uses of cash for the fiscal year, displayed in the following categories: cash flows from operating activities, cash flows for non-capital and related financing activities, cash flows from capital and related financing activities and cash from investing activities.

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. They are an integral part of the basic financial statements.

### ***Financial Analysis of the Commission***

#### **Net Position and Changes in Net Position**

Net position represents the difference between total assets plus deferred outflows and total liabilities plus deferred inflows. Because the Commission is required by law to make transfers of its surplus revenues to the State of Indiana, the change in net position does not necessarily reflect the results of the Commission's operating activities.

**Condensed Statements of Net Position**  
(in millions of dollars)

	June 30,		
	2016	2015	2014
Current assets	\$ 161	\$ 132	\$ 129
Restricted assets	8	9	9
Noncurrent investments	135	133	126
Capital assets - net	1	1	2
Other assets	-	-	5
Total assets	<u>305</u>	<u>275</u>	<u>271</u>
Deferred outflows	<u>2</u>	<u>1</u>	<u>-</u>
Current liabilities	147	134	133
Long-term liabilities	136	125	117
Total liabilities	<u>283</u>	<u>259</u>	<u>250</u>
Deferred inflows	<u>-</u>	<u>1</u>	<u>-</u>
Net position			
Unrestricted	23	14	19
Net investment in capital assets	1	2	2
Total net position	<u>\$ 24</u>	<u>\$ 16</u>	<u>\$ 21</u>

**Condensed Statements of Revenues, Expenses and Changes in Net Position**  
(in millions of dollars)

	Years Ended June 30,		
	2016	2015	2014
Operating revenues	\$ 1,208	\$ 1,041	\$ 1,019
Operating - direct game expenses	(772)	(671)	(637)
Operating - indirect game expenses	(150)	(137)	(128)
Other operating expenses	(6)	(6)	(6)
Operating income	<u>280</u>	<u>227</u>	<u>248</u>
Non-operating revenues	<u>10</u>	<u>17</u>	<u>2</u>
Net income prior to distributions	290	244	250
Distributions	(282)	(243)	(251)
Change in net position	<u>8</u>	<u>1</u>	<u>(1)</u>
Net position - beginning of year	<u>16</u>	<u>15</u>	<u>22</u>
Net position - end of year	<u>\$ 24</u>	<u>\$ 16</u>	<u>\$ 21</u>

The net position at the beginning of the year ended June 30, 2015, was restated during the June 30, 2015 audit in order to implement GASB 68.

**Assets**

The FY 16 increase of \$30 million in total assets from FY 15 was primarily the result of an increase in cash and cash equivalents, an increase in prepaid expenses, and an increase in accounts receivables.

The FY 15 increase of \$4 million in total assets from FY 14 was primarily the result of an increase in cash and cash equivalents, an increase in the noncurrent investments, and a decrease in other assets.

**Liabilities**

Current liabilities increased by \$13 million in FY 16 from FY 15 primarily as a result of an increase in accounts payable, an increase in unearned revenue, and an increase in accrued prizes payable. Long-term liabilities increased \$11 million in FY 16 over FY 15 primarily due to an increase in unearned revenue.

Current liabilities increased by \$1 million in FY 15 from FY 14 primarily as a result of a decrease in accounts payable and an increase in accrued prizes payable. Long-term liabilities increased \$8 million in FY 15 over FY 14 due to an increase in noncurrent prizes payable and net pension liability.

**Net Position**

Net position consists of unrestricted income retained for the future cash flow needs of the Commission and capital assets. The Commission's total net position at June 30, 2016 was \$24 million, at June 30, 2015 was \$16 million, and at June 30, 2014 was \$21 million. The fair market value of investments adjustment and net pension obligation adjustment are excluded from surplus revenue to be transferred to the State. As such, these changes form part of the net position.

**Sales and Prize Expense**  
(in millions of dollars)

	<b>Scratch-Off</b>			<b>Powerball</b>		
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Operating Revenues	\$ 870	\$ 760	\$ 110	\$ 132	\$ 87	\$ 45
Game Prizes	600	525	75	64	42	22
Gross Margin	<u>\$ 270</u>	<u>\$ 235</u>	<u>\$ 35</u>	<u>\$ 68</u>	<u>\$ 45</u>	<u>\$ 23</u>
	<b>Mega Millions</b>			<b>Hoosier Lotto</b>		
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Operating Revenues	\$ 33	\$ 36	\$ (3)	\$ 45	\$ 43	\$ 2
Game Prizes	16	17	(1)	24	23	1
Gross Margin	<u>\$ 17</u>	<u>\$ 19</u>	<u>\$ (2)</u>	<u>\$ 21</u>	<u>\$ 20</u>	<u>\$ 1</u>
	<b>Mix &amp; Match</b>			<b>Daily Games</b>		
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Operating Revenues	\$ -	\$ 1	\$ (1)	\$ 73	\$ 66	\$ 7
Game Prizes	-	-	-	35	36	(1)
Gross Margin	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ (1)</u>	<u>\$ 38</u>	<u>\$ 30</u>	<u>\$ 8</u>
	<b>Cash 5</b>			<b>Quick Draw</b>		
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Operating Revenues	\$ 11	\$ 13	\$ (2)	\$ 19	\$ 20	\$ (1)
Game Prizes	6	6	-	11	11	-
Gross Margin	<u>\$ 5</u>	<u>\$ 7</u>	<u>\$ (2)</u>	<u>\$ 8</u>	<u>\$ 9</u>	<u>\$ (1)</u>
	<b>Poker Lotto</b>			<b>EZ Match</b>		
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Operating Revenues	\$ 2	\$ 3	\$ (1)	\$ 7	\$ 7	\$ -
Game Prizes	2	2	-	4	5	(1)
Gross Margin	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ (1)</u>	<u>\$ 3</u>	<u>\$ 2</u>	<u>\$ 1</u>
	<b>Fast Play</b>			<b>Bingo</b>		
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Operating Revenues	\$ 13	\$ 1	\$ 12	\$ 2	\$ 3	\$ (1)
Game Prizes	9	1	8	1	2	(1)
Gross Margin	<u>\$ 4</u>	<u>\$ -</u>	<u>\$ 4</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ -</u>
	<b>Monopoly Millionaires' Club</b>			<b>PLUS</b>		
	<b>2016</b>	<b>2015</b>	<b>Change</b>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Operating Revenues	\$ -	\$ 1	\$ (1)	\$ 1	\$ -	\$ 1
Game Prizes	-	1	(1)	-	-	-
Gross Margin	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 1</u>
	<b>Total</b>					
	<b>2016</b>	<b>2015</b>	<b>Change</b>			
Operating Revenues	\$ 1,208	\$ 1,041	\$ 167			
Game Prizes	772	671	101			
Gross Margin	<u>\$ 436</u>	<u>\$ 370</u>	<u>\$ 66</u>			

**Sales and Prize Expense**  
(in millions of dollars)

	<b>Scratch-Off</b>			<b>Powerball</b>		
	<b>2015</b>	<b>2014</b>	<b>Change</b>	<b>2015</b>	<b>2014</b>	<b>Change</b>
Operating Revenues	\$ 760	\$ 703	\$ 57	\$ 87	\$ 107	\$ (20)
Game Prizes	525	481	44	42	50	(8)
Gross Margin	<u>\$ 235</u>	<u>\$ 222</u>	<u>\$ 13</u>	<u>\$ 45</u>	<u>\$ 57</u>	<u>\$ (12)</u>
	<b>Mega Millions</b>			<b>Hoosier Lotto</b>		
	<b>2015</b>	<b>2014</b>	<b>Change</b>	<b>2015</b>	<b>2014</b>	<b>Change</b>
Operating Revenues	\$ 36	\$ 46	\$ (10)	\$ 43	\$ 49	\$ (6)
Game Prizes	17	23	(6)	23	22	1
Gross Margin	<u>\$ 19</u>	<u>\$ 23</u>	<u>\$ (4)</u>	<u>\$ 20</u>	<u>\$ 27</u>	<u>\$ (7)</u>
	<b>Mix &amp; Match</b>			<b>Daily Games</b>		
	<b>2015</b>	<b>2014</b>	<b>Change</b>	<b>2015</b>	<b>2014</b>	<b>Change</b>
Operating Revenues	\$ 1	\$ 3	\$ (2)	\$ 66	\$ 61	\$ 5
Game Prizes	-	2	(2)	36	30	6
Gross Margin	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 30</u>	<u>\$ 31</u>	<u>\$ (1)</u>
	<b>Cash 5</b>			<b>Quick Draw</b>		
	<b>2015</b>	<b>2014</b>	<b>Change</b>	<b>2015</b>	<b>2014</b>	<b>Change</b>
Operating Revenues	\$ 13	\$ 12	\$ 1	\$ 20	\$ 20	\$ -
Game Prizes	6	5	1	11	12	(1)
Gross Margin	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ -</u>	<u>\$ 9</u>	<u>\$ 8</u>	<u>\$ 1</u>
	<b>Poker Lotto</b>			<b>Raffle</b>		
	<b>2015</b>	<b>2014</b>	<b>Change</b>	<b>2015</b>	<b>2014</b>	<b>Change</b>
Operating Revenues	\$ 3	\$ 8	\$ (5)	\$ -	\$ 1	\$ (1)
Game Prizes	2	5	(3)	-	1	(1)
Gross Margin	<u>\$ 1</u>	<u>\$ 3</u>	<u>\$ (2)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
	<b>Fast Play</b>			<b>EZ Match</b>		
	<b>2015</b>	<b>2014</b>	<b>Change</b>	<b>2015</b>	<b>2014</b>	<b>Change</b>
Operating Revenues	\$ 1	\$ -	\$ 1	\$ 7	\$ 9	\$ (2)
Game Prizes	1	-	1	5	6	(1)
Gross Margin	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2</u>	<u>\$ 3</u>	<u>\$ (1)</u>
	<b>Monopoly Millionaires' Club</b>			<b>Bingo</b>		
	<b>2015</b>	<b>2014</b>	<b>Change</b>	<b>2015</b>	<b>2014</b>	<b>Change</b>
Operating Revenues	\$ 1	\$ -	\$ 1	\$ 3	\$ -	\$ 3
Game Prizes	1	-	1	2	-	2
Gross Margin	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 1</u>
	<b>Total</b>					
	<b>2015</b>	<b>2014</b>	<b>Change</b>			
Operating Revenues	\$ 1,041	\$ 1,019	\$ 22			
Game Prizes	671	637	34			
Gross Margin	<u>\$ 370</u>	<u>\$ 382</u>	<u>\$ (12)</u>			

The tables above compare FY 16, FY 15 and FY 14 sales, prize expense and gross margin for major lottery game categories. FY 16 sales increased in the Scratch-off, Powerball, Hoosier Lotto, Daily Games, and Fast Play categories. FY 16 saw decreases in Mega Millions, Mix & Match, Cash 5, Quick Draw, and Poker Lotto. One new game, Plus, was launched in April 2016 which is an add-on game to Hoosier Lotto. Bingo to Go came to an end in May 2016.

In FY 15, sales decreased for Powerball, Hoosier Lotto and Mega Millions due to lower than average jackpots. There were also decreases in the EZ Match and Poker Lotto product lines. Three new games were introduced in FY 15. Bingo to Go launched in August 2014, Monopoly Millionaires' Club launched in October 2014 (and ended in December), and Fast Play launched in June 2015. Mix and Match ended in August 2014.

Powerball is a multi-state lotto game offering large jackpot prizes. The Commission participates in this game along with 46 other United States lotteries, including the District of Columbia, the U.S. Virgin Islands and Puerto Rico. Powerball sales increased in FY 16 by approximately \$45 million to \$132 million. The primary reason for the increase in ticket sales was a record \$1.5 billion jackpot in January 2016.

Powerball sales for FY 15 were \$87 million, which was a \$20 million decrease from prior year. The primary reason for the decrease in ticket sales was lower average jackpots than in FY 14.

Mega Millions is also a multi-state lotto game offering large jackpot prizes. The Commission participates in this game along with 45 other United States lotteries, including the District of Columbia and US Virgin Islands. Mega Millions recognized sales of approximately \$33 million in FY 16 and \$36 million in FY 15. Mega Millions decreased by \$10 million in FY 15 due to lower than average jackpot levels.

Hoosier Lotto is a game available only in Indiana. Sales increased in FY 16 by \$2 million. Sales decreased in FY 15 by approximately \$6 million. The increase in FY 16 was due to re-structuring of the game in April 2016, the biggest change being the increase in price point from \$1 to \$2. Beginning in FY 15, the amount of the annuity jackpot increase between draws was lowered. The amount was lowered to an increase of \$200,000 for draws falling on Wednesday and \$300,000 for draws falling on Saturday. Prior to FY 15, the annuity jackpot amount increased by \$500,000 for each draw.

The "Daily Games" consists of the Daily 3 and Daily 4 games. FY 16 had an increase of \$7 million in sales over FY 15, part of which was due to the addition of 1-Off to the Daily games which gives players more ways to win with the cost of an additional \$1. FY 15 was also a strong year for Daily games as sales increased by \$5 million over FY 14.

Quick Draw sales had a slight decrease in sales in FY 16 from FY 15. Sales remained relatively consistent from FY 14 to FY 15.

Cash 5 sales decreased in FY 16 from FY 15 by \$2 million. This decrease was directly related to the decrease in average jackpots. There was a slight increase of \$1 million in sales in FY 15. Beginning in April 2014, the jackpot began increasing by \$5,000 per draw instead of \$2,500 per draw which resulted in the increase.

Poker Lotto sales decreased by \$1 million in FY 16 and decreased by \$5 million in FY 15 from prior year. The poor performance and the continued effort to optimize the online game portfolio has led to the discontinuance of Poker Lotto in July 2016.

EZ Match is an add-on game available with Daily 3, Daily 4, Cash 5, Quick Draw, and previously Hoosier Lotto prior to the game restructure in April of 2016. In FY 16, EZ Match sales remained consistent with prior year. FY 15 sales decreased by \$2 million from FY 14.

Fast Play is an instant on-line game category with 21 individual games available as of June 30, 2016. Fast Play sales increased \$11 million in FY 16 from FY 15 due to its first full year of sales.

Hoosier Lotto Plus, also referred to as "Plus", was launched in April 2016 as an add-on game with Hoosier Lotto. Plus had sales of \$1 million in FY 16.

Mix & Match ended in FY 15.

### **Prize Expense**

In general, prize expense by game will increase or decrease from year to year in proportion to the increase or decrease in ticket sales for the corresponding game. However, prize expense can also be impacted by the luck of the draw, unclaimed prizes, modifications to the game design, or adjustments to the required reserve balances to fund Hoosier Lotto jackpots.

Total prize expense in FY 16 was \$772 million, which was an increase of 15% over FY 15 primarily attributable to the 16% increase in FY 16 revenue. Total prize expense in FY 15 of \$671 million increased by 5% over FY 14 prize expense of \$637 million. The FY 15 increase in prize expense outpaced revenue growth by 3% which was primarily the result of: scratch-off prize expense increasing by nearly 1% as a percent of revenue, Hoosier Lotto jackpot reserve adjustments, a \$2 million reduction in unclaimed Powerball prizes, and increased payouts for Daily 3 and Daily 4 due the number of drawings that resulted in payouts to highly wagered numbers.

- FY 16 scratch-off game prize expense increased 14% or \$75 million. FY 15 scratch-off game prize expense increased 9% or \$44 million. Both increases are directly related to scratch-off sales increases for their respective years.
- On-line game prize expense reached \$172 million in FY 16 which was an 18% or \$26 million increase over FY 15. This increase is directly related to the 20% increase in On-line revenue growth during FY 16. On-line game prize expense decreased 6% or \$10 million in FY 15 as compared to FY 14. This decrease is in large part related to a decrease in Powerball and Mega Millions sales and an increase in sales from the 3 new games introduced in FY 15 (Fast Play, Bingo to Go and Monopoly Millionaires' Club).

## Indirect Game Expenses and Other Operating Expenses

### Indirect Game Expenses and Other Operating Expenses (in millions of dollars)

	Years Ended June 30,		
	2016	2015	2014
Indirect game expenses:			
Retailer commissions	\$ 82	\$ 70	\$ 68
Central gaming system expense	21	18	17
Advertising and promotion	19	20	17
Management fees	13	15	14
Ticket printing expense	12	12	9
Miscellaneous lottery expense	2	1	3
Other game expense	1	1	-
	<u>150</u>	<u>137</u>	<u>128</u>
Other operating expenses:			
Salaries, wages, and benefits	3	3	3
General and administrative	3	3	3
	<u>6</u>	<u>6</u>	<u>6</u>
Total indirect game and other operating expenses	<u>\$ 156</u>	<u>\$ 143</u>	<u>\$ 134</u>

Indirect game and other operating expenses increased \$13 million from FY 15 to FY 16. This is due to increases in retailer commissions, ticket printing expense, and central gaming system expense. The increases in the retailer commissions, ticket printing expense and central gaming system expenses are directly related to the increase in ticket sales. Other operating expenses remained relatively consistent between FY 15 and FY 16. Indirect game and other operating expenses increased \$9 million from FY 14 to FY 15. This is due to increases in retailer commissions, advertising and promotions, ticket printing expense and central gaming system expenses. The increases in the retailer commissions, ticket printing expense and central gaming system expenses are directly related to the increase in ticket sales. Other operating expenses remained consistent between FY 14 and FY 15.

### Other

During fiscal year 2013, the Commission entered into an Integrated Services Agreement with IGT Indiana, LLC, formerly GTECH Indiana, LLC for the purpose of increasing sales and net income. This strategic relationship with IGT Indiana, LLC is expected to increase revenues net of game expenses over the term of the Integrated Service Agreement of 15 years. Depending on where Provider Net Income, a/k/a "PNI", where PNI is equal to Operating Income less Other Operating Expenses, falls during each fiscal year of the contract, a "Provider Shortfall" payment may be due from IGT Indiana, LLC to the Commission or a "Provider Incentive" payment may be due from the Commission to IGT Indiana, LLC.

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**THE STATE LOTTERY COMMISSION OF INDIANA  
STATEMENTS OF NET POSITION  
AS OF JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 33,713,655	\$ 23,310,339
Investments - current portion	11,638,492	11,654,116
Accounts receivable - net	98,727,015	97,114,077
Prepaid expenses	16,984,325	128,838
Accrued interest receivable	-	452
Total current assets	<u>161,063,487</u>	<u>132,207,822</u>
<b>NONCURRENT ASSETS:</b>		
Investments - less current portion	135,117,392	132,341,282
Restricted assets	8,026,215	8,598,161
Capital assets - net	1,409,259	1,529,110
Total noncurrent assets	<u>144,552,866</u>	<u>142,468,553</u>
Total assets	<u>305,616,353</u>	<u>274,676,375</u>
<b>DEFERRED OUTFLOWS:</b>		
Deferred outflows - contributions made subsequent to measurement date	244,166	267,847
Deferred outflows - change in assumptions	274,482	229,587
Deferred outflows - earnings	794,235	162,192
Deferred outflows - proportionate share	768,064	1,006,427
Deferred outflows - experience	164,313	-
Total deferred outflows	<u>2,245,260</u>	<u>1,666,053</u>
<b>CURRENT LIABILITIES:</b>		
Accounts payable:		
State	21,097,723	33,941,084
Trade	9,400,564	2,639,161
Prize liability - current portion	113,199,597	96,381,990
Unearned revenue - current portion	2,528,835	789,660
Other accrued expenses	443,697	636,452
Total current liabilities	<u>146,670,416</u>	<u>134,388,347</u>
<b>LONG-TERM LIABILITIES:</b>		
Prize liability - less current portion	117,894,544	123,525,675
Unearned revenue - less current portion	15,442,308	-
Net pension liability	3,083,616	1,993,093
Total noncurrent liabilities	<u>136,420,468</u>	<u>125,518,768</u>
Total liabilities	<u>283,090,884</u>	<u>259,907,115</u>
<b>DEFERRED INFLOWS:</b>		
Deferred inflows - experience	262,236	435,452
Deferred inflows - earnings	151,952	191,367
Deferred inflows - assumptions	37,657	-
Total deferred inflows	<u>451,845</u>	<u>626,819</u>
<b>NET POSITION:</b>		
Unrestricted	22,909,625	14,279,384
Net investment in capital assets	1,409,259	1,529,110
<b>TOTAL NET POSITION</b>	<u>\$ 24,318,884</u>	<u>\$ 15,808,494</u>

See accompanying Notes to Financial Statements.

**THE STATE LOTTERY COMMISSION OF INDIANA  
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
OPERATING REVENUES:		
Scratch-off sales - net	\$ 869,945,711	\$ 759,457,779
On-line ticket sales	337,668,847	281,206,095
Total operating revenues	<u>1,207,614,558</u>	<u>1,040,663,874</u>
OPERATING EXPENSES:		
Direct game expenses:		
Scratch-off game prizes	600,288,790	525,052,162
On-line games prizes	171,685,163	145,927,864
	<u>771,973,953</u>	<u>670,980,026</u>
Indirect game expenses:		
Retailer commissions	81,927,212	70,129,231
Lottery expenses:		
Ticket printing expense	12,164,702	11,697,226
Advertising and promotion	18,911,496	19,665,133
Central gaming system expense	21,135,202	18,346,437
Miscellaneous lottery expense	1,924,521	1,934,436
Management fees	13,160,201	14,693,414
Other game expense	574,246	934,571
	<u>149,797,580</u>	<u>137,400,448</u>
Total game expenses	<u>921,771,533</u>	<u>808,380,474</u>
PROVIDER NET INCOME	<u>285,843,025</u>	<u>232,283,400</u>
OTHER OPERATING EXPENSES:		
Salaries, wages, and benefits	3,499,829	3,231,711
General and administrative	2,724,670	2,717,089
Total other operating expenses	<u>6,224,499</u>	<u>5,948,800</u>
OPERATING INCOME	<u>279,618,526</u>	<u>226,334,600</u>
NON-OPERATING REVENUES (EXPENSES):		
Interest income	96,953	17,172
Net increase in fair value of investments	8,846,733	821,941
Decrease in net pension obligation	(336,343)	(118,348)
Provider shortfall	-	16,000,000
Other income - net	1,756,274	315,966
Total non-operating revenues - net	<u>10,363,617</u>	<u>17,036,731</u>
NET INCOME PRIOR TO DISTRIBUTIONS	<u>289,982,143</u>	<u>243,371,331</u>
DISTRIBUTIONS:		
Distributions to the State	(260,374,031)	(208,726,653)
Distributions to be paid to the State	(21,097,723)	(33,941,085)
Total distributions	<u>(281,471,754)</u>	<u>(242,667,738)</u>
CHANGES IN NET POSITION	8,510,389	703,593
NET POSITION — Beginning of year - Restated 2015	<u>15,808,494</u>	<u>15,104,901</u>
NET POSITION — Ending of year	<u>\$ 24,318,883</u>	<u>\$ 15,808,494</u>

See accompanying Notes to Financial Statements.

**THE STATE LOTTERY COMMISSION OF INDIANA  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Cash received from ticket sales	\$ 1,206,332,449	\$ 1,058,150,959
Payments to ticket winners	(760,787,467)	(661,830,210)
Payments to employees	(3,692,583)	(3,559,030)
Payments to suppliers	(145,420,222)	(141,114,855)
	<u>296,432,177</u>	<u>251,646,864</u>
<b>CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Distributions to the State	(311,161,269)	(242,458,988)
Up-front IGT payment	18,250,000	-
Others	352,428	315,966
Net decrease in restricted assets	571,946	410,732
	<u>(291,986,895)</u>	<u>(241,732,290)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Purchase of capital assets	(230,118)	(58,793)
Proceeds from the sale of capital assets	4,500	5,800
	<u>(225,618)</u>	<u>(52,993)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of investments	(495,094)	(11,145,500)
Investment maturities	6,581,341	5,640,399
Interest income	97,405	17,039
	<u>6,183,652</u>	<u>(5,488,062)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	10,403,316	4,373,519
CASH AND CASH EQUIVALENTS — Beginning of year	<u>23,310,339</u>	<u>18,936,820</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 33,713,655</u>	<u>\$ 23,310,339</u>

(Continued)

**THE STATE LOTTERY COMMISSION OF INDIANA  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 279,618,526	\$ 226,334,600
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	349,969	346,168
Change in provision for ticket returns	2,888,950	5,303,254
Loss (Gain) on sale of capital assets	(4,500)	6,803
Changes in certain assets and liabilities:		
Accounts receivable	(4,501,887)	12,146,182
Prepaid expenses	(16,855,487)	(1,673)
Accounts payable - trade	6,761,403	(1,341,974)
Unearned revenue	17,181,482	31,006
Other accrued expenses	(192,755)	(327,319)
Prize liability	11,186,476	9,149,817
	<u>\$ 296,432,177</u>	<u>\$ 251,646,864</u>
Net cash provided by operating activities		
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES —		
Net increase in fair value of investments	\$ 8,846,733	\$ 821,941
Decrease in net pension obligation	(336,343)	(118,348)
IGT Indiana provider shortfall, included in accounts receivable	-	16,000,000
	<u>\$ 8,510,390</u>	<u>\$ 16,703,593</u>
Net noncash investing, capital, and related financing activities		

(Concluded)

**THE STATE LOTTERY COMMISSION OF INDIANA  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

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**1. ORGANIZATION**

The State Lottery Commission of Indiana (the Commission) was established by Public Law No. 341, as amended, as listed in Indiana Code Section 4, Article 30 in May 1989 (Lottery Article). The Commission offers various on-line games, including Hoosier Lotto, Hoosier Lotto Plus, Powerball, Mega Millions, Daily 3, Daily 4, Quick Draw, Cash 5, EZ Match, Poker Lotto, and Fast Play. On-line tickets are generated from a terminal and all but EZ Match and Fast Play require a subsequent drawing of numbers to determine winners. EZ Match and Fast Play winners are determined instantly. Poker Lotto also has an instant and subsequent drawing win feature. Mix & Match was discontinued in August 2014, Monopoly Millionaires' Club was discontinued in December 2014, and Bingo to Go was discontinued in May 2016. The Commission also offers numerous scratch-off games. Scratch-off games have preprinted tickets that require players to scratch off a coating to reveal the play area. The Commission also offers several 2<sup>nd</sup> chance promotions where non-winning tickets are entered by players and winners are randomly drawn using a random number generator.

The Commission is organized to provide for administering and overseeing the operation of the Indiana Lottery with the assistance of a provider under an integrated services agreement.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Reporting Entity** — The Commission is a discretely presented component unit of the State of Indiana (the State) for financial reporting purposes and is reported as such in the State's Comprehensive Annual Financial Report (CAFR). Component units are separate legal entities for which the primary government is legally accountable. The Commission itself does not have any component units.

**Basis of Accounting** — The Commission's financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. Under this method, revenues are recognized when earned and expenses are recognized when incurred.

Operating revenues, such as sale of lottery tickets, result from exchange transactions associated with the principal activity of the Commission. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as interest income and changes in fair value of investments, result from non-exchange transactions or ancillary activities.

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

**Revenue Recognition** — Ticket revenue for on-line games is recognized on the date of the draw for which the ticket was purchased for those that require a subsequent drawing, and immediately for those on-line games with the instant feature. Scratch-off ticket revenue, less an allowance for returns, is recognized at the time tickets are shipped to retailers. Certain scratch-off ticket games include free ticket prizes that entitle the holder to exchange one ticket for another of equal value. The selling price of free tickets reduces scratch-off ticket revenue when tickets are redeemed by retailers.

**THE STATE LOTTERY COMMISSION OF INDIANA  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

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**Cash and Cash Equivalents** — Cash and cash equivalents consist of cash on deposit and short-term, highly liquid investments, with original maturity dates of three months or less. Short term investments may include direct obligations of the U.S. government or government agencies, short-term commercial paper or various money market funds.

**Investments** — The Treasurer of the State, on behalf of the Commission, is permitted to invest Commission funds in direct obligations of the U.S. Treasury or insurance annuities to fund future installment prize obligations. Except for the insurance annuities, investments are recorded at fair value at June 30, 2016 and 2015. The insurance annuities are considered to be nonparticipating interest-earning contracts and are carried at accreted cost.

**Accounts Receivable, Net** — Accounts receivable represent proceeds due from retailers for net ticket sales, less commissions and prizes redeemed by retailers. Accounts receivable is reduced by an allowance for ticket returns. Allowance for ticket returns is an estimate based on historical average rate of ticket returns associated with scratch-off games and was \$11,018,038 and \$13,906,987 as of June 30, 2016 and 2015, respectively. Prior to October 2013, accounts receivable was also reduced by an allowance for doubtful accounts. The Commission uses the direct write off method; therefore, there is no balance for doubtful accounts at June 30, 2016 and 2015. Accounts receivable includes other receivables, which consists of amounts owed to the Commission by non-retailers. The balance of other receivables was \$174,853 and \$17,465,458 as of June 30, 2016 and 2015, respectively.

**Prepaid Expenses** — Expenses benefiting future accounting periods include payments for rent, insurance, equipment and software maintenance, dues & subscriptions, retirement, and upfront payments to the Treasurer of the State for surplus revenue.

**Restricted Assets** — Restricted assets consist principally of cash and investments held in prize reserve accounts for Mega Millions and Powerball as required by the Multi State Lottery Association (MUSL).

**Capital Assets** — Capital assets are stated at cost. Capital assets are defined as assets that have a useful life of at least three years and a cost equal to or greater than \$1,000 individually or \$5,000 in aggregate. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets. Generally, data processing equipment and software are depreciated over a minimum of three years, vehicles are depreciated over four years and leasehold improvements are depreciated over the remaining life of the lease. Most of the other assets are depreciated over five years. Intangibles are amortized over the useful life of the asset. Depreciation and amortization expense was \$349,969 and \$346,168 for the years ended June 30, 2016 and 2015, respectively.

**Prize Expense and Liability** — Prize liability includes an estimate of sold and unclaimed scratch-off and on-line game winners as of June 30, 2016 and 2015, as well as installment amounts payable to past scratch-off, on-line game, and game show winners. Installment prizes are recorded at a discount based on interest rates that range from approximately 2% to 6%, which is reflective of the interest rate earned on the investments held to fund the related liabilities.

For scratch-off games, a liability is recorded when tickets are shipped to the licensed retailers. The accrual is based on the specified prize payout structure established for each game. Scratch-off game prizes must be claimed within 180 days after the declared end-of-game date or they will be forfeited. The liability for on-line draw games is determined based on the actual winning numbers drawn and the number of wagers placed for each draw date. An additional liability for Hoosier Lotto is determined by the level of the jackpot that could be won on a given draw date. All on-line game prizes must be claimed within 180 days of the date of the selection event or instant win date or they will be forfeited. Unclaimed

**THE STATE LOTTERY COMMISSION OF INDIANA  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

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prize money is included in the current portion of prize liability in the accompanying statements of net position. All unclaimed prize money during the years ended June 30, 2016 and 2015 was used to offset future prizes. Therefore, the unclaimed prize balance as of the June 30, 2016 and 2015 was \$-0-.

**Net Position** — As stated in the Lottery Article, funds in excess of the amounts necessary to pay prizes and expenses for the operation of the Commission referred to as “surplus revenue” are to be distributed per a statutory schedule to the Indiana Treasurer of State. The Commission excludes the change in fair market value of investments and changes in net pension obligations from surplus revenue transferred to the Indiana Treasurer of State. The Commission has set aside amounts that it estimates are necessary to meet future cash flow needs of the Commission until the next transfer to the Indiana Treasurer of State. These amounts have been reflected in the accompanying financial statements as unrestricted net position.

The Lottery Article requires that the Indiana Treasurer of State distribute \$30 million annually to the Indiana State Teachers’ Retirement Fund to pay a portion of the current pension obligations, and \$30 million annually to the State Pension Relief Fund to assist cities and towns in the payment of current and future pension obligations. The remaining balance of the amount distributed to the Indiana Treasurer of State is deposited into the State’s Build Indiana Fund, to be distributed to state and local capital projects and for the Lottery/Gaming Surplus Account. Distributions to the State’s Build Indiana Fund totaled \$251,161,269 and \$182,458,988 for the years ended June 30, 2016 and 2015, respectively.

**Classification of Operating and Nonoperating** — The Commission’s operating revenues and expenses consist of revenues earned and expenses incurred relating to the operation of the Commission. All other revenues and expenses are reported as nonoperating revenues and expenses.

**Commissions and Bonuses** — Retailers earn a 6.0% sales commission on on-line game tickets and scratch-off game tickets. Retailers earn a 1.0% cashing commission for redeeming winning tickets and the lesser of 1.0% or \$100,000 for selling winning jackpot tickets or top prizes on certain draw games. Additionally, retailers may be eligible for performance based incentives throughout the year.

**Lottery Expenses** — The Commission entered into an Integrated Services Agreement with IGT Indiana, LLC on July 1, 2013. As part of this agreement, indirect game expenses (“lottery expenses”) that are incurred by IGT Indiana, LLC are billed to the Commission. These lottery expenses include the following: central gaming system expenses, advertising and promotions expense, instant ticket printing expense and miscellaneous lottery expenses (see Note 9).

**Management Fees** — As part of the Integrated Services Agreement, the Commission is required to reimburse IGT Indiana, LLC for management fees. These fees consist of the following costs: personnel, occupancy, insurance, communications, other operating expenses, and the amortization of transition expenses (see Note 9).

**Other Game Expenses** — Other game expenses mainly consist of operating expenditures that are paid by the Commission and do not qualify as a reimbursable Commission paid expense. A few of the biggest items reflected in this category are promotion expenses and MUSL operating expenses paid directly by the Commission.

**Pension Liability** — For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense, information about the fiduciary net position of the Hoosier Lottery’s share in the Public Employees’ Retirement Fund (PERF) and additions to/deductions from said fiduciary net position have been determined on the same basis as

**THE STATE LOTTERY COMMISSION OF INDIANA  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

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they are reported by Indiana Public Retirement System (INPRS). For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

The Commission also sponsors a single employer plan, Employees' Pension Plan of the State Lottery Commission of Indiana (Commission Plan), which was frozen effective July 1, 2013. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense, information about the fiduciary net position of the Commission Plan and additions to/deductions from said fiduciary net position have been determined on the basis as they are reported by the Commission Plan's actuary. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

**3. DEPOSITS AND INVESTMENTS**

The Commission applies GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, which provides guidance on disclosure information relating to investment credit risk, investment maturity information, interest rate sensitivity and foreign exchange exposure. The Commission was not subject to interest rate sensitivity of foreign exchange exposure for the years ended June 30, 2016 and 2015.

**Deposits** — The Commission's investment policy establishes cash and investment guidelines for the deposit of funds. The Commission is authorized to make deposits in commercial banks, savings and loan institutions, obligations of the U.S. Treasury and U.S. Agencies, money market funds with portfolios of securities issued or guaranteed by the United States of America or agreements to repurchase these same obligations, and short-term commercial paper.

The carrying amount of the Commission's deposits and outstanding checks with financial institutions at June 30, 2016 and 2015, totaled \$393,490 and (\$4,203,353), respectively, while bank balances totaled \$1,105,116 and (\$2,976,449), respectively. Prior to May 1, 2014, the bank balances were categorized as insured by the FDIC or collateralized with securities held by the Commission in its name. Beginning May 1, 2014, the Commission began investing all funds not needed to cover the outflows of cash for operating expenses and payments of prizes in a money market fund. Uninsured, uncollateralized bank balances were \$851,359 as of June 30, 2016 and \$-0- as of June 30, 2015.

The insured, collateralized, and the uninsured, uncollateralized cash balances carried during the year represent the compensating balances that are required to be maintained at banks in exchange for goods received or services provided.

**Investments** — During the year ended June 30, 2016, the Lottery adopted *Governmental Accounting Standards Board Statement 72, Fair Value Measurement and Application*. Accordingly, the Lottery categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs, and Level 3 inputs are significant unobservable inputs.

The Lottery has the following recurring fair value measurement as of June 30, 2016 and 2015:

- U.S. Treasury securities of \$132 and \$127 million, respectively, are valued using quoted market prices (Level 1 inputs).

**THE STATE LOTTERY COMMISSION OF INDIANA  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

The Lottery Article states that money that the Commission anticipates will be available for the payment of prizes on a deferred basis may be invested in direct U.S. Treasury obligations or insurance annuities. Investments in U.S. Treasury obligations are reported at fair value using quoted market prices. Insurance annuities are carried at accreted cost. Changes in the fair value of the investments are recognized as non-operating revenue or expense in the statements of revenues, expenses and changes in net position. The net change in the fair value of U.S. treasury obligations for the years ended June 30, 2016 and 2015 was \$8,846,733 and \$821,941, respectively. Investments in insurance annuity contracts, at rates yielding approximately 3% to 6%, relate to deferred prize obligations.

As of June 30, 2016, the Commission had the following investments and maturities:

	Fair Value	Investment Maturities (in Years)			
		< 1 Year	1-5 Years	6-10 Years	> 10 Years
U.S. government securities	\$ 132,024,000	\$ 8,915,492	\$ 43,220,003	\$ 37,468,209	\$ 42,420,296
Money Market Fund	33,320,165	33,320,165	-	-	-
	<u>165,344,165</u>	<u>42,235,657</u>	<u>43,220,003</u>	<u>37,468,209</u>	<u>42,420,296</u>
	Carrying Value				
Insurance annuities	14,731,884	2,723,000	10,470,704	1,538,180	-
Total investments	<u>\$ 180,076,049</u>	<u>\$ 44,958,657</u>	<u>\$ 53,690,707</u>	<u>\$ 39,006,389</u>	<u>\$ 42,420,296</u>

As of June 30, 2015, the Commission had the following investments and maturities:

	Fair Value	Investment Maturities (in Years)			
		< 1 Year	1-5 Years	6-10 Years	> 10 Years
U.S. government securities	\$ 127,381,968	\$ 8,931,116	\$ 42,511,176	\$ 36,121,319	\$ 39,818,357
Money Market Fund	27,768,692	27,768,692	-	-	-
	<u>155,150,660</u>	<u>36,699,808</u>	<u>42,511,176</u>	<u>36,121,319</u>	<u>39,818,357</u>
	Carrying Value				
Insurance annuities	16,613,430	2,723,000	10,884,171	3,006,259	-
Total investments	<u>\$ 171,764,090</u>	<u>\$ 39,422,808</u>	<u>\$ 53,395,347</u>	<u>\$ 39,127,578</u>	<u>\$ 39,818,357</u>

**THE STATE LOTTERY COMMISSION OF INDIANA  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

A reconciliation of cash, cash equivalents, and investments per the Statements of Net Position to the deposits and investments previously presented is as follows as of June 30:

	<u>2016</u>	<u>2015</u>
Statement of Net Position:		
Cash and cash equivalents	\$ 33,713,655	\$ 23,310,339
Investments (current)	11,638,492	11,654,116
Investments (noncurrent)	135,117,392	132,341,282
Restricted assets *	-	255,000
	<u>                    </u>	<u>                    </u>
Total	<u>\$ 180,469,539</u>	<u>\$ 167,560,737</u>
Notes to the Financial Statements:		
Deposits	\$ 393,490	\$ (4,203,353)
Investments (current and noncurrent)	180,076,049	171,764,090
	<u>                    </u>	<u>                    </u>
Total	<u>\$ 180,469,539</u>	<u>\$ 167,560,737</u>

\*Included as a component of the restricted assets balance in the accompanying statements of net position.

The following table provides information on the credit ratings associated with the Commission's investments as of June 30, 2016 and 2015:

	<u>S &amp; P</u>	<u>Fitch</u>	<u>Moody's</u>	<u>A.M. Best</u>	<u>Balance at June 30, 2016</u>	<u>Percent of Total</u>	<u>Balance at June 30, 2015</u>	<u>Percent of Total</u>
U.S. government securities	AA+	AAA	Aaa	Unrated	\$ 132,023,937	73%	\$ 127,381,968	74%
Insurance annuities	AA-	AA-	A1	A+	14,731,884	8%	16,613,430	10%
Money market mutual fund	AAAm		Aaa-mf		33,320,165	19%	27,768,692	16%
					<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
Total investments					<u>\$ 180,075,986</u>	<u>100%</u>	<u>\$ 171,764,090</u>	<u>100%</u>

The Commission is not limited on the amount it can invest in U.S. Treasury Bills, repurchase agreements, money market funds or an interest bearing checking account. No more than \$5 million may be invested in securities for any one government agency (i.e., Federal Home Loan Bank, Federal National Mortgage Association, Federal Farm Credit Bank, and Federal Home Loan Mortgage Corporation) and no more than \$20 million in the aggregate. No more than \$5 million may be invested in commercial paper for any one company and no more than \$20 million in the aggregate. Commercial paper must be rated P-1 (Moody) or A-1 (S & P) at the time of purchase. More than 5% of the Commission's investments are in AEGON Institutional Markets annuities.

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Commission will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. In FY 16, the \$165 million of investments were not held by the Commission. Investments totaling \$132 million were held by the Indiana Treasurer of State; therefore, these investments were not considered to have custodial credit risk. The remaining \$33 million of investments were held by outside counterparties. In FY 15, the \$155 million of investments were not held by the Commission. Investments totaling \$127 million were held by the Indiana Treasurer of State; therefore, these investments were not considered to have custodial credit risk. The remaining \$28 million of investments were held by outside counterparties.

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Securities lending credit risk – The Treasurer of State is authorized by Indiana Code 5-13-10.5-13 to lend securities. Securities may be lent only if the agreement under which the securities are lent is collateralized by (1) cash or (2) interest bearing obligations that are issued by, fully insured by, or guaranteed by the United States, an agency of the United States, a federal instrumentality, or a federal government sponsored enterprise in excess of the total market value of the loaned securities.

Cash and collateral securities are initially pledged at 102% of the market value of the securities lent. Collateral securities cannot be pledged or sold by the Board unless the borrower defaults, but cash collateral may be invested. Cash collateral is generally invested in securities of a longer term with the mismatch of maturities generally 0-15 days. The custodian bank provides 100% indemnification to the lender against any borrower default, overnight market risk, and failure to return loaned securities.

As of June 30, 2016 and 2015, the Treasurer of State did not lend any securities related to the Commission.

**4. CAPITAL ASSETS**

A summary of the Commission's capital assets at June 30, 2016 and 2015 is as follows:

	<u>Balances at June 30, 2015</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balances at June 30, 2016</u>
Capital assets being depreciated:				
Vehicles	\$ 165,640	\$ -	\$ (28,686)	\$ 136,954
Furniture, fixtures, and equipment	559,252	-	-	559,252
Leasehold improvements	1,016,848	-	-	1,016,848
Data processing equipment	659,457	230,118	-	889,575
	<u>2,401,197</u>	<u>230,118</u>	<u>(28,686)</u>	<u>2,602,629</u>
Total capital assets — being depreciated				
Less accumulated depreciation:				
Vehicles	(95,913)	(23,579)	28,686	(90,806)
Furniture, fixtures, and equipment	(213,819)	(73,687)	-	(287,506)
Leasehold improvements	(415,914)	(122,756)	-	(538,670)
Data processing equipment	(500,931)	(53,929)	-	(554,860)
	<u>(1,226,577)</u>	<u>(273,951)</u>	<u>28,686</u>	<u>(1,471,842)</u>
Total accumulated depreciation				
Intangible assets being amortized:				
Patent	550,869	-	-	550,869
Less accumulated amortization	(196,379)	(76,018)	-	(272,397)
	<u>354,490</u>	<u>(76,018)</u>	<u>-</u>	<u>278,472</u>
Total intangible assets being amortized				
Total capital assets - net	<u>\$ 1,529,110</u>	<u>\$(119,851)</u>	<u>\$ -</u>	<u>\$ 1,409,259</u>

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	<u>Balances at June 30, 2014</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balances at June 30, 2015</u>
Capital assets being depreciated:				
Vehicles	\$ 166,575	\$ 35,160	\$ (36,095)	\$ 165,640
Furniture, fixtures, and equipment	572,405	8,474	(21,627)	559,252
Leasehold improvements	1,016,848	-	-	1,016,848
Data processing equipment	754,748	15,159	(110,450)	659,457
	<u>2,510,576</u>	<u>58,793</u>	<u>(168,172)</u>	<u>2,401,197</u>
Total capital assets — being depreciated				
	<u>2,510,576</u>	<u>58,793</u>	<u>(168,172)</u>	<u>2,401,197</u>
Less accumulated depreciation:				
Vehicles	(111,810)	(20,198)	36,095	(95,913)
Furniture, fixtures, and equipment	(146,321)	(76,523)	9,025	(213,819)
Leasehold improvements	(291,658)	(124,256)	-	(415,914)
Data processing equipment	(562,208)	(49,173)	110,450	(500,931)
	<u>(1,111,997)</u>	<u>(270,150)</u>	<u>155,570</u>	<u>(1,226,577)</u>
Total accumulated depreciation				
	<u>(1,111,997)</u>	<u>(270,150)</u>	<u>155,570</u>	<u>(1,226,577)</u>
Intangible assets being amortized:				
Patent	550,869	-	-	550,869
Less accumulated amortization	(120,361)	(76,018)	-	(196,379)
	<u>430,508</u>	<u>(76,018)</u>	<u>-</u>	<u>354,490</u>
Total intangible assets being amortized				
	<u>430,508</u>	<u>(76,018)</u>	<u>-</u>	<u>354,490</u>
Total capital assets - net	<u>\$ 1,829,087</u>	<u>\$ (287,375)</u>	<u>\$ (12,602)</u>	<u>\$ 1,529,110</u>

The Commission removed \$28,686 and \$146,545 of fully depreciated capital assets during the years ended June 30, 2016 and 2015, respectively.

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**5. PRIZE LIABILITY**

The prize liability relating to past game show, scratch-off, and on-line winners, including an estimate of unclaimed scratch-off and on-line winners at June 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Installment prizes liability	\$ 129,866,100	\$ 135,394,231
Scratch-off game liability	90,216,033	80,921,726
On-line game liability	<u>11,012,008</u>	<u>3,591,708</u>
Total prize liability	231,094,141	219,907,665
Less current portion	<u>(113,199,597)</u>	<u>(96,381,990)</u>
Noncurrent portion	<u>\$ 117,894,544</u>	<u>\$ 123,525,675</u>

Future payments of prize liability as of June 30, 2016 are as follows:

Fiscal Years Ending June 30	<u>Long-Term Liability</u>	<u>Other Accrued Prize Liability</u>	<u>Total</u>
2017	\$ 11,971,556	\$ 101,228,041	\$ 113,199,597
2018	11,898,556	-	11,898,556
2019	11,914,556	-	11,914,556
2020	11,932,556	-	11,932,556
2021	11,488,556	-	11,488,556
2022-2026	49,439,780	-	49,439,780
2027-2031	29,136,780	-	29,136,780
2032-2036	19,702,793	-	19,702,793
2037-2041	14,889,800	-	14,889,800
2042-2060	<u>6,379,960</u>	<u>-</u>	<u>6,379,960</u>
Total	178,754,893	101,228,041	279,982,934
Less unamortized discount	<u>(48,888,793)</u>	<u>-</u>	<u>(48,888,793)</u>
Total at present value	129,866,100	101,228,041	231,094,141
Less current portion	<u>(11,971,556)</u>	<u>(101,228,041)</u>	<u>(113,199,597)</u>
Total long-term portion at present value	<u>\$ 117,894,544</u>	<u>\$ -</u>	<u>\$ 117,894,544</u>

Prize liability installments are discounted to their present value at date of award. This discounted value approximates fair value. Interest is not paid on prizes.

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As of June 30, activity in prize liability accounts consists of:

	<u>2016</u>	<u>2015</u>
Balance - beginning of the year	\$ 219,907,655	\$ 210,757,849
Prize expense	771,973,953	670,980,026
Prize payments	<u>(760,787,467)</u>	<u>(661,830,220)</u>
Balance - end of the year	<u>\$ 231,094,141</u>	<u>\$ 219,907,655</u>

**6. OPERATING LEASES**

The Commission leases office space, under a non-cancelable operating lease, at its headquarters located in Indianapolis, IN under an initial lease term of 10 years. The Commission also leases office equipment on terms ranging from two to five years. Total rental expense was \$666,424 and \$707,492 for the years ended June 30, 2016 and 2015, respectively.

As of June 30, 2016, the future minimum rental payments required under non-cancelable operating leases with original terms in excess of one year are as follows:

<b>Fiscal Years Ending June 30</b>	
2017	\$ 678,071
2018	710,080
2019	710,080
2020	703,293
2021	<u>644,120</u>
Total	<u>\$ 3,445,644</u>

The Commission entered into a memorandum of understanding (MOU) with the Indiana Horse Racing Commission for the purpose of subleasing a portion of the Commission's headquarters to the Indiana Horse Racing Commission. The term of the MOU is four years effective March 31, 2012 to March 31, 2016. In March 2016, the Horse Racing Commission exercised its option to renew the MOU with the Commission for one additional year ending March 30, 2017. The total amount of minimum rental payments to be received under the MOU is \$51,417 in fiscal year 2017.

**7. COMMITMENTS AND CONTINGENCIES**

**Commitments** — The Commission is a member of the Multi-State Lottery Association (MUSL), an unincorporated government-benefit voluntary association created for the purpose of administering joint lottery games. MUSL currently consists of 37 state and district lotteries ("member lotteries") and operates the on-line Powerball game and manages the Mega Millions game for its participating member lotteries. Under separate agreements between MUSL and each lottery, the member lotteries sell tickets for these games and remit a percentage of sales to prize winners or to MUSL for payment of prizes.

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As a member of MUSL, the Commission is required to contribute to various prize reserve funds held by MUSL. Accounts were established by MUSL as a contingency reserve to fund prizes in excess of the game prize structure and to protect all member lotteries and MUSL from any unforeseen liabilities. All funds remitted, and the related interest earned, will be returned to the Commission upon leaving MUSL, less any portion of unanticipated prize claims that may have been paid from the funds. As of June 30, 2016 and 2015, the Commission's balance of prize reserve funds, included in restricted assets in the accompanying statement of net position, was \$8,026,215 and \$8,338,853, respectively.

Restricted assets also contain the Retailers Bonding Fund, with a balance as of June 30, 2016 and 2015, of \$-0- and \$259,308, respectively. In FY 16, the Commission pulled the remaining funds from the Retailer Bonding Fund.

*Litigation* — Periodically, the Commission is subject to certain legal and administrative actions that arise in the normal course of its operations. As of June 30, 2016, the Commission's management believes that the ultimate outcome of any pending legal matters will not have a material adverse impact on the Commission's financial position.

**8. RISK MANAGEMENT**

The Commission is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets or property; errors and omissions; injuries to employees; and natural disasters. The Commission has purchased commercial insurance to cover these risks. The amount of commercial coverage has not decreased nor has the amount of settlements exceeded coverage in any of the past three fiscal years.

**9. INTEGRATED SERVICES AGREEMENT**

The Commission entered into a 15-year integrated services agreement (ISA) with IGT Indiana, LLC, formerly, GTECH Indiana, LLC, effective October 12, 2012, for the purpose of coordinating, consulting, providing for and integrating the Commission's management and performing all functions necessary to operate the Lottery except those functions specifically retained by the Commission to facilitate the Commission's carrying out its public purpose as set forth in the Indiana Code. Under the terms of the agreement, effective July 1, 2013, the compensation to be paid under the ISA is comprised of reimbursement of operating expenses, management fees and possible incentive compensation payments in accordance with the agreement.

Subject to certain annual operating income targets, the ISA also provides for IGT Indiana, LLC to pay the Commission a shortfall payment amounting to the difference between the target and actual net operating income or 5% of the target income (whichever is less). For the year ended June 30, 2016, IGT Indiana, LLC met the net operating income target, which resulted in no shortfall payment. For the year ended June 30, 2015, the net operating income target was not met, which resulted in a shortfall payment in the amount of \$16,000,000 to the Commission. This amount is included in accounts receivable – net in the Statement of Net Position at June 30, 2015.

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As a result of a renegotiation, an amended ISA was executed on June 12, 2015. One of the changes in the amended ISA is the adjustment of net operating income thresholds necessary for IGT Indiana, LLC to meet as it relates to incentive compensation and shortfall payments. The remaining yearly thresholds were adjusted as of contract year three, "FY 16", in the amended ISA. As an additional component of the adjusted ISA, an upfront payment from IGT Indiana, LLC to the Commission was made in the amount of \$18.25 million. The Commission is amortizing the payment over the remaining life of the 15 year contract beginning in FY 16. If the Commission terminates the agreement for its convenience by providing a termination notice in contract year four, "FY 17", the Commission shall return \$12 million of the upfront payment to IGT Indiana, LLC; if the Commission provides such notice in contract year five, "FY 18", the Commission shall return \$6 million; furthermore, the Commission shall not owe any amount if a termination notice is submitted in contract year six, "FY 19" or later.

**10. RETIREMENT PLANS**

The Commission participates in two defined benefit retirement plans: the Public Employees' Retirement Fund (a multi-employer plan for employees of the state of Indiana) and the Employees' Pension Plan of the State Lottery Commission of Indiana (a single employer plan for employees of the Commission). The Commission also participates in a defined contribution plan.

***PUBLIC EMPLOYEES' RETIREMENT FUND (PERF)***

***Plan description*** — Senate Enrolled Act No. 526 required the transfer of the Commission's defined benefit plan to the Public Employees' Retirement Fund (PERF) of the State of Indiana effective July 1, 2013. In order to facilitate this transfer, \$1.4 million from the Commission's pension plan was transferred to Indiana Public Employee Retirement System (INPRS) and the amount remaining in the Lottery's defined benefit pension plan was frozen as of July 2013. All employees of the Commission became members of the PERF on July 1, 2013. Accordingly, the Commission participates in the PERF Hybrid Plan administered by the Indiana Public Retirement System (INPRS). There are two (2) aspects to the PERF Hybrid Plan defined benefit structure. The first portion is the monthly defined benefit pension that is funded by the employer. The second portion of the PERF Hybrid Plan benefit structure is the Annuity Savings Account (ASA) that supplements the defined benefit at retirement. The employer defined benefit pension benefit contribution rate is based on an actuarial valuation and is adopted by the INPRS Board of Trustees in accordance with Indiana Code 5-10.2-2-11. The ASA consists of the member's contributions, set by statute at three (3)% of compensation as defined by Indiana Code 5-10.2-3-2, plus the interest/earnings or losses credited to the member's account. The employer may elect to make contributions on behalf of the member. In addition, under certain conditions, members may elect to make additional voluntary contributions of up to ten (10)% of their compensation into his/her ASA. A member's contributions and interest credits belong to the member and do not belong to the State or political subdivision.

***Benefits provided*** — PERF provides retirement, disability, and survivor benefits to full-time employees. Retirement benefits are determined as 1.1% of the employee's average highest 20 quarters of salary times the employee's years of creditable service. Employees are eligible for pension benefit payment as follows: early retirement with reduced benefits between ages 50-59 with 15 years of service, at age 55 if age and creditable service total at least 85, at age 60 with 15 years of service, at age 65 with 8 years of service, at age 70 with 20 years of service. Employees are fully vested in the 3% employee share to ASA upon hire. Employee's share of employer contributions to the ASA is based on full years of participation, and are vested immediately.

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**Contributions** — Employer contribution rates for PERF are determined annually by the INPRS Board based on recommendations by the INPRS actuary. Members are required to contribute 3% of gross wages to their ASA accounts. Employers have the option of making all or part of this contribution on behalf of the member. Members may also make voluntary contributions to the ASA, up to an additional 10% of gross wages, under certain limitations. Contributions to PERF from the Commission were \$309,568 and \$267,847 for the years ended June 30, 2016 and 2015, respectively.

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

At June 30, 2016, the Commission reported a liability of \$1,615,720 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Commission's proportion of the net pension liability was based on the Commission's wages relative to the collective wages of all participating employers to the PERF plan. At June 30, 2015, the Commission's proportion was 0.04% with a .002% change from June 30, 2014.

For the years ended June 30, 2016 and 2015, the Commission recognized pension expense of \$572,299 and \$2,100,826, respectively. At June 30, 2016, the Commission reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Description	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences Between Expected and Actual Experience	\$ 69,354	\$ 3,341
Difference Between Projected and Actual Earnings	272,431	151,952
Changes in Assumptions	136,583	-
Changes in Proportion and Differences Between Commission Contributions and Proportionate Share of Contributions	768,064	-
Total	\$ 1,246,432	\$ 155,293

Deferred outflows in the amount of \$244,166, for contributions made subsequent to the measurement date, will be recognized as a reduction of the net pension liability in the year ended June 30, 2017.

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

<b>Fiscal Years Ending June 30</b>		
2017	\$	410,418
2018		410,418
2019		202,193
2020		68,110
2021		-
Thereafter		-
Total	\$	<u>1,091,139</u>

**Actuarial assumptions** — The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.25 Percent
Salary Increases	2.50 Percent to 4.25 Percent, Including Inflation
Investment Rate of Return	6.75 Percent, Net of Pension Plan Investment Expense, Including Inflation

The actuarial assumptions and methods used in the June 30, 2015 valuation were adopted by the INPRS Board in April 2014. The majority of the actuarial assumptions and methods are based on plan experience from July 1, 2005 through June 30, 2010, which were adopted by the INPRS Board in September 2011, and were first used in the June 30, 2011 valuation. The interest rate/ investment return and mortality assumptions were updated for the June 30, 2012 valuation. In addition to the actuarial assumptions and methods the INPRS Board also adopted the funding policy in April 2014.

The long-term expected rate of return on pension plan investments was determined using annualized time-weighted rate of return for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Public Equity	22.5%	5.3%
Private Equity	10.0%	5.6%
Fixed Income - Ex Inflation-Linked	22.0%	2.1%
Fixed Income - Inflation-Linked	10.0%	0.7%
Commodities	8.0%	2.0%
Real Estate	7.5%	3.0%
Absolute Return	10.0%	3.9%
Risk Parity	10.0%	5.0%
Total	<u>100.0%</u>	<u>27.6%</u>

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*Discount rate* — The discount rate used to measure the total pension liability was 6.75%.

*Sensitivity of the Commission's proportionate share of the net pension liability to changes in the discount rate* — The following presents the Commission's proportionate share of the net pension liability calculated using the discount rate of 6.75%, as well as what the Commission's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.75%) or 1-percentage-point higher (7.75%) than the current rate:

	<u>1% Decrease</u> <u>(5.75%)</u>	<u>Current</u> <u>Discount Rate</u> <u>(6.75%)</u>	<u>1% Increase</u> <u>(7.75%)</u>
Commission's Proportionate Share of the Net Pension Liability	\$ 2,383,326	\$ 1,615,720	\$ 978,467

*Pension plan fiduciary net position* — Detailed information about the pension plan's fiduciary net position is available in the separate financial reports issued by INPRS which may be requested from:

The Indiana Public Retirement System  
One North Capitol, Suite 001  
Indianapolis, IN 46204

***DEFERRED COMPENSATION PLAN***

*Plan description* — The Commission offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, allows an employee to contribute a minimum of \$15 per paycheck or 1% of eligible earning (percentage withholding must equal at least \$15) and a maximum of 100% of includible compensation (subject to Internal Revenue Service limitations). Employees are immediately vested in their contributions. Contributions by plan participants during the fiscal years ended June 30, 2016 and 2015 were approximately \$69,252 and \$57,959 respectively.

Beginning in January 2012, the Commission made a matching contribution of \$15 per paycheck for each employee participating in the 457 Deferred Compensation Plan into a 401(a) Incentive Match Plan. Employees are immediately vested in the employer match made by the Commission. Contributions by the Commission during the fiscal years ended June 30, 2016 and 2015 were approximately \$11,948 and \$11,550, respectively.

***EMPLOYEES PENSION PLAN OF THE STATE LOTTERY COMMISSION OF INDIANA***

*Plan description* — The Commission had adopted a single-employer defined benefit pension plan. Prior to July 1, 2013, Article 30 of the Indiana Code assigned the Commission to establish and amend benefit provisions. An independent contractor administered the Employees' Pension Plan of the State Lottery Commission of Indiana (the Plan). The Plan covered virtually all of the Commission's full time employees over the age of 21, providing retirement, death, and disability benefits. The plan does not issue a stand-alone financial report. Employees could not make contributions to the plan. Effective July 1, 2013 the Plan was frozen as all employees became eligible for the PERF plan (above) under the Senate Enrollment Act No. 526. The Commission adopted GASB Statement No. 68 for the Plan effective June 30, 2015. The following disclosures are related to June 30, 2016 and 2015.

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**Benefits provided** — Upon employee retirement at age 65, the Plan provided annual benefits equal to 2% of an employee’s average salary earned during the highest five consecutive years of employment multiplied by the number of full-time years of employment up to a maximum of 25 years. Participants became fully vested after four years of service. Employees cannot contribute to the plan. The plan permits retirees to choose their form of distribution from several alternatives including a lump sum option.

**Employees covered by benefit terms** — At June 30, 2016 and 2015, the following employees were covered by the benefit terms:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Inactive employees or beneficiaries currently receiving benefits	48	42
Inactive employees entitled to but not yet receiving benefits	60	67
Active employees	<u>27</u>	<u>28</u>
Total	<u>135</u>	<u>137</u>

**Contributions** — The Commission establishes rates based on an actuarially determined rate recommended by an independent actuary. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. For the year ended June 30, 2016, the Commissions average contribution rate was 10.15% of annual payroll.

**Net pension liability** — The Commission's net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

**Actuarial assumptions** — The total pension liability in the June 30, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.25%
Salary increases	N/A
Investment rate of return	6.75%, net of pension plan investment expense, including inflation

The mortality tables were revised from the 2015 IRS small plan combined static mortality tables to the 2016 IRS small plan combined static mortality for the actuarial valuation.

The actuarial assumptions used in the June 30, 2016 valuation were based on the Entry Age Actuarial Cost Method.

The long-term expected rate of return on pension plan investments was determined the Fair Market Value Method using a four year smoothing period. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>
Equity	71%
Fixed income	27%
Cash	<u>2%</u>
Total	<u>100%</u>

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**Discount rate** — The discount rate used to measure the total pension liability was 6.75%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that Commission contributions will be made at the actuarially determined contribution rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. 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.

**Changes in the net pension liability** —

	<b>Increase (Decrease)</b>		
	<b>Total Pension Liability</b>	<b>Plan Fiduciary Net Position</b>	<b>Net Pension Liability</b>
Balance at June 30, 2015	\$ 7,219,486	\$ 6,211,082	\$ 1,008,404
Changes for the year			
Service cost	-	-	-
Interest	472,636	-	472,636
Difference between expected and actual experience	207,737	-	207,737
Contributions -- employer	-	233,261	(233,261)
Net investment income	-	(96,780)	96,780
Benefit payments	(668,196)	(668,196)	-
Administrative expenses	-	-	-
Other changes	(82,380)	2,021	(84,401)
Net changes	(70,203)	(529,694)	459,491
Balance at June 30, 2016	<u>\$ 7,149,283</u>	<u>\$ 5,681,388</u>	<u>\$ 1,467,895</u>

**Sensitivity of the net pension liability to changes in the discount rate** — The following table presents the net pension liability of the Commission, calculated using the discount rate of 6.75%, as well as what the Commission's net pension liability would be if it were calculated using a discount rate that is one percentage point lower (5.75%) or one percentage point higher (7.75%) than the current rate:

	<b>1% Decrease</b>	<b>Current</b>	<b>1% Increase</b>
	<b>(5.75%)</b>	<b>Discount Rate</b>	<b>(7.75%)</b>
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Commissions Net Pension Liability	\$ 2,086,988	\$ 1,467,895	\$ 927,567

**Pension plan fiduciary net position** — The plan does not issue a stand-alone financial report.

**THE STATE LOTTERY COMMISSION OF INDIANA  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

*Pension expense and deferred outflows of resources and deferred inflows of resources related to pensions* — For the years ended June 30, 2016 and 2015, the Commission recognized pension expense of \$195,387 and \$212,149, respectively. At June 30, 2016, the Commission reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

<u>Description</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 94,959	\$ 258,895
Change of assumptions	137,899	37,657
Net difference between projected and actual earnings on pension plan investments	521,804	-
Total	<u>\$ 754,662</u>	<u>\$ 296,552</u>

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

<b>Year Ended June 30</b>	
2017	\$ 117,440
2018	100,042
2019	140,588
2020	<u>100,040</u>
Total	<u>\$ 458,110</u>

**11. CHANGE IN ACCOUNTING PRINCIPLE**

During the year ended June 30, 2015, the Commission adopted GASB Statement No. 68, Accounting and Financial Reporting for Pensions and the related GASB Statement No. 71 Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68 for the Employees' Pension Plan of the State Lottery Commission of Indiana (the Plan). The Commission determined it was not practical to complete the actuarial valuation and relevant calculations effective June 30, 2015, and rather deemed June 30, 2015 as the appropriate date on which to complete the valuation and adoption of these standards for the Plan. Accordingly, these pronouncements require the restatement of the June 30, 2014, as presented in the Statement of Revenues, expenses and changes in net position for the year ending June 30, 2016 as follows:

Beginning net position, June 30, 2015	\$ 20,929,964
Cumulative effect of application of GASB 68, net pension liability	(835,510)
Cumulative effect of reversal of net pension asset as calculated in accordance with GASB 27	(4,989,553)
Beginning net position, June 30, 2015, as restated	<u>\$ 15,104,901</u>

**REQUIRED SUPPLEMENTARY INFORMATION**

**THE STATE LOTTERY COMMISSION OF INDIANA  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF FUNDING PROGRESS FOR PENSION PLAN\***

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<b>Valuation Date</b>	<b>Valuation of Assets (a)</b>	<b>Accrued Liability (b)</b>	<b>Unfunded Accrued Liability (b-a)</b>	<b>Funded Ratio (a/b)</b>	<b>Covered Payroll (c)</b>	<b>Unfunded Liability as % of Payroll ((b-a)/c)</b>
1/1/2006	\$ 9,146,422	\$ 9,597,771	\$ 451,349	95.3%	\$ 6,676,472	6.8%
7/1/2006	9,684,229	12,789,759	3,105,530	75.7	7,331,750	42.4
7/1/2007	14,212,236	12,825,945	(1,386,291)	110.8	7,798,129	(17.8)
7/1/2008	12,656,765	12,920,838	264,073	98.0	8,591,645	3.1
7/1/2009	8,871,453	12,524,241	3,652,788	70.8	8,467,374	43.1
7/1/2010	10,085,843	11,986,403	1,900,560	84.1	7,335,049	25.9
7/1/2011	12,443,439	12,948,905	505,466	96.1	7,978,173	6.3
7/1/2012	12,081,239	15,090,262	3,009,023	80.1	7,828,729	38.4
7/1/2013	6,425,469	7,650,535	1,225,066	84.0	1,808,138	67.8
7/1/2014	6,778,640	7,614,150	835,510	89.0	N/A	N/A
7/1/2015	6,211,082	7,219,486	1,008,404	86.0	N/A	N/A
7/1/2016	5,681,388	7,149,283	1,467,895	79.5	N/A	N/A

\*Prior to July 1, 2006, determined under the Frozen Entry Age Actuarial Cost Method, as defined in Statement No. 27 of the Governmental Accounting Standards Board GASB No. 27. Effective July 1, 2006, determined under the Entry Age Normal Actuarial Cost Method, as defined in GASB No. 27. The amortization of the Unfunded Actuarial Liability is based on a 30 - year closed period from July 1, 2006. Effective July 1, 2012, fresh-started over a 30-year closed period from July 1, 2012.

**SCHEDULES OF REQUIRED SUPPLEMENTARY INFORMATION**  
**SCHEDULE OF CHANGES IN NET PENSION LIABILITY AND RELATED RATIOS**  
**EMPLOYEES PENSION PLAN OF THE STATE LOTTERY COMMISSION OF INDIANA**  
**LAST TEN FISCAL YEARS**

	<u>2016</u>	<u>2015</u>	
<b>Total Pension Liability</b>			
Service Cost	\$ -	\$ -	
Interest	472,636	498,173	
Changes in Benefit Terms	-	-	
Differences Between Expected and Actual Experience	207,737	(603,171)	
Changes of Assumptions	(82,380)	321,275	
Benefit Payments, Including Refunds of Employee Contributions	(668,196)	(610,941)	
Net Change in Total Pension Liability	<u>(70,203)</u>	<u>(394,664)</u>	
Total Pension Liability - Beginning of Year	7,219,486	7,614,150	
Total Pension Liability - End of Year	<u>7,149,283</u>	<u>7,219,486</u>	
<b>Plan Fiduciary Net Position</b>			
Contributions - Employer	233,261	143,329	
Contributions - Employee	-	-	
Net Investment Income	(96,780)	220,909	
Benefit Payments, Including Refunds of Employee Contributions	(668,196)	(610,940)	
Administrative Expenses	-	-	
Other	2,022	(320,856)	
Net Change in Plan Fiduciary Net Position	<u>(529,693)</u>	<u>(567,558)</u>	
Plan Fiduciary Net Position - Beginning of Year	6,211,082	6,778,640	
Plan Fiduciary Net Position - End of Year	<u>5,681,389</u>	<u>6,211,082</u>	
Net Pension Liability - End of Year	<u>\$ 1,467,894</u>	<u>\$ 1,008,404</u>	
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	79.47%	86.03%	
Covered Employee Payroll	N/A	N/A	
Commission 's Net Pension Liability as a Percentage of Covered Pay roll	N/A	N/A	
	<u>2016</u>	<u>2015</u>	<u>2014</u>
Total Pension Liability	\$ 7,149,283	\$ 7,219,486	\$ 7,614,150
Plan Fiduciary Net Position	5,681,389	6,211,082	6,778,640
Net Pension Liability	<u>\$ 1,467,894</u>	<u>\$ 1,008,404</u>	<u>\$ 835,510</u>
Plan Fiduciary Net Position as a Percentage of Total Pension Liability	<u>79.47%</u>	<u>86.03%</u>	<u>89.03%</u>

**SCHEDULES OF REQUIRED SUPPLEMENTARY INFORMATION**  
**SCHEDULE OF COMMISSION CONTRIBUTIONS**  
**EMPLOYEES PENSION PLAN OF THE STATE LOTTERY COMMISSION OF INDIANA**  
**LAST TEN FISCAL YEARS**

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Actuarially Determined Contribution	\$ 82,149	\$ 92,659	\$ 97,334	\$ 1085,298	\$ 792,899	\$ 894,186	\$ 1,146,464	\$ 824,943	\$ 561,405	\$ 958,889
Contributions in Relation of the Actuarially Determined Contribution	233,261	143,329	186,036	1,272,352	872,145	1,129,491	1,514,023	776,417	237,693	4,026,480
Contribution Deficiency (Excess)	\$ (151,112)	\$ (50,670)	\$ (88,702)	\$ (187,054)	\$ (79,246)	\$ (235,305)	\$ (367,559)	\$ 48,526	\$ 323,712	\$ (3,067,591)
Covered-Employee Payroll	N/A	N/A	N/A	\$ 1,808,138	\$ 7,828,729	\$ 7,978,173	\$ 7,335,049	\$ 8,467,374	\$ 8,591,645	\$ 7,798,129
Contributions as a Percentage of Covered Employee Payroll	N/A	N/A	N/A	70.37%	11.4%	14.16%	20.64%	9.17%	2.77%	5.163%

Notes to Schedules

Valuation Date:  
June 30, 2015

Methods and Assumptions Used to Determine the Most Current Contribution Rates:

Actuarial Cost Method	Entry age normal
Amortization Method	Level Percentage of Payroll, Closed
Remaining Amortization Period	26 years
Asset Valuation Method	Market Value
Inflation	2.25%
Salary Increases	N/A
Investment Rate of Return	6.75% net of pension plan investment expense, including inflation
Retirement Age	Retirement rates are based on age with 10% assumed to retire at 60 years old, 22% at 62 years, 33% at 65 years, and 30% at 70 years old. 100% retirement at ages 75 and older.
Mortality	2015 IRS Small Plan Combined Static Mortality
Other information	Actuarially determined contribution rates are calculated as of July 1, one year prior to the end of the fiscal year in which contributions are reported. For the July 1, 2015 actuarial valuation, the mortality tables were revised from the 2014 IRS small plan combined static mortality tables to the 2015 IRS small plan combined static mortality.

**SCHEDULES OF REQUIRED SUPPLEMENTARY INFORMATION**  
**SCHEDULE OF THE COMMISSION'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY**  
**INDIANA PUBLIC EMPLOYEES RETIREMENT FUND**  
**LAST TEN FISCAL YEARS**

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	<u>2016</u>	<u>2015</u>
Commission's proportion (percentage) of collective net pension liability (asset)	0.03967%	0.03747%
Commission's proportionate share of the collective pension liability (asset)	\$ 1,615,720	\$ 984,687
Lottery's covered-employee payroll	\$ 1,900,340	\$ 1,829,317
Lottery's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll	85.0%	53.8%
Plan fiduciary net position as a percentage of the total pension liability	77.3%	84.3%

\* The amounts presented for each fiscal year were determined as of June 30.

**SCHEDULES OF REQUIRED SUPPLEMENTARY INFORMATION**  
**SCHEDULE OF COMMISSION CONTRIBUTIONS**  
**INDIANA PUBLIC EMPLOYEES RETIREMENT FUND**  
**LAST TEN FISCAL YEARS**

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	<u>2016</u>	<u>2015</u>
Contractually Required Contributions	\$ 263,490	\$ 212,838
Contributions in relation to the statutorily required contribution	<u>244,166</u>	<u>221,764</u>
Contribution deficiency (excess)	<u>\$ 19,324</u>	<u>\$ (8,926)</u>
Covered-employee payroll	\$ 2,352,591	\$ 1,900,340
Contribution as a percentage of covered employee payroll	11.2%	11.2%

\* The amounts presented for each fiscal year were determined as of June 30.



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**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***

Board of Commissioners  
The State Lottery Commission of Indiana  
Indianapolis, Indiana

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 State Lottery Commission of Indiana, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise The State Lottery Commission of Indiana's basic financial statements, and have issued our report thereon dated October 10, 2016.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered The State Lottery Commission of Indiana'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 State Lottery Commission of Indiana's internal control. Accordingly, we do not express an opinion on the effectiveness of The State Lottery Commission of Indiana'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 State Lottery Commission of Indiana's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations – specifically Indiana Code, Title 4, Article 30, 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 result 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.



**CliftonLarsonAllen LLP**

Indianapolis, Indiana  
October 10, 2016