

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

Financial and Compliance Audit
Years Ended June 30, 2017 and 2016

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

INTRODUCTION

Year Ended June 30, 2017

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, 2017.

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, 2017

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 Performance 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, 2017 and 2016, 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, 2017 and 2016, 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, 2017 and 2016 and its changes in financial position, and, 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 Kansas Lottery's proportionate share of the net pension liability and required contributions on page 39, 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 22, 2017, 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 22, 2017

**KANSAS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2017 AND 2016**

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, 2017 and 2016. 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 2017 were \$258.0 million. This is the second highest sales year ever, behind only the \$272.0 million in fiscal year 2016. Actual cash transfers to the State Gaming Revenue Fund (SGRF) totaled \$75.3 million, trailing only the \$78.2 million in 2016. The previous year's record sales and transfers were in part due to the frenzy surrounding the \$1.59 billion Powerball jackpot in January 2016.
- The Lottery launched Lucky for Life in November 2016, joining 22 other states in offering the multi-state game. Sales for the new game were in excess of \$4.2 million in less than eight months. Top prize winners will win \$1,000 per day for life. Two Kansas players have already won second prizes of \$25,000 per year for life.
- Kansas participated in the first national Powerball Power Cruise collect and win promotion. Thirty Kansas winners and their guests will join winners from other states on an exclusive cruise vacation in January 2018.
- In January 2017, the Lottery also launched its new player's loyalty club, PlayOn. Lottery players can now earn points redeemable for second chance drawings. Through June 2017, more than 100,000 members have been signed up and more than 2.4 million tickets have been entered.
- Kansas Crossing Casino in southeast Kansas opened in March 2017. The Lottery is responsible for distributing the net casino revenues in accordance with the Expanded Lottery Act. For 2017, Expanded Lottery net revenues totaled \$371.1 million, which is the highest ever and \$6.7 million more than the previous year. Transfers totaling \$81.6 million from Expanded Lottery activities were made to the State General Fund. Excluding the \$5.5 million casino privilege fee transferred in fiscal year 2016, this represents a \$1.4 million increase and is the highest transfer ever.

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, 2017 and 2016. 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, 2017 and 2016 as well as the Expanded Lottery casino gaming activities for the years ended June 30, 2017 and 2016. 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, 2017 and 2016.

Summary of Statements of Net Position

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

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current and other assets	\$ 18.1	\$ 19.9	\$ 39.0
Capital assets	0.6	0.7	0.3
Total assets	<u>\$ 18.7</u>	<u>\$ 20.6</u>	<u>\$ 39.3</u>
Deferred Outflows	<u>\$ 1.6</u>	<u>\$ 0.9</u>	<u>\$ 0.4</u>
Current liabilities	\$ 20.4	\$ 20.3	\$ 37.8
Net Pension Liability	6.5	6.5	5.5
Total liabilities	<u>\$ 26.9</u>	<u>\$ 26.8</u>	<u>\$ 43.3</u>
Deferred Inflows	<u>\$ 0.5</u>	<u>\$ 0.6</u>	<u>\$ 1.1</u>
Net Position			
Net Investment in capital assets	0.6	0.7	0.3
Unrestricted	(7.7)	(6.6)	(5.0)
Total net position	<u>(7.1)</u>	<u>(5.9)</u>	<u>(4.7)</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.

For fiscal year 2017, current and other assets decreased \$1.8 million due to a decrease in receivables of \$1.3 million and a decrease in ticket inventory of \$0.7 million, which was partially offset by a \$0.2 million increase in cash on hand.

During fiscal year 2016, current and other assets decreased \$19.1 million due to a decrease in cash on hand of \$19.7 million, which was partially offset by an increase in accounts receivable of \$0.3 million and an increase in ticket inventory of \$0.3 million.

In general, cash on hand and receivables at year end tend to be fairly steady, with some fluctuation due to timing of payments and receipts. The significant change in cash on hand at year-end from 2015 to 2016 was primarily due to \$16.5 million received as privilege fee deposits from bidders during the southeast gaming zone bidding process. The receivables fluctuation from 2016 to 2017 was primarily due to June 30 falling on a Friday in 2017, as the Lottery receives its weekly sweep from retailers each Friday.

Current liabilities consist of accounts payable and accrued liabilities, transfers due to the State of Kansas, unearned revenue and refundable deposits, and prize liabilities.

From 2016 to 2017, total current liabilities are fairly steady. There is an increase in accounts payable and accrued liabilities of \$1.2 million and an increase in prize liability of \$0.3 million. These increases are offset by a decrease in amounts due to the state of Kansas of \$1.4 million.

The decrease in current liabilities from 2015 to 2016 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 a decrease of \$3.0 million in accounts payable and accrued liabilities from 2015.

The changes in accounts payable and accrued liabilities are primarily due to timing differences at yearend for the expanded lottery (casino) financial statements. Payments to the casino managers are made on the same day each week. On June 30th, the amounts due could represent the manager's share of net revenues for as few as 5 days and as many as 11 days. The fluctuation in prize liabilities at yearend have been due to rising jackpot levels in the Super Kansas Cash game. The jackpots were growing at the end of June 2016 and 2017, both eventually reaching more than \$3 million. This growing jackpot was also the primary contributor to the July 2017 transfer to the state being smaller than that of the previous July. The privilege fee deposits on hand at June 2015 were a one-time item due to the timing of the bidding and approval process for the casino in the southeast gaming zone.

During the year ended June 30, 2015, the Lottery implemented the provisions of GASB 68, Accounting and Financial Reporting for Pensions. The purpose of this accounting pronouncement is to highlight unfunded pension liabilities by making the participating employers reflect an allocated share of the net pension liability on the face of the financial statements. The net pension liability, deferred inflows of resources and deferred outflows of resources on the Lottery's Statements of Net Position are entirely attributable to this accounting pronouncement.

Other than actual contributions of approximately \$0.5 million made by the Lottery to KPERs each year, all net pension activity reported on the financial statements is incidental to Lottery operations. The implementation of GASB 68 and the reporting of net pension liability have been responsible for all or substantially all of any deficit net position reported in 2015, 2016 and 2017.

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):

	2017	2016	2015
Operating revenues:			
Traditional Lottery game revenues	\$ 258.0	\$ 272.0	\$ 250.0
Expanded lottery net revenues	371.1	364.4	365.0
Reimbursements and other	4.8	10.1	4.8
Total operating revenues	<u>633.9</u>	<u>646.5</u>	<u>619.8</u>
Operating expenses:			
Lottery	187.3	195.4	178.6
Expanded lottery	285.8	280.5	281.1
Total operating expenses	<u>473.1</u>	<u>475.9</u>	<u>459.7</u>
Operating income	<u>160.8</u>	<u>170.6</u>	<u>160.1</u>
Non-operating revenues (expenses):			
Lottery transfers	(73.9)	(78.8)	(74.5)
Expanded lottery transfers	(89.1)	(93.0)	(87.6)
Other	1.0	-	-
Total non-operating revenues (expenses)	<u>(162.0)</u>	<u>(171.8)</u>	<u>(162.1)</u>
Change in net position	(1.2)	(1.2)	(2.0)
Net position, beginning of year	(5.9)	(4.7)	3.6
Restatement for GASB 68			(6.3)
Net position, beginning of year	<u>(5.9)</u>	<u>(4.7)</u>	<u>(2.7)</u>
Net position, end of year	<u>\$ (7.1)</u>	<u>\$ (5.9)</u>	<u>\$ (4.7)</u>

Lottery Game Revenues

Presented in millions of dollars, the following table compares online and instant Lottery sales by game types between fiscal years 2017 and 2016:

Type of Game	2017	2016	Increase (Decrease)	Percentage Change
Instant	\$ 142.6	\$ 143.4	\$ (0.8)	-0.6%
Pull-Tabs	8.4	10.1	(1.7)	-16.8%
Powerball	36.8	54.3	(17.5)	-32.2%
Mega Millions	12.3	14.0	(1.7)	-12.1%
2 by 2	1.7	1.9	(0.2)	-10.5%
Super Kansas Cash	16.4	12.8	3.6	28.1%
Lucky For Life	4.2	-	4.2	100.0%
Keno	15.5	16.0	(0.5)	-3.1%
Pick 3	6.8	6.5	0.3	4.6%
Holiday Raffle	4.0	3.5	0.5	14.3%
Hot Lotto	6.7	6.7	-	0.0%
Kansas Hold'Em	2.6	2.8	(0.2)	-7.1%
Total	<u>\$ 258.0</u>	<u>\$ 272.0</u>	<u>\$ (14.0)</u>	<u>-5.1%</u>

Fiscal year 2017 sales were \$258.0 million compared to \$272.0 million in fiscal year 2016. Revenues from the sales on online and instant lottery tickets for the fiscal year ended June 30, 2017 decreased 5.4% or \$14.0 million compared to the previous year.

- Powerball sales normalized after the record jackpot in January 2016. Combined sales of the national jackpot games (Powerball and Mega Millions) were \$49.1 million were down from 2016, but only slightly less than the \$50.0 million in 2015.
- The Lottery launched Lucky for Life in November 2016, joining 22 other states in offering the multi-state game. Sales for the new game were in excess of \$4.2 million in less than eight months.
- Super Kansas Cash had a significant increase in sales during the year. The jackpot grew to a (then) record of \$3.16 million before being won in September 2016. The jackpot then grew throughout the year, reaching a new record of \$3.62 million that was captured in July 2017.
- Instant and Pull-Tab tickets also saw a combined sales decrease of \$2.5 million from the record sales in the previous fiscal year. Players have continued to respond favorably 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 2016 and 2015:

Type of Game	2016	2015	Increase (Decrease)	Percentage Change
Instant	\$ 143.4	\$ 133.7	\$ 9.7	7.3%
Pull-Tab	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>8.1%</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.

Lottery Expenses

Game Related

The following table compares the lottery game-related expenses between fiscal year 2017 and fiscal year 2016. The expenses are shown in millions of dollars:

Description	2017	2016	Increase (Decrease)	Percentage Change
Game Prizes	\$ 149.7	\$ 157.3	\$ (7.6)	-4.8%
Retailer commissions	15.3	16.0	(0.7)	-4.4%
Online Games Service Bureau	5.8	6.0	(0.2)	-3.3%
Instant Ticket Printing Cost	3.5	3.3	0.2	6.1%
Total	<u>\$ 174.3</u>	<u>\$ 182.6</u>	<u>\$ (8.3)</u>	<u>-4.5%</u>

The overall decrease in game prizes was the result of the decrease in sales compared to those in fiscal year 2016. The online games service bureau cost decreased as a result of lower online sales.

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.

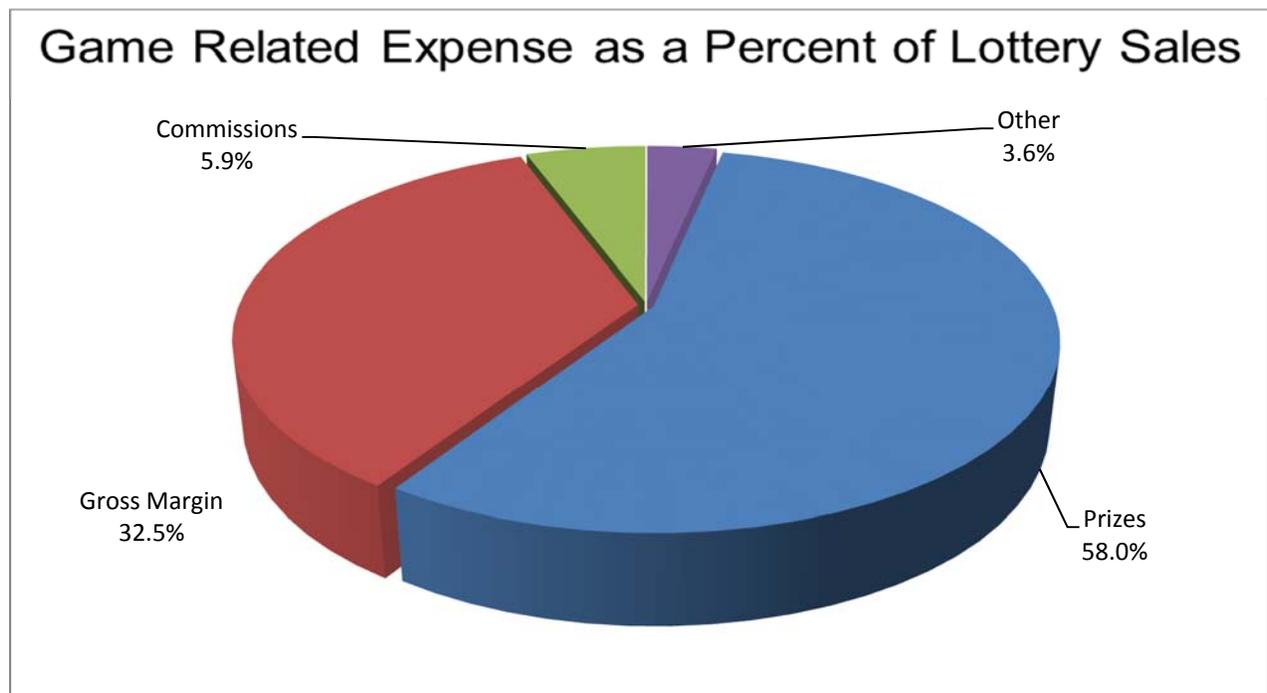
Non-game Related

Of the \$13.0 million of fiscal year 2017 lottery operating expenses that were non-game related, \$4.9 million was for employees' salaries and wages, \$4.6 was spent for games and promotional advertising, and other administrative expenses accounted for \$3.5 million.

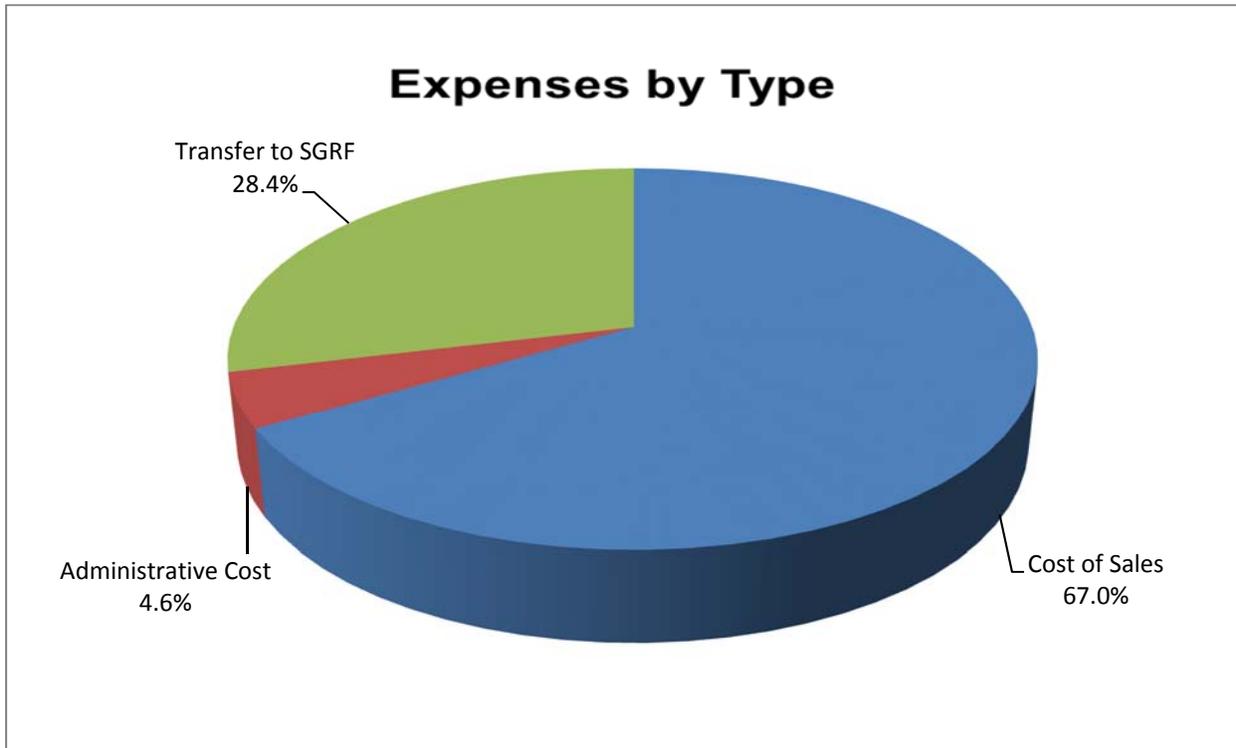
Of the \$12.8 million of fiscal year 2016 lottery operating expenses that were non-game related, \$4.7 million was for employees' salaries and wages, \$4.8 was spent for games and promotional advertising, and other administrative expenses accounted for \$3.3 million.

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.

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 2017, the legislature again waived the percentage of sales transfer requirement for a minimum transfer request of \$75.2 million, with a minimum monthly transfer of \$4.7 million. For 2017, the accrual basis transfers to the SGRF were \$73.9 million, a decrease of \$4.9 million from 2016. Actual cash transfers to the SGRF were \$75.3 million and \$78.2 million in 2017 and 2016, 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.

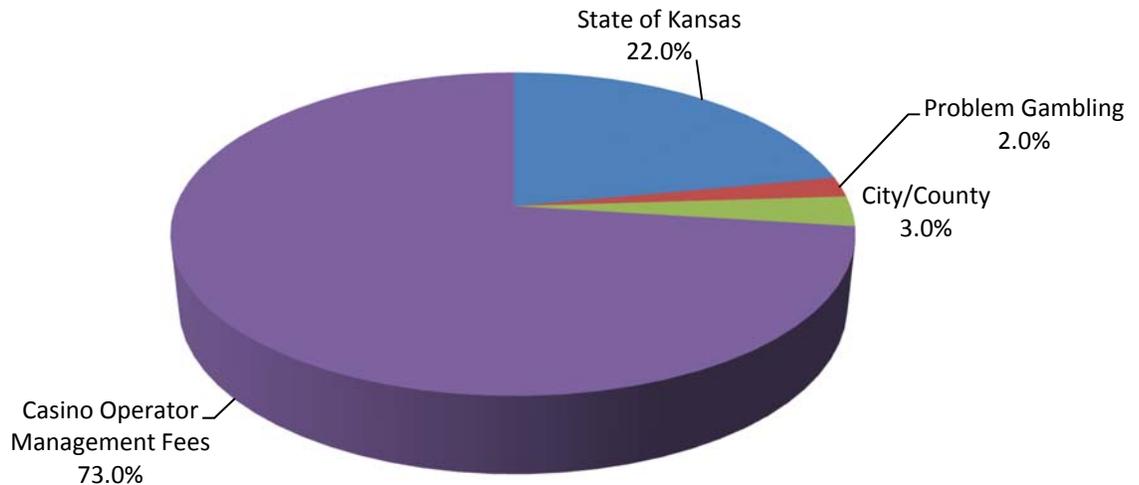
Expanded Lottery Revenues and Expenses

As of June 30, 2017, the State had four 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 2017 and 2016. Kansas Crossing Casino opened on March 29, 2017. The net revenue and related expenses are as follows (shown in millions of dollars):

	2017	2016	Increase (Decrease)	Percentage Change
Net Revenue	\$ 371.1	\$ 364.4	\$ 6.7	1.8%
Expenses:				
State of Kansas	81.7	80.2	1.5	1.9%
Problem Gambling	7.4	7.3	0.1	1.4%
City and County	11.1	10.9	0.2	1.8%
Management Fees	270.9	266.0	4.9	1.8%
Total	\$ 371.1	\$ 364.4	\$ 6.7	1.8%
	2016	2015	Increase (Decrease)	Percentage Change
Net Revenue	\$ 364.4	\$ 365.0	\$ (0.6)	-0.2%
Expenses:				
State of Kansas	80.2	80.3	(0.1)	-0.1%
Problem Gambling	7.3	7.3	-	0.0%
City and County	10.9	10.9	-	0.0%
Management Fees	266.0	266.5	(0.5)	-0.2%
Total	\$ 364.4	\$ 365.0	\$ (0.6)	-0.2%

The following chart depicts the distribution of net revenue as set forth in the 2007 Legislature enacting the Expanded Lottery Act.

Expanded Lottery Distributions



Economic Outlook

Traditional lottery sales and related transfers to the State Gaming Revenues Fund are expected to continue to grow. 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 kicked off its 30th year. The year-long “birthday bash” began in January 2017 with monthly prize giveaways and will end in November with a concert at the Kansas Star Casino.

There will also be changes to several multi-state games in the coming year.

- Mega Millions will be changing from a \$1 game to a \$2 game in October 2017, with a change in the prize matrix that will closely resemble Powerball. The game will also feature a ‘Just the Jackpot’ option that will allow players to buy 2 tickets for \$3, but will only be eligible to win the jackpot level prizes.
- Powerball will be adding a ‘Winner Take All’ option in April 2018 that will add two supplemental drawings each week with a guaranteed winner (or winners) to take (or share) the entire prize pool.
- Hot Lotto will be ending in October 2017. In November 2017, the Kansas Lottery will begin participating in Lotto America. This \$1 game will be drawn each Wednesday and Saturday and have jackpots starting at \$2 million.

To grow its players-base and to create more product value, the Lottery will continue to emphasize the PlayOn player loyalty program, and will participate in the second Powerball Power Cruise Collect N Win promotion.

Expanded Lottery revenues and transfers to the State of Kansas are expected to increase with fourth casino in the South East Gaming Zone operating for a full year in fiscal year 2018.

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, 2017 and 2016 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, 2017 AND 2016

<u>ASSETS</u>	2017	2016
Current Assets:		
Cash:		
Operating fund	\$ 5,650,519	\$ 4,905,506
Prize payment fund	203,012	777,809
Accounts receivable, net of allowance for doubtful accounts of \$253,905 and \$228,593 at 2017 and 2016, respectively	1,996,132	4,469,696
Accounts receivable - unbilled	4,607,529	4,406,105
Other receivable	2,976,925	1,980,663
Instant ticket game inventory	2,706,100	3,409,859
Total current assets	18,140,217	19,949,638
Capital assets, net of depreciation	566,807	655,500
Total assets	18,707,024	20,605,138
<u>DEFERRED OUTFLOWS OF RESOURCES</u>		
Employer contributions to pension plan made subsequent to measurement date	473,826	479,221
KPERS Pension - Net differences between projected and actual earnings on investments	584,584	-
KPERS Pension - Changes in proportion	506,114	429,410
Total deferred outflows	1,564,524	908,631
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	6,317,049	5,115,945
Due to the State of Kansas	4,011,475	5,410,666
Prize liability	10,047,087	9,783,440
Total current liabilities	20,375,611	20,310,051
Net pension liability	6,472,314	6,475,132
Total liabilities	26,847,925	26,785,183
<u>DEFERRED INFLOWS OF RESOURCES</u>		
KPERS Pension - Differences between actual and expected experience	305,567	194,045
KPERS Pension - Net differences between projected and actual earnings on investments	-	168,686
KPERS Pension - Changes in assumptions	11,703	14,410
KPERS Pension - Changes in proportion	186,927	253,213
Total deferred inflows	504,197	630,354
<u>NET POSITION</u>		
Net Invested in capital assets	566,807	655,500
Unrestricted (deficit)	(7,647,381)	(6,557,268)
Total net position	\$ (7,080,574)	\$ (5,901,768)

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, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
Operating revenues:		
Net game revenues	\$ 258,030,943	\$ 272,017,364
Expanded lottery revenues	371,117,198	364,371,095
Expanded lottery reimbursements	3,774,908	3,650,189
Phone reimbursements	905,630	917,055
Retailer fees and miscellaneous income	26,837	5,539,995
	<u>633,855,516</u>	<u>646,495,698</u>
Total operating revenues		
Operating expenses:		
Game prizes	149,709,855	157,300,767
Casino operator management fee	270,915,554	265,926,380
Retailer commissions	15,325,980	16,017,493
On-line games service bureau	5,794,571	6,037,953
Salaries and benefits	6,182,701	5,909,651
Cost of instant tickets	3,536,928	3,265,526
Advertising	4,623,134	4,806,871
Other administrative expenses	2,723,352	2,743,500
Depreciation	341,908	317,136
City and County expanded lottery fees	11,133,516	10,931,133
Professional services	450,018	320,884
On-line service bureau - expanded lottery	2,095,023	2,049,377
Telecommunications	243,626	232,049
	<u>473,076,166</u>	<u>475,858,720</u>
Total operating expenses		
Operating income	<u>160,779,350</u>	<u>170,636,978</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(73,856,690)	(78,809,580)
Transfers to the Expanded Lottery Act Revenues Fund	(81,645,784)	(85,726,159)
Transfers to the Problem Gambling Fund	(7,422,344)	(7,287,423)
KPERs Contribution by State of Kansas	962,991	-
Write-off and adjustment of capital assets	3,671	(247)
	<u>(161,958,156)</u>	<u>(171,823,409)</u>
Total nonoperating revenues (expenses)		
Change in net position	(1,178,806)	(1,186,431)
Net position, beginning of year	<u>(5,901,768)</u>	<u>(4,715,337)</u>
Net position, end of year	<u>\$ (7,080,574)</u>	<u>\$ (5,901,768)</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, 2017 AND 2016

	2017	2016
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 635,131,394	\$ 640,720,657
Cash (paid)/received for casino privilege fee deposits	-	(11,000,000)
Cash paid for prizes, commissions, and other expenses	(464,383,047)	(471,617,783)
Cash paid to employees	(6,004,578)	(5,899,462)
	<u>164,743,769</u>	<u>152,203,412</u>
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(75,255,881)	(78,205,450)
Payments to State General Fund	(81,645,784)	(85,726,159)
Payments to State Problem Gambling Fund	(7,422,344)	(7,287,423)
	<u>(164,324,009)</u>	<u>(171,219,032)</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	15,350	4,000
Purchases of capital assets	(264,894)	(685,380)
	<u>(249,544)</u>	<u>(681,380)</u>
Net increase (decrease) in cash	170,216	(19,697,000)
Cash, beginning of year	<u>5,683,315</u>	<u>25,380,315</u>
Cash, end of year	<u>\$ 5,853,531</u>	<u>\$ 5,683,315</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 160,779,350	\$ 170,636,978
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	341,908	317,136
Net recognition of deferred amounts of pension liability	(782,050)	(944,899)
KPERS contribution on behalf of Lottery	962,991	-
Changes in operating assets and liabilities:		
Accounts receivable	2,272,140	(163,978)
Other deposits and receivables	(996,262)	(111,063)
Instant ticket game inventory	703,759	(329,962)
Accounts payable and accrued liabilities	1,201,104	(3,669,863)
Net pension liability	(2,818)	955,088
Unearned revenues	-	(5,500,000)
Refundable deposits	-	(11,000,000)
Prize liability	263,647	2,013,975
	<u>\$ 164,743,769</u>	<u>\$ 152,203,412</u>
Noncash capital and related financing activities:		
KPERS contribution on behalf of Lottery by State	<u>\$ 962,991</u>	<u>\$ -</u>

See accompanying notes to financial statements.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2017 and 2016

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, Lucky for Life, 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. Operations began in the southeast gaming zone in the year ending June 30, 2017.

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, 2017 and 2016

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, 2017 and 2016

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 or a winning Lucky for Life top prize ticket, and a \$1,000 bonus for selling a winning Kansas Cash or Holiday Raffle jackpot ticket or a winning Powerball ticket equal to or greater than \$200,000 or a winning Mega Millions ticket equal to or greater than \$250,000.

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 2017 and 2016 were \$3,774,908 and \$3,650,189 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, 2017 and 2016

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 acquisition 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 managers own 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
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Notes to Financial Statements
June 30, 2017 and 2016

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 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, 2017 and 2016

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

The Lottery has implemented GASB 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position and GASB 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, 2017 and 2016

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, 2017 and 2016, the Lottery's share in the State's common cash pool was \$5,745,797 and \$5,576,957, respectively.

3 - Capital Assets

Property and equipment consisted of the following at June 30, 2017:

	Beginning Balances	Increases	Decreases	Ending Balances
Equipment, furnishing and software	\$ 1,485,266	\$ 158,109	\$ -	\$ 1,643,375
Vehicles	765,380	106,785	(83,227)	788,938
Total Lottery capital assets	<u>2,250,646</u>	<u>264,894</u>	<u>(83,227)</u>	<u>2,432,313</u>
Accumulated depreciatiion	<u>(1,595,146)</u>	<u>(341,908)</u>	<u>71,548</u>	<u>(1,865,506)</u>
Total capital assets, net of depreciation	<u>\$ 655,500</u>			<u>\$ 566,807</u>

Property and equipment 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>

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2017 and 2016

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:

2018	\$	719,769
2019		737,899
2020		756,634
2021		775,973
2022		795,916
Thereafter		407,929
	<u>\$</u>	<u>4,194,120</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 \$732,030 and \$727,392 under operating leases for the years ended June 30, 2017 and 2016, respectively.

The Lottery has contracted with a service bureau which provides computer services for on-line games and instant-win validation. The contract provides that the Lottery pay a fee of net on-line sales to the service bureau, and the duration of the current contract is through June 30, 2018. Fees were \$5,794,571 and \$6,037,953 for the years ended June 30, 2017 and 2016, 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 \$2,095,023 and \$2,049,377 for the years ended June 30, 2017 and 2016, 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, 2017 and 2016

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 12 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, 2017 and 2016, the fee was \$29,362,740 and \$28,424,074 as is recorded in the statements of revenues, expenses, and changes in net position.

Northeast Gaming Zone

In 2009, the Lottery entered into a facility management agreement with a third party to develop, construct, and manage the lottery casino gaming facility in the northeast gaming zone. The terms of the northeast gaming zone agreement are similar in nature to the terms of the agreement that the Lottery entered into related to the southwest gaming zone described above. Full time casino gaming operations in the northeast gaming zone commenced on February 3, 2012.

As part of the agreement, the facility manager purchased land and constructed the building used for the purposes of the casino. See Note 12 for information related to Expanded Lottery Facility Games Ownership.

Kansas Lottery
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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, 2017 and 2016, the fee was \$105,544,887 and \$104,998,331 as is recorded in the statements of revenues, expenses, and changes in net position.

South Central Gaming Zone

In 2009, the Lottery entered into a facility management agreement with a third party to develop, construct, and manage the lottery casino gaming facility in the South Central gaming zone. The terms of the gaming zone agreement are similar in nature to the terms of the agreement that the Lottery entered into related to the southwest gaming zone described above. Full time casino gaming operations in the South Central gaming zone commenced on December 20, 2011.

As part of the agreement, the facility manager purchased land and constructed the building used for the purposes of the casino. See Note 12 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, 2017 and 2016, the fee was \$130,017,357 and \$132,503,975 as is recorded in the statements of revenues, expenses, and changes in net position.

South East Gaming Zone

In 2015, the Lottery began the application process for a facility management agreement with a third party to develop, construct, and manage the lottery casino gaming facility in the southeast gaming zone. The terms of the agreement will be similar in nature to the terms of the agreements described above. The Lottery has collected privilege fee deposits of \$5.5 million from each of the three applicants. 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. Full time casino gaming operations in the South East gaming zone commenced on March 29, 2017.

As part of the agreement, the facility manager purchased land and constructed the building used for the purposes of the casino. See Note 12 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 \$49 million, 71% of revenues between \$49 million and \$60 million and 69% of revenues above \$60 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, 2017 and 2016, the fee was \$5,990,570 and \$0 as is recorded in the statements of revenues, expenses, and changes in net position.

5 - Contingencies

Zero Coupon Bonds

Powerball prizes awarded to the grand prize winner are payable in annual installments over 20 years. Prizes awarded to grand prize winners after November 2, 1997 are payable in annual installments over 25 years. The payment is made by the Lottery within weeks of the drawing. Treasury zero coupon bonds that provide payments corresponding to the Lottery's obligation to these winners are purchased by the Multi-State Lottery (MUSL). MUSL holds these bonds in an account for the Lottery, cashes the bonds when due, and wires the money to the Lottery on or before the anniversary date of the winner. The investments and related prize liabilities for winners of these games are excluded from these financial statements. Total future installments outstanding were \$0 at June 30, 2017 and 2016.

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).

MUSL Prize Reserves

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

The Powerball prize reserve and set prize reserve account monies are refundable to MUSL members if MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2017 and 2016, the prize reserve account had a balance \$77,900,260 and \$72,114,390, respectively, of which the Lottery's portion was \$1,315,455 and \$1,332,988, respectively. The set prize reserve at June 30, 2017 and 2016 had a balance of \$39,992,162 and \$39,307,288, respectively, of which the Lottery's portion was \$597,602 and \$580,069, respectively.

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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, 2017 and 2016 was \$38,041,470 and \$38,541,036, respectively, of which the Lottery's portion was \$628,538 and \$617,053, respectively.

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, 2017 and 2016, 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, 2017 and 2016, the prize reserve account had a balance of \$6,070,116 and \$7,170,477, respectively, of which the Lottery's portion was \$713,213 and \$790,311, 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, 2017 and 2016 the Lottery's portion of the balance of this account was \$10,253 and \$10,194, and is reportable as a receivable.

Lifetime Guarantee Prizes

The Lottery purchases annual contracts from insurance companies in the name of the lifetime guarantee 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.

The Lottery has participated in two lifetime guarantee prize games, Cash for Life from March 1998 to September 2000 and Lucky for Life from November 2016 to present.

Annuity contracts have been purchased for lifetime prize payments. At June 30, 2017 and 2016, the approximate remaining prize payments are \$355,500 and \$373,500, respectively. Prize payments are due in varying amounts through September 2048 or the life of the individuals.

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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.

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, 2017, the State Legislature set a minimum transfer to the Fund of \$75,200,000, which includes at least \$1,200,000 designated for the veteran transfer. For the year ended June 30, 2016 the State Legislature set a minimum transfer to the Fund of \$76,200,000, 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, 2017 and 2016 were \$73,856,690 and \$78,809,580, respectively, of which \$4,011,475 and \$5,410,666 was unpaid, respectively. Actual cash transfers to the State of Kansas for years ended June 30, 2017 and 2016 were \$75,255,881

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and \$78,205,450, respectively. Included in the minimum transfer amount were mandated transfer of \$1,255,812 and \$1,658,099 for the years ended June 30, 2017 and 2016, 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, 2017 and 2016:

	FY 2017 <u>Boot Hill</u>	FY 2016 <u>Boot Hill</u>
Gaming Facility Revenue:		
Electronic games	\$ 35,186,589	\$ 34,130,946
Table games	5,036,343	4,806,142
Total	<u>\$ 40,222,932</u>	<u>\$ 38,937,088</u>
Distributions:		
State of Kansas - 22%	\$ 8,849,045	\$ 8,566,159
Problem Gambling Fund - 2%	804,459	778,742
City & County - 3%	1,206,688	1,168,113
Casino operator management fees - 73%	29,362,740	28,424,074
Total	<u>\$ 40,222,932</u>	<u>\$ 38,937,088</u>

	FY 2017 <u>Kansas Star</u>	FY 2016 <u>Kansas Star</u>
Gaming Facility Revenue:		
Electronic games	\$ 151,479,596	\$ 154,541,022
Table games	26,626,372	27,059,655
Total	<u>\$ 178,105,968</u>	<u>\$ 181,600,677</u>
Distributions:		
State of Kansas - 22%	\$ 39,183,313	\$ 40,016,668
Problem Gambling Fund - 2%	3,562,119	3,632,014
City & County - 3%	5,343,179	5,448,020
Casino operator management fees - 73%	130,017,357	132,503,975
Total	<u>\$ 178,105,968</u>	<u>\$ 181,600,677</u>

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	FY 2017 <u>Hollywood</u>	FY 2016 <u>Hollywood</u>
Gaming Facility Revenue:		
Electronic games	\$ 125,678,469	\$ 124,733,467
Table games	18,903,568	19,099,863
Total	<u>\$ 144,582,037</u>	<u>\$ 143,833,330</u>
Distributions:		
State of Kansas - 22%	\$ 31,808,048	\$ 31,643,332
Problem Gambling Fund - 2%	2,891,641	2,876,667
City & County - 3%	4,337,461	4,315,000
Casino operator management fees - 73%	105,544,887	104,998,331
Total	<u>\$ 144,582,037</u>	<u>\$ 143,833,330</u>

	FY 2017 <u>Kansas Crossing</u>	FY 2016 <u>Kansas Crossing</u>
Gaming Facility Revenue:		
Electronic games	\$ 7,191,126	\$ -
Table games	1,015,134	-
Total	<u>\$ 8,206,260</u>	<u>\$ -</u>
Distributions:		
State of Kansas - 22%	\$ 1,805,377	\$ -
Problem Gambling Fund - 2%	164,125	-
City & County - 3%	246,188	-
Casino operator management fees - 73%	5,990,570	-
Total	<u>\$ 8,206,260</u>	<u>\$ -</u>

At June 30, 2017 and 2016, \$2,671,117, and \$1,729,351, respectively, was receivable from the casino manager for online and table game net revenue. At June 30, 2017 and 2016, \$5,162,030 and \$3,486,948, 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:

<u>Sales, Net</u>	<u>FY 2017</u>	<u>FY 2016</u>
Instant Games	\$ 142,572,474	\$ 143,388,902
Pull Tabs	8,451,645	10,065,837
Powerball	36,781,987	54,254,605
MegaMillions	12,336,420	14,021,964
Super Kansas Cash	16,339,578	12,820,012
Pick 3	6,811,012	6,536,670
Keno	15,494,968	16,053,147
Holiday Raffle	4,000,000	3,500,000
2by2	1,708,499	1,919,689
Hot Lotto	6,739,519	6,697,606
Kansas Hold Em	2,611,650	2,758,932
Lucky 4 Life	4,183,191	-
Total	<u>\$ 258,030,943</u>	<u>\$ 272,017,364</u>
Prizes, net	(149,709,855)	(157,300,767)
Retailer Commissions	<u>(15,325,980)</u>	<u>(16,017,493)</u>
Gross Margin	<u>\$ 92,995,108</u>	<u>\$ 98,699,104</u>

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9 - Pension Plan

Plan description:

The Lottery participates in the Kansas Public Employees Retirement System (KPERs), a cost-sharing multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, et. seq. Kansas law establishes and amends benefit provisions. KPERs issues a publicly available financial report that includes financial statements and required supplementary information. KPERs' financial statements are included in its Comprehensive Annual Financial Report which can be found on the KPERs website at www.kpers.org or by writing to KPERs (611 South Kansas, Suite 100, Topeka, KS 66603) or by calling 1-888-275-5737.

Benefits provided.

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

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

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

The 2012 Legislature made changes affecting new hires, current member employees and employers. A new KPERs 3 cash balance retirement plan for new hires starting January 1, 2015 was created. Normal retirement age for KPERs 3 is 65 with five years of service or 60 years with 30 years of service. Early retirement is available at age 55 with ten years of service, with a reduced benefit. Monthly benefit options are an annuity benefit based on the account balance at retirement. The retirement benefits are disbursed from the retirement benefit payment reserve fund as established by K.S.A. 74-4922.

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Contributions.

K.S.A. 74-4919 and K.S.A. 74-49,210 establish the KPERS member-employee contributions rates. KPERS has multiple benefit structures and contribution rates depending on whether the employee is a KPERS 1, KPERS 2 or KPERS 3 member. KPERS 1 members are active and contributing members hired before July 1, 2009. KPERS 2 members were first employed in a covered position on or after July 1, 2009, and KPERS 3 members were first employed in a covered position on or after January 1, 2015. Effective January 1, 2015, Kansas law establishes the KPERS member-employee contribution rate at 6% of covered salary for KPERS 1, KEPRS 2 and KPERS 3 members. 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 for KPERS 1, KPERS 2 and KPERS 3 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 rates were 11.44% and 11.27%, respectively, for the fiscal year ended June 30, 2016. The actuarially determined employer contribution rate (not including the 1.00% contribution rate for the Death and Disability Program) and the statutory contribution rates were 10.77% and 10.81%, respectively, for the fiscal year ended June 30, 2017. Contributions to the pension plan from the Lottery were \$473,826 and \$479,221 for the years ended June 30, 2017 and 2016, respectively.

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

At June 30, 2017, the Lottery reported a liability of \$6,472,314 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2015, which was rolled forward to June 30, 2016. 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, 2016. The contributions used exclude contributions made for prior service, excess benefits and irregular payments. At June 30, 2016, the Lottery proportion was 0.096%, which was an increase of 0.002% from its proportion measured as of June 30, 2015.

In August 2015, the State of Kansas issued \$1 billion in pension obligation bonds and KPERS received the full proceeds. The proceeds have been invested to assist with financing the State and School group's unfunded actuarial liability. The debt service on the bonds will be paid by the State of Kansas in addition to the State's regular employer contributions to KPERS. The bond proceeds were allocated as employer and nonemployer contributions across the state/school group. The Lottery was attributed with an additional \$962,991 in employer contributions during the measurement period. This contribution on behalf of the Lottery in excess of actual cash contributions made during the period has been reported as a nonoperating revenue on the Lottery financial statements as of June 30, 2017.

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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 0.007% from its proportion measured as of June 30, 2014.

For the year ended June 30, 2017, the Lottery recognized pension expense of \$651,931. At June 30, 2017, 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	\$ -	\$ 305,567
Net difference between projected and actual earnings on pension plan investments	584,584	-
Changes in assumptions	-	11,703
Changes in proportion	506,114	186,927
Lottery contributions subsequent to measurement date	<u>473,826</u>	<u>-</u>
Total	<u>\$ 1,564,524</u>	<u>\$ 504,197</u>

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:

	<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>

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The amounts reported as deferred outflows of resources, \$473,826 at June 30, 2017 and \$479,221 at June 30, 2016, related to pensions resulting from “state agency” contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the following year. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

	<u>At June 30, 2017</u>	<u>At June 30, 2016</u>
Recognized in FY 2017		\$ (111,855)
Recognized in FY 2018	\$ 54,358	(111,855)
Recognized in FY 2019	54,358	(111,855)
Recognized in FY 2020	254,878	83,205
Recognized in FY 2021	221,249	51,416
Recognized in FY 2022	1,658	-
Total	\$ 586,501	\$ (200,944)

Actuarial assumptions.

The total pension liability in the December 31, 2015 and 2014 actuarial valuations were 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, 2015 and 2014 valuations 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.

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June 30, 2017 and 2016

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, 2016 are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Global equity	47%	6.80%
Fixed income	13	1.25
Yield driven	8	6.55
Real return	11	1.71
Real estate	11	5.05
Alternatives	8	9.85
Short-term investments	2	(0.25)
Total	<u>100%</u>	

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:

<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	0.80
Yield driven	8	4.20
Real return	11	1.70
Real estate	11	5.40
Alternatives	8	9.40
Short-term investments	2	(0.50)
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.

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June 30, 2017 and 2016

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 net pension liability at June 30, 2017	\$ 8,416,044	\$ 6,472,314	\$ 4,821,245
Lottery proportionate share of net pension liability at June 30, 2016	\$ 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.

Subsequent events.

Under the budgetary allotment process for the State of Kansas, the Kansas governor has authority to reduce or defer the approved budget for purposes of balancing the budget. For the State's fiscal year ended June 30, 2016, approximately \$99 million, including accrued interest through June 30, 2016, in State funded employer contributions to the State/School group were deferred. Senate Bill 249 provided that the delayed contributions would be repaid in full, with interest at 8% by June 30, 2018.

During the 2017 legislative session, the repayment provision in the 2016 legislation was declared to be null and void. It is unknown at the time whether this reduction will have a significant effect on "state agency" proportionate share of the KPERS collective net pension liability, or an effect on any actuarial assumptions used by KPERS to calculate the net pension liability.

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10 - 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 years ended June 30, 2017 and June 30, 2016. During year ended June 30, 2016, the Lottery transferred \$5,500,000 to the State's general fund received for the binding contract in southeast region, and privilege fee deposits of \$11,000,000 were returned to the applicants not awarded contracts in the southeast region.

11 - 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.

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Required Supplementary Information
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Schedule of Proportionate Share of the Net Pension Liability and Required Contributions

	<u>June 30, 2017</u>	<u>June 30, 2016</u>	<u>June 30, 2015</u>	<u>June 30, 2014</u>
Proportion of the net pension liability	0.096%	0.094%	0.086%	0.092%
Proportionate share of the net pension liability	\$ 6,472,314	\$ 6,475,132	\$ 5,520,044	\$ 6,660,853
Covered employee payroll for valuation period	\$ 4,580,081	\$ 4,558,350	\$ 4,224,000	\$ 4,019,000
Proportionate share of the net pension liability as a percentage of covered-employee payroll	141.3%	142.0%	130.7%	165.7%
Plan fiduciary net position as a percentage of the total pension liability	65.1%	65.0%	66.6%	59.9%
Required contributions	\$ 450,236	\$ 455,109	\$ 406,220	\$ 389,521
Contributions in relation to required contribution	<u>450,236</u>	<u>455,109</u>	<u>406,220</u>	<u>389,521</u>
Contribution deficiency	\$ -	\$ -	\$ -	\$ -
Covered employee payroll for valuation period	\$ 4,580,081	\$ 4,558,350	\$ 4,224,000	\$ 4,019,000
Contributions as a percentage of covered-employee payroll	9.8%	10.0%	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, 2017

	Kansas Lottery		Total 2017
	Lottery	Expanded Lottery	
<u>ASSETS</u>			
Current Assets:			
Cash:			
Operating fund	\$ 3,055,190	\$ 2,595,329	\$ 5,650,519
Prize payment fund	203,012	-	203,012
Accounts receivable, net of allowance for doubtful accounts of \$253,905	1,996,132	-	1,996,132
Accounts receivable - unbilled	4,607,529	-	4,607,529
Other deposits and receivables	305,808	2,671,117	2,976,925
Instant ticket game inventory	2,706,100	-	2,706,100
 Total current assets	 12,873,771	 5,266,446	 18,140,217
Capital assets, net of depreciation:	566,807	-	566,807
 Total assets	 13,440,578	 5,266,446	 18,707,024
<u>DEFERRED OUTFLOWS OF RESOURCES</u>			
Employer contributions to pension plan made subsequent to measurement date	473,826	-	473,826
KPERS Pension - Net differences between projected and actual earnings on investments	584,584	-	584,584
KPERS Pension - Changes in proportion	506,114	-	506,114
 Total deferred outflows	 1,564,524	 -	 1,564,524
<u>LIABILITIES</u>			
Current liabilities:			
Accounts payable and accrued liabilities	1,050,603	5,266,446	6,317,049
Due to the State of Kansas	4,011,475	-	4,011,475
Prize liability	10,047,087	-	10,047,087
 Total current liabilities	 15,109,165	 5,266,446	 20,375,611
Net pension liability	6,472,314	-	6,472,314
 Total liabilities	 21,581,479	 5,266,446	 26,847,925
<u>DEFERRED INFLOWS OF RESOURCES</u>			
KPERS Pension - Differences between actual and expected experience	305,567	-	305,567
KPERS Pension - Changes in assumptions	11,703	-	11,703
KPERS Pension - Changes in proportion	186,927	-	186,927
 Total deferred inflows	 504,197	 -	 504,197
<u>NET POSITION</u>			
Net Invested in capital assets	566,807	-	566,807
Unrestricted (deficit)	(7,647,381)	-	(7,647,381)
 Total net position	 \$ (7,080,574)	 \$ -	 \$ (7,080,574)

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEAR ENDED JUNE 30, 2017

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2017
Operating revenues:			
Net game revenues	\$ 258,030,943	\$ -	\$ 258,030,943
Expanded lottery revenues	-	371,117,198	371,117,198
Expanded lottery reimbursements	-	3,774,908	3,774,908
Phone reimbursements	905,630	-	905,630
Retailer fees and miscellaneous income	26,837	-	26,837
Total operating revenues	258,963,410	374,892,106	633,855,516
Operating expenses:			
Game prizes	149,709,855	-	149,709,855
Casino operator management fee	-	270,915,554	270,915,554
Retailer commissions	15,325,980	-	15,325,980
On-line games service bureau	5,794,571	-	5,794,571
Salaries and benefits	4,879,655	1,303,046	6,182,701
Cost of instant tickets	3,536,928	-	3,536,928
Advertising	4,623,134	-	4,623,134
Other administrative expenses	2,406,437	316,915	2,723,352
Depreciation	341,908	-	341,908
City and County expanded lottery fees	-	11,133,516	11,133,516
Professional services	397,835	52,183	450,018
On-line service bureau - lottery gaming	-	2,095,023	2,095,023
Telecommunications	235,885	7,741	243,626
Total operating expenses	187,252,188	285,823,978	473,076,166
Operating income	71,711,222	89,068,128	160,779,350
Nonoperating revenues (expenses):			
Transfers to the State Gaming Revenue Fund	(73,856,690)	-	(73,856,690)
Transfers to the Expanded Lottery Act Revenues Fund	-	(81,645,784)	(81,645,784)
Transfers to the Problem Gambling Fund	-	(7,422,344)	(7,422,344)
KPERS Contribution by State of Kansas	962,991	-	962,991
Gain (loss) on disposal of capital assets	3,671	-	3,671
Total nonoperating revenues (expenses)	(72,890,028)	(89,068,128)	(161,958,156)
Change in net position	(1,178,806)	-	(1,178,806)
Net position, beginning of year	(5,901,768)	-	(5,901,768)
Net position, end of year	\$ (7,080,574)	\$ -	\$ (7,080,574)

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2017

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2017
Cash flows from operating activities:			
Cash received from sales and reimbursements	\$ 261,181,054	\$ 373,950,340	\$ 635,131,394
Cash paid for prizes, commissions, and other expenses	(181,520,781)	(282,862,266)	(464,383,047)
Cash paid to employees	(4,701,532)	(1,303,046)	(6,004,578)
Net cash provided by operating activities	<u>74,958,741</u>	<u>89,785,028</u>	<u>164,743,769</u>
Cash flows from noncapital financing activities:			
Payments to State Gaming Revenue Fund	(75,255,881)	-	(75,255,881)
Payments to State General Fund	-	(81,645,784)	(81,645,784)
Payments to State Problem Gambling Fund	-	(7,422,344)	(7,422,344)
Net cash used by noncapital financing activities	<u>(75,255,881)</u>	<u>(89,068,128)</u>	<u>(164,324,009)</u>
Cash flows from capital and related financing activities:			
Proceeds from sale of capital assets	15,350	-	15,350
Purchases of capital assets	(264,894)	-	(264,894)
Net cash used by capital and related financing activities	<u>(249,544)</u>	<u>-</u>	<u>(249,544)</u>
Net increase (decrease) in cash	(546,684)	716,900	170,216
Cash, beginning of year	<u>3,804,886</u>	<u>1,878,429</u>	<u>5,683,315</u>
Cash, end of year	<u>\$ 3,258,202</u>	<u>\$ 2,595,329</u>	<u>\$ 5,853,531</u>
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	\$ 71,711,222	\$ 89,068,128	\$ 160,779,350
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	341,908	-	341,908
Net recognition of deferred amounts of pension liability	(782,050)	-	(782,050)
KPERS contribution on behalf of Lottery	962,991	-	962,991
Changes in operating assets and liabilities:			
Accounts receivable	2,272,140	-	2,272,140
Other deposits and receivables	(54,496)	(941,766)	(996,262)
Instant ticket game inventory	703,759	-	703,759
Accounts payable and accrued liabilities	(457,562)	1,658,666	1,201,104
Net pension liability	(2,818)	-	(2,818)
Unearned revenues	-	-	-
Refundable deposits	-	-	-
Prize liability	263,647	-	263,647
Net cash provided by operating activities	<u>\$ 74,958,741</u>	<u>\$ 89,785,028</u>	<u>\$ 164,743,769</u>
Noncash capital and related financing activities:			
KPERS contribution on behalf of Lottery by State	<u>\$ 962,991</u>	<u>\$ -</u>	<u>\$ 962,991</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF NET POSITION - LOTTERY
JUNE 30, 2017 AND 2016

<u>ASSETS</u>	<u>Lottery</u>	
	2017	2016
Current Assets:		
Cash:		
Operating fund	\$ 3,055,190	\$ 3,027,077
Prize payment fund	203,012	777,809
Accounts receivable, net of allowance for doubtful accounts of \$253,905 and \$228,593 at 2017 and 2016, respectively	1,996,132	4,469,696
Accounts receivable - unbilled	4,607,529	4,406,105
Other receivable	305,808	251,312
Instant ticket game inventory	2,706,100	3,409,859
Total current assets	12,873,771	16,341,858
Capital assets, net of depreciation	566,807	655,500
Total assets	13,440,578	16,997,358
<u>DEFERRED OUTFLOWS OF RESOURCES</u>		
Employer contributions to pension plan made subsequent to measurement date	473,826	479,221
KPERs Pension - Net differences between projected and actual earnings on investment	584,584	-
KPERs Pension - Changes in proportion	506,114	429,410
Total deferred inflows	1,564,524	908,631
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,050,603	\$ 1,508,165
Due to the State of Kansas	4,011,475	5,410,666
Prize liability	10,047,087	9,783,440
Total current liabilities	15,109,165	16,702,271
Net pension liability	6,472,314	6,475,132
Total liabilities	21,581,479	23,177,403
<u>DEFERRED INFLOWS OF RESOURCES</u>		
KPERs Pension - Differences between actual and expected experience	305,567	194,045
KPERs Pension - Net differences between projected and actual earnings on investment	-	168,686
KPERs Pension - Changes in assumptions	11,703	14,410
KPERs Pension - Changes in proportion	186,927	253,213
Total deferred inflows	504,197	630,354
<u>NET POSITION</u>		
Net Investment in capital assets	566,807	655,500
Unrestricted	(7,647,381)	(6,557,268)
Total net position	\$ (7,080,574)	\$ (5,901,768)

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION - LOTTERY
YEARS ENDED JUNE 30, 2017 AND 2016

	Lottery	
	2017	2016
Operating revenues:		
Net game revenues	\$ 258,030,943	\$ 272,017,364
Phone reimbursements	905,630	917,055
Retailer fees and miscellaneous income	26,837	39,995
	<u>258,963,410</u>	<u>272,974,414</u>
Total operating revenues	258,963,410	272,974,414
Operating expenses:		
Game prizes	149,709,855	157,300,767
Retailer commissions	15,325,980	16,017,493
On-line games service bureau	5,794,571	6,037,953
Salaries and benefits	4,879,655	4,685,922
Cost of instant tickets	3,536,928	3,265,526
Advertising	4,623,134	4,806,871
Other administrative expense	2,406,437	2,463,760
Depreciation	341,908	317,136
Professional services	397,835	231,780
Telecommunications	235,885	223,810
	<u>187,252,188</u>	<u>195,351,018</u>
Total operating expenses	187,252,188	195,351,018
Operating income	<u>71,711,222</u>	<u>77,623,396</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(73,856,690)	(78,809,580)
KPERs Contribution by State of Kansas	962,991	-
Gain (loss) on disposal of capital assets	3,671	(247)
	<u>(72,890,028)</u>	<u>(78,809,827)</u>
Total nonoperating revenues (expenses)	(72,890,028)	(78,809,827)
Change in net position	(1,178,806)	(1,186,431)
Net position, beginning of year	<u>(5,901,768)</u>	<u>(4,715,337)</u>
Net position, end of year	<u>\$ (7,080,574)</u>	<u>\$ (5,901,768)</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF CASH FLOWS - LOTTERY
YEARS ENDED JUNE 30, 2017 AND 2016

	Lottery	
	2017	2016
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 261,181,054	\$ 273,007,599
Cash (paid)/received for casino privelege fees	-	(5,500,000)
Cash (paid)/received for casino privelege fee deposits	-	(11,000,000)
Cash paid for prizes, commissions, and other expenses	(181,520,781)	(188,596,673)
Cash paid to employees	(4,701,532)	(4,675,733)
	74,958,741	63,235,193
Net cash provided by operating activities		
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(75,255,881)	(78,205,450)
	(75,255,881)	(78,205,450)
Net cash used by noncapital financing activities		
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	15,350	4,000
Purchases of capital assets	(264,894)	(685,380)
	(249,544)	(681,380)
Net cash used by capital and related financing activities		
Net decrease in cash	(546,684)	(15,651,637)
Cash, beginning of year	3,804,886	19,456,523
Cash, end of year	\$ 3,258,202	\$ 3,804,886
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 71,711,222	\$ 77,623,396
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	341,908	317,136
Net recognition of deferred amounts of pension liability	(782,050)	(944,899)
KPERs Contribution by State of Kansas	962,991	-
Changes in operating assets and liabilities:		
Accounts receivable	2,272,140	(163,978)
Other deposits and receivables	(54,496)	197,163
Instant ticket game inventory	703,759	(329,962)
Accounts payable and accrued liabilities	(457,562)	67,274
Unearned revenues	(2,818)	955,088
Unearned revenues	-	(5,500,000)
Refundable deposits	-	(11,000,000)
Prize liability	263,647	2,013,975
	74,958,741	63,235,193
Net cash provided by operating activities	\$ 74,958,741	\$ 63,235,193
Noncash capital and related financing activities:		
KPERs contribution on behalf of Lottery by State	\$ 962,991	\$ -

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF NET POSITION - EXPANDED LOTTERY
JUNE 30, 2017 AND 2016

	Expanded Lottery	
	2017	2016
<u>ASSETS</u>		
Current Assets:		
Cash:		
Operating fund	\$ 2,595,329	\$ 1,878,429
Other receivable	2,671,117	1,729,351
	5,266,446	3,607,780
Total current assets		
	5,266,446	3,607,780
Total assets		
	5,266,446	3,607,780
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 5,266,446	\$ 3,607,780
	5,266,446	3,607,780
Total current liabilities		
	5,266,446	3,607,780
<u>NET POSITION</u>		
Total net position	\$ -	\$ -

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2017 AND 2016

	Expanded Lottery	
	2017	2016
Operating revenues:		
Expanded lottery revenues	\$ 371,117,198	\$ 364,371,095
Expanded lottery reimbursements	3,774,908	3,650,189
Miscellaneous income - privilege fees	-	5,500,000
Total operating revenues	<u>374,892,106</u>	<u>373,521,284</u>
Operating expenses:		
Casino operator management fee	270,915,554	265,926,380
Salaries and benefits	1,303,046	1,223,729
Other administrative expenses	316,915	279,740
City and County expanded lottery fees	11,133,516	10,931,133
Professional services	52,183	89,104
On-line service bureau - expanded lottery	2,095,023	2,049,377
Telecommunications	7,741	8,239
Total operating expenses	<u>285,823,978</u>	<u>280,507,702</u>
Operating income	<u>89,068,128</u>	<u>93,013,582</u>
Nonoperating revenues (expenses):		
Transfers to the State General Fund	(81,645,784)	(85,726,159)
Transfers to the Problem Gambling Fund	(7,422,344)	(7,287,423)
Total nonoperating revenues (expenses)	<u>(89,068,128)</u>	<u>(93,013,582)</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, 2017 AND 2016

	Expanded Lottery	
	2017	2016
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 373,950,340	\$ 367,713,058
Cash received from casino privilege fees	-	5,500,000
Cash paid for prizes, commissions, and other expenses	(282,862,266)	(283,021,110)
Cash paid to employees	(1,303,046)	(1,223,729)
	89,785,028	88,968,219
Cash flows from noncapital financing activities:		
Payments to State General Fund	(81,645,784)	(85,726,159)
Payments to State Problem Gambling Fund	(7,422,344)	(7,287,423)
	(89,068,128)	(93,013,582)
Net increase (decrease) in cash	716,900	(4,045,363)
Cash, beginning of year	1,878,429	1,878,429
Cash, end of year	\$ 2,595,329	\$ 1,878,429
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 89,068,128	\$ 93,013,582
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Other receivable	(941,766)	(308,226)
Accounts payable and accrued liabilities	1,658,666	(3,737,137)
	\$ 89,785,028	\$ 88,968,219

**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, 2017, 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 22, 2017.

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 22, 2017

KANSAS LOTTERY
A COMPONENT UNIT OF THE STATE OF KANSAS

SCHEDULE OF FINDINGS AND RESPONSES
For The Year Ended June 30, 2017

None

KANSAS LOTTERY
AUDITOR COMMUNICATIONS
JUNE 30, 2017



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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 as of and for the years ended June 30, 2017 and 2016, and have issued our report thereon dated September 22, 2017. 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 May 8, 2017, 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 Kansas 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 2017 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 Kansas 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 Kansas Lottery dated November 20, 2013, within our engagement letter dated May 8, 2017, and during our planning meeting held on June 19, 2017 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 Kansas Lottery are described in Note 1 to the financial statements. We noted no transactions entered into by the Kansas 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 the pension liability is based on the Kansas Lottery's proportionate share of the Kansas Public Employees Retirement System's (KPERS) net pension liability which was measured as of June 30, 2016 and determined by an actuarial valuation as of December 31, 2015, which was rolled forward to June 30, 2016. We evaluated the key factors and assumptions used to develop the Kansas Lottery's pension liability 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 Kansas 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 Kansas Lottery Facility Games.

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 Kansas 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 22, 2017.

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 Kansas 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 22, 2017



Terry P. Presta
Executive Director

Sam Brownback
Governor

September 22, 2017

RubinBrown LLP
1200 Main Street
Suite 1000
Kansas City, Missouri 64105

We are providing this letter in connection with your audit of the Statement of Net Position of the Kansas Lottery as of June 30, 2017 and 2016 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 judgement of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

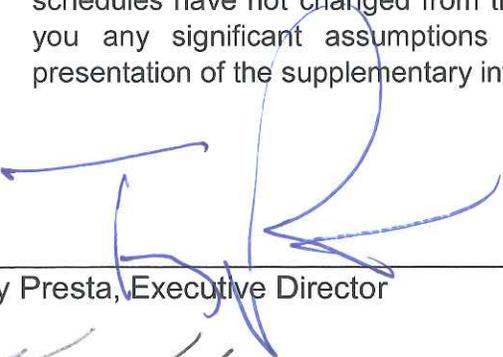
We confirm, to the best of our knowledge and belief the following representations made to you during your audit.

1. We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter.
2. The financial statements referred to above are fairly presented in conformity with U.S. generally accepted accounting principles and include all properly classified funds and other financial information of the primary government and all component units required by generally accepted accounting principles to be included in the financial reporting entity.

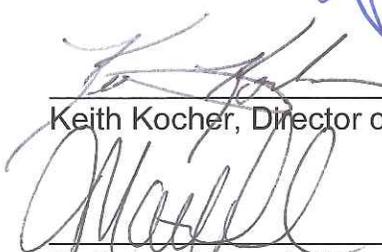
3. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
4. We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.
5. Significant assumptions we used in making accounting estimates are reasonable.
6. Related party relationships and transactions, including revenues, expenditures/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. There are no known actual or possible litigation, claims, or assessments against the Lottery that require disclosure 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 are not aware of any 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 depreciated.

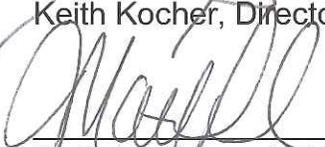
34. We have appropriately disclosed the Kansas Lottery's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position is available and have determined that net position was properly recognized under the policy.
35. We acknowledge our responsibility for presenting the required supplementary information (RSI) in accordance with the accounting principles generally accepted in the United States of America. The RSI is measured and presented within prescribed guidelines and the methods of measurement and presentation have not changed from those used in the prior period. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the RSI.
36. We acknowledge our responsibility for presenting the combining financial statements and schedules in accordance with the accounting principles generally accepted in the United States of America, and we believe the combining financial statements and schedules, including their form and content, are fairly presented in accordance with those principles. The methods of measurement and presentation of the combining financial statements and schedules have not changed from those used in the prior period, and we have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information.



Terry Presta, Executive Director



Keith Kocher, Director of Program Assurance and Integrity



Matthew Schwartz, Director of Finance