



# **FINANCIAL AUDIT REPORT**

**Kansas Lottery: Fiscal Year 2016**

**A Report to the Legislative Post Audit Committee  
By RubinBrown, Under Contract with  
the Legislative Division of Post Audit  
State of Kansas  
December 2016**

# Legislative Division of Post Audit

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

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

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

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Senator Jeff Longbine  
Senator Julia Lynn

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**Scott Frank, Legislative Post Auditor**

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LEGISLATURE OF KANSAS  
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December 7, 2016

To: Members, Legislative Post Audit Committee

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

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

This report contains the findings and conclusions from the completed financial audit of the Kansas Lottery for fiscal year 2016. 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, 2016 and 2015

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

INTRODUCTION

Year Ended June 30, 2016

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, 2016.

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

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

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS**

Year Ended June 30, 2016

**A. SUMMARY OF AUDIT RESULTS**

1. The auditors' report expresses an unmodified opinion on the financial statements of the Kansas Lottery.
  
2. No material weaknesses related to the audit of the financial statements are reported in the Independent Auditors' Report on Internal Controls Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Governmental Auditing Standards.
  
3. No instances of noncompliance material to the financial statements of the Kansas Lottery were disclosed during the audit.

**B. FINDINGS – FINANCIAL STATEMENT AUDIT**  
See Schedule of Findings and Responses





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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, 2016 and 2015, 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 an opinion on these financial statements based on our audits. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 Kansas Lottery as of June 30, 2016 and 2015, 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 Kansas Lottery. They do not purport to, and do not present fairly, the financial position of the State of Kansas as of June 30, 2016 and 2015 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.

## ***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 12 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 41, 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 an opinion 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, 2016, 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, 2016

**KANSAS LOTTERY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEARS ENDED JUNE 30, 2016 AND 2015**

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, 2016 and 2015. 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 2016 were \$272.0 million reflecting an increase of \$22.0 million or 8.80% compared to fiscal year 2015.
- 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 2016, Expanded Lottery net revenues totaled \$364.3 million. Transfers totaling \$85.7 million from Expanded Lottery activities were made to the State General Fund. An increase of \$5.2 million over the prior fiscal year.
- Transfers to the State Gaming Revenue Fund (SGRF) totaled \$78.8 million in fiscal year 2016, an increase of \$4.3 million over the prior fiscal year. Actual cash transfers totaled \$78.2 million in fiscal year 2016, an increase of \$3.2 million over the prior fiscal year.

**Using this Financial Report**

This report consists of a series of financial statements and reflects the self-supporting activities of the Kansas Lottery. The Statement of Net Position provides information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2016 and 2015. 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, 2016 and 2015 as well as the Expanded Lottery casino gaming activities for the years ended June 30, 2016 and 2015. 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, 2016 and 2015.

## Summary of Balance Sheets

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

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Current and other assets	\$ 19.9	\$ 39.0	\$ 23.2
Capital assets	0.7	0.3	0.3
Total assets	<u>\$ 20.6</u>	<u>\$ 39.3</u>	<u>\$ 23.5</u>
Deferred Outflows	<u>\$ 0.9</u>	<u>\$ 0.4</u>	<u>\$ -</u>
Current liabilities	\$ 20.3	\$ 37.8	\$ 19.9
Net pension liability	6.5	5.5	-
Total liabilities	<u>\$ 26.8</u>	<u>\$ 43.3</u>	<u>\$ 19.9</u>
Deferred Inflows	<u>\$ 0.6</u>	<u>\$ 1.1</u>	<u>\$ -</u>
Net Position			
Net investment in capital assets	\$ 0.7	\$ 0.3	\$ 0.3
Unrestricted	(6.6)	(5.0)	3.3
Total net position	<u>\$ (5.9)</u>	<u>\$ (4.7)</u>	<u>\$ 3.6</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 2016, current and other assets decreased \$18.7 million due to an decrease in cash on hand of \$19.7 million, a increase in accounts receivable of \$0.3 million and an increase in ticket inventory of \$0.3 million.

For 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.

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 decrease in current liabilities from 2015 is attributable to \$16.5 million in casino privilege fee deposits, a decrease in amounts due to the State of Kansas of \$0.6 million, an increase in prize liability of \$2.0 million, and an decrease of \$3.0 million in accounts payable and accrued liabilities from 2015.

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.

For the year ended June 30, 2015, the Lottery implemented the provisions of GASB 68, Accounting and Financial Reporting for Pensions. 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.

For fiscal year 2016, the Lottery's proportionate share of the net pension liability as of the most recent measurement date increased by \$1.0 million from the previous measurement date, which is reflected by a \$0.5 million increase in deferred outflow of resources and a \$0.5 million decrease in 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.

For fiscal year 2015, the 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 are recognized as a deferred outflow of resources.

## Summary of Revenues, Expenses, and Changes in Net Position

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

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating revenues:			
Traditional Lottery game revenues	\$ 272.0	\$ 250.0	\$ 245.7
Expanded lottery net revenues	364.4	365.0	353.0
Reimbursements and other	10.1	4.8	4.4
Total operating revenues	<u>646.5</u>	<u>619.8</u>	<u>603.1</u>
Operating expenses:			
Lottery	195.4	178.6	173.4
Expanded lottery	280.5	281.1	271.4
Total operating expenses	<u>475.9</u>	<u>459.7</u>	<u>444.8</u>
Operating income	<u>170.6</u>	<u>160.1</u>	<u>158.3</u>
Non-operating revenues (expenses):			
Lottery	(78.8)	(74.5)	(74.0)
Expanded lottery	(93.0)	(87.6)	(85.0)
Total non-operating revenues (expenses)	<u>(171.8)</u>	<u>(162.1)</u>	<u>(159.0)</u>
Change in net position	(1.2)	(2.0)	(0.7)
Net position, beginning of year	(4.7)	3.6	<u>4.3</u>
Restatement for GASB 68		<u>(6.3)</u>	
Net position, beginning of year		(2.7)	
Net position, end of year	<u>\$ (5.9)</u>	<u>\$ (4.7)</u>	<u>\$ 3.6</u>

The change in the Lottery's proportionate share of the net pension liability accounts for \$1.0 million of the decrease in net position between fiscal year 2016 and fiscal year 2015. The remaining \$0.2 million is the result of transfers to the State of Kansas exceeding the amount of revenue the Lottery received.

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 Lottery received.



## Lottery Game Revenues

Presented in millions of dollars, the following table compares online and instant Lottery sales by game types between fiscal years 2016 and 2015:

Type of Game	2016	2015	Increase (Decrease)	Percentage Change
Instant	\$ 143.4	\$ 133.7	\$ 9.7	7.3%
Pull-Tabs	10.1	12.6	(2.5)	-19.8%
Powerball	54.3	35.3	19.0	53.8%
Mega Millions	14.0	14.7	(0.7)	-4.8%
2 by 2	1.9	1.8	0.1	5.6%
Super Kansas Cash	12.8	12.7	0.1	0.8%
Keno	16.0	18.2	(2.2)	-12.1%
Pick 3	6.5	6.1	0.4	6.6%
Holiday Raffle	3.5	3.5	-	0.0%
Hot Lotto	6.7	8.6	(1.9)	-22.1%
Kansas Hold'Em	2.8	2.8	-	0.0%
Total	<u>\$ 272.0</u>	<u>\$ 250.0</u>	<u>\$ 22.0</u>	<u>8.8%</u>

Fiscal year 2016 sales were \$272.0 million compared to \$250.0 million in fiscal year 2015. Revenues from the sales on online and instant lottery tickets for the fiscal year ended June 30, 2016 increased 8.8% or \$22.0 million compared to the previous year.

- Powerball sales rebounded nationwide after a change in the game matrix resulted in larger overall jackpots. In January 2016, the industry saw the largest jackpot ever at more than \$1.5 billion. The state of Kansas saw an increase in Powerball sales of \$19.0 million from the previous fiscal year.
- Some of the Powerball increase resulted in play shifting away from other national games, such as Mega Millions and Hot Lotto. These games saw decreases of \$0.7 million and \$1.9 million, respectively from the previous fiscal year.
- Instant and Pull-Tab tickets also saw a combined sales increase of \$7.2 million from the previous fiscal year as players have continued to respond favorable to new games at a variety of price points.

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.

## Lottery Expenses

### Game Related

The following table compares the lottery game-related expenses between fiscal year 2016 and fiscal year 2015. The expenses are shown in millions of dollars:

Description	2016	2015	Increase (Decrease)	Percentage Change
Game Prizes	\$ 157.3	\$ 144.9	\$ 12.4	8.6%
Retailer commissions	16.0	14.8	1.2	8.1%
Online Games Service Bureau	6.0	5.1	0.9	17.6%
Instant Ticket Printing Cost	3.3	3.0	0.3	10.0%
Total	<u>\$ 182.6</u>	<u>\$ 167.8</u>	<u>\$ 14.8</u>	<u>8.8%</u>

The overall increase in game prizes was the result of the increase in sales compared to those in fiscal year 2015. The online games service bureau cost increased as a result of higher online sales.

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	<u>\$ 167.8</u>	<u>\$ 162.1</u>	<u>\$ 5.7</u>	<u>3.5%</u>

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.

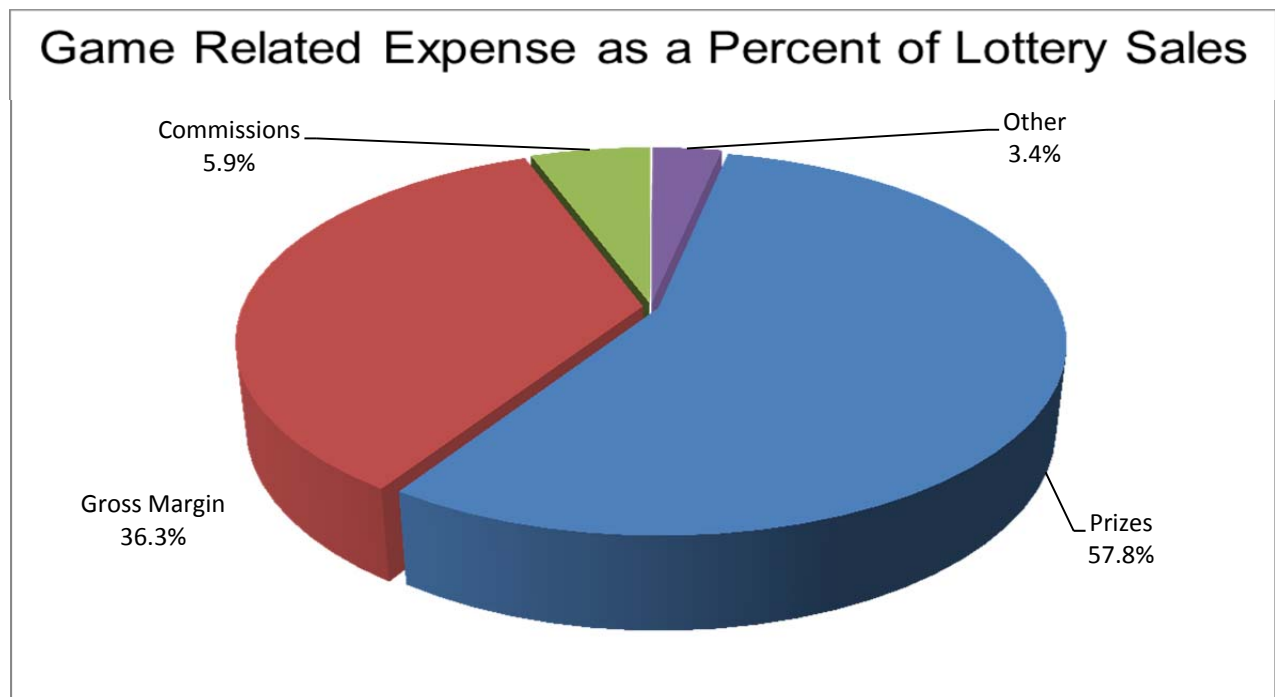
### Non-game Related

Of the \$12.8 million of fiscal year 2016 lottery operating expenses that were non-game related, \$4.7 million was for employees' salaries and wages, \$4.8 was spent for games and promotional advertising, and other administrative expenses accounted for \$3.3 million.

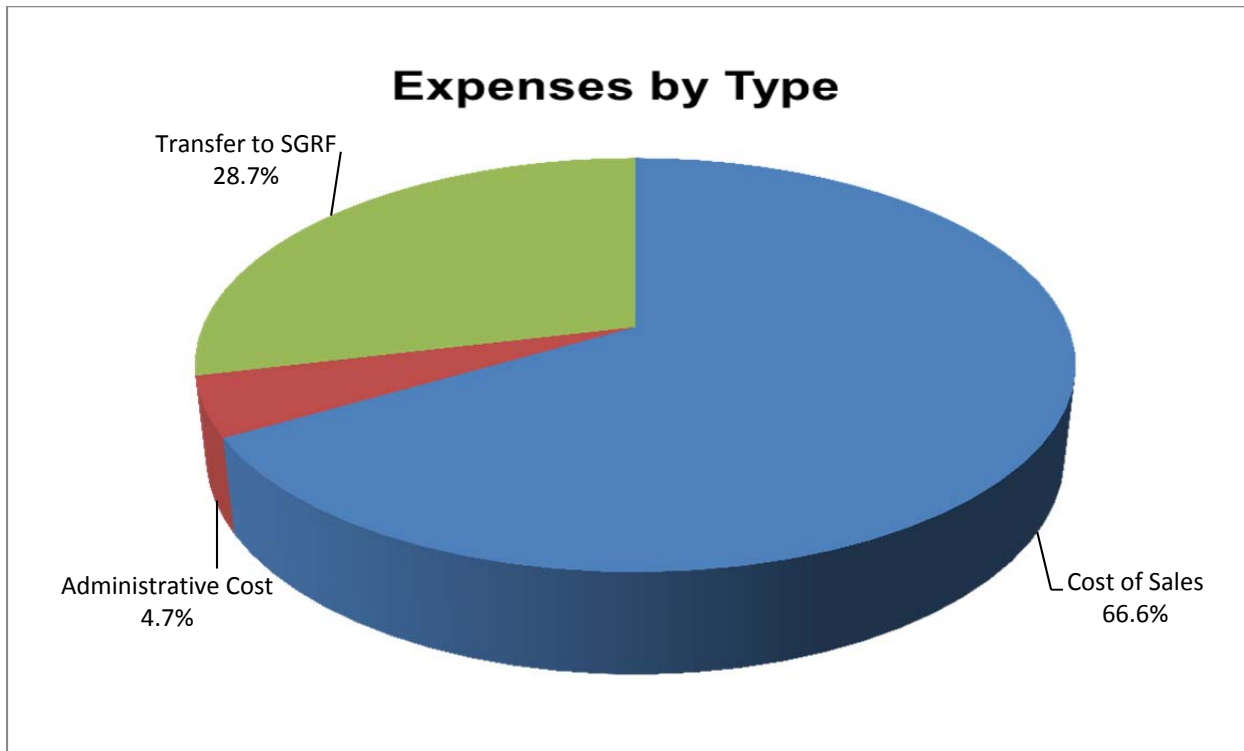
Of the \$10.8 million of fiscal year 2015 lottery operating expenses that were non-game related, \$4.6 million was for employees' salaries and wages, \$3.6 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.6 million.

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.

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



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



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

### **Transfer to the State Gaming Revenues Fund and State General Fund**

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

For fiscal year 2016, the legislature again waived the percentage of sales transfer requirement for a minimum transfer request of \$76.5 million, with a minimum monthly transfer of \$4.8 million. For 2016, the accrual basis transfers to the SGRF were \$78.8 million, an increase of \$4.3 million over 2015. Actual cash transfers to the SGRF were \$78.2 million and \$75.0 million in 2016 and 2015, respectively.

## 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.

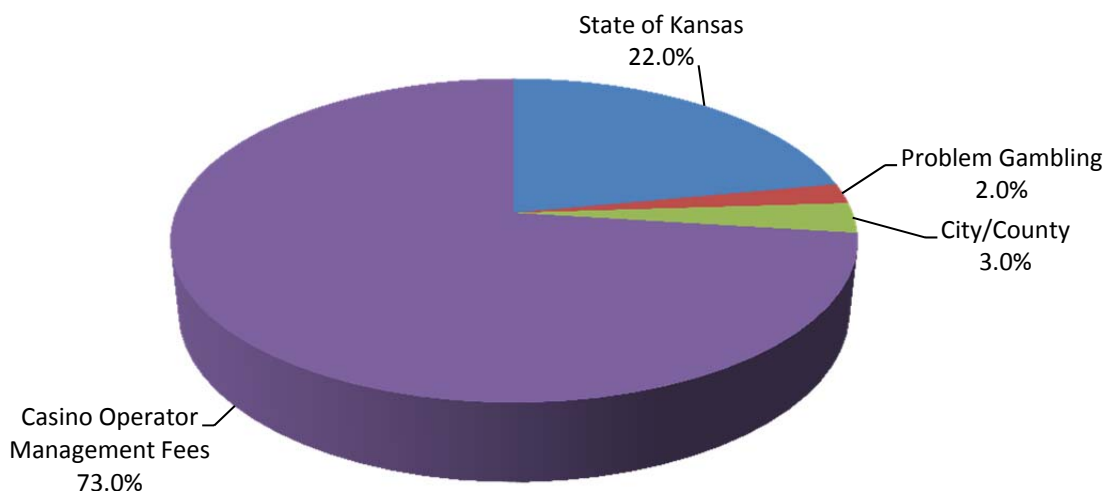
## Expanded Lottery Revenues and Expenses

As of June 30, 2016, 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 2016 and 2015. The net revenue and related expenses are as follows (shown in millions of dollars):

	<u>2016</u>	<u>2015</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 364.4</u>	<u>\$ 365.0</u>	<u>\$ (0.6)</u>	<u>-0.2%</u>
Expenses:				
State of Kansas	85.7	80.3	5.4	6.7%
Problem Gambling	7.3	7.3	-	0.0%
City and County	10.9	10.9	-	0.0%
Management Fees	<u>265.9</u>	<u>266.5</u>	<u>(0.6)</u>	<u>-0.2%</u>
Total	<u>\$ 369.8</u>	<u>\$ 365.0</u>	<u>\$ 4.8</u>	<u>1.3%</u>
	<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>

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.

In fiscal year 2017, the Lottery will kick off its 30th year. The year-long “birthday bash” will begin in January 2017 with monthly prize giveaways and end in November with a concert at the Kansas Star Casino. The Lottery will launch a Kansas City Chiefs instant scratch game as well as its first instant game at the \$30 price point. It will also expand its draw game offerings to include Lucky for Life, a multi-state game that offers players the chance to win \$1,000 a day for life.

To grow its players-base and to create more product value, the Lottery will launch a player loyalty program, a new prize matrix for the Lottery’s Holiday Millionaire Raffle and a Powerball Power Cruise Collect N Win promotion.

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, 2016 and 2015 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, 2016 AND 2015**

<u>ASSETS</u>	<u>2016</u>	<u>2015</u>
Current Assets:		
Cash:		
Operating fund	\$ 4,905,506	\$ 25,135,734
Prize payment fund	777,809	244,581
Accounts receivable, net of allowance for doubtful accounts of \$228,593 and \$353,615 at 2016 and 2015, respectively	4,469,696	2,805,119
Accounts receivable - unbilled	4,406,105	5,906,704
Other receivable	1,980,663	1,869,600
Instant ticket game inventory	3,409,859	3,079,897
Total current assets	19,949,638	39,041,635
Capital assets, net of depreciation	655,500	291,503
Total assets	20,605,138	39,333,138
<u>DEFERRED OUTFLOWS OF RESOURCES</u>		
Employer contributions to pension plan made subsequent to measurement date	479,221	440,805
KPERs Pension - Changes in proportion	429,410	-
Total deferred outflows	908,631	440,805
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	5,115,945	8,785,808
Due to the State of Kansas	5,410,666	4,806,536
Unearned revenue	-	5,500,000
Refundable deposits	-	11,000,000
Prize liability	9,783,440	7,769,465
Total current liabilities	20,310,051	37,861,809
Net pension liability	6,475,132	5,520,044
Total liabilities	26,785,183	43,381,853
<u>DEFERRED INFLOWS OF RESOURCES</u>		
KPERs Pension - Differences between actual and expected experience	194,045	130,749
KPERs Pension - Net differences between projected and actual earnings on investments	168,686	657,179
KPERs Pension - Changes in assumptions	14,410	-
KPERs Pension - Changes in proportion	253,213	319,499
Total deferred inflows	630,354	1,107,427
<u>NET POSITION</u>		
Net Invested in capital assets	655,500	291,503
Unrestricted (deficit)	(6,557,268)	(5,006,840)
Total net position	\$ (5,901,768)	\$ (4,715,337)

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, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
Operating revenues:		
Net game revenues	\$ 272,017,364	\$ 250,025,840
Expanded lottery revenues	364,371,095	365,026,301
Expanded lottery reimbursements	3,650,189	3,689,706
Phone reimbursements	917,055	931,510
Retailer fees and miscellaneous income	5,539,995	152,646
	<u>646,495,698</u>	<u>619,826,003</u>
Total operating revenues		
Operating expenses:		
Game prizes	157,300,767	144,914,052
Casino operator management fee	265,926,380	266,469,200
Retailer commissions	16,017,493	14,806,722
On-line games service bureau	6,037,953	5,107,939
Salaries and benefits	5,909,651	5,815,783
Cost of instant tickets	3,265,526	3,028,077
Advertising	4,806,871	3,629,835
Other administrative expenses	2,743,500	2,365,626
Depreciation	317,136	116,855
City and County expanded lottery fees	10,931,133	10,950,789
Professional services	320,884	280,222
On-line service bureau - expanded lottery	2,049,377	2,108,583
Telecommunications	232,049	154,639
	<u>475,858,720</u>	<u>459,748,322</u>
Total operating expenses		
Operating income	<u>170,636,978</u>	<u>160,077,681</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(78,809,580)	(74,543,887)
Transfers to the Expanded Lottery Act Revenues Fund	(85,726,159)	(80,305,786)
Transfers to the Problem Gambling Fund	(7,287,423)	(7,300,526)
Write-off and adjustment of capital assets	(247)	8,449
	<u>(171,823,409)</u>	<u>(162,141,750)</u>
Total nonoperating revenues (expenses)		
Change in net position	(1,186,431)	(2,064,069)
Net position, beginning of year	<u>(4,715,337)</u>	<u>3,620,064</u>
Prior period restatement for recognition of pension liability		<u>(6,271,332)</u>
Net position, beginning of year as restated		<u>(2,651,268)</u>
Net position, end of year	<u>\$ (5,901,768)</u>	<u>\$ (4,715,337)</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, 2016 AND 2015**

	<b>2016</b>	<b>2015</b>
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 640,720,657	\$ 623,987,507
Cash (paid)/received for casino privilege fees	-	5,500,000
Cash (paid)/received for casino privilege fee deposits	(11,000,000)	11,000,000
Cash paid for prizes, commissions, and other expenses	(471,617,783)	(452,834,887)
Cash paid to employees	(5,899,462)	(5,900,449)
Net cash provided by operating activities	152,203,412	181,752,171
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(78,205,450)	(75,020,240)
Payments to State General Fund	(85,726,159)	(80,469,906)
Payments to State Problem Gambling Fund	(7,287,423)	(7,300,526)
Net cash used by noncapital financing activities	(171,219,032)	(162,790,672)
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	4,000	26,800
Purchases of capital assets	(685,380)	(153,316)
Net cash used by capital and related financing activities	(681,380)	(126,516)
Net increase (decrease) in cash	(19,697,000)	18,834,983
Cash, beginning of year	25,380,315	6,545,332
Cash, end of year	\$ 5,683,315	\$ 25,380,315
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 170,636,978	\$ 160,077,681
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	317,136	116,855
Net recognition of deferred amounts of pension liability	(944,899)	1,056,143
Changes in operating assets and liabilities:		
Accounts receivable	(163,978)	1,249,839
Other deposits and receivables	(111,063)	2,911,665
Instant ticket game inventory	(329,962)	(1,140,233)
Accounts payable and accrued liabilities	(3,669,863)	540,218
Net pension liability	955,088	(1,140,809)
Unearned revenues	(5,500,000)	5,500,000
Refundable deposits	(11,000,000)	11,000,000
Prize liability	2,013,975	1,580,812
Net cash provided by operating activities	\$ 152,203,412	\$ 181,752,171

See accompanying notes to financial statements.

**Kansas Lottery**  
**(A component unit of the State of Kansas)**  
**Notes to Financial Statements**  
**June 30, 2016 and 2015**

**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, 2016 and 2015**

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, 2016 and 2015**

Retailer commissions

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

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

Retailer Fees

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

Expanded Lottery Reimbursements

According to the Expanded Lottery Act, each potential management company in each of the expanded gaming zones is to reimburse the Lottery for expenses incurred related to the management of the expanded lottery initiative. The Lottery recognizes these revenues as the related expenses are incurred. The reimbursements for the years ended 2016 and 2015 were \$3,650,189 and \$3,689,706, 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, 2016 and 2015**

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*

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

Prize Liability

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

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, 2016 and 2015**

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

During 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, 2016 and 2015**

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, 2016 and 2015**

**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, 2016 and 2015, the Lottery's share in the State's common cash pool was \$5,576,957 and \$25,273,395, respectively.

**3 - Capital Assets**

Capital assets consisted of the following at June 30, 2016:

	Beginning Balances	Increases	Decreases	Ending Balances
Equipment, furnishing and software	\$ 1,326,417	\$ 627,500	\$ (468,651)	\$ 1,485,266
Vehicles	778,445	57,880	(70,945)	765,380
Total Lottery capital assets	<u>2,104,862</u>	<u>685,380</u>	<u>(539,596)</u>	<u>2,250,646</u>
Accumulated depreciatiion	<u>(1,813,359)</u>	<u>(317,136)</u>	<u>535,349</u>	<u>(1,595,146)</u>
Total capital assets, net of depreciation	<u>\$ 291,503</u>			<u>\$ 655,500</u>

Capital assets consisted of the following at June 30, 2015:

	Beginning Balances	Increases	Decreases	Ending Balances
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 depreciatiion	<u>(1,832,042)</u>	<u>(116,855)</u>	<u>135,538</u>	<u>(1,813,359)</u>
Total capital assets, net of depreciation	<u>\$ 273,393</u>			<u>\$ 291,503</u>

**Kansas Lottery**  
**(A component unit of the State of Kansas)**  
**Notes to Financial Statements**  
**June 30, 2016 and 2015**

**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:

2017	\$	702,243
2018		719,769
2019		737,899
2020		756,634
2021		775,973
2022-2023		1,203,845
	<u>\$</u>	<u>4,896,363</u>

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

The Lottery incurred office, warehouse and miscellaneous rental expense of \$727,392 and \$740,411 under operating leases for the years ended June 30, 2016 and 2015, 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 \$6,037,953 and \$5,107,939 for the years ended June 30, 2016 and 2015, 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 \$2,049,377 and \$2,108,583 for the years ended June 30, 2016 and 2015, 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, 2016 and 2015**

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, 2016 and 2015, the fee was \$28,424,074 and \$29,574,624, respectively, and 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.

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.

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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, 2016 and 2015, the fee was \$104,998,331 and \$104,214,118, respectively, and 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, 2016 and 2015, the fee was \$132,503,975 and \$132,680,457, respectively, and 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. The privilege fee deposits have been returned to the other two applicants, and the privilege fee from the awarded contract has been deposited to the State's general fund. As of June 30, 2016, the contract has been awarded and completed construction is planned for March 2017 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, 2016 and 2015 were \$0 and \$759,000, 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 serve 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, 2016 and 2015, the prize reserve account had a balance \$72,114,390 and \$74,843,800, respectively, of which the Lottery's portion was \$1,332,988 and \$1,308,801, respectively. The set prize reserve at June 30, 2016 and 2015 had a balance of \$39,307,288 and \$35,096,120, respectively, of which the Lottery's portion was \$580,069 and \$604,256, 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, 2016 and 2015 was \$38,541,036 and \$37,271,793, respectively, of which the Lottery's portion was \$617,053 and \$611,548, respectively.

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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, 2016 and 2015, 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, 2016 and 2015, the prize reserve account had a balance of \$7,170,477 and \$8,022,038, respectively, of which the Lottery's portion was \$790,311 and \$876,587, 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, 2016 and 2015 the Lottery's portion of the balance of this account was \$10,194 and \$79,937, 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, 2016 and 2015, the approximate remaining prize payments are \$373,500 and \$391,500, 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, 2016, the State Legislature set a minimum transfer to the Fund of \$76,500,000, which includes at least \$1,200,000 designated for the veteran transfer. 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. Under the accrual basis of accounting, total transfers to the State of Kansas for years ended June 30, 2016 and 2015 were \$78,809,580 and \$74,543,887, respectively, of which \$5,410,666 and \$4,806,536 was unpaid, respectively. Actual cash transfers to the State of Kansas for years ended June 30, 2016 and 2015 were \$78,205,450 and \$75,020,240, respectively. Included in the minimum transfer amount were mandated transfer of \$1,658,099 and \$1,587,428 for the years ended June 30, 2016 and 2015, 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, 2016 and 2015:



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	FY 2016	FY 2015
	<u>Boot Hill</u>	<u>Boot Hill</u>
Gaming Facility Revenue:		
Electronic games	\$ 34,130,946	\$ 35,716,999
Table games	4,806,142	4,796,186
Total	<u>\$ 38,937,088</u>	<u>\$ 40,513,185</u>
Distributions:		
State of Kansas - 22%	\$ 8,566,159	\$ 8,912,901
Problem Gambling Fund - 2%	778,742	810,264
City & County - 3%	1,168,113	1,215,396
Casino operator management fees - 73%	28,424,074	29,574,624
Total	<u>\$ 38,937,088</u>	<u>\$ 40,513,185</u>
	FY 2016	FY 2015
	<u>Kansas Star</u>	<u>Kansas Star</u>
Gaming Facility Revenue:		
Electronic games	\$ 154,541,022	\$ 153,746,959
Table games	27,059,655	28,007,092
Total	<u>\$ 181,600,677</u>	<u>\$ 181,754,051</u>
Distributions:		
State of Kansas - 22%	\$ 40,016,668	\$ 39,985,891
Problem Gambling Fund - 2%	3,632,014	3,635,081
City & County - 3%	5,448,020	5,452,622
Casino operator management fees - 73%	132,503,975	132,680,457
Total	<u>\$ 181,600,677</u>	<u>\$ 181,754,051</u>
	FY 2016	FY 2015
	<u>Hollywood</u>	<u>Hollywood</u>
Gaming Facility Revenue:		
Electronic games	\$ 124,733,467	\$ 122,021,238
Table games	19,099,863	20,737,827
Total	<u>\$ 143,833,330</u>	<u>\$ 142,759,065</u>
Distributions:		
State of Kansas - 22%	\$ 31,643,332	\$ 31,406,994
Problem Gambling Fund - 2%	2,876,667	2,855,181
City & County - 3%	4,315,000	4,282,772
Casino operator management fees - 73%	104,998,331	104,214,118
Total	<u>\$ 143,833,330</u>	<u>\$ 142,759,065</u>

At June 30, 2016 and 2015, \$1,729,351 and \$1,421,125, respectively, was receivable from the casino manager for online and table game net revenue. At June 30, 2016 and 2015, \$3,607,780 and \$7,234,924, 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**

Sales by game and overall gross margin are as follows:

	FY 2016	FY 2015
Sales, Net		
Instant Games	\$ 143,388,902	\$ 133,685,288
Pull Tabs	10,065,837	12,574,359
Powerball	54,254,605	35,271,222
MegaMillions	14,021,964	14,719,132
Super Kansas Cash	12,820,012	12,687,474
Pick 3	6,536,670	6,138,612
Keno	16,053,147	18,155,675
Holiday Raffle	3,500,000	3,500,000
2 by 2	1,919,689	1,848,931
Hot Lotto	6,697,606	8,609,114
Kansas Hold Em	2,758,932	2,836,033
Total	<u>\$ 272,017,364</u>	<u>\$ 250,025,840</u>
Prizes, net	(157,300,767)	(144,914,052)
Retailer Commissions	(16,017,493)	(14,806,722)
Gross Margin	<u>\$ 98,699,104</u>	<u>\$ 90,305,066</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](http://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

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December 31, 2014. On January 1, 2015, Kansas law increased the KPERs member-employee 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 1.00% contribution rate for the Death and Disability Program) and the statutory contribution rate was 10.91% for the fiscal year ended June 30, 2016. The actuarially determined employer contribution rate (not including the 0.85% contribution rate for the Death and Disability Program) 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 \$479,221 and \$440,805 for the years ended June 30, 2016 and 2015.

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

At June 30, 2016, the Lottery reported a liability of \$6,475,132 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2014, which was rolled forward to June 30, 2015. 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, 2015. The contributions used exclude contributions made for prior service, excess benefits and irregular payments. At June 30, 2015, the Lottery proportion was 0.094%, which was an increase of 0.008% from its proportion measured as of June 30, 2014.

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, 2016, the Lottery recognized pension expense of \$454,825. At June 30, 2016, 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 of Resources</u>	<u>Deferred inflows of Resources</u>
Difference between expected and actual experience	\$ -	\$ 194,045
Net difference between projected and actual earnings on pension plan investments	-	168,686
Changes in assumptions	-	14,410
Changes in proportion	429,410	253,213
Lottery contributions subsequent to measurement date	<u>479,221</u>	<u>-</u>
Total	<u>\$ 908,631</u>	<u>\$ 630,354</u>

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:

	<u>Deferred Outflows of Resources</u>	<u>Deferred inflows 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>

\$479,221 reported as deferred outflows of resources related to pensions resulting from “state agency” contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

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**Year ended June 30:**

2017	(111,855)
2018	(111,855)
2019	(111,855)
2020	83,205
2021	51,416
Thereafter	-
Total	<u><u>(200,944)</u></u>

Actuarial assumptions

The total pension liability in the December 31, 2014 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 16.00 percent, including inflation
Long-term rate of return net of investment expense, and including price inflation	8.00 percent

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, 2014 valuation were based on the results of an actuarial experience study conducted for the three year period beginning December 31, 2012.

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, 2015 are summarized in the following table:

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<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Global equity	47%	6.30%
Fixed income	13	0.8
Yield driven	8	4.2
Real return	11	1.7
Real estate	11	5.4
Alternatives	8	9.4
Short-term investments	2	(0.5)
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 proportionate share of the net pension liability calculated using the discount rate of 8.00%, as well as what the Lottery 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:

	<u>1% Decrease (7.00%)</u>	<u>Current Discount Rate (8.00%)</u>	<u>1% Increase (9.00%)</u>
Lottery proportionate share of the net pension liability	\$ 8,335,548	\$ 6,475,132	\$ 4,894,954

Pension plan fiduciary net position

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

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Subsequent events

During Fiscal Year 2016, the Director of the Budget for the State of Kansas authorized and initiated a process pursuant to Senate Bill 161, Section 98 (a)(1), that delayed General Fund cash disbursement associated with Executive Branch SHARP Agencies and Regent Institution KPERS employer contributions for the final three pay periods of Fiscal Year 2016. As of June 30, 2016, an expenditure and corresponding accounts payable have been recorded in the State's General Fund. It is unknown at the time whether this delay will have a significant effect on any actuarial assumptions used by KPERS to calculate the cumulative net pension liability in future periods.

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 effect on the collective net pension liability. In August 2015, bonds were issued and the proceeds were deposited by KPERS for investment. As the issuance of these bonds was subsequent to the measurement date for the liability calculation, the effect of the 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.

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 2016 and 2015, the Lottery did not contribute to the plan.



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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, 2016 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, 2016 and 2015 were \$6,274 and \$6,856 respectively. As of June 30, 2016, 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.

Annual required Contribution (ARC)	\$ 32,011
Interest in the net OPEB obligation	14,399
Adjustment to the ARC	<u>(361,199)</u>
Annual OPEB cost (expense)	(314,789)
Net Employer contributions	<u>38,201</u>
Decrease in net OPEB obligation	(352,990)
Net OPEB obligation, beginning of year	<u>374,000</u>
Net OPEB obligation, end of year	<u><u>\$ 21,010</u></u>

**Kansas Lottery**  
**(A component unit of the State of Kansas)**  
**Notes to Financial Statements**  
**June 30, 2016 and 2015**

Fiscal Year	Annual OPEB Cost	Net Employer Contributions	Percentage Contributed	End of Year Net OPEB Obligation
2014	\$ 51,000	\$ 20,000	39%	\$ 363,000
2015	47,000	36,000	77%	374,000
2016	(314,789)	38,201	0%	21,010

Funded Status and Funding Progress

As of June 30, 2016, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$21,010. 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 \$21,010. The covered payroll (annual payroll of active employees covered by the plan) was \$4,558,350, and the ratio of the UAAL to covered payroll was 0 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.

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 January 1, 2016 actuarial valuation, the entry age normal method was applied. The actuarial assumptions included a 3.85 percent investment rate of return, which is a blended rate of the expected long-term investment returns on the State's pooled funds and investments. The valuation assumed annual healthcare cost trend rates of 5 to 7 percent in the next fifteen years. The UAAL is being amortized over a 30 year open period in level dollar amounts.

**Kansas Lottery**  
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**Notes to Financial Statements**  
**June 30, 2016 and 2015**

**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 did not receive privilege fees the year ended June 30, 2016. The State of Kansas received \$16,500,000 in privilege fee deposits during the year ended June 30, 2015. For year ended June 30, 2016, the State's general fund received \$5,500,000 for the binding contract in the southeast region, and privilege fee deposits of \$11,000,000 were returned to the applicants not awarded contracts in the southeast region.

**12 - Subsequent Event**

The Lottery has evaluated subsequent events through September 30, 2016, 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.

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.

**Kansas Lottery**  
**(A component unit of the State of Kansas)**  
**Notes to Financial Statements**  
**June 30, 2016 and 2015**

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

For the 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 implementation, net position as of July 1, 2014, was restated as follows:

Net position, as previously reported	<u>\$</u>	<u>3,620,064</u>
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		<u>389,521</u>
Total prior period adjustment		<u>(6,271,332)</u>
Net position, as restated	<u>\$</u>	<u>(2,651,268)</u>

**Kansas Lottery**  
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**Required Supplementary Information**  
**June 30, 2016 and 2015**

**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)
6/30/2016	\$ -	\$ 21,010	\$ 21,010	0%	\$ 4,558,350	0%
6/30/2015	-	569,000	569,000	0%	4,224,000	13%
6/30/2014	-	624,000	624,000	0%	4,019,000	16%
6/30/2013	-	767,000	767,000	0%	4,073,000	19%

**Schedule of Proportionate Share of the Net Pension Liability and Required Contributions**

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Proportion of the net pension liability	0.094%	0.086%
Proportionate share of the net pension liability	\$ 6,475,132	\$ 5,520,044
Covered employee payroll for valuation period	\$ 4,224,000	\$ 4,019,000
Proportionate share of the net pension liability as a percentage of covered-employee payroll	153.3%	137.3%
Plan fiduciary net position as a percentage of the total pension liability	64.6%	66.6%
Required contributions	\$ 406,220	\$ 389,521
Contributions in relation to required contribution	406,220	389,521
Contribution deficiency	\$ -	\$ -
Covered employee payroll for valuation period	\$ 4,224,000	\$ 4,019,000
Contributions as a percentage of covered-employee payroll	9.6%	9.7%

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

**KANSAS LOTTERY**  
**(A COMPONENT UNIT OF THE STATE OF KANSAS)**  
**COMBINING STATEMENT OF NET POSITION**  
**JUNE 30, 2016**

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2016
<b><u>ASSETS</u></b>			
Current Assets:			
Cash:			
Operating fund	\$ 3,027,077	\$ 1,878,429	\$ 4,905,506
Prize payment fund	777,809	-	777,809
Accounts receivable, net of allowance for doubtful accounts of \$353,615	4,469,696	-	4,469,696
Accounts receivable - unbilled	4,406,105	-	4,406,105
Other deposits and receivables	251,312	1,729,351	1,980,663
Instant ticket game inventory	3,409,859	-	3,409,859
 Total current assets	 16,341,858	 3,607,780	 19,949,638 :
Capital assets, net of depreciation:	655,500	-	655,500
 Total assets	 16,997,358	 3,607,780	 20,605,138 :
<b><u>DEFERRED OUTFLOWS OF RESOURCES</u></b>			
Employer contributions to pension plan made subsequent to measurement date	479,221	-	479,221
KPERS Pension - Changes in proportion	429,410	-	429,410
 Total deferred outflows	 908,631	 -	 908,631 :
<b><u>LIABILITIES</u></b>			
Current liabilities:			
Accounts payable and accrued liabilities	1,508,165	3,607,780	5,115,945
Due to the State of Kansas	5,410,666	-	5,410,666
Due to Problem Gambling Fund	-	-	-
Unearned revenue	-	-	-
Refundable deposits	-	-	-
Prize liability	9,783,440	-	9,783,440
 Total current liabilities	 16,702,271	 3,607,780	 20,310,051 :
Net pension liability	6,475,132	-	6,475,132
 Total liabilities	 23,177,403	 3,607,780	 26,785,183 :
<b><u>DEFERRED INFLOWS OF RESOURCES</u></b>			
KPERS Pension - Differences between actual and expected experience	194,045	-	194,045
KPERS Pension - Net differences between projected and actual earnings on investments	168,686	-	168,686
KPERS Pension - Changes in assumptions	14,410	-	14,410
KPERS Pension - Changes in proportion	253,213	-	253,213
 Total deferred inflows	 630,354	 -	 630,354 :
<b><u>NET POSITION</u></b>			
Net Invested in capital assets	655,500	-	655,500
Unrestricted (deficit)	(6,557,268)	-	(6,557,268)
 Total net position	 \$ (5,901,768)	 \$ -	 \$ (5,901,768) :

**KANSAS LOTTERY**  
**(A COMPONENT UNIT OF THE STATE OF KANSAS)**  
**COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**  
**YEAR ENDED JUNE 30, 2016**

	Lottery	Kansas Lottery Expanded Lottery	Total 2016
Operating revenues:			
Net game revenues	\$ 272,017,364	\$ -	\$ 272,017,364
Expanded lottery revenues	-	364,371,095	364,371,095
Expanded lottery reimbursements	-	3,650,189	3,650,189
Phone reimbursements	917,055	-	917,055
Retailer fees and miscellaneous income	39,995	5,500,000	5,539,995
<b>Total operating revenues</b>	<b>272,974,414</b>	<b>373,521,284</b>	<b>646,495,698 :</b>
Operating expenses:			
Game prizes	157,300,767	-	157,300,767
Casino operator management fee	-	265,926,380	265,926,380
Retailer commissions	16,017,493	-	16,017,493
On-line games service bureau	6,037,953	-	6,037,953
Salaries and benefits	4,685,922	1,223,729	5,909,651
Cost of instant tickets	3,265,526	-	3,265,526
Advertising	4,806,871	-	4,806,871
Other administrative expenses	2,463,760	279,740	2,743,500
Depreciation	317,136	-	317,136
City and County expanded lottery fees	-	10,931,133	10,931,133
Professional services	231,780	89,104	320,884
On-line service bureau - expanded lottery	-	2,049,377	2,049,377
Telecommunications	223,810	8,239	232,049
<b>Total operating expenses</b>	<b>195,351,018</b>	<b>280,507,702</b>	<b>475,858,720 :</b>
<b>Operating income</b>	<b>77,623,396</b>	<b>93,013,582</b>	<b>170,636,978 *</b>
Nonoperating revenues (expenses):			
Transfers to the State Gaming Revenue Fund	(78,809,580)	-	(78,809,580)
Transfers to the Expanded Lottery Act Revenues Fund	-	(85,726,159)	(85,726,159)
Transfers to the Problem Gambling Fund	-	(7,287,423)	(7,287,423)
Gain (loss) on disposal of capital assets	(247)	-	(247)
<b>Total nonoperating revenues (expenses)</b>	<b>(78,809,827)</b>	<b>(93,013,582)</b>	<b>(171,823,409) :</b>
<b>Change in net position</b>	<b>(1,186,431)</b>	<b>-</b>	<b>(1,186,431) *</b>
<b>Net position, beginning of year</b>	<b>(4,715,337)</b>	<b>-</b>	<b>(4,715,337) †</b>
<b>Net position, end of year</b>	<b>\$ (5,901,768)</b>	<b>\$ -</b>	<b>\$ (5,901,768) :</b>

**KANSAS LOTTERY**  
**(A COMPONENT UNIT OF THE STATE OF KANSAS)**  
**COMBINING STATEMENT OF CASH FLOWS**  
**YEAR ENDED JUNE 30, 2016**

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2016
Cash flows from operating activities:			
Cash received from sales and reimbursements	\$ 273,007,599	367,713,058	\$ 640,720,657
Cash paid/received for casino privelege fees	(5,500,000)	5,500,000	-
Cash paid for casino privelege fee deposits	(11,000,000)	-	(11,000,000)
Cash paid for prizes, commissions, and other expenses	(188,596,673)	(283,021,110)	(471,617,783)
Cash paid to employees	(4,675,733)	(1,223,729)	(5,899,462)
Net cash provided by operating activities	<u>63,235,193</u>	<u>88,968,219</u>	<u>152,203,412</u>
Cash flows from noncapital financing activities:			
Payments to State Gaming Revenue Fund	(78,205,450)	-	(78,205,450)
Payments to State General Fund	-	(85,726,159)	(85,726,159)
Payments to State Problem Gambling Fund	-	(7,287,423)	(7,287,423)
Net cash used by noncapital financing activities	<u>(78,205,450)</u>	<u>(93,013,582)</u>	<u>(171,219,032)</u>
Cash flows from capital and related financing activities:			
Proceeds from sale of capital assets	4,000	-	4,000
Purchases of capital assets	(685,380)	-	(685,380)
Net cash used by capital and related financing activities	<u>(681,380)</u>	<u>-</u>	<u>(681,380)</u>
Net increase (decrease) in cash	(15,651,637)	(4,045,363)	(19,697,000)
Cash, beginning of year	<u>19,456,523</u>	<u>5,923,792</u>	<u>25,380,315</u>
Cash, end of year	<u>\$ 3,804,886</u>	<u>\$ 1,878,429</u>	<u>\$ 5,683,315</u>
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	\$ 77,623,396	\$ 93,013,582	\$ 170,636,978
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	317,136	-	317,136
Net recognition of deferred amounts of pension liability	(944,899)	-	(944,899)
Changes in operating assets and liabilities:			
Accounts receivable	(163,978)	-	(163,978)
Other deposits and receivables	197,163	(308,226)	(111,063)
Instant ticket game inventory	(329,962)	-	(329,962)
Accounts payable and accrued liabilities	67,274	(3,737,137)	(3,669,863)
Net pension liability	955,088	-	955,088
Unearned revenues	(5,500,000)	-	(5,500,000)
Refundable deposits	(11,000,000)	-	(11,000,000)
Prize liability	2,013,975	-	2,013,975
Net cash provided by operating activities	<u>\$ 63,235,193</u>	<u>\$ 88,968,219</u>	<u>\$ 152,203,412</u>



**KANSAS LOTTERY**  
**(A COMPONENT UNIT OF THE STATE OF KANSAS)**  
**STATEMENTS OF NET POSITION - LOTTERY**  
**JUNE 30, 2016 AND 2015**

<u>ASSETS</u>	<b>Lottery</b>	
	2016	2015
Current Assets:		
Cash:		
Operating fund	\$ 3,027,077	\$ 19,211,942
Prize payment fund	777,809	244,581
Accounts receivable, net of allowance for doubtful accounts of \$234,118 and \$236,708 at 2014 and 2013, respectively	4,469,696	2,805,119
Accounts receivable - unbilled	4,406,105	5,906,704
Other receivable	251,312	448,475
Instant ticket game inventory	3,409,859	3,079,897
Total current assets	16,341,858	31,696,718
Capital assets, net of depreciation	655,500	291,503
Total assets	16,997,358	31,988,221
<u>DEFERRED OUTFLOWS OF RESOURCES</u>		
Employer contributions to pension plan made subsequent to measurement date	479,221	440,805
KPERS Pension - Changes in proportion	429,410	-
Total deferred outflows	908,631	440,805
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,508,165	\$ 1,440,891
Due to the State of Kansas	5,410,666	4,806,536
Unearned revenue	-	5,500,000
Refundable deposits	-	11,000,000
Prize liability	9,783,440	7,769,465
Total current liabilities	16,702,271	30,516,892
Net pension liability	6,475,132	5,520,044
Total liabilities	23,177,403	36,036,936
<u>DEFERRED INFLOWS OF RESOURCES</u>		
KPERS Pension - Differences between actual and expected experience	194,045	130,749
KPERS Pension - Net differences between projected and actual earnings on investments	168,686	657,179
KPERS Pension - Changes in assumptions	14,410	-
KPERS Pension - Changes in proportion	253,213	319,499
Total deferred inflows	630,354	1,107,427
<u>NET POSITION</u>		
Net Investment in capital assets	655,500	291,503
Unrestricted	(6,557,268)	(5,006,840)
Total net position	\$ (5,901,768)	\$ (4,715,337)

**KANSAS LOTTERY**  
**(A COMPONENT UNIT OF THE STATE OF KANSAS)**  
**STATEMENTS OF REVENUES, EXPENSES,**  
**AND CHANGES IN NET POSITION - LOTTERY**  
**YEARS ENDED JUNE 30, 2016 AND 2015**

	<b>Lottery</b>	
	<u>2016</u>	<u>2015</u>
Operating revenues:		
Net game revenues	\$ 272,017,364	\$ 250,025,840
Phone reimbursements	917,055	931,510
Retailer fees and miscellaneous income	39,995	152,646
	<u>272,974,414</u>	<u>251,109,996</u>
Operating expenses:		
Game prizes	157,300,767	144,914,052
Retailer commissions	16,017,493	14,806,722
On-line games service bureau	6,037,953	5,107,939
Salaries and benefits	4,685,922	4,598,453
Cost of instant tickets	3,265,526	3,028,077
Advertising	4,806,871	3,629,835
Other administrative expense	2,463,760	2,067,744
Depreciation	317,136	116,855
Professional services	231,780	221,433
Telecommunications	223,810	147,517
	<u>195,351,018</u>	<u>178,638,627</u>
Operating income	<u>77,623,396</u>	<u>72,471,369</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(78,809,580)	(74,543,887)
Gain (loss) on disposal of capital assets	(247)	8,449
	<u>(78,809,827)</u>	<u>(74,535,438)</u>
Change in net position	(1,186,431)	(2,064,069)
Net position, beginning of year	<u>(4,715,337)</u>	<u>3,620,064</u>
Prior period restatement for recognition of pension liability		<u>(6,271,332)</u>
Net position, beginning of year as restated		<u>(2,651,268)</u>
Net position, end of year	<u>\$ (5,901,768)</u>	<u>\$ (4,715,337)</u>

**KANSAS LOTTERY**  
**(A COMPONENT UNIT OF THE STATE OF KANSAS)**  
**STATEMENTS OF CASH FLOWS - LOTTERY**  
**YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>Lottery</u>	
	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 273,007,599	\$ 252,388,312
Cash (paid)/received for casino privelege fees	(5,500,000)	5,500,000
Cash (paid)/received for casino privelege fee deposits	(11,000,000)	11,000,000
Cash paid for prizes, commissions, and other expenses	(188,596,673)	(173,786,769)
Cash paid to employees	(4,675,733)	(4,683,119)
Net cash provided by operating activities	<u>63,235,193</u>	<u>90,418,424</u>
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(78,205,450)	(75,020,240)
Payments to State General Fund	-	-
Net cash used by noncapital financing activities	<u>(78,205,450)</u>	<u>(75,020,240)</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	4,000	26,800
Purchases of capital assets	(685,380)	(153,316)
Net cash used by capital and related financing activities	<u>(681,380)</u>	<u>(126,516)</u>
Net increase in cash	(15,651,637)	15,271,668
Cash, beginning of year	19,456,523	4,184,855
Cash, end of year	<u>\$ 3,804,886</u>	<u>\$ 19,456,523</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 77,623,396	\$ 72,471,369
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	317,136	116,855
Net recognition of deferred amounts of pension liability	(944,899)	1,056,143
Changes in operating assets and liabilities:		
Accounts receivable	(163,978)	1,249,839
Other deposits and receivables	197,163	28,477
Instant ticket game inventory	(329,962)	(1,140,233)
Accounts payable and accrued liabilities	67,274	(304,029)
Unearned revenues	955,088	(1,140,809)
Unearned revenues	(5,500,000)	5,500,000
Refundable deposits	(11,000,000)	11,000,000
Prize liability	2,013,975	1,580,812
Net cash provided by operating activities	<u>\$ 63,235,193</u>	<u>\$ 90,418,424</u>

**KANSAS LOTTERY**  
**(A COMPONENT UNIT OF THE STATE OF KANSAS)**  
**STATEMENTS OF NET POSITION - EXPANDED LOTTERY**  
**JUNE 30, 2016 AND 2015**

	<b>Expanded Lottery</b>	
	2016	2015
<u><b>ASSETS</b></u>		
Current Assets:		
Cash:		
Operating fund	\$ 1,878,429	\$ 5,923,792
Other receivable	1,729,351	1,421,125
	3,607,780	7,344,917
Total current assets	3,607,780	7,344,917
Total assets	3,607,780	7,344,917
<u><b>LIABILITIES</b></u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 3,607,780	\$ 7,344,917
Due to the State of Kansas	-	-
Due to Problem Gambling Fund	-	-
	3,607,780	7,344,917
Total current liabilities	3,607,780	7,344,917
<u><b>NET POSITION</b></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, 2016 AND 2015**

	<b>Expanded Lottery</b>	
	2016	2015
Operating revenues:		
Expanded lottery revenues	\$ 364,371,095	\$ 365,026,301
Expanded lottery reimbursements	3,650,189	3,689,706
Miscellaneous income - privilege fees	5,500,000	-
Total operating revenues	<u>373,521,284</u>	<u>368,716,007</u>
Operating expenses:		
Casino operator management fee	265,926,380	266,469,200
Salaries and benefits	1,223,729	1,217,330
Other administrative expenses	279,740	297,882
City and County expanded lottery fees	10,931,133	10,950,789
Professional services	89,104	58,789
On-line service bureau - expanded lottery	2,049,377	2,108,583
Telecommunications	8,239	7,122
Total operating expenses	<u>280,507,702</u>	<u>281,109,695</u>
Operating income	<u>93,013,582</u>	<u>87,606,312</u>
Nonoperating revenues (expenses):		
Transfers to the Expanded Lottery		
Act Revenues Fund	(85,726,159)	(80,305,786)
Transfers to the Problem Gambling Fund	(7,287,423)	(7,300,526)
Loss on disposal of capital assets	-	-
Total nonoperating revenues (expenses)	<u>(93,013,582)</u>	<u>(87,606,312)</u>
Change in net position	-	-
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, 2016 AND 2015**

	<u>Expanded Lottery</u>	
	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 367,713,058	\$ 371,599,195
Cash received from casino privelege fees	5,500,000	-
Cash paid for prizes, commissions, and other expenses	(283,021,110)	(279,048,118)
Cash paid to employees	(1,223,729)	(1,217,330)
Net cash provided by operating activities	<u>88,968,219</u>	<u>91,333,747</u>
Cash flows from noncapital financing activities:		
Payments to State General Fund	(85,726,159)	(80,469,906)
Payments to State Problem Gambling Fund	(7,287,423)	(7,300,526)
Net cash used by noncapital financing activities	<u>(93,013,582)</u>	<u>(87,770,432)</u>
Net increase (decrease) in cash	(4,045,363)	3,563,315
Cash, beginning of year	<u>5,923,792</u>	<u>2,360,477</u>
Cash, end of year	<u>\$ 1,878,429</u>	<u>\$ 5,923,792</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 93,013,582	\$ 87,606,312
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Other receivable	(308,226)	2,883,188
Accounts payable and accrued liabilities	(3,737,137)	844,247
Net cash provided by operating activities	<u>\$ 88,968,219</u>	<u>\$ 91,333,747</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, a component unit of the State of Kansas, as of and for the year ended June 30, 2016, 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, 2016.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Kansas 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 Kansas Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Kansas 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 Kansas 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 Kansas 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 Kansas 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, 2016



**KANSAS LOTTERY**  
**A COMPONENT UNIT OF THE STATE OF KANSAS**

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**SCHEDULE OF FINDINGS AND RESPONSES**  
**For The Year Ended June 30, 2016**

None

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***KANSAS LOTTERY***  
*AUDITOR COMMUNICATIONS*  
*JUNE 30, 2016*

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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, 2016 and 2015, and have issued our report thereon dated September 30, 2016. Our audit was performed in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement and presented in accordance with accounting principles generally accepted in the United States of America. Those standards require the auditor to ensure that those charged with corporate governance receive additional information regarding the scope and results of the audit that may assist the governing body in overseeing the financial reporting and disclosure process for which management is responsible. The following sections describe matters which are required to be reported to you.

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

As stated in the Agreement for Auditing and Related Services for the Kansas Lottery dated November 20, 2013 and our engagement letter dated September 2, 2016, our responsibility, as described by professional standards, is to express an opinion 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 2016 audited financial statements are not included within any other document.

Our audit has been conducted for the purpose of forming an opinion 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 September 2, 2016, 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 restate July 1, 2014 net position due to adopting 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, 2016.

### *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, 2016



**Terry P. Presta**  
Executive Director

**Sam Brownback**  
Governor

September 30, 2016

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

We are providing this letter in connection with your audit of the Statement of Net Position of the Kansas Lottery as of June 30, 2016 and 2015 and the related statements of revenues, expenses, and change in net position, and cash flows for the years then ended for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the respective financial position, results of operations, and cash flows for the Kansas Lottery in conformity with U.S. generally accepted accounting principles. We confirm that we are responsible for the fair presentation of the previously mentioned financial statements in conformity with U.S. generally accepted accounting principles.

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

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

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

1. We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter.




2. The financial statements referred to above are fairly presented in conformity with U.S. generally accepted accounting principles and include all properly classified funds and other financial information of the primary government and all component units required by generally accepted accounting principles to be included in the financial reporting entity.
3. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
4. We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.
5. Significant assumptions we used in making accounting estimates are reasonable.
6. Related party relationships and transactions, including revenues, expenditures/expenses, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP.
7. All events subsequent to the date of the financial statements and for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed. No events, including instances of noncompliance, have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements or in the schedule of findings and questioned costs.
8. The effects of all known actual or possible litigation, claims, and assessments have been accounted for and disclosed in accordance with U.S. GAAP.
9. Guarantees, whether written or oral, under which the Kansas Lottery is contingently liable, if any, have been properly recorded or disclosed.
10. We have provided you with:
  - a. Access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.
  - b. Additional information that you have requested from us for the purpose of the audit.
  - c. Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
  - d. Minutes of the meetings of the Kansas Lottery Commission or summaries of actions of recent meetings for which minutes have not yet been prepared.
11. All material transactions have been recorded in the accounting records and are reflected in the financial statements.

12. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
13. We have no knowledge of any fraud or suspected fraud that affects the entity and involves:
  - a. Management,
  - b. Employees who have significant roles in internal control, or
  - c. Others where the fraud could have a material effect on the financial statements.
14. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, regulators, or others.
15. We have disclosed to you all known instances of noncompliance or suspected noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse, whose effects should be considered when preparing financial statements.
16. We have disclosed to you all known actual or possible litigation, claims, and assessments whose effects should be considered when preparing the financial statements.
17. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
18. We have made available to you all financial records and related data.
19. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
20. We have identified to you any previous audits, attestation engagements, and other studies related to the audit objectives and whether related recommendations have been implemented.
21. The Kansas Lottery has no plans or intentions that may materially affect the carrying value or classification of assets, liabilities, or net position.
22. We are responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to us, including tax or debt limits and debt contracts; and we have identified and disclosed to you all laws, regulations and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives, including legal and contractual provisions for reporting specific activities in separate funds.
23. There are no violations or possible violations of budget ordinances, laws and regulations (including those pertaining to adopting, approving, and amending budgets), provisions of contracts and grant agreements, tax or debt limits, and any related debt covenants whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or for reporting on noncompliance.

24. As part of your audit, you assisted with preparation of the financial statements and related notes. We have designated an individual with suitable skill, knowledge, or experience to oversee your services and have made all management decisions and performed all management functions. We have reviewed, approved, and accepted responsibility for those financial statements and related notes.
25. The Kansas Lottery has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral.
26. The Kansas Lottery has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
27. We have followed all applicable laws and regulations in adopting, approving, and amending budgets.
28. The financial statements properly classify all funds and activities.
29. Components of net position (net investment in capital assets; restricted; and unrestricted) are properly classified and, if applicable, approved.
30. Provisions for uncollectible receivables have been properly identified and recorded.
31. Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.
32. Deposits and investment securities and derivative instruments are properly classified as to risk and are properly disclosed.
33. Capital assets are properly capitalized, reported, and, if applicable, depreciated.
34. We have appropriately disclosed the Kansas Lottery's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position is available and have determined that net position was properly recognized under the policy.
35. We acknowledge our responsibility for presenting the RSI in accordance with accounting principles generally accepted in the United States of America, and we believe the RSI, including its form and content, is fairly presented in accordance with accounting principles generally accepted in the United States of America. The methods of measurement and presentation of the RSI have not changed from those used in the prior period, and we have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information.

36. We acknowledge our responsibility for presenting the combining financial statements and schedules in accordance with U.S. generally accepted accounting principles, and we believe the combining financial statements and schedules, including their form and content, are fairly presented in accordance with U.S. generally accepted accounting principles. The methods of measurement and presentation of the combining financial statements and schedules have not changed from those used in the prior period, and we have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information.



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Terry Presta, Executive Director



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Matthew Schwartz, Director of Finance