



FINANCIAL AND COMPLIANCE AUDIT REPORT

Tennessee Education Lottery Corporation

For the Year Ended June 30, 2021

Jason E. Mumpower
Comptroller of the Treasury



DIVISION OF STATE AUDIT

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JASON E. MUMPOWER
Comptroller

November 2, 2021

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, 2021. 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

22/012

Audit Report
Tennessee Education Lottery Corporation
For the Year Ended June 30, 2021

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State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

Tennessee Education Lottery Corporation

For the Year Ended June 30, 2021

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Findings

The audit report contains no findings.



JASON E. MUMPOWER
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 year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise the 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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

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, 2021, and the changes in financial position and cash flows thereof for the year 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 25, 2021, on our consideration of the 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 corporation's internal control over financial reporting and compliance.



Katherine J. Stickel, CPA, CGFM, Director
Division of State Audit
October 25, 2021

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, 2021, and June 30, 2020. 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 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 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 statement of net position** – reflects TEL's financial position at June 30, 2021;
- **the statement of revenues, expenses, and changes in net position** – reports revenues and expenses incurred in relation to the sale of lottery products, sports wagering operations, as well as other non-gaming related activity for the fiscal year ended June 30, 2021; and
- **the statement of cash flows** – outlines the cash inflows and outflows related to the activity of selling lottery products, the oversight of sports wagering, and other business-related activities for the fiscal year ended June 30, 2021.

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.

In April 2019, the Tennessee General Assembly approved the Tennessee Sports Gaming Act and apportioned the regulatory responsibilities of online sports wagering to the TEL. The Tennessee Sports Gaming Act allows for online wagers on approved professional, athletic, and collegiate sporting events, excluding horse racing, which have governing bodies with prescribed rules and enforces a code of conduct via a mobile sports wagering platform. Per the Tennessee Sports

Gaming Act, approved licensees must remit 20% of their adjusted gross income as a privilege tax to the TEL. The privilege tax collected is distributed to the state treasurer for deposit to the lottery for education account at 80%, the general fund at 15%, and the mental health and substance abuse services fund at 5% on a quarterly basis.

The consolidated financial statements are comprised of lottery and sports wagering operations.

Overview of Financial Position

Condensed Statement of Net Position

	June 30, 2021	Increase / (Decrease)	June 30, 2020
Assets:			
<i>Current assets</i>			
Cash	\$ 179,642,000	\$ 31,943,000	\$ 147,699,000
Retailer accounts receivable, net	86,177,000	(5,676,000)	91,853,000
Other	9,322,000	(155,000)	9,477,000
Sports wagering licensee receivables	3,220,000	3,220,000	-
Total current assets	278,361,000	29,332,000	249,029,000
<i>Noncurrent assets</i>			
Capital assets, net	1,868,000	(234,000)	2,102,000
Total noncurrent assets	1,868,000	(234,000)	2,102,000
Total assets	280,229,000	29,098,000	251,131,000
Liabilities:			
<i>Current liabilities</i>			
Due to Lottery for Education Account	132,636,000	14,373,000	118,263,000
Due to After-School Programs Account	17,569,000	(36,000)	17,605,000
Due to Tennessee Promise Account	1,625,000	1,625,000	-
Due to General Fund Account	1,330,000	1,330,000	-
Due to Mental Health Account	443,000	443,000	-
Prizes payable	115,264,000	8,237,000	107,027,000
Accounts payable and accrued liabilities	6,669,000	1,103,000	5,566,000
Unearned revenue	2,888,000	1,992,000	896,000
Unearned rent	134,000	-	134,000
Total current liabilities	278,558,000	29,067,000	249,491,000
<i>Noncurrent liabilities</i>			
Unearned rent	1,641,000	(373,000)	2,014,000
Total noncurrent liabilities	1,641,000	(373,000)	2,014,000
Total liabilities	280,199,000	28,694,000	251,505,000

Net Position:

Investment in capital assets	1,868,000	(234,000)	2,102,000
Unrestricted	(1,868,000)	633,000	(2,501,000)
Restricted for uncollectible retailer receivables	30,000	5,000	25,000
Total net position	\$ 30,000	\$ 404,000	\$ (374,000)

Assets

The \$29.1 million increase in total assets at June 30, 2021, was primarily due to an increase in lottery ticket revenues resulting in increased cash, and cash collected for the sports wagering privilege tax that is due and payable after the fiscal year end.

Liabilities

The \$28.7 million increase in total liabilities at June 30, 2021, 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, and the sports wagering privilege tax and net sports wagering operating income payable to Tennessee Promise.

Condensed Statement of Revenues and Expenditures

	<u>June 30, 2021</u>	<u>Increase / (Decrease)</u>	<u>June 30, 2020</u>
<i>Revenues:</i>			
Instant games	\$ 1,736,563,000	\$180,327,000	\$ 1,556,236,000
Drawing-style games	347,310,000	62,746,000	284,564,000
Less instant/promotional tickets provided as prizes	(145,399,000)	(16,934,000)	(128,465,000)
Games revenue, net	1,938,474,000	226,139,000	1,712,335,000
Bad debt recoveries/(expense), net	(88,000)	4,000	(92,000)
Retailer service fees	2,911,000	(197,000)	3,108,000
Interest income	400,000	(1,247,000)	1,647,000
Licensing fees sports wagering	3,576,000	3,387,000	189,000
Other revenue	1,094,000	786,000	308,000
Total revenues	1,946,367,000	228,872,000	1,717,495,000
<i>Expenses</i>			
Cost of revenues	1,423,494,000	163,991,000	1,259,503,000
General, administrative, and other operating expenses	20,936,000	807,000	20,129,000
Other expenses	23,000	(25,000)	48,000
Proceeds to Lottery for Education Account	482,316,000	61,691,000	420,625,000
Proceeds to After-School Programs Account	17,569,000	(36,000)	17,605,000

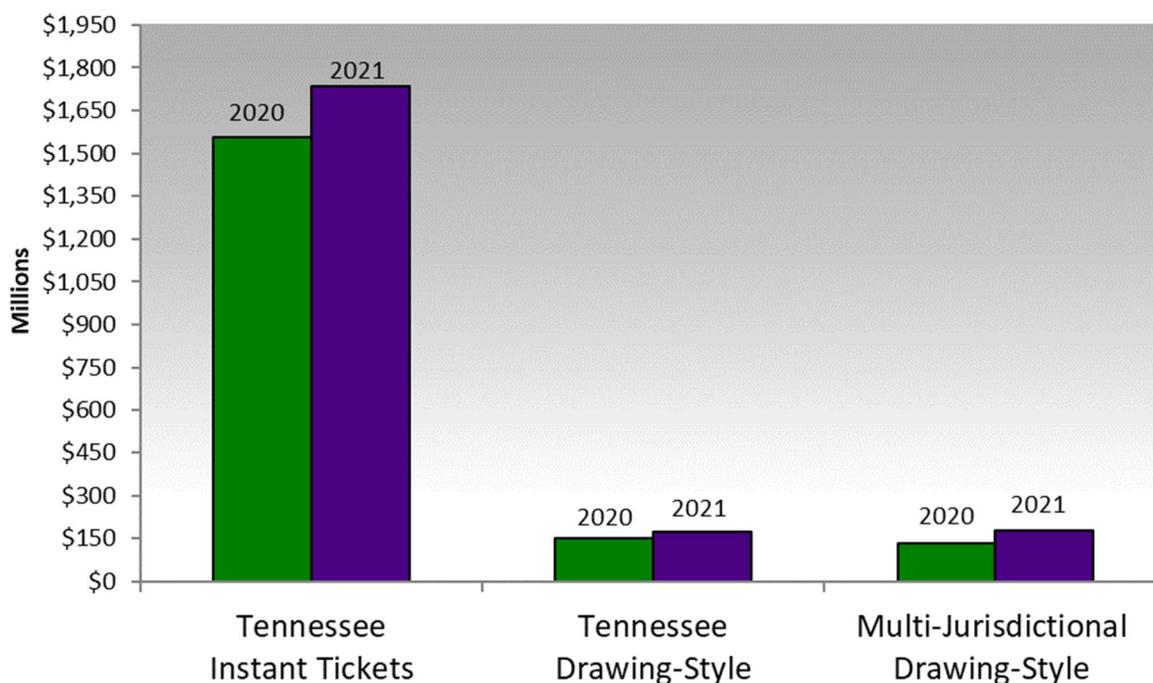
Proceeds to Tennessee Promise	1,625,000	1,625,000	-
Total expenses	1,945,963,000	228,053,000	1,717,910,000
Change in net position	404,000	819,000	(415,000)
Total net position, beginning of year	(374,000)	(415,000)	41,000
Total net position, end of year	\$ 30,000	\$ 404,000	\$ (374,000)

Fiscal Year 2021 Financial Highlights for the Tennessee Education Lottery

The Tennessee Education Lottery Corporation set a new record in fiscal year 2021 with a contribution of \$499.8 million to all Lottery-funded education programs, bringing the total to over \$6 billion since sales began January 20, 2004.

Gross ticket revenues for the fiscal year 2021 were \$2.084 billion, bringing the total since inception to more than \$24 billion. Total prizes won since inception total more than \$16.5 billion, with 319 winning tickets sold worth \$1 million or more.

**Tennessee Education Lottery Gross Ticket Revenues
Fiscal Year 2021 Comparison to 2020**



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 2021, revenues for *Instant Tickets* reached a record-setting high of \$1.736 billion, topping the fiscal year 2020 record of \$1.556 billion by \$180 million, or 11.6%.

Fifty-nine new instant ticket games were introduced during fiscal year 2021 compared to 52 in fiscal year 2020. These new games contributed to the instant product's success by providing players with new and exciting ways to play the popular games. TEL's Jumbo Bucks family of games continues to be the top choice of players in both fiscal years.

Drawing-Style:

Cash 3 revenues of \$84.2 million in fiscal year 2021 increased by 17.1% compared to fiscal year 2020.

Cash 4 revenues of \$52.9 million increased by 19.6% compared to fiscal year 2020.

Revenues for *Tennessee Cash* were \$18.4 million during fiscal year 2021, down \$2.1 million year over year. *Tennessee Cash* is a cash jackpot drawing-style game.

Fiscal year 2021 *Keno to Go!* revenues were \$16.1 million, up \$2.6 million or 19.7% in comparison to fiscal year 2020.

Multi-Jurisdictional Games

Powerball revenues were \$84.7 million, an increase of \$18 million, or 27%, in fiscal year 2021. The year-over-year increase is due primarily to an increase in jackpot cycles between fiscal years.

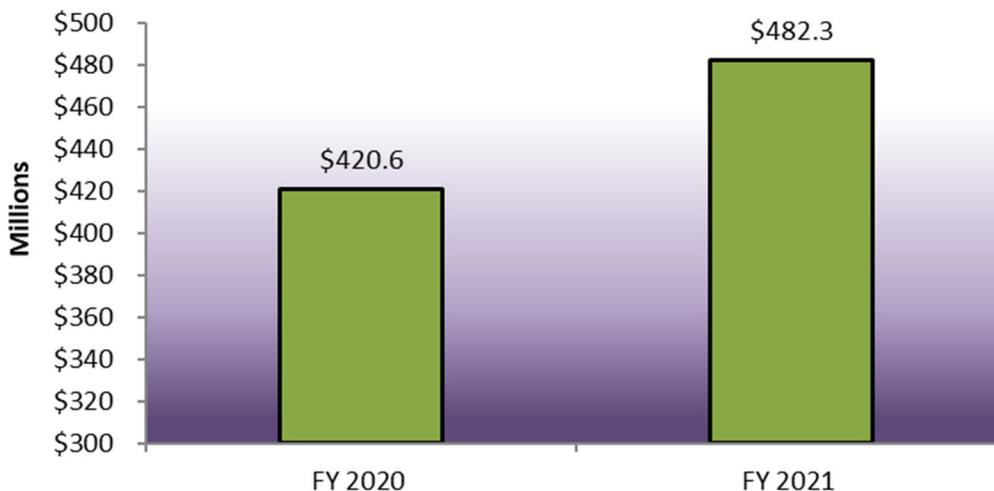
Revenues for *Mega Millions* in fiscal year 2021 were \$67.5 million compared to \$46.3 million in the prior year, an increase of \$21.2 million, or 45.7 %, year over year.

Cash 4 Life revenues were \$13.5 million in fiscal year 2021, an increase of \$2.4 million, or 21.6%, over fiscal year 2020. In fiscal year 2021, the *Quick Cash* add-on feature was launched.

Revenues for *Lotto America* for fiscal year 2021 were \$9.7 million, a 3.4% decrease over fiscal year 2020. This is a jackpot-driven game, and fiscal year 2021 had a lower average jackpot compared to the prior year.

TEL generated \$482.3 million for the Lottery for Education Account in fiscal year 2021, compared to \$420.6 million in fiscal year 2020.

Tennessee Education Lottery Proceeds for the Lottery for Education Account



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 2021, TEL recognized \$17.6 million for the After-School Programs special account, matching the amount in fiscal year 2020.

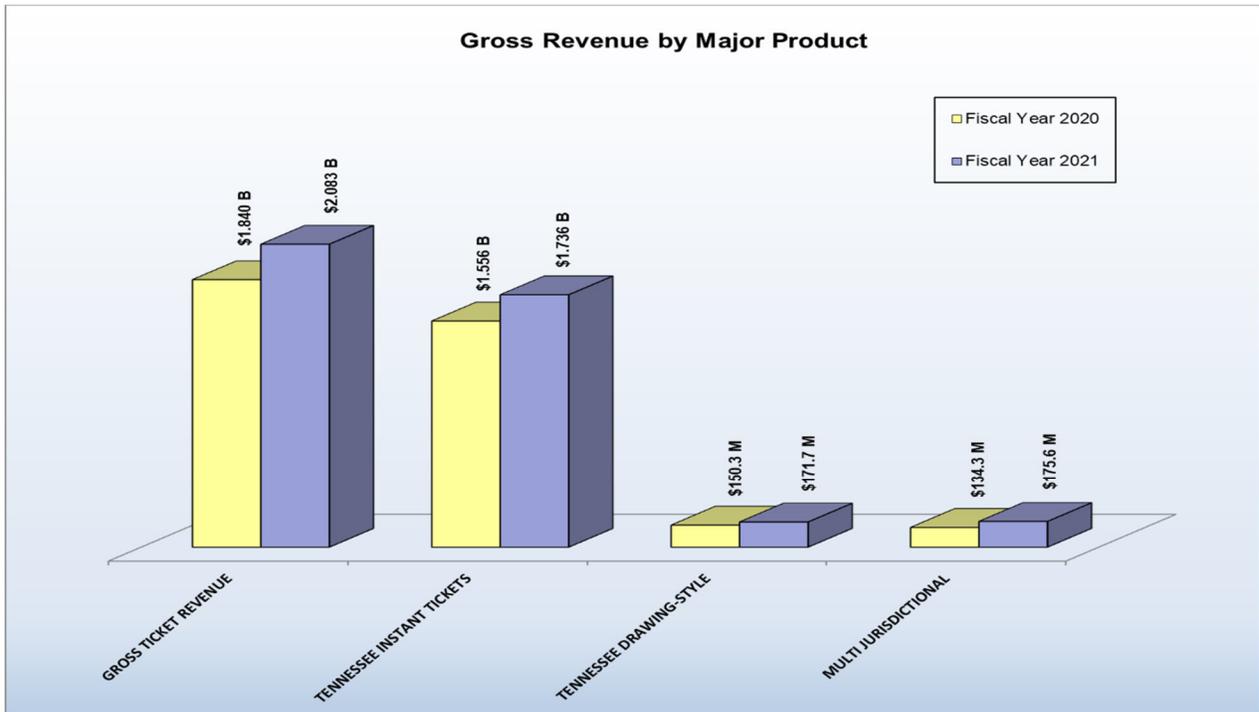
**Tennessee Education Lottery
Proceeds for the After-School Programs Special Account**



Revenues

Gross Lottery ticket revenues for fiscal years 2021 and 2020 were \$2.084 billion and \$1.840 billion, respectively.

The following chart depicts the distribution of revenues by product for the two fiscal years ended June 30:



Tennessee Games:

Gross *Instant Ticket* revenues for fiscal year 2021 were \$1.736 billion. This represents an 11.6% increase from fiscal year 2020's instant ticket revenues of \$1.556 billion. Instant tickets represent an average of approximately 82% of total gross revenues in fiscal years 2021 and 2020. 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.

Cash 3 revenues for fiscal years 2021 and 2020 were \$84.2 million and \$71.9 million, respectively.

Cash 4 revenues were \$52.9 million and \$44.3 million in fiscal years 2021 and 2020, respectively.

Tennessee Cash revenues for fiscal years 2021 and 2020 were \$18.4 million and \$20.6 million, respectively.

Keno to Go! revenues for fiscal years 2021 and 2020 were \$16.1 million and \$13.5 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 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 2021 and 2020 were \$84.7 million and \$66.7 million, respectively. These amounts represent approximately 4.1% and 3.6% of gross ticket revenues, respectively.

Mega Millions is a drawing-style lottery game administered by the Mega Millions lottery consortium. The consortium 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, which began in January 2010. Revenues for fiscal years 2021 and 2020 were \$67.5 million and \$46.3 million, respectively.

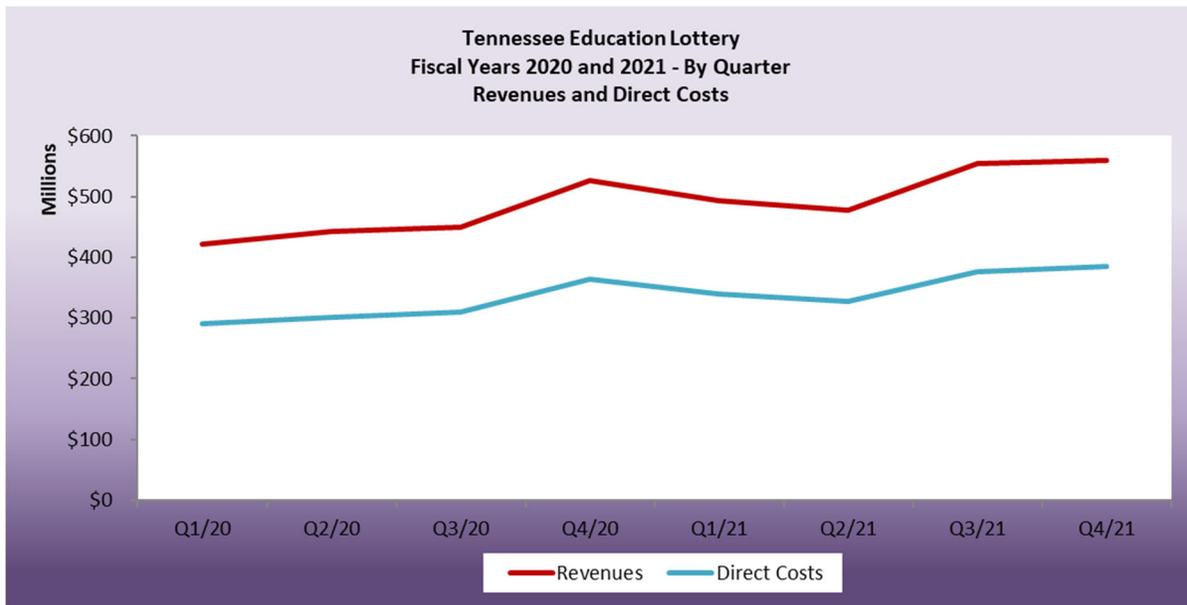
Cash 4 Life, a drawing-style game, was introduced in Tennessee on November 1, 2015, and has 10 member lotteries: Florida, Georgia, Indiana, Maryland, Missouri, New Jersey,

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 \$13.5 million for 2021 and \$11.1 million for 2020.

Lotto America, a drawing-style game, was launched in Tennessee on November 15, 2017, and has 13 members: Delaware, Indiana, Iowa, Kansas, Maine, Minnesota, Montana, North Dakota, New Mexico, Oklahoma, South Dakota, Tennessee, and West Virginia. Revenues were \$9.7 million for 2021 and \$10.1 million for 2020.

Cost of Revenues

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



Gross prize expense was \$1.253 billion and \$1.109 billion in the years 2021 and 2020, respectively. The increase of \$144.1 million in 2021 reflects 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 68% of instant game revenues, net of free tickets, for fiscal year 2021 and 67.6% for fiscal year 2020.

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 50.5% and 50.7% for fiscal years 2021 and 2020, respectively.

Retailer commissions were \$136 million and \$120 million for fiscal years 2021 and 2020, respectively. Consistent with the cost driver relationship of ticket revenues to retailer commissions, the increase of \$16 million in 2021 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 \$15,000 and \$65,000 were awarded for fiscal years 2021 and 2020, respectively.

Major Gaming Vendor fees for fiscal years 2021 and 2020 were \$38.8 million and \$35 million, respectively. TEL has retained two major gaming contractors, one for the operation of its gaming systems and retailer network and one for the manufacturing, warehousing, and distribution of its instant ticket games. 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 for both fiscal years 2021 and 2020. Budget directives and constraints significantly influence these costs. 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 \$19.4 million and \$19.5 million for the fiscal years 2021 and 2020, respectively. For each of these years, the five major components were depreciation, personnel, professional fees, property, and telecommunications expenses. These expenses do not change in direct proportion to 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.

Fiscal Year 2021 Financial Highlights for Sports Wagering

Sports wagering began in November 2020 with four approved licensees. All licensees have an online sports wagering platform as required by the Tennessee Sports Gaming Act. All licensees go through an extensive review covering compliance, legal, and financial requirements to ensure they are in compliance with the Tennessee Sports Gaming Act. Licensees are presented to the Sports Wagering Committee of the Board of Directors for approval prior to the start of operations in Tennessee.

Sports wagering licensees reported a gross handle of \$1.413 billion and a gross payout of \$1.286 billion through June 30, 2021.

Sports wagering adjusted gross income through June 30, 2021, totaled \$122.5 million.

Privilege tax remitted to the state treasurer for deposit, as required by statute, totaled \$24.5 million.

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.
- During the 2021 legislative session, bills were passed in the Senate and House transferring the regulatory authority for sports wagering operations to the Sports Wagering Advisory Council effective January 1, 2022.
- Changes 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
Statement of Net Position
As of June 30, 2021

	Lottery	Sports Wagering	Total
ASSETS			
Current assets:			
Cash (Note 2)	\$ 169,354,000	\$ 9,758,000	\$ 179,112,000
Lottery retailer accounts receivable, net (Note 1)	86,177,000	-	86,177,000
Sports wagering licensee receivables, net (Note 1)	-	3,220,000	3,220,000
Restricted sports wagering cash (Note 2)	-	500,000	500,000
Restricted fidelity fund cash (Note 2)	30,000	-	30,000
Prepaid expenses and other assets	9,322,000	-	9,322,000
Total current assets	264,883,000	13,478,000	278,361,000
Noncurrent assets:			
Capital assets, net of depreciation of \$7,451,000 (Note 4)	1,868,000	-	1,868,000
Total noncurrent assets	1,868,000	-	1,868,000
Total assets	266,751,000	13,478,000	280,229,000
LIABILITIES			
Current liabilities:			
Due to Tennessee Promise Account - Sports Wagering (Note 9)	-	1,625,000	1,625,000
Due to Lottery for Education Account (Notes 7 and 9)	125,542,000	7,094,000	132,636,000
Due to Lottery After-School Programs Account (Note 8)	17,569,000	-	17,569,000
Due to General Fund Account - Sports Wagering (Note 9)	-	1,330,000	1,330,000
Due to Mental Health Account - Sports Wagering (Note 9)	-	443,000	443,000
Lottery prizes payable	115,264,000	-	115,264,000
Accounts payable	34,000	309,000	343,000
Accrued liabilities	5,807,000	519,000	6,326,000
Unearned revenues	730,000	2,158,000	2,888,000
Unearned rent (Note 6)	134,000	-	134,000
Total current liabilities	265,080,000	13,478,000	278,558,000
Noncurrent liabilities:			
Unearned rent (Note 6)	1,641,000	-	1,641,000
Total noncurrent liabilities	1,641,000	-	1,641,000
Total liabilities	266,721,000	13,478,000	280,199,000
NET POSITION			
Investment in capital assets	1,868,000	-	1,868,000
Restricted:			
Restricted for uncollectible retailer receivables	30,000	-	30,000
Unrestricted	(1,868,000)	-	(1,868,000)
Total net position	\$ 30,000	\$ -	\$ 30,000

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

TENNESSEE EDUCATION LOTTERY CORPORATION
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2021

	Lottery	Sports Wagering	Total
OPERATING REVENUES			
Lottery ticket revenue	\$ 2,083,785,000	\$ -	\$ 2,083,785,000
Less instant/promotional tickets provided as prizes	(145,399,000)	-	(145,399,000)
Net lottery ticket revenue	1,938,386,000	-	1,938,386,000
Retailer service fees	2,911,000	-	2,911,000
Licensee fees, sports wagering	-	3,576,000	3,576,000
Other	1,066,000	-	1,066,000
Net operating revenues	1,942,363,000	3,576,000	1,945,939,000
OPERATING EXPENSES			
Available lottery prizes	1,253,821,000	-	1,253,821,000
Current year actual unclaimed prizes (Note 8)	(17,569,000)	-	(17,569,000)
Net lottery prizes	1,236,252,000	-	1,236,252,000
Retailer commissions and bonuses	135,957,000	-	135,957,000
Contractor fees	38,812,000	-	38,812,000
Advertising	7,185,000	-	7,185,000
Salaries and benefits	15,361,000	1,190,000	16,551,000
Retailer merchandising and marketing	5,288,000	-	5,288,000
Rent, utilities, and maintenance	1,775,000	-	1,775,000
Depreciation	882,000	-	882,000
Professional fees	309,000	343,000	652,000
General, administrative, and other operating	1,045,000	31,000	1,076,000
Total operating expenses	1,442,866,000	1,564,000	1,444,430,000
Operating income	499,497,000	2,012,000	501,509,000
NONOPERATING REVENUES (EXPENSES)			
Interest revenue	388,000	12,000	400,000
Retailer fees for future uncollectible retailer receivables	28,000	-	28,000
Fidelity fund retailer non-feasance (Note 1)	(23,000)	-	(23,000)
Proceeds for Tennessee Promise Account - Sports Wagering (Note 9)	-	(1,625,000)	(1,625,000)
Proceeds to Lottery for Education Account (Note 7)	(482,316,000)	-	(482,316,000)
Proceeds to After-School Programs Account (Note 8)	(17,569,000)	-	(17,569,000)
Total nonoperating revenues (expenses)	(499,492,000)	(1,613,000)	(501,105,000)
Change in net position	5,000	399,000	404,000
NET POSITION			
Net position, beginning of year	25,000	(399,000)	(374,000)
Net position, end of year	\$ 30,000	\$ -	\$ 30,000

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

TENNESSEE EDUCATION LOTTERY CORPORATION
Statement of Cash Flows
For the Year Ended June 30, 2021

	Lottery	Sports Wagering	Total
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash received from customers	\$1,943,941,000	\$ -	\$ 1,943,941,000
Cash received from sports wagering operations	-	5,734,000	5,734,000
Other operating cash received	3,803,000	-	3,803,000
Cash paid for lottery prizes	(1,227,980,000)	-	(1,227,980,000)
Cash paid to/on behalf of gaming vendors	(38,456,000)	-	(38,456,000)
Cash paid to retailers	(135,941,000)	-	(135,941,000)
Cash paid for advertising	(7,085,000)	-	(7,085,000)
Cash paid to/on behalf of employees	(15,015,000)	(1,190,000)	(16,205,000)
Other operating payments	(8,625,000)	(634,000)	(9,259,000)
Net cash provided by operating activities	514,642,000	3,910,000	518,552,000
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Payments to Lottery for Education Account	(475,039,000)	(12,509,000)	(487,548,000)
Received from sports gaming privilege tax	-	21,283,000	21,283,000
Payments to General Fund Account	-	(2,345,000)	(2,345,000)
Payments to Mental Health Account	-	(782,000)	(782,000)
Payments to Lottery for After-School Programs Account	(17,605,000)	-	(17,605,000)
Fidelity fund cash received from retailers	31,000	-	31,000
Fidelity fund cash refunded to retailers	(3,000)	-	(3,000)
Fidelity fund cash non-feasance	(22,000)	-	(22,000)
Reserve fund cash received from sports wagering licensee	-	500,000	500,000
Net cash provided by (used in) noncapital financing activities	(492,638,000)	6,147,000	(486,491,000)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Purchase of property and equipment	(648,000)	-	(648,000)
Proceeds from disposal of capital assets	130,000	-	130,000
Net cash used in capital and related financing activities	(518,000)	-	(518,000)
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest income	388,000	12,000	400,000
Net cash provided by investing activities	388,000	12,000	400,000
Net cash provided by all activities	21,874,000	10,069,000	31,943,000
Cash - beginning of year	147,510,000	189,000	147,699,000
Cash - end of year	\$ 169,384,000	\$ 10,258,000	\$ 179,642,000
Reconciliation of cash on the statement of net position			
Cash	\$ 169,354,000	\$ 9,758,000	\$ 179,112,000
Restricted sports wagering cash	-	500,000	500,000
Restricted fidelity fund cash	30,000	-	30,000
Cash at end of year	\$ 169,384,000	\$ 10,258,000	\$ 179,642,000

TENNESSEE EDUCATION LOTTERY CORPORATION
Statement of Cash Flows (Continued)
For the Year Ended June 30, 2021

	Lottery	Sports Wagering	Total
Reconciliation of net operating income to net cash provided by operating activities:			
Operating income	499,497,000	2,012,000	501,509,000
Adjustments to reconcile operating income to net cash provided by operating activities			
Bad debt expense	88,000	-	88,000
Depreciation	882,000	-	882,000
Gain on disposal of capital assets	(130,000)	-	(130,000)
Changes in assets and liabilities:			
Retailer/licensee accounts receivable	5,589,000	-	5,589,000
Prepays and other assets	743,000	-	743,000
Accounts payable and accrued liabilities	275,000	(260,000)	15,000
Lottery prizes payable	8,238,000	-	8,238,000
Unearned revenues	(167,000)	2,158,000	1,991,000
Unearned rent	(373,000)	-	(373,000)
Net cash provided by operating activities	<u>\$514,642,000</u>	<u>\$3,910,000</u>	<u>\$518,552,000</u>

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

TENNESSEE EDUCATION LOTTERY CORPORATION
Notes to the Financial Statements
June 30, 2021

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 to 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 *Annual Comprehensive Financial Report*, which may be viewed at <https://www.tn.gov/finance/rd-doa/fa-accfin-ar.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. For the year ended June 30, 2021, 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 April 2019, the Tennessee General Assembly approved the Tennessee Sports Gaming Act, Sections 4-51-301 et seq., *Tennessee Code Annotated*, and apportioned the regulatory responsibilities of online sports wagering to the TEL. The Tennessee Sports Gaming Act allows for online wagers on approved professional, athletic, and collegiate sporting events, excluding horse racing, that have governing bodies with prescribed rules and enforces a code of conduct on a mobile sports wagering platform. Per the Tennessee Sports Gaming Act, approved licensees must remit 20% of their adjusted gross income as privilege tax to the TEL, to be distributed as required in Section 4-51-304(e), *Tennessee Code Annotated*.

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.

Lottery revenues are presented net of bad debt expense.

Sports wagering revenues are recognized by the TEL for application and licensing fees. Licensee fees are recognized over the 12-month period of the license. Supplier and vendor fees are recognized upon receipt.

Net Position

Net position represents cumulative revenues less expenses and required beneficiary program payments in accordance with the Acts (see Notes 7, 8, and 9). Net position includes funds invested in capital assets, restricted net position, and unrestricted net position.

Notes to the Financial Statements (Continued)

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).

Lottery Retailer Accounts Receivable

Lottery retailer accounts receivables 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, 2021, the Allowance for Doubtful Accounts was \$428 thousand.

Sports Wagering Licensee Receivable

Sports wagering licensee receivables represent the 20% privilege tax on adjusted gross income due from each licensee.

Privilege taxes are collected monthly from each licensee's escrow account. This escrow account is separate from all other accounts of the licensee to ensure the security of funds due to the TEL for payment of the privilege tax. At June 30, 2021, the licensee accounts receivable was approximately \$3.2 million.

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.

Sports wagering unearned revenue is annual licensee fees collected but not yet recognized.

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.

Notes to the Financial Statements (Continued)

These funds may be used to cover losses incurred as a result of the nonfeasance, malfeasance, or misfeasance of TEL retailers. During the year ended June 30, 2021, \$23 thousand was 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 year ended June 30, 2021, 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.

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 *drawing-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.

As of June 30, 2021, there were \$15,000 in selling incentives earned for the fiscal year.

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. On February 23, 2021, the contract was amended to extend the end date to June 30, 2027. In accordance with the amended contract,

Notes to the Financial Statements (Continued)

SGI will receive the negotiated fee of 0.8128% on the selling price of all instant ticket activations, beginning July 1, 2021.

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

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. There were no *Powerball* or *Mega Millions* jackpot winners in Tennessee for fiscal year 2021.

In November 2015, TEL began selling *Cash 4 Life*. *Cash 4 Life* prizes are 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. For fiscal year 2021, there were no first- or second-level prize winners in Tennessee.

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 to 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 the 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.

Notes to the Financial Statements (Continued)

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 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-cancelable when entered.

Nonoperating Revenues and Expenses

Revenues and expenses resulting from activities not directly associated with the sale of lottery tickets or sports wagering 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. The estimated current portion of the compensated absences liability was \$735 thousand at June 30, 2021.

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 six 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 \$670 thousand accrued for employment separation obligations at fiscal year end June 30, 2021.

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 custodial credit risk disclosure. At June 30, 2021, bank balances of

Notes to the Financial Statements (Continued)

approximately \$463 thousand were insured by the bank collateral pool. The June 30, 2021, bank balance includes \$61 thousand of restricted sports wagering deposits.

For the year ended June 30, 2021, the bank balance for the fidelity fund account was approximately \$30 thousand 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 \$169 million at June 30, 2021. 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.

For the year ended June 30, 2021, sports wagering deposits with the LGIP were approximately \$9.7 million. One of the requirements of being an approved licensee is to have a \$500 thousand reserve to cover any outstanding liability related to the patron accounts. TEL has \$500 thousand on deposit on behalf of William Hill in the LGIP. These funds are credited for any interest earned over the period.

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:// treasury.tn.gov](http://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 \$17,988,000 at June 30, 2021.

Notes to the Financial Statements (Continued)

Note 4. Capital Assets

Capital assets consisted of the following as of June 30, 2021:

	Beginning Balance	Additions	Reductions	Ending Balance
Furniture and fixtures	\$ 798,000	\$ -	\$ -	\$ 798,000
Computer equipment	1,008,000	62,000	(3,000)	1,067,000
Vehicles	289,000	-	(18,000)	271,000
High mileage vehicles/vans	1,907,000	193,000	(349,000)	1,751,000
Leasehold improvements	2,635,000	-	-	2,635,000
Communication equipment	659,000	4,000	-	663,000
Software	945,000	-	-	945,000
Gaming equipment	799,000	390,000	-	1,189,000
Total	9,040,000	649,000	(370,000)	9,319,000
Less Accumulated Depreciation/Amortization:				
Furniture and fixtures	(787,000)	(5,000)	-	(792,000)
Computer equipment	(805,000)	(91,000)	2,000	(894,000)
Vehicles	(229,000)	(28,000)	18,000	(239,000)
High mileage vehicles/vans	(1,341,000)	(388,000)	349,000	(1,380,000)
Leasehold improvements	(1,564,000)	(229,000)	-	(1,793,000)
Communication equipment	(631,000)	(7,000)	-	(638,000)
Software	(883,000)	(47,000)	-	(930,000)
Gaming equipment	(698,000)	(87,000)	-	(785,000)
Total	(6,938,000)	(882,000)	369,000	(7,451,000)
Capital assets, net	\$2,102,000	\$ (233,000)	\$ (1,000)	\$1,868,000

Note 5. Leasing Arrangements

TEL's leasing arrangements consist of non-cancelable operating leases for office space and outdoor advertising billboards. These leases expire at various dates through 2026. Certain of these leases contain provisions for scheduled rental increases and are renewable at the option of TEL. During the year ended June 30, 2021, the TEL exercised the option to extend the rental lease term for the Memphis District Office for an additional five years.

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

Notes to the Financial Statements (Continued)

Year Ending June 30:

2022	\$2,584,000
2023	2,290,000
2024	1,807,000
2025	1,438,000
2026	63,000
Total minimum rental payments	\$8,182,000

TEL also subleases office space under operating leases expiring through 2025 to its major gaming vendors. Minimum rental payments at June 30, 2021, have not been reduced by minimum sublease rentals of \$450,000 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-cancelable operating leases with original terms of one year or more as of June 30:

Year Ending June 30:

2022	\$120,000
2023	114,000
2024	117,000
2025	99,000
Total minimum sublease payments	\$450,000

The following schedule shows the composition of total rental expense, net of unearned rent expense and income, for all operating leases for the year ended June 30, 2021:

Minimum rentals:	
Property	\$1,363,000
Billboards	1,333,000
Less: Sublease rentals	(113,000)
Total minimum rentals	\$2,583,000

Rental expense under all operating leases totaled approximately \$2,583,000 for the year ended June 30, 2021.

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.

Notes to the Financial Statements (Continued)

At June 30, 2021, total unearned rent consisted of \$2,148,000 in the straight-lining of rental expense over the life of the related lease terms less rent abatements of \$373,000 for net unearned rent of \$1,775,000. Unearned rent is a noncurrent liability on the statement of net position.

Noncurrent liabilities consisted of the following as of June 30, 2021:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Unearned rent	\$2,148,000	\$ -	\$(373,000)	\$1,775,000	\$134,000
Total noncurrent liabilities	\$2,148,000	\$ -	\$(373,000)	\$1,775,000	\$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 year ended June 30, 2021, is summarized as follows:

Operating revenues:	
Lottery ticket revenue (See Note 1)	\$ 2,083,785,000
Less instant/promotional tickets provided as prizes	(145,399,000)
Net lottery ticket revenue	1,938,386,000
Retailer service fees and other revenue	3,977,000
Total lottery proceeds	1,942,363,000
Operating expenses, as defined:	
Gaming	1,441,063,000
Operating	19,372,000
Total operating expenses, as defined	1,460,435,000
Net proceeds before distribution of unrestricted net position	481,928,000
Nonoperating revenues and expenses	
Interest revenue	388,000
Total nonoperating revenues and expenses	388,000
Net proceeds	\$ 482,316,000

Notes to the Financial Statements (Continued)

Amount due to Lottery for Education Account for year	\$ 482,316,000
Amount paid during year	(356,774,000)
Amount due to Lottery for Education Account, end of year	\$ 125,542,000

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, 100% of any unclaimed prize money is 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 2021, unclaimed prizes were \$17,569,000, which was current and payable to the After-School Programs special account at June 30, 2021.

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.

Note 9. Sports Wagering

In accordance with the Tennessee Sports Gaming Act, monies collected from license and application fees for sports wagering must be used by the corporation to pay for operating and administrative expenses. The remaining net proceeds must be distributed to the state treasurer for deposit into the Tennessee Promise scholarship endowment fund.

For fiscal year 2021, funds due to Tennessee Promise were \$1,625,000.

Notes to the Financial Statements (Continued)

Operating revenues:	
Application fees	\$ 834,000
Annual licensing fees	2,742,000
Interest income	12,000
Total operating revenues	3,588,000
Operating expenses, as defined	
Personnel	1,190,000
Professional fees	343,000
General administrative and other operating	31,000
Total operating expenses, as defined	1,564,000
Net program proceeds	2,024,000
Net program proceeds, beginning of year	(399,000)
Net program proceeds, end of year	\$ 1,625,000

The Tennessee Sports Gaming Act also states that 80% of the privilege tax collected must be distributed by the corporation to the state treasurer for deposit into the lottery for education account, 15% must be distributed to the general fund, and 5% must be distributed to the Department of Mental Health and Substance Abuse Services.

For fiscal year 2021, the total privilege tax collected was \$24,502,000, of which \$8,867,000 was payable in the subsequent period.

Lottery for education proceeds 80%	\$ 19,602,000
General fund proceeds 15%	3,675,000
Mental health & substance abuse proceeds 5%	1,225,000
Total funding	\$24,502,000

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. For the fiscal year ended June 30, 2021, employees contributed approximately \$611,000 to the 457 Plan.

The aggregate fair value of the plan's assets was approximately \$10,261,000, net of administrative fees, as of June 30, 2021.

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 deferral 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 \$922,000 to the 401(a) Plan on behalf of its employees for the year ended June 30, 2021.

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 June 30, 2021, forfeited amounts of approximately \$58,000 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 \$14,339,000 net of forfeitures and administrative fees, as of June 30, 2021.

As of June 30, 2021, the TEL's outstanding employer liability was \$38,000.

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 to \$75,000 of losses based on a tiered deductible system that accounts for averaged losses over a three year period and the type of loss.

Notes to the Financial Statements (Continued)

For earthquake, named storm, wind/hail, and flood, there is a deductible of \$10 million per occurrence. The maximum insurance coverage was \$500 million for perils other than earthquake and flood. The maximum flood insurance coverage is \$50 million per occurrence, except there is only \$25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is \$50 million per occurrence, except there is only \$25 million of coverage in the New Madrid Zone.

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, 2021, additional insurance coverage was provided at the following maximum amounts:

<u>Coverage</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, 2021, management is not aware of any related liabilities.



JASON E. MUMPOWER
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, 2021, and the related notes to the financial statements, which collectively comprise the corporation’s basic financial statements, and have issued our report thereon dated October 25, 2021. 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 corporation’s internal control. Accordingly, we do not express an opinion on the effectiveness of the 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 25, 2021