



FINANCIAL AND COMPLIANCE AUDIT REPORT

Tennessee Education Lottery Corporation

For the Year Ended June 30, 2020

Justin P. Wilson
Comptroller of the Treasury



DIVISION OF STATE AUDIT

Katherine J. Stickel, CPA, CGFM
Deborah V. Loveless, CPA, CGFM, CGMA
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Audit Manager

Mark White, CPA, CFE
In-Charge Auditor

Erica Bradshaw
Staff Auditor

Gerry C. Boaz, CPA, CGFM, CGMA
Technical Manager

Amy Brack
Editor

Amanda Adams
Assistant Editor

Comptroller of the Treasury, Division of State Audit
Cordell Hull Building
425 Fifth Avenue North
Nashville, TN 37243
(615) 401-7897

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JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

November 10, 2020

The Honorable Bill Lee, Governor
Members of the General Assembly
Board of Directors, Tennessee Education Lottery Corporation

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Education Lottery Corporation for the year ended June 30, 2020. You will note from the independent auditor's report that an unmodified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

A handwritten signature in black ink that reads "Katherine J. Stickel".

Katherine J. Stickel, CPA, CGFM, Director
Division of State Audit

KJS/aj
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Audit Report
Tennessee Education Lottery Corporation
For the Year Ended June 30, 2020

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State of Tennessee

A u d i t H i g h l i g h t s

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

Tennessee Education Lottery Corporation

For the Year Ended June 30, 2020

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Findings

The audit report contains no findings.



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

Independent Auditor's Report

The Honorable Bill Lee, Governor
Members of the General Assembly
Board of Directors, Tennessee Education Lottery Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of the Tennessee Education Lottery Corporation, a component unit of the State of Tennessee, as of and for the years ended June 30, 2020, and June 30, 2019, and the related notes to the financial statements, which collectively comprise the Tennessee Education Lottery Corporation's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

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

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 14 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, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2020, on our consideration of the Tennessee Education Lottery Corporation'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 and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Tennessee Education Lottery Corporation's internal control over financial reporting and compliance.



Katherine J. Stickel, CPA, CGFM, Director
Division of State Audit
October 28, 2020

TENNESSEE EDUCATION LOTTERY CORPORATION

Management's Discussion and Analysis

The Tennessee Education Lottery Corporation (TEL) offers the following discussion and analysis to the readers of the financial statements. This narrative overview provides an objective analysis of TEL's financial activity for the fiscal years ended June 30, 2020, and June 30, 2019, with comparative information presented for the fiscal year ended June 30, 2018. The overview should be considered in conjunction with the independent auditor's report, the accompanying audited financial statements, and the notes to the financial statements. The financial statements, notes, and this discussion are the responsibility of management.

Understanding TEL's Financial Statements

TEL, a quasi-public instrumentality, is a component unit of the State of Tennessee. TEL's activities are accounted for as a business-type activity using the full accrual basis of accounting, similar to a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of comparative financial statements, along with notes to the financial statements designed to highlight TEL's net position and changes therein resulting from business operations.

The financial statements are comprised of three components:

- **the statements of net position** – reflect TEL's financial position at June 30, 2020, and June 30, 2019.
- **the statements of revenues, expenses, and changes in net position** – report revenues and expenses incurred in relation to the sale of lottery products, as well as other non-gaming related activity for the fiscal years ended June 30, 2020, and June 30, 2019.
- **the statements of cash flows** – outline the cash inflows and outflows related to the activity of selling lottery products and other business-related activities for the fiscal years ended June 30, 2020, and June 30, 2019.

The notes to the financial statements document additional information that is essential for readers to gain a comprehensive understanding of the data provided in TEL's financial statements.

TEL's primary business purpose is to generate revenues to fund college scholarships and grants for residential Tennessee students attending higher educational institutions within the state. Accordingly, the main focus of the financial statements is determining funds available for deposit to the State of Tennessee's Lottery for Education Account. Furthermore, in addition to funding this account, TEL's unclaimed prize funds are deposited to the After-School Programs special account, which benefits after-school programs throughout the state of Tennessee.

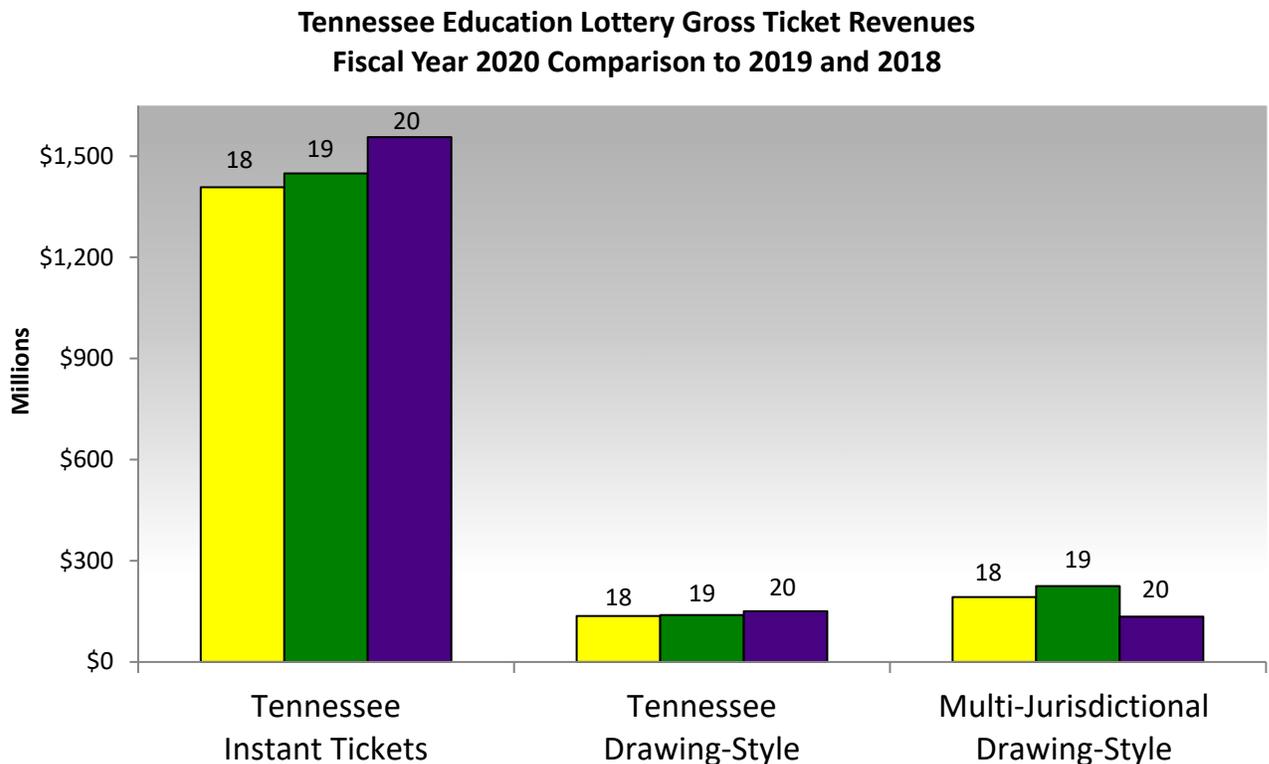
The State of Tennessee passed legislation approving the TEL to license and regulate online sports wagering under the Tennessee Sports Gaming Act in April 2019. Pursuant with the Act, the TEL's Board of Directors approved the rules and regulations and set policies in April 2020. The TEL started to receive operator, supplier and vendor applications and fees for review and approval in May and June 2020. According to the Tennessee Sports Gaming Act, the fees collected must be

used by the corporation to pay actual operating and administrative expenses incurred. Any excess fees collected must be distributed to the state treasurer for deposit into the Tennessee Promise scholarship endowment fund. At fiscal year-end 2020, all applications submitted were in the review process. The application fees and operating expenses are presented in combination with the Tennessee Education Lottery and detailed out the Notes section of the financial statements.

Fiscal Year 2020 Financial Highlights for the Tennessee Education Lottery

The Tennessee Education Lottery Corporation closed its fiscal year 2020 with a contribution of \$438.2 million for all Lottery-funded education programs, bringing the total to over \$5.5 billion since sales began January 20, 2004. Revenues of Tennessee-only games were up 7.5% over the prior year led by Instant Tickets at 7.4%.

Gross ticket revenues for the fiscal year 2020 were \$1.840 billion, bringing the total since inception to more than \$22 billion. During the period, there were 24 winners of \$1 million or more, including a Tennessee Cash winner of \$1.497 million and a Lotto America winner of \$9.01 million in Tennessee. Total prizes won since inception total more than \$15.2 billion, with 298 winning tickets sold worth \$1 million or more.



Management attributes the success to staying focused on the corporation’s mission to serve Tennessee students and their families by responsibly maximizing proceeds for all education programs. The TEL works continually to refine our business model, introduce innovative and entertaining games for our players, promote efficiencies and best business practices across the organization, and provide quality support for the retailers selling the Lottery’s products.

Tennessee Games

Instant Tickets:

In fiscal year 2020, revenues for *Instant Tickets* reached a record-setting high of \$1.556 Billion, topping last year's record of \$1.448 billion by \$108 million, or 7.4%.

Fifty-two new instant ticket games were introduced during the year, including a Special Edition of our extremely popular Jumbo Bucks family of games. These new games contributed to the instant product's success by providing players with new and exciting ways to play the popular games.

In fiscal year 2019, revenues for *Instant Ticket* reached a record-setting high of \$1.448 billion, topping last year's record of \$1.407 billion by \$41 million, or 2.9%.

Fifty new instant ticket games were introduced during the year. These new games contributed to the instant product's success by providing players with new and exciting ways to play the popular games. In addition, TEL's Jumbo Bucks family of games continued to be a top choice of players during fiscal year 2019.

Drawing-Style:

Cash 3 revenues in fiscal year 2020 increased 6.8% compared to fiscal year 2019. In fiscal year 2019, revenues increased \$3.9 million, or 6.3%, compared to fiscal year 2018.

Cash 4 revenues increased by 8.8% when compared to fiscal year 2019. In fiscal year 2019, revenues increased by \$1.8 million, or 4.7%, when compared to fiscal year 2018.

Revenues for *Tennessee Cash* increased \$3.5 million, or 21%, during fiscal year 2020. *Tennessee Cash* is a cash jackpot drawing-style game. In fiscal year 2019, revenues decreased \$1.9 million during fiscal year 2019. The revenues for this game are normally driven by the size of the jackpot. During fiscal year 2020, Quick Cash was added to Tennessee Cash to give players an additional way to win.

Keno to Go! is a drawing-style game that can be played every five minutes for an opportunity to win up to \$100,000. Fiscal year 2020 Keno to Go! revenues were down 2.5% in comparison to fiscal year 2019. In fiscal year 2019 revenues were \$13.8 million, which is slightly down from 2018 at 6.2%.

Multi-Jurisdictional Games

Powerball revenues decreased by \$42.3 million (38.8%) in fiscal year 2020. In fiscal year 2019, revenues decreased by \$8.9 million as compared to 2018. The year-over-year decreases are due primarily to lower jackpot cycles compared to cycles in previous fiscal years.

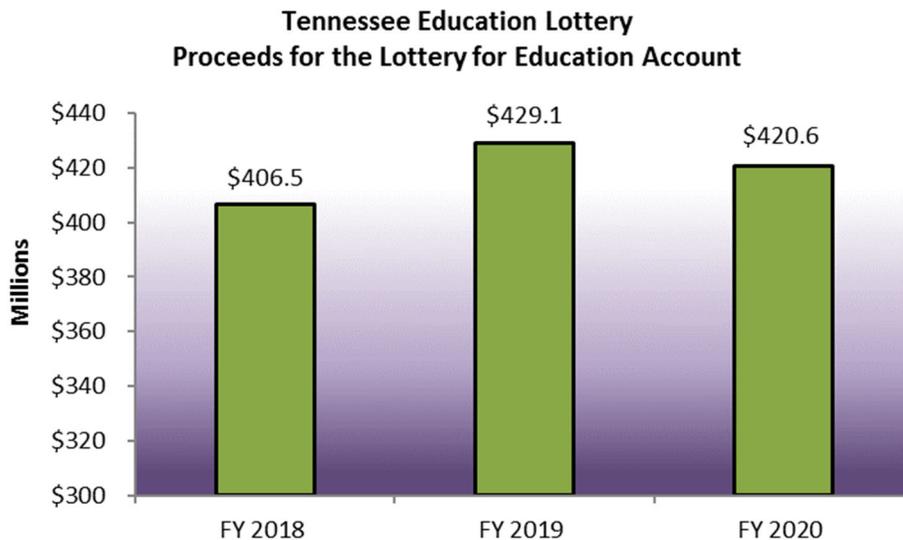
Revenues for *Mega Millions* in fiscal year 2020 were \$46.3 million compared to \$93.4 million the prior year. In fiscal year 2019, revenues were \$93.4 million compared to \$51.7

million in the prior year. The year-over-year decrease in 2020 compared to 2019 and the increase in 2019 compared to 2018 can be attributed to the lack of a significantly large jackpot compared to the \$1.5 billion jackpot in 2019.

The *Cash 4 Life* drawing-style game operates in nine states providing a chance to win \$1,000 a day for life or \$1,000 a week for life. Total revenues were \$11.1 million in fiscal year 2020, an increase of \$2.9 million, or 35.3%, over 2019. The increase in revenues was driven by the change to daily drawings. Total revenues were \$8.2 million in fiscal year 2019, a decrease of \$571 thousand from 2018.

Revenues for Lotto America for fiscal year 2020 were \$10.1 million, a 28.6% decrease over fiscal year 2019. This is a jackpot driven game without comparable jackpots in fiscal year 2020 compared to fiscal year 2019. Revenues for Lotto America for fiscal year 2019 were \$14.1 million, a 76.4% increase over fiscal year 2018. The increase can be attributed to its first complete fiscal year and to the jackpot exceeding \$21.2 million through June 30, 2019. This is a jackpot game with a purchase price of \$1.

TEL generated \$420.6 million for the Lottery for Education Account in fiscal year 2020, compared to \$429.1 million in fiscal year 2019 and \$406.5 million in fiscal year 2018.

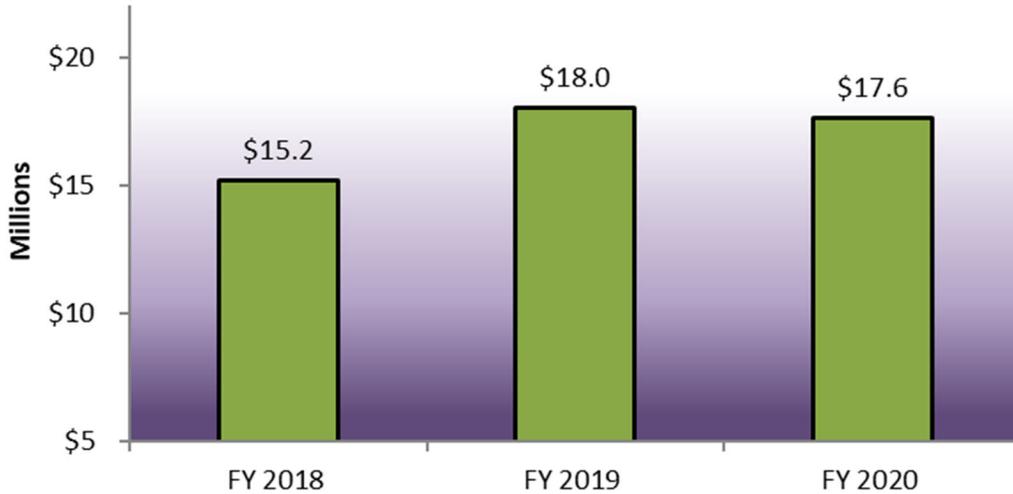


The amounts deposited to the After-School Programs special account are derived from unclaimed instant and drawing-style game prizes at fiscal year-end. Prizes not claimed within 90 days of the announced game-end date for instant games, and within 180 days of the draw for all drawing-style games, are forfeited as unclaimed prizes.

TEL records estimated unclaimed prizes for each instant game within the month the game is closed and reconciles the actual amounts when the claim period ends. For drawing-style games, TEL records the actual unclaimed amounts determined after the expiration of the related claim period for the draw.

In fiscal year 2020, TEL recognized \$17.6 million for the After-School Programs special account, as compared to \$18 million in fiscal year 2019 and \$15.2 million in fiscal year 2018.

**Tennessee Education Lottery
Proceeds for the After-School Programs Special Account**



Overview of Financial Position

Condensed Statement of Net Position

	June 30, 2020	Increase / (Decrease)	June 30, 2019	Increase / (Decrease)	June 30, 2018
Assets:					
<i>Current assets</i>					
Cash	\$147,699,000	\$15,009,000	\$132,690,000	\$ 2,427,000	\$ 130,263,000
Retailer accounts receivable, net	91,853,000	8,888,000	82,965,000	3,634,000	79,331,000
Other	9,477,000	(163,000)	9,640,000	(5,427,000)	15,067,000
Total current assets	249,029,000	23,734,000	225,295,000	634,000	224,661,000
<i>Noncurrent assets</i>					
Capital assets, net	2,102,000	(307,000)	2,409,000	(767,000)	3,176,000
Total noncurrent assets	2,102,000	(307,000)	2,409,000	(767,000)	3,176,000
Total assets	251,131,000	23,427,000	227,704,000	(133,000)	227,837,000
Liabilities:					
<i>Current liabilities</i>					
Due to Lottery for Education account	118,263,000	16,963,000	101,300,000	2,870,000	98,430,000
Due to After-School Programs account	17,605,000	(395,000)	18,000,000	2,832,000	15,168,000
Prizes payable	107,027,000	7,600,000	99,427,000	(5,762,000)	105,189,000
Accounts payable and accrued liabilities	5,566,000	18,000	5,548,000	81,000	5,467,000

Unearned revenue	896,000	(6,000)	902,000	153,000	749,000
Unearned rent	134,000	-	134,000	-	134,000
Total current liabilities	249,491,000	24,180,000	225,311,000	174,000	225,137,000
<i>Noncurrent liabilities</i>					
Unearned rent	2,014,000	(338,000)	2,352,000	(303,000)	2,655,000
Total noncurrent liabilities	2,014,000	(338,000)	2,352,000	(303,000)	2,655,000
Total liabilities	251,505,000	23,842,000	227,663,000	(129,000)	227,792,000
Net Position:					
Investment in capital assets	2,102,000	(307,000)	2,409,000	(767,000)	3,176,000
Unrestricted	(2,501,000)	(92,000)	(2,409,000)	767,000	(3,176,000)
Restricted for uncollectible retailer receivables	25,000	(16,000)	41,000	(4,000)	45,000
Total net position	\$ (374,000)	\$ (415,000)	\$ 41,000	(4,000)	\$ 45,000

Assets

The \$23 million increase in total assets at June 30, 2020, was primarily due to an increase in lottery ticket revenues resulting in increased cash and accounts receivable at fiscal year-end. The decrease of \$133 thousand at June 30, 2019, was a direct result of a receivable from the *Cash 4 Life* settlement that occurred in July 2018 related to the win on June 21, 2018, of \$1,000 a day for life.

Liabilities

The \$24 million increase in total liabilities at June 30, 2020, relates primarily to increased ticket revenues during the last quarter of the fiscal year, resulting in higher prizes payable and net proceeds payable to the Lottery for Education Account. The \$129 thousand decrease in total liabilities at June 30, 2019, relates primarily to the release of the prize payable related to the *Cash 4 Life* winner on June 21, 2018.

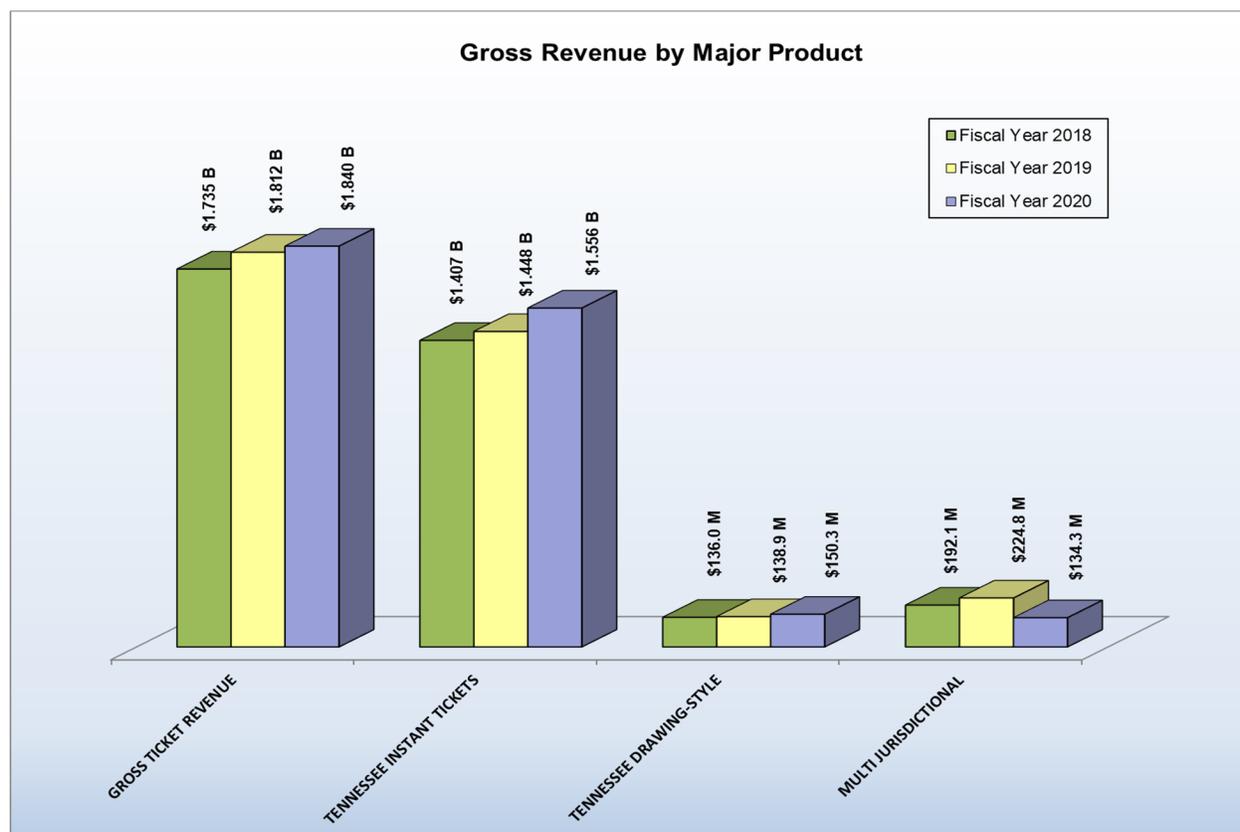
Condensed Statement of Revenues and Expenses

	June 30, 2020	Increase / (Decrease)	June 30, 2019	Increase / (Decrease)	June 30, 2018
<i>Revenues:</i>					
Instant games	\$ 1,556,236,000	\$107,358,000	\$ 1,448,878,000	\$41,015,000	\$ 1,407,863,000
Drawing-style games	284,564,000	(79,162,000)	363,726,000	35,674,000	328,052,000
Less instant/promotional tickets provided as prizes	(128,465,000)	(5,912,000)	(122,553,000)	(3,340,000)	(119,213,000)
Games revenue, net	1,712,335,000	22,284,000	1,690,051,000	73,349,000	1,616,702,000
Bad debt recoveries/(expense), net	(92,000)	301,000	(393,000)	(153,000)	(240,000)
Retailer service fees	3,108,000	(8,000)	3,116,000	(150,000)	3,266,000
Interest income	1,647,000	(533,000)	2,180,000	886,000	1,294,000
Other revenue	497,000	(108,000)	605,000	(208,000)	813,000
Total revenues	1,717,495,000	21,936,000	1,695,559,000	73,724,000	1,621,835,000
<i>Expenses</i>					
Cost of revenues	1,259,503,000	31,142,000	1,228,361,000	47,404,000	1,180,957,000
General, administrative, and other operating expenses	20,129,000	143,000	19,986,000	820,000	19,166,000
Other expenses	48,000	17,000	31,000	6,000	25,000
Proceeds to After-School Program account	17,605,000	(395,000)	18,000,000	2,832,000	15,168,000

Proceeds to Lottery for Education account	420,625,000	(8,560,000)	429,185,000	22,673,000	406,512,000
Total expenses	1,717,910,000	22,347,000	1,695,563,000	73,735,000	1,621,828,000
Change in net position	(415,000)	(411,000)	(4,000)	(11,000)	7,000
Total net position, beginning of year	41,000	(4,000)	45,000	7,000	38,000
Total net position, end of year	\$ (374,000)	\$ (415,000)	\$ 41,000	\$ (4,000)	\$ 45,000

Revenues

Gross lottery ticket revenues for fiscal years 2020, 2019, and 2018, were \$1.840 billion, \$1.812 billion, and \$1.735 billion, respectively. The following chart depicts the distribution of revenues by product for the three fiscal years ended June 30:



Tennessee Games:

Gross *Instant Ticket* revenues for fiscal year 2020 were \$1.556 billion. This represents a 7.4% increase from fiscal year 2019's instant ticket revenues of \$1.448 billion, which represented a 2.9% increase from fiscal year 2018 instant ticket revenues of \$1.407 billion. Instant tickets represent an average of approximately 82% of total gross revenues in fiscal years 2020, 2019, and 2018. The year-over-year increase in gross instant ticket revenues is attributed to the instant-ticket marketing strategy, which involves the ongoing introduction of multiple games, including special theme games, families of games, and higher price-point games with higher prize payouts. The games most popular with the players in 2020 continue to be the Jumbo Bucks themed family of games.

Cash 3 revenues for fiscal years 2020, 2019, and 2018 were \$71.9 million, \$67.3 million, and \$63.3 million, respectively.

Cash 4 revenues were \$44.3 million, \$40.7 million, and \$38.9 million in the years 2020, 2019, and 2018, respectively.

Tennessee Cash revenues for fiscal years 2020, 2019, and 2018 were \$20.6 million, \$17.1 million, and \$18.9 million, respectively.

Keno to Go! revenues for fiscal years 2020, 2019, and 2018 were \$13.5 million, \$13.8 million, and \$14.7 million, respectively.

Multi-jurisdictional games:

Powerball is a drawing-style lottery game operated in the following jurisdictions in addition to Tennessee: Arizona, Arkansas, Colorado, Connecticut, Delaware, the District of Columbia, Florida, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Texas, U.S. Virgin Islands, Vermont, Wisconsin, West Virginia, and Wyoming. Starting in January 2010, the Mega Millions lottery consortium group began selling *Powerball* tickets as part of a cross-selling agreement with members of the Multi-State Lottery Association (MUSL).

Powerball revenues for fiscal years 2020, 2019, and 2018 were \$67 million, \$109 million, and \$117.9 million, respectively. These amounts represent approximately 3.6%, 6%, and 7% of gross ticket revenues, respectively, for each fiscal year.

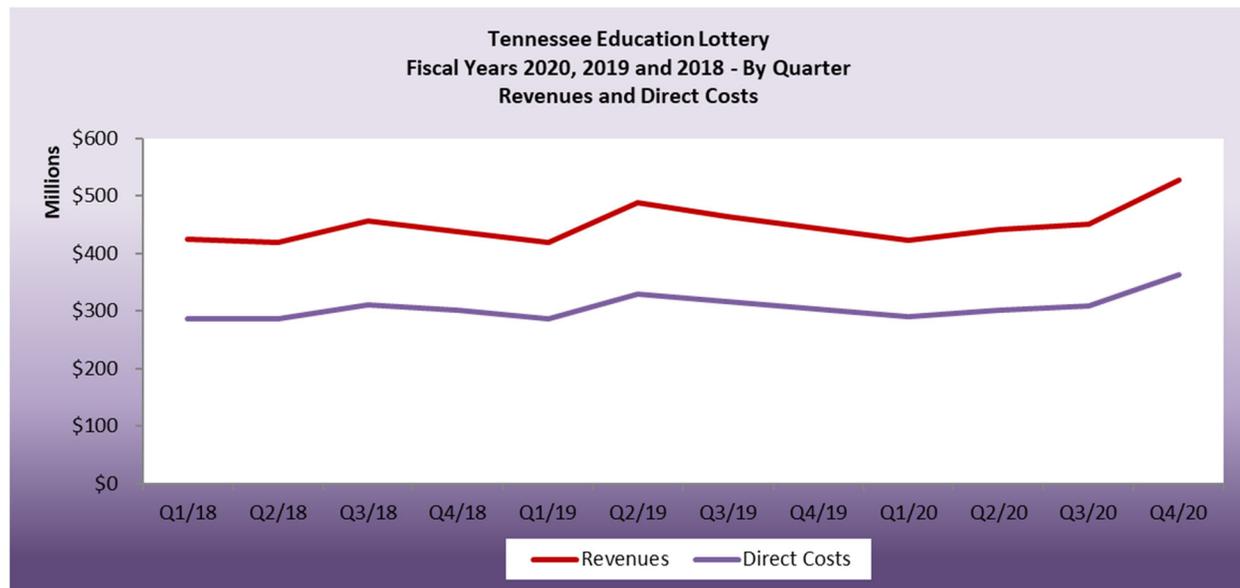
Mega Millions is a drawing-style lottery game administered by the Mega Millions lottery consortium group. The group includes the following state lotteries: California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, Ohio, Virginia, and Washington. Tennessee and certain other MUSL lottery members are authorized to sell the consortium's *Mega Millions* game as part of a cross-selling agreement that began in January 2010. Revenues for fiscal years 2020, 2019, and 2018 were \$46.3 million, \$93.4 million, and \$51.7 million, respectively.

Cash 4 Life, a drawing-style game, was introduced in Tennessee on November 1, 2015, and has nine member lotteries: Florida, Georgia, Indiana, Maryland, New Jersey, New York, Pennsylvania, Tennessee, and Virginia. The game provides for opportunities to win either \$1,000 a day for life or \$1,000 a week for life. Revenues were \$11.1 million for 2020, \$8.2 million for 2019, and \$8.8 million for 2018. In July of 2019, this game began conducting drawings daily.

Lotto America, a drawing-style game, was launched in Tennessee on November 15, 2017, and has thirteen members: Delaware, Indiana, Iowa, Kansas, Maine, Minnesota, Montana, North Dakota, New Mexico, Oklahoma, South Dakota, Tennessee and West Virginia. Revenues were \$10.1 million for 2020, \$14.1 million for 2019, and \$7.9 million for eight months of 2018.

Cost of Revenues

The cost of revenues is comprised of prize expense, net of unclaimed prizes; retailer commissions; and major gaming vendor fees. As the following chart depicts, these expenses relate to and change in direct proportion with changes in ticket revenues:



Gross prize expense was \$1.109 billion, \$1.083 billion, and \$1.039 billion in the years 2020, 2019, and 2018, respectively. Increases of \$26 million in 2020 and \$44 million in 2019 reflect the introduction of new ways to win, fluctuation in ticket revenues, and product choice of players in the related period.

Instant games prize expense is managed through the number of tickets printed for each game and the value of prizes as determined prior to ticket production. Prize expense is recorded based on an established prize structure and a related percentage of revenues for each game introduced and is recognized when products are made available to the public. The aggregated prize payout for all instant games was 67.6% of instant game revenues, net of free tickets, each year for 2020, 2019, and 2018.

Gross prize expense for drawing-style games generally increases or decreases in direct proportion to ticket revenues of the related game and is recorded at the time of the related draw. The aggregated prize payout for all drawing-style games was 50.7%, 51.1%, and 51.1% for 2020, 2019, and 2018, respectively.

Retailer commissions were \$120 million, \$118 million, and \$113 million for fiscal years 2020, 2019, and 2018, respectively. Consistent with the cost driver relationship of ticket revenues to retailer commissions, the increase of \$2 million in 2020 and \$5 million in 2019 reflects the marginal fiscal fluctuation of ticket revenues realized in the related period.

Retailers are compensated a set commission percentage of 6.5% on all instant tickets settled and drawing-style tickets sold. They also receive an additional 1% bonus for cashing *Cash 3* and *Cash*

4 ticket prizes. Additionally, TEL will pay a bonus of \$50,000 to a retailer who sells a single jackpot-winning ticket for *Powerball* or *Mega Millions*; however, if there are multiple winning *Powerball* or *Mega Millions* jackpot winning tickets sold in Tennessee in a single drawing, the \$50,000 selling bonus will be proportionately divided among the respective retailers based on the number of winning tickets sold by the retailer. TEL will also pay a \$5,000 bonus to retailers selling any drawing-style game ticket where the prize won is equal to or greater than \$1 million; however, if there are multiple winning tickets sold in Tennessee in a single drawing that qualify for one of the selling bonuses, the respective selling bonus will be divided between or among the respective retailers equally based on the number of winning tickets sold by each retailer.

Drawing-style game ticket selling bonuses equaling \$65,000, \$45,000, and \$45,000 were awarded for fiscal years 2020, 2019, and 2018, respectively.

Major Gaming Vendor fees for fiscal years 2020, 2019, and 2018 were \$35.0 million, \$33.3 million, and \$32.0 million, respectively. TEL has retained two major gaming contractors, one for the operation of its gaming systems and network and one for the manufacturing, warehousing, and distribution of its instant ticket games. During fiscal year 2015, lower negotiated vendor fees were implemented. The instant ticket vendor receives 0.8998% of the selling price of all instant ticket activations, whereas the gaming systems and network vendor receives 1.1999% of the selling price of drawing-style tickets sold and of the selling price of instant ticket activations net of free instant tickets available as prizes.

Advertising costs incurred by TEL were \$7.2 million, \$6.6 million, and \$8.3 million for fiscal years 2020, 2019, and 2018, respectively. These costs are significantly influenced by budget directives and constraints. Management continually strives to achieve an optimal balance between advertising costs and obtained benefits, while keeping the costs relatively consistent with prior-year amounts.

General, administrative, and other operating expenses were \$19.5 million, \$19.9 million, and \$19.2 million for the fiscal years 2020, 2019, and 2018, respectively. For each of these years, the five major expense components were depreciation, personnel, professional fees, property, and telecommunications expenses. These expenses do not change in direct proportion with revenues but are instead significantly influenced by budget directives and constraints, as well as current business and economic conditions. In view of these factors, moderate variances in these expenses are expected to occur over fiscal periods. Nevertheless, to the most reasonable extent possible, TEL's management team works diligently to make these expenses relatively consistent year-over-year.

Potential Factors Impacting Future Results

TEL's mission is to maximize revenues for the purpose of maximizing payments to the Lottery for Education Account. A continuous assessment of Tennessee's economic environment and TEL's own product lines and operations is essential to accomplish this mission. The following considerations have been presented to inform those interested in TEL's operations about factors that could potentially affect future results:

- TEL will continue to introduce new and/or enhanced instant and drawing-style game product offerings.
- TEL will continually review the prize payout percentages for its instant games to ensure we are receiving the highest actual net proceeds for each game and/or price-point category.
- TEL will continue to enhance its promotional offerings and VIP Rewards program to improve brand awareness and increase player participation in our games.
- Tennessee's launching of Sports Wagering and the level of adoption by eligible Tennesseans in fiscal year 2021.
- Any change to TEL's enabling legislation.

Contacting TEL's Financial Management

This financial report is designed to provide the State of Tennessee, the public, and other interested parties with an overview of the financial results of TEL's activities and to show TEL's accountability for conducting business in a fiscally responsible manner. If you have questions about this report or require additional financial information, contact TEL's Finance Department at the following address:

Tennessee Education Lottery Corporation
26 Century Boulevard
Suite 200
Nashville, Tennessee 37214

TENNESSEE EDUCATION LOTTERY CORPORATION
Statements of Net Position
As of June 30, 2020 and June 30, 2019

	June 30, 2020	June 30, 2019
ASSETS		
Current assets:		
Cash (Note 2)	\$ 147,485,000	\$ 132,649,000
Restricted sports wagering cash (Note 2)	189,000	-
Restricted fidelity fund cash (Note 2)	25,000	41,000
Retailer accounts receivable, net (Note 1)	91,853,000	82,965,000
Prepaid expenses and other assets	9,477,000	9,640,000
Total current assets	249,029,000	225,295,000
Noncurrent assets:		
Capital assets, net of depreciation of \$6,938,000 and \$6,341,000 (Note 4)	2,102,000	2,409,000
Total noncurrent assets	2,102,000	2,409,000
Total assets:	251,131,000	227,704,000
LIABILITIES		
Current Liabilities		
Due to Lottery for Education Account (Note 7)	118,263,000	101,300,000
Due to After School Programs Account (Note 8)	17,605,000	18,000,000
Prizes payable	107,027,000	99,427,000
Accounts payable	118,000	125,000
Accrued liabilities	5,448,000	5,423,000
Unearned revenues	896,000	902,000
Unearned rent (Note 6)	134,000	134,000
Total current liabilities	249,491,000	225,311,000
Noncurrent liabilities		
Unearned rent (Note 6)	2,014,000	2,352,000
Total noncurrent liabilities	2,014,000	2,352,000
Total liabilities	251,505,000	227,663,000
NET POSITION:		
Investment in capital assets	2,102,000	2,409,000
Restricted:		
Restricted for uncollectible retailer receivables	25,000	41,000
Unrestricted	(2,501,000)	(2,409,000)
Total net position	\$ (374,000)	\$ 41,000

The notes to financial statements are an integral part of this statement.

TENNESSEE EDUCATION LOTTERY CORPORATION
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2020, and June 30, 2019

	<u>June 30, 2020</u>	<u>June 30, 2019</u>
OPERATING REVENUES:		
Ticket revenue	\$ 1,840,708,000	\$ 1,812,212,000
Less instant/promotional tickets provided as prizes	(128,465,000)	(122,553,000)
Net ticket revenue	1,712,243,000	1,689,659,000
Retailer service fees	3,108,000	3,116,000
Fees, sports wagering	189,000	-
Other	276,000	576,000
Net operating revenues	1,715,816,000	1,693,351,000
OPERATING EXPENSES:		
Available prizes	1,109,655,000	1,083,572,000
Current year actual unclaimed prizes (Note 8)	(17,605,000)	(18,224,000)
Net prizes	1,092,050,000	1,065,348,000
Retailer commissions	120,069,000	118,177,000
Contractor fees	35,012,000	33,380,000
Advertising	7,204,000	6,608,000
Salaries and benefits	16,035,000	15,918,000
Retailer merchandising and marketing	5,168,000	4,848,000
Rent, utilities, and maintenance	1,732,000	1,605,000
Depreciation	886,000	925,000
Professional fees	359,000	296,000
General administrative and other operating	1,117,000	1,242,000
Total operating expenses	1,279,632,000	1,248,347,000
Operating income	436,184,000	445,004,000
NONOPERATING REVENUES (EXPENSES):		
Interest revenue	1,647,000	2,180,000
Retailer fees for future uncollectible retailer receivables	32,000	28,000
Fidelity fund retailer non-feasance (Note 1)	(48,000)	(31,000)
Proceeds to Lottery for Education Account (Note 7)	(420,625,000)	(429,185,000)
Proceeds to After School Programs Account (Note 8)	(17,605,000)	(18,000,000)
Total nonoperating revenues (expenses)	(436,599,000)	(445,008,000)
Change in Net Position	(415,000)	(4,000)
Net position, beginning of year	41,000	45,000
Net position, end of year	\$ (374,000)	\$ 41,000

The notes to financial statements are an integral part of this statement.

TENNESSEE EDUCATION LOTTERY CORPORATION
Statements of Cash Flows
For the Years Ended June 30, 2020, and June 30, 2019

	Year Ended June 30, 2020	Year Ended June 30, 2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 1,703,409,000	\$ 1,686,194,000
Cash received from MUSL for grand prize winners	128,130,000	-
Other operating cash received	3,481,000	3,633,000
Cash paid for prizes	(1,084,322,000)	(1,072,885,000)
Cash paid to grand prize winners	(128,130,000)	-
Cash paid to/on behalf of gaming vendors	(34,908,000)	(33,208,000)
Cash paid to retailers	(120,068,000)	(118,201,000)
Cash paid for advertising	(7,300,000)	(6,772,000)
Cash paid to/on behalf of employees	(15,968,000)	(15,818,000)
Other operating payments	(8,738,000)	(1,091,000)
Net cash provided by operating activities	435,586,000	441,852,000
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Payments to Lottery for Education Account	(403,662,000)	(426,315,000)
Payments to After School Programs Account	(18,000,000)	(15,168,000)
Fidelity fund cash received from retailers	36,000	32,000
Fidelity fund cash refunded to retailers	(4,000)	(4,000)
Fidelity fund cash non-feasance	(48,000)	(30,000)
Net cash used in noncapital financing activities	(421,678,000)	(441,485,000)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of property and equipment	(578,000)	(158,000)
Proceeds from disposal of capital assets	32,000	38,000
Net cash used in capital and related financing activities	(546,000)	(120,000)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income	1,647,000	2,180,000
Net cash provided by investing activities	1,647,000	2,180,000
Net cash provided by all activities	15,009,000	2,427,000
Cash - beginning of year	132,690,000	130,263,000
Cash - end of year	\$ 147,699,000	\$ 132,690,000

TENNESSEE EDUCATION LOTTERY CORPORATION
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2020, and June 30, 2019

	Year Ended June 30, 2020	Year Ended June 30, 2019
Reconciliation of cash on the statement of net position		
Cash	\$ 147,485,000	\$ 132,649,000
Restricted sports wagering cash	189,000	-
Restricted fidelity fund cash	25,000	41,000
Cash at end of year	\$ 147,699,000	\$ 132,690,000

Reconciliation of net operating income to net cash provided by operating activities:

Operating income	\$ 436,184,000	\$ 445,004,000
Adjustments to reconcile operating income to net cash provided by operating activities:		
Bad debt expense	92,000	393,000
Depreciation	886,000	925,000
Gain on disposal of capital assets	(32,000)	(38,000)
Changes in assets and liabilities:		
Retailer accounts receivable	(8,980,000)	(4,030,000)
Prepays and other assets	162,000	5,428,000
Accounts payable and accrued liabilities	19,000	81,000
Prizes payable	7,599,000	(5,761,000)
Unearned revenue	(6,000)	153,000
Unearned rent	(338,000)	(303,000)
Net cash provided by operating activities	\$ 435,586,000	\$ 441,852,000

The notes to financial statements are an integral part of this statement.

TENNESSEE EDUCATION LOTTERY CORPORATION
Notes to the Financial Statements
June 30, 2020, and June 30, 2019

Note 1. Summary of Significant Accounting Policies

Organization and Description of Reporting Entity

Effective June 11, 2003, the Tennessee Education Lottery Implementation Law (the “Act”), Sections 4-51-101 et seq., *Tennessee Code Annotated*, was signed into law, creating the Tennessee Education Lottery Corporation (TEL). Pursuant with the Act, TEL was incorporated in the State of Tennessee as a body, politic and corporate, and a quasi-public instrumentality.

TEL is considered a component unit of the State of Tennessee as the state has financial accountability for fiscal matters as follows:

1. the board of directors is appointed by the Governor;
2. upon dissolution of TEL, title to all TEL property shall vest in the State of Tennessee; and
3. TEL provides financial benefits to the state in the form of deposit payments to the state treasury.

The accompanying financial statements present information only as to the transactions of TEL’s programs. TEL is reported as a discretely presented component unit within the State of Tennessee’s *Comprehensive Annual Financial Report*, which may be viewed at <http://tn.gov/finance/rd-doa/fa-accfm-cafr.html>.

TEL is responsible for the provision of lotteries on behalf of the State of Tennessee in accordance with the Act and is deemed to be acting, in all respects, for the benefit of the people of the State of Tennessee.

On January 20, 2004, TEL began selling lottery tickets. During the years ended June 30, 2020, and June 30, 2019, TEL’s lottery revenues included a variety of instant ticket games and drawing-style games: *Cash 3*, *Cash 4*, *Tennessee Cash*, *Keno to Go!*, *Powerball*, *Mega Millions*, *Cash 4 Life*, and *Lotto America*.

In May 2018, sports betting became legal in the United States as a result of the repeal of the Professional and Amateur Sports Protection Act. Effective April 30, 2019, the State of Tennessee passed legislation appointing the Tennessee Education Lottery Corporation responsible for the licensing and regulation of online sports wagering in Tennessee. The Tennessee Education Lottery Board of Directors approved on April 15, 2020, the rules and processes to establish and support a responsible and competitive sports wagering program in Tennessee.

Notes to the Financial Statements (Continued)

Basis of Presentation

The accompanying financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board.

Basis of Accounting and Measurement Focus

Basis of accounting refers to the timing of recognition of revenues and expenses in the accounts and reporting in the financial statements, and the measurement focus refers to what transactions and events should be recorded. The financial statements are reported using the accrual basis of accounting and the economic resources measurement focus in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when they are earned and expenses are recognized when a liability is incurred, regardless of the timing of related cash flows.

Revenue Recognition

Lottery games are sold to the public by contracted retailers. Revenue is recognized for instant games when retailers make them available for sale to the public, as indicated by the retailers' activation of tickets.

Revenue for drawing-style games is recognized based on the game characteristics. For drawing-style games where the prize expense is determinable only upon occurrence of the related draw, revenues for sold tickets are recognized when the related drawing occurs. Also, amounts collected from retailers in advance of the draw are recorded as unearned revenue and recognized once the drawing occurs.

Revenues for drawing-style games where both prize expense and the draw date are known prior to ticket sales occurring are recognized at the time of the sale.

Certain instant and drawing-style games include free ticket prizes that entitle the holder to exchange a winning ticket for another of equal value. The selling price of the game ticket awarded as a prize reduces ticket revenue when the related winning ticket is validated.

Revenues are presented net of bad debt expense.

Net Position

Net position represents cumulative revenues less expenses and required beneficiary program payments in accordance with the Act (see Notes 7 and 8). Net position includes funds invested in capital assets, restricted net position, and unrestricted net position.

Cash

Cash includes cash in banks, petty cash, and deposits on account in the State of Tennessee Local Government Investment Pool (LGIP) (see Note 2).

Notes to the Financial Statements (Continued)

Retailer Accounts Receivable

Retailer accounts receivable represent gross lottery proceeds due from retailers, net of commissions due to and prizes paid by the retailers, and allowance for bad debt.

Lottery proceeds are collected weekly from retailer bank accounts established in trust for TEL. Amounts not collected upon the established collection date are deemed delinquent. Delinquent accounts are reviewed periodically by TEL management. Accounts outstanding more than 180 days from the most recent date of delinquency or date of last payment are considered doubtful. At June 30, 2020, and June 30, 2019, the Allowance for Doubtful Accounts was \$554 thousand and \$684 thousand, respectively.

Capital Assets

Capital assets are stated at historical cost less accumulated depreciation. Depreciation on capital assets is computed using the straight-line method over the estimated useful lives of the assets, which is three to seven years for most assets. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal. TEL's general threshold for capitalization is assets valued at \$1,000 or greater.

Unearned Revenue

Funds collected from retailers for drawing-style game tickets sold in advance of the drawings are recorded as unearned revenue and recognized as revenue once the related drawing occurs.

Fidelity Fund

In accordance with Section 4-51-118(a), *Tennessee Code Annotated*, TEL retailers are assessed a one-time fidelity fund fee of \$50. Fidelity fund proceeds are held in a demand deposit account at Citizens Bank and are classified as restricted fidelity fund cash on the statement of net position. These funds may be used to cover losses incurred as a result of the nonfeasance, malfeasance, or misfeasance of TEL retailers. During the years ended June 30, 2020, and June 30, 2019, \$48 thousand and \$31 thousand, respectively, were used to cover losses incurred as a result of uncollected accounts of TEL retailers.

At the end of each fiscal year, fidelity funds exceeding \$500,000 may be treated as net proceeds from the TEL, subject to deposit to the Lottery for Education account. As of the years ended June 30, 2020, and June 30, 2019, there were no fidelity funds available for deposit as net proceeds.

Retailer Commissions and Incentives

Retailers receive a commission of 6.5% on all instant tickets settled and drawing-style tickets sold. In addition, retailers cashing *Cash 3* and *Cash 4* tickets receive an additional 1% for amounts cashed. Where commission has been paid to retailers for tickets sold prior to drawings, this fee is recorded as a prepaid expense until the related revenue is recognized.

Notes to the Financial Statements (Continued)

TEL will pay an incentive of \$50,000 to a retailer who sells a single jackpot winning ticket for *Powerball* or *Mega Millions*; however, if there are multiple winning *Powerball* or *Mega Millions* jackpot-winning tickets sold in Tennessee in a single drawing, the \$50,000 selling incentive will be divided proportionately (based on the number of winning tickets sold by each retailer) between or among the respective retailers.

TEL will pay a selling incentive of \$5,000 to a retailer who sells a winning *draw-style game* whereby the prize is equal to or greater than one million dollars (\$1,000,000). However, if there are multiple winning *drawing-style game* jackpot-winning tickets sold in Tennessee in a single drawing, the \$5,000 selling incentive will be divided proportionately (based on the number of winning tickets sold by each retailer) between or among the respective retailers.

Selling incentives were earned as follows during the years ended June 30:

<u>Drawing-Style Game</u>	<u>2020</u>	<u>2019</u>
Powerball	\$55,000	\$20,000
Mega Millions	-	20,000
Tennessee Cash	5,000	5,000
Lotto America	5,000	-
Total Retailer Incentives	\$65,000	\$45,000

Major Gaming Contractor Fees

TEL has contracted with two vendors, IGT Corporation and Scientific Games Inc. (SGI), for the majority of the gaming systems and supplies.

IGT operates the gaming network, which consists of over 5,000 instant and drawing-style retailer ticket terminals and associated software. On July 18, 2014, TEL signed a new contract with IGT through June 30, 2022. This contract was amended on April 15, 2020, to extend the end date to June 30, 2027. In return, IGT will provide additional standalone ticket vending terminals, and the company will relaunch and update TEL's loyalty program for players including the platforms for both the Play It Again and VIP programs. Terms of this contract maintain the current service fee rate of 1.1999% on the selling price of drawing-style tickets sold and on instant ticket activations, net of free tickets available as prizes.

SGI prints, warehouses, and distributes the instant ticket games to retailers. On October 28, 2014, TEL signed a new contract with SGI through June 30, 2022. In accordance with this contract, SGI received the negotiated fee of 0.8998% on the selling price of all instant ticket activations, beginning January 4, 2015.

Prizes

In accordance with the Act, as nearly as practical, at least 50% of ticket proceeds must be made available as prize money. Gross prize expense for instant games is recognized based on a predetermined prize structure for each game in accordance with the approved game working papers

Notes to the Financial Statements (Continued)

when tickets are activated for sale. Gross prize expense for *Cash 3*, *Cash 4*, and *Tennessee Cash* is recognized based on historical payout experience when the related drawings occur.

In August 2017, TEL began selling *Keno to Go!* with prizes based on a portion of gross sales set aside for payment of prizes. The prize fund for any drawing is expected to be 60% of revenue, but may be higher or lower based upon the number of winners at each prize level.

Powerball and *Mega Millions* prizes are shared based on contributions made to the prize pool by all member lotteries of the Powerball Group and the Mega Millions Group of the Multi-State Lottery Association (MUSL). All *Powerball* and *Mega Millions* grand prizes won by players who purchase tickets in Tennessee are funded from pooled contributions by all participating lottery states. For *Powerball* and *Mega Millions*, the contributions are held by MUSL in trust for TEL and are paid, at the option of the prize winner, in either a lump-sum or 30 annual payments. Lump-sum payments are discounted to present value, as calculated by MUSL for the *Powerball* game, and the Mega Millions Consortium Group for the *Mega Millions* game. TEL had one *Powerball* jackpot winner in fiscal year 2020, in July 2019, for \$198 million. There were no *Powerball* or *Mega Millions* jackpot winners in Tennessee for fiscal year 2019.

In November 2015, TEL began selling *Cash 4 Life* with prizes based on a portion of gross revenue set aside for payment of prizes. The prize fund for any drawing is expected to be 55% of revenue, but may be higher or lower based upon the number of winners at each prize level, as well as the funding required to contribute to the jackpot and second level prize. Grand prizes won by Tennessee players are funded from pooled contributions by all participating lottery states. As of June 30, 2020, and June 30, 2019, there were no first- or second-level prize winners for the fiscal years.

Lotto America, a drawing-style game, was launched in Tennessee in November 2017. The prize fund for any drawing is expected to be 50% of revenue, but may be higher or lower based upon the number of winners at each prize level.

Unclaimed Prizes

Prizes not claimed within 90 days of the game-end date for instant games, and within 180 days of a game draw date for drawing-style games, are forfeited as unclaimed prizes.

Budget

Pursuant with the Act, annually by June 30, TEL is required to submit a board-approved operating budget for the next fiscal year to the Tennessee Department of Finance and Administration, Office of Legislative Budget Analysis, and Comptroller of the Treasury. Additionally, by September 1, TEL is required to submit a preliminary operating budget for the succeeding fiscal year to the Tennessee Department of Finance and Administration for informational purposes.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make certain estimates and

Notes to the Financial Statements (Continued)

assumptions that affect the reported amounts of assets and liabilities and disclosures 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. Estimates and assumptions are reviewed periodically, and the effects of revisions are reflected in the financial statements in the period they are determined.

Advertising

Advertising costs are expensed when the related advertising takes place or the contract is non-cancellable when entered.

Nonoperating Revenues and Expenses

Revenues and expenses resulting from activities not directly associated with the sale of lottery tickets are reflected as nonoperating revenues and expenses.

Compensated Absences

Effective November 29, 2004, TEL implemented an attendance and leave policy allowing employees to earn vacation and sick leave during their employment. The corporation recognizes expense for accrued but unused vacation leave for all employees who have completed one year of service. No such expense exists for accrued but unused sick leave. At June 30, 2020, and June 30, 2019, the estimated current portion of the compensated absences liability was \$745 thousand and \$688 thousand, respectively.

Employment Separation

On February 17, 2016, the board of directors approved a change in separation pay policy. The revised policy allows for corporate officers hired prior to January 1, 2006, to continue accruing 40 hours of separation pay for each year of employment with TEL. Corporate officers hired January 1, 2006, and thereafter are granted 240 hours of leave in the event they are terminated without cause or upon retirement. After 6 years of employment in a corporate officer position, he/she shall accrue an additional 40 hours of severance pay for every year of employment. Such expense is accrued in the period it is earned. The TEL had \$597 thousand and \$610 thousand accrued for employment separation obligations for the years ending June 30, 2020, and June 30, 2019, respectively.

Note 2. Cash

A significant portion of TEL's deposits are in a financial institution that participates in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure. At June 30, 2020, and June 30, 2019, bank balances of approximately \$2.265 million and \$2.254 million, respectively, were insured by the

Notes to the Financial Statements (Continued)

bank collateral pool. The June 30, 2020 bank balance includes \$189 thousand of restricted sports wagering deposits.

For the years ended June 30, 2020, and June 30, 2019, the bank balance for the fidelity fund account was approximately \$25 thousand and \$41 thousand, respectively, and was maintained in a demand deposit account that was insured by the Federal Deposit Insurance Corporation for up to a maximum of \$250,000.

TEL also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. TEL's deposits with the LGIP were approximately \$146 million and \$130 million at June 30, 2020, and June 30, 2019, respectively. The LGIP is part of the State Pooled Investment Fund. The LGIP is measured at amortized cost. The fund is not rated by a nationally recognized statistical rating organization.

The fund's investment policy and required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at <http://www.treasury.tn.gov> or by calling (615) 741-2956.

Note 3. Prize Annuity Obligations

The TEL offers games where the prize structure allows for specific prizes to be paid in a cash value or annuity option. In accordance with policy, TEL may enter into insurance annuity contracts in order to fund annuity prizes. All life insurance annuity contracts must be issued by companies which are financially rated "A" or better by a nationally recognized rating agency duly licensed, admitted, and authorized to transact business in the State of Tennessee.

Because the TEL cannot unilaterally change the beneficiary for the annuities that are purchased in order to satisfy the liability to the prize winner, and because it is the intent of the TEL that the insurance companies make future installment payments directly to each prize winner named as the beneficiary of the annuity, neither the value of the annuities nor the value of the related future payments are reflected in the accompanying financial statements. The TEL would assume liability for future payments if the insurance companies were to default on their payments; however, this possibility is remote and therefore no liability is recorded. The present value of future payments to be made to grand-prize winners by these insurance companies totaled approximately \$12,472,000 and \$11,306,000 at June 30, 2020, and June 30, 2019, respectively.

Note 4. Capital Assets

Capital assets consisted of the following as of June 30, 2020:

Notes to the Financial Statements (Continued)

	Beginning Balance	Additions	Reductions	Ending Balance
Furniture and fixtures	\$ 798,000	\$ -	\$ -	\$ 798,000
Computer equipment	947,000	91,000	(30,000)	1,008,000
Vehicles	347,000	-	(58,000)	289,000
High mileage vehicles/vans	1,662,000	446,000	(201,000)	1,907,000
Leasehold improvements	2,635,000	-	-	2,635,000
Communication equipment	659,000	-	-	659,000
Software	939,000	6,000	-	945,000
Gaming equipment	763,000	36,000	-	799,000
Total	8,750,000	579,000	(289,000)	9,040,000
Less Accumulated Depreciation/Amortization:				
Furniture and fixtures	(783,000)	(4,000)	-	(787,000)
Computer equipment	(735,000)	(100,000)	30,000	(805,000)
Vehicles	(246,000)	(41,000)	58,000	(229,000)
High mileage vehicles/vans	(1,148,000)	(394,000)	201,000	(1,341,000)
Leasehold improvements	(1,329,000)	(235,000)	-	(1,564,000)
Communication equipment	(623,000)	(8,000)	-	(631,000)
Software	(829,000)	(54,000)	-	(883,000)
Gaming equipment	(648,000)	(50,000)	-	(698,000)
Total	(6,341,000)	(886,000)	289,000	(6,938,000)
Capital assets, net	\$2,409,000	\$(307,000)	\$ -	\$ 2,102,000

Capital assets consisted of the following as of June 30, 2019:

	Beginning Balance	Additions	Reductions	Ending Balance
Furniture and fixtures	\$ 795,000	\$ 3,000	\$ -	\$ 798,000
Computer equipment	881,000	66,000	-	947,000
Vehicles	327,000	20,000	-	347,000
High mileage vehicles/vans	2,062,000	-	(400,000)	1,662,000
Leasehold improvements	2,635,000	-	-	2,635,000
Communication equipment	630,000	29,000	-	659,000
Software	899,000	40,000	-	939,000
Gaming equipment	763,000	-	-	763,000
Total	8,992,000	158,000	(400,000)	8,750,000
Less Accumulated Depreciation/Amortization:				
Furniture and fixtures	(778,000)	(5,000)	-	(783,000)
Computer equipment	(622,000)	(113,000)	-	(735,000)
Vehicles	(205,000)	(41,000)	-	(246,000)

Notes to the Financial Statements (Continued)

High mileage vehicles/vans	(1,111,000)	(437,000)	400,000	(1,148,000)
Leasehold improvements	(1,093,000)	(236,000)	-	(1,329,000)
Communication equipment	(618,000)	(5,000)	-	(623,000)
Software	(788,000)	(41,000)	-	(829,000)
Gaming equipment	(601,000)	(47,000)	-	(648,000)
Total	(5,816,000)	(925,000)	400,000	(6,341,000)
Capital assets, net	\$3,176,000	\$(767,000)	\$ -	\$2,409,000

Note 5. Leasing Arrangements

TEL's leasing arrangements consist of non-cancellable operating leases for office space, outdoor advertising billboards, and related equipment that expire at various dates through 2025. Certain of these leases contain provisions for scheduled rental increases and are renewable at the option of TEL. During the year ended June 30, 2020, no options were exercised.

The following is a schedule by years of future minimum rental payments required of TEL under all non-cancellable operating leases with original terms of one year or more:

<u>Year Ending June 30:</u>	<u>2020</u>
2021	\$2,605,000
2022	2,122,000
2023	1,946,000
2024	1,724,000
2025	1,335,000
Total minimum rental payments	\$9,732,000

TEL also subleases office space under operating leases expiring through 2025 to its major gaming vendors. Minimum rental payments at June 30, 2020, have not been reduced by minimum sublease rentals of \$567,000 over the remaining sublease rental period.

The following is a schedule by years of future minimum sublease rental payments due to TEL under all non-cancellable operating leases with original terms of one year or more as of June 30:

<u>Year Ending June 30:</u>	<u>2020</u>
2021	\$117,000
2022	120,000
2023	114,000
2024	117,000
2025	99,000
Total minimum sublease payments	\$567,000

The following schedule shows the composition of total rental expense, net of unearned rent expense and income, for all operating leases for the years ended June 30:

Notes to the Financial Statements (Continued)

	<u>2020</u>	<u>2019</u>
Minimum rentals:		
Property	\$ 1,327,000	\$ 1,312,000
Billboards	1,314,000	1,298,000
Less: Sublease rentals	(116,000)	(118,000)
Total minimum rentals	\$ 2,525,000	\$ 2,492,000

Rental expense under all operating leases totaled approximately \$2,525,000 and \$2,492,000 for the years ended June 30, 2020, and June 30, 2019, respectively.

Note 6. Unearned Rent

As an incentive for entering into certain lease agreements, TEL received rent abatements approximating \$3,795,000 from landlords. In accordance with Governmental Accounting Standards Board Statement 13, *Accounting for Operating Leases with Scheduled Rent Increases*, TEL allocates rent incentives over the entire lease term on a straight-line basis. Additionally, where lease agreements stipulate escalation of rental payments over the term of the lease, TEL recognizes related rental expense on a straight-line basis over the entire term of the lease.

At June 30, 2020, total unearned rent consisted of \$2,486,000 in the straight-lining of rental expense over the life of the related lease terms less rent abatements of \$338,000 for net unearned rent of \$2,148,000. Unearned rent is a non-current liability on the statement of net position. Noncurrent liabilities consisted of the following as of June 30, 2020:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Unearned rent	\$2,486,000	-	\$(338,000)	\$2,148,000	\$134,000
Total noncurrent liabilities	\$2,486,000	-	\$(338,000)	\$2,148,000	\$134,000

At June 30, 2019, total unearned rent consisted of \$2,789,000 in the straight-lining of rental expense over the life of the related lease terms less rent abatements of \$303,000 for net unearned rent of \$2,486,000.

Notes to the Financial Statements (Continued)

Noncurrent liabilities consisted of the following as of June 30, 2019:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Unearned rent	\$2,789,000	-	\$(303,000)	\$2,486,000	\$134,000
Total noncurrent liabilities	\$2,789,000	-	\$(303,000)	\$2,486,000	\$134,000

Note 7. Due to Lottery for Education Account

In accordance with the Act, all net proceeds of TEL are due to the Lottery for Education account. “Net proceeds” are defined under the Act as “all revenue derived from the sale of lottery tickets or shares and all other monies derived from lottery games less operating expenses.” “Operating expenses” are defined under the Act as “all costs of doing business, including, but not limited to, prizes, commissions, and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of property and equipment, amounts held in or paid from a fidelity fund, and all other operating costs.” All other expenses are considered nonoperating.

Net proceeds and operating expenses for the Tennessee Education Lottery for the years ended June 30, 2020, and June 30, 2019, are summarized as follows:

	2020	2019
Operating revenues:		
Ticket revenues (See Note 1)	\$ 1,840,708,000	\$ 1,812,212,000
Less tickets provided as prizes	(128,465,000)	(122,553,000)
Net ticket revenues	1,712,243,000	1,689,659,000
Fees and other revenue	3,384,000	3,692,000
Total lottery proceeds	1,715,627,000	1,693,351,000
Operating expenses, as defined:		
Gaming	1,277,108,000	1,246,585,000
Operating	19,541,000	19,985,000
Total operating expenses, as defined	1,296,649,000	1,266,570,000
Net proceeds before distribution of unrestricted net position	418,978,000	426,781,000
Nonoperating revenue and expenses:		
Interest revenue	1,647,000	2,180,000
Excess after school proceeds (Note 8)	-	224,000
Total nonoperating revenue and expenses	1,647,000	2,404,000
Net proceeds	\$ 420,625,000	\$ 429,185,000

Notes to the Financial Statements (Continued)

Amount due to Lottery for Education account for year	\$ 420,625,000	\$ 429,185,000
Amount paid during year	(302,362,000)	(327,885,000)
<hr/>		
Amount due to Lottery for Education account, end of year	\$ 118,263,000	\$ 101,300,000

All amounts due at the end of each fiscal year were deposited to the Lottery for Education account in July of the subsequent fiscal year.

Note 8. Due to After-School Programs Special Account

In accordance with the Act, at the end of each fiscal year, one hundred percent of any unclaimed prize money are deposited in the After-School Programs special account; however, if the unclaimed prizes in any fiscal year total more than \$18 million, then the excess accrues to the Lottery for Education account.

The amounts due to the After-School Programs special account are derived from unclaimed prizes for instant games that have been officially closed and drawing-style games that have exceeded the 180-day claim period.

Unclaimed prizes for instant games are estimated based upon historical percentages of actual unclaimed dollars at the time of game close and reconciliation at the end of the 90-day redemption period.

For drawing-style games, the actual unclaimed amounts are determined after the expiration of the related claim period for the draw.

For instant games, prizes not claimed within 90 days of the announced game-end date are forfeited as unclaimed prizes. For drawing-style games, prizes not claimed within 180 days of a game draw date are forfeited as unclaimed prizes.

For fiscal year 2020, unclaimed prizes were \$17,605,000, which was current and payable to the After-School Programs special account at June 30, 2020.

For fiscal year 2019, unclaimed prizes were \$18,224,000. In accordance with the statute, \$18,000,000 was current and payable to the After-School Programs special account at June 30, 2019. The \$224,000 was deposited to the Lottery for Education account.

All amounts due at the end of each fiscal year were deposited to the After-School Programs special account before August 1 of the subsequent fiscal year.

Notes to the Financial Statements (Continued)

Note 9. Sports Wagering

In fiscal year 2020, the lottery began to receive applications for review and approval for sports wagering. In accordance with the Tennessee Sports Gaming Act, the fees collected must be used by the corporation to pay the actual operating and administrative expenses incurred. Any excess fees collected must be distributed to the state treasurer for deposit into the Tennessee Promise scholarship endowment fund. As of fiscal year ended 2020, all applications submitted were still in the review process.

	2020
Operating revenues:	
Sports wagering fees	\$ 189,000
<u>Total operating revenues</u>	<u>189,000</u>
Operating expenses, as defined	
Personnel	539,000
Professional fees	31,000
General administrative and other operating	18,000
<u>Total operating expenses, as defined</u>	<u>588,000</u>
<u>Net program proceeds</u>	<u>\$(399,000)</u>

TEL has incurred operating expenses of \$588,000 that have been paid for in whole by the lottery operations of the Tennessee Education Lottery Corporation. In fiscal year 2021, the Tennessee Education Lottery Sports Wagering operations will collect license fee revenues to repay the funds used in FY2020 to cover related costs.

Note 10. Employee Benefits

A. *Deferred Compensation*

Effective September 22, 2003, TEL provided its employees with a deferred compensation plan created in accordance with Internal Revenue Code Section 457 (the 457 Plan). The 457 Plan is available to all eligible employees at their option and permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency. During the years ended June 30, 2020, and June 30, 2019, employees contributed approximately \$602,000 and \$628,000, respectively, to the 457 Plan.

The aggregate fair value of the plan's assets was approximately \$7,978,000 and \$7,862,000, net of administrative fees, as of June 30, 2020, and June 30, 2019, respectively.

Notes to the Financial Statements (Continued)

B. Defined Contribution Plan

Effective September 22, 2003, the TEL Board of Directors established a defined contribution plan in accordance with Internal Revenue Code Section 401(a) (the 401(a) Plan). Under the 401(a) Plan, all eligible employees receive compensation from TEL in the form of non-voluntary deferrals to their individual 401(a) accounts as follows:

1. contribution of 5% of employee's compensation;
2. matching contribution of 100% of the participant's contributions to the 457 Plan, up to the first 5% of the participant's compensation; and
3. changes to the plan must be approved by TEL's Board of Directors.

These contributions vest over a four-year period at a rate of 25% per year and are not available to participants until termination, retirement, death, or unforeseeable emergency. TEL expensed approximately \$934,000 and \$875,000 to the 401(a) Plan on behalf of its employees for the years ended June 30, 2020, and June 30, 2019, respectively.

In accordance with the 401(a) Plan, forfeitures of employer contributions may be used to offset plan administrative expenses and/or reduce future contribution costs. As of the years ended June 30, 2020, and June 30, 2019, forfeited amounts of approximately \$15,000 and \$30,000, respectively, were used to offset employer contributions and plan administrative expenses.

Section 1448 of the Small Business Job Protection Act of 1996 added Subsection (g) to Section 457 of the Internal Revenue Code to provide that all assets and income under a Section 457(b) Plan that are maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. On January 1, 2018, TEL changed the custodian for both the 457 plan and the 401(a) plan from John Hancock Financial to Mass Mutual.

The aggregate fair value of the plans' assets was approximately \$11,064,000 and \$10,234,000 net of forfeitures and administrative fees, as of June 30, 2020, and June 30, 2019, respectively.

As of June 30, 2020, and June 30, 2019, TEL's employer liability outstanding was \$42,000 and \$39,000, respectively.

Note 11. Risk Management

Effective July 31, 2005, TEL became a member of the Risk Management Fund, an internal service fund of the State of Tennessee. The Risk Management Fund allocates the cost of providing claims servicing and claims payment by charging a premium to TEL based on a percentage of TEL's expected loss costs, which includes both experience and exposures. This Risk Management Fund provides general and automobile liability up to \$300,000 per person and \$1,000,000 per occurrence. For property, the deductible is the first \$25,000 of losses for a member.

Notes to the Financial Statements (Continued)

Additionally, in order to minimize financial losses resulting from the occurrence of theft; employee dishonesty; legal judgments; work-related employee injury and accidents; and catastrophic events, TEL maintains insurance from various other providers. At June 30, 2020, additional insurance coverage was provided at the following maximum amounts:

<u>Coverage</u>	<u>2020</u>
Employee Fidelity	\$ 500,000
Automobile/Property	1,000,000
Workers' Compensation	1,000,000
Employment Practices	1,000,000
General Liability/Umbrella	5,000,000

Over the past three fiscal years, in the ordinary course of business, TEL has filed insurance claims with both the risk pool and the commercial insurers. None of the related settlements exceeded the provided insurance coverage.

Note 12. Commitments and Contingencies

Legal – TEL is subject to litigation in the ordinary course of its business. Liabilities related to contingencies are recognized when a loss is probable and can be reasonably estimated. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of TEL. Furthermore, as of the year ended June 30, 2020, management is not aware of any related liabilities.



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

**Independent Auditor’s Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance With *Government Auditing Standards***

The Honorable Bill Lee, Governor
Members of the General Assembly
Board of Directors, Tennessee Education Lottery Corporation

We have audited the financial statements of the Tennessee Education Lottery Corporation, a component unit of the State of Tennessee, as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the Tennessee Education Lottery Corporation’s basic financial statements, and have issued our report thereon dated October 28, 2020. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Tennessee Education Lottery Corporation’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 Tennessee Education Lottery Corporation’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Tennessee Education Lottery Corporation’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 Tennessee Education Lottery Corporation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

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



Katherine J. Stickel, CPA, CGFM, Director
Division of State Audit
October 28, 2020