



FINANCIAL AUDIT REPORT

Kansas Lottery: Fiscal Year 2012

**A Report to the Legislative Post Audit Committee
By Cochran Head Vick & Co., P.A., Under Contract with
the Legislative Division of Post Audit
State of Kansas
December 2012**

Legislative Post Audit Committee

Legislative Division of Post Audit

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$14 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. Government Accountability Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the ten members, the two majority caucuses each have three members, while the two minority caucuses each have two members.

Audits are performed at the direction of the Legislative Post Audit Committee. Legislators or committees should make their requests

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LEGISLATIVE DIVISION OF POST AUDIT

800 SW Jackson
Suite 1200
Topeka, Kansas 66612-2212
Telephone (785) 296-3792
FAX (785) 296-4482
Website: <http://www.kslpa.org>
Scott Frank, Legislative Post Auditor

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LEGISLATURE OF KANSAS
LEGISLATIVE DIVISION OF POST AUDIT



800 SOUTHWEST JACKSON STREET, SUITE 1200
TOPEKA, KANSAS 66612-2212
TELEPHONE (785) 296-3792
FAX (785) 296-4482
WWW.KSLPA.ORG

December 6, 2012

To: Members, Legislative Post Audit Committee

Senator Mary Pilcher-Cook, Chair	Representative Peggy Mast, Vice-Chair
Senator Terry Bruce	Representative Tom Burroughs
Senator Anthony Hensley	Representative John Grange
Senator Laura Kelly	Representative Ann Mah
Senator Dwayne Umbarger	Representative Virgil Peck Jr.

This report contains the findings, conclusions, and recommendations from the completed financial audit of the Kansas Lottery for Fiscal Year 2012. Cochran Head Vick & Co., P.A., a certified public accounting firm under contract with the Legislative Division of Post Audit, conducted this audit. We would be happy to discuss the findings, recommendations, or any other items presented in this report with any legislative committees, individual legislators, or other State officials.

Sincerely,

A handwritten signature in black ink, appearing to read 'S. Frank', written in a cursive style.

Scott Frank
Legislative Post Auditor

This audit was conducted by Cochran Head Vick & Co., P.A., under contract with the Legislative Division of Post Audit. Julie Pennington was the audit manager. If you need any additional information about the audit's findings, please contact Julie at the Division's offices.

Legislative Division of Post Audit
800 SW Jackson Street, Suite 1200
Topeka, Kansas 66612

(785) 296-3792
Website: www.kslpa.org

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

Financial and Compliance Audit
Years Ended June 30, 2012 and 2011

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

Financial and Compliance Audit
Years Ended June 30, 2012 and 2011

TABLE OF CONTENTS

	<u>Page</u>
Introduction	i
Schedule of Findings and Recommendations	ii
Independent Auditor's Report	iii-iv
Management's Discussion and Analysis	1-9
Financial Statements:	
Balance Sheets	10
Statements of Revenues, Expenses, and Changes in Net Assets	11
Statements of Cash Flows	12
Notes to Financial Statements	13-31
Required Supplementary Information:	
Schedule of Funding Progress – Health Insurance Post Employment Benefits	32
Other Supplementary Information:	
Combining Balance Sheet	33
Combining Statement of Revenues, Expenses, and Changes in Net Assets	34
Combining Statement of Cash Flows	35
Balance Sheets - Lottery	36
Schedules of Revenues, Expenses, and Changes in Net Assets – Lottery	37
Schedules of Cash Flows - Lottery	38
Balance Sheets - Expanded Lottery	39
Schedules of Revenues, Expenses, and Changes in Net Assets – Expanded Lottery	40
Schedules of Cash Flows – Expanded Lottery	41

Other Supplementary Information (continued):

Combining Balance Sheets - Expanded Lottery	42
Combining Schedules of Revenues, Expenses, and Changes in Net Assets – Expanded Lottery	43
Combining Schedules of Cash Flows – Expanded Lottery	44
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	45-46
Schedule of Findings and Responses	47
Schedule of Prior Year Findings and Responses	48

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

INTRODUCTION

Year Ended June 30, 2012

The accompanying report represents the results of the financial and compliance audit of the operations of the Kansas Lottery (the Lottery) for the fiscal year ended June 30, 2012.

The Lottery was created as an independent component unit of the State of Kansas to operate lottery games and manage expanded lottery operations. The Lottery is administered by the Executive Director and the five members of the Lottery Commission appointed by the Governor. The Lottery is an enterprise fund wherein the activities are financed and operated through user charges similar to a private business enterprise.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Year Ended June 30, 2012

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of the Kansas Lottery.
2. A material weakness related to the audit of the financial statements is reported in the Report on Internal Controls Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Governmental Auditing Standards*.
3. No instances of noncompliance material to the financial statements of the Kansas Lottery were disclosed during the audit.

B. FINDINGS – FINANCIAL STATEMENT AUDIT

See Schedule of Findings and Responses

C. PRIOR YEAR FINDINGS

See Schedule of Prior Year Findings and Responses



COCHRAN HEAD VICK & CO., P.A.

& Co

Certified Public Accountants

1333 Meadowlark Lane
Kansas City, KS 66102
(913) 287-4433
(913) 287-0010 FAX

INDEPENDENT AUDITOR'S REPORT

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the accompanying financial statements of the Kansas Lottery (the Lottery), a component unit of the State of Kansas, as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Kansas Lottery and do not purport to, and do not, present fairly the financial position of the State of Kansas as of June 30, 2012 or 2011, and the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Offices

1251 NW Briarcliff Pkwy
Suite 125
Kansas City, MO 64116
(816) 453-7014
(816) 453-7016 FAX

400 Jules Street
Suite 415
St. Joseph, MO 64501
(816) 364-1118
(816) 364-6144 FAX

6700 Antioch Rd, Suite 460
Merriam, Kansas 66204
(913) 378-1100
(913) 378-1177 FAX

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Kansas Lottery, as of June 30, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 12, 2012, 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, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and the schedule of funding progress as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Lottery's financial statements as a whole. The combining financial statements and schedules are presented for purposes of additional analysis and are not a required part of the financial statements. The combining financial statements and schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

October 12, 2012

Cochran Hand Video & Photo P.A.

**KANSAS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011**

The following management's discussion and analysis (MD&A) provides a general overview of the Kansas Lottery's (the Lottery) financial performance and financial activities for the fiscal years ended June 30, 2012 and 2011. We encourage readers to consider this information in conjunction with the Lottery's financial statements and notes, which follow the MD&A. The financial statements reflect only the activities of the Kansas Lottery, which is a component unit of the State of Kansas.

Fiscal Year Financial Highlights

- Online and instant Lottery sales for fiscal year 2012 were \$246.1 million reflecting an increase of \$13.7 million or 5.9% compared to fiscal year 2011.
- The State opened two new casinos during the 2012 fiscal year. Kansas Star Casino, in the south central region, and Hollywood Casino at Kansas Speedway, in the northeast region, opened in December 2011 and February 2012, respectively. Boot Hill Casino and Resort continued operations for the second full fiscal year, having opened in December 2009. The Lottery is responsible for distributing the net revenues of the casinos in accordance with the Expanded Lottery Act. For 2012, Expanded Lottery net revenues totaled \$197.4 million. Transfers totaling \$43.4 million from Expanded Lottery activities were made to the State General Fund. An increase of \$34.6 over the prior fiscal year.
- Transfers to the State Gaming Revenue Fund (SGRF) totaled \$71 million in fiscal year 2012, a decrease of \$0.5 million over the prior fiscal year. Cash basis transfers totaled \$72 million in fiscal year 2012, an increase of \$2 million over the prior fiscal year.

Using this Financial Report

This report consists of a series of financial statements and reflects the self-supporting activities of the Kansas Lottery. The Balance Sheets provide information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2012 and 2011. The Statements of Revenues, Expenses, and Changes in Net Assets report the activities of selling online and instant lottery tickets as well as the Expanded Lottery casino gaming activities for the years ended June 30, 2012 and 2011. Lastly, the Statements of Cash Flows reflect the cash inflows and outflows attributed to the sales of lottery tickets as well as the cash inflows and outflows of the Expanded Lottery casino activities for the years ended June 30, 2012 and 2011.

Summary of Balance Sheets

The following table presents the Lottery's assets, liabilities, and net assets (shown in millions of dollars):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current and other assets	\$ 25.7	\$ 18.2	\$ 18.0
Capital assets	54.3	6.2	8.3
Total assets	<u>\$ 80.0</u>	<u>\$ 24.4</u>	<u>\$ 26.3</u>
Current liabilities	<u>\$ 19.7</u>	<u>\$ 15.8</u>	<u>\$ 12.4</u>
Net assets			
Invested in capital assets	54.3	6.2	8.3
Unrestricted	6.0	2.4	5.6
Total net assets	<u>60.3</u>	<u>8.6</u>	<u>13.9</u>
Total liabilities and net assets	<u>\$ 80.0</u>	<u>\$ 24.4</u>	<u>\$ 26.3</u>

Current and other assets consist primarily of cash balances for operations, expanded lottery and prizes, accounts receivable from Lottery retailers for lottery ticket sales activity, and instant ticket inventory. During fiscal year 2012, current and other assets increased \$7.5 million due to an increase in cash on hand of \$3.5 million, an increase in accounts receivable of \$3.8 million and an increase in ticket inventory of \$0.2 million.

For fiscal year 2011, current and other assets increased \$0.2 million due to an increase in accounts receivable of \$0.6 million and a decrease in instant ticket inventory of \$0.3 million over the prior year.

Capital assets increased \$48.1 million from 2011 as a result of recording contributed capital assets related to Expanded Lottery activities of \$56.0 million less \$7.9 million in current year depreciation. Additional detailed information on capital assets may be found in notes 1 and 3 of the notes to the financial statements.

Current liabilities consist of accounts payable and accrued liabilities, transfers due to the State of Kansas, and prize liabilities. The increase in current liabilities from 2011 is attributable to an increase in amounts due to the State of Kansas of \$0.3 million, and decrease in prize liability of \$1.1 million, and an increase of \$4.7 million in accounts payable and accrued liabilities from 2011.

For fiscal year 2011, the increase in current liabilities is attributable to an increase in amounts due to the State of Kansas of \$1.5 million, and increases in prize liability of \$2.2 million, and a decrease of \$0.4 million in accounts payable and accrued liabilities.

Summary of Revenue, Expenses, and Changes in Net Assets

The following table presents the Lottery's changes in net assets (shown in millions of dollars):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating revenues:			
Net Lottery game revenues	\$ 246.1	\$ 232.4	\$ 235.4
Expanded lottery net revenues	197.4	40.1	20.7
Reimbursements and other	4.1	2.3	2.4
Total operating revenues	<u>447.6</u>	<u>274.8</u>	<u>258.5</u>
Operating expenses:			
Lottery	172.6	165.2	166.0
Expanded lottery	160.9	33.8	17.9
Total operating expenses	<u>333.5</u>	<u>199.0</u>	<u>183.9</u>
Operating income	<u>114.1</u>	<u>75.8</u>	<u>74.6</u>
Non-operating expenses:			
Lottery	(71.0)	(71.5)	(67.9)
Expanded lottery	(47.4)	(9.6)	(5.0)
Total non-operating revenues (expenses)	<u>(118.4)</u>	<u>(81.1)</u>	<u>(72.9)</u>
Income (loss) before contributions	(4.3)	(5.3)	1.7
Capital contributions	<u>56.0</u>	<u>-</u>	<u>9.1</u>
Change in net assets	51.7	(5.3)	10.8
Net assets, beginning of year	<u>8.6</u>	<u>13.9</u>	<u>3.1</u>
Net assets, end of year	<u>\$ 60.3</u>	<u>\$ 8.6</u>	<u>\$ 13.9</u>

The change in net assets between fiscal year 2012 and fiscal year 2011 represents an increase of \$51.7 million. The increase is the result of the increase in capital asset contribution related to Expanded Lottery activities.

The change in net assets between fiscal year 2011 and fiscal year 2010 was a decrease of \$5.3 million. The decrease is the result of the decrease in sales revenue in excess of corresponding increases in operating expenses, as well as an increase in contribution to the State Gaming Revenue Fund.

Lottery Game Revenues

Presented in millions of dollars, the following table compares online and instant Lottery sales by game type between fiscal years 2012 and 2011:

Type of Game	2012	2011	Increase (Decrease)	Percentage Change
Instant	\$ 124.0	\$ 118.6	\$ 5.4	4.6%
Pull-Tabs	9.0	8.1	0.9	11.1%
Powerball	37.6	32.6	5.0	15.3%
Mega Millions	15.7	11.4	4.3	37.7%
2 by 2	1.9	1.8	0.1	5.6%
Super Kansas Cash	15.6	14.9	0.7	4.7%
Keno	23.1	24.0	(0.9)	-3.7%
Pick 3	6.0	5.8	0.2	3.4%
Holiday Raffle	3.0	3.0	-	0.0%
Hot Lotto	7.0	8.8	(1.8)	-20.5%
Kansas Hold'Em	3.2	3.4	(0.2)	-5.9%
Total	<u>\$ 246.1</u>	<u>\$ 232.4</u>	<u>\$ 13.7</u>	<u>5.9%</u>

Fiscal year 2012 sales were \$246.1 million compared to \$232.4 million in fiscal year 2011. Revenues from the sales on online and instant lottery tickets for the fiscal year ended June 30, 2012 increased 5.9% or \$13.7 million compared to the previous year. Powerball and Mega Millions saw sales increases of \$5.0 and \$4.3 million, respectively, due to large jackpot payouts. Instant tickets also saw a sales increase of \$5.4 million.

Presented in millions of dollars, the following table compares online and instant Lottery sales by game types between fiscal years 2011 and 2010:

Type of Game	2011	2010	Increase (Decrease)	Percentage Change
Instant	\$ 118.6	\$ 114.5	\$ 4.1	3.6%
Pull-Tabs	8.1	9.6	(1.5)	-15.6%
Powerball	32.6	41.0	(8.4)	-20.5%
Mega Millions	11.4	3.9	7.5	192.3%
2 by 2	1.8	1.7	0.1	5.9%
Super Kansas Cash	14.9	14.8	0.1	0.7%
Keno	24.0	26.6	(2.6)	-9.8%
Pick 3	5.8	6.1	(0.3)	-4.9%
Holiday Raffle	3.0	3.0	-	0.0%
Hot Lotto	8.8	10.7	(1.9)	-17.8%
Kansas Hold'Em	3.4	3.5	(0.1)	-2.9%
Total	<u>\$ 232.4</u>	<u>\$ 235.4</u>	<u>\$ (3.0)</u>	<u>-1.3%</u>

Revenues from the sale of online and instant lottery tickets for the fiscal year ended June 30, 2011 decreased by 1.3% or \$3.0 million compared to the previous year. Fiscal year 2011 sales were \$232.4 million compared to \$235.4 million in fiscal year 2010. A decrease of \$8.4 million in Powerball sales was offset by an increase of \$7.5 million for Mega Millions, which was its first full year of sales in Kansas.

Lottery Expenses

Game Related

The following table compares the Lottery's game-related expenses between fiscal year 2012 and fiscal year 2011. The expenses are shown in millions of dollars:

Description	2012	2011	Increase (Decrease)	Percentage Change
Game Prizes	\$ 138.9	\$ 132.3	\$ 6.6	5.0%
Retailer commissions	14.4	13.8	0.6	4.3%
Online Games Service Bureau	5.7	5.3	0.4	7.5%
Instant Ticket Printing Cost	3.8	3.8	-	0.0%
Total	\$ 162.8	\$ 155.2	\$ 7.6	4.9%

The overall increase in game prizes was the result of the increase in sales compared to those in fiscal year 2011. The online games service bureau cost increased as a result of more online sales.

Non-game Related

Of the \$9.8 million of fiscal year 2012 lottery operating expenses that were non-game related, \$4.6 million was for employees' salaries and wages, \$2.5 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.7 million. In fiscal year 2011, these same expenses totaled \$10.0 including \$4.6 million for employees' salaries and wages, \$2.9 million for games and promotional advertising, and \$2.5 million for other administrative expenses.

The following table compares the lottery game-related expenses between fiscal year 2011 and fiscal year 2010. The expenses are shown in millions of dollars:

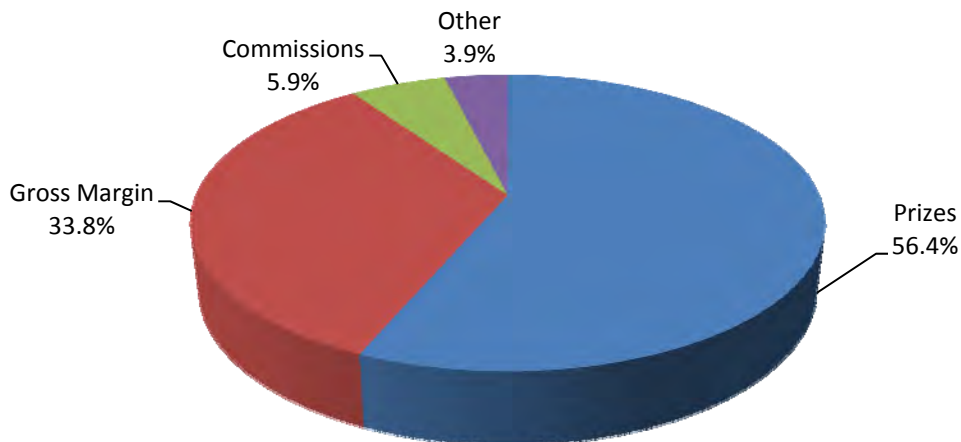
Description	2011	2010	Increase (Decrease)	Percentage Change
Game Prizes	\$ 132.3	\$ 132.6	\$ (0.3)	-0.2%
Retailer commissions	13.8	13.7	0.1	0.7%
Online Games Service bureau	5.3	5.6	(0.3)	-5.4%
Instant Ticket Printing Costs	3.8	3.8	-	0.0%
	<u>\$ 155.2</u>	<u>\$ 155.7</u>	<u>\$ (0.5)</u>	<u>-0.3%</u>

The overall decrease in game prizes was the result of the decrease in sales compared to those in fiscal year 2010. The online games service bureau cost decreased as a result of less online sales.

Of the \$10.0 million of fiscal year 2011 lottery operating expenses that were non-game related, \$4.6 million was for employees' salaries and wages, \$2.9 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.5 million. In fiscal year 2010, these same expenses totaled \$10.3 including \$4.4 million for employees' salaries and wages, \$2.9 million for games and promotional advertising, and \$3.0 million for other administrative expenses.

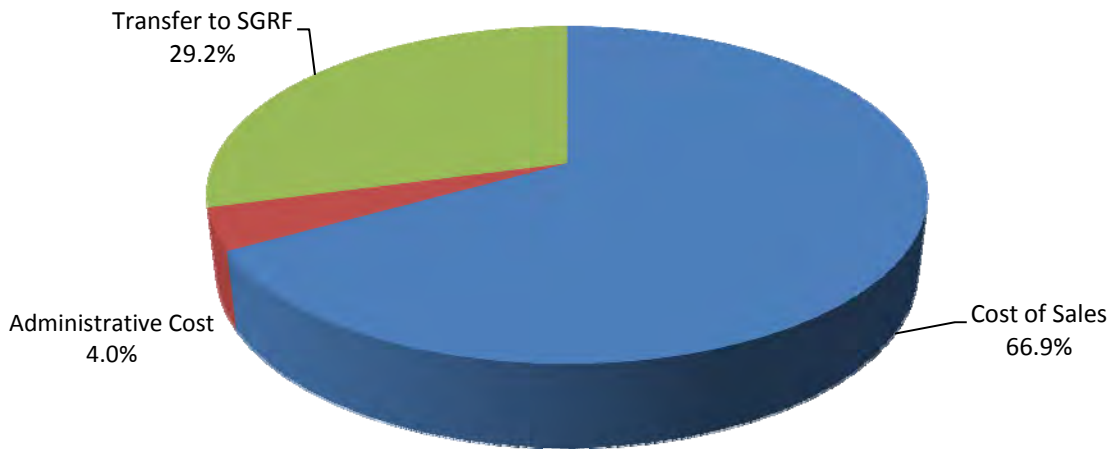
Kansas Lottery
 Graphs of Financial Highlights
 For the Fiscal Year Ended June 30, 2012

Game Related Expense as a Percent of Lottery Sales



To depict compliance with the not less than 45% prize payment statute and the retailers' commissions rules.

Expenses by Type



The Cost of Sales category includes prizes, commissions, service bureau, auto-ship, and instant ticket printing.

Transfer to the State Gaming Revenues Fund and State General Fund

Pursuant to the Lottery Act, the Director of Accounts and Reports of the State of Kansas shall transfer monies in the Lottery Operating Fund to the State Gaming Revenue Fund (SGRF), at least monthly, in the amount equal to the monies in such fund in excess of those needed for payment of Lottery expenses, payment of compensation to retailers and transfers to the Prize Payment Fund as certified by the Execution Director of the Lottery. Although all Lottery transfers are made to the SGRF, there is a \$50.0 million cap. Therefore, any transfers in excess of \$50.0 million are subsequently transferred to the State General Fund. Of the \$50.0 million in SGRF, the first \$80,000 is transferred to the Problem Gambling Grant Fund. Then, of the balance remaining, 85% is transferred to the Economic Development Initiative Fund, 10% to the Correctional Institutions Building Fund, and 5% to the Juvenile Detention Facilities Fund.

For fiscal year 2012, the legislature again waived the percentage of sales transfer requirement for a minimum transfer request of \$72 million, with a minimum monthly transfer of \$4.5 million. For 2012, the accrual basis transfers to the SGRF were \$71 million, a decrease of \$0.5 million over 2011. Actual cash transfers to the SGRF were \$72 million in 2012. The fiscal year 2011, accrual basis transfer of \$71.5 million was \$3.7 million more than the fiscal year 2010.

Expanded Lottery

The 2007 Legislature passed Senate Bill 66, the Expanded Lottery Act. The Act provides for the Kansas Lottery to own and operate electronic gaming machines at County voter approved Kansas horse and dog racetracks. Currently there are no active horse or dog racetracks in the State. The Expanded Lottery Act also allows for the Lottery, upon County voter approval, to operate lottery gaming facilities in four specific gaming zones. The Expanded Lottery Act establishes the distribution requirement of net gaming revenues.

Expanded Lottery Revenues and Expenses

As of June 30, 2012, the State had three casinos operational. Hollywood Casino at Kansas Speedway and Kansas Star Casino were operational for part of fiscal year 2012, having opened February 2012 and December 2011, respectively. The Boot Hill Casino and Resort was open for the full fiscal year. The following table compares net revenue and related expenses between fiscal years 2012 and 2011. Amounts are shown in millions of dollars:

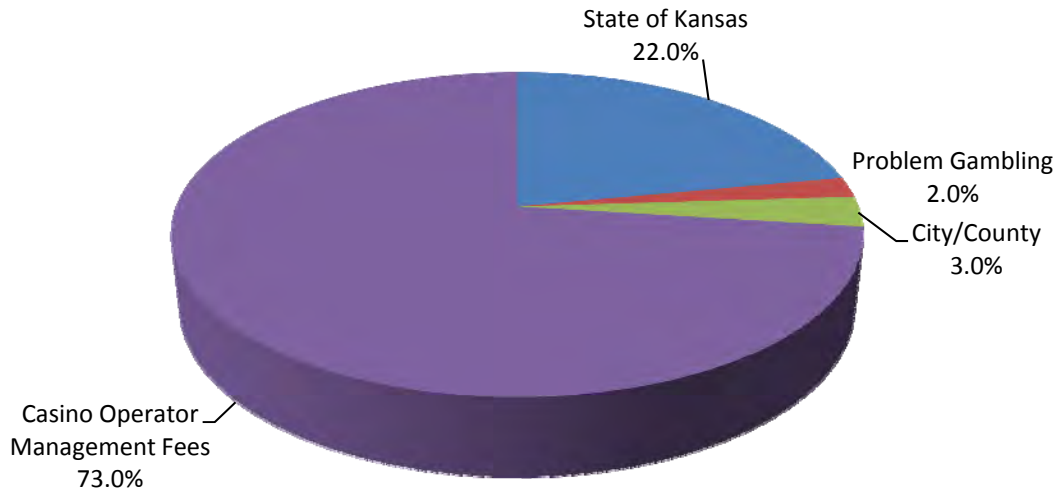
	<u>2012</u>	<u>2011</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 197.3</u>	<u>\$ 40.1</u>	<u>\$ 157.2</u>	<u>392.0%</u>
Expenses:				
State of Kansas	\$ 43.4	\$ 8.8	\$ 34.6	393.2%
Problem Gambling	3.9	0.8	3.1	387.5%
City and County	5.9	1.2	4.7	391.7%
Management Fees	<u>144.1</u>	<u>29.3</u>	<u>114.8</u>	<u>391.8%</u>
Total	<u>\$ 197.3</u>	<u>\$ 40.1</u>	<u>\$ 157.2</u>	<u>392.0%</u>

The Boot Hill Casino and Resort represents the State's first casino which opened Mid-December 2009. The following table compares net revenue and related expenses between fiscal years 2011 and 2010. Amounts are shown in millions of dollars:

	<u>2011 *</u>	<u>2010 *</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 40.1</u>	<u>\$ 20.7</u>	<u>\$ 19.4</u>	<u>93.7%</u>
Expenses:				
State of Kansas	\$ 8.8	\$ 4.6	\$ 4.2	91.3%
Problem Gambling	0.8	0.4	0.4	100.0%
City and County	1.2	0.6	0.6	100.0%
Management Fees	<u>29.3</u>	<u>15.1</u>	<u>14.2</u>	<u>94.0%</u>
Total	<u>\$ 40.1</u>	<u>\$ 20.7</u>	<u>\$ 19.4</u>	<u>93.7%</u>

* - The net revenue for 2010 reflects operations for 7 months of operations. The net revenue for 2011 is for the fiscal year ended June 30, 2011.

Expanded Lottery Distributions



To depict the distribution of net revenue as set forth in the 2007 Legislature enacting the Expanded Lottery Act.

Contacting the Lottery's Financial Management

This management's discussion and analysis report is designed to provide Kansas citizens, Kansas government officials, players, retailer and other interested parties with a general overview of the Lottery's financial activity for the fiscal years ended June 30, 2012 and 2011 and to demonstrate the Lottery's accountability for the monies it received from its lottery ticket sales, and expanded lottery activities. Questions or comments about this report may be addressed to Amber Korbe, Director of Finance or Wayne Regnier, Fiscal Manager at 128 N Kansas Avenue, Topeka, KS 66603.

**KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
BALANCE SHEETS
JUNE 30, 2012 and 2011**

<u>ASSETS</u>	2012	2011
Current assets:		
Cash:		
Operating fund	\$ 8,479,559	\$ 6,151,008
Prize payment fund	1,357,321	167,052
Accounts receivable, net of allowance for doubtful accounts of \$226,209 and \$349,123 at 2012 and 2011, respectively	2,158,648	3,869,022
Accounts receivable - unbilled	8,304,976	5,935,433
Other receivable	3,476,790	364,100
Instant ticket game inventory	1,921,646	1,730,739
Total current assets	25,698,940	18,217,354
Capital assets, net of depreciation:		
Property and equipment - Lottery	389,045	385,479
Property and equipment - Expanded Lottery	53,864,785	5,786,413
Total capital assets	54,253,830	6,171,892
Total assets	\$ 79,952,770	\$ 24,389,246
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 6,811,567	\$ 2,092,741
Due to the State of Kansas	6,314,151	6,090,202
Due to Problem Gambling Fund	119,468	8,200
Prize liability	6,483,465	7,587,466
Total current liabilities	19,728,651	15,778,609
Net assets:		
Invested in capital assets	389,045	385,479
Invested in capital assets - restricted	53,864,785	5,786,413
Unrestricted	5,970,289	2,438,745
Total net assets	60,224,119	8,610,637
Total liabilities and net assets	\$ 79,952,770	\$ 24,389,246

See accompanying notes to financial statements.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Net game revenues	\$ 246,144,512	\$ 232,372,510
Expanded lottery revenues	197,365,116	40,055,280
Expanded lottery reimbursements	3,067,065	1,282,191
Phone reimbursements	962,910	947,390
Retailer fees and miscellaneous income	<u>57,741</u>	<u>139,773</u>
Total operating revenues	<u>447,597,344</u>	<u>274,797,144</u>
Operating expenses:		
Game prizes	138,903,876	132,332,017
Casino operator management fee	144,076,535	29,240,354
Retailer commissions	14,385,728	13,783,253
On-line games service bureau	5,663,986	5,299,915
Salaries and benefits	5,505,720	5,098,242
Cost of instant tickets	3,840,210	3,761,082
Advertising	2,474,333	2,867,437
Other administrative expenses	2,472,827	1,999,348
Depreciation	8,027,329	2,254,972
City and County expanded lottery fees	5,920,953	1,201,658
Professional services	446,367	480,216
On-line service bureau - expanded lottery	1,730,024	403,683
Telecommunications	<u>132,148</u>	<u>265,205</u>
Total operating expenses	<u>333,580,036</u>	<u>198,987,382</u>
Operating income	<u>114,017,308</u>	<u>75,809,762</u>
Nonoperating expenses:		
Transfers to the State Gaming Revenue Fund	(71,000,000)	(71,500,000)
Transfers to the State General Fund	(43,420,326)	(8,822,703)
Transfers to the Problem Gambling Fund	(3,947,302)	(801,106)
Loss on disposal of capital assets	<u>(5,100)</u>	<u>-</u>
Total nonoperating expenses	<u>(118,372,728)</u>	<u>(81,123,809)</u>
Loss before contributions	(4,355,420)	(5,314,047)
Capital contributions	<u>55,968,902</u>	<u>-</u>
Change in net assets	51,613,482	(5,314,047)
Net assets, beginning of year	<u>8,610,637</u>	<u>13,924,684</u>
Net assets, end of year	<u>\$ 60,224,119</u>	<u>\$ 8,610,637</u>

See accompanying notes to financial statements.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 443,825,485	\$ 274,186,775
Cash paid for prizes, commissions, and other expenses	(316,623,069)	(189,511,114)
Cash paid to employees	(5,505,720)	(5,098,242)
Net cash provided by operating activities	121,696,696	79,577,419
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(72,000,000)	(70,000,000)
Payments to State General Fund	(42,196,377)	(8,794,557)
Payments to State Problem Gambling Fund	(3,836,034)	(798,547)
Net cash used by noncapital financing activities	(118,032,411)	(79,593,104)
Cash flows from capital and related financing activities:		
Purchases of capital assets	(145,465)	(95,280)
Net cash used by capital and related financing activities	(145,465)	(95,280)
Net increase (decrease) in cash	3,518,820	(110,965)
Cash, beginning of year	6,318,060	6,429,025
Cash, end of year	\$ 9,836,880	\$ 6,318,060
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 114,017,308	\$ 75,809,762
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	8,027,329	2,254,972
Changes in operating assets and liabilities:		
Accounts receivable	(659,169)	(480,988)
Other receivable	(3,112,690)	(129,381)
Instant ticket game inventory	(190,907)	283,639
Accounts payable and accrued liabilities	4,718,826	(389,055)
Prize liability	(1,104,001)	2,228,470
Net cash provided by operating activities	\$ 121,696,696	\$ 79,577,419
Noncash capital and related financing activities:		
Contributed capital assets	\$ 55,968,902	\$ -

See accompanying notes to financial statements.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

1 - Summary of Significant Account Policies

Reporting Entity

In November 1986, a constitutional amendment was approved by the Kansas voters authorizing a State Lottery. During the 1987 Legislative session, the State Legislature adopted the Lottery Act (the Act), and created the Kansas Lottery (the Lottery) as an independent component unit of the State of Kansas to operate lottery games. The 2007 Legislative session continued the Lottery until July 1, 2022. The Kansas Lottery Act abolishes the Lottery on July 1, 2022 unless the Legislature reaches an affirmative vote to continue the Lottery.

The Lottery was organized on March 19, 1987 and commenced administrative operations on May 21, 1987 but was strictly in the development stage through fiscal year 1987. Instant win tickets games began November 12, 1987. On February 2, 1988, the Lottery began participating in Lotto America, a multi-state on-line game now called Powerball. Additional games offered by the Lottery include Mega Millions, Kansas Cash, Keno, Pick 3, 2 by 2, Hot Lotto, Kansas Hold 'Em, Raffle, and Pull Tabs.

The 2007 Legislature passed Senate Bill 66, the Expanded Lottery Act. The Act provides for the Kansas Lottery to own and operate electronic gaming machines at Kansas horse and dog racetracks, if the facilities are established upon the County's voter approval. Currently there are no active horse and dog racetracks in the State. The Act also allows for the Lottery, upon county voter approval, to operate lottery gaming facilities in four specific gaming zones. During the year ended June 30, 2010, casino gaming operations began in the southwest gaming zone. Casino gaming operations in the northeast and the south central gaming zones began in the year ended June 30, 2012.

The Lottery operates under the direction of the Executive Director of the Lottery and a five-member Lottery Commission appointed by the Governor. The Commission advises the Executive Director and reviews and approves Lottery Games, rules, and regulations.

Basis of Presentation

The Lottery is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the intent is that the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or where the periodic determination of net income is considered appropriate. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed by the Lottery to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Lottery has elected not to follow subsequent private-sector guidance.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Basic of Accounting

The financial statements of the Lottery have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of accounting refers to when revenues, expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Measurement focus refers to what is being measured. The financial statements of the proprietary funds are prepared on the accrual basis of accounting and on an economic resources measurement focus in accordance with GAAP.

The Lottery distinguishes operating revenue and expenses from non operating items. The principal revenue of the Lottery is primarily comprised of sales from instant and on-line tickets, and expanded lottery casino gaming revenues. Operating expenses mainly consist of payments to prize winners, commissions to retailer agents, expanded lottery, and payments to vendors and employees.

Revenue Recognition

Lottery Games

Lottery games are sold to the public by contracted retailers. The Lottery utilizes an on-line instant ticket validation system. This system utilizes a bar code system to activate and validate instant win tickets which are consigned to retailers. The activated and unsettled instant win ticket packets are reflected in revenues in the current period and are carried on the balance sheet as accounts receivable-unbilled. Consigned instant win and pull tab ticket packets at the retailer that have not been activated are reflected on the financial statements in ticket inventory at original cost.

Certain instant ticket games include tickets which entitle the holder to exchange the ticket for another ticket ("free ticket"). Such tickets are deemed to be replacements and, therefore, are not included in sales. On-line game revenue is recognized in the period in which tickets are sold.

Expanded Lottery

Electronic-game slots and table games net revenue is the amounts played less amounts paid to players. The net gaming revenue is recognized based upon the gaming date.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Retailer Commissions

Retailers receive a commission of five percent of ticket sales, which is recognized as expense when sales are recorded. In addition to the five percent commission of sales, retailers receive a one percent cashing bonus for redeeming prizes that are less than \$600, an additional one percent for redeeming Keno prizes and a bonus of one percent on instant and on-line tickets they sell that win over \$600, with a minimum of \$10 and a maximum of \$100 for each prize.

Retailers also receive a bonus of \$10,000 for selling a winning Powerball or Mega Millions jackpot ticket, a \$2,500 bonus for selling a winning Hot Lotto jackpot ticket, and a \$1,000 bonus for selling a winning Kansas Cash or Holiday Raffle jackpot ticket or a winning Powerball or Mega Millions ticket equal to or greater than \$100,000.

Retailer Fees

Licensed retailers are charged a one-time fee of \$150 for the right to sell lottery tickets. Fees are recorded as income when received by the Lottery.

Expanded Lottery Reimbursements

According to the Expanded Lottery Act, each potential management company in each of the expanded gaming zones is to reimburse the Lottery for expenses incurred related to the management of the expanded lottery initiative. The Lottery recognizes these revenues as the related expenses are incurred. The reimbursements for the years ended 2012 and 2011 were \$3,067,065 and \$1,282,191 respectively.

Accounts Receivable

Accounts receivable represent amounts to be collected from retailers and casino management companies and are shown net of an allowance for doubtful accounts. The allowance for doubtful accounts is based on an analysis of accounts receivable, which considers the age of the accounts and current economic conditions. Generally accounts greater than 60 days old are included in the allowance for doubtful accounts.

Instant Ticket Game Inventory

Instant ticket game inventory consists of tickets stored in the main warehouse and consigned tickets at the retailers. Inventories are carried at cost based on the specific identification method. Tickets are charged to expense when activated by a licensed retailer. Unsold tickets are charged to expense at the end of each instant ticket game.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Capital Assets

Lottery

Capital assets, which include property and equipment, are defined by the State of Kansas as assets with an initial, individual cost of more than \$5,000. Such assets are recorded at historical cost or at fair value if donated. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. Depreciation is computed on the straight-line basis using estimated useful lives of three to five years for lottery activities.

Expanded Lottery

In accordance with Kansas Statutes and the gaming facility management agreements, the facility managers must purchase or lease on behalf of the State of Kansas, for the Kansas Lottery, all facility games and other related gaming equipment. Accordingly, certain equipment agreements considered to qualify as a purchase of such equipment have been recorded at the fair value of the equipment at the date of the agreement as a capital contribution from the respective facility manager and a capital asset of the Lottery. As discussed in Note 4, if an Expanded Lottery Gaming Facility Management Agreement is terminated, the ownership of such equipment will be transferred to the facility manager. For the years ended June 30, 2012 and June 30, 2011, the amount of expanded lottery equipment contributed to the Lottery was \$55,968,902 and \$0, respectively. Depreciation is computed using the straight-line depreciation method using the estimated useful lives of three to five years.

Certain other equipment agreements qualify as short-term operating leases that carry month-to-month rental terms beyond the initial term of the lease. Rent payments paid by the facility managers on behalf of the Lottery were approximately \$2 million and \$800,000 for the years ended June 30, 2012 and 2011, respectively.

Real Estate

Additionally, the respective facility manager owns the related land and building used for the purpose of the casino. See Note 4 for information related to the Expanded Lottery Gaming Facility Management agreements with the third-party casino facility managers.

Prize Liability

The Act states "as nearly as practical, an amount equal to not less than 45 percent of the total sales of lottery tickets or shares, computed on an annual basis, shall be allocated for payment of Lottery prizes." Actual prize structure percentages for each game meet or exceed this 45 percent requirement.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Prize expense for instant ticket games is recorded based on the predetermined prize structure for each game as tickets are activated. Actual prizes paid are treated as a reduction of liability. Since instant prize tickets are randomly distributed throughout the tickets, there will be differences between amounts accrued and the amounts actually paid if all tickets for a game have not yet been sold.

Prizes which are not claimed within 180 days after the termination of each game are removed from the prize pool, and future prizes will be increased accordingly through special prize promotions.

Prize expense for on-line games is recorded based on ticket sales. Prizes which are not claimed within one year after the drawing remain in the prize pool, and future prizes will be increased accordingly through special prize promotions.

Compensated Absences

Under the terms of the Lottery's personnel policy, employees are granted vacation and sick leave in varying amounts based upon length of service. In the event of termination or separation, an employee is generally paid for accumulated vacation up to 144 hours for service less than five years; 176 hours for service between five and ten years; 208 hours for service between ten and fifteen years; and 240 hours if service exceeds fifteen years (K.A.R.1-9-4). Accordingly, it is the Lottery's policy to record vacation pay as an expense as it is earned. The amount of earned but unused accumulated vacation is included as an accrued liability in the accompanying financial statements.

Retiring employees are paid a portion of their accumulated sick leave in excess of 100 or more days, depending upon the total number of accumulated days and years of service. The minimum payable is 30 days, and the maximum is limited to 60 days. The amount of earned but unused accumulated sick leave is paid from the State Leave Payment Reserve fund to which the Lottery makes payroll contributions.

Budget

The Lottery prepares an annual budget of expenses which is approved by the State Legislature of Kansas. Any changes in the budget must also be approved by the State Legislature. Such budgets are adopted on a cash plus encumbrance basis, which differs from accounting principles generally accepted in the United States of America. Encumbrances represent commitments relating to unperformed contracts for goods or services. All budgeted, unencumbered funds lapse at fiscal year-end.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

The operating and cost of sales (COS) expenses are currently on a no-limit basis, with the exception of official hospitality line items. The no-limit allows the budget to be prepared to reflect the operating and COS requirements of increasing sales and doing business as a lottery. The prize fund has a no-limit appropriation allowing the flexibility needed for paying winners' claims. Each year the current year budget is revised and the next year's budget is prepared. The completed budget document is submitted to the Department of Budget, and must have the approval of the Governor and Legislature.

Statement of Cash Flows

For purposes of the statement of cash flows, cash includes cash on hand, in banks, and amounts deposited with the Treasurer of the State of Kansas.

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 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.

2 - Cash

Cash, other than petty cash and imprest funds, is part of the common cash pool in the State Treasury. The Pooled Money Investment Board invests funds of the common cash pool in excess of that necessary to meet current obligations. Collateral is required for deposits made by the common cash pool that are not covered by federal depository insurance. The fair value of the collateral must equal 100 percent of the uninsured deposit and is held by the State Treasurer or an independent third party in the State Treasurer's name. At least monthly, the State Treasurer determines that the fair value of the collateral is adequate. Earning on investments are retained by the State of Kansas. At June 30, 2012 and 2011, the Lottery's share in the State's common cash pool was \$9,701,611 and \$6,198,041 respectively.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

3 - Capital Assets

Property and equipment consisted of the following at June 30, 2012:

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balances</u>
Lottery:				
Equipment, furnishing and software	\$ 1,274,958	\$ -	\$ -	\$ 1,274,958
Vehicles	686,615	145,465	99,369	732,711
Total Lottery capital assets	<u>1,961,573</u>	<u>145,465</u>	<u>99,369</u>	<u>2,007,669</u>
Accumulated depreciatiion	<u>(1,576,094)</u>	<u>(136,799)</u>	<u>94,269</u>	<u>(1,618,624)</u>
Lottery capital assets, net of depreciation	<u>385,479</u>			<u>389,045</u>
Expanded Lottery:				
Expanded Lottery equipment	9,115,652	55,968,902	-	65,084,554
Accumulated depreciation	<u>(3,329,239)</u>	<u>(7,890,530)</u>	<u>-</u>	<u>(11,219,769)</u>
Expanded Lottery capital assets, net of depreciation	<u>5,786,413</u>			<u>53,864,785</u>
Total capital assets, net of depreciation	<u>\$ 6,171,892</u>			<u>\$ 54,253,830</u>

4 - Commitments

The Lottery leases office and warehouse space in both Topeka and Great Bend under operating leases from unrelated parties. Minimum future lease payments by fiscal year are as follows:

2013	\$ 659,161
2014	675,479
2015	691,796
2016	708,717
2017	702,243
2018-2022	3,786,190
2023	815,859
	<u>\$ 8,039,445</u>

It is anticipated that as leases expire they will be replaced with new leases.

The Lottery incurred office, warehouse and miscellaneous rental expense of \$678,321 and \$665,690 under operating leases for the years ended June 30, 2012 and 2011, respectively.

The Lottery has contracted with a service bureau which provides computer services for on-line games and instant-win validation. The contract provides that the Lottery pay a fee of net on-line sales to the service bureau, and the duration of the current contract is through June 30, 2018.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Fees were \$5,663,986 and \$5,299,915 for the years ended June 30, 2012 and 2011, respectively. Future fees are based on 4.9999 percent of net on-line sales.

The Lottery entered into a contract with a service bureau which provides service for electronic gaming machines in relation to the Expanded Lottery activities. The contract provides that the Lottery pay a fee of net electronic gaming machine income to the service bureau, and the duration of the contract is through December 2019. Fees were \$1,730,024 and \$403,683 for the years ended June 30, 2012 and 2011, respectively. Future fees are based on 1.2 percent of net electronic gaming machine revenue up to \$80 million, 0.8 percent of net electronic gaming machine revenue above \$80 million up to \$160 million, and 0.3 percent of net electronic gaming machine revenue above \$160 million.

Expanded Lottery Gaming Facility Management Agreements

Southwest Gaming Zone

In 2008, the Lottery entered into a facility management agreement (the agreement) with a third party to develop, construct, and manage the lottery casino gaming facility in the southwest gaming zone, the gaming business of which is owned and operated by the Lottery. The agreement will terminate 15 years after the commencement date, as defined in the agreement, or by operation of law, unless the agreement is terminated earlier, renegotiated or renewed. The agreement also requires the facility manager to pay certain oversight and regulation expenses of the Lottery and the Kansas Racing and Gaming Commission. Amounts attributable to the Lottery are reported as Expanded Lottery Reimbursements in these financial statements. Casino gaming operations in the southwest gaming zone commenced in December 2009.

As part of the agreement, the facility manager will provide the facilities to be used for the purposes of the casino. As discussed in Note 1, casino gaming equipment was contributed to and is owned by the Lottery.

The manager will be paid a management fee calculated as 73% of Lottery Gaming Facility Revenues. The manager must perform an annual calculation to determine if some of the management fee must be refunded to the State of Kansas. This calculation uses a base revenue ranging between approximately \$40 million and \$73 million for the first 5 years with the base amount increasing by 3% each year thereafter. Annual Gaming Wins in excess of the base amount must be paid back using a scale ranging from a 2% refund for amounts between 1% and 10% above the base to a 16% refund for amounts greater than 100% above the base. In addition, 2% of Lottery Gaming Facility Revenues will be paid to the problem gambling and addictions grant fund and 3% will be paid to the City and County in which the manager operates. All remaining Lottery Gaming Facility Revenues will be transferred to the State of Kansas. For the year ended June 30, 2012 and 2011, the fee was \$32,037,146 and \$29,240,354, respectively, and is recorded in the statements of revenues, expenses, and changes in net assets.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Northeast Gaming Zone

In 2009, the Lottery entered into a facility management agreement (northeast gaming zone agreement) with a third party to develop, construct, and manage the lottery casino gaming facility in the northeast gaming zone. The agreement will terminate 15 years after the commencement date, as defined in the agreement, or by operation of law, unless the agreement is terminated earlier, renegotiated or renewed. The agreement also requires the facility manager to pay certain oversight and regulation expenses of the Lottery and the Kansas Racing and Gaming Commission. Amounts attributable to the Lottery are reported as Expanded Lottery Reimbursements in these financial statements. Full-time casino gaming operations in the northeast gaming zone commenced on February 3, 2012.

As part of the agreement, the facility manager will provide the facilities to be used for the purposes of the casino. As discussed in Note 1, casino gaming equipment was contributed to and is owned by the Lottery.

The manager will be paid a management fee calculated as a percentage of Lottery Gaming Facility Revenues as follows: 73% of revenues up to \$350 million, 70% of revenues between \$350 million and \$400 million and 67% of revenues above \$400 million. In addition, 2% of Lottery Gaming Facility Revenues will be paid to the problem gambling and addictions grant fund and 3% will be paid to the City and County in which the manager operates. All remaining Lottery Gaming Facility Revenues will be transferred to the State of Kansas. For the year ended June 30, 2012, the management fee was \$39,874,561 and is recorded in the statements of revenues, expenses, and changes in net assets.

South Central Gaming Zone

In fiscal year 2011, the Lottery entered into a facility management agreement (south central gaming zone agreement) with a third party to develop, construct, and manage the lottery casino gaming facility in the south central gaming zone. The agreement will terminate 15 years after the commencement date, as defined in the agreement, or by operation of law, unless the agreement is terminated earlier, renegotiated or renewed. The facility manager has committed to pay \$1.5 million annually to the families of Sumner County through the creation of the Kansas All-Star Scholars Fund. From this fund, all students in the region in grades K-12 will be given a \$100 educational award card to be used to purchase back to school supplies and all graduating high school seniors in Sumner County and Mulvane will be given a \$1,000 scholarship to be used towards post-secondary education. All amounts remaining in the fund at the end of each year will be contributed to the Sumner County General Fund. The agreement also requires the facility manager to pay certain oversight and regulation expenses of the Lottery and the Kansas Racing and Gaming Commission. Amounts attributable to the Lottery are reported as Expanded Lottery Reimbursements in these financial statements. Full-time casino gaming operations in the south central gaming zone commenced on December 26, 2011.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

As part of the agreement, the facility manager will provide the facilities to be used for the purposes of the casino. As discussed in Note 1, casino gaming equipment was contributed to and is owned by the Lottery.

The manager will be paid a management fee calculated as a percentage of Lottery Gaming Facility Revenues as follows: 73% of revenues up to \$180 million, 71% of revenues between \$180 million and \$220 million and 69% of revenues above \$220 million. In addition, 2% of Lottery Gaming Facility Revenues will be paid to the problem gambling and addictions grant fund and 3% will be paid to the City and County in which the manager operates. All remaining Lottery Gaming Facility Revenues will be transferred to the State of Kansas. For the year ended June 30, 2012, the management fee was \$72,164,828 and is recorded in the statements of revenues, expenses, and changes in net assets.

5 - Contingencies

Zero Coupon Bonds

Powerball prizes awarded to the grand prize winner are payable in annual installments over 20 years. Prizes awarded to grand prize winners after November 2, 1997 are payable in annual installments over 25 years. The payment is made by the Lottery within weeks of the drawing. Treasury zero coupon bonds that provide payments corresponding to the Lottery's obligation to these winners are purchased by the Multi-State Lottery (MUSL). MUSL holds these bonds in an account for the Lottery, cashes the bonds when due, and wires the money to the Lottery on or before the anniversary date of the winner. The investments and related prize liabilities for winners of these games are excluded from these financial statements.

Prior to 1998, MUSL had purchased zero coupon bonds for the Lottery to fund future installment payments aggregating \$224,979,000. The total purchase price of these bonds was \$117,288,823. During fiscal year 2001, a cash out option was offered to these prize winners as a result of Congressional changes in the United States Internal Revenue Code of 1986, as amended, specifically Section 451(h). These cash out options were taken by six prize winners in the amount of approximately \$43,500,000. Total future installments outstanding at June 30, 2012 and 2011 were \$5,132,000 and \$6,939,000, respectively.

MUSL Prize Reserves

The Lottery is a member of the MUSL, which consists of 33 states and district lotteries. MUSL operates the Powerball, Mega Millions, 2 by 2, and Hot Lotto games. Each MUSL member sells game tickets through its retailers and makes weekly wire transfers to MUSL. The weekly transfer amount consists of 50 percent of weekly sales less actual set cash prizes paid by the Lottery which is allocated to prize pools to make grand prize payments, as well as prize reserve accounts. The prize reserve accounts, serves as a contingency reserve fund to protect MUSL in case of unforeseen, but valid liabilities for grand prize claims or for set prizes. In addition to the prize reserve account, the Powerball game has set prize reserve and operating reserve accounts.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

The Powerball prize reserve and set prize reserve account monies are refundable to MUSL members if MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2012 and 2011, the prize reserve account had a balance of \$95,747,340 and \$97,413,591, respectively, of which the Lottery's portion was \$1,715,857 and \$1,719,787, respectively. The set prize reserve at June 30, 2012 and 2011 had a balance of \$30,733,770 and \$25,000,000, respectively, of which the Lottery's portion was \$391,629 and \$387,699, respectively.

The Mega Millions prize reserve monies are refundable to MUSL members if MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. The prize reserve account at June 30, 2012 and 2011 was \$18,827,770 and \$9,146,437, respectively, of which the Lottery's portion was \$310,505 and \$153,404.

The 2 by 2 prize reserve monies are refundable to MUSL members if MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2012 and 2011, the prize reserve amount had a balance of \$280,972, for both years, of which the Lottery's portion was \$122,318 for both years.

The Hot Lotto prize reserve monies are refundable to MUSL members if MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2012 and 2011, the prize reserve account had a balance of \$7,383,082 and \$7,441,187, respectively, of which the Lottery's portion was \$957,868 and \$963,883, respectively.

The Lottery has contributed to an account with MUSL which is used to pay certain operating expenses incurred by member lotteries for the Powerball game. With certain restrictions, the balances in this account are refundable to the member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 2012 and 2011 the Lottery's portion of the balance of this account was \$25,703 and \$94,023 respectively, and is reportable as a receivable.

Win for Life Guarantee

The Lottery purchases annual contracts from insurance companies in the name of the Win for Life game jackpot prize winners. In the event an insurance company defaults on the payments, the Kansas Life and Health Insurance Guarantee Association (KLHIGA) will make the payments. The KLHIGA was statutorily created, as set forth in K.S.A. 40-3008, subsection (o), to provide coverage in the event an insurance company defaults. The Lottery remains contingently liable for the payment of the lifetime prizes in the event the insurance companies and the KLHIGA fail to meet their obligation.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Annuity contracts have been purchased for lifetime prize payments. At June 30, 2012 and 2011, the approximate remaining prize payments are \$445,500 and \$463,500, respectively. Prize payments are due in varying amounts through September 2048 or the life of the individuals.

Litigation

There may, at times, be claims or lawsuits to which the Lottery is a party. The Lottery management and legal counsel anticipate that the potential claims against the Lottery would not materially affect the financial position of the Lottery.

6 - Risk Management

The Lottery's risk management activities for workers' compensation and unemployment are recorded in the State Workers' Compensation Self-Insurance Fund and the Employment Security Fund, funds of the State of Kansas. The Lottery contributes to these funds based upon annual assessed rates.

Employees are offered various health insurance coverage programs of the State. The Lottery's contribution toward single member coverage ranges from 85 percent to 97 percent, based on salary level and tobacco usage of the employee.

State agencies are not allowed to purchase or carry insurance on any property owned by the State or its agencies, except as expressly and specifically authorized by statute. Currently, none of the exceptions apply to property of the Lottery. The State has not encountered any significant difficulties in resolving losses in the past through utilization of resources available at the time the loss occurred. The Lottery retains liability for property and equipment damage.

Tort claims involving Lottery employees are subject to the Kansas Tort Claims Act (K.S.A. 75-6101, etseq.).

Employees' faithful performance is covered by commercial insurance. There has been no significant reduction in insurance coverage. Settlements have not exceeded insurance coverage in the past three years.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

7 - Required Transfers

Lottery

Pursuant to the Act, the Director of Accounts and Reports of the State of Kansas shall transfer monies in the Lottery Operating Fund to the State Gaming Revenue Fund (the Fund), at least monthly, in the amount equal to the monies in such fund in excess of those needed for payment of Lottery expenses, payment of compensation to retailers and transfers to the Prize Payment Fund as certified by the Executive Director of the Lottery. For the years ended June 30, 2012 and 2011, the State Legislature set a minimum transfer to the Fund of \$72,000,000 and \$70,000,000, respectively. Under the accrual basis of accounting, total transfers to the State of Kansas for years ended June 30, 2012 and 2011 were \$71,000,000 and \$71,510,541, respectively, of which \$5,000,000 and \$6,000,000 was unpaid, respectively. Actual cash transfers to the State of Kansas for years ended June 30, 2012 and 2011 were \$72,000,000 and \$70,510,541, respectively. Included in the minimum transfer amount were mandated transfers of \$1,352,562 and \$775,687 for the years ended June 30, 2012 and 2011, respectively, from proceeds of special veterans' games. In addition, mandated transfers of \$10,541 for the year ended June 30, 2011 were made to the State General Fund.

Expanded Lottery

All expanded lottery net revenue is forwarded to the Expanded Lottery Act Receipts Fund each business day. Gaming revenue collected is then distributed in accordance with governing legislation. The following is a summary of revenues collected and distributions made for the years ended June 30, 2012 and 2011:

	FY 2012 <u>Boot Hill</u>	FY 2011 <u>Boot Hill</u>
Gaming Facility Revenue:		
Electronic games	\$ 37,461,685	\$ 33,640,213
Table games	6,424,816	6,415,067
Total	<u>\$ 43,886,501</u>	<u>\$ 40,055,280</u>
Distributions:		
State of Kansas - 22%	\$ 9,655,030	\$ 8,812,162
Problem Gambling Fund - 2%	877,730	801,106
City & County - 3%	1,316,595	1,201,658
Casino operator management fees - 73%	32,037,146	29,240,354
Total	<u>\$ 43,886,501</u>	<u>\$ 40,055,280</u>

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

For the 7 months ended June 30, 2012

Kansas Star

Gaming Facility Revenue:	
Electronic games	\$ 85,588,561
Table games	13,267,367
Total	<u>\$ 98,855,928</u>
Distributions:	
State of Kansas - 22%	\$ 21,748,305
Problem Gambling Fund - 2%	1,977,118
City & County - 3%	2,965,677
Casino operator management fees - 73%	72,164,828
Total	<u>\$ 98,855,928</u>

For the 5 months ended June 30, 2012

Hollywood

Gaming Facility Revenue:	
Electronic games	\$ 44,995,452
Table games	9,627,235
Total	<u>\$ 54,622,687</u>
Distributions:	
State of Kansas - 22%	\$ 12,016,991
Problem Gambling Fund - 2%	1,092,454
City & County - 3%	1,638,681
Casino operator management fees - 73%	39,874,561
Total	<u>\$ 54,622,687</u>

At June 30, 2012 and 2011, \$3,212,264 and \$151,770, respectively, was receivable from the casino managers for online and table game net revenue. At June 30, 2012 and 2011, \$5,003,393 and \$397,057, respectively, was payable to the casino managers, the Cities, and Counties for revenues collected but not yet distributed, and is included in accounts payable and accrued liabilities. At June 30, 2012 and 2011, \$1,433,619 and \$98,402, respectively, was payable to the State of Kansas for amounts due to the State General Fund and Problem Gambling Fund for revenues collected but not yet distributed.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

8 - Schedule of Gross Margin-Lottery

Gross margin by game is as follows:

Year Ended June 30, 2012												
	Instant	Pulltabs	Pow erball	2 by 2	Kansas Cash	Keno	Mega Millions	Pick 3	Hot Lotto	Kansas Hold'Em	Holiday Raffle	Total
Sales, net	\$ 124,007,907	\$ 9,044,227	\$ 37,649,433	\$ 1,851,778	\$ 15,591,591	\$ 23,127,363	\$ 15,657,440	\$ 6,005,406	\$ 6,975,917	\$ 3,233,450	\$ 3,000,000	\$ 246,144,512
Prizes, net	(70,869,646)	(6,059,632)	(19,344,163)	(953,666)	(8,029,669)	(15,264,060)	(8,063,582)	(3,092,784)	(3,592,597)	(2,134,077)	(1,500,000)	(138,903,876)
Retailer Commissions	(7,237,286)	(528,183)	(2,208,727)	(108,144)	(910,549)	(1,350,638)	(920,059)	(350,716)	(407,394)	(188,833)	(175,200)	(14,385,728)
Gross Margin	<u>\$ 45,900,975</u>	<u>\$ 2,456,412</u>	<u>\$ 16,096,543</u>	<u>\$ 789,968</u>	<u>\$ 6,651,373</u>	<u>\$ 6,512,665</u>	<u>\$ 6,673,800</u>	<u>\$ 2,561,906</u>	<u>\$ 2,975,926</u>	<u>\$ 910,540</u>	<u>\$ 1,324,800</u>	<u>\$ 92,854,908</u>
Year Ended June 30, 2011												
	Instant	Pulltabs	Pow erball	2 by 2	Kansas Cash	Keno	Mega Millions	Pick 3	Hot Lotto	Kansas Hold'Em	Holiday Raffle	Total
Sales, net	\$ 118,610,443	\$ 8,151,291	\$ 32,563,974	\$ 1,781,362	\$ 14,856,830	\$ 24,051,459	\$ 11,396,810	\$ 5,827,678	\$ 8,755,197	\$ 3,377,466	\$ 3,000,000	\$ 232,372,510
Prizes, net	(69,964,368)	(5,420,609)	(15,956,347)	(855,054)	(7,205,563)	(16,219,735)	(5,789,579)	(2,884,701)	(4,290,047)	(2,246,015)	(1,500,000)	(132,332,017)
Retailer Commissions	(7,037,162)	(483,372)	(1,931,044)	(105,635)	(881,010)	(1,426,252)	(675,831)	(345,581)	(519,183)	(200,284)	(177,900)	(13,783,253)
Gross Margin	<u>\$ 41,608,912</u>	<u>\$ 2,247,311</u>	<u>\$ 14,676,583</u>	<u>\$ 820,673</u>	<u>\$ 6,770,257</u>	<u>\$ 6,405,473</u>	<u>\$ 4,931,400</u>	<u>\$ 2,597,396</u>	<u>\$ 3,945,967</u>	<u>\$ 931,167</u>	<u>\$ 1,322,100</u>	<u>\$ 86,257,240</u>

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

9 - Pension Plan

Plan Description

The Lottery participates in the Kansas Public Employees Retirement System (KPERs), a cost-sharing, multiple-employer defined benefit pension plan as provided by K.S.A 74-4901, et seq. KPERs provides retirement benefits, life insurance, disability income benefits, and death benefits, Kansas law establishes and amends benefits provisions. KPERs issues a publicly available financial report that includes financial statements and required supplementary information. This report may be obtained by writing to KPERs (611 S. Kansas Avenue, Suite 100, Topeka, KS 66603-3803) or by calling 1-800-228-0366.

Funding Policy

K.S.A 74-4919 establishes the KPERs member-employee contribution rate at four and six percent of covered salary for Tier 1 and Tier 2 employees, respectively. Effective July 1, 2009 KPERs became a two tier plan with immediate participation. Tier 1 is the active members hired before July 1, 2009 under the original statute, and Tier 2 employees are hired on or after July 1, 2009. The employer collects and remits member-employee contributions according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rate be determined annually based on the results of an annual actuarial valuation. KPERs is funded on an actuarial reserve basis. State law sets a limitation on annual increases in the contribution rates for KPERs employers. The employer rates established by statute for calendar years 2012 and 2011 are 8.77 and 8.17 percent, respectively. The Lottery contributions to KPERs for the years ending June 30, 2012, 2011 and 2010, were approximately \$375,000, \$328,000, and \$284,000, respectively, equal to 100% of the statutorily required portions for each year.

10 - Other Postemployment Healthcare Benefits

Description

Kansas statutes provide that postemployment healthcare benefits be extended to retired employees who have met age and/or service eligibility requirements. The health insurance benefit generally provides the same coverage for retirees and their dependents as for active employees and their dependents. The health insurance benefit plan is a single employer defined benefit plan administered by Kansas Health Policy Authority. The benefit is available for selection at retirement and is extended to retirees and their dependents for life. Non-Medicare participants are subsidized by the State, thus resulting in a liability to the State. The accounting for the health insurance for retirees is included in the State's Self-insurance Health fund, with the subsidy provided from the Self-Insurance Health fund. The Plan does not issue a stand-alone financial report.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Funding Policy

The State provides health insurance benefits to retirees and their dependents in accordance with Kansas law (K.S.A. 75-6511). Kansas statutes, which may be amended by the state legislature, established that participating retirees contribute to the employee group health fund benefits plan, including administrative costs. The State appropriates funds annually for the costs associated with this retirement benefit and provides funding for the expenditure on a pay-as-you-go basis through the Self-Insurance Fund. In fiscal years 2012 and 2011, the Lottery did not contribute to the plan.

Voluntary Retirement Incentive Program

On August 2, 2011 the State of Kansas announced a Voluntary Retirement Incentive Program (VRIP) that provides group health insurance to eligible State of Kansas employees who retired between August 2, 2011 and October 31, 2011. Under the VRIP the State will subsidize the cost of retiree health coverage by paying the employer's share of the active State employee rates for the coverage in which the employee was enrolled on August 1, 2011. Employer group health insurance payments continue for 60 months if the coverage is member only, 42 months for member plus dependent coverage or until the retiree reaches the age of 65, whichever occurs earliest. The dollar amount of the subsidy for the year ended June 30, 2012 is \$542 for single coverage and \$793 for member plus dependent coverage.

Two Lottery employees retired before October 31, 2011 to participate in VRIP. Lottery VRIP payments for the year ended June 30, 2012 were \$11,226. Management has estimated an additional amount payable for the VRIP in the amount of \$54,623 which is reported with accounts payable and accrued liabilities.

Annual OPEB Cost and Net OPEB Obligation

The Lottery's annual Other Post Employment Benefits (OPEB) cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities over a period of not to exceed thirty years. The following table presents the components of the Lottery's annual OPEB cost for the year, the contributions to the plan, and changes in the Lottery's net OPEB obligation.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Annual required Contribution (ARC)	\$ 72,000
Interest in the net OPEB obligation	10,000
Adjustment to the ARC	<u>(15,000)</u>
Annual OPEB cost (expense)	67,000
Net Employer contributions	<u>(40,371)</u>
Increase in net OPEB obligation	26,629
Net OPEB obligation, beginning of year	<u>273,371</u>
Net OPEB obligation, end of year	<u><u>\$ 300,000</u></u>

	Fiscal Year	Annual OPEB Cost	Net Employer Contributions	Percentage Contributed	End of Year Net OPEB Obligation
Kansas Lottery	2010	\$ 63,338	\$ -	0%	\$ 203,970
Kansas Lottery	2011	69,402	-	0%	273,371
Kansas Lottery	2012	67,000	40,371	60%	300,000

Funded Status and Funding Progress

As of June 30, 2012, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$746,000. The Lottery's policy is to fund the benefits on a pay as you go basis, resulting in an unfunded actuarial accrued liability (UAAL) of \$746,000. The covered payroll (annual payroll of active employees covered by the plan) was \$4,115,000, and the ratio of the UAAL to covered payroll was 18.13 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. The valuation includes, for example, assumptions about future employment, mortality and the healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with the past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presented multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liabilities for benefits.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2012 and 2011

Actuarial Methods and Assumptions

Projections of benefits for reporting purposes are based on the substantive plan and include the types of benefits provided at the time of valuation and the historical pattern of sharing of benefit cost between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and actuarial value as assets, consistent with the long-term perspective of calculations.

In the June 30, 2012 actuarial valuation, the projected unit credit cost method was applied. The actuarial assumptions included a 3.85 percent investment rate of return, which is a blended rate of the expected long-term investment returns on the State's pooled funds and investments. The valuation assumed annual healthcare cost trend rates of 5 to 9 percent in the next fifteen years. The UAAL is being amortized over a 30 year open period in level dollar amounts.

11 - Privilege Fee Payments

The Lottery assesses a privilege fee on applicants who would like to be considered as a potential expanded gaming facility manager. The privilege fee acts as a deposit showing the management company's interest in managing one of the four gaming facilities throughout the State of Kansas. Privilege fees assessed are \$25,000,000 per applicant for the southeast, south central, and northeast regions and \$5,500,000 per applicant for the southwest region. If an applicant is not awarded the contract for the region, the privilege fee is reimbursed in full. When a contract becomes binding the privilege fee is transferred to the State's general fund immediately. During fiscal year 2011, the State of Kansas received \$25,000,000 in privilege fees from the south central gaming zone when the contractual agreement became binding. The State of Kansas did not receive privilege fees during the year ended June 30, 2012.

12 - Subsequent Events

The Lottery has evaluated subsequent events through the October 12, 2012, the date of the independent auditor's report which is the date the financial statements are available to be issued.

Kansas Lottery
(A Component Unit of the State of Kansas)

Schedule of Funding Progress

Health Insurance Post Employment Benefits

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percent of Covered Payroll (b-a)(c)
1/1/2012	\$ -	\$ 746,000	\$ 746,000	0%	\$ 4,115,000	18.13%
1/1/2011	-	733,603	733,603	0%	3,865,681	18.98%
1/1/2010	-	652,394	652,394	0%	3,745,917	17.42%

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING BALANCE SHEET
JUNE 30, 2012

<u>ASSETS</u>	Kansas Lottery		Total 2012
	Lottery	Expanded Lottery	
Current assets:			
Cash:			
Operating fund	\$ 5,254,811	\$ 3,224,748	\$ 8,479,559
Prize payment fund	1,357,321	-	1,357,321
Accounts receivable, net of allowance for doubtful accounts of \$226,209	2,158,648	-	2,158,648
Accounts receivable - unbilled	8,304,976	-	8,304,976
Other receivable	264,526	3,212,264	3,476,790
Instant ticket game inventory	1,921,646	-	1,921,646
Total current assets	19,261,928	6,437,012	25,698,940
Capital assets, net of depreciation:			
Property and equipment - Lottery	389,045	-	389,045
Property and equipment - Expanded Lottery	-	53,864,785	53,864,785
Total capital assets	389,045	53,864,785	54,253,830
Total assets	\$ 19,650,973	\$ 60,301,797	\$ 79,952,770
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Accounts payable and accrued liabilities	\$ 1,808,174	\$ 5,003,393	\$ 6,811,567
Due to the State of Kansas	5,000,000	1,314,151	6,314,151
Due to Problem Gambling Fund	-	119,468	119,468
Prize liability	6,483,465	-	6,483,465
Total current liabilities	13,291,639	6,437,012	19,728,651
Net assets:			
Invested in capital assets	389,045	-	389,045
Invested in capital assets - restricted	-	53,864,785	53,864,785
Unrestricted	5,970,289	-	5,970,289
Total net assets	6,359,334	53,864,785	60,224,119
Total liabilities and net assets	\$ 19,650,973	\$ 60,301,797	\$ 79,952,770

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2012

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2012
Operating revenues:			
Net game revenues	\$ 246,144,512	\$ -	\$ 246,144,512
Expanded lottery revenues	-	197,365,116	197,365,116
Expanded lottery reimbursements	-	3,067,065	3,067,065
Phone reimbursements	962,910	-	962,910
Retailer fees and miscellaneous income	57,741	-	57,741
Total operating revenues	247,165,163	200,432,181	447,597,344
Operating expenses:			
Game prizes	138,903,876	-	138,903,876
Casino operator management fee	-	144,076,535	144,076,535
Retailer commissions	14,385,728	-	14,385,728
On-line games service bureau	5,663,986	-	5,663,986
Salaries and benefits	4,647,256	858,464	5,505,720
Cost of instant tickets	3,840,210	-	3,840,210
Advertising	2,474,333	-	2,474,333
Other administrative expenses	2,074,671	398,156	2,472,827
Depreciation	136,799	7,890,530	8,027,329
City and County expanded lottery fees	-	5,920,953	5,920,953
Professional services	375,185	71,182	446,367
On-line service bureau - lottery gaming	-	1,730,024	1,730,024
Telecommunications	122,909	9,239	132,148
Total operating expenses	172,624,953	160,955,083	333,580,036
Operating income	74,540,210	39,477,098	114,017,308
Nonoperating expenses:			
Transfers to the State Gaming Revenue Fund	(71,000,000)	-	(71,000,000)
Transfers to the State General Fund	-	(43,420,326)	(43,420,326)
Transfers to the Problem Gambling Fund	-	(3,947,302)	(3,947,302)
Loss on disposal of capital assets	(5,100)	-	(5,100)
Total nonoperating expenses	(71,005,100)	(47,367,628)	(118,372,728)
Income (loss) before contributions	3,535,110	(7,890,530)	(4,355,420)
Capital contributions	-	55,968,902	55,968,902
Change in net assets	3,535,110	48,078,372	51,613,482
Net assets, beginning of year	2,824,224	5,786,413	8,610,637
Net assets, end of year	\$ 6,359,334	\$ 53,864,785	\$ 60,224,119

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2012

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2012
Cash flows from operating activities:			
Cash received from sales and reimbursements	\$ 246,453,798	\$ 197,371,687	\$ 443,825,485
Cash paid for prizes, commissions, and other expenses	(169,023,316)	(147,599,753)	(316,623,069)
Cash paid to employees	(4,647,256)	(858,464)	(5,505,720)
Net cash provided by operating activities	<u>72,783,226</u>	<u>48,913,470</u>	<u>121,696,696</u>
Cash flows from noncapital financing activities:			
Payments to State Gaming Revenue Fund	(72,000,000)	-	(72,000,000)
Payments to State General Fund	-	(42,196,377)	(42,196,377)
Payments to State Problem Gambling Fund	-	(3,836,034)	(3,836,034)
Net cash used by noncapital financing activities	<u>(72,000,000)</u>	<u>(46,032,411)</u>	<u>(118,032,411)</u>
Cash flows from capital and related financing activities:			
Purchases of capital assets	(145,465)	-	(145,465)
Net cash used by capital and related financing activities	<u>(145,465)</u>	<u>-</u>	<u>(145,465)</u>
Net increase in cash	637,761	2,881,059	3,518,820
Cash, beginning of year	<u>5,974,371</u>	<u>343,689</u>	<u>6,318,060</u>
Cash, end of year	<u>\$ 6,612,132</u>	<u>\$ 3,224,748</u>	<u>\$ 9,836,880</u>
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	\$ 74,540,210	\$ 39,477,098	\$ 114,017,308
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	136,799	7,890,530	8,027,329
Changes in operating assets and liabilities:			
Accounts receivable	(659,169)	-	(659,169)
Other receivable	(52,196)	(3,060,494)	(3,112,690)
Instant ticket game inventory	(190,907)	-	(190,907)
Accounts payable and accrued liabilities	112,490	4,606,336	4,718,826
Prize liability	(1,104,001)	-	(1,104,001)
Net cash provided by operating activities	<u>\$ 72,783,226</u>	<u>\$ 48,913,470</u>	<u>\$ 121,696,696</u>
Noncash capital and related financing activities:			
Contributed capital assets	<u>\$ -</u>	<u>\$ 55,968,902</u>	<u>\$ 55,968,902</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
BALANCE SHEETS - LOTTERY
JUNE 30, 2012 AND 2011

	Lottery	
<u>ASSETS</u>	2012	2011
Current assets:		
Cash:		
Operating fund	\$ 5,254,811	\$ 5,807,319
Prize payment fund	1,357,321	167,052
Accounts receivable, net of allowance for doubtful accounts of \$226,209 and \$349,123 at 2012 and 2011, respectively	2,158,648	3,869,022
Accounts receivable - unbilled	8,304,976	5,935,433
Other receivable	264,526	212,330
Instant ticket game inventory	1,921,646	1,730,739
Total current assets	19,261,928	17,721,895
Capital assets, net of depreciation:		
Property and equipment - Lottery	389,045	385,479
Total assets	\$ 19,650,973	\$ 18,107,374
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,808,174	\$ 1,695,684
Due to the State of Kansas	5,000,000	6,000,000
Prize liability	6,483,465	7,587,466
Total current liabilities	13,291,639	15,283,150
Net assets:		
Invested in capital assets	389,045	385,479
Unrestricted	5,970,289	2,438,745
Total net assets	6,359,334	2,824,224
Total liabilities and net assets	\$ 19,650,973	\$ 18,107,374

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULES OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS - LOTTERY
YEARS ENDED JUNE 30, 2012 AND 2011

	Lottery	
	2012	2011
Operating revenues:		
Net game revenues	\$ 246,144,512	\$ 232,372,510
Phone reimbursements	962,910	947,390
Retailer fees and miscellaneous income	57,741	139,773
Total operating revenues	<u>247,165,163</u>	<u>233,459,673</u>
Operating expenses:		
Game prizes	138,903,876	132,332,017
Retailer commissions	14,385,728	13,783,253
On-line games service bureau	5,663,986	5,299,915
Salaries and benefits	4,647,256	4,609,625
Cost of instant tickets	3,840,210	3,761,082
Advertising	2,474,333	2,867,437
Other administrative expense	2,074,671	1,709,086
Depreciation	136,799	152,295
Professional services	375,185	385,097
Telecommunications	122,909	260,695
Total operating expenses	<u>172,624,953</u>	<u>165,160,502</u>
Operating income	<u>74,540,210</u>	<u>68,299,171</u>
Nonoperating expenses:		
Transfers to the State Gaming Revenue Fund	(71,000,000)	(71,500,000)
Transfers to the State General Fund	-	(10,541)
Loss on disposal of capital assets	(5,100)	-
Total nonoperating expenses	<u>(71,005,100)</u>	<u>(71,510,541)</u>
Change in net assets	3,535,110	(3,211,370)
Net assets, beginning of year	<u>2,824,224</u>	<u>6,035,594</u>
Net assets, end of year	<u><u>\$ 6,359,334</u></u>	<u><u>\$ 2,824,224</u></u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULES OF CASH FLOWS - LOTTERY
YEARS ENDED JUNE 30, 2012 AND 2011

	Lottery	
	2012	2011
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 246,453,798	\$ 232,919,733
Cash paid for prizes, commissions, and other expenses	(169,023,316)	(157,939,762)
Cash paid to employees	(4,647,256)	(4,609,625)
Net cash provided by operating activities	<u>72,783,226</u>	<u>70,370,346</u>
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(72,000,000)	(70,000,000)
Payments to State General Fund	-	(10,541)
Net cash used by noncapital financing activities	<u>(72,000,000)</u>	<u>(70,010,541)</u>
Cash flows from capital and related financing activities:		
Purchases of capital assets	(145,465)	(95,280)
Net cash used by capital and related financing activities	<u>(145,465)</u>	<u>(95,280)</u>
Net increase in cash	637,761	264,525
Cash, beginning of year	<u>5,974,371</u>	<u>5,709,846</u>
Cash, end of year	<u><u>\$ 6,612,132</u></u>	<u><u>\$ 5,974,371</u></u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 74,540,210	\$ 68,299,171
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	136,799	152,295
Changes in operating assets and liabilities:		
Accounts receivable	(659,169)	(480,988)
Other receivable	(52,196)	(58,952)
Instant ticket game inventory	(190,907)	283,639
Accounts payable and accrued liabilities	112,490	(53,289)
Prize liability	(1,104,001)	2,228,470
Net cash provided by operating activities	<u><u>\$ 72,783,226</u></u>	<u><u>\$ 70,370,346</u></u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
BALANCE SHEETS - EXPANDED LOTTERY
JUNE 30, 2012 AND 2011

	Expanded Lottery	
<u>ASSETS</u>	2012	2011
Current assets:		
Cash:		
Operating fund	\$ 3,224,748	\$ 343,689
Other receivable	3,212,264	151,770
	6,437,012	495,459
Total current assets		
Capital assets, net of depreciation:		
Property and equipment - Expanded Lottery	53,864,785	5,786,413
	53,864,785	5,786,413
Total capital assets		
	\$ 60,301,797	\$ 6,281,872
	\$ 60,301,797	\$ 6,281,872
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 5,003,393	\$ 397,057
Due to the State of Kansas	1,314,151	90,202
Due to Problem Gambling Fund	119,468	8,200
	6,437,012	495,459
Total current liabilities		
Net assets:		
Invested in capital assets - restricted	53,864,785	5,786,413
	53,864,785	5,786,413
Total net assets		
	\$ 60,301,797	\$ 6,281,872
Total liabilities and net assets	\$ 60,301,797	\$ 6,281,872

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULES OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2012 AND 2011

	<u>Expanded Lottery</u>	
	<u>2012</u>	<u>2011</u>
Operating revenues:		
Expanded lottery revenues	\$ 197,365,116	\$ 40,055,280
Expanded lottery reimbursements	3,067,065	1,282,191
	<u>200,432,181</u>	<u>41,337,471</u>
Operating expenses:		
Casino operator management fee	144,076,535	29,240,354
Salaries and benefits	858,464	488,617
Other administrative expenses	398,156	290,262
Depreciation	7,890,530	2,102,677
City and County expanded lottery fees	5,920,953	1,201,658
Professional services	71,182	95,119
On-line service bureau - expanded lottery	1,730,024	403,683
Telecommunications	9,239	4,510
	<u>160,955,083</u>	<u>33,826,880</u>
Operating income	<u>39,477,098</u>	<u>7,510,591</u>
Nonoperating expenses:		
Transfers to the State General Fund	(43,420,326)	(8,812,162)
Transfers to the Problem Gambling Fund	(3,947,302)	(801,106)
	<u>(47,367,628)</u>	<u>(9,613,268)</u>
Income (loss) before contributions	(7,890,530)	(2,102,677)
Capital contributions	55,968,902	-
Change in net assets	48,078,372	(2,102,677)
Net assets, beginning of year	<u>5,786,413</u>	<u>7,889,090</u>
Net assets, end of year	<u>\$ 53,864,785</u>	<u>\$ 5,786,413</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULES OF CASH FLOWS - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2012 AND 2011

	<u>Expanded Lottery</u>	
	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 197,371,687	\$ 41,267,042
Cash paid for prizes, commissions, and other expenses	(147,599,753)	(31,571,352)
Cash paid to employees	(858,464)	(488,617)
	<u>48,913,470</u>	<u>9,207,073</u>
Cash flows from noncapital financing activities:		
Payments to State General Fund	(42,196,377)	(8,784,016)
Payments to State Problem Gambling Fund	(3,836,034)	(798,547)
	<u>(46,032,411)</u>	<u>(9,582,563)</u>
Net increase (decrease) in cash	2,881,059	(375,490)
Cash, beginning of year	<u>343,689</u>	<u>719,179</u>
Cash, end of year	<u>\$ 3,224,748</u>	<u>\$ 343,689</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 39,477,098	\$ 7,510,591
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	7,890,530	2,102,677
Changes in operating assets and liabilities:		
Other receivable	(3,060,494)	(70,429)
Accounts payable and accrued liabilities	4,606,336	(335,766)
	<u>\$ 48,913,470</u>	<u>\$ 9,207,073</u>
Noncash capital and related financing activities:		
Contributed capital assets	<u>\$ 55,968,902</u>	<u>\$ -</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING BALANCE SHEETS - EXPANDED LOTTERY
JUNE 30, 2012 AND 2011

	Expanded Lottery				
	2012				2011
	Southwest Gaming Zone	Northeast Gaming Zone *	Southcentral Gaming Zone **	Total	Southwest Gaming Zone
<u>ASSETS</u>					
Current assets:					
Cash:					
Operating fund	\$ 404,771	\$ 1,116,856	\$ 1,703,121	\$ 3,224,748	\$ 343,689
Other receivable	436,040	1,147,887	1,628,337	3,212,264	151,770
Total current assets	<u>840,811</u>	<u>2,264,743</u>	<u>3,331,458</u>	<u>6,437,012</u>	<u>495,459</u>
Capital assets, net of depreciation:					
Property and equipment - Expanded Lottery	<u>5,033,794</u>	<u>26,357,094</u>	<u>22,473,897</u>	<u>53,864,785</u>	<u>5,786,413</u>
Total capital assets	<u>5,033,794</u>	<u>26,357,094</u>	<u>22,473,897</u>	<u>53,864,785</u>	<u>5,786,413</u>
Total assets	<u>\$ 5,874,605</u>	<u>\$ 28,621,837</u>	<u>\$ 25,805,355</u>	<u>\$ 60,301,797</u>	<u>\$ 6,281,872</u>
<u>LIABILITIES AND NET ASSETS</u>					
Current liabilities:					
Accounts payable and accrued liabilities	\$ 653,651	\$ 1,760,467	\$ 2,589,275	\$ 5,003,393	\$ 397,057
Due to the State of Kansas	171,563	462,253	680,335	1,314,151	90,202
Due to Problem Gambling Fund	15,597	42,023	61,848	119,468	8,200
Total current liabilities	<u>840,811</u>	<u>2,264,743</u>	<u>3,331,458</u>	<u>6,437,012</u>	<u>495,459</u>
Net assets:					
Invested in capital assets - restricted	5,033,794	26,357,094	22,473,897	53,864,785	5,786,413
Unrestricted	-	-	-	-	-
Total net assets	<u>5,033,794</u>	<u>26,357,094</u>	<u>22,473,897</u>	<u>53,864,785</u>	<u>5,786,413</u>
Total liabilities and net assets	<u>\$ 5,874,605</u>	<u>\$ 28,621,837</u>	<u>\$ 25,805,355</u>	<u>\$ 60,301,797</u>	<u>\$ 6,281,872</u>

* - The Northeast gaming zone began operations in February, 2012

** - The South Central gaming zone began operations in December, 2011

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING SCHEDULES OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2012 AND 2011

	Expanded Lottery				
	2012				2011
	Southwest Gaming Zone	Northeast Gaming Zone *	Southcentral Gaming Zone **	Total	Southwest Gaming Zone
Operating revenues:					
Expanded lottery revenues	\$ 43,886,501	\$ 54,622,687	\$ 98,855,928	\$ 197,365,116	\$ 40,055,280
Expanded lottery reimbursements	857,180	856,059	1,353,826	3,067,065	1,282,191
Total operating revenues	<u>44,743,681</u>	<u>55,478,746</u>	<u>100,209,754</u>	<u>200,432,181</u>	<u>41,337,471</u>
Operating expenses:					
Casino operator management fee	32,037,146	39,874,561	72,164,828	144,076,535	29,240,354
Salaries and benefits	306,706	270,076	281,682	858,464	488,617
Other administrative expenses	122,845	134,253	141,058	398,156	290,262
Depreciation	2,102,677	2,834,699	2,953,154	7,890,530	2,102,677
City and County expanded lottery fees	1,316,595	1,638,681	2,965,677	5,920,953	1,201,658
Professional services	12,163	3,613	55,406	71,182	95,119
On-line service bureau - expanded lottery	411,602	445,610	872,812	1,730,024	403,683
Telecommunications	3,864	2,507	2,868	9,239	4,510
Total operating expenses	<u>36,313,598</u>	<u>45,204,000</u>	<u>79,437,485</u>	<u>160,955,083</u>	<u>33,826,880</u>
Operating income	<u>8,430,083</u>	<u>10,274,746</u>	<u>20,772,269</u>	<u>39,477,098</u>	<u>7,510,591</u>
Nonoperating expenses:					
Transfers to the State General Fund	(9,655,030)	(12,016,991)	(21,748,305)	(43,420,326)	(8,812,162)
Transfers to the Problem Gambling Fund	(877,730)	(1,092,454)	(1,977,118)	(3,947,302)	(801,106)
Total nonoperating expenses	<u>(10,532,760)</u>	<u>(13,109,445)</u>	<u>(23,725,423)</u>	<u>(47,367,628)</u>	<u>(9,613,268)</u>
Income (loss) before contributions	(2,102,677)	(2,834,699)	(2,953,154)	(7,890,530)	(2,102,677)
Capital contributions	<u>1,350,058</u>	<u>29,191,793</u>	<u>25,427,051</u>	<u>55,968,902</u>	<u>-</u>
Change in net assets	(752,619)	26,357,094	22,473,897	48,078,372	(2,102,677)
Net assets, beginning of year	<u>5,786,413</u>	<u>-</u>	<u>-</u>	<u>5,786,413</u>	<u>7,889,090</u>
Net assets, end of year	<u>\$ 5,033,794</u>	<u>\$ 26,357,094</u>	<u>\$ 22,473,897</u>	<u>\$ 53,864,785</u>	<u>\$ 5,786,413</u>

* - The Northeast gaming zone began operations in February, 2012

** - The South Central gaming zone began operations in December, 2011

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING SCHEDULES OF CASH FLOWS - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2012 AND 2011

	Expanded Lottery				
	2012			2011	
	Southwest Gaming Zone	Northeast Gaming Zone *	Southcentral Gaming Zone **	Total	Southwest Gaming Zone
Cash flows from operating activities:					
Cash received from sales and reimbursements	\$ 44,459,411	\$ 54,330,859	\$ 98,581,417	197,371,687	\$ 41,267,042
Cash paid for prizes, commissions, and other expenses	(33,647,621)	(40,338,758)	(73,613,374)	(147,599,753)	(31,571,352)
Cash paid to employees	(306,706)	(270,076)	(281,682)	(858,464)	(488,617)
Net cash provided by operating activities	10,505,084	13,722,025	24,686,361	48,913,470	9,207,073
Cash flows from noncapital financing activities:					
Payments to State General Fund	(9,573,669)	(11,554,738)	(21,067,970)	(42,196,377)	(8,784,016)
Payments to State Problem Gambling Fund	(870,333)	(1,050,431)	(1,915,270)	(3,836,034)	(798,547)
Net cash used by noncapital financing activities	(10,444,002)	(12,605,169)	(22,983,240)	(46,032,411)	(9,582,563)
Net increase (decrease) in cash	61,082	1,116,856	1,703,121	2,881,059	(375,490)
Cash, beginning of year	343,689	-	-	343,689	719,179
Cash, end of year	\$ 404,771	\$ 1,116,856	\$ 1,703,121	3,224,748	\$ 343,689
Reconciliation of operating income to net cash provided by operating activities:					
Operating income	\$ 8,430,083	\$ 10,274,746	\$ 20,772,269	39,477,098	\$ 7,510,591
Adjustments to reconcile operating income to net cash provided by operating activities:					
Depreciation	2,102,677	2,834,699	2,953,154	7,890,530	2,102,677
Changes in operating assets and liabilities:					
Other receivable	(284,270)	(1,147,887)	(1,628,337)	(3,060,494)	(70,429)
Accounts payable and accrued liabilities	256,594	1,760,467	2,589,275	4,606,336	(335,766)
Net cash provided by operating activities	\$ 10,505,084	\$ 13,722,025	\$ 24,686,361	48,913,470	\$ 9,207,073
Noncash capital and related financing activities:					
Contributed capital assets	\$ 1,350,058	\$ 29,191,793	\$ 25,427,051	55,968,902	\$ -

* - The Northeast gaming zone began operations in February, 2012

** - The South Central gaming zone began operations in December, 2011



COCHRAN HEAD VICK & CO., P.A.

& Co

Certified Public Accountants

1333 Meadowlark Lane
Kansas City, KS 66102
(913) 287-4433
(913) 287-0010 FAX

**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***

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the financial statements of the Kansas Lottery (the Lottery), a component unit of the State of Kansas, as of and for the year ended June 30, 2012, and have issued our report thereon dated October 12, 2012. 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

Management of the Lottery is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be a material weakness.

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. We consider the deficiencies described in the accompanying schedule of findings and responses as item 2012-1 to be a material weakness.

Other Offices

1251 NW Briarcliff Pkwy
Suite 125
Kansas City, MO 64116
(816) 453-7014
(816) 453-7016 FAX

400 Jules Street
Suite 415
St. Joseph, MO 64501
(816) 364-1118
(816) 364-6144 FAX

6700 Antioch Rd, Suite 460
Merriam, Kansas 66204
(913) 378-1100
(913) 378-1177 FAX

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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Lottery, in a separate letter dated October 12, 2012.

The Lottery's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Lottery's response and, accordingly, we express no opinion on it.

This report is intended solely for the use of management, the Legislative Post Audit Committee, and the Kansas Lottery Commission and is not intended to be and should not be used by anyone other than these specified parties.

October 12, 2012

Cochran Hard V. de Ho, P.A.

Kansas Lottery
(A Component Unit of the State of Kansas)
Schedule of Findings and Responses
Year Ended June 30, 2012

Finding 2012-1 – Material Weakness

Financial Reporting

Condition - Under our professional standards, we are required to assess the Lottery's controls over financial statement preparation including assessing the controls necessary to prevent, detect, and correct misstatements. Our audit procedures identified certain financial statement misstatements indicating that certain amounts did not agree to the underlying supporting documentation provided to us. As a result of this, we determined that a number of adjustments were required.

Criteria - A system of internal control over financial reporting includes identifying and correcting misstatements and reconciling account balances to the underlying supporting documents.

Cause – The Lottery does not have adequate controls over the preparation of financial statements as General Ledger balances were not properly revised or reconciled to supporting documentation after year end closing entries were posted to the General Ledger.

Effect - The financial statements may be materially misstated and/or not contain all required disclosures.

Recommendation - We recommend that management review processes for making year-end closing entries and reviewing account balances to ensure that accounts agree to reconciliations and underlying supporting documentation.

Management's Response – The Lottery continues to understand the SMART accounting system and identify reporting tools available in the SMART system that may be helpful in the reconciliation and year end closing entry processes. Additionally, the Lottery is reviewing and modifying reconciliation and year end closing entry processes as needed.

Kansas Lottery
(A Component Unit of the State of Kansas)
Schedule of Prior Year Findings and Responses
Year Ended June 30, 2012

Finding 2011-1 – Significant Deficiency

Financial Statement Preparation

Condition - Under our professional standards, we are required to assess the Lottery's controls over financial statement preparation including assessing the controls necessary to prevent, detect, and correct misstatements. As part of our audit, we reviewed and assisted management with changes to a draft of the financial statements which management prepared. Management reviewed, approved, and accepted responsibility for those statements prior to their issuance. The outsourcing of these services is not unusual; however, we cannot be considered part of the Lottery's internal control over financial reporting.

Our audit procedures identified certain financial statement misstatements indicating that certain amounts did not agree to the underlying supporting documentation provided to us. Additionally, we noted that certain accrual basis financial reporting aspects of new accounting system used by the Lottery and the State during 2011 were not fully implemented by the Lottery. During our audit, we noted that the Lottery currently recorded year end accrual entries outside of the new accounting system and then created a reconciliation in order to generate a trial balance. In addition to these year end accrual entries, the reconciliation included two separate reports that were exported from the new accounting system.

Recommendation – Due to the complexities of financial statement reporting including inclusion of required disclosures, we recommend that management explore various alternatives to improving the controls over financial reporting including the use of continuing education and training courses and the use of reference guides provided by the Government Finance Officers Association, (GFOA), the American Institute of Certified Public Accountants, (AICPA), the Governmental Accounting Standards Board (GASB) and other various financial publishing companies. We recommend that management review processes for making year-end closing entries and review account balances to ensure that accounts agree to reconciliations and underlying supporting documentation, in particular the Lottery's accounts receivable. Performing more frequent reconciliations will allow staff to more easily identify differences as they occur, and quickly make adjusting entries to correct if necessary. We also recommend lottery personnel obtain additional guidance and instructions to assist in implementing the accrual basis aspect of the new accounting system to facilitate preparation of accrual basis trial balances and financial statements.

Current Status – While certain aspects of the above recommendation were implemented, significant adjustments were still required in the current year. Accordingly, comment was repeated in the current year.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)

REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2012



1333 Meadowlark Lane
Kansas City, KS 66102
(913) 287-4433
(913) 287-0010 FAX

October 12, 2012

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the financial statements of the Kansas Lottery (the Lottery), a component unit of the State of Kansas, as of and for the year ended June 30, 2012. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter to you dated February 6, 2012. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Lottery are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2012. We noted no transactions entered into by the Lottery during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the Lottery's financial statements were the actuarial assumptions and methods used by the actuary to prepare the annual actuarial valuation report related to the other postemployment healthcare benefits plan, the allowance for doubtful accounts, the estimated useful lives of capital assets, and the amount of prize liabilities. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Other Offices

1251 NW Briarcliff Pkwy
Suite 125
Kansas City, MO 64116
(816) 453-7014
(816) 453-7016 FAX

400 Jules Street
Suite 415
St. Joseph, MO 64501
(816) 364-1118
(816) 364-6144 FAX

6700 Antioch Rd, Suite 460
Merriam, Kansas 66204
(913) 378-1100
(913) 378-1177 FAX

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management corrected all such misstatements. The following material misstatements detected as a result of audit procedures were corrected by management:

- A \$1,620,197 adjustment was required to reclassify year end accrual amounts originally recorded in incorrect accounts.
- An adjustment was required to correct accumulated depreciation and depreciation expense in the amount of \$1,423,251.
- An adjustment was required to capitalize \$1,350,057 of equipment acquired by capital lease that was initially recorded as an operating lease.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 12, 2012.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

In planning and performing our audit of the financial statements of the Lottery as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the Lottery's internal control over financial reporting (internal control) as a basis for designing auditing 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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 were not identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be a material weakness.

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. We consider the deficiencies described below under Financial Reporting to be a material weakness.

As part of our annual audit, we try to identify opportunities for improving the management of financial resources and for improving the internal controls over financial reporting. We are submitting, for your consideration, our observations and recommendations with regard to these matters. The Lottery's responses to our comments are included in this report. We did not audit the Lottery's responses and, accordingly, we express no opinion on them.

Current Year Comments

Material Weakness

Financial Reporting

Condition - Under our professional standards, we are required to assess the Lottery's controls over financial statement preparation including assessing the controls necessary to prevent, detect, and correct misstatements. Our audit procedures identified certain financial statement misstatements indicating that certain amounts did not agree to the underlying supporting documentation provided to us. As a result of this, we determined that a number of adjustments were required.

Criteria - A system of internal control over financial reporting includes identifying and correcting misstatements and reconciling account balances to the underlying supporting documents.

Cause - The Lottery does not have adequate controls over the preparation of financial statements as General Ledger balances were not properly revised or reconciled to supporting documentation after year end closing entries were posted to the General Ledger.

Effect - The financial statements may be materially misstated and/or not contain all required disclosures.

Recommendation - We recommend that management review processes for making year-end closing entries and reviewing account balances to ensure that accounts agree to reconciliations and underlying supporting documentation.

Management's Response - The Lottery continues to understand the SMART accounting system and identify reporting tools available in the SMART system that may be helpful in the reconciliation and year end closing entry processes. Additionally, the Lottery is reviewing and modifying reconciliation and year end closing entry processes as needed.

Control Deficiencies

Approval of Minutes

During our review of the Lottery Commission minutes, it was noted that while there is evidence in each meeting that the Lottery Commission approves the minutes of the prior meeting, there is not a process in place to ensure that the final minutes are signed by a member of the Commission. Without this formal approval process, one cannot be certain that the minutes that are prepared and available for examination are copies of the final approved Lottery Commission minutes. We recommend that the Lottery implement procedures to ensure that all Lottery Commission minutes are formally signed when approved.

Management's Response – The Lottery Commission meeting minutes are approved in a meeting held in accordance with the Kansas Open Meetings Act. The motions of the Commissioner moving to approve the minutes as well as the Commissioner seconding the motion are recorded in the official minutes. The process will be reviewed and this recommendation will be taken under advisement.

Accounts Receivable Reconciliation

The Not-sufficient-funds (NSF) retailers outstanding balance report for accounts receivable did not reconcile to the general ledger at year-end. The resulting adjustment, while not material, was sufficiently large enough to indicate that more frequent and regular reconciliations are desirable. We recommend that management perform more frequent reconciliations for accounts receivable. Performing more frequent reconciliations will allow staff to more easily identify differences as they occur, and quickly make adjusting entries to correct if necessary. We also recommend that management review the policy for placing retailers on HOLD status as a result of NSF notifications in order to reduce the amount of bad debt write-offs that must be recorded by the Lottery.

Management's Response – Not-sufficient-funds (NSF) retailer's outstanding balance is being reconciled weekly in order to identify differences on a more timely basis.

Retailers are billed a week in arrears and the Lottery receives NSF notifications three business days following the billing date. This timeline leads to two often three billing dates before a retailer is placed on HOLD. Per the NSF policy, the Lottery will make contact with the retailer to determine the reason for the NSF and when payment will be made. Retailer NSF situations are evaluated case by case before the retailer is placed on HOLD.

Other Comments

Future Accounting Pronouncements

The GASB has recently issued the following statements which may impact the Lottery's financial reporting requirements in the future:

- GASB Statement 60 – Accounting and Financial Reporting for Service Concession Arrangements, effective for the fiscal year beginning July 1, 2012
- GASB Statement 61 – *The Financial Reporting Entity – Omnibus*, effective for the fiscal year beginning July 1, 2012.
- GASB Statement 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective for the fiscal year beginning July 1, 2012.
- GASB Statement 63 – *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective for the fiscal year beginning July 1, 2012
- GASB Statement 65 – *Items Previously Reported as Assets and Liabilities*, effective for the fiscal year beginning July 1, 2013
- GASB Statement 66 – *Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62*, effective for the fiscal year beginning July 1, 2013.
- GASB Statement 67 – *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*, effective for the fiscal year beginning July 1, 2013.

- GASB Statement 68 – *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, effective for the fiscal year beginning July 1, 2014.

We recommend management review these standards to determine the impact they may have on the Lottery's financial reporting.

Prior Year Comments

In the prior year, we issued certain comments and recommendations in regard to the Lottery's accounting, internal control and financial reporting issues. The following table summarizes the nature of these comments, the significance of the comments as described in the prior year's reports and our determination of the status of those comments.

Financial Statement Preparation	In the prior year, we reviewed and assisted management with changes to a draft of the financial statements. We also noted that management recorded year end accrual entries outside of the accounting system and then created a reconciliation in order to generate a trial balance. We recommended that management explore various alternatives to improve controls over financial reporting and that management review processes related to year end accrual entries.	Recommendation was partially implemented in the current year.
Expanded Lottery	We recommended that management review and evaluate procedures in place to timely identify and account for any agreements related to the two new gaming facilities that opened during the 2012 fiscal year in order to properly report their impact on the Lottery's financial statements.	Adjustments were required in the current year. See current year Financial Reporting comments.
Future Accounting Pronouncements	We recommended that management review upcoming standards to determine what impact they may have on the Lottery's financial reporting.	The Lottery determined that there were no policy changes necessary. See current year comment for additional standards that apply in the future.

CONCLUSION

Our audit procedures required us to obtain an understanding of controls over primary systems affecting the financial statement amounts. The Lottery may be able to benefit from additional, in-depth reviews of internal controls in other areas. We look forward to discussing opportunities to continue to assist the Lottery.

This information is intended solely for the use of the Legislative Post Audit Committee, Kansas Lottery Commission and management of the Kansas Lottery and is not intended to be and should not be used by anyone other than these specified parties.

Cochran Hood Vick & Co. P.A.