

VIRGIN ISLANDS LOTTERY
FINANCIAL STATEMENTS

SEPTEMBER 30, 2017
(Together With Independent Auditor's Report Thereon)

**VIRGIN ISLANDS LOTTERY
FINANCIAL STATEMENTS
FOR THE FISCAL YEAR SEPTEMBER 30, 2017**

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INDEPENDENT AUDITOR'S REPORT

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Board of Commissioners
Virgin Islands Lottery
St. Thomas, U.S. Virgin Islands

Report on the Financial Statements

We have audited the accompanying statement of net position of the Virgin Islands Lottery (the "Lottery") as of September 30, 2017 and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements. The Virgin Islands Lottery is an enterprise fund of the Government of the U.S. Virgin Islands.

Management's Responsibility

The Lottery's 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 the 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 audit 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 of 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 Lottery'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 of the effectiveness of the Lottery'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.

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Unmodified Opinion

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net position of the Lottery as of September 30, 2017 and the changes in net position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, the financial statements present only the Lottery's financial position and the changes in financial position and cash flows and do not purport to, and do not, present fairly the financial position of the Government of the U.S. Virgin Islands as of September 30, 2017 and changes in the financial position of the Government of the U.S. Virgin Islands for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Other Matters

We have previously audited the Lottery's September 30, 2016 financial statements, and our report dated, April 28, 2017, expressed an unmodified opinion thereon. In our opinion, the comparative information presented herein as of and for the year ended September 30, 2016, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6 and the Schedules of Proportionate Share of the Net Pension Liability and Schedule of Contributions on pages 18 and 19 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the *Government Accounting Standards Board* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 31, 2018, on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control over financial reporting and compliance.

Belt Smith & Co

U.S. Virgin Islands
May 31, 2018

VIRGIN ISLANDS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
(UNAUDITED)
FOR THE YEAR ENDED SEPTEMBER 30, 2017

INTRODUCTION

The Virgin Islands Lottery (the Lottery) was created by statute in 1937, and in 1971 was established as an independent agency of the Virgin Islands Government. The Lottery is an enterprise fund of the U.S. Virgin Islands Government. Under provisions of the Virgin Islands Code, Title 32, Chapter 13, the Executive Director is appointed by the Governor of the U.S. Virgin Islands, by and with the consent of the Legislature.

This section of the Lottery's annual financial report presents management's discussion and analysis of the financial position and changes in net position for the fiscal year ended September 30, 2017. This information is being presented to provide additional information regarding the activities of the Lottery and to meet the disclosure requirements of Government Accounting Standards Board Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Government*. This analysis should be read in conjunction with the financial statements and notes to the financial statements.

BASIC FINANCIAL STATEMENTS

The financial statements of the Lottery report information about the Lottery using accounting methods similar to those used by private sector companies. These statements offer information about the Lottery's activities.

- **The Statement of Net Position:** This statement presents information on all of the Lottery's assets, deferred outflows of resources, deferred inflows of resources, and liabilities. The difference between total assets plus deferred outflows of resources and total liabilities is classified as net position. Over time, increases or decreases in net position serve as a relative indicator of the change in financial position.
- **Statement of Revenues, Expenses, and Changes in Net Position:** All of the current year's revenue and expenses are accounted for in the Statement of Revenue, Expenses and Changes in Net Position. This statement measures the activities of the Lottery's operations over the past year and reflects both operating and nonoperating activities.
- **Statement of Cash Flows:** The primary purpose of this statement is to provide information about the Lottery's net cash used in operating activities, capital and related financing activities and provide information regarding the sources and uses of cash and the changes in the cash balance during the reporting period.
- **Notes to the Financial Statements:** The notes to the financial statements provide additional information that is essential to the full understanding of the data provided in the financial statements.

VIRGIN ISLANDS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
(UNAUDITED)
FOR THE YEAR ENDED SEPTEMBER 30, 2017

2017 FINANCIAL HIGHLIGHTS

- The Lottery's cash balance increased by 439% or \$1,002,100.
- Investment in certificate of deposits totaled \$1,650,663.
- The Lottery's long-term net pension liability is \$32,027,197 increased by 8% or \$2,455,010.
- Total operating revenues, including activities from the traditional games and fees from contractors, decreased by 5% or \$1,034,177.
- Total direct operating expenses decreased by 20% or \$1,331,059 and indirect operating expenses decreased by 7% or \$729,846.
- Fund transfers totaled \$4,470,386, a decrease of 14% or \$728,670.

The following table presents condensed information of the Statements of Net Position as of September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>	<u>\$ Variance</u>	<u>% Variance</u>
Assets				
Current Assets	\$ 3,196,193	\$ 2,621,682	\$ 574,511	21.91%
Capital Assets	403,017	260,041	142,976	54.98%
Total Assets	<u>3,599,210</u>	<u>2,881,723</u>	<u>717,487</u>	<u>24.90%</u>
Deferred Outflows of Resources	<u>8,552,627</u>	<u>7,347,687</u>	<u>1,204,940</u>	<u>16.40%</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 12,151,837</u>	<u>\$ 10,229,410</u>	<u>\$ 1,922,427</u>	<u>18.79%</u>
Liabilities				
Current Liabilities	\$ 3,067,975	\$ 3,325,851	\$ (257,876)	-7.75%
Noncurrent Liabilities	32,055,329	29,662,220	2,393,109	8.07%
Total Liabilities	<u>35,123,304</u>	<u>32,988,071</u>	<u>2,135,233</u>	<u>6.47%</u>
Deferred Inflows of Resources	<u>1,411,104</u>	<u>576,987</u>	<u>834,117</u>	<u>144.56%</u>
Total Liabilities and Deferred Inflows of Resources	<u>\$ 36,534,408</u>	<u>\$ 33,565,058</u>	<u>\$ 2,969,350</u>	<u>8.85%</u>
Net Position				
Net Investment in Capital Assets	\$ 403,017	\$ 260,041	\$ 142,976	54.98%
Unrestricted (Deficiency)	(24,785,588)	(23,595,689)	(1,189,899)	5.04%
Total Net Position	<u>\$(24,382,571)</u>	<u>\$(23,335,648)</u>	<u>\$ (1,046,923)</u>	<u>4.49%</u>

- Assets increased by \$717,487 or 25% due principally to the timing of receipts and vendor payments.
- Capital Assets increased by \$142,976 net effect of depreciation resulting primarily from upgrades to the Lottery's Information Technology (IT) Systems.
- The Lottery's liabilities are comprised of 1% for compensated absences, 6% to the Education Initiative Fund, Pharmaceutical programs, Retirement System of the Virgin Islands and the VI Horse Racing Committee, 91% represents pension liability, and the remaining 2% represents accounts payable and other liabilities. Total liabilities increased by \$2,135,233 or 6% in Fiscal Year 2017 primarily due to an increase in the Lottery's allocated proportion share of the central government's pension liability.

VIRGIN ISLANDS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
(UNAUDITED)
FOR THE YEAR ENDED SEPTEMBER 30, 2017

The following table presents condensed information of the Statements of Revenues, Expenses, and Changes in Net Position for the years ended September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>	<u>\$</u> <u>Variance</u>	<u>%</u> <u>Variance</u>
Operating Revenues	\$ 17,990,834	\$ 19,025,011	\$ (1,034,177)	-5.44%
Operating Expenses	(14,598,443)	(16,660,055)	2,061,612	-12.37%
Operating Income	<u>3,392,391</u>	<u>2,364,956</u>	<u>1,027,435</u>	<u>43.44%</u>
Nonoperating Revenues	<u>21,585</u>	<u>12,671</u>	<u>8,914</u>	<u>70.35%</u>
Change in Net Position Before				
Transfers and Extraordinary Items	3,413,976	2,377,627	1,036,349	43.59%
Transfers	(4,470,386)	(5,199,056)	728,670	-14.02%
Extraordinary Items	<u>9,487</u>	<u>-</u>	<u>9,487</u>	<u>100.00%</u>
Change in Net Position	(1,046,923)	(2,821,429)	1,774,506	-62.89%
Net Position, Beginning of the Year				
(Deficiency)	<u>(23,335,648)</u>	<u>(20,514,219)</u>	<u>(2,821,429)</u>	<u>13.75%</u>
Net Position End of the Year				
(Deficiency)	<u>\$(24,382,571)</u>	<u>\$(23,335,648)</u>	<u>\$ (1,046,923)</u>	<u>4.49%</u>

- Operating Revenue decreased by \$1,034,177 or 5%. The decrease is the result of the decline in sales in the online games and traditional ticket sales due to Hurricanes Irma and Maria that occurred in September 2017.
- Operating Expenses decreased by \$2,061,612 or 12%. The decrease is attributed to the closure of the Lottery during and after the two hurricanes.
- Funds Transfers decreased by \$728,670 or 14% mainly due to the decrease in revenues received from the Online Games (Compensation from Contractors).

VIRGIN ISLANDS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*
(UNAUDITED)
FOR THE YEAR ENDED SEPTEMBER 30, 2017

FUTURE EVENTS

The Lottery has adopted an operating budget for fiscal year ended September 30, 2018. The proposed budget reflects adequate revenues and operating expenses. The budget reflects revenues from the traditional games, third party lottery games, and instant games. The budget also reflects expenses for composed of prize obligations, administration, and contributions to the Educational Initiative Fund, the Pharmaceutical Assistance Program, the Government Employees' Retirement System of the Virgin Islands, and the VI Horse Racing Commission. The Lottery will continue to seek legislative action to reduce the burden imposed by the mandated funding of government programs from gross revenues of contracted games. Existing legislation mandates that certain positions of the gross earnings from contracted revenue be transferred to other funds.

CONTACTING FINANCIAL MANAGEMENT

This management discussion and analysis is designed to provide a general overview of the Lottery's finances for all parties with an interest in the Lottery's finances. Questions concerning any of the information provided in this report or request for additional information should be addressed to:

Virgin Islands Lottery
5800 Kronprindsens Gade
St. Thomas, VI 00802

Telephone (340) 774-2502

BASIC FINANCIAL STATEMENTS

VIRGIN ISLANDS LOTTERY
STATEMENT OF NET POSITION
AS OF SEPTEMBER 30, 2017
(With Comparative Totals for 2016)

	2017	2016
Assets and Deferred Outflows of Resources		
Current Assets		
Cash	\$ 1,230,550	\$ 228,450
Accounts Receivables, net	217,006	610,313
Insurance Receivable	27,715	-
Investments	1,650,663	1,648,210
Prepaid and Other Assets	70,259	134,709
Total Current Assets	3,196,193	2,621,682
Noncurrent Assets		
Capital Assets, net	403,017	260,041
Total Noncurrent Assets	403,017	260,041
Total Assets	3,599,210	2,881,723
Deferred Outflows of Resources	8,552,627	7,347,687
Total Assets and Deferred Outflows of Resources	\$ 12,151,837	\$ 10,229,410
Liabilities and Deferred Inflows of Resources		
Current Liabilities		
Prizes Payable	\$ 32,336	\$ 269,626
Accounts Payable	211,269	170,348
Accrued Liabilities	204,874	213,423
Deferred Revenue	202,194	172,645
Compensated Absences	284,443	191,319
Due to Other Virgin Islands Agencies	2,132,859	2,308,490
Total Current Liabilities	3,067,975	3,325,851
Noncurrent Liabilities		
Compensated Absences	28,132	90,033
Net Pension Liability	32,027,197	29,572,187
Total Noncurrent Liabilities	32,055,329	29,662,220
Total Liabilities	35,123,304	32,988,071
Deferred Inflows of Resources	1,411,104	576,987
Total Liabilities and Deferred Inflows of Resources	\$ 36,534,408	\$ 33,565,058
Net Position		
Net Position		
Net Investment in Capital Assets	\$ 403,017	\$ 260,041
Unrestricted (Deficiency)	(24,785,588)	(23,595,689)
Total Net Position (Deficiency)	\$(24,382,571)	\$(23,335,648)

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

VIRGIN ISLANDS LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED SEPTEMBER 30, 2017
(With Comparative Totals for 2016)

	<u>2017</u>	<u>2016</u>
Operating Revenues		
Ticket Sales	\$ 7,454,134	\$ 8,062,449
Compensation from Contractors	10,522,400	10,947,580
License and Permit Fees	14,300	14,982
Total Operating Revenues	<u>17,990,834</u>	<u>19,025,011</u>
Operating Expenses		
<i>Direct Expenses:</i>		
Prizes Expenses	5,173,067	6,536,776
Retailer Bonuses and Incentives	69,300	36,650
Total Direct Costs	<u>5,242,367</u>	<u>6,573,426</u>
<i>Indirect Expenses:</i>		
Salaries and Benefits	6,356,333	6,945,495
Occupancy	253,092	249,802
Utility	463,414	399,174
Professional Services	424,954	354,371
Advertising and Promotions	309,179	347,575
Donations and Sponsorships	342,250	327,457
General and Administrative	1,119,409	1,333,478
Depreciation	87,445	129,277
Total Indirect Costs	<u>9,356,076</u>	<u>10,086,629</u>
Total Operating Expenses	<u>14,598,443</u>	<u>16,660,055</u>
Operating Income	<u>3,392,391</u>	<u>2,364,956</u>
Nonoperating Revenues		
Interest Income	5,492	8,882
Other Income	16,093	3,789
Total Nonoperating Revenues	<u>21,585</u>	<u>12,671</u>
Changes in Net Position Before Transfers and Extraordinary Items	3,413,976	2,377,627
Transfers		
Transfers - Special Educational Initiative Fund	(1,569,966)	(1,629,528)
Transfers - Pharmaceutical Assistance Program	(1,569,966)	(1,629,498)
Transfers - Government Employees' Retirement System	(1,046,644)	(1,086,332)
Transfers - Horse Racing Commission	(283,810)	(290,523)
Transfers - Virgin Islands Government General Fund	-	(563,175)
Total Transfers	<u>(4,470,386)</u>	<u>(5,199,056)</u>
Extraordinary Items		
Impairment Loss	(18,228)	-
Hurricane Insurance	27,715	-
Total Extraordinary Items	<u>9,487</u>	<u>-</u>
Changes in Net Position	(1,046,923)	(2,821,429)
Net Position (Deficiency), Beginning of Year	<u>(23,335,648)</u>	<u>(20,514,219)</u>
Net Position (Deficiency), End of Year	<u>\$ (24,382,571)</u>	<u>\$ (23,335,648)</u>

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

VIRGIN ISLANDS LOTTERY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30, 2017
(With Comparative Totals for 2016)

	2017	2016
Cash Flows from Operating Activities		
Cash Received from Sales of Tickets	\$ 7,497,984	\$ 8,141,931
Cash Received from Contractors	10,915,707	10,926,820
Cash Paid for Prize Winners	(5,410,357)	(6,522,804)
Cash Paid for Goods and Services	(3,389,500)	(3,841,257)
Cash Paid to Employees for Services	(3,736,198)	(3,911,906)
Net Cash Provided by Operating Activities	5,877,636	4,792,784
Cash Flows from Noncapital Financing Activities		
Cash Payments to Virgin Islands Agencies	(4,646,019)	(5,098,838)
Other Proceeds	21,585	12,669
Net Cash Used in Noncapital Financing Activities	(4,624,434)	(5,086,169)
Cash Flows from Capital and Related Financing Activities		
Purchase of Capital Assets	(248,649)	(32,798)
Net Cash Used in Capital and Related Financing Activities	(248,649)	(32,798)
Cash Flows from Investing Activities		
Purchase of Investments	(2,453)	(6,337)
Net Cash Used in Investing Activities	(2,453)	(6,337)
Net Increase (Decrease) in Cash	1,002,100	(332,520)
Cash, Beginning of Year	228,450	560,970
Cash, End of Year	\$ 1,230,550	\$ 228,450
<i>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</i>		
Operating Income	\$ 3,392,391	\$ 2,364,956
Adjustments to Reconcile of Excess of Revenue Over Expenses to Net Cash Provided by Operating Activities:		
Depreciation	87,445	129,277
<i>(Increase) Decrease in Assets:</i>		
Accounts Receivable	393,307	(20,760)
Prepaid and Other Assets	64,450	(58,500)
Deferred Outflows of Resources	(1,204,940)	(5,046,627)
<i>(Decrease) Increase in Liabilities:</i>		
Prize Payable	(237,290)	13,972
Accounts Payable	40,923	(77,199)
Accrued Liabilities	(8,549)	(103,680)
Deferred Revenue	29,549	64,499
Compensated Absences	31,223	(59,438)
Net Pension Liability	2,455,010	384,642
Deferred Inflows of Resources	834,117	7,201,642
Net Cash Provided by Operating Activities	\$ 5,877,636	\$ 4,792,784

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

VIRGIN ISLANDS LOTTERY
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2017

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- **Organization:** The Virgin Islands Lottery (the “Lottery”), was created by statute in 1937 and established as an independent agency of the Government of the Virgin Islands (Government) in 1971. The Lottery operates a traditional biweekly lottery and earns a percentage of net revenue as compensation from Caribbean Lottery Services and Southland Gaming. The Lottery also derives revenue from the licensing of agents and dealers.

The Lottery’s main sources of income are from traditional games, on-line games, instant games, and pull tabs. The traditional games comprise of 22 regular games and two extraordinary games. On-line games have two major components: 1) Pairs, Daily Pick 3, Daily Pick 4, Lucky 6, Keno, Power Ball and Mega Millions which are all managed by Caribbean Lottery Services, Inc. through a contractual agreement with Virgin Islands Lottery; and 2) On-Line Gaming, a game that is managed by Southland Gaming of the Virgin Islands through a contractual agreement with the Virgin Islands Lottery.

The Lottery’s primary obligations are in the form of prize payouts for its traditional, instant and pull-tab games. The prize payout is recorded at the time of the drawing based on the known prize payout structure.

- **Reporting Entity:** The Lottery is an enterprise fund of the United States Virgin Islands and as such, its financial statements are included in the U.S. Virgin Islands Comprehensive Annual Financial Report.
- **Natural Disasters:** On September 6 and 19, 2017, the United States Virgin Islands were struck by two Category 5 hurricanes. The extent and severity of the storms was unprecedented and resulted in catastrophic damage to the Territory.

The Lottery suffered losses to its furniture, equipment, and vehicles. The Lottery had purchased commercial insurance to cover its risk of loss from destruction of assets and under these policies realized \$27,715 in insurance recoveries that was paid fiscal year 2018.

- **Basis of Presentation:** In accordance with accounting principles generally accepted in the United States of America, the financial statements are prepared on the accrual basis of accounting, which requires recognition of revenues when earned and expenses when incurred.

The Lottery distinguishes operating revenues and expenses from nonoperating. Operating revenues and expenses result from providing services or producing and delivering goods in connection with the Lottery’s principal ongoing operations. Operating expenses include the cost of sales and services, selling and administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

- **Revenue Recognition:** Revenue for the traditional lottery is recognized when tickets are sold to the public. The sales of tickets for future drawings are deferred until the drawings are held. Revenue and accounts receivable from the Lottery’s contractors are recognized when sales reports are received.

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- **Accounts Receivable:** Accounts receivable is recorded at net realizable value. An allowance for doubtful accounts has been recorded for accounts determined to be uncollectible or more than one year old. At September 30, 2017, an allowance for doubtful accounts was \$549,379.
- **Investment:** Investments are stated at amortized cost which approximates fair value.
- **Capital Assets:** Capital assets are carried at cost less accumulated depreciation. The Lottery defines capital assets as those with an initial, individual cost of more than \$500. Depreciation is computed using the straight-line method over estimated lives. Leasehold improvements are amortized over the lease term. 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 operations in the period of disposal.

The estimated useful lives by asset classification are as follows:

Furniture	10 years
Equipment	5 years
Vehicles	5 years

- The Lottery reviews the carrying value of its capital assets to determine if circumstance exist indicating impairment. If facts of circumstances support the possibility of impairment, management follows the guidance in GASB Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries. If impairment is indicated, an adjustment is made to the carrying value of the capital assets.
- **Prize Expense:** Prize expense represents claimed and unclaimed prizes. Unclaimed prizes must be claimed within 180 days following the drawing date for each game. Prizes unclaimed beyond this period are forfeited by the ticket holder. Total prizes lapsed amounted to \$289,028 for the fiscal year 2017. These forfeited prizes are netted against prize expense in the Statement of Revenues, Expenses, and Changes in Net Position.
- **Compensated Absences:** The compensated absences balance represents amounts due and payable to covered employees such as transfer to other government departments, resignations, retirements, and use of leave balances.
- **Net Position:** The Lottery's Net Position are classified as follows:
 - ... **Net Investment in Capital Assets** – this represents the Lottery's total investment in capital assets net of accumulated depreciation.
 - ... **Unrestricted Net Position** – assets are unrestricted when their use is not subject to external limits such as legal agreements or statutes.
- **Use of Estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

NOTE 2 DEPOSITS AND INVESTMENTS

Custodial Credit Risk

The custodial credit risk for deposits is the risk that in the event of a bank failure, the Lottery's deposits may not be recovered. The Lottery does not have a policy to address custodial credit risk. Cash consists of cash held by various depository institutions in the Lottery's name. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$250,000. At September 30, 2017, the Lottery had a cash balance of \$4,610,729 that was uninsured and uncollateralized.

NOTE 3 FAIR VALUE MEASUREMENT

The Lottery categorizes its fair value measurement within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other than observables inputs; Level 3 inputs are significant observable inputs. At September 30, 2017, the Lottery's investments consisted of certificate of deposits which had a recurring fair value of \$1,650,663 at year-end. The certificate of deposits are classified as Level 2 in the fair value hierarchy and are valued at amortized cost plus accrued interest.

NOTE 4 CAPITAL ASSETS

Capital assets activities for the fiscal year ended September 30, 2017 are as follows:

	Beginning Balance 10/01/2016	Additions	Deductions	Ending Balance 09/30/2017
Depreciable Assets				
Furniture and Equipment	\$ 2,715,933	\$ 248,649	\$ (269,247)	\$2,695,335
Vehicles	464,794	-	-	464,794
Leasehold Improvement	692,445	-	(279,871)	412,574
Total Depreciable Assets	<u>3,873,172</u>	<u>248,649</u>	<u>(549,118)</u>	<u>3,572,703</u>
Less: Accumulated Depreciation				
Furniture and Equipment	2,507,862	74,346	(251,018)	2,331,190
Vehicles	412,824	13,099	-	425,923
Leasehold Improvement	692,445	-	(279,872)	412,573
Total Accumulated Depreciation	<u>3,613,131</u>	<u>87,445</u>	<u>(530,890)</u>	<u>3,169,686</u>
Net Capital Assets	<u>\$ 260,041</u>	<u>\$ 161,204</u>	<u>\$ (18,228)</u>	<u>\$ 403,017</u>

During 2017, the Lottery was impacted by Hurricanes Irma and Maria and certain assets sustained physical damage, were destroyed, and other assets require considerable effort to restore their service utility.

The Lottery evaluated its capital assets in accordance with GASB Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries, and realized a loss from impairment \$18,228. The amount of the impairment loss for damaged capital assets is based on calculations using the restoration cost approach. Under this approach, the amount of impairment is derived from the estimated costs to restore the utility of the capital asset. The estimated restoration cost can be converted to historical cost either by restating the estimated restoration cost using an appropriate cost index or by applying a ratio of the capital asset. As a result, assets fully depreciated prior to the hurricanes would have an impairment loss of \$-0-, regardless of the damage. The impairment loss is reported as an extraordinary item in the accompanying statement of revenues, expenses, and changes in the net position.

NOTE 5 DUE TO THE GOVERNMENT OF THE VIRGIN ISLANDS

The Virgin Islands Code requires the Lottery make the following transfers: (a) a minimum of 20% of the Lottery's net income to the General Fund of the Virgin Islands Treasury; (b) 15% of the lottery games revenue derived from the private contractors to the Virgin Islands Educational Initiative Fund and the Pharmaceutical Assistance to the Aged Program; (c) 10% of the revenue to the Government Employees' Retirement System; and (d) 3% of the revenue to the VI Horse Racing Commission. Mandatory fund transfers due at September 30, 2017 are as follows:

Educational Initiative Fund	\$ 915,835
Pharmaceutical Assistance Program	832,074
Government Employees' Retirement System	245,483
Virgin Islands Horse Racing Commission	139,467
Total	<u>\$ 2,132,859</u>

NOTE 6 COMPENSATED ABSENCES

<u>Balance at 10/01/16</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at 9/30/17</u>	<u>Amount Due Within One Year</u>
\$ 281,352	\$ 185,566	\$ (154,343)	\$ 312,575	\$ 284,443

NOTE 7 RISK MANAGEMENT

The Lottery faces various risks of loss related to torts; theft of, damages to, and destruction of assets; and natural disasters for which the Lottery has commercial insurance coverage. Annual premium payments are made in proportion to the anticipated exposure to the liability losses assessed.

NOTE 8 CONTRACTUAL ARRANGEMENTS

Except for the traditional lottery and pull tab games, all other lottery games are supported by the services of two contractors: Caribbean Lottery Services, Inc. (CLS) and Southland Gaming of the Virgin Islands, Inc. (Southland Gaming).

Video lottery games are serviced by Southland Gaming. Southland Gaming is responsible for the design, installation and operation of a video lottery control system that includes maintaining video lottery terminals and other related equipment. Southland Gaming allocates a percentage of the weekly net game revenues to the Lottery.

Caribbean Lottery Services, Inc. provides services and equipment to operate lottery games that include Super Lotto, Caribbean Keno, Daily Numbers (Pick 3 and Pick 4), Instant Scratch Ticket, Lucky Pick, Powerball and Mega Millions. CLS allocates a percentage of the monthly net game revenues to the Lottery.

NOTE 9 NET PENSION LIABILITY

Net Pension Liability

Effective July 1, 2014, the Lottery implemented the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*. Following is a description of the pension plan and accounting for pension expense, liabilities, and deferred outflows/inflows of resources.

Plan Description and Benefits

Full time employees of the Lottery are members of the Government Employees' Retirement System of the Virgin Islands (GERS), a cost sharing multiple-employer, defined benefit pension plan (the plan) established as of October 1, 1959 in accordance with Title 3, Chapter 27 of the Virgin Islands Code to provide retirement, death, and disability benefits. Benefits may be extended to beneficiaries of plan members. The plan covers all employees of the Government, including the Lottery, except employees compensated on a contract fee basis, casual, per diem or provisional and part time employees who work less than 20 hours per week. Persons over the age of 55 may opt out of the plan by providing formal notification to the plan. Vesting of benefits occurs after 10 years of service. Benefits may be extended to beneficiaries of plan members.

There are two tiers within the plan:

Tier I: Employees hired prior to September 30, 2005

Tier II: Employees hired on or after October 1, 2005

Regular employees who have completed 30 years of credited service or have attained age 60 with at least 10 years of credited service are eligible for a full-service retirement annuity. Members who are considered "safety employees" as defined in the Code are eligible for full retirement benefits when they have earned at least 20 years of service or have reached the age of 55 with at least 10 years of credited service. Regular and safety employees who have attained age 50 with at least 10 years of credited service may elect to retire early with a reduced benefit.

The monthly annuity benefit payment is determined by applying a stipulated benefit ratio to the member's average compensation. Average compensation for Tier I members is determined by averaging the five highest years of credited service within the last ten years of service, subject to the maximum salary limitations in effect during such service. Average compensation for Tier II members is determined by averaging the most recent five years of credited service within the last ten years of service, subject to the maximum salary limitations in effect during the service. The maximum annual salary that can be used in this computation is \$65,000, except for senators and judges, whose annual salary is used.

Funding and Contribution Policy

Contributions to GERS are established by the Board of Trustees of GERS. The Government's required employer contribution for Tier I and Tier II members was 20.5% of the member's annual salary.

Effective January 1, 2017, Tier I member contributions increased by 1% to 11% of annual salary for regular employees. Member contributions will increase an additional 1% on January 1, 2017, and January 1, 2018.

Effective January 1, 2017, Tier II member contributions increased by 1% to 11.5% of annual salary for regular employees, and will increase an additional 1% on and January 1, 2018.

Prior to June 29, 2000, member contributions were refundable without interest upon withdrawal from employment before retirement. Effective July 1, 2009, GERS' Board of Trustees approved an effective annual interest rate on refunded contributions of 2% per annum.

Both the Plan and the Lottery have a September fiscal year end. GASB Statement No. 68 requires that the reported results must pertain to liability and asset information within certain defined time frames. For this report, the following time frames are used:

NOTE 9 – NET PENSION LIABILITY**(CONTINUED)**

Valuation Date:	October 1, 2016
Measurement Date:	September 30, 2016
Measurement Period:	October 1, 2015 – September 30, 2016

The Lottery's proportionate share of employer contributions recognized by GERS was \$504,235 for the Plan's fiscal year ended September 30, 2016.

Pension Liabilities and Expense and Deferred Outflows/Inflows of Resources

As of September 30, 2017, the actuarial calculated net pension liability for the Lottery's proportionate share of the net pension liability of the Plan was \$32,027,197. The net pension liability of the Plan is measured as of September 30, 2016, and the total pension liability for the Plan used to calculate the net pension liability was determined by an actuarial valuation as of October 1, 2016. Actuarially determined proportionate share information from GERS was estimated by management based on an average four-year respective share of the Lottery's contributions to the Plan relative to all contributions to the Plan. At September 30, 2016, the Lottery's proportion was .6922 percent, which was a decrease of .0341 from its proportion measured as of September 30, 2015.

For the year ended September 30, 2017, the Lottery recognized \$2,588,912 of pension expense, inclusive of amortization of deferred outflows of pension related items. Following is a schedule of deferred outflows/inflows of resources allocated to the Entity in the computation of net pension liability:

	Deferred Outflows by Resources	Deferred Inflows of Resources
Change in assumptions	\$ 6,606,788	\$ -
Difference between expected and actual experience	1,007,648	-
Net difference between projected and actual earnings		
on pension plan investments	385,356	37,058
Change in proportionate share	27,102	1,374,046
Contributions made subsequent to measurement date	525,733	-
	\$ 8,552,627	\$ 1,411,104

Amounts reported as deferred outflows/inflows, exclusive of contributions made after the measurement date, will be recognized in pension expense as follows:

Year ending September 30,	
2017	\$ 1,975,896
2018	1,975,896
2019	1,554,606
2020	1,450,958
2021	500,462

Actuarial Assumptions

A summary of the actuarial assumptions and methods used to calculate the total pension liability as of September 30, 2015, is provided below, including any assumptions that differ from those used in the October 1, 2015 actuarial valuation. Refer to October 1, 2015 actuarial valuation report for a complete description of all other assumptions, which can be found on GERS' website.

Inflation Rate:	2.50%
Salary Increases:	3.25% including inflation
Actuarial Cost Method:	Entry Age Normal
Expected Rate of Return:	7.0%
Municipal Bond Yield:	3.06%
Discount Rate:	3.20%
Mortality Table:	RP-2014 Blue Collar

Investment Rate of Return

The long-term expected rate of return of 7.0% on plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the plan's target asset allocation as of September 30, 2016, are summarized as follows:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic equity	29%	6.59%
International equity	12%	8.29%
Fixed income	27%	1.59%
Cash	2%	.99%
Alternative	30%	5.50%

Discount Rate

The discount rate used to measure the total pension liability was 3.20% as of September 30, 2016 and 3.84% as of September 30, 2015. The projection of cash flows used to determine the discount rate assumed plan member contributions will be made at the current contribution rate, including the future increases in the employee contribution rates legislated. Based on those assumptions, the plan's fiduciary net position was not projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on plan investments of 7.0% was applied to all periods of projected benefit payments that are covered by projected assets. For periods where projected future benefit payments are not covered by projected assets, the yield on a 20-year AA Municipal Bond index was applied, which was 3.06% and 3.71% at September 30, 2016 and 2015, respectively.

Sensitivity of Proportionate Share of Net Pension Liability to Changes in the Discount Rate

The following presents the Lottery's allocation of its proportionate share of the net pension liability (NPL) for the plan, calculated using the discount rate, and what the allocation of the Lottery's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1% higher than the current rate.

1% Decrease Share of NPL @ 2.20%	Share of NPL @3.20%	1% Increase Share of NPL @4.20%
\$37,450,675	\$32,027,197	\$27,574,521

Detailed information about pension plan's fiduciary net position is available in the separately issued GERS financial report.

NOTE 10 CONTINGENCIES

The Lottery is subject to various claims and legal proceedings that arise in the ordinary course of its business activities. The outcome of these cases or claims are pending arbitration or hearings and management is not able to make an estimate of the amount of loss, if any, that could result from an unfavorable resolution of these matters.

NOTE 11 SUBSEQUENT EVENTS

The Lottery has evaluated all subsequent events through May 31, 2018, which is the date the financial statements were available to be issued. This review and evaluation revealed no material events that would have an effect on the accompanying financial statements.

VIRGIN ISLANDS LOTTERY
(A Component Unit of the Government of the U.S. Virgin Islands)

Schedule of Lottery's Share of the Net Pension Liability

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Lottery's Proportion Share of the Net Pension Liability	.6922%	.7263%	.7249%
Lottery's Proportionate Share of the Net Pension Liability	\$32,027,197	\$29,572,187	\$22,370,545
Covered-Employee Payroll	\$ 2,512,849	\$ 2,582,749	\$ 2,684,327
Proportionate Share of the Net Pension Liability as a Percentage of Covered-Employee Payroll	1275%	1145%	849%
Plan Fiduciary Net Position as Percentage of the Total Pension Liability	16.54%	19.58%	27.03%

* *The schedule is intended to show a 10-year trend. Additional years will be reported as they become available.*

VIRGIN ISLANDS LOTTERY
(A Component Unit of the Government of the U.S. Virgin Islands)

Schedule of the Lottery's Contributions

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually Required Contributions	\$ 1,710,829	\$ 1,453,252	\$ 1,375,246
Contributions in Relation to the Contractually Required Contribution	<u>550,121</u>	<u>531,987</u>	<u>495,097</u>
Annual Contribution Deficiency (Excess)	<u>\$ 1,160,708</u>	<u>\$ 921,265</u>	<u>\$ 880,149</u>
Covered Employee Payroll	\$ 2,512,849	\$ 2,582,749	\$ 2,634,237
Contributions as a Percentage of Covered Employee Payroll	21.89%	20.60%	18.44%

The schedule is intended to show a 10-year trend. Additional years will be reported as they become available.



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

Board of Commissioners
Virgin Islands Lottery
St. Thomas, U.S. Virgin Islands

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Virgin Islands Lottery (the "Lottery") as of and for the year ended September 30, 2017, and the related notes to the financial statements and have issued our report thereon dated May 31, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Lottery'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 Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Lottery'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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Lottery'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 over financial reporting 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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses that we consider to be significant deficiencies as 2017-01 through 2017-02.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Lottery's Response to Findings

The Lottery's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Lottery's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 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.

Bert Smith & Co

U.S. Virgin Islands
May 31, 2018

VIRGIN ISLANDS LOTTERY
SCHEDULE OF FINDINGS AND RESPONSES
FOR THE YEAR ENDED SEPTEMBER 30, 2017

2017-01 ***Audit or Review of Contractor's Records***

The Lottery's on-line video games are operated by two contractors whom remit funds to the Lottery on a weekly and monthly basis of the cash collected less fees from the on-line games. Stipulated in the contracts with vendors, the Lottery is entitled to audit or review the records of the contractors. It is also supposed to receive the audited financial statements of one contractor. For one of the contractors, the Lottery does have access to one of the contractor's machine operating system. As a result, it is able to review the machine's financial information on a real time basis. The Lottery, however, did not perform any audits or reviews of the other contractor's accounting records during the fiscal year and did not receive any audited financial statements from the one contractor that was required to do so.

The Lottery does not have any policies procedures in place for auditing or reviewing the contractor's accounting records. It also does not require the contractors to submit SOC 1 report (Service Organization Controls Report), which is an independent assessment of the effectiveness of the contractor's internal controls over its on-line video game operations. Since a significant portion of the Lottery's revenue is derived from the on-line video games, it is essential that the agency audits or reviews the contractors' records on a periodic basis.

Recommendation: We recommend the Lottery establish policies and procedures for auditing or reviewing the contractors accounting records on a periodic basis; obtain the required contractor audited financial statements; and if performed, the contractors SOC 1 reports.

Management's Responses: The Virgin Islands Lottery agrees with the finding. We will establish a policy and procedure for auditing and reviewing the contractors accounting records on a periodic basis and to obtain a SOC 1 Report on an annual basis.

Presently, The Virgin Islands Lottery has access to the Bally system. We can confirm the number of locations, how many machines at every location, compare reports received, how much money each location receive per hour and when the locations receive and pay out monies.

VIRGIN ISLANDS LOTTERY
SCHEDULE OF FINDINGS AND RESPONSES (Continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2017

2017-02 ***Development of Written Closing Process***

The Lottery does not have a formal written closing process for analyzing and reconciling accounts and closing its accounting during the fiscal year and at year-end for the audit. As a result, there were a number of audit adjustments proposed to correct certain accounts. The development of a formal closing process will ensure that financial reports from the Lottery's accounting system are accurate and complete.

Recommendations: We recommend the Lottery develop a formal written closing process which outlines the specific procedures to be performed for analyzing and reconciling each financial account throughout the fiscal year and at year-end.

Management's Responses: The Virgin Islands Lottery agrees with the finding. We will develop a formal written closing process which outlines the specific procedures to be performed for analyzing and reconciling each financial account throughout the fiscal year and at year end.