



FINANCIAL AUDIT REPORT

Kansas Lottery: Fiscal Year 2014

**A Report to the Legislative Post Audit Committee
By RubinBrown, Under Contract with
the Legislative Division of Post Audit
State of Kansas
December 2014**

Legislative Division of Post Audit

The **Legislative Division of Post Audit** is the audit arm of the Kansas Legislature. Created in 1971, the division's mission is to conduct audits that provide the Legislature with accurate, unbiased information on the performance of state and local government. The division's audits typically examine whether agencies and programs are effective in carrying out their duties, efficient with their resources, or in compliance with relevant laws, regulations and other requirements.

The division's audits are performed at the direction of the **Legislative Post Audit Committee**, a bipartisan committee comprising five senators and five representatives. By law, individual legislators, legislative committees, or the Governor may request a performance audit, but the Legislative Post Audit Committee determines which audits will be conducted.

Although the Legislative Post Audit Committee determines the areas of government that will be audited, the audits themselves are conducted independently by the division's professional staff. The division's reports are issued without any input from the committee or other legislators. As a result, the findings, conclusions, and recommendations included in the division's audits do not necessarily reflect the views of the Legislative Post Audit Committee or any of its members.

The division conducts its 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, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants (AICPA) and adopted by the Legislative Post Audit Committee.

LEGISLATIVE POST AUDIT COMMITTEE

Senator Jeff Longbine, Chair
Senator Anthony Hensley
Senator Laura Kelly
Senator Julia Lynn
Senator Michael O'Donnell

Representative John Barker, Vice-Chair
Representative Tom Burroughs
Representative Peggy Mast
Representative Virgil Peck, Jr.
Representative Ed Trimmer

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

HOW DO I REQUEST AN AUDIT?

By law, individual legislators, legislative committees, or the Governor may request an audit, but any audit work conducted by the division must be directed by the Legislative Post Audit Committee. Any legislator who would like to request an audit should contact the division directly at (785) 296-3792.

The Legislative Division of Post Audit supports full access to the services of state government for all citizens. Upon request, the division can provide its audit reports in an appropriate alternative format to accommodate persons with visual impairments. Persons with hearing or speech disabilities may reach the division through the Kansas Relay Center at 1-800-766-3777. The division's office hours are 8:00 a.m. to 5:00 p.m., Monday through Friday.



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 18, 2014

To: Members, Legislative Post Audit Committee

Senator Jeff Longbine, Chair
Senator Anthony Hensley
Senator Laura Kelly
Senator Julia Lynn
Senator Michael O'Donnell

Representative John Barker, Vice-Chair
Representative Tom Burroughs
Representative Peggy Mast
Representative Virgil Peck, Jr.
Representative Ed Trimmer

This report contains the findings, conclusions, and recommendations from the completed financial audit of the Kansas Lottery for Fiscal Year 2014. RubinBrown, 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,

Scott Frank
Legislative Post Auditor

This audit was conducted by RubinBrown 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, 2014 and 2013

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

Financial and Compliance Audit
Years Ended June 30, 2014 and 2013

TABLE OF CONTENTS

	<u>Page</u>
Introduction	i
Schedule of Findings and Recommendations	ii
Independent Auditors' Report	iii – vi
Management's Discussion and Analysis	1 – 10
Financial Statements:	
Statements of Net Position	11
Statements of Revenues, Expenses, and Changes in Net Position	12
Statements of Cash Flows	13
Notes to the Financial Statements	14 - 33
Required Supplementary Information:	
Schedule of Funding Progress – Health Insurance Employment Benefits	34
Other Supplementary Information:	
Combining Statement of Net Position (2014)	35
Combining Statement of Revenues, Expenses, and Changes in Net Position (2014)	36
Combining Statement of Cash Flows (2014)	37
Statements of Net Position – Lottery	38
Statements of Revenues, Expenses, and Changes in Net Position – Lottery	39
Statements of Cash Flows – Lottery	40
Statements of Net Position - Expanded Lottery	41
Statements of Revenues, Expenses, and Changes in Net Position – Expanded Lottery	42
Statements of Cash Flows – Expanded Lottery	43

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	44 – 46
Schedule of Findings and Responses	47 – 48
Schedule of Prior Year Findings and Responses	49

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

INTRODUCTION

Year Ended June 30, 2014

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, 2014.

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, 2014

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unmodified opinion on the financial statements of the Kansas Lottery.
2. Material weaknesses related to the audit of the financial statements are reported in the Independent Auditors' 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



RubinBrown LLP
Certified Public Accountants
& Business Consultants

10975 Grandview Drive
Suite 600
Overland Park, KS 66210

T 913.491.4144
F 913.491.6821

W rubinbrown.com
E info@rubinbrown.com

Independent Auditors' Report

Legislative Post Audit Committee
Kansas State Legislature
Topeka, Kansas

Report On The Financial Statements

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 year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements, as listed in the table of contents.

Management's Responsibility For The Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lottery as of June 30, 2014, and the respective changes in financial position and its cash flows, for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis Of A Matter – Reporting Entity

As discussed in Note 1 to the financial statements, the financial statements referred to above present only the financial position, changes in financial position and cash flows of the Lottery. They do not purport to, and do not present fairly, the financial position of the State of Kansas as of June 30, 2014 and the changes in financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Emphasis Of A Matter – Prior Period Adjustment

As discussed in Note 14 to the financial statements, a prior period adjustment was made to remove the Expanded Lottery Facility Games which resulted in a restatement of the 2013 financial statements. Our opinion is not modified with respect to this matter.

Other Matters

The statement of net position of the Lottery as of June 30, 2013 and the related statement of revenues, expenses and changes in net position and cash flows for the year then ended was audited by other auditors whose report dated September 30, 2013, expressed an unmodified opinion on those financial statements.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 10 and the schedule of funding progress on page 34, to be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

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

Other Reporting Required By *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 10, 2014, on our consideration of the Lottery's internal control over financial reporting and 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 the internal control over financial reporting, or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Lottery's internal control over financial reporting and compliance.

RubinBrown LLP

October 10, 2014

**KANSAS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2014 AND 2013**

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, 2014 and 2013. 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 2014 were \$245.7 million reflecting an increase of \$0.9 million or 0.36% compared to fiscal year 2013.
- The State's casinos Kansas Star Casino, in the south central region, and Hollywood Casino at Kansas Speedway, in the northeast region, were open for a second full fiscal year, having opened in December 2011 and February 2012, respectively. Boot Hill Casino and Resort continued operations for the fourth full fiscal year, having opened in December 2009. The Lottery is responsible for distributing the net revenues of the casino in accordance with the Expanded Lottery Act. For 2014, Expanded Lottery net revenues totaled \$353 million. Transfers totaling \$77.9 million from Expanded Lottery activities were made to the State General Fund. A decrease of \$1.5 million over the prior fiscal year.
- Transfers to the State Gaming Revenue Fund (SGRF) totaled \$74 million in fiscal year 2014, a decrease of \$1.1 million over the prior fiscal year. Actual cash transfers totaled \$74.3 million in fiscal year 2014, a decrease of \$0.2 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 Statement of Net Position provides information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2014 and 2013. The Statement of Revenues, Expenses, and Changes in Net Position report the activities of selling online and instant lottery tickets for the years ended June 30, 2014 and 2013 as well as the Expanded Lottery casino gaming activities for the years ended June 30, 2014 and 2013. 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 activity for the years ended June 30, 2014 and 2013.

Summary of Balance Sheets

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

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Current and other assets	\$ 23.2	\$ 27.3	\$ 25.7
Capital assets	0.3	0.4	0.4
Total assets	<u>\$ 23.5</u>	<u>\$ 27.7</u>	<u>\$ 26.1</u>
Current liabilities	<u>\$ 19.9</u>	<u>\$ 23.4</u>	<u>\$ 19.7</u>
Net Position			
Net Investment in capital assets	0.3	0.4	0.4
Unrestricted	3.3	3.9	6.0
Total net position	<u>3.6</u>	<u>4.3</u>	<u>6.4</u>
Total liabilities and net position	<u>\$ 23.5</u>	<u>\$ 27.7</u>	<u>\$ 26.1</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 2014, current and other assets decreased \$4.1 million due to a decrease in cash on hand of \$3.5 million, a decrease in accounts receivable of \$0.4 million and a decrease in ticket inventory of \$0.2 million.

For fiscal year 2013, current and other assets increased \$1.6 million due to an increase in cash on hand of \$0.2 million, an increase in accounts receivable of \$1.2 million and an increase in ticket inventory of \$0.2 million.

Current liabilities consist of accounts payable and accrued liabilities, transfers due to the State of Kansas, and prize liabilities. The decrease in current liabilities from 2013 is attributable to a decrease in amounts due to the State of Kansas of \$2.0 million, and a decrease in prize liability of \$1.0 million, and a decrease of \$0.5 million in accounts payable and accrued liabilities from 2013.

The increase in current liabilities from 2012 is attributable to an increase in amounts due to the State of Kansas of \$1.2 million, and an increase in prize liability of \$0.7 million, and an increase of \$1.8 million in accounts payable and accrued liabilities from 2012.

Summary of Revenues, Expenses, and Changes in Net Position

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

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Operating revenues:			
Traditional Lottery game revenues	\$ 245.7	\$ 244.8	\$ 246.1
Expanded lottery net revenues	353.0	360.5	197.4
Reimbursements and other	<u>4.4</u>	<u>4.4</u>	<u>4.1</u>
Total operating revenues	<u>603.1</u>	<u>609.7</u>	<u>447.6</u>
Operating expenses:			
Lottery	173.4	172.7	172.6
Expanded lottery	<u>271.4</u>	<u>277.4</u>	<u>153.1</u>
Total operating expenses	<u>444.8</u>	<u>450.1</u>	<u>325.7</u>
Operating income	<u>158.3</u>	<u>159.6</u>	<u>121.9</u>
Non-operating revenues (expenses):			
Lottery	(74.0)	(75.1)	(71.0)
Expanded lottery	<u>(85.0)</u>	<u>(86.6)</u>	<u>(47.4)</u>
Total non-operating revenues (expenses)	<u>(159.0)</u>	<u>(161.7)</u>	<u>(118.4)</u>
Change in net position	(0.7)	(2.1)	3.5
Net position, beginning of year	<u>4.3</u>	<u>6.4</u>	<u>2.9</u>
Net position, end of year	<u>\$ 3.6</u>	<u>\$ 4.3</u>	<u>\$ 6.4</u>

The change in net position between fiscal year 2014 and fiscal year 2013 represents a decrease of \$0.7 million. The decrease is the result of transfers to the State of Kansas exceeded the amount of revenue Kansas Lottery received.

The change in net position between fiscal year 2013 and fiscal year 2012 represents a decrease of \$2.1 million. The decrease is the result of transfers to the State of Kansas exceeded the amount of revenue Kansas Lottery received.

Lottery Game Revenues

Presented in millions of dollars, the following table compares online and instant Lottery sales by game type between fiscal years 2014 and 2013:

Type of Game	2014	2013	Increase (Decrease)	Percentage Change
Instant	\$ 122.8	\$ 117.2	\$ 5.6	4.8%
Pull-Tabs	11.2	10.2	1.0	9.8%
Powerball	41.3	52.0	(10.7)	-20.6%
Mega Millions	16.8	10.4	6.4	61.5%
2 by 2	1.8	1.7	0.1	5.9%
Super Kansas Cash	13.0	13.4	(0.4)	-3.0%
Keno	19.1	20.5	(1.4)	-6.8%
Pick 3	6.0	5.8	0.2	3.4%
Holiday Raffle	3.5	3.0	0.5	16.7%
Hot Lotto	7.4	7.4	-	0.0%
Firecracker 50/50 Raffle	-	0.3	(0.3)	0.0%
Kansas Hold'Em	2.8	2.9	(0.1)	-3.4%
Total	<u>\$ 245.7</u>	<u>\$ 244.8</u>	<u>\$ 0.9</u>	<u>0.4%</u>

Fiscal year 2014 sales were \$245.7 million compared to \$244.8 million in fiscal year 2013. Revenues from the sales on online and instant lottery tickets for the fiscal year ended June 30, 2014 increased 0.4% or \$0.9 million compared to the previous year.

- Mega Millions saw sales increase of \$6.4 million, due to large jackpot payouts.
- Holiday Raffle saw an increase of \$0.5 million compared to the previous year, due to an increase of tickets being offered in the game.
- Instant tickets also saw a sales increase of \$5.6 million. Much credit for the instant game sales increase is due to the Lottery's efforts to replacing in-counter ticket dispensers with larger, on-counter dispensers to give players a better view of ticket offerings and a larger variety from which to choose.
- Powerball sales decreased \$10.7 million due to record-breaking sales in fiscal year 2013.

Presented in millions of dollars, the following table compares online and instant Lottery sales by game types between fiscal years 2013 and 2012:

Type of Game	2013	2012	Increase (Decrease)	Percentage Change
Instant	\$ 117.2	\$ 124.0	\$ (6.8)	-5.5%
Pull-Tabs	10.2	9.0	1.2	12.8%
Powerball	52.0	37.6	14.4	38.3%
Mega Millions	10.4	15.7	(5.3)	-33.6%
2 by 2	1.7	1.9	(0.2)	-8.2%
Super Kansas Cash	13.4	15.6	(2.2)	-14.1%
Keno	20.5	23.1	(2.6)	-11.3%
Pick 3	5.8	6.0	(0.2)	-3.3%
Holiday Raffle	3.3	3.0	0.3	10.0%
Hot Lotto	7.4	7.0	0.4	6.1%
Kansas Hold'Em	2.9	3.2	(0.3)	-10.3%
Total	<u>\$ 244.8</u>	<u>\$ 246.1</u>	<u>\$ (1.3)</u>	<u>-0.5%</u>

Fiscal year 2013 sales were \$244.8 million compared to \$246.1 million in fiscal year 2012. Revenues from the sales on online and instant lottery tickets for the fiscal year ended June 30, 2013 decreased 0.5% or \$1.3 million compared to the previous year. Powerball and Hot Lotto saw sales increases of \$14.4 and \$0.4 million, respectively, due to large jackpot payouts. Instant tickets also saw a sales decrease of \$6.8 million. The decrease is due to the record-breaking sales of Powerball.

Lottery Expenses

Game Related

The following table compares the Lottery's game-related expenses between fiscal year 2014 and fiscal year 2013. The expenses are shown in millions of dollars:

Description	2014	2013	Increase (Decrease)	Percentage Change
Game Prizes	138.7	\$ 138.6	\$ 0.1	0.1%
Retailer commissions	14.4	14.3	\$ 0.1	0.7%
Online Games Service Bureau	5.6	5.9	\$ (0.3)	-5.1%
Instant Ticket Printing Cost	3.7	3.6	\$ 0.1	2.8%
Total	<u>\$ 162.4</u>	<u>\$ 162.4</u>	<u>\$ (0.0)</u>	<u>0.0%</u>

The overall increase in game prizes was the result of the increase in sales compared to those in fiscal year 2013. The online games service bureau cost decreased as a result of decreased online sales.

The following table compares the lottery game-related expenses between fiscal year 2013 and fiscal year 2012. The expenses are shown in millions of dollars:

Description	2013	2012	Increase (Decrease)	Percentage Change
Game Prizes	\$ 138.6	\$ 138.9	\$ (0.3)	-0.2%
Retailer commissions	14.3	14.4	(0.1)	-0.7%
Online Games Service bureau	5.9	5.7	0.2	3.5%
Instant Ticket Printing Costs	3.6	3.8	(0.2)	-5.3%
	<u>\$ 162.4</u>	<u>\$ 162.8</u>	<u>\$ (0.4)</u>	<u>-0.2%</u>

The overall decrease in game prizes was the result of the decrease in sales compared to those in fiscal year 2012. The online games service bureau cost increased as a result of more online sales.

Non-game Related

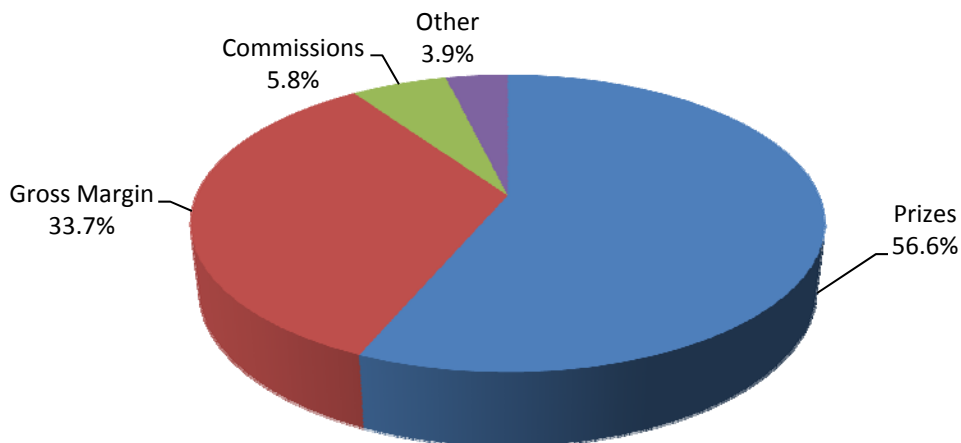
Of the \$10.8 million of fiscal year 2014 lottery operating expenses that were non-game related, \$4.4 million was for employees' salaries and wages, \$3.8 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.6 million. Of the \$10.3 million of fiscal year 2013 lottery operating expenses that were non-game related, \$4.5 million was for employees' salaries and wages, \$3.5 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.3 million.

Of the \$10.3 million of fiscal year 2013 lottery operating expenses that were non-game related, \$4.5 million was for employees' salaries and wages, \$3.5 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.3 million. In fiscal year 2012, these same expenses totaled \$9.7, including \$4.6 million was for employees' salaries and wages, \$2.5 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.6 million.

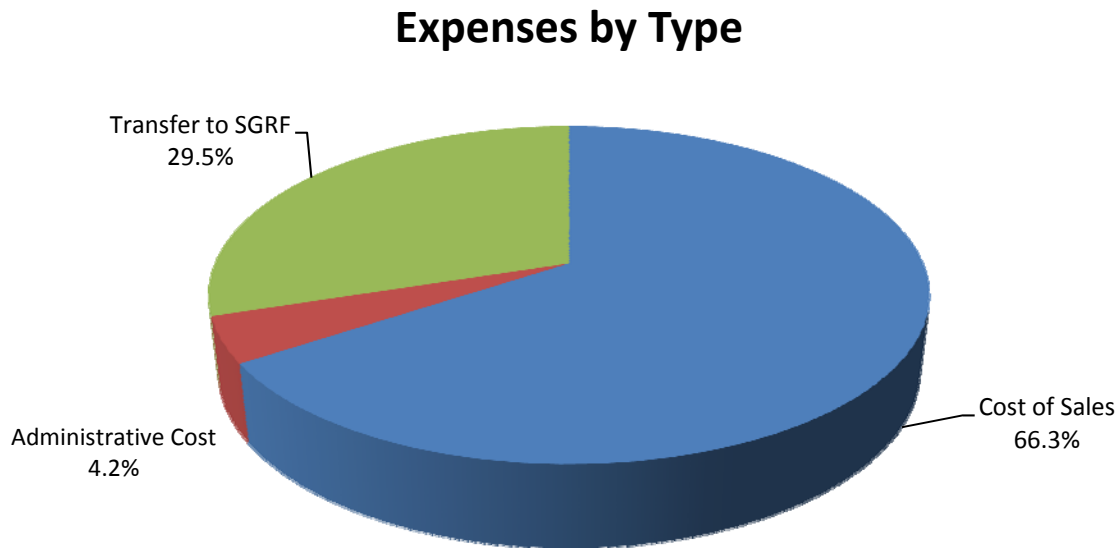
The following chart depicts Kansas Lottery's compliance with the not less than 45% prize payment statute and the retailers' commissions rules.

Kansas Lottery
Graphs of Financial Highlights
For the Fiscal Year Ended June 30, 2014

Game Related Expense as a Percent of Lottery Sales



The following chart breaks down expenses by type incurred by Kansas Lottery for traditional lottery activity.



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 Executive 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 2014, the legislature again waived the percentage of sales transfer requirement for a minimum transfer request of \$75.7 million, with a minimum monthly transfer of \$4.6 million. For 2014, the accrual basis transfers to the SGRF were \$74 million, a decrease of \$1.1 million over 2013. Actual cash transfers to the SGRF were \$74.3 million in 2014. The fiscal year 2013, accrual basis transfer of \$75.1 million was \$4.1 million more than the fiscal year 2012.

Expanded Lottery

The 2007 Legislature passed Senate Bill 66, the Kansas 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

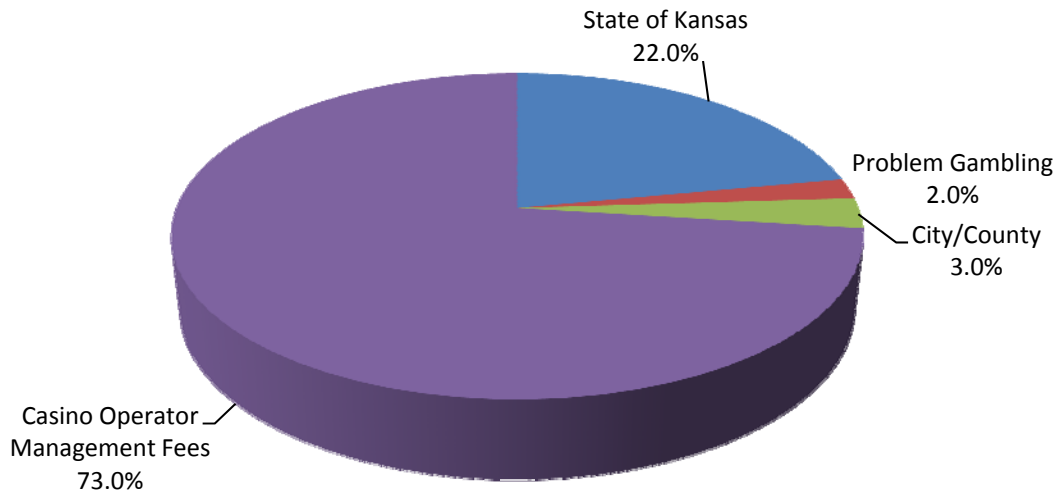
As of June 30, 2014, the State had three casinos operational. Hollywood Casino at Kansas Speedway and Kansas Star Casino were operational for the full fiscal year 2013, having opened February 2012 and December 2011, respectively. The Boot Hill Casino and Resort was open for the full fiscal year. The net revenue and related expenses are as follows (shown in millions of dollars):

	<u>2014</u>	<u>2013</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 353.0</u>	<u>\$ 360.5</u>	<u>\$ (7.5)</u>	<u>-2.1%</u>
Expenses:				
State of Kansas	77.9	79.4	(1.5)	-1.9%
Problem Gambling	7.1	7.2	(0.1)	-1.4%
City and County	10.6	10.8	(0.2)	-1.9%
Management Fees	<u>257.4</u>	<u>263.1</u>	<u>(5.7)</u>	<u>-2.2%</u>
Total	<u>\$ 353.0</u>	<u>\$ 360.5</u>	<u>\$ (7.5)</u>	<u>-2.1%</u>

	<u>2013</u>	<u>2012</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 360.5</u>	<u>\$ 197.3</u>	<u>\$ 163.2</u>	<u>82.7%</u>
Expenses:				
State of Kansas	79.4	43.4	36.0	82.9%
Problem Gambling	7.2	3.9	3.3	82.4%
City and County	10.8	5.9	4.9	82.4%
Management Fees	<u>263.1</u>	<u>144.1</u>	<u>119.0</u>	<u>82.6%</u>
Total	<u>\$ 360.5</u>	<u>\$ 197.3</u>	<u>\$ 163.2</u>	<u>82.7%</u>

The following chart depicts expenses incurred by Kansas Lottery for Expanded Gaming activity.

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, 2014 and 2013 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 Calhoun, Fiscal Analyst, at 128 N Kansas Avenue, Topeka, KS 66603.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENT OF NET POSITION
JUNE 30, 2014 AND 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u> <u>As Restated</u>
Current Assets:		
Cash:		
Operating fund	\$ 5,445,054	\$ 9,935,514
Prize payment fund	1,100,278	121,091
Accounts receivable, net of allowance for doubtful accounts of \$234,118 and \$236,708 at 2014 and 2013, respectively	2,744,572	2,370,739
Accounts receivable - unbilled	7,217,090	7,791,202
Other receivable	4,781,265	4,947,431
Instant ticket game inventory	1,939,664	2,153,725
Total current assets	<u>23,227,923</u>	<u>27,319,702</u>
Capital assets, net of depreciation	<u>273,393</u>	<u>359,456</u>
Total assets	<u>23,501,316</u>	<u>27,679,158</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Current liabilities:		
Accounts payable and accrued liabilities	8,245,590	8,587,169
Due to the State of Kansas	5,447,009	7,463,228
Due to Problem Gambling Fund	-	159,736
Prize liability	6,188,653	7,189,909
Total current liabilities	<u>19,881,252</u>	<u>23,400,042</u>
Net position:		
Net Investment in capital assets	273,393	359,456
Unrestricted	3,346,671	3,919,660
Total net position	<u>\$ 3,620,064</u>	<u>\$ 4,279,116</u>

See accompanying notes to financial statements.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEARS ENDED JUNE 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u> As Restated
Operating revenues:		
Net game revenues	\$ 245,708,290	\$ 244,764,848
Expanded lottery revenues	353,022,317	360,534,392
Expanded lottery reimbursements	3,401,967	3,453,148
Phone reimbursements	936,900	937,810
Retailer fees and miscellaneous income	42,150	63,056
	<u>603,111,624</u>	<u>609,753,254</u>
Operating expenses:		
Game prizes	138,741,873	138,554,999
Casino operator management fee	257,451,264	263,126,107
Retailer commissions	14,435,510	14,295,934
On-line games service bureau	5,647,024	5,877,944
Salaries and benefits	5,542,124	5,508,412
Cost of instant tickets	3,368,506	3,553,165
Advertising	3,804,097	3,465,437
Other administrative expenses	2,599,789	2,222,369
Depreciation	147,323	145,867
City and County expanded lottery fees	10,590,670	10,816,032
Professional services	346,484	486,299
On-line service bureau - expanded lottery	1,985,931	1,950,412
Telecommunications	134,851	129,337
	<u>444,795,446</u>	<u>450,132,315</u>
Operating income	<u>158,316,178</u>	<u>159,620,939</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(73,994,846)	(75,101,625)
Transfers to the State General Fund	(77,919,938)	(79,381,564)
Transfers to the Problem Gambling Fund	(7,060,446)	(7,210,688)
Write-off and adjustment of capital assets	-	(7,280)
	<u>(158,975,230)</u>	<u>(161,701,157)</u>
Change in net position	(659,052)	(2,080,219)
Net position, beginning of year (as restated)	<u>4,279,116</u>	<u>6,359,335</u>
Net position, end of year	<u>\$ 3,620,064</u>	<u>\$ 4,279,116</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, 2014 AND 2013

	2014	2013 As Restated
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 603,478,069	\$ 608,584,296
Cash paid for prizes, commissions, and other expenses	(440,234,773)	(442,228,069)
Cash paid to employees	(5,542,124)	(5,508,412)
Net cash provided by operating activities	157,701,172	160,847,815
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(74,291,352)	(74,522,230)
Payments to State General Fund	(79,639,651)	(78,811,882)
Payments to State Problem Gambling Fund	(7,220,182)	(7,170,420)
Net cash used by noncapital financing activities	(161,151,185)	(160,504,532)
Cash flows from capital and related financing activities:		
Purchases of capital assets	(61,260)	(123,558)
Net cash used by capital and related financing activities	(61,260)	(123,558)
Net increase (decrease) in cash	(3,511,273)	219,725
Cash, beginning of year	10,056,605	9,836,880
Cash, end of year	\$ 6,545,332	\$ 10,056,605
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 158,316,178	\$ 159,620,939
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	147,323	145,867
Changes in operating assets and liabilities:		
Accounts receivable	200,279	301,683
Other receivable	166,166	(1,470,641)
Instant ticket game inventory	214,061	(232,079)
Accounts payable and accrued liabilities	(341,579)	1,775,602
Prize liability	(1,001,256)	706,444
Net cash provided by operating activities	\$ 157,701,172	\$ 160,847,815

See accompanying notes to financial statements.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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 Kansas 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.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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, 2014 and 2013

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 2014 and 2013 were \$3,401,967 and \$3,453,148 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, 2014 and 2013

Capital Assets

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 Real Estate and Lottery Facility Games

The respective facility managers own the related land and building used for the purpose of the casino. In addition, the respective facility managers must purchase the Lottery Facility Games on behalf of the State of Kansas. See Note 4 for information related to the Expanded Lottery Gaming Facility Management agreements with the third-party casino facility managers. See Note 13 for information related to Expanded Lottery Facility Games Ownership.

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.

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.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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.

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.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

Deferred outflows/inflows of resources

As of June 30, 2013 the Lottery implemented GASB Statements No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position and No. 65, Items Previously Reported as Assets and Liabilities. These statements changed the format of the Lottery's financial statements and added two additional classifications. These new classifications are described below.

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expense) until then. The Lottery does not currently have any items that qualify for reporting in this category.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Lottery does not currently have any items that qualify for reporting in this category.

Net Position Flow Assumption

Sometimes the Lottery will fund outlays for a particular purpose from both restricted and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted – net position in the statement of net position, a flow assumption must be made about the order in which the resources are considered to be applied. It is the Lottery's policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

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.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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. Earnings on investments are retained by the State of Kansas. At June 30, 2014 and 2013, the Lottery's share in the State's common cash pool was \$6,453,309 and \$9,959,454, respectively.

3 - Capital Assets

Property and equipment consisted of the following at June 30, 2014:

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balances</u>
Equipment, furnishing and software	\$ 1,274,958			\$ 1,274,958
Vehicles	769,217	61,260	-	830,477
Total Lottery capital assets	<u>2,044,175</u>	<u>61,260</u>	<u>-</u>	<u>2,105,435</u>
Accumulated depreciation	<u>(1,684,719)</u>	<u>(147,323)</u>	<u>-</u>	<u>(1,832,042)</u>
Total capital assets, net of depreciation	<u>\$ 359,456</u>			<u>\$ 273,393</u>

Property and equipment consisted of the following at June 30, 2013:

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balances</u>
Equipment, furnishing and software	\$ 1,274,958			\$ 1,274,958
Vehicles	732,711	123,558	87,052	769,217
Total Lottery capital assets	<u>2,007,669</u>	<u>123,558</u>	<u>87,052</u>	<u>2,044,175</u>
Accumulated depreciation	<u>(1,618,624)</u>	<u>(145,867)</u>	<u>79,772</u>	<u>(1,684,719)</u>
Total capital assets, net of depreciation	<u>\$ 389,045</u>			<u>\$ 359,456</u>

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

4 - Commitments

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

2015	\$	667,796
2016		684,717
2017		702,243
2018		719,769
2019		737,899
2020-2023		2,736,452
	<u>\$</u>	<u>6,248,876</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 \$733,907 and \$710,276 under operating leases for the years ended June 30, 2014 and 2013, 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. Fees were \$5,647,024 and \$5,877,944 for the years ended June 30, 2014 and 2013, 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 \$1,985,931 and \$1,950,412 for the years ended June 30, 2014 and 2013, 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.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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.

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 years ended June 30, 2014 and 2013, the fee was \$29,131,581 and \$31,648,058 as is recorded in the statements of revenues, expenses, and changes in net position.

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 terms of the northeast gaming zone agreement are similar in nature to the terms of the agreement that the Lottery entered into related to the southwest gaming zone described above. Full time casino gaming operations in the northeast gaming zone commenced on February 3, 2012.

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

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

Facility Revenues will be transferred to the State of Kansas. For the years ended June 30, 2014 and 2013, the fee was \$96,386,566 and \$91,245,417 as is recorded in the statements of revenues, expenses, and changes in net position.

South Central Gaming Zone

In 2009, 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 terms of the gaming zone agreement are similar in nature to the terms of the agreement that the Lottery entered into related to the southwest gaming zone described above. Full time casino gaming operations in the South Central gaming zone commenced on December 20, 2011.

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 years ended June 30, 2014 and 2013, the fee was \$131,933,117 and \$140,232,633 as is recorded in the statements of revenues, expenses, and changes in net position.

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 payment 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 installment outstanding at June 30, 2014 and 2013 were \$1,518,000 and \$3,325,000, respectively.

MUSL Prize Reserves

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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.

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, 2014 and 2013, the prize reserve account had a balance \$76,376,927 and \$78,975,475, respectively, of which the Lottery's portion was \$1,299,625 and \$1,288,230, respectively. The set prize reserve at June 30, 2014 and 2013 had a balance of \$35,199,525 and \$34,898,046, respectively, of which the Lottery's portion was \$613,433 and \$642,485, 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, 2014 and 2013 was \$35,842,966 and \$27,968,381, respectively, of which the Lottery's portion was \$611,548 and \$463,001.

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, 2014 and 2013, 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, 2014 and 2013, the prize reserve account had a balance of \$7,411,908 and \$7,920,821, respectively, of which the Lottery's portion was \$866,707 and \$986,890, 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, 2014 and 2013 the Lottery's portion of the balance of this account was \$154,245 and \$52,446, 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.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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.

Annuity contracts have been purchased for lifetime prize payments. At June 30, 2014 and 2013, the approximate remaining prize payments are \$409,500 and \$427,500, 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 had no problem 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.

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

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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 year ended June 30, 2014, the State Legislature set a minimum transfer to the Fund of \$74,520,000 in addition to \$1,200,000 for the veteran transfer. For the year ended June 30, 2013 the State Legislature set a minimum transfer to the Fund of \$72,500,000. Under the accrual basis of accounting, total transfers to the State of Kansas for years ended June 30, 2014 and 2013 were \$73,994,846 and \$75,101,625, respectively, of which \$5,282,889 and \$5,579,395 was unpaid, respectively. Actual cash transfers to the State of Kansas for years ended June 30, 2014 and 2013 were \$74,291,352 and \$74,522,230, respectively. Included in the minimum transfer amount were mandated transfer of \$1,795,054 and \$1,594,127 for the years ended June 30, 2014 and 2013, respectively, from proceeds of special veterans' games.

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, 2014 and 2013:

	FY 2014 <u>Boot Hill</u>	FY 2013 <u>Boot Hill</u>
Gaming Facility Revenue:		
Electronic games	\$ 35,097,472	\$ 36,854,929
Table games	4,808,803	6,498,575
Total	<u>\$ 39,906,275</u>	<u>\$ 43,353,504</u>
Distributions:		
State of Kansas - 22%	\$ 8,779,381	\$ 9,537,771
Problem Gambling Fund - 2%	798,125	867,070
City & County - 3%	1,197,188	1,300,605
Casino operator management fees - 73%	29,131,581	31,648,058
Total	<u>\$ 39,906,275</u>	<u>\$ 43,353,504</u>

	FY 2014 <u>Kansas Star</u>	FY 2013 <u>Kansas Star</u>
Gaming Facility Revenue:		
Electronic games	\$ 153,943,700	\$ 164,230,157
Table games	27,135,950	27,957,009
Total	<u>\$ 181,079,650</u>	<u>\$ 192,187,166</u>
Distributions:		
State of Kansas - 22 - 24%	\$ 40,092,550	\$ 42,345,174
Problem Gambling Fund - 2%	3,621,593	3,843,744
City & County - 3%	5,432,390	5,765,615
Casino operator management fees - 71 - 73%	131,933,117	140,232,633
Total	<u>\$ 181,079,650</u>	<u>\$ 192,187,166</u>

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

	FY 2014 <u>Hollywood</u>	FY 2013 <u>Hollywood</u>
Gaming Facility Revenue:		
Electronic games	\$ 112,156,119	\$ 104,017,241
Table games	19,880,273	20,976,481
Total	<u>\$ 132,036,392</u>	<u>\$ 124,993,722</u>
Distributions:		
State of Kansas - 22%	\$ 29,048,006	\$ 27,498,619
Problem Gambling Fund - 2%	2,640,728	2,499,874
City & County - 3%	3,961,092	3,749,811
Casino operator management fees - 73%	96,386,566	91,245,417
Total	<u>\$ 132,036,392</u>	<u>\$ 124,993,721</u>

At June 30, 2014 and 2013, \$4,304,313 and \$4,681,822, respectively, was receivable from the casino manager for online and table game net revenue. At June 30, 2014 and 2013, \$6,500,670 and \$6,609,483, respectively, was payable to the casino management, the Cities, and Counties for revenues collected but not yet distributed, and is included in accounts payable and accrued liabilities. At June 30, 2014 and 2013, \$164,120 and \$2,043,569, 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, 2014 and 2013

8 - Schedule of Gross Margin-Lottery

Gross margin by game is as follows:

	Year Ended June 30, 2014												
	Instant	Pulltabs	Powerball	2 by 2	Kansas Cash	Keno	Mega Millions	Pick 3	Hot Lotto	Kansas Hold'Em	Holiday Raffle 50/50 Raffle	Total	
Sales, net	\$ 122,880,422	\$ 11,161,448	\$ 41,301,245	\$ 1,826,953	\$ 13,008,560	\$ 19,086,066	\$ 16,758,706	\$ 5,990,759	\$ 7,368,317	\$ 2,803,874	\$ 3,521,940	\$ 245,708,290	
Prizes, net	(75,835,815)	(6,649,910)	(20,652,980)	(913,477)	(6,504,280)	(9,543,033)	(8,379,353)	(2,995,380)	(3,684,159)	(1,822,518)	(1,760,970)	(138,741,875)	
Retailer Commissions	(7,219,299)	(655,742)	(2,426,472)	(107,335)	(764,261)	(1,121,318)	(984,584)	(351,961)	(432,893)	(164,729)	(206,916)	(14,435,510)	
Gross Margin	<u>\$ 39,825,308</u>	<u>\$ 3,855,796</u>	<u>\$ 18,221,793</u>	<u>\$ 806,141</u>	<u>\$ 5,740,019</u>	<u>\$ 8,421,715</u>	<u>\$ 7,394,769</u>	<u>\$ 2,643,418</u>	<u>\$ 3,251,265</u>	<u>\$ 816,627</u>	<u>\$ 1,554,054</u>	<u>\$ 92,530,905</u>	
	Year Ended June 30, 2013												
	Instant	Pulltabs	Powerball	2 by 2	Kansas Cash	Keno	Mega Millions	Pick 3	Hot Lotto	Kansas Hold'Em	Firecracker 50/50 Raffle	Holiday Raffle	Total
Sales, net	\$ 117,150,914	\$ 10,193,505	\$ 52,050,674	\$ 1,691,050	\$ 13,388,882	\$ 20,465,130	\$ 10,389,089	\$ 5,823,707	\$ 7,440,836	\$ 2,894,281	\$ 276,780	\$ 3,000,000	\$ 244,764,848
Prizes, net	(72,213,098)	(6,116,103)	(26,025,337)	(845,525)	(6,694,441)	(11,255,522)	(5,350,381)	(2,911,854)	(3,720,418)	(1,783,930)	(138,390)	(1,500,000)	(138,554,999)
Retailer Commissions	(6,843,751)	(595,260)	(3,039,591)	(98,751)	(781,857)	(1,195,082)	(606,681)	(340,081)	(434,515)	(169,014)	(16,163)	(175,188)	(14,295,934)
Gross Margin	<u>\$ 38,094,065</u>	<u>\$ 3,482,142</u>	<u>\$ 22,985,746</u>	<u>\$ 746,774</u>	<u>\$ 5,912,584</u>	<u>\$ 8,014,526</u>	<u>\$ 4,432,027</u>	<u>\$ 2,571,772</u>	<u>\$ 3,285,903</u>	<u>\$ 941,337</u>	<u>\$ 122,227</u>	<u>\$ 1,324,812</u>	<u>\$ 91,913,915</u>

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

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 2014 and 2013 are 10.27 and 9.37 percent, respectively. The Lottery contributions to KPERs for the years ending June 30, 2014, 2013 and 2012, were approximately \$ 424,000, \$403,000, and \$375,000, 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, 2014 and 2013

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 2014 and 2013, 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, 2014 is \$530 for single coverage and \$800 for member plus dependent coverage.

Two Lottery employees retired before October 31, 2011 to participate in VRIP. Lottery VRIP payments for the years ended June 30, 2014 and 2013 were \$6,995 and \$17,228 respectively. Management has estimated an additional amount payable for the VRIP in the amount of \$16,322.

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, 2014 and 2013

Annual required Contribution (ARC)	\$ 57,000
Interest in the net OPEB obligation	13,000
Adjustment to the ARC	<u>(19,000)</u>
Annual OPEB cost (expense)	51,000
Net Employer contributions	<u>(20,000)</u>
Increase in net OPEB obligation	31,000
Net OPEB obligation, beginning of year	<u>332,000</u>
Net OPEB obligation, end of year	<u><u>\$ 363,000</u></u>

	Fiscal Year	Annual OPEB Cost	Net Employer Contributions	Percentage Contributed	End of Year Net OPEB Obligation
Kansas Lottery	2012	\$ 67,000	\$ 36,000	54%	\$ 300,000
Kansas Lottery	2013	69,000	37,000	54%	332,000
Kansas Lottery	2014	51,000	20,000	39%	363,000

Funded Status and Funding Progress

As of June 30, 2014, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$624,000. 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 \$624,000. The covered payroll (annual payroll of active employees covered by the plan) was \$4,019,000, and the ratio of the UAAL to covered payroll was 16 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, 2014 and 2013

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, 2014 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 7 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. The State of Kansas did not receive privilege fees during the years ended June 30, 2014 and 2013.

12 - Subsequent Event

The Lottery has evaluated subsequent events through October 10, 2014, the date the financial statements were available to be issued. There were no subsequent events that require recognition or disclosure in the financial statements.

13 - Expanded Lottery Facility Games Ownership

In accordance with the Kansas Expanded Lottery Act, and the management contracts with the Lottery Gaming Facility Managers: (a) only the State of Kansas can own and/ or lease Lottery Facility Games; and, (b) the Lottery Gaming Facility Managers must purchase or lease the lottery facility games on behalf of the Kansas Lottery.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2014 and 2013

However, according to the most relevant accounting guidance available, the Lottery's ownership of the Lottery Facility Games may not meet the technical definition of an asset, as outlined in the Governmental Accounting Standards Board Conceptual Statement #4 – Elements of the Financial Statement, for financial reporting purposes. If the Lottery Facility Games met the technical definition of an asset, the Lottery would have recorded additional net position of \$43,468,222 and \$29,371,000 in 2013 and 2014, respectively.

It should be expressly noted that this interpretation on how, or if, these Lottery Facility Games are booked is so the Lottery can properly report capital assets in accordance with generally accepted accounting principles, and that the legal interpretation of the Lottery's ownership and control of these games has not changed. It is possible that future authoritative guidance may provide for a different interpretation or recommendation as to how or whether these machines should be booked by the Lottery.

14 - Prior Period Adjustment

A prior period adjustment was made to remove the Expanded Lottery Facility Games (as discussed in Note 13) that were previously capitalized. The prior period adjustment adjusted total assets at June 30, 2013 from \$71,147,380 to \$27,679,158. Change in net position for the fiscal year ended June 30, 2013 was adjusted from (\$12,476,781) to (\$2,080,219). The net position at the start of the fiscal year ended June 30, 2013 was adjusted from \$60,224,119 to \$6,359,335.

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)
6/30/2014	0	\$ 624,000	\$ 624,000	0%	\$ 4,019,000	16%
6/30/2013	0	767,000	767,000	0%	4,073,000	19%
6/30/2012	0	746,000	746,000	0%	4,115,000	18%

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF NET POSITION
JUNE 30, 2014

	Kansas Lottery		Total 2014
	Lottery	Expanded Lottery	
<u>ASSETS</u>			
Current Assets:			
Cash:			
Operating fund	\$ 3,084,577	\$ 2,360,477	\$ 5,445,054
Prize payment fund	1,100,278	-	1,100,278
Accounts receivable, net of allowance for doubtful accounts of \$234,118	2,744,572	-	2,744,572
Accounts receivable - unbilled	7,217,090	-	7,217,090
Other receivable	476,952	4,304,313	4,781,265
Instant ticket game inventory	1,939,664	-	1,939,664
 Total current assets	 16,563,133	 6,664,790	 23,227,923
Capital assets, net of depreciation:	273,393	-	273,393
 Total assets	 16,836,526	 6,664,790	 23,501,316
<u>LIABILITIES AND NET POSITION</u>			
Current liabilities:			
Accounts payable and accrued liabilities	1,744,920	6,500,670	8,245,590
Due to the State of Kansas	5,282,889	164,120	5,447,009
Due to Problem Gambling Fund	-	-	-
Prize liability	6,188,653	-	6,188,653
 Total current liabilities	 13,216,462	 6,664,790	 19,881,252
Net position:			
Net Investment in capital assets	273,393	-	273,393
Unrestricted	3,346,671	-	3,346,671
 Total net position	 \$ 3,620,064	 \$ -	 \$ 3,620,064

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEAR ENDED JUNE 30, 2014

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2014
Operating revenues:			
Net game revenues	\$ 245,708,290		\$ 245,708,290
Expanded lottery revenues		353,022,317	353,022,317
Expanded lottery reimbursements		3,401,967	3,401,967
Phone reimbursements	936,900		936,900
Retailer fees and miscellaneous income	42,150		42,150
Total operating revenues	<u>246,687,340</u>	<u>356,424,284</u>	<u>603,111,624</u>
Operating expenses:			
Game prizes	138,741,873		138,741,873
Casino operator management fee		257,451,264	257,451,264
Retailer commissions	14,435,510		14,435,510
On-line games service bureau	5,647,024		5,647,024
Salaries and benefits	4,441,378	1,100,746	5,542,124
Cost of instant tickets	3,368,506		3,368,506
Advertising	3,804,097		3,804,097
Other administrative expenses	2,328,241	271,548	2,599,789
Depreciation	147,323		147,323
City and County expanded lottery fees		10,590,670	10,590,670
Professional services	310,006	36,478	346,484
On-line service bureau - lottery gaming		1,985,931	1,985,931
Telecommunications	127,588	7,263	134,851
Total operating expenses	<u>173,351,546</u>	<u>271,443,900</u>	<u>444,795,446</u>
Operating income	<u>73,335,794</u>	<u>84,980,384</u>	<u>158,316,178</u>
Nonoperating revenues (expenses):			
Transfers to the State Gaming Revenue Fund	(73,994,846)		(73,994,846)
Transfers to the State General Fund		(77,919,938)	(77,919,938)
Transfers to the Problem Gambling Fund		(7,060,446)	(7,060,446)
Loss on disposal of capital assets	-	-	-
Total nonoperating revenues (expenses)	<u>(73,994,846)</u>	<u>(84,980,384)</u>	<u>(158,975,230)</u>
Change in net position	(659,052)	-	(659,052)
Net position, beginning of year	4,279,116	-	4,279,116
Net position, end of year	<u>\$ 3,620,064</u>	<u>\$ -</u>	<u>\$ 3,620,064</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2014

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2014
Cash flows from operating activities:			
Cash received from sales and reimbursements	\$ 246,676,276	356,801,793	\$ 603,478,069
Cash paid for prizes, commissions, and other expenses	(169,782,806)	(270,451,967)	(440,234,773)
Cash paid to employees	(4,441,378)	(1,100,746)	(5,542,124)
Net cash provided by operating activities	<u>72,452,092</u>	<u>85,249,080</u>	<u>157,701,172</u>
Cash flows from noncapital financing activities:			
Payments to State Gaming Revenue Fund	(74,291,352)		(74,291,352)
Payments to State General Fund		(79,639,651)	(79,639,651)
Payments to State Problem Gambling Fund		(7,220,182)	(7,220,182)
Net cash used by noncapital financing activities	<u>(74,291,352)</u>	<u>(86,859,833)</u>	<u>(161,151,185)</u>
Cash flows from capital and related financing activities:			
Purchases of capital assets	(61,260)	-	(61,260)
Net cash used by capital and related financing activities	<u>(61,260)</u>	<u>-</u>	<u>(61,260)</u>
Net increase (decrease) in cash	(1,900,520)	(1,610,753)	(3,511,273)
Cash, beginning of year	6,085,375	3,971,230	10,056,605
Cash, end of year	<u>\$ 4,184,855</u>	<u>\$ 2,360,477</u>	<u>\$ 6,545,332</u>
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	\$ 73,335,794	\$ 84,980,384	\$ 158,316,178
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	147,323		147,323
Changes in operating assets and liabilities:			
Accounts receivable	200,279		200,279
Other receivable	(211,343)	377,509	166,166
Instant ticket game inventory	214,061		214,061
Accounts payable and accrued liabilities	(232,766)	(108,813)	(341,579)
Prize liability	(1,001,256)		(1,001,256)
Net cash provided by operating activities	<u>\$ 72,452,092</u>	<u>\$ 85,249,080</u>	<u>\$ 157,701,172</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF NET POSITION - LOTTERY
JUNE 30, 2014 AND 2013

<u>ASSETS</u>	Lottery	
	2014	2013
Current Assets:		
Cash:		
Operating fund	\$ 3,084,577	\$ 5,964,284
Prize payment fund	1,100,278	121,091
Accounts receivable, net of allowance for doubtful accounts of \$234,118 and \$236,708 at 2014 and 2013, respectively	2,744,572	2,370,739
Accounts receivable - unbilled	7,217,090	7,791,202
Other receivable	476,952	265,609
Instant ticket game inventory	1,939,664	2,153,725
	16,563,133	18,666,650
Total current assets		
Capital assets, net of depreciation	273,393	359,456
	16,836,526	19,026,106
Total assets		
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,744,920	\$ 1,977,686
Due to the State of Kansas	5,282,889	5,579,395
Prize liability	6,188,653	7,189,909
	13,216,462	14,746,990
Total current liabilities		
Net position:		
Net Investment in capital assets	273,393	359,456
Unrestricted	3,346,671	3,919,660
	\$ 3,620,064	\$ 4,279,116
Total net position		

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION - LOTTERY
YEARS ENDED JUNE 30, 2014 AND 2013

	Lottery	
	2014	2013
Operating revenues:		
Net game revenues	\$ 245,708,290	\$ 244,764,848
Phone reimbursements	936,900	937,810
Retailer fees and miscellaneous income	42,150	63,056
Total operating revenues	<u>246,687,340</u>	<u>245,765,714</u>
Operating expenses:		
Game prizes	138,741,873	138,554,999
Retailer commissions	14,435,510	14,295,934
On-line games service bureau	5,647,024	5,877,944
Salaries and benefits	4,441,378	4,485,978
Cost of instant tickets	3,368,506	3,553,165
Advertising	3,804,097	3,465,437
Other administrative expense	2,328,241	1,929,692
Depreciation	147,323	145,867
Professional services	310,006	306,546
Telecommunications	127,588	121,464
Total operating expenses	<u>173,351,546</u>	<u>172,737,027</u>
Operating income	<u>73,335,794</u>	<u>73,028,687</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(73,994,846)	(75,101,625)
Transfers to the State General Fund		
Write-off and adjustment of capital assets	-	(7,280)
Total nonoperating revenues (expenses)	<u>(73,994,846)</u>	<u>(75,108,905)</u>
Change in net position	(659,052)	(2,080,218)
Net position, beginning of year	<u>4,279,116</u>	<u>6,359,334</u>
Net position, end of year	<u>\$ 3,620,064</u>	<u>\$ 4,279,116</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF CASH FLOWS - LOTTERY
YEARS ENDED JUNE 30, 2014 AND 2013

	Lottery	
	2014	2013
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 246,676,276	\$ 246,066,314
Cash paid for prizes, commissions, and other expenses	(169,782,806)	(167,493,305)
Cash paid to employees	(4,441,378)	(4,453,978)
Net cash provided by operating activities	<u>72,452,092</u>	<u>74,119,032</u>
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(74,291,352)	(74,522,230)
Payments to State General Fund	-	-
Net cash used by noncapital financing activities	<u>(74,291,352)</u>	<u>(74,522,230)</u>
Cash flows from capital and related financing activities:		
Purchases of capital assets	(61,260)	(123,560)
Net cash used by capital and related financing activities	<u>(61,260)</u>	<u>(123,560)</u>
Net increase in cash	(1,900,520)	(526,758)
Cash, beginning of year	<u>6,085,375</u>	<u>6,612,133</u>
Cash, end of year	<u><u>\$ 4,184,855</u></u>	<u><u>\$ 6,085,375</u></u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 73,335,794	\$ 73,073,310
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	147,323	145,867
Changes in operating assets and liabilities:		
Accounts receivable	200,279	257,061
Other receivable	(211,343)	(1,083)
Instant ticket game inventory	214,061	(232,079)
Accounts payable and accrued liabilities	(232,766)	169,512
Prize liability	(1,001,256)	706,444
Net cash provided by operating activities	<u><u>\$ 72,452,092</u></u>	<u><u>\$ 74,119,032</u></u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF NET POSITION - EXPANDED LOTTERY
JUNE 30, 2014 AND 2013

	Expanded Lottery	
	2014	2013 As Restated
<u>ASSETS</u>		
Current Assets:		
Cash:		
Operating fund	\$ 2,360,477	\$ 3,971,230
Other receivable	4,304,313	4,681,822
Total current assets	6,664,790	8,653,052
Total assets	6,664,790	8,653,052
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 6,500,670	\$ 6,609,483
Due to the State of Kansas	164,120	1,883,833
Due to Problem Gambling Fund	-	159,736
Total current liabilities	6,664,790	8,653,052
Total net position	\$ -	\$ -

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2014 AND 2013

	<u>Expanded Lottery</u>	
	<u>2014</u>	<u>2013 As Restated</u>
Operating revenues:		
Expanded lottery revenues	\$ 353,022,317	\$ 360,534,392
Expanded lottery reimbursements	3,401,967	3,453,148
Total operating revenues	<u>356,424,284</u>	<u>363,987,540</u>
Operating expenses:		
Casino operator management fee	257,451,264	263,126,108
Salaries and benefits	1,100,746	1,022,434
Other administrative expenses	271,548	292,677
City and County expanded lottery fees	10,590,670	10,816,032
Professional services	36,478	179,753
On-line service bureau - expanded lottery	1,985,931	1,950,412
Telecommunications	7,263	7,872
Total operating expenses	<u>271,443,900</u>	<u>277,395,288</u>
Operating income	<u>84,980,384</u>	<u>86,592,252</u>
Nonoperating revenues (expenses):		
Transfers to the State General Fund	(77,919,938)	(79,381,564)
Transfers to the Problem Gambling Fund	(7,060,446)	(7,210,688)
Loss on disposal of capital assets		
Total nonoperating revenues (expenses)	<u>(84,980,384)</u>	<u>(86,592,252)</u>
Change in net position	-	-
Net position, beginning of year (as restated)	-	-
Net position, end of year	<u>\$ -</u>	<u>\$ -</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF CASH FLOWS - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2014 AND 2013

	Expanded Lottery	
	2014	2013 As Restated
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 356,801,793	\$ 362,517,982
Cash paid for prizes, commissions, and other expenses	(270,451,967)	(274,766,764)
Cash paid to employees	(1,100,746)	(1,022,434)
Net cash provided by operating activities	85,249,080	86,728,784
Cash flows from noncapital financing activities:		
Payments to State General Fund	(79,639,651)	(78,811,882)
Payments to State Problem Gambling Fund	(7,220,182)	(7,170,420)
Net cash used by noncapital financing activities	(86,859,833)	(85,982,302)
Net increase (decrease) in cash	(1,610,753)	746,482
Cash, beginning of year	3,971,230	3,224,748
Cash, end of year	\$ 2,360,477	\$ 3,971,230
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 84,980,384	\$ 86,592,252
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Other receivable	377,509	(1,469,558)
Accounts payable and accrued liabilities	(108,813)	1,606,090
Net cash provided by operating activities	\$ 85,249,080	\$ 86,728,784

**Independent Auditors' Report On Internal Control
Over Financial Reporting And On Compliance And
Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With
*Government Auditing Standards***

Legislative Post Audit Committee
Kansas State Legislature
Topeka, Kansas

We have audited, in accordance with the auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Kansas Lottery (the Lottery), a component unit of the State of Kansas (the State), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements and have issued our report thereon dated October 10, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Lottery's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our 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.

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 State's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as items 2014-001 and 2014-002 that we consider to be significant deficiencies.

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*.

The Lottery's Responses To Findings

The Lottery's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Lottery's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose Of This Report

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

RubinBrown LLP

October 10, 2014

KANSAS LOTTERY
A COMPONENT UNIT OF THE STATE OF KANSAS

SCHEDULE OF FINDINGS AND RESPONSES
For The Year Ended June 30, 2014

2014- 001 – Significant Deficiency

Segregation of Duties within Finance Department

Condition - The Director of Finance position at the Kansas Lottery is currently vacant. Therefore, the finance department lacks a key component in its current control structure, specifically as it relates to performing an internal review of the closing procedures at year end and preparing GAAP compliant financial statements for external reporting.

Criteria - A system of internal control over financial reporting includes identifying appropriate financial statement disclosures, reconciling account balances to the underlying supporting documents and reviewing the preparation of the financial statements.

Cause - The Director of Finance position is currently vacant and, therefore, certain controls over year-end close and external financial reporting in accordance with GAAP cannot be properly performed.

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

Recommendation - We recommend that the Lottery identify a qualified individual to be the new Director of Finance. In addition, we recommend that management review processes and controls around year end close and the preparation of the financial statements to ensure proper segregation can be maintained once the position is filled.

Management Response – The Kansas Lottery is in the process of searching and filling the vacant position with a qualified candidate. Once the Director of Finance position has been filled by a qualified candidate the deficiency will be resolved and corrected. Once a new Director of Finance is hired the Kansas Lottery will also review processes and controls as recommended above.

KANSAS LOTTERY
A COMPONENT UNIT OF THE STATE OF KANSAS

Schedule Of Findings And Responses (*Continued*)

2014-002 – Significant Deficiency

User Access Review

Condition - We noted that the Lottery's review of user access is focused on ensuring user accounts are restricted to current employees; however, the review does not ensure the access granted to current employees aligns with their job responsibilities. Therefore, individuals may have more access to Boris than the current job duties require.

Criteria - A system of internal control over information technology includes identifying the access assigned to users and continual review over this access for appropriateness.

Cause - The Lottery's user access review process does not ensure access provided appropriately aligns with the job responsibilities of each individual.

Effect - The improper user access within Boris could allow for internal control systems to be circumvented leading to a misstatement in the financial statements.

Recommendation - We recommend that Management performs an in-depth user access review on an annual basis. The in-depth review should include a comparison of access granted within Boris to the job responsibilities assigned to each employee. In completing the review the business process owners should work in conjunction with the IT department to ensure access is appropriately configured.

Management Response - The Security Division, in conjunction with other directors, has begun to review each user's access to ensure it aligns with the user's current job responsibilities and make changes as necessary. The Lottery expects the review process and necessary updates to be completed on or before November 1, 2014. Furthermore, the Lottery will update its policy to include an annual review by the Security Division of user access that ensures access granted aligns with current job responsibilities. The Lottery also will establish a review of both physical and logical access in the event an employee's job responsibilities change within the Lottery.

KANSAS LOTTERY
A COMPONENT UNIT OF THE STATE OF KANSAS

SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES
For The Year Ended June 30, 2014

2013-001 – Material Weakness

Financial Reporting

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

Status - RubinBrown noted that in the current year there were no material journal entries resulting from the agreement of supporting documentation to the financial statements. However due to the departure of the Director of Finance prior to the completion of the final financial statements, RubinBrown has carried forward a similar significant deficiency in 2014.

2013-002 – Material Weakness

Account Reconciliation

Condition - As reported in the four previous years, supporting documentation for the accounts receivable balance has not reconciled to the general ledger at year-end. Additionally, in the prior year, supporting documentation for the accounts payable balance did not reconcile to the general ledger at year-end. The resulting differences indicate that more frequent and regular reconciliations are necessary.

Status - RubinBrown noted no issues with the reconciliation of accounts receivable and accounts payable balances in the current year.

KANSAS LOTTERY
AUDITOR COMMUNICATIONS
JUNE 30, 2014



RubinBrown LLP
Certified Public Accountants
& Business Consultants

10975 Grandview Drive
Suite 600
Overland Park, KS 66210

T 913.491.4144
F 913.491.6821

W rubinbrown.com
E info@rubinbrown.com

The Honorable Sam Brownback, Governor of the State of Kansas,
Members of the Kansas Legislature and
Members of the Legislative Post Audit Committee
Kansas Lottery
Topeka, Kansas

We have audited the financial statements of the Kansas Lottery (the Lottery) as of and for the year ended June 30, 2014, and have issued our report thereon dated October 10, 2014. Our audit was performed in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement and presented in accordance with accounting principles generally accepted in the United States of America. Those standards require the auditor to ensure that those charged with corporate governance receive additional information regarding the scope and results of the audit that may assist the governing body in overseeing the financial reporting and disclosure process for which management is responsible. The following sections describe matters which are required to be reported to you.

Our Responsibility Under U.S. Generally Accepted Auditing Standards and *Government Auditing Standards*

As stated in the Agreement for Auditing and Related Services for the Kansas Lottery dated November 20, 2013 and our engagement letter dated September 22, 2014, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of responsibility for the accuracy of the financial statements.

Professional standards also require that we obtain an understanding of the Lottery's internal control to plan the audit. However, such understanding is required for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. Accordingly, we express no such assurance.

Other Information In Documents Containing Audited Financial Statements

To our knowledge, the 2014 audited financial statements are not included within any other document.

Our audit has been conducted for the purpose of forming opinions on the basic financial statements that collectively comprise the Lottery's basic financial statements. The combining financial statements and schedules, as listed in the table of contents in the financial statements, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The Management's Discussion and Analysis and the Schedule of Funding Progress as listed in the table of contents in the financial statements are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit. However, we did not audit the information and express no opinion on it.

Planned Scope And Timing Of The Audit

We performed the audit according to the planned scope and timing previously communicated to you in the Agreement for Auditing and Related Services for the Lottery dated November 20, 2013 and our engagement letter dated September 22, 2014, regarding the nature, timing and extent of our audit procedures.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. 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 the year ended June 30, 2014. We noted no transactions entered into by the Lottery during the year for which there was a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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 consolidated financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

Management's estimate of the allowance for doubtful accounts is based on the amount management expects to be uncollectable on balances outstanding during the year. We evaluated the key factors and assumptions used to develop the allowance for doubtful accounts in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of depreciation expense is based on the use of the straight-line method over the estimated useful lives of the assets, ranging from 3 to 5 years. We evaluated the key factors and assumptions used to develop the depreciation expense in determining that it is reasonable in relation to the financial statements taken as a whole.

The disclosures to the financial statements are neutral, consistent and clear. Certain financial statement disclosures are particularly sensitive because of their significance to the financial statements users. The most sensitive disclosures affecting the financial statements are:

The disclosure of Note 4, Commitments, to the financial statements provides information regarding the expanded lottery gaming facility management agreements and certain other lease agreements.

The disclosure of Note 7, Required Transfers, to the financial statements provides information regarding the required transfers from the Lottery to the State of Kansas.

The disclosure of Note 13, Expanded Lottery Facility Games Ownership, to the financial statements explains the contractual relationship and the related accounting treatment for the Lottery Facility Games.

The disclosure of Note 14, Prior Period Adjustment, to the financial statements outlines the impact of a prior period adjustment. This adjustment removed the Lottery Facility Games from the Statement of Net Position and resulted in a restatement of the 2013 financial statements.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatement

Professional standards require us to accumulate all factual, judgmental and projected misstatements identified during the audit, other than those that are trivial, communicate them to the appropriate level of management, and request their correction. Management has corrected all audit adjustments considered to be material, either individually or in the aggregate, which collectively increased the change in net position by \$14,097,219. In addition, we accumulated uncorrected misstatements which in the aggregate would have increased change in net position by \$245,283, that management has determined are not material, both individually and in the aggregate, to the financial statements taken as a whole. See the attached representation letter for a listing of corrected and uncorrected misstatements.

Disagreements with Management

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

Management Representation

We have requested certain representations from management that are included in the attached management representation letter dated October 10, 2014.

Management Consultations with Other Independent Accountant

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 an entity's financial statements or a determination of the type of auditors' 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 Issue

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 Lottery's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Honorable Sam Brownback, Governor of the State of Kansas, Members of Kansas Legislature, and Members of the Legislative Post Audit Committee, and is not intended to be, and should not be used by anyone other than these specified parties.

RubinBrown LLP

October 10, 2014



Terry P. Presta
Executive Director

Sam Brownback
Governor

October 10, 2014

RubinBrown LLP
10975 Grandview Drive
Building 27, Suite 600
Overland Park, Kansas 66210

We are providing this letter in connection with your audit of the Statement of Net Position of the Kansas Lottery as of June 30, 2014 and the related statements of revenues, expenses and change in net position, and cash flows for the year then ended for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the respective financial position, results of operations, and cash flows of the Kansas Lottery in conformity with U.S. generally accepted accounting principles. We confirm that we are responsible for the fair presentation of the previously mentioned financial statements in conformity with U.S. generally accepted accounting principles.

We understand we are responsible for management decisions and functions, for designating a qualified employee to oversee any non-attest services you provide, for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material if they involve an omission or misstatement of accounting information, that in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

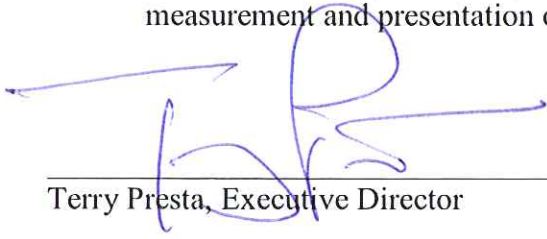
We confirm, to the best of our knowledge and belief the following representations made to you during your audit.

1. We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter.
2. The financial statements referred to above are fairly presented in conformity with U.S. generally accepted accounting principles and include all properly classified funds and other financial information of the primary government and all component units required by generally accepted accounting principles to be included in the financial reporting entity.
3. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
4. We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

5. Significant assumptions we used in making accounting estimates are reasonable.
6. Related party relationships and transactions, including revenues, expenditures, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP.
7. All events subsequent to the date of the financial statements and for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed. No events, including instances of noncompliance, have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.
8. The effects of uncorrected misstatements are immaterial both individually and in the aggregate, to the financial statements for each opinion unit. A list of the uncorrected misstatements is attached to the representation letter.
9. The effects of all known actual or possible litigation, claims, and assessments have been accounted for and disclosed in accordance with U.S. GAAP.
10. Guarantees, whether written or oral, under which the Kansas Lottery is contingently liable, if any, have been properly recorded or disclosed.
11. We have provided you with:
 - a. Access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.
 - b. Additional information that you have requested from us for the purpose of the audit.
 - c. Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
 - d. Minutes of the meetings of the Kansas Lottery Commission or summaries of actions of recent meetings for which minutes have not yet been prepared.
12. All material transactions have been recorded in the accounting records and are reflected in the financial statements.
13. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
14. We have no knowledge of any fraud or suspected fraud that affects the entity and involves:
 - a. Management,
 - b. Employees who have significant roles in internal control, or
 - c. Others where the fraud could have a material effect on the financial statements.
15. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, regulators, or others.
16. We have disclosed to you all known instances of noncompliance or suspected noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse, whose effects should be considered when preparing financial statements.
17. We have disclosed to you all known actual or possible litigation, claims, and assessments whose effects should be considered when preparing the financial statements.
18. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

19. We have made available to you all financial records and related data.
20. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
21. We have identified to you any previous audits, attestation engagements, and other studies related to the audit objectives and whether related recommendations have been implemented.
22. We have provided our views on reported findings, conclusions, and recommendations, as well as our planned corrective actions, for the report.
23. We have a process to track the status of audit findings and recommendations.
24. There are no violations or possible violations of budget ordinances, laws and regulations (including those pertaining to adopting, approving, and amending budgets), provisions of contracts and grant agreements, tax or debt limits, and any related debt covenants whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or for reporting on noncompliance.
25. We have followed all applicable laws and regulations in adopting, approving, and amending budgets.
26. The Kansas Lottery has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
27. As part of your audit, you assisted with preparation of the financial statements and related notes. We have designated an individual with suitable skill, knowledge, or experience to oversee your services and have made all management decisions and performed all management functions. We have reviewed, approved, and accepted responsibility for those financial statements and related notes.
28. The Kansas Lottery has no plans or intentions that may materially affect the carrying value or classification of assets, liabilities, or net position.
29. Components of net position (net investment in capital assets; restricted; and unrestricted) and net position amounts are properly classified and, if applicable, approved.
30. Provisions for uncollectible receivables have been properly identified and recorded.
31. Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.
32. Capital assets, including infrastructure and intangible assets, are properly capitalized, reported, and, if applicable, depreciated.
33. Deposits and investment securities and derivative instruments are properly classified as to risk and are properly disclosed.
34. We acknowledge our responsibility for the required supplementary information (RSI). The RSI is measured and presented within prescribed guidelines and the methods of measurement and presentation have not changed from those used in the prior period. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the RSI.
35. We acknowledge our responsibility for presenting the combining financial statements and schedules in accordance with U.S. generally accepted accounting principles, and we believe the combining financial statements and schedules, including their form and content, are fairly presented in accordance with U.S. generally accepted accounting principles. The methods of measurement and presentation of the combining financial statements and schedules have not changed from those used in the prior period, and we


have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information.



Terry Presta, Executive Director



Keith Kocher, Director of Program Assurance and Integrity



Amber Calhoon, Interim Director of Finance

Client: **20217-0000 - Kansas Lottery**
Engagement: **2014 AUD - Kansas Lottery**
Trial Balance: **TB Database**
Workpaper: **3010 - Adjusting Journal Entries Report**

Account	Description	Debit	Credit
Adjusting Journal Entries JE # 1			
To remove the Expanded Lottery Facility Games from the financial statements.			
300001	Net Investment in Capital Assets - Restricted	43,468,222.00	
5128-170199	-Depr	29,018,088.00	
5128-170699	-Depr	13,189,856.00	
5128-540100	AG Equipment and Machinery	6,590,539.00	
5128-170100	Slot Machines		55,334,448.00
5128-170600	Software		16,244,499.00
5128-441040	Contribution of Assets		4,567,959.00
5128-541810	Software		546,565.00
5128-549900	Depreciation Exp-Expanded		15,573,232.00
7381-526900	Other Fees		2.00
Total		92,266,705.00	92,266,705.00

Client: **20217-0000 - Kansas Lottery**
 Engagement: **2014 AUD - Kansas Lottery**
 Trial Balance: **TB Database**
 Workpaper: **3012 - Passed Journal Entries Report**

Account	Description	Debit	Credit
Passed Journal Entries JE # 2			
To reverse an accounts payable entry applied to FY 2014 for expenses incurred in FY 2015.			
5123-2201001	Accounts Payable-Generic	245,283.00	
5123-527500	Advertising Agency		245,283.00
Total		245,283.00	245,283.00