

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

Financial and Compliance Audit
Years Ended June 30, 2018 and 2017

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KANSAS LOTTERY
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INTRODUCTION

Year Ended June 30, 2018

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, 2018.

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
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SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Year Ended June 30, 2018

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, 2018 and 2017, 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, 2018 and 2017, 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 Matters

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, 2018 and 2017 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.

As discussed in Note 10 to the financial statements, in fiscal year 2018 the Kansas Lottery adopted GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Our opinion is not modified with respect to the 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, the schedule of Kansas Lottery's proportionate share of the net pension liability and required contributions on page 44, and the schedule of changes in the death & disability total OPEB liability and related ratios on page 45, 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 26, 2018, 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 26, 2018

KANSAS LOTTERY MANAGEMENT'S DISCUSSION AND ANALYSIS YEARS ENDED JUNE 30, 2018 AND 2017

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, 2018 and 2017. 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

- Lottery sales of instant tickets and draw games for fiscal year 2018 were \$268.9 million. This is the second highest sales year ever, behind only the \$272.0 million in fiscal year 2016. The record sales and transfers were in part due to the frenzy surrounding the \$1.59 billion Powerball jackpot in January 2016. Actual cash transfers to the State Gaming Revenue Fund (SGRF) for fiscal year 2018 totaled \$74.7.
- The Lottery is responsible for distributing the net casino revenues in accordance with the Expanded Lottery Act. For 2018, Expanded Lottery net revenues totaled \$404.5 million, which is the highest ever and \$33.4 million more than the previous year. Transfers totaling \$89.0 million from Expanded Lottery activities were made to the Expanded Lottery Act Revenues Fund (ELARF). This represents a \$7.3 million increase and is the highest transfer ever.
- The Lottery had its first Lucky for Life top prize winner in June 2018. The winner had an option between \$1,000 per day for life and a one-time cash prize of \$5.75 million. A record Super Kansas Cash jackpot of \$3.62 million was captured in July 2017, besting the previous record of \$3.16 million that was won in September 2016. The Super Kansas Cash winner and the Lucky for Life winner were two of eight Kansas Lottery players who won prizes of \$1 million or more in fiscal year 2018.
- Kansas participated in the first national Powerball Power Cruise collect and win promotion. Thirty Kansas winners and their guests joined winners from other states on an exclusive cruise vacation in January 2018. One of the Kansas winners also took home the \$50,000 he won in the grand prize drawing on the cruise.
- In January 2017, the Lottery launched its new PlayOn® players loyalty program. Lottery players can now earn points redeemable for second chance drawings. Through the first 18 months, total members have exceeded 146,000 and more than 12.7 million tickets have been entered by players.
- The Lottery also celebrated its 30th anniversary year. The year-long "Birthday Bash" began in January 2017 with monthly prize giveaways and ended in November 2017 with a concert and event at the Kansas Star Casino.

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, 2018 and 2017. 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, 2018 and 2017 as well as the Expanded Lottery casino gaming activities for the years ended June 30, 2018 and 2017. 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, 2018 and 2017.

Summary of Statements of Net Position

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

	2018	2017	2016
Current and other assets	\$ 18.6	\$ 18.1	\$ 19.9
Capital assets	0.5	0.6	0.7
Total assets	<u>\$ 19.1</u>	<u>\$ 18.7</u>	<u>\$ 20.6</u>
Deferred Outflows	<u>\$ 1.4</u>	<u>\$ 1.6</u>	<u>\$ 0.9</u>
Current liabilities	\$ 22.5	\$ 20.4	\$ 20.3
Pension and OPEB Liabilities	6.5	6.5	6.5
Total liabilities	<u>\$ 29.0</u>	<u>\$ 26.9</u>	<u>\$ 26.8</u>
Deferred Inflows	<u>\$ 0.5</u>	<u>\$ 0.5</u>	<u>\$ 0.6</u>
Net Position			
Net Investment in capital assets	\$ 0.5	\$ 0.6	\$ 0.7
Unrestricted	(9.5)	(7.7)	(6.6)
Total net position	<u>\$ (9.0)</u>	<u>\$ (7.1)</u>	<u>\$ (5.9)</u>

Current and other assets consist primarily of cash balances for operations, expanded lottery and prizes, accounts receivable from Lottery retailers for lottery ticket sales activity, and instant ticket inventory.

During fiscal year 2018, current and other assets increased \$0.5 million due to a decrease in cash on hand of \$0.6 million, an increase in accounts receivable of \$1.1 million and a decrease in ticket inventory of \$0.2 million.

For fiscal year 2017, current and other assets decreased \$1.9 million due to an increase in cash on hand of \$0.1 million, a decrease in accounts receivable of \$1.3 million and a decrease in ticket inventory of \$0.7 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 cash and receivables fluctuations 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.

The increase in current liabilities from 2017 to 2018 is attributable to an increase in accounts payable and accrued liabilities of \$1.8 million an increase in amounts due to the State of Kansas of \$0.1 million, and an increase in prize liability of \$0.2 million from 2017.

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 changes in accounts payable and accrued liabilities are primarily due to timing differences at year-end 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 Lottery has 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 2016, 2017 and 2018.

Summary of Revenues, Expenses, and Changes in Net Position

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

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Operating revenues:			
Traditional Lottery game revenues	\$ 268.9	\$ 258.0	\$ 272.0
Expanded lottery net revenues	404.5	371.1	364.4
Reimbursements and other	<u>4.8</u>	<u>4.8</u>	<u>10.1</u>
Total operating revenues	<u>678.2</u>	<u>633.9</u>	<u>646.5</u>
Operating expenses:			
Lottery	197.0	187.3	195.4
Expanded lottery	<u>299.1</u>	<u>274.7</u>	<u>269.6</u>
Total operating expenses	<u>496.1</u>	<u>462.0</u>	<u>465.0</u>
Operating income	<u>182.1</u>	<u>171.9</u>	<u>181.5</u>
Non-operating revenues (expenses):			
Lottery transfers	(74.8)	(73.9)	(78.8)
Expanded lottery transfers	(109.2)	(100.2)	(103.9)
Other	-	1.0	-
Total non-operating revenues (expenses)	<u>(184.0)</u>	<u>(173.1)</u>	<u>(182.7)</u>
Change in net position	(1.9)	(1.2)	(1.2)
Net position, beginning of year	<u>(7.1)</u>	<u>(5.9)</u>	<u>(4.7)</u>
Net position, end of year	<u>\$ (9.0)</u>	<u>\$ (7.1)</u>	<u>\$ (5.9)</u>

Lottery Game Revenues

Presented in millions of dollars, the following table compares online and instant Lottery sales by game type between fiscal years 2018 and 2017:

Type of Game	2018	2017	Increase (Decrease)	Percentage Change
Instant	\$ 150.0	\$ 142.6	\$ 7.4	5.2%
Pull-Tabs	7.4	8.4	(1.0)	-11.9%
Powerball	40.0	36.8	3.2	8.7%
Mega Millions	17.2	12.3	4.9	39.8%
2 by 2	1.6	1.7	(0.1)	-5.9%
Super Kansas Cash	11.8	16.4	(4.6)	-28.0%
Lucky For Life	5.9	4.2	1.7	100.0%
Keno	14.2	15.5	(1.3)	-8.4%
Pick 3	7.1	6.8	0.3	4.4%
Holiday Raffle	3.9	4.0	(0.1)	-2.5%
Hot Lotto	3.3	6.7	(3.4)	-50.7%
Lotto America	4.0	-	4.0	n/a
Kansas Hold'Em	2.5	2.6	(0.1)	-3.8%
Total	<u>\$ 268.9</u>	<u>\$ 258.0</u>	<u>\$ 10.9</u>	<u>4.2%</u>

Fiscal year 2018 sales were \$268.9 million compared to \$258.0 million in fiscal year 2017. Revenues from the sales on online and instant lottery tickets for the fiscal year ended June 30, 2018 increased 4.2% or \$10.9 million compared to the previous year.

- Mega Millions made a change in price point from \$1 to \$2 per play and made a change in game matrix to resemble Powerball. This resulted in higher jackpots and higher sales during the year.
- Super Kansas Cash sales declined after the record jackpot was hit in July 2017. Sales in the prior year were bolstered by the jackpot growing continuously from September 2016 to July 2017.
- Hot Lotto was replaced by Lotto America during the year. Initial Lotto America sales benefitted with a starting jackpot of \$15 million jackpot that was rolled over from Hot Lotto.
- The Kansas-only Holiday Millionaire Raffle came up 3,328 tickets shy of selling out for the ninth year in a row.
- Instant and Pull-Tab tickets also saw a combined sales increase of \$6.4 million from the previous fiscal year as players have continued to respond favorable to new games at a variety of price points. Increasingly, players are gravitating toward higher price point tickets with bigger prizes and payouts. The Lottery launched its first \$30 ticket in FY 2018 with top prizes of \$250,000.

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.

Lottery Expenses

Game Related

The following table compares the lottery game-related expenses between fiscal year 2018 and fiscal year 2017. The expenses are shown in millions of dollars:

Description	2018	2017	Increase (Decrease)	Percentage Change
Game Prizes	\$ 157.9	\$ 149.7	\$ 8.2	5.5%
Retailer commissions	15.9	15.3	0.6	3.9%
Central Gaming and Loyalty Systems	6.5	5.8	0.7	12.1%
Instant Ticket Printing Cost	3.3	3.5	(0.2)	-5.7%
Total	<u>\$ 183.6</u>	<u>\$ 174.3</u>	<u>\$ 9.3</u>	<u>5.3%</u>

The overall increase in game prizes was the result of the increase in sales compared to those in fiscal year 2017, including the increase in higher price point games. The central gaming and loyalty systems cost increased as a result of higher draw game sales.

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%
Central Gaming and Loyalty Systems	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 central gaming and loyalty systems cost decreased as a result of lower draw game sales.

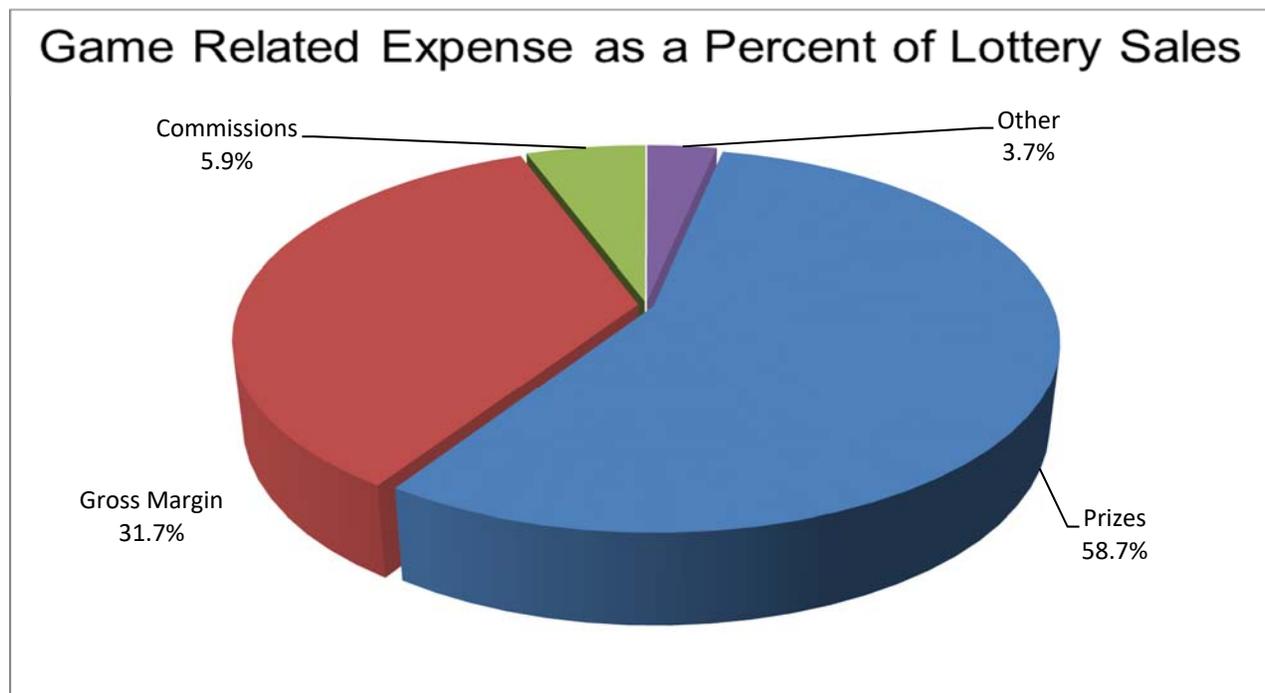
Non-game Related

Of the \$13.4 million of fiscal year 2018 lottery operating expenses that were non-game related, \$5.1 million was for employees' salaries and wages, \$4.6 was spent for games and promotional advertising, and other administrative expenses accounted for \$3.7 million.

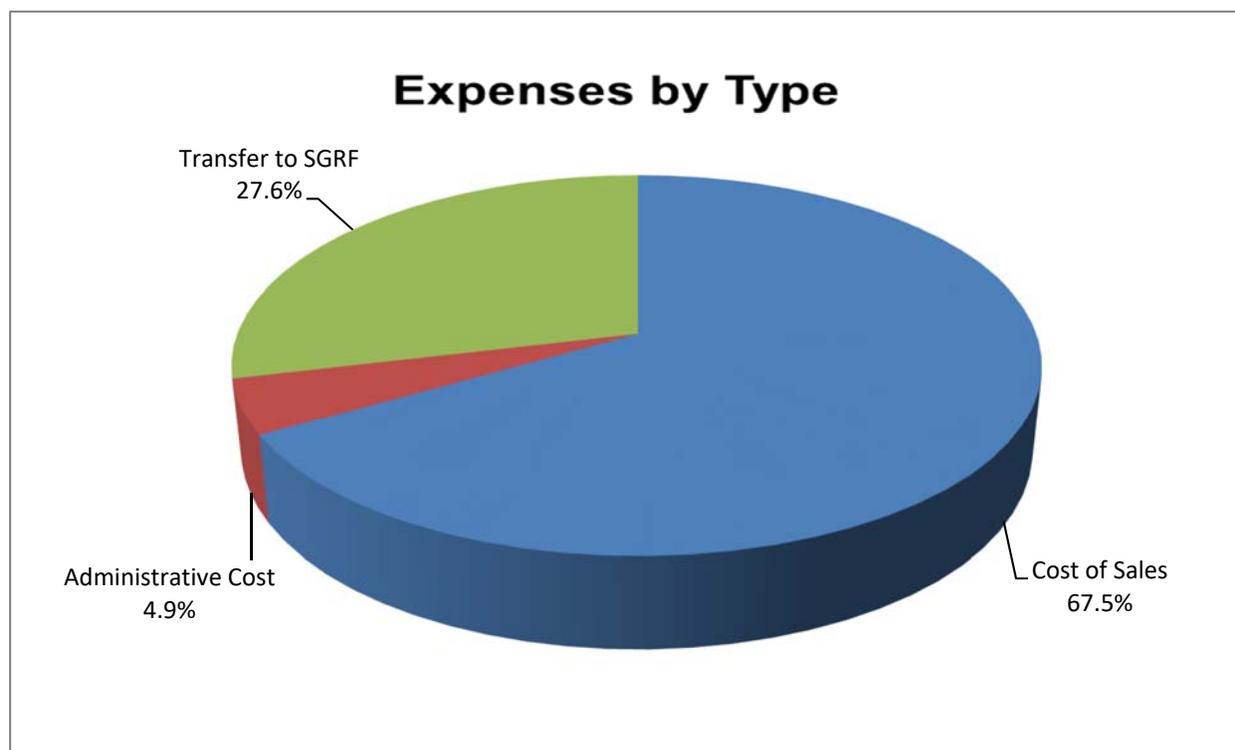
Of the \$13.0 million of fiscal year 2017 lottery operating expenses that were non-game related, \$4.9 million was for employees' salaries and wages, \$4.6 was spent for games and promotional advertising, and other administrative expenses accounted for \$3.5 million.

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.

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, central gaming and loyalty systems, ticket distribution, and instant ticket printing.

Transfer to the State Gaming Revenues Fund and State General Fund

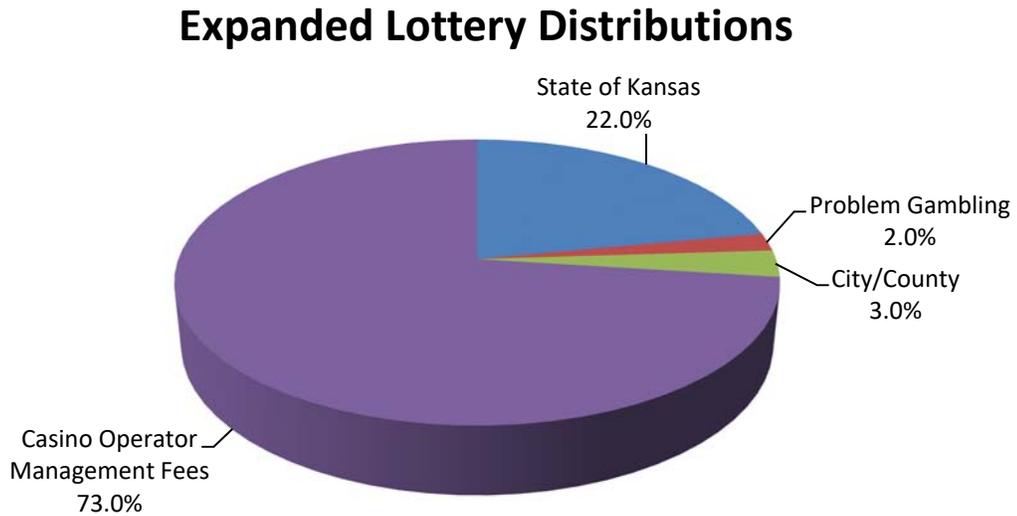
Pursuant to the Lottery Act, the Director of Accounts and Reports of the State of Kansas shall transfer monies in the Lottery Operating Fund to the State Gaming Revenue Fund (SGRF), at least monthly, in the amount equal to the monies in such fund in excess of those needed for payment of Lottery expenses, 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 2018, the legislature again waived the percentage of sales transfer requirement for a budgeted transfer request of \$76.5 million, with a minimum monthly transfer of \$4.8 million. For 2018, the accrual basis transfers to the SGRF were \$74.8 million, an increase of \$0.9 million from 2017. Actual cash transfers to the SGRF were \$74.7 million and \$75.3 million in 2018 and 2017, 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.

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



Expanded Lottery Revenues and Expenses

As of June 30, 2018, the State had four casinos in operation. Hollywood Casino at Kansas Speedway Kansas Star Casino and Boot Hill Casino and Resort were operational for the full fiscal year in both 2018 and 2017. Kansas Crossing Casino opened on March 29, 2017. The net revenue and related expenses are as follows (shown in millions of dollars):

	<u>2018</u>	<u>2017</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 404.5</u>	<u>\$ 371.1</u>	<u>\$ 33.4</u>	<u>9.0%</u>
Expenses:				
State of Kansas	89.0	81.7	7.3	8.9%
Problem Gambling	8.1	7.4	0.7	9.5%
City and County	12.1	11.1	1.0	9.0%
Management Fees	295.3	270.9	24.4	9.0%
Total	<u>\$ 404.5</u>	<u>\$ 371.1</u>	<u>\$ 33.4</u>	<u>9.0%</u>

	<u>2017</u>	<u>2016</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 371.1</u>	<u>\$ 364.4</u>	<u>\$ 6.7</u>	<u>1.8%</u>
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	<u>\$ 371.1</u>	<u>\$ 364.4</u>	<u>\$ 6.7</u>	<u>1.8%</u>

Economic Outlook

The Lottery's goals are to continue to increase sales even when not driven by large multi-state jackpots. 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.

The Lottery also will continue the Veterans' instant scratch games as well as its partnerships with Kansas Speedway, the Kansas State Fair, Kansas universities and the use of various licensed properties.

In July 2018, the Lottery and our new vendor Scientific Games launched new central gaming and back office systems. The new systems will allow the Lottery to offer more innovative ways of product delivery and improve the services it offers lottery retailers. The Lottery's marketing and gaming efforts will include identifying new Kansas-focused partnerships for its instant ticket games as well as improving and expanding its Kansas-only draw games.

The Lottery added a new monitor game, Racetrax, replacing the Kansas Hold'Em game. It provides Keno style prize payouts with the excitement of horse-racing shown on display monitors at retailers across the state.

In 2018, legislation passed and was signed allowing the Lottery to use self-service ticket vending machines at new and existing retailer locations. The ticket vending machines will allow for greater sales distribution, while easing long lines during peak purchasing times. The Lottery will place an initial order of 272 machines that are expected to be installed in Spring 2019. A second order is expected to be placed in service in Spring 2020.

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

Expanded Lottery revenues and transfers to the State of Kansas are expected to stabilize with all four casinos 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, 2018 and 2017 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, 2018 AND 2017

	2018	2017
<u>ASSETS</u>		
Current Assets:		
Cash:		
Operating fund	\$ 5,051,452	\$ 5,650,519
Prize payment fund	191,221	203,012
Accounts receivable, net of allowance for doubtful accounts of \$260,104 and \$253,905 at 2018 and 2017, respectively	2,353,764	1,996,132
Accounts receivable - unbilled	3,978,690	4,607,529
Other receivable	4,445,529	2,976,925
Instant ticket game inventory	2,533,423	2,706,100
Total current assets	18,554,079	18,140,217
Capital assets, net of depreciation	521,139	566,807
Total assets	19,075,218	18,707,024
<u>DEFERRED OUTFLOWS OF RESOURCES</u>		
KPERS Pension	1,384,789	1,564,524
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	8,188,014	6,317,049
Due to the State of Kansas	4,128,208	4,011,475
Prize liability	10,221,643	10,047,087
Total current liabilities	22,537,865	20,375,611
Net pension liability	6,459,616	6,472,314
OPEB liability	72,703	-
Total liabilities	29,070,184	26,847,925
<u>DEFERRED INFLOWS OF RESOURCES</u>		
KPERS Pension	458,800	504,197
KPERS OPEB	284	-
Total deferred inflows	459,084	504,197
<u>NET POSITION</u>		
Net Invested in capital assets	521,139	566,807
Unrestricted (deficit)	(9,590,400)	(7,647,381)
Total net position	\$ (9,069,261)	\$ (7,080,574)

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, 2018 AND 2017

	2018	2017
Operating revenues:		
Net game revenues	\$ 268,948,805	\$ 258,030,943
Expanded lottery revenues	404,508,001	371,117,198
Expanded lottery reimbursements	3,767,828	3,774,908
Phone reimbursements	916,395	905,630
Retailer fees and miscellaneous income	38,525	26,837
	<u>678,179,554</u>	<u>633,855,516</u>
 Operating expenses:		
Game prizes	157,890,979	149,709,855
Casino operator management fee	295,290,841	270,915,554
Retailer commissions	15,881,181	15,325,980
Central gaming and loyalty systems	8,665,462	7,889,594
Salaries and benefits	6,412,567	6,182,701
Cost of instant tickets	3,317,805	3,536,928
Advertising	4,641,903	4,623,134
Other administrative expenses	2,951,022	2,723,352
Depreciation	346,746	341,908
Professional services	391,791	450,018
Telecommunications	274,175	243,626
	<u>496,064,472</u>	<u>461,942,650</u>
 Operating income	<u>182,115,082</u>	<u>171,912,866</u>
 Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(74,843,276)	(73,856,690)
Transfers to the Expanded Lottery Act Revenues Fund	(88,991,760)	(81,645,784)
Transfers to the Problem Gambling Fund	(8,090,161)	(7,422,344)
Distributions to City and County governments	(12,135,239)	(11,133,516)
KPERS Contribution by State of Kansas	-	962,991
Write-off and adjustment of capital assets	12,887	3,671
	<u>(184,047,549)</u>	<u>(173,091,672)</u>
 Change in net position	<u>(1,932,467)</u>	<u>(1,178,806)</u>
 Net position, beginning of year (as previously reported)	<u>(7,080,574)</u>	<u>(5,901,768)</u>
 Prior period restatement for adoption of GASB Statement No. 75	<u>(56,220)</u>	<u>-</u>
 Net position, beginning of year (as restated)	<u>(7,136,794)</u>	<u>(5,901,768)</u>
 Net position, end of year	<u>\$ (9,069,261)</u>	<u>\$ (7,080,574)</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, 2018 AND 2017

	2018	2017
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 676,982,157	\$ 635,131,394
Cash (paid)/received for casino privilege fee deposits	-	-
Cash paid for prizes, commissions, and other expenses	(487,086,961)	(453,249,531)
Cash paid to employees	(6,274,160)	(6,004,578)
Net cash provided by operating activities	183,621,036	175,877,285
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(74,726,543)	(75,255,881)
Payments to State General Fund	(88,991,760)	(81,645,784)
Payments to State Problem Gambling Fund	(8,090,161)	(7,422,344)
Payments to City and County Governments	(12,135,239)	(11,133,516)
Net cash used by noncapital financing activities	(183,943,703)	(175,457,525)
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	16,780	15,350
Purchases of capital assets	(304,971)	(264,894)
Net cash used by capital and related financing activities	(288,191)	(249,544)
Net increase (decrease) in cash	(610,858)	170,216
Cash, beginning of year	5,853,531	5,683,315
Cash, end of year	\$ 5,242,673	\$ 5,853,531
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 182,115,082	\$ 171,912,866
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	346,746	341,908
Net recognition of deferred amounts of pension and OPEB liabilities	134,622	(782,050)
KPERs contribution on behalf of Lottery	-	962,991
Changes in operating assets and liabilities:		
Accounts receivable	271,207	2,272,140
Other deposits and receivables	(1,468,604)	(996,262)
Instant ticket game inventory	172,677	703,759
Accounts payable and accrued liabilities	1,870,965	1,201,104
Net pension liability	(12,698)	(2,818)
Unearned revenues	-	-
Refundable deposits	-	-
OPEB liability	16,483	-
Prize liability	174,556	263,647
Net cash provided by operating activities	\$ 183,621,036	\$ 175,877,285
Noncash capital and related financing activities:		
KPERs contribution on behalf of Lottery by State	\$ -	\$ 962,991

See accompanying notes to financial statements.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2018 and 2017

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 2018 Legislative session continued the Lottery until July 1, 2037. The Kansas Lottery Act abolishes the Lottery on July 1, 2037 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 draw game now called Powerball. In the current year, the Lottery offered several multi-state draw games (Powerball, Mega Millions, Lucky for Life, Hot Lotto, 2 by 2, and the new Lotto America), Kansas only draw games (Keno, Pick 3, Super Kansas Cash, Holiday Raffle and Kansas Hold'Em) and instant scratch and pull-tab games.

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, 2018 and 2017

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 management fees, 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. Draw 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.

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

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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 or Lotto America 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, a winning second prize Lucky for Life ticket, a winning Keno ticket equal to or greater than \$100,000, 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 2018 and 2017 were \$3,767,828 and \$3,774,908 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.

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

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Notes to Financial Statements
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computed on the straight-line basis using estimated useful lives of three to five years for lottery activities.

Real estate

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

Prize Liability

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

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

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

Prize expense for draw 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.

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.

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

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Notes to Financial Statements
June 30, 2018 and 2017

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.

OPEB

During the year ended June 30, 2018, The Lottery implemented the provisions of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (OPEB). For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources, and OPEB 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

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2018 and 2017

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.

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

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expense) until then.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

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.

Reclassifications

In 2018, management changed the classification of the expanded lottery distributions to city and county governments from operating expenses to non-operating expenses. The change in classification provided greater consistency in reporting, when compared to similar lottery operations. As a result of this change in classification, the 2017 city and county expanded lottery distributions have been reclassified to conform to the 2018 financial statement presentation, which increased operating income, non-operating expenses, cash provided by operations, and cash used in non-capital financing activities by \$11,133,516. The reclassification had no effect on the previously reported change in net position or the net increase in cash.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2018 and 2017

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, 2018 and 2017, the Lottery's share in the State's common cash pool was \$5,121,103 and \$5,745,797, respectively.

3 - Capital Assets

Property and equipment consisted of the following at June 30, 2018:

	Beginning Balances	Increases	Decreases	Ending Balances
Equipment, furnishing and software	\$ 1,643,375	\$ 42,972	\$ -	\$ 1,686,347
Vehicles	788,938	261,999	(174,890)	876,047
Total Lottery capital assets	2,432,313	304,971	(174,890)	2,562,394
Accumulated depreciation	(1,865,506)	(346,746)	170,997	(2,041,255)
Total capital assets, net of depreciation	<u>\$ 566,807</u>			<u>\$ 521,139</u>

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	2,250,646	264,894	(83,227)	2,432,313
Accumulated depreciation	(1,595,146)	(341,908)	71,548	(1,865,506)
Total capital assets, net of depreciation	<u>\$ 655,500</u>			<u>\$ 566,807</u>

Kansas Lottery
(A component unit of the State of Kansas)
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4 - Commitments

The Lottery leases office and warehouse space in Topeka under operating leases from unrelated parties. The lease contract is through December 31, 2022 and there is a one-year renewal option. Minimum future lease payments by fiscal year are as follows:

2019	\$	737,899
2020		756,634
2021		775,973
2022		795,916
2023		407,929
	<u>\$</u>	<u>3,474,351</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 \$765,091 and \$732,030 under operating leases for the years ended June 30, 2018 and 2017, respectively.

The Lottery has contracted with a service bureau which provides computer services for draw games and instant-win validation. The contract provides that the Lottery pay a fee of net draw game sales to the service bureau, and the duration of the current contract is through July 28, 2018. Fees were \$5,756,834 and \$5,319,904 for the years ended June 30, 2018 and 2017, respectively. Future fees are based on 4.9999 percent of net on-line sales.

The Lottery has contracted with a service bureau which provides computer services for draw games and instant-win validation. The contract takes effect on July 29, 2018 and the duration of the current contract is through June 30, 2028. Future fees are based on a fixed annual fee of \$1,040,000 plus 5.2463% percent of gross gaming revenues, defined as net game revenues less game prizes.

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 \$2,196,628 and \$2,095,023 for the years ended June 30, 2018 and 2017, 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.

The Lottery has contracted with a vendor to provide its players loyalty program. The duration of the contract is through June 20, 2022. Fees were \$712,000 and \$474,667 for the years ended June 30, 2018 and 2017, respectively. Future fees are \$712,000 annually through June 30, 2020 and \$812,000 per year thereafter.

Kansas Lottery
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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, 2018 and 2017, the fee was \$30,066,245 and \$29,362,740 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.

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

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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, 2018 and 2017, the fee was \$108,602,818 and \$105,544,887 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, 2018 and 2017, the fee was \$132,921,705 and \$130,017,357 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. 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.

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

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Revenues will be transferred to the State of Kansas. For the years ended June 30, 2018 and 2017, the fee was \$23,700,073 and \$5,990,570 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, 2018 and 2017.

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, Hot Lotto and Lotto America 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, 2018 and 2017, the prize reserve account had a balance \$81,746,568 and \$77,900,260, respectively, of which the Lottery's portion was \$1,234,532 and \$1,315,455, respectively. The set prize reserve at June 30, 2018 and 2017 had a balance of \$35,410,219 and \$39,992,162, respectively, of which the Lottery's portion was \$477,508 and \$597,602, respectively.

The Mega Millions prize reserve monies are refundable to MUSL members if MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. The prize reserve account at June 30, 2018 and 2017 was \$58,073,937 and \$38,041,470, respectively, of which the Lottery's portion was \$852,650 and \$628,538, respectively.

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The 2 by 2 prize reserve monies are refundable to MUSL members if MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 2018 and 2017, 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. This game ended in October 2017 and the reserve will be distributable once all claims have expired or otherwise been satisfied. At June 30, 2018 and 2017, the prize reserve account had a balance of \$6,918,607 and \$6,070,116, respectively, of which the Lottery's portion was \$802,128 and \$713,213, respectively.

The Lotto America 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 game began selling in November 2017. At June 30, 2018, the prize reserve account had a balance of \$1,009,868, of which the Lottery's portion was \$107,579.

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, 2018 and 2017 the Lottery's portion of the balance of this account was \$4,008 and \$10,253, 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 three Cash for Life lifetime prize payments. The winners receive \$6,000 per year for life, with a guaranteed minimum of \$100,000. The guaranteed minimums have all been reached. The estimated present value of the remaining prize payments is calculated based on the life expectancy of the winners, based on actuarial tables, and an annual discount rate of 4%. The payments are expected to continue until 2048. At June 30 2018 and 2017, the present value of the estimated remaining payments was \$296,411 and \$302,370, respectively.

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During the year ending June 30, 2018, annuity contracts have been purchased for two Lucky for Life lifetime prize payments. The winners receive \$25,000 per year for life, with a guaranteed minimum of 20 years. Each player is guaranteed payments through 2036. The estimated present value of the remaining prize payments is calculated based on the life expectancy of the winners, based on actuarial tables, and an annual discount rate of 4%. The payments are expected to continue until 2052. At June 30 2018, the present value of the estimated remaining payments was \$850,832.

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

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as certified by the Executive Director of the Lottery. For the year ended June 30, 2018, the State Legislature established a budgeted transfer to the Fund of \$76,500,000, which includes \$1,500,000 designated for the veteran transfer. For the year ended June 30, 2017 the State Legislature established a budgeted transfer to the Fund of \$75,200,000, which includes \$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, 2018 and 2017 were \$74,843,276 and \$73,856,690, respectively, of which \$4,128,208 and \$4,011,475 was unpaid, respectively. Actual cash transfers to the State of Kansas for years ended June 30, 2018 and 2017 were \$74,726,543 and \$75,255,881, respectively. Included in the minimum transfer amount were mandated transfer of \$1,023,873 and \$1,255,812 for the years ended June 30, 2018 and 2017, 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, 2018 and 2017:

	FY 2018 <u>Boot Hill</u>	FY 2017 <u>Boot Hill</u>
Gaming Facility Revenue:		
Electronic games	\$ 36,041,408	\$ 35,186,589
Table games	5,145,229	5,036,343
Total	<u>\$ 41,186,637</u>	<u>\$ 40,222,932</u>
Distributions:		
State of Kansas - 22%	\$ 9,061,060	\$ 8,849,045
Problem Gambling Fund - 2%	823,733	804,459
City & County - 3%	1,235,599	1,206,688
Casino operator management fees - 73%	30,066,245	29,362,740
Total	<u>\$ 41,186,637</u>	<u>\$ 40,222,932</u>

	FY 2018 <u>Kansas Star</u>	FY 2017 <u>Kansas Star</u>
Gaming Facility Revenue:		
Electronic games	\$ 156,719,719	\$ 151,479,596
Table games	25,364,809	26,626,372
Total	<u>\$ 182,084,528</u>	<u>\$ 178,105,968</u>
Distributions:		
State of Kansas - 22%	\$ 40,058,596	\$ 39,183,313
Problem Gambling Fund - 2%	3,641,691	3,562,119
City & County - 3%	5,462,536	5,343,179
Casino operator management fees - 73%	132,921,705	130,017,357
Total	<u>\$ 182,084,528</u>	<u>\$ 178,105,968</u>

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	FY 2018 <u>Hollywood</u>	FY 2017 <u>Hollywood</u>
Gaming Facility Revenue:		
Electronic games	\$ 131,099,423	\$ 125,678,469
Table games	17,671,560	18,903,568
Total	<u>\$ 148,770,983</u>	<u>\$ 144,582,037</u>
Distributions:		
State of Kansas - 22%	\$ 32,729,616	\$ 31,808,048
Problem Gambling Fund - 2%	2,975,420	2,891,641
City & County - 3%	4,463,129	4,337,461
Casino operator management fees - 73%	108,602,818	105,544,887
Total	<u>\$ 148,770,983</u>	<u>\$ 144,582,037</u>

	FY 2018 <u>Kansas Crossing</u>	FY 2018 <u>Kansas Crossing</u>
Gaming Facility Revenue:		
Electronic games	\$ 28,299,973	\$ 7,191,126
Table games	4,165,880	1,015,134
Total	<u>\$ 32,465,853</u>	<u>\$ 8,206,260</u>
Distributions:		
State of Kansas - 22%	\$ 7,142,488	\$ 1,805,377
Problem Gambling Fund - 2%	649,317	164,125
City & County - 3%	973,975	246,188
Casino operator management fees - 73%	23,700,073	5,990,570
Total	<u>\$ 32,465,853</u>	<u>\$ 8,206,260</u>

At June 30, 2018 and 2017, \$4,147,701, and \$2,671,117, respectively, was receivable from the casino manager for online and table game net revenue. At June 30, 2018 and 2017, \$6,461,869 and \$5,162,030, 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 2018</u>	<u>FY 2017</u>
Instant Games	\$ 149,979,002	\$ 142,572,474
Pull Tabs	7,410,040	8,451,645
Powerball	40,047,750	36,781,987
MegaMillions	17,220,849	12,336,420
Super Kansas Cash	11,831,489	16,339,578
Pick 3	7,089,797	6,811,012
Keno	14,200,817	15,494,968
Holiday Raffle	3,933,440	4,000,000
2by2	1,550,011	1,708,499
Hot Lotto	3,326,783	6,739,519
Lotto America	4,011,859	-
Kansas Hold Em	2,459,770	2,611,650
Lucky 4 Life	5,887,198	4,183,191
Total	<u>\$ 268,948,805</u>	<u>\$ 258,030,943</u>
Prizes, net	(157,890,979)	(149,709,855)
Retailer Commissions	<u>(15,881,181)</u>	<u>(15,325,980)</u>
Gross Margin	<u>\$ 95,176,645</u>	<u>\$ 92,995,108</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, KPERS 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 --- 9.62% and 12.01%, respectively, for the fiscal year ended June 30, 2018. 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 \$562,731 and \$473,826 for the years ended June 30, 2018 and 2017, respectively.

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

At June 30, 2018, the Lottery reported a liability of \$6,459,616 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2016, which was rolled forward to June 30, 2017. 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, 2017. The contributions used exclude contributions made for prior service, excess benefits and irregular payments. At June 30, 2017, the Lottery proportion was 0.096%, which was the same as its proportion measured as of June 30, 2016.

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.

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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 for the year ended June 30, 2017.

For the year ended June 30, 2018, the Lottery recognized pension expense of \$684,351. At June 30, 2018, 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	\$ -	\$ 321,253
Net difference between projected and actual earnings on pension plan investments	138,536	-
Changes in assumptions	305,002	8,551
Changes in proportion	378,520	128,996
Lottery contributions subsequent to measurement date	<u>562,731</u>	<u>-</u>
Total	<u>\$ 1,384,789</u>	<u>\$ 458,800</u>

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>

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The amounts reported as deferred outflows of resources, \$562,731 at June 30, 2018 and \$473,826 at June 30, 2017, 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, 2018</u>	<u>At June 30, 2017</u>
Recognized in FY 2018	\$ -	\$ 54,358
Recognized in FY 2019	7,541	54,358
Recognized in FY 2020	207,750	254,878
Recognized in FY 2021	174,225	221,249
Recognized in FY 2022	(45,141)	1,658
Recognized in FY 2023	18,883	-
Thereafter	-	-
Total	<u>\$ 363,258</u>	<u>\$ 586,501</u>

Actuarial assumptions.

The total pension liability in the December 31, 2016 actuarial valuations was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Price inflation	2.75 percent
Wage inflation	3.50 percent
Salary increases, including wage increases	3.50 to 12.00 percent, including inflation
Long-term rate of return net of investment expense, and including price inflation	7.75 percent

Mortality rates were based on the RP 2014 Mortality Tables, with age setbacks and age set forwards as well as other adjustments based on different membership groups. Future mortality improvements are anticipated using Scale MP-2016.

The actuarial assumptions used in the December 31, 2016, valuation were based on the results of an actuarial experience study conducted for the period January 1, 2013, through December 31, 2015. The experience study is dated November 18, 2016.

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The total pension liability in the December 31, 2015 actuarial valuations was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Price inflation	3.00 percent
Wage inflation	4.00 percent
Salary increases, including wage increases	4.00 to 16.00 percent, including inflation
Long-term rate of return net of investment expense, and including price inflation	8.00 percent

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

The actuarial assumptions used in the December 31, 2015 valuation were based on the results of an actuarial experience study conducted for the three-year period ending December 31, 2012.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocations as of June 30, 2016 and 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%	6.80%
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>	

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Discount rate.

The discount rate used to measure the total pension liability as of June 30, 2017 was 7.75 percent. The projection of contributions as outlined below:

In KPERS, the State/School and Local groups do not necessarily contribute the full actuarial determined rate. Based on legislation first passed in 1993 and subsequent legislation, the employer contribution rates certified by the Board may not increase by more than the statutory cap. The statutory cap for Fiscal Year 2017 was 1.2 percent.

In recent years, the Legislature has made several changes to statutory rates that deviate from the scheduled contribution increases set under the caps established in 2012 for the State/School group. Under 2015 SB 4, the previously certified State/School statutory rate for Fiscal Year 2015 of 11.27 percent was reduced to 8.65 percent for the last half of the fiscal year as part of the Governor's allotment. That same session, SB 228 recertified statutory rates for the State/School group to 10.91 percent for Fiscal Year 2016 and 10.81 percent for Fiscal Year 2017 in anticipation of the issuance of \$1 billion in pension obligation bonds. Legislation in the 2016 session (SB 161) provided for the delay of up to \$100 million in State and School contributions to the Pension Plan. Legislation passed by the 2017 Legislature removed the repayment provisions included in SB 161.

In addition, 2017 S Sub. For Sub. HB 2052 delayed \$64.1 million in Fiscal Year State/School contributions, to be repaid over 20 years in level dollar installments. The first year payment of \$6.4 million was received in July 2017 and appropriations for Fiscal Year 2018 are intended to fully fund the State/School group statutory contribution rate of 12.01 percent for that year. Additional legislation in the 2017 Session (S Sub for HB 2002) provided for a reduction of \$194 million from the previously certified contribution rate of 13.21 percent in the State/School contributions for Fiscal Year 2019. Like the Fiscal Year 2017 reduction, it is to be paid back over a 20-year period, beginning in Fiscal Year 2020. Therefore, both reductions will be accounted for as long-term receivables by the Pension Plan.

Based on employer contribution history as described above, it is a reasonable estimate that the State/School group's contribution rate may not be certified at the statutory rate. It has been assumed that contribution rates will be made within the same range as have been seen in the past few years. Using this assumption actuarial modeling indicates that employer contribution rates for the State/School group are sufficient to avoid a depletion date.

The discount rate used to measure the total pension liability as of June 30, 2016 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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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 7.75%, 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 (6.75%) or 1-percentage-point higher (8.75%) than the current rate:

	1% Decrease (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
Lottery proportionate share of the net pension liability at June 30, 2018	\$ 8,612,111	\$ 6,459,616	\$ 4,643,315

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:

	1% Decrease (7.00%)	Current Discount Rate (8.00%)	1% Increase (9.00%)
Lottery proportionate share of the net pension liability at June 30, 2017	\$ 8,416,044	\$ 6,472,314	\$ 4,821,245

Pension plan fiduciary net position.

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

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Notes to Financial Statements
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10 - KPERS Death and Disability OPEB Plan

Plan Description.

The Lottery participates in an agent multiple-employer defined benefit other post-employment benefit (OPEB) plan which is administered by KPERS. The Plan provides long-term disability benefits and life insurance benefit for disabled members to KPERS members, as provided by K.S.A. 74-04927. The plan is administered through a trust held by KPERS that is funded to pay annual benefit payments. Because the trust's assets are used to pay employee benefits other than OPEB, no assets are accumulated in a trust that meets the criteria in paragraph 4 of GASB Statement 75. There is no stand-alone financial report for the plan.

Benefits provided.

Benefits are established by statute and may be amended by the KPERS Board of Trustees. The Plan provides long-term disability benefits equal to 60% (prior to January 1, 2006, 66 2/3%) of annual compensation, offset by other benefits. Members receiving long-term disability benefits also receive credit towards their KPERS retirement benefits and have their group life insurance coverage continued under the waiver premium provision.

Long-term disability benefit.

Monthly benefit is 60% of the member's monthly compensation, with a minimum of \$100 and maximum of \$5,000. The monthly benefit is subject to reduction by deductible sources of income, which include Social Security primary disability or retirement benefits, worker's compensation benefits, other disability benefits from any other source by reason of employment, and earnings from any form of employment. If the disability begins before age 60, benefits are payable while disability continues until the member's 65th birthday or retirement date, whichever occurs first. If the disability occurs after age 60, benefits are payable while disability continues, for a period of 5 years or until the member retires, whichever occurs first. Benefit payments for disabilities caused or contributed to by substance abuse or non-biologically based mental illnesses are limited to the term of the disability or 24 months per lifetime, whichever is less. There are no automatic cost-of-living increase provisions. KPERS has the authority to implement an ad hoc cost-of living increase.

Group life waiver of premium benefit.

Upon the death of an employee who is receiving monthly disability benefits, the plan will pay a lump-sum benefit to eligible beneficiaries. The benefit amount will be 150% of the greater of the member's previous 12 months of compensation at the time of the last date on payroll. If the member has been disabled for 5 or more years, the annual compensation or salary rate at the time of death will be indexed using the consumer price before the life insurance benefit is computed. The indexing is based on the consumer price index, less one percentage point, to compute the death benefit. If a member is diagnosed as terminally ill with a life expectancy of 12 months or less, the member may be eligible to receive up to 100% of the death benefit rather than having the benefit paid to the beneficiary. If a member retires or disability benefits end, the member may convert the group life insurance coverage to an individual life insurance plan.

Kansas Lottery
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Notes to Financial Statements
June 30, 2018 and 2017

Members covered by benefit terms.

At June 30, 2018, the following members were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefit payments	—
Active employees	84
	84
	84

Total OPEB Liability.

The Lottery's total OPEB liability of \$72,703 was measured as of June 30, 2017, and was determined by an actuarial valuation as of June 30, 2017.

Actuarial assumptions and other inputs.

The total OPEB liability in the December 31, 2016 actuarial valuation was determined using the following actuarial assumptions and other inputs, applied to all period included in the measurement, unless otherwise noted:

Price inflation	2.75%
Payroll growth	3.00%
Salary increases, including inflation	3.50% - 10.00%, including price inflation
Discount rate	3.58%
Healthcare cost trend rates	Not applicable for the coverage in this plan
Retiree share of benefit cost	Not applicable for the coverage in this plan

The discount rate was based on the Bond Buyer General Obligation 20-Bond Municipal Index.

Mortality rates were based on the RP-2014 Mortality tables, as appropriate, with adjustment for mortality improvements based on Scale MP-2017.

The actuarial assumptions used in the June 30, 2017 valuation were based on actuarial experience study for the period July 1, 2014 – June 30, 2016. Other demographic assumptions are set to be consistent with the actuarial assumptions reflected in the December 31, 2016 KPERS pension valuation.

Changes in the Total OPEB Liability.

	<u>Total OPEB Liability</u>
Balance at Fiscal Year End June 30, 2017	\$ 56,220
Changes for the year:	
Service cost	23,212
Interest	2,143
Effect of assumptions changes or inputs	(317)
Benefit payments	(8,555)
	(8,555)
Net changes	16,483
	16,483
Balance at Fiscal Year End June 30, 2018	\$ 72,703
	72,703

Kansas Lottery
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Notes to Financial Statements
June 30, 2018 and 2017

Changes of assumptions.

Changes of assumptions and other inputs reflect the effects of changes in the discount rate each period. The discount rate increased from 2.85% on June 30, 2016 to 3.58% on June 30, 2017.

Sensitivity of the total OPEB liability to changes in the discount rate.

The following presents the total OPEB liability of the Lottery, as well as what the Lottery's total OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (2.58%) or 1-percentage-point higher (4.58%) than the current discount rate:

	1% Decrease (2.58%)	Current Discount Rate (3.58%)	1% Increase (4.58%)
Total OPEB Liability	\$ 72,906	\$ 72,703	\$ 71,735

Sensitivity of the total OPEB liability to changes in the healthcare cost trend rates.

The healthcare trend rates do not affect the liabilities related to the long-term disability benefits sponsored by KPERS. Therefore, there is no sensitivity to a change in healthcare trend rates.

OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

For the year ended June 30, 2018, the Lottery recognized OPEB expense of \$25,322. At June 30, 2018, the (Client) reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Changes in assumptions	\$ —	\$ 284
Total	\$ —	\$ 284

Other amounts reported as deferred outflows of sources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

	Deferred Outflows (Inflows) of Resources
Year ended June 30:	
2019	\$ (33)
2020	(33)
2021	(33)
2022	(33)
2023	(33)
Thereafter	(119)
	\$ (284)

Prior period adjustment.

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For fiscal year ended June 30, 2018, the Lottery implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB)*. This statement establishes accounting and financial reporting for OPEB provided to the employees of state and local government employers. This statement substantially changes the accounting required under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB 75 requires a liability for OPEB obligations, known as the Total OPEB Liability for unfunded plans to be recognized on the statement of net position of participating employers and changes in the Total OPEB Liability to be immediately recognized as OPEB Expense on the statement of revenues, expenses, and changes in net position or reported as deferred inflows/outflows of resources depending on the nature of the change.

Net position, as previously reported	\$ (7,080,574)
Prior period adjustment	<u>(56,220)</u>
Net position, as restated	<u>\$ (7,136,794)</u>

Net position as of July 1, 2016 was not restated because the information needed to make the restatement was not provided by KPERS.

Kansas Lottery
(A component unit of the State of Kansas)
Notes to Financial Statements
June 30, 2018 and 2017

11 - Privilege Fee Payments

The Lottery assesses a privilege fee on applicants who would like to be considered as a potential expanded gaming facility manager. The privilege fee acts as a deposit showing the management company's interest in managing one of the four gaming facilities throughout the State of Kansas. Privilege fees assessed are \$25,000,000 per applicant for the south-central and northeast regions and \$5,500,000 per applicant for the southwest and southeast region. If an applicant is not awarded the contract for the region, the privilege fee is reimbursed in full. When a contract becomes binding the privilege fee is transferred to the State's general fund immediately. The State of Kansas did not receive privilege fees the years ended June 30, 2018 and June 30, 2017.

12 - 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.

13 - Subsequent Event

The Lottery has evaluated subsequent events through September 26, 2018, the date the financial statements were available to be issued. There were no subsequent events that require recognition or disclosure in the financial statements.

Kansas Lottery
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Required Supplementary Information
June 30, 2018 and 2017

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

Proportionate Share of the Net Pension Liability (Measurement Date)	June 30, 2017	June 30, 2016	June 30, 2015	June 30, 2014	June 30, 2013
Proportion of the net pension liability	0.096%	0.096%	0.094%	0.086%	0.092%
Proportionate share of the net pension liability	\$ 6,459,616	\$ 6,472,314	\$ 6,475,132	\$ 5,520,044	\$ 6,660,853
Covered payroll for valuation period	\$ 4,135,682	\$ 4,508,081	\$ 4,558,350	\$ 4,224,000	\$ 4,019,000
Proportionate share of the net pension liability as a percentage of covered payroll	156.2%	143.6%	142.0%	130.7%	165.7%
Plan fiduciary net position as a percentage of the total pension liability	67.1%	65.1%	65.0%	66.6%	59.9%
 Required Contributions (Fiscal Year Ended)	 June 30, 2018	 June 30, 2017	 June 30, 2016	 June 30, 2015	 June 30, 2014
Required contributions	\$ 562,731	\$ 473,826	\$ 479,221	\$ 440,805	\$ 389,521
Contributions in relation to required contribution	562,731	473,826	479,221	440,805	389,521
Contribution deficiency	\$ -	\$ -	\$ -	\$ -	\$ -
Covered payroll for valuation period	\$ 4,682,502	\$ 4,135,682	\$ 4,508,081	\$ 4,558,350	\$ 4,224,000
Contributions as a percentage of covered payroll	12.0%	11.5%	10.6%	9.7%	9.2%

Note: The above schedules are intended to show information for 10 years. Additional years will be displayed as the information becomes available from KPERs.

Kansas Lottery
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Required Supplementary Information
June 30, 2018 and 2017

Schedule of Changes in the Death & Disability
Total OPEB Liability and Related Ratios

For the Fiscal Years Ending June 30*

Measurement Date	2018 June 30, 2017
Total OPEB liability	
Service cost	\$ 23,212
Interest	2,143
Effect of assumptions changes or inputs	(317)
Benefit payments	(8,555)
Net change in total OPEB liability	16,483
Total OPEB liability - beginning	56,220
Total OPEB liability - ending	\$ 72,703
Covered payroll	\$ 4,135,682
 Total OPEB liability as a percentage of covered payroll	 1.76%

* GASB 75 requires presentation of ten years. As of June 30, 2018, only one year of information is available.

Changes of assumptions. Changes of assumptions and other inputs reflect the effects of changes in the discount rate each period. The discount rate decreased from 2.85% on June 30, 2016 to 3.58% on June 30, 2017.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF NET POSITION
JUNE 30, 2018

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2018
<u>ASSETS</u>			
Current Assets:			
Cash:			
Operating fund	\$ 2,649,969	\$ 2,401,483	\$ 5,051,452
Prize payment fund	191,221	-	191,221
Accounts receivable, net of allowance for doubtful accounts of \$253,905	2,353,764	-	2,353,764
Accounts receivable - unbilled	3,978,690	-	3,978,690
Other deposits and receivables	297,828	4,147,701	4,445,529
Instant ticket game inventory	2,533,423	-	2,533,423
 Total current assets	 <u>12,004,895</u>	 <u>6,549,184</u>	 <u>18,554,079</u>
Capital assets, net of depreciation:	<u>521,139</u>	<u>-</u>	<u>521,139</u>
 Total assets	 <u>12,526,034</u>	 <u>6,549,184</u>	 <u>19,075,218</u>
<u>DEFERRED OUTFLOWS OF RESOURCES</u>			
KPERS Pension	<u>1,384,789</u>	<u>-</u>	<u>1,384,789</u>
<u>LIABILITIES</u>			
Current liabilities:			
Accounts payable and accrued liabilities	1,638,830	6,549,184	8,188,014
Due to the State of Kansas	4,128,208	-	4,128,208
Prize liability	10,221,643	-	10,221,643
 Total current liabilities	 <u>15,988,681</u>	 <u>6,549,184</u>	 <u>22,537,865</u>
Net pension liability	6,459,616	-	6,459,616
OPEB liability	72,703	-	72,703
 Total liabilities	 <u>22,521,000</u>	 <u>6,549,184</u>	 <u>29,070,184</u>
<u>DEFERRED INFLOWS OF RESOURCES</u>			
KPERS Pension	458,800	-	458,800
KPERS OPEB	284	-	284
 Total deferred inflows	 <u>459,084</u>	 <u>-</u>	 <u>459,084</u>
<u>NET POSITION</u>			
Net Invested in capital assets	521,139	-	521,139
Unrestricted (deficit)	<u>(9,590,400)</u>	<u>-</u>	<u>(9,590,400)</u>
 Total net position	 <u>\$ (9,069,261)</u>	 <u>\$ -</u>	 <u>\$ (9,069,261)</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEAR ENDED JUNE 30, 2018

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2018
Operating revenues:			
Net game revenues	\$ 268,948,805	\$ -	\$ 268,948,805
Expanded lottery revenues	-	404,508,001	404,508,001
Expanded lottery reimbursements	-	3,767,828	3,767,828
Phone reimbursements	916,395	-	916,395
Retailer fees and miscellaneous income	38,525	-	38,525
Total operating revenues	<u>269,903,725</u>	<u>408,275,829</u>	<u>678,179,554</u>
Operating expenses:			
Game prizes	157,890,979	-	157,890,979
Casino operator management fee	-	295,290,841	295,290,841
Retailer commissions	15,881,181	-	15,881,181
Central gaming and loyalty systems	6,468,834	2,196,628	8,665,462
Salaries and benefits	5,131,438	1,281,129	6,412,567
Cost of instant tickets	3,317,805	-	3,317,805
Advertising	4,641,903	-	4,641,903
Other administrative expenses	2,691,223	259,799	2,951,022
Depreciation	346,746	-	346,746
Professional services	372,692	19,099	391,791
Telecommunications	263,002	11,173	274,175
Total operating expenses	<u>197,005,803</u>	<u>299,058,669</u>	<u>496,064,472</u>
Operating income	<u>72,897,922</u>	<u>109,217,160</u>	<u>182,115,082</u>
Nonoperating revenues (expenses):			
Transfers to the State Gaming Revenue Fund	(74,843,276)	-	(74,843,276)
Transfers to the Expanded Lottery Act Revenues Fund	-	(88,991,760)	(88,991,760)
Transfers to the Problem Gambling Fund	-	(8,090,161)	(8,090,161)
Distributions to City and County governments	-	(12,135,239)	(12,135,239)
Gain (loss) on disposal of capital assets	12,887	-	12,887
Total nonoperating revenues (expenses)	<u>(74,830,389)</u>	<u>(109,217,160)</u>	<u>(184,047,549)</u>
Change in net position	(1,932,467)	-	(1,932,467)
Net position, beginning of year (as previously reported)	<u>(7,080,574)</u>	<u>-</u>	<u>(7,080,574)</u>
Prior period restatement for adoption of GASB Statement No. 75	<u>(56,220)</u>	<u>-</u>	<u>(56,220)</u>
Net position, beginning of year (as restated)	<u>(7,136,794)</u>	<u>-</u>	<u>(7,136,794)</u>
Net position, end of year	<u>\$ (9,069,261)</u>	<u>\$ -</u>	<u>\$ (9,069,261)</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2018

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2018
Cash flows from operating activities:			
Cash received from sales and reimbursements	\$ 270,182,912	\$ 406,799,245	\$ 676,982,157
Cash paid for prizes, commissions, and other expenses	(190,592,159)	(296,494,802)	(487,086,961)
Cash paid to employees	(4,993,031)	(1,281,129)	(6,274,160)
Net cash provided by operating activities	<u>74,597,722</u>	<u>109,023,314</u>	<u>183,621,036</u>
Cash flows from noncapital financing activities:			
Payments to State Gaming Revenue Fund	(74,726,543)	-	(74,726,543)
Payments to State General Fund	-	(88,991,760)	(88,991,760)
Payments to State Problem Gambling Fund	-	(8,090,161)	(8,090,161)
Payments to City and County governments	-	(12,135,239)	(12,135,239)
Net cash used by noncapital financing activities	<u>(74,726,543)</u>	<u>(109,217,160)</u>	<u>(183,943,703)</u>
Cash flows from capital and related financing activities:			
Proceeds from sale of capital assets	16,780	-	16,780
Purchases of capital assets	(304,971)	-	(304,971)
Net cash used by capital and related financing activities	<u>(288,191)</u>	<u>-</u>	<u>(288,191)</u>
Net increase (decrease) in cash	(417,012)	(193,846)	(610,858)
Cash, beginning of year	<u>3,258,202</u>	<u>2,595,329</u>	<u>5,853,531</u>
Cash, end of year	<u>\$ 2,841,190</u>	<u>\$ 2,401,483</u>	<u>\$ 5,242,673</u>
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	\$ 72,897,922	\$ 109,217,160	\$ 182,115,082
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	346,746	-	346,746
Net recognition of deferred amounts of pension and OPEB liabilities	134,622	-	134,622
KPERS contribution on behalf of Lottery	-	-	-
Changes in operating assets and liabilities:			
Accounts receivable	271,207	-	271,207
Other deposits and receivables	7,980	(1,476,584)	(1,468,604)
Instant ticket game inventory	172,677	-	172,677
Accounts payable and accrued liabilities	588,227	1,282,738	1,870,965
Net pension liability	(12,698)	-	(12,698)
OPEB Liability	16,483	-	16,483
Prize liability	174,556	-	174,556
Net cash provided by operating activities	<u>\$ 74,597,722</u>	<u>\$ 109,023,314</u>	<u>\$ 183,621,036</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF NET POSITION - LOTTERY
JUNE 30, 2018 AND 2017

	Lottery	
<u>ASSETS</u>	2018	2017
Current Assets:		
Cash:		
Operating fund	\$ 2,649,969	\$ 3,055,190
Prize payment fund	191,221	203,012
Accounts receivable, net of allowance for doubtful accounts of \$260,104 and \$253,905 at 2018 and 2017, respectively	2,353,764	1,996,132
Accounts receivable - unbilled	3,978,690	4,607,529
Other receivable	297,828	305,808
Instant ticket game inventory	2,533,423	2,706,100
Total current assets	12,004,895	12,873,771
Capital assets, net of depreciation	521,139	566,807
Total assets	12,526,034	13,440,578
<u>DEFERRED OUTFLOWS OF RESOURCES</u>		
KPERS Pension	1,384,789	1,564,524
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,638,830	\$ 1,050,603
Due to the State of Kansas	4,128,208	4,011,475
Prize liability	10,221,643	10,047,087
Total current liabilities	15,988,681	15,109,165
Net pension liability	6,459,616	6,472,314
OPEB liability	72,703	-
Total liabilities	22,521,000	21,581,479
<u>DEFERRED INFLOWS OF RESOURCES</u>		
KPERS Pension	458,800	504,197
KPERS OPEB	284	-
Total deferred inflows	459,084	504,197
<u>NET POSITION</u>		
Net Investment in capital assets	521,139	566,807
Unrestricted	(9,590,400)	(7,647,381)
Total net position	\$ (9,069,261)	\$ (7,080,574)

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION - LOTTERY
YEARS ENDED JUNE 30, 2018 AND 2017

	Lottery	
	<u>2018</u>	<u>2017</u>
Operating revenues:		
Net game revenues	\$ 268,948,805	\$ 258,030,943
Phone reimbursements	916,395	905,630
Retailer fees and miscellaneous income	38,525	26,837
	<u>269,903,725</u>	<u>258,963,410</u>
Total operating revenues		
Operating expenses:		
Game prizes	157,890,979	149,709,855
Retailer commissions	15,881,181	15,325,980
Central gaming and loyalty systems	6,468,834	5,794,571
Salaries and benefits	5,131,438	4,879,655
Cost of instant tickets	3,317,805	3,536,928
Advertising	4,641,903	4,623,134
Other administrative expense	2,691,223	2,406,437
Depreciation	346,746	341,908
Professional services	372,692	397,835
Telecommunications	263,002	235,885
	<u>197,005,803</u>	<u>187,252,188</u>
Total operating expenses		
Operating income	<u>72,897,922</u>	<u>71,711,222</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(74,843,276)	(73,856,690)
KPERs Contribution by State of Kansas	-	962,991
Gain (loss) on disposal of capital assets	12,887	3,671
	<u>(74,830,389)</u>	<u>(72,890,028)</u>
Total nonoperating revenues (expenses)		
Change in net position	(1,932,467)	(1,178,806)
Net position, beginning of year (as previously reported)	<u>(7,080,574)</u>	<u>(5,901,768)</u>
Prior period restatement for adoption of GASB Statement No. 75	(56,220)	-
Net position, beginning of year (as restated)	<u>(7,136,794)</u>	<u>(5,901,768)</u>
Net position, end of year	<u>\$ (9,069,261)</u>	<u>\$ (7,080,574)</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF CASH FLOWS - LOTTERY
YEARS ENDED JUNE 30, 2018 AND 2017

	Lottery	
	2018	2017
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 270,182,912	\$ 261,181,054
Cash paid for prizes, commissions, and other expenses	(190,592,159)	(181,520,781)
Cash paid to employees	(4,993,031)	(4,701,532)
Net cash provided by operating activities	<u>74,597,722</u>	<u>74,958,741</u>
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(74,726,543)	(75,255,881)
Net cash used by noncapital financing activities	<u>(74,726,543)</u>	<u>(75,255,881)</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	16,780	15,350
Purchases of capital assets	(304,971)	(264,894)
Net cash used by capital and related financing activities	<u>(288,191)</u>	<u>(249,544)</u>
Net decrease in cash	(417,012)	(546,684)
Cash, beginning of year	3,258,202	3,804,886
Cash, end of year	<u>\$ 2,841,190</u>	<u>\$ 3,258,202</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 72,897,922	\$ 71,711,222
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	346,746	341,908
Net recognition of deferred amounts of pension and OPEB liabilities	134,622	(782,050)
KPERS Contribution by State of Kansas	-	962,991
Changes in operating assets and liabilities:		
Accounts receivable	271,207	2,272,140
Other deposits and receivables	7,980	(54,496)
Instant ticket game inventory	172,677	703,759
Accounts payable and accrued liabilities	588,227	(457,562)
Unearned revenues	(12,698)	(2,818)
OPEB liability	16,483	-
Prize liability	174,556	263,647
Net cash provided by operating activities	<u>\$ 74,597,722</u>	<u>\$ 74,958,741</u>
Noncash capital and related financing activities:		
KPERS contribution on behalf of Lottery by State	<u>\$ -</u>	<u>\$ 962,991</u>

**KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF NET POSITION - EXPANDED LOTTERY
JUNE 30, 2018 AND 2017**

	Expanded Lottery	
	2018	2017
<u>ASSETS</u>		
Current Assets:		
Cash:		
Operating fund	\$ 2,401,483	\$ 2,595,329
Other receivable	4,147,701	2,671,117
	6,549,184	5,266,446
Total current assets		
	6,549,184	5,266,446
Total assets	6,549,184	5,266,446
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 6,549,184	\$ 5,266,446
	6,549,184	5,266,446
Total current liabilities	6,549,184	5,266,446
<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, 2018 AND 2017

	Expanded Lottery	
	2018	2017
Operating revenues:		
Expanded lottery revenues	\$ 404,508,001	\$ 371,117,198
Expanded lottery reimbursements	3,767,828	3,774,908
Total operating revenues	408,275,829	374,892,106
Operating expenses:		
Casino operator management fee	295,290,841	270,915,554
Central gaming systems	2,196,628	2,095,023
Salaries and benefits	1,281,129	1,303,046
Other administrative expenses	259,799	316,915
Professional services	19,099	52,183
Telecommunications	11,173	7,741
Total operating expenses	299,058,669	274,690,462
Operating income	109,217,160	100,201,644
Nonoperating revenues (expenses):		
Transfers to the State General Fund	(88,991,760)	(81,645,784)
Transfers to the Problem Gambling Fund	(8,090,161)	(7,422,344)
Distribution to City and County governments	(12,135,239)	(11,133,516)
Total nonoperating revenues (expenses)	(109,217,160)	(100,201,644)
Change in net position	-	-
Net position, beginning of year	-	-
Net position, end of year	\$ -	\$ -

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF CASH FLOWS - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2018 AND 2017

	Expanded Lottery	
	2018	2017
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 406,799,245	\$ 373,950,340
Cash paid for prizes, commissions, and other expenses	(296,494,802)	(271,728,750)
Cash paid to employees	(1,281,129)	(1,303,046)
Net cash provided by operating activities	109,023,314	100,918,544
Cash flows from noncapital financing activities:		
Payments to State General Fund	(88,991,760)	(81,645,784)
Payments to State Problem Gambling Fund	(8,090,161)	(7,422,344)
Payments to City and County governments	(12,135,239)	(11,133,516)
Net cash used by noncapital financing activities	(109,217,160)	(100,201,644)
Net increase (decrease) in cash	(193,846)	716,900
Cash, beginning of year	2,595,329	1,878,429
Cash, end of year	\$ 2,401,483	\$ 2,595,329
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 109,217,160	\$ 100,201,644
Adjustments to reconcile operating income to net cash provided by operating activities:		
Changes in operating assets and liabilities:		
Other receivable	(1,476,584)	(941,766)
Accounts payable and accrued liabilities	1,282,738	1,658,666
Net cash provided by operating activities	\$ 109,023,314	\$ 100,918,544

**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, 2018, 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 26, 2018.

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 26, 2018

KANSAS LOTTERY
A COMPONENT UNIT OF THE STATE OF KANSAS

SCHEDULE OF FINDINGS AND RESPONSES
For The Year Ended June 30, 2018

None