



FINANCIAL AUDIT REPORT

Kansas Lottery: Fiscal Year 2015

**A Report to the Legislative Post Audit Committee
By RubinBrown, Under Contract with
the Legislative Division of Post Audit
State of Kansas
December 2015**

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.

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Senator Julia Lynn

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Scott Frank, Legislative Post Auditor

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LEGISLATURE OF KANSAS
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December 10, 2015

To: Members, Legislative Post Audit Committee

Representative John Barker, Chair	Senator Michael O'Donnell, Vice-Chair
Representative Tom Burroughs	Senator Anthony Hensley
Representative Peggy Mast	Senator Laura Kelly
Representative Virgil Peck, Jr.	Senator Jeff Longbine
Representative Ed Trimmer	Senator Julia Lynn

This report contains the findings and conclusions from the completed financial audit of the Kansas Lottery for Fiscal Year 2015. 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 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.

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

Financial and Compliance Audit
Years Ended June 30, 2015 and 2014

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

Financial and Compliance Audit
Years Ended June 30, 2015 and 2014

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

INTRODUCTION

Year Ended June 30, 2015

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, 2015.

The Lottery was created as a 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, 2015

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unmodified opinion on the financial statements of the Kansas Lottery.
2. Control Deficiencies, if any, 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



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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 a component unit of the State of Kansas, as of and for the years ended June 30, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the Kansas 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, 2015 and 2014, and the respective changes in financial position and its cash flows, for the years 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, 2015 and 2014 and the changes in financial position, or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 adopt GASB Statement No. 68, *Accounting and Financial Report for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 10 and the schedule of funding progress, schedule of Kansas Lottery's proportionate share of the net pension liability, and schedule of Kansas Lottery's contributions on page 38, 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 Kansas 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 September 30, 2015, on our consideration of the Kansas 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 Kansas Lottery's internal control over financial reporting and compliance.

RubinBrown LLP

September 30, 2015

**KANSAS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2015 AND 2014**

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, 2015 and 2014. 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 2015 were \$250.0 million reflecting an increase of \$4.3 million or 1.75% compared to fiscal year 2014.
- 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 third full fiscal year, having opened in December 2011 and February 2012, respectively. Boot Hill Casino and Resort continued operations for the fifth 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 2015, Expanded Lottery net revenues totaled \$365 million. Transfers totaling \$80.3 million from Expanded Lottery activities were made to the State General Fund. An increase of \$2.4 million over the prior fiscal year.
- Transfers to the State Gaming Revenue Fund (SGRF) totaled \$74.5 million in fiscal year 2015, an increase of \$0.5 million over the prior fiscal year. Actual cash transfers totaled \$75.0 million in fiscal year 2015, an increase of \$0.7 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, 2015 and 2014. 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, 2015 and 2014 as well as the Expanded Lottery casino gaming activities for the years ended June 30, 2015 and 2014. 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, 2015 and 2014.

Summary of Balance Sheets

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

	2015	2014	2013
Current and other assets	\$ 39.0	\$ 23.2	\$ 27.3
Capital assets	0.3	0.3	0.4
Total assets	<u>39.3</u>	<u>23.5</u>	<u>27.7</u>
 Deferred Outflows	 <u>0.4</u>	 <u>-</u>	 <u>-</u>
 Current liabilities	 37.8	 19.9	 23.4
Net Pension Liability	5.5	-	-
Total liabilities	<u>43.3</u>	<u>19.9</u>	<u>23.4</u>
 Deferred Inflows	 <u>1.1</u>	 <u>-</u>	 <u>-</u>
 Net Position			
Net Investment in capital assets	0.3	0.3	0.4
Unrestricted	(5.0)	3.3	3.9
Total net position	<u>\$ (4.7)</u>	<u>\$ 3.6</u>	<u>\$ 4.3</u>

Current and other assets consist primarily of cash balances for operations, expanded lottery and prizes, accounts receivable from Lottery retailers for lottery ticket sales activity, and instant ticket inventory. During fiscal year 2015, current and other assets increased \$15.8 million due to an increase in cash on hand of \$18.8 million, a decrease in accounts receivable of \$4.1 million and an increase in ticket inventory of \$1.1 million.

For 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.

Current liabilities consist of accounts payable and accrued liabilities, transfers due to the State of Kansas unearned revenue and refundable deposits, and prize liabilities. The increase in current liabilities from 2014 is attributable to \$16.5 million in casino privilege fee deposits, a decrease in amounts due to the State of Kansas of \$0.5 million, an increase in prize liability of \$1.6 million, and an increase of \$0.3 million in accounts payable and accrued liabilities from 2014.

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.

For the year ended June 30, 2015, the Lottery implemented the provisions of GASB 68, Accounting and Financial Reporting for Pensions. The Net Lottery's proportionate share of the

net pension liability as of the most recent measurement date decreased by \$1.1 million from the previous measurement date, which is reflected a deferred inflow of resources. The Lottery made actual contributions during the fiscal year after the measurement date of \$0.4 million that are recognized as a deferred outflow of resources.

Recognition of the net pension liability resulted in a decrease in unrestricted net position of \$6.3 million as of the beginning of fiscal year 2015.

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):

	2015	2014	2013
Operating revenues:			
Traditional Lottery game revenues	\$ 250.0	\$ 245.7	\$ 244.8
Expanded lottery net revenues	365.0	353.0	360.5
Reimbursements and other	4.8	4.4	4.4
Total operating revenues	<u>619.8</u>	<u>603.1</u>	<u>609.7</u>
Operating expenses:			
Lottery	178.6	173.4	172.7
Expanded lottery	281.1	271.4	277.4
Total operating expenses	<u>459.7</u>	<u>444.8</u>	<u>450.1</u>
Operating income	<u>160.1</u>	<u>158.3</u>	<u>159.6</u>
Non-operating revenues (expenses):			
Lottery	(74.5)	(74.0)	(75.1)
Expanded lottery	(87.6)	(85.0)	(86.6)
Total non-operating revenues (expenses)	<u>(162.1)</u>	<u>(159.0)</u>	<u>(161.7)</u>
Change in net position	(2.0)	(0.7)	(2.1)
Net position, beginning of year	3.6	<u>4.3</u>	<u>6.4</u>
Restatement for GASB 68	(6.3)		
Net position, beginning of year	<u>(2.7)</u>		
Net position, end of year	<u>\$ (4.7)</u>	<u>\$ 3.6</u>	<u>\$ 4.3</u>

Recognition of the net pension liability resulted in a decrease in unrestricted net position of \$6.3 million as of the beginning of fiscal year 2015. The remainder of the change in net position between fiscal year 2015 and fiscal year 2014 represents a decrease of \$2.0 million. The decrease is the result of transfers to the State of Kansas exceeding the amount of revenue Kansas Lottery received.

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 exceeding 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 2015 and 2014:

Type of Game	2015	2014	Increase (Decrease)	Percentage Change
Instant	\$ 133.7	\$ 122.8	\$ 10.9	8.9%
Pull-Tabs	12.6	11.2	1.4	12.5%
Powerball	35.3	41.3	(6.0)	-14.5%
Mega Millions	14.7	16.8	(2.1)	-12.5%
2 by 2	1.8	1.8	-	0.0%
Super Kansas Cash	12.7	13.0	(0.3)	-2.3%
Keno	18.2	19.1	(0.9)	-4.7%
Pick 3	6.1	6.0	0.1	1.7%
Holiday Raffle	3.5	3.5	-	0.0%
Hot Lotto	8.6	7.4	1.2	16.2%
Kansas Hold'Em	2.8	2.8	-	0.0%
Total	<u>\$ 250.0</u>	<u>\$ 245.7</u>	<u>\$ 4.3</u>	<u>1.8%</u>

Fiscal year 2015 sales were \$250.0 million compared to \$245.7 million in fiscal year 2014. Revenues from the sales on online and instant lottery tickets for the fiscal year ended June 30, 2015 increased 1.8% or \$4.3 million compared to the previous year.

- Nationwide, Powerball and Mega Millions both saw significant decreases in sales due to a lack of large jackpots in the games. Kansas was not immune, with decreases in sales of \$6.0 million and \$2.1 million, respectively from the previous year.
- Instant and Pull-Tab tickets saw a combined sales increase of \$12.3 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.
- Sales of Hot Lotto increased by \$1.2 million due to a growing jackpot during the latter part of the fiscal year driving increased sales. This jackpot was eventually won by a player in Kansas early in fiscal year 2016.

Presented in millions of dollars, the following table compares online and instant Lottery sales by game types 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)	-100.0%
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, 2013 increased 0.4% or \$0.9 million compared to the previous year. Powerball sales decreased \$10.7 million due to record-breaking sales in fiscal year 2013. Mega Millions saw sales increase of \$6.4 million, due to large jackpot payouts. Instant and Pull-Tab tickets also saw a combined sales increase of \$6.8 million. Holiday raffle saw an increase of \$0.5 million due to an increase in tickets being offered in the game.

Lottery Expenses

Game Related

The following table compares the lottery game-related expenses between fiscal year 2015 and fiscal year 2014. The expenses are shown in millions of dollars:

Description	2015	2014	Increase (Decrease)	Percentage Change
Game Prizes	\$ 144.9	\$ 138.7	\$ 6.2	4.5%
Retailer commissions	14.8	14.4	\$ 0.4	2.8%
Online Games Service Bureau	5.1	5.6	\$ (0.5)	-8.9%
Instant Ticket Printing Cost	3.0	3.4	\$ (0.4)	-11.8%
Total	\$ 167.8	\$ 162.1	\$ 5.7	3.5%

The overall increases in game prizes and retailer commissions were the result of the increase in sales compared to those in fiscal year 2014. The online games service bureau cost decreased as a result of lower online sales. Ticket printing costs decreased as a result of changes in order sizes resulting in lower per unit costs, even though related instant ticket sales increased significantly.

The following table compares the lottery 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	3.4	3.6	\$ (0.2)	-5.6%
Total	\$ 162.1	\$ 162.4	\$ (0.3)	-0.2%

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 increased as a result of lower online sales.

Non-game Related

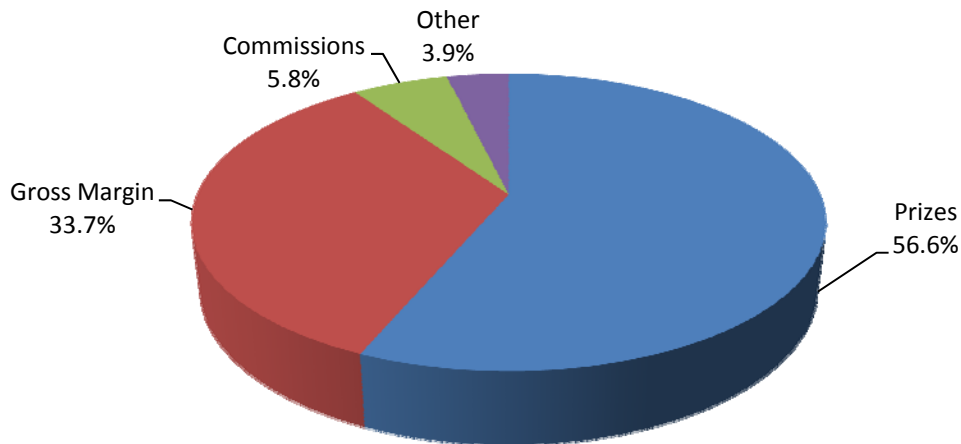
Of the \$10.8 million of fiscal year 2015 lottery operating expenses that were non-game related, \$4.6 million was for employees' salaries and wages, \$3.6 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.6 million. Of the \$11.1 million of fiscal year 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 \$2.9 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.

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

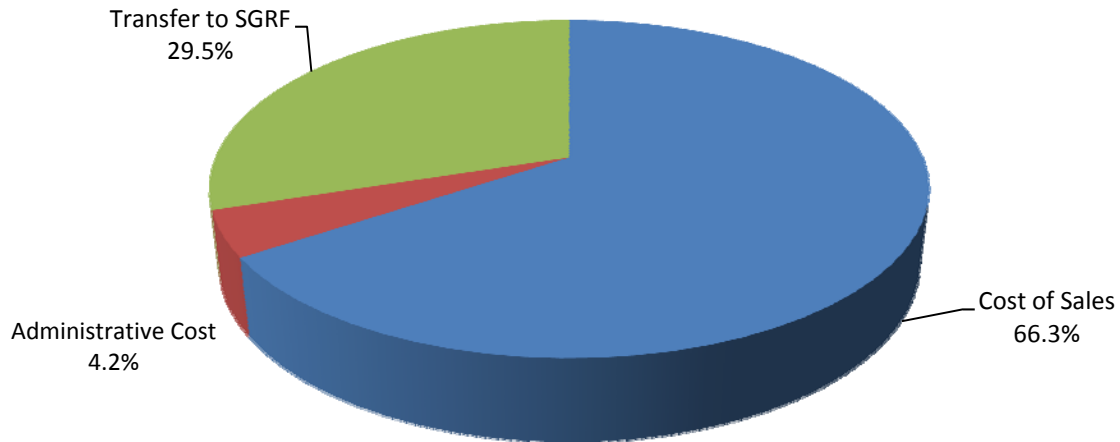
Kansas Lottery
Graphs of Financial Highlights
For the Fiscal Year Ended June 30, 2015

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.

Expenses by Type



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

Transfer to the State Gaming Revenues Fund and State General Fund

Pursuant to the Lottery Act, the Director of Accounts and Reports of the State of Kansas shall transfer monies in the Lottery Operating Fund to the State Gaming Revenue Fund (SGRF), at least monthly, in the amount equal to the monies in such fund in excess of those needed for payment of Lottery expenses, payment of compensation to retailers and transfers to the Prize Payment Fund as certified by the 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 years 2015, the legislature again waived the percentage of sales transfer requirement for a minimum transfer request of \$73.5 million, with a minimum monthly transfer of \$4.7 million. For 2015, the accrual basis transfers to the SGRF were \$74.5 million, an increase of \$0.5 million over 2014. Actual cash transfers to the SGRF were \$75.0 million in 2015.

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

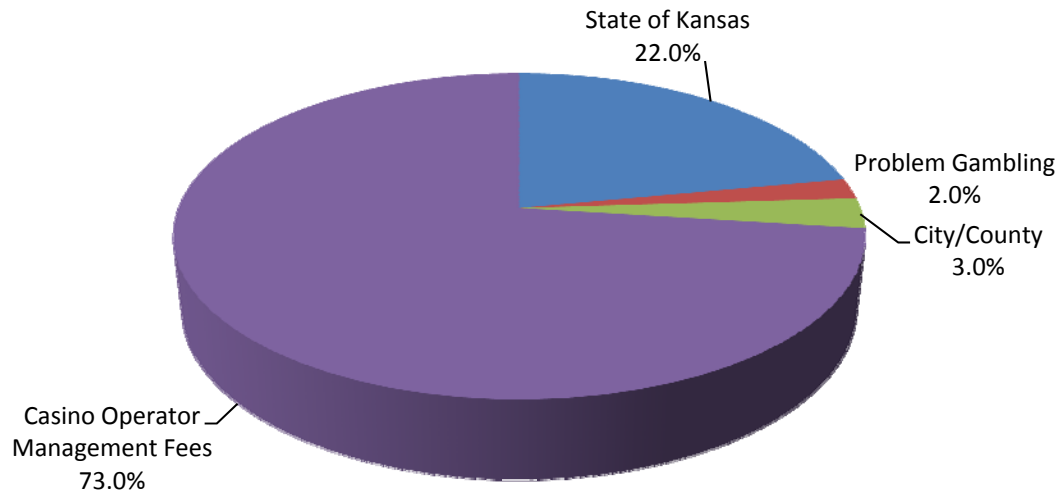
As of June 30, 2015, the State had three casinos operational. Hollywood Casino at Kansas Speedway Kansas Star Casino and Boot Hill Casino and Resort were operational for the full fiscal year in both 2015 and 2014. The net revenue and related expenses are as follows (shown in millions of dollars):

	<u>2015</u>	<u>2014</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 365.0</u>	<u>\$ 353.0</u>	<u>\$ 12.0</u>	<u>3.4%</u>
Expenses:				
State of Kansas	80.3	77.9	2.4	3.1%
Problem Gambling	7.3	7.1	0.2	2.8%
City and County	10.9	10.6	0.3	2.8%
Management Fees	<u>266.5</u>	<u>257.4</u>	<u>9.1</u>	<u>3.5%</u>
Total	<u>\$ 365.0</u>	<u>\$ 353.0</u>	<u>\$ 12.0</u>	<u>3.4%</u>

	<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>

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.

Economic Outlook

Traditional lottery sales and related transfers to the State Gaming Revenues Fund are expected to continue to increase. The Lottery will continue many successful initiatives, including draw game flash sales and replacement of 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. Matrix changes to the national Powerball game in October 2015 will improve players' overall odds of winning a prize and increase the payout prize in the game's third prize level. And with a legislative change to the Kansas Lottery Act that allows the Lottery to be onsite at universities' sporting events, the Lottery will partner with the Kansas Board of Regents' major universities and colleges with fun and exciting promotions.

Expanded Lottery revenues and transfers to the State of Kansas are expected to increase with the addition of a fourth casino in the South East Gaming Zone in fiscal year 2017.

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, 2015 and 2014 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 Matthew Schwartz, Director of Finance, at 128 N Kansas Avenue, Topeka, KS 66603.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENT OF NET POSITION
JUNE 30, 2015 AND 2014

	2015	2014
<u>ASSETS</u>		
Current Assets:		
Cash:		
Operating fund	\$ 25,135,734	\$ 5,445,054
Prize payment fund	244,581	1,100,278
Accounts receivable, net of allowance for doubtful accounts of \$353,615 and \$234,118 at 2015 and 2014, respectively	2,805,119	2,744,572
Accounts receivable - unbilled	5,906,704	7,217,090
Other receivable	1,869,600	4,781,265
Instant ticket game inventory	3,079,897	1,939,664
Total current assets	39,041,635	23,227,923
Capital assets, net of depreciation	291,503	273,393
Total assets	39,333,138	23,501,316
<u>DEFERRED OUTFLOWS OF RESOURCES</u>		
Employer contributions to pension plan made subsequent to measurement date	440,805	-
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	8,785,808	8,409,710
Due to the State of Kansas	4,806,536	5,282,889
Unearned revenue	5,500,000	-
Refundable deposits	11,000,000	-
Prize liability	7,769,465	6,188,653
Total current liabilities	37,861,809	19,881,252
Net pension liability	5,520,044	-
Total liabilities	43,381,853	19,881,252
<u>DEFERRED INFLOWS OF RESOURCES</u>		
KPERS Pension - Differences between actual and expected experience	130,749	-
KPERS Pension - Net differences between projected and actual earnings on investments	657,179	-
KPERS Pension - Changes in proportion	319,499	-
Total deferred inflows	1,107,427	-
<u>NET POSITION</u>		
Net investment in capital assets	291,503	273,393
Unrestricted (deficit)	(5,006,840)	3,346,671
Total net position	\$ (4,715,337)	\$ 3,620,064

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, 2015 AND 2014

	<u>2015</u>	<u>2014</u>
Operating revenues:		
Net game revenues	\$ 250,025,840	\$ 245,708,290
Expanded lottery revenues	365,026,301	353,022,317
Expanded lottery reimbursements	3,689,706	3,401,967
Phone reimbursements	931,510	936,900
Retailer fees and miscellaneous income	<u>152,646</u>	<u>42,150</u>
Total operating revenues	<u>619,826,003</u>	<u>603,111,624</u>
Operating expenses:		
Game prizes	144,914,052	138,741,873
Casino operator management fee	266,469,200	257,451,264
Retailer commissions	14,806,722	14,435,510
On-line games service bureau	5,107,939	5,647,024
Salaries and benefits	5,815,783	5,542,124
Cost of instant tickets	3,028,077	3,368,506
Advertising	3,629,835	3,804,097
Other administrative expenses	2,365,626	2,599,789
Depreciation	116,855	147,323
City and County expanded lottery fees	10,950,789	10,590,670
Professional services	280,222	346,484
On-line service bureau - expanded lottery	2,108,583	1,985,931
Telecommunications	<u>154,639</u>	<u>134,851</u>
Total operating expenses	<u>459,748,322</u>	<u>444,795,446</u>
Operating income	<u>160,077,681</u>	<u>158,316,178</u>
Transfers to the State Gaming Revenue Fund	(74,543,887)	(73,994,846)
Transfers to the State General Fund	(80,305,786)	(77,919,938)
Transfers to the Problem Gambling Fund	(7,300,526)	(7,060,446)
Write-off and adjustment of capital assets	<u>8,449</u>	<u>-</u>
Total nonoperating revenues (expenses)	<u>(162,141,750)</u>	<u>(158,975,230)</u>
Change in net position	<u>(2,064,069)</u>	<u>(659,052)</u>
Net position, beginning of year (as previously reported)	3,620,064	4,279,116
Prior period restatement for recognition of pension liability	<u>(6,271,332)</u>	<u>-</u>
Net position, beginning of year(as restated)	<u>(2,651,268)</u>	<u>4,279,116</u>
Net position, end of year	<u>\$ (4,715,337)</u>	<u>\$ 3,620,064</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, 2015 AND 2014

	2015	2014
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 623,987,507	\$ 603,478,069
Cash received for casino privilege fee deposits	16,500,000	-
Cash paid for prizes, commissions, and other expenses	(452,834,887)	(440,234,773)
Cash paid to employees	(5,900,449)	(5,542,124)
Net cash provided by operating activities	181,752,171	157,701,172
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(75,020,240)	(74,291,352)
Payments to State General Fund	(80,469,906)	(79,639,651)
Payments to State Problem Gambling Fund	(7,300,526)	(7,220,182)
Net cash used by noncapital financing activities	(162,790,672)	(161,151,185)
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	26,800	-
Purchases of capital assets	(153,316)	(61,260)
Net cash used by capital and related financing activities	(126,516)	(61,260)
Net increase (decrease) in cash	18,834,983	(3,511,273)
Cash, beginning of year	6,545,332	10,056,605
Cash, end of year	\$ 25,380,315	\$ 6,545,332
provided by operating activities:		
Operating income	\$ 160,077,681	\$ 158,316,178
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	116,855	147,323
Net recognition of deferred amounts of pension liability	1,056,143	-
Changes in operating assets and liabilities:		
Accounts receivable	1,249,839	200,279
Other receivable	2,911,665	166,166
Instant ticket game inventory	(1,140,233)	214,061
Accounts payable and accrued liabilities	540,218	(341,579)
Net pension liability	(1,140,809)	-
Unearned revenues	5,500,000	-
Refundable deposits	11,000,000	-
Prize liability	1,580,812	(1,001,256)
Net cash provided by operating activities	\$ 181,752,171	\$ 157,701,172

See accompanying notes to financial statements.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2015 and 2014

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, 2015 and 2014

Basis 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, 2015 and 2014

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 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 2015 and 2014 were \$3,689,706 and \$3,401,967, 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, 2015 and 2014

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.

Real estate

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

Prize Liability

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

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, 2015 and 2014

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.

Pensions

For the year ended June 30, 2015, the Lottery implemented the provisions of GASB Statement No. 68, Accounting and Financial Reporting for Pensions. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Kansas Public Employees Retirement System (KPERS) and additions to/deductions from KPERS' fiduciary net position have been determined on the same basis as they are reported by KPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2015 and 2014

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.

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.

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.

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, 2015 and 2014

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, 2015 and 2014, the Lottery's share in the State's common cash pool was \$25,273,395 and \$6,453,309, respectively.

3 - Capital Assets

Property and equipment consisted of the following at June 30, 2015:

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balances</u>
Equipment, furnishing and software	\$ 1,274,958	\$ 51,459	\$ -	\$ 1,326,417
Vehicles	830,477	101,857	(153,889)	778,445
Total Lottery capital assets	<u>2,105,435</u>	<u>153,316</u>	<u>(153,889)</u>	<u>2,104,862</u>
Accumulated depreciation	<u>(1,832,042)</u>	<u>(116,855)</u>	<u>135,538</u>	<u>(1,813,358)</u>
Total capital assets, net of depreciation	<u>\$ 273,393</u>			<u>\$ 291,504</u>

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>
Lottery:				
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>(1,684,718)</u>	<u>(147,324)</u>	<u>-</u>	<u>(1,832,042)</u>
Total capital assets, net of depreciation	<u>\$ 359,457</u>			<u>\$ 273,393</u>

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2015 and 2014

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:

2016		\$	684,717
2017			702,243
2018			719,769
2019			737,899
2020			756,634
2021-2023			1,979,818
			1,979,818
		\$	5,581,080

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

The Lottery incurred office, warehouse and miscellaneous rental expense of \$740,411 and \$733,907 under operating leases for the years ended June 30, 2015 and 2014, 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 \$5,107,939 and \$5,647,024 for the years ended June 30, 2015 and 2014, 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 \$2,108,583 and \$1,985,931 for the years ended June 30, 2015 and 2014, 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, 2015 and 2014

Expanded Lottery Gaming Facility Management Agreements

Southwest Gaming Zone

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

As part of the agreement, the facility manager purchased land and constructed the building used for the purposes of the casino. See Note 13 for information related to Expanded Lottery Facility Games Ownership.

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, 2015 and 2014, the fee was \$29,574,625 and \$29,131,581 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 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.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2015 and 2014

As part of the agreement, the facility manager purchased land and constructed the building used for the purposes of the casino. See Note 13 for information related to Expanded Lottery Facility Games Ownership.

The manager will be paid a management fee calculated as a percentage of Lottery Gaming Facility Revenues as follows: 73% of revenues up to \$350 million, 70% of revenues between \$350 million and \$400 million and 67% of revenues above \$400 million. In addition, 2% of Lottery Gaming Facility Revenues will be paid to the problem gambling and addictions grant fund and 3% will be paid to the City and County in which the manager operates. All remaining Lottery Gaming Facility Revenues will be transferred to the State of Kansas. For the years ended June 30, 2015 and 2014, the fee was \$104,214,118 and \$96,386,566 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 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.

As part of the agreement, the facility manager purchased land and constructed the building used for the purposes of the casino. See Note 13 for information related to Expanded Lottery Facility Games Ownership.

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, 2015 and 2014, the fee was \$132,680,457 and \$131,933,117 as is recorded in the statements of revenues, expenses, and changes in net position.

South East Gaming Zone

In 2015, the Lottery began the application process for a facility management agreement with a third party to develop, construct, and manage the lottery casino gaming facility in the southeast gaming zone. The terms of the agreement will be similar in nature to the terms of the agreements described above. The Lottery has collected privilege fee deposits of \$5.5 million from each of the three applicants. When the contract is awarded, the privilege fee deposits will be returned to the other two applicants. As of June 30, 2015, the contract had not been awarded and no construction had begun on the facility.

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5 - Contingencies

Zero Coupon Bonds

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

Prior to 1998, MUSL had purchased zero coupon bonds for the Lottery to fund future installment payments aggregating \$224,979,000. The total purchase price of these bonds was \$117,288,823. During fiscal year 2001, a cash out option was offered to these prize winners as a result of Congressional changes in the United States Internal Revenue Code of 1986, as amended, specifically Section 451(h). These cash out options were taken by six prize winners in the amount of approximately \$43,500,000. Total future installments outstanding at June 30, 2015 and 2014 were \$759,000 and \$1,518,000, respectively.

MUSL Prize Reserves

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

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, 2015 and 2014, the prize reserve account had a balance \$74,843,800 and \$76,376,927, respectively, of which the Lottery's portion was \$1,308,801 and \$1,299,625, respectively. The set prize reserve at June 30, 2015 and 2014 had a balance of \$35,096,120 and \$35,199,525, respectively, of which the Lottery's portion was \$604,256 and \$613,433, 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, 2015 and 2014 was \$37,271,793 and \$35,842,966, respectively, of which the Lottery's portion was \$611,548 for both years.

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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, 2015 and 2014, 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, 2015 and 2014, the prize reserve account had a balance of \$8,022,038 and \$7,411,908, respectively, of which the Lottery's portion was \$876,587 and \$866,707, 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, 2015 and 2014 the Lottery's portion of the balance of this account was \$79,937 and \$154,245, and is reportable as a receivable.

Win for Life Guarantee

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

Annuity contracts have been purchased for lifetime prize payments. At June 30, 2015 and 2014, the approximate remaining prize payments are \$391,500 and \$409,500, 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, which are funds of the State of Kansas. The Lottery contributes to these funds based upon annual assessed rates.

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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 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, 2015, the State Legislature set a minimum transfer to the Fund of \$73,500,000, which includes at least \$1,200,000 designated for the veteran transfer. For the year ended June 30, 2014 the State Legislature set a minimum transfer to the Fund of \$75,720,000, which includes at least \$1,200,000 designated for the veteran transfer. Under the accrual basis of accounting, total transfers to the State of Kansas for years ended June 30, 2015 and 2014 were \$74,543,887 and \$73,994,846, respectively, of which \$4,806,536 and \$5,282,889 was unpaid, respectively. Actual cash transfers to the State of Kansas for years ended June 30, 2015 and 2014 were \$75,020,240 and \$74,291,352, respectively. Included in the minimum transfer amount were mandated transfer of \$1,587,428 and \$1,795,054 for the years ended June 30, 2015 and 2014, 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, 2015 and 2014:

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	FY 2015 <u>Boot Hill</u>	FY 2014 <u>Boot Hill</u>
Gaming Facility Revenue:		
Electronic games	\$ 35,716,999	\$ 35,097,472
Table games	4,796,186	4,808,803
Total	<u>\$ 40,513,185</u>	<u>\$ 39,906,275</u>
Distributions:		
State of Kansas - 22%	\$ 8,912,901	\$ 8,779,381
Problem Gambling Fund - 2%	810,264	798,125
City & County - 3%	1,215,396	1,197,188
Casino operator management fees - 73%	29,574,625	29,131,581
Total	<u>\$ 40,513,186</u>	<u>\$ 39,906,275</u>

	FY 2015 <u>Kansas Star</u>	FY 2014 <u>Kansas Star</u>
Gaming Facility Revenue:		
Electronic games	\$ 153,746,959	\$ 153,943,700
Table games	28,007,092	27,135,950
Total	<u>\$ 181,754,051</u>	<u>\$ 181,079,650</u>
Distributions:		
State of Kansas - 22 - 24%	\$ 39,985,891	\$ 40,092,550
Problem Gambling Fund - 2%	3,635,081	3,621,593
City & County - 3%	5,452,622	5,432,390
Casino operator management fees - 71 - 73%	132,680,457	131,933,117
Total	<u>\$ 181,754,051</u>	<u>\$ 181,079,650</u>

	FY 2015 <u>Hollywood</u>	FY 2014 <u>Hollywood</u>
Gaming Facility Revenue:		
Electronic games	\$ 122,021,238	\$ 112,156,119
Table games	20,737,827	19,880,273
Total	<u>\$ 142,759,065</u>	<u>\$ 132,036,392</u>
Distributions:		
State of Kansas - 22%	\$ 31,406,994	\$ 29,048,006
Problem Gambling Fund - 2%	2,855,181	2,640,728
City & County - 3%	4,282,772	3,961,092
Casino operator management fees - 73%	104,214,118	96,386,566
Total	<u>\$ 142,759,065</u>	<u>\$ 132,036,392</u>

At June 30, 2015 and 2014, \$1,421,125 and \$4,304,313, respectively, was receivable from the casino manager for online and table game net revenue. At June 30, 2015 and 2014, \$7,234,924 and \$6,500,670, 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.

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8 - Schedule of Gross Margin-Lottery

Gross margin by game is as follows:

Year Ended June 30, 2015												
	Instant	Pulltabs	Powerball	2 by 2	Kansas Cash	Keno	Mega Millions	Pick 3	Hot Lotto	Kansas Hold'Em	Holiday Raffle	Total
Sales, net	\$ 133,685,288	\$ 12,574,359	\$ 35,269,937	\$ 1,848,864	\$ 12,690,787	\$ 18,155,015	\$ 14,718,597	\$ 6,138,389	\$ 8,608,801	\$ 2,835,930	\$ 3,499,873	\$ 250,025,840
Prizes, net Retailer	(83,892,976)	(7,796,103)	(18,164,018)	(952,165)	(6,218,486)	(9,549,538)	(7,477,047)	(3,032,364)	(4,209,704)	(1,871,714)	(1,749,937)	(144,914,052)
Commissions	(7,916,945)	(744,663)	(2,088,713)	(109,491)	(751,558)	(1,075,154)	(871,647)	(363,520)	(509,820)	(167,946)	(207,265)	(14,806,722)
Gross Margin	<u>\$ 41,875,367</u>	<u>\$ 4,033,593</u>	<u>\$ 15,017,206</u>	<u>\$ 787,208</u>	<u>\$ 5,720,743</u>	<u>\$ 7,530,323</u>	<u>\$ 6,369,903</u>	<u>\$ 2,742,505</u>	<u>\$ 3,889,277</u>	<u>\$ 796,270</u>	<u>\$ 1,542,671</u>	<u>\$ 90,305,066</u>
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 Retailer	(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)
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>

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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. Kansas law establishes and amends benefit provisions. KPERs issues a publicly available financial report that includes financial statements and required supplementary information. KPERs' financial statements are included in its Comprehensive Annual Financial Report which can be found on the KPERs website at www.kpers.org or by writing to KPERs (611 South Kansas, Suite 100, Topeka, KS 66603) or by calling 1-888-275-5737.

Benefits provided

KPERs provides retirement benefits, life insurance, disability income benefits, and death benefits. Benefits are established by statute and may only be changed by the General Assembly. Member employees with ten or more years of credited service, may retire as early as age 55, with an actuarially reduced monthly benefit. Normal retirement is at age 65, age 62 with ten years of credited service, or whenever an employee's combined age and years of credited service equal 85 "points".

Monthly retirement benefits are based on a statutory formula that includes final average salary and years of service. When ending employment, member employees may withdraw their contributions from their individual accounts, including interest. Member employees who withdraw their accumulated contributions lose all rights and privileges of membership. The accumulated contributions and interest are deposited into and disbursed from the membership accumulated reserve fund as established by K.S.A. 74-4922.

Member employees chose one of seven payment options for their monthly retirement benefits. At retirement a member employee may receive a lump-sum payment of up to 50% of the actuarial present value of the member employee's lifetime benefit. His or her monthly retirement benefit is then permanently reduced based on the amount of the lump-sum. Benefit increases, including ad hoc post-retirement benefit increases, must be passed into law by the Kansas Legislature. Benefit increases are under the authority of the Legislature and the Governor of the State of Kansas. The retirement benefits are disbursed from the retirement benefit payment reserve fund as established by K.S.A. 74-4922.

Contributions

K.S.A. 74-4919 and K.S.A. 74-49,210 establish the KPERs member-employee contributions rates. Effective July 1, 2009, KPERs has two benefit structures and contribution rates depend on whether the employee is a Tier 1 or Tier 2 member. Tier 1 members are active and contributing member hired before July 1, 2009. Tier 2 members were first employed in a covered position on or after July 1, 2009. Kansas law establishes the KPERs member-employee contribution rate at 5% of covered salary for Tier 1 member and 6% of covered salary for Tier 2 members through December 31, 2014. On January 1, 2015, Kansas law increased the KPERs member-employee

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contribution rate to 6% of covered salary for Tier 1 members; however, the Tier 2 member-employee contribution rate remained at 6% of covered salary. Member employee's contributions are withheld by their employer and paid to KPERS according to the provisions of Section 414(h) of the Internal Revenue Code.

State law provides that the employer contribution rates be determined based on the results of each annual actuarial valuation. KPERS is funded on an actuarial reserve basis. Kansas law sets a limitation on annual increases in the employer contribution rates. The actuarially determined employer contribution rate (not including the 0.85% contribution rate for the Death and Disability Program) and the statutory contribution rate was 15.12% and 10.27%, respectively, for the fiscal year ended June 30, 2014. The actuarially determined employer contribution rate was 15.41% for the fiscal year ended June 30, 2015. The statutory contribution rate was 11.27% from July 1, 2014 to December 31, 2014 and 8.65% from January 1, 2015 to June 30, 2015. Contributions to the pension plan from the Lottery were \$440,805 and \$389,521 for the years ended June 30, 2015 and 2014, respectively.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2015, the Lottery reported a liability of \$5,520,044 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2013, which was rolled forward to June 30, 2014. The Lottery proportion of the net pension liability was based on the ratio of the Lottery's actual contributions to KPERS, relative to the total employer and nonemployer contributions of the State/School subgroup within KPERS for the fiscal year ended June 30, 2014. The contributions used exclude contributions made for prior service, excess benefits and irregular payments. At June 30, 2014, the Lottery proportion was 0.086%, which was a decrease of 0.005% from its proportion measured as of June 30, 2013.

For the year ended June 30, 2015, the Lottery recognized pension expense of \$356,139. At June 30, 2015, the Lottery reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

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	<u>Deferred Outflows</u> <u>of Resources</u>	<u>Deferred inflows</u> <u>of Resources</u>
Difference between expected and actual experience	\$ -	\$ 130,749
Net difference between projected and actual earnings on pension plan investments	-	657,179
Changes in proportion	-	319,499
Lottery contributions subsequent to measurement date	<u>440,805</u>	<u>-</u>
Total	<u>\$ 440,805</u>	<u>\$ 1,107,427</u>

\$440,805 reported as deferred outflows of resources related to pensions resulting from Lottery contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ended June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended June 30:

2016	264,941
2017	264,941
2018	264,941
2019	264,941
2020	47,663
Thereafter	-
Total	<u><u>1,107,427</u></u>

Actuarial Assumptions

The total pension liability in the December 31, 2013 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Price inflation	3.00 percent
Wage inflation	4.00 percent
Salary increases, including wage increases	4.00 to 12.50 percent, including inflation
Long-term rate of return net of investment expense, and including price inflation	8.00 percent

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Mortality rates were based on the RP-2000 Combined Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements based on Scale AA.

The actuarial assumptions used in the December 31, 2013 valuation were based on the results of an actuarial experience study conducted for the three year period beginning December 31, 2009.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocations as of June 30, 2014 are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Global equity	47%	6.00%
Fixed income	14	0.85
Yield driven	8	5.50
Real return	11	3.75
Real estate	11	6.65
Alternatives	8	9.50
Short-term investments	1	-
Total	<u>100%</u>	

Discount rate.

The discount rate used to measure the total pension liability was 8.00%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from "state agency" will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of Lottery proportionate share of the net pension liability to changes in the discount rate.

The following presents the Lottery's proportionate share of the net pension liability calculated using the discount rate of 8.00%, as well as what the Lottery's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7.00%) or 1-percentage-point higher (9.00%) than the current rate:

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	1% Decrease (7.00%)	Current Discount Rate (8.00%)	1% Increase (9.00%)
Lottery proportionate share of the net pension liability	\$ 7,205,261	\$ 5,520,044	\$ 4,089,096

Pension plan fiduciary net position.

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

Subsequent events.

Under the budgetary allotment process for the State of Kansas, the Kansas governor has authority to reduce the approved budget for purposes of balancing the budget. For the State's fiscal year ending June 30, 2015, the KPERS employer contribution to the State/School group was reduced by \$58 million. It is unknown at the time whether this reduction will have a significant effect on "state agency" proportionate share of the KPERS collective net pension liability, or an effect on any actuarial assumptions used by KPERS to calculate the net pension liability.

During the 2015 state legislative session, Senate Bill 228 was passed authoring the issuance of one or more series of revenue bonds to provide deposits to KPERS in a total amount not to exceed \$1 billion. The purpose of such bond issuance would be for financing a portion of the unfunded actuarial pension liability of KPERS, which would also have an affect on the collective net pension liability. Final issuance of such bonds must be approved by a resolution of the State Finance Council. As of the date of this report, no such bonds under Senate Bill 228 had been issued. The effect of any potential bond issuance on "state agency" proportionate share of the KPERS collective net pension liability is unknown at this time.

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.

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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 2015 and 2014, 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, 2015 is \$571 for single coverage and \$835 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, 2015 and 2014 were \$6,856 and \$6,995 respectively. As of June 30, 2015, all eligible employees have reached the age or time restrictions on the subsidy and there is no additional amount payable for the VRIP.

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.

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Annual required Contribution (ARC)	\$ 54,000
Interest in the net OPEB obligation	14,000
Adjustment to the ARC	<u>(21,000)</u>
Annual OPEB cost (expense)	47,000
Net Employer contributions	<u>(36,000)</u>
Increase in net OPEB obligation	11,000
Net OPEB obligation, beginning of year	<u>363,000</u>
Net OPEB obligation, end of year	<u><u>\$ 374,000</u></u>

	Fiscal Year	Annual OPEB Cost	Net Employer Contributions	Percentage Contributed	End of Year Net OPEB Obligation
Kansas Lottery	2013	\$ 69,000	\$ 37,000	54%	\$ 332,000
Kansas Lottery	2014	51,000	20,000	39%	363,000
Kansas Lottery	2015	47,000	36,000	77%	374,000

The Net OPEB Obligation is reported as part of accounts payable and accrued liabilities on the statement of net position.

Funded Status and Funding Progress

As of June 30, 2015, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$569,000. 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 \$569,000. The covered payroll (annual payroll of active employees covered by the plan) was \$4,224,000, and the ratio of the UAAL to covered payroll was 13 percent.

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

Kansas Lottery
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Notes to Financial Statements
June 30, 2015 and 2014

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, 2015 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 6.5 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 south-central and northeast regions and \$5,500,000 per applicant for the southwest and southeast 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 received \$16,500,000 in privilege fee deposits during the year ended June 30, 2015. The State of Kansas did not receive privilege fees the year ended June 30, 2014.

12 - Subsequent Event

The Lottery has evaluated subsequent events through September 29, 2015, 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.

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Notes to Financial Statements
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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.

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 - Restatement of Prior Period Balance Due to Adoption of GASB 68

For fiscal year ended June 30, 2015, the Lottery implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. These statements established standards for measuring and recognizing liabilities, deferred outflows and inflows of resources, and expense. As a result of the implementation, net position as of July 1, 2014, was restated as follows:

Net position, as previously reported	\$ 3,620,064
Prior period adjustments	
Net pension liability (measurement date of June 30, 2013)	(6,660,853)
Deferred outflows	
Contributions during the fiscal year ended June 30, 2014	389,521
Total prior period adjustment	<u>(6,271,332)</u>
Net position, as restated	<u>\$ (2,651,268)</u>

Net position as of July 1, 2013 was not restated because the information needed to make the restatement was not provided by KPERS.

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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)
6/30/2015	0	\$ 569,000	\$ 569,000	0%	\$ 4,224,000	13%
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%

Schedule of Lottery's Proportionate Share of the Net Pension Liability

Lottery's proportion of the net pension liability	0.086%
Lottery's proportionate share of the net pension liability	\$ 5,520,044
Lottery's covered-employee payroll	\$ 4,019,000
Lottery's proportionate share of the net pension liability as a percentage of its covered-employee payroll	137.3%
Plan fiduciary net position as a percentage of the total pension liability	66.6%

Schedule of Lottery's Contributions

Required contribution	\$ 389,521
Contributions in relation to required contribution	<u>389,521</u>
Contribution deficiency	\$ -
Lottery's covered-employee payroll	\$ 4,019,000
Contributions as a percentage of covered-employee payroll	9.7%

The above schedules are intended to show information for 10 years. Additional years will be displayed as they become available.

Changes in Benefit Terms

Effective January 1 2014, KPERS Tier 1 member's employee contribution rate increased to 5.0% and then on January 1, 2015, will increase to 6.00%, with an increase in benefit multiplier to 1.85% for future years of service. For Tier II members retiring after July 1, 2012, the cost of living adjustment (COLA) is eliminated, but members will receive a 1.85% multiplier for all years of service.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF NET POSITION
JUNE 30, 2015

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2015
<u>ASSETS</u>			
Current Assets:			
Cash:			
Operating fund	\$ 19,211,942	\$ 5,923,792	\$ 25,135,734
Prize payment fund	244,581	-	244,581
Accounts receivable, net of allowance for doubtful accounts of \$353,615	2,805,119	-	2,805,119
Accounts receivable - unbilled	5,906,704	-	5,906,704
Other deposits and receivables	448,475	1,421,125	1,869,600
Instant ticket game inventory	3,079,897	-	3,079,897
Total current assets	<u>31,696,718</u>	<u>7,344,917</u>	<u>39,041,635</u>
Capital assets, net of depreciation:	<u>291,503</u>	<u>-</u>	<u>291,503</u>
Total assets	<u>31,988,221</u>	<u>7,344,917</u>	<u>39,333,138</u>
<u>DEFERRED OUTFLOWS OF RESOURCES</u>			
Employer contributions to pension plan made subsequent to measurement date	<u>440,805</u>	<u>-</u>	<u>440,805</u>
<u>LIABILITIES</u>			
Current liabilities:			
Accounts payable and accrued liabilities	1,440,891	7,344,917	8,785,808
Due to Problem Gambling Fund	-	-	-
Unearned revenue	5,500,000	-	5,500,000
Refundable deposits	11,000,000	-	11,000,000
Prize liability	7,769,465	-	7,769,465
Total current liabilities	<u>30,516,892</u>	<u>7,344,917</u>	<u>37,861,809</u>
Net pension liability	<u>5,520,044</u>	<u>-</u>	<u>5,520,044</u>
Total liabilities	<u>36,036,936</u>	<u>7,344,917</u>	<u>43,381,853</u>
<u>DEFERRED INFLOWS OF RESOURCES</u>			
KPERS Pension - Differences between actual and expected experience	130,749	-	130,749
KPERS Pension - Net differences between projected and actual earnings on investments	657,179	-	657,179
KPERS Pension - Changes in proportion	319,499	-	319,499
Total deferred inflows	<u>1,107,427</u>	<u>-</u>	<u>1,107,427</u>
<u>NET POSITION</u>			
Net Investment in capital assets	291,503	-	291,503
Unrestricted (deficit)	<u>(5,006,840)</u>	<u>-</u>	<u>(5,006,840)</u>
Total net position	<u>\$ (4,715,337)</u>	<u>\$ -</u>	<u>\$ (4,715,337)</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEAR ENDED JUNE 30, 2015

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2015
Operating revenues:			
Net game revenues	\$ 250,025,840	\$ -	\$ 250,025,840
Expanded lottery revenues	-	365,026,301	365,026,301
Expanded lottery reimbursements	-	3,689,706	3,689,706
Phone reimbursements	931,510	-	931,510
Retailer fees and miscellaneous income	152,646	-	152,646
	<u>251,109,996</u>	<u>368,716,007</u>	<u>619,826,003</u>
Total operating revenues			
Operating expenses:			
Game prizes	144,914,052	-	144,914,052
Casino operator management fee	-	266,469,200	266,469,200
Retailer commissions	14,806,722	-	14,806,722
On-line games service bureau	5,107,939	-	5,107,939
Salaries and benefits	4,598,453	1,217,330	5,815,783
Cost of instant tickets	3,028,077	-	3,028,077
Advertising	3,629,835	-	3,629,835
Other administrative expenses	2,067,744	297,882	2,365,626
Depreciation	116,855	-	116,855
City and County expanded lottery fees	-	10,950,789	10,950,789
Professional services	221,433	58,789	280,222
On-line service bureau - lottery gaming	-	2,108,583	2,108,583
Telecommunications	147,517	7,122	154,639
	<u>178,638,627</u>	<u>281,109,695</u>	<u>459,748,322</u>
Total operating expenses			
Operating income	<u>72,471,369</u>	<u>87,606,312</u>	<u>160,077,681</u>
Nonoperating revenues (expenses):			
Transfers to the State Gaming Revenue Fund	(74,543,887)	-	(74,543,887)
Transfers to the State General Fund	-	(80,305,786)	(80,305,786)
Transfers to the Problem Gambling Fund	-	(7,300,526)	(7,300,526)
Gain (loss) on disposal of capital assets	8,449	-	8,449
	<u>(74,535,438)</u>	<u>(87,606,312)</u>	<u>(162,141,750)</u>
Total nonoperating revenues (expenses)			
Change in net position	<u>(2,064,069)</u>	<u>-</u>	<u>(2,064,069)</u>
Net position, beginning of year (as previously reported)	3,620,064	-	3,620,064
Prior period restatement for recognition of pension liability	(6,271,332)	-	(6,271,332)
Net position, beginning of year (as restated)	<u>(2,651,268)</u>	<u>-</u>	<u>(2,651,268)</u>
Net position, end of year	<u>\$ (4,715,337)</u>	<u>\$ -</u>	<u>\$ (4,715,337)</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2015

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2015
Cash flows from operating activities:			
Cash received from sales and reimbursements	\$ 252,388,312	\$ 371,599,195	\$ 623,987,507
Cash received for casino privilege fee deposits	16,500,000	-	16,500,000
Cash paid for prizes, commissions, and other expenses	(173,786,769)	(279,048,118)	(452,834,887)
Cash paid to employees	(4,683,119)	(1,217,330)	(5,900,449)
Net cash provided by operating activities	<u>90,418,424</u>	<u>91,333,747</u>	<u>181,752,171</u>
Cash flows from noncapital financing activities:			
Payments to State Gaming Revenue Fund	(75,020,240)	-	(75,020,240)
Payments to State General Fund	-	(80,469,906)	(80,469,906)
Payments to State Problem Gambling Fund	-	(7,300,526)	(7,300,526)
Net cash used by noncapital financing activities	<u>(75,020,240)</u>	<u>(87,770,432)</u>	<u>(162,790,672)</u>
Cash flows from capital and related financing activities:			
Proceeds from sale of capital assets	26,800	-	26,800
Purchases of capital assets	(153,316)	-	(153,316)
Net cash used by capital and related financing activities	<u>(126,516)</u>	<u>-</u>	<u>(126,516)</u>
Net increase (decrease) in cash	15,271,668	3,563,315	18,834,983
Cash, beginning 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	\$ 72,471,369	\$ 87,606,312	\$ 160,077,681
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	116,855	-	116,855
Net recognition of deferred amounts of pension liability	1,056,143	-	1,056,143
Changes in operating assets and liabilities:			
Accounts receivable	1,249,839	-	1,249,839
Other deposits and receivables	28,477	2,883,188	2,911,665
Instant ticket game inventory	(1,140,233)	-	(1,140,233)
Accounts payable and accrued liabilities	(304,029)	844,247	540,218
Net pension liability	(1,140,809)	-	(1,140,809)
Unearned revenues	5,500,000	-	5,500,000
Refundable deposits	11,000,000	-	11,000,000
Prize liability	1,580,812	-	1,580,812
Net cash provided by operating activities	<u>\$ 90,418,424</u>	<u>\$ 91,333,747</u>	<u>\$ 181,752,171</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF NET POSITION - LOTTERY
JUNE 30, 2015 AND 2014

	<u>Lottery</u>	
	<u>2015</u>	<u>2014</u>
<u>ASSETS</u>		
Current Assets:		
Cash:		
Operating fund	\$ 19,211,942	\$ 3,084,577
Prize payment fund	244,581	1,100,278
Accounts receivable, net of allowance for doubtful accounts of \$234,118 and \$236,708 at 2014 and 2013, respectively	2,805,119	2,744,572
Accounts receivable - unbilled	5,906,704	7,217,090
Other receivable	448,475	476,952
Instant ticket game inventory	3,079,897	1,939,664
Total current assets	<u>31,696,718</u>	<u>16,563,133</u>
Capital assets, net of depreciation	<u>291,503</u>	<u>273,393</u>
Total assets	<u>31,988,221</u>	<u>16,836,526</u>
<u>DEFERRED OUTFLOWS OF RESOURCES</u>		
Employer contributions to pension plan made subsequent to measurement date	<u>440,805</u>	<u>-</u>
<u>LIABILITIES</u>		
Accounts payable and accrued liabilities	\$ 1,440,891	\$ 1,744,920
Due to the State of Kansas	4,806,536	5,282,889
Unearned revenue	5,500,000	
Refundable deposits	11,000,000	
Prize liability	7,769,465	6,188,653
Total current liabilities	<u>30,516,892</u>	<u>13,216,462</u>
Net pension liability	<u>5,520,044</u>	<u>-</u>
Total liabilities	<u>36,036,936</u>	<u>13,216,462</u>
<u>DEFERRED INFLOWS OF RESOURCES</u>		
KPERS Pension - Differences between actual and expected experience	130,749	-
KPERS Pension - Net differences between projected and actual earnings on investments	657,179	-
KPERS Pension - Changes in proportion	319,499	-
Total deferred inflows	<u>1,107,427</u>	<u>-</u>
<u>NET POSITION</u>		
Net Investment in capital assets	291,503	273,393
Unrestricted	<u>(5,006,840)</u>	<u>3,346,671</u>
Total net position	<u>\$ (4,715,337)</u>	<u>\$ 3,620,064</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION - LOTTERY
YEARS ENDED JUNE 30, 2015 AND 2014

	Lottery	
	2015	2014
Operating revenues:		
Net game revenues	\$ 250,025,840	\$ 245,708,290
Phone reimbursements	931,510	936,900
Retailer fees and miscellaneous income	152,646	42,150
	<u>251,109,996</u>	<u>246,687,340</u>
Operating expenses:		
Game prizes	144,914,052	138,741,873
Retailer commissions	14,806,722	14,435,510
On-line games service bureau	5,107,939	5,647,024
Salaries and benefits	4,598,453	4,441,378
Cost of instant tickets	3,028,077	3,368,506
Advertising	3,629,835	3,804,097
Other administrative expense	2,067,744	2,328,241
Depreciation	116,855	147,323
Professional services	221,433	310,006
Telecommunications	147,517	127,588
	<u>178,638,627</u>	<u>173,351,546</u>
Operating income	<u>72,471,369</u>	<u>73,335,794</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming		
Gain (loss) on disposal of capital assets	8,449	-
	<u>(74,535,438)</u>	<u>(73,994,846)</u>
Change in net position	<u>(2,064,069)</u>	<u>(659,052)</u>
Net position, beginning of year (as previously reported)	3,620,064	4,279,116
Prior period restatement for recognition of pension liability	(6,271,332)	-
Net position, beginning of year (as restated)	<u>(2,651,268)</u>	<u>4,279,116</u>
Net position, end of year	<u>\$ (4,715,337)</u>	<u>\$ 3,620,064</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF CASH FLOWS - LOTTERY
YEARS ENDED JUNE 30, 2015 AND 2014

	Lottery	
	2015	2014
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 252,388,312	\$ 246,676,276
Cash received for casino privelege fee deposits	16,500,000	-
Cash paid for prizes, commissions, and other expenses	(173,786,769)	(169,782,806)
Cash paid to employees	(4,683,119)	(4,441,378)
	90,418,424	72,452,092
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(75,020,240)	(74,291,352)
Payments to State General Fund	-	-
	(75,020,240)	(74,291,352)
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	26,800	-
Purchases of capital assets	(153,316)	(61,260)
	(126,516)	(61,260)
Net increase in cash	15,271,668	(1,900,520)
Cash, beginning of year	4,184,855	6,085,375
Cash, end of year	\$ 19,456,523	\$ 4,184,855
provided by operating activities:		
Operating income	\$ 72,471,369	\$ 73,335,794
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	116,855	147,323
Net recognition of deferred amounts of pension liability	1,056,143	-
Changes in operating assets and liabilities:		
Accounts receivable	1,249,839	200,279
Other deposits and receivables	28,477	(211,343)
Instant ticket game inventory	(1,140,233)	214,061
Accounts payable and accrued liabilities	(304,029)	(232,766)
Net pension liability	(1,140,809)	-
Unearned revenues	5,500,000	-
Refundable deposits	11,000,000	-
Prize liability	1,580,812	(1,001,256)
	\$ 90,418,424	\$ 72,452,092

**KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF NET POSITION - EXPANDED LOTTERY
JUNE 30, 2015 AND 2014**

	Expanded Lottery	
	2015	2014
<u>ASSETS</u>		
Current Assets:		
Cash:		
Operating fund	\$ 5,923,792	\$ 2,360,477
Other receivable	1,421,125	4,304,313
	7,344,917	6,664,790
Total current assets		
	7,344,917	6,664,790
Total assets		
	7,344,917	6,664,790
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 7,344,917	\$ 6,664,790
Due to the State of Kansas	-	-
Due to Problem Gambling Fund	-	-
	7,344,917	6,664,790
Total current liabilities		
	7,344,917	6,664,790
<u>NET POSITION</u>		
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, 2015 AND 2014

	<u>Expanded Lottery</u>	
	<u>2015</u>	<u>2014</u>
Operating revenues:		
Expanded lottery revenues	\$ 365,026,301	\$ 353,022,317
Expanded lottery reimbursements	3,689,706	3,401,967
	<u>368,716,007</u>	<u>356,424,284</u>
Operating expenses:		
Casino operator management fee	266,469,200	257,451,264
Salaries and benefits	1,217,330	1,100,746
Other administrative expenses	297,882	271,548
City and County expanded lottery fees	10,950,789	10,590,670
Professional services	58,789	36,478
On-line service bureau - expanded lottery	2,108,583	1,985,931
Telecommunications	7,122	7,263
	<u>281,109,695</u>	<u>271,443,900</u>
Operating income	<u>87,606,312</u>	<u>84,980,384</u>
Nonoperating revenues (expenses):		
Transfers to the State General Fund	(80,305,786)	(77,919,938)
Transfers to the Problem Gambling Fund	(7,300,526)	(7,060,446)
Loss on disposal of capital assets	-	-
	<u>(87,606,312)</u>	<u>(84,980,384)</u>
Net position, beginning of year	<u>-</u>	<u>-</u>
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, 2015 AND 2014**

	<u>Expanded Lottery</u>	
	<u>2015</u>	<u>2014</u>
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 371,599,195	\$ 356,801,793
Cash paid for prizes, commissions, and other expenses	(279,048,118)	(270,451,967)
Cash paid to employees	(1,217,330)	(1,100,746)
Net cash provided by operating activities	<u>91,333,747</u>	<u>85,249,080</u>
Cash flows from noncapital financing activities:		
Payments to State General Fund	(80,469,906)	(79,639,651)
Payments to State Problem Gambling Fund	(7,300,526)	(7,220,182)
Net cash used by noncapital financing activities	<u>(87,770,432)</u>	<u>(86,859,833)</u>
Net increase (decrease) in cash	3,563,315	(1,610,753)
Cash, beginning of year	<u>2,360,477</u>	<u>3,971,230</u>
Cash, end of year	<u>\$ 5,923,792</u>	<u>\$ 2,360,477</u>
Reconciliation of operating income to net cash		
Operating income	\$ 87,606,312	\$ 84,980,384
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Other receivable	2,883,188	377,509
Accounts payable and accrued liabilities	844,247	(108,813)
Net cash provided by operating activities	<u>\$ 91,333,747</u>	<u>\$ 85,249,080</u>



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

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, 2015, and the related notes to the financial statements, which collectively comprise the Lottery's basic financial statements and have issued our report thereon dated September 30, 2015.

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 Lottery'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 material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the 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*.

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

September 30, 2015

KANSAS LOTTERY
A COMPONENT UNIT OF THE STATE OF KANSAS

SCHEDULE OF FINDINGS AND RESPONSES
For The Year Ended June 30, 2015

None

KANSAS LOTTERY
A COMPONENT UNIT OF THE STATE OF KANSAS

SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES
For The Year Ended June 30, 2015

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.

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 and the Director of Finance position was filled by an individual who has the appropriate skills and knowledge for the position.

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.

Status - RubinBrown noted in the current year that a user access review was performed by the Lottery.

KANSAS LOTTERY
AUDITOR COMMUNICATIONS
JUNE 30, 2015



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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 years ended June 30, 2015 and 2014, and have issued our report thereon dated September 30, 2015. 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 April 8, 2015, 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 2015 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, the Schedule of Funding Progress, Schedule of Lottery's Proportionate Share of the Net Pension Liability, and Schedule of Lottery Contributions 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 April 8, 2015, 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. As discussed in Note 14 to the financial statements, a prior period adjustment was made to adopt GASB Statement No. 68, *Accounting and Financial Report for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. 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 to adopt GASB Statement No. 68, *Accounting and Financial Report for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*.

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 audits, other than those that are trivial, communicate them to the appropriate level of management, and request their correction. We noted no audit adjustments (corrected or uncorrected) for the Lottery through the course of audit fieldwork.

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 September 30, 2015.

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

September 30, 2015