

This audit was conducted by Cochran Head Vick & Co., P.A., under contract with the Legislative Division of Post Audit. Julie Pennington was the audit manager. If you need any additional information about the audit's findings, please contact her at the Division's offices.

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

Financial and Compliance Audit
Years Ended June 30, 2011 and 2010

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

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

INTRODUCTION

Year Ended June 30, 2011

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, 2011.

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

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Year Ended June 30, 2011

A. SUMMARY OF AUDIT RESULTS

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

B. FINDINGS – FINANCIAL STATEMENT AUDIT

See Schedule of Findings and Responses

C. PRIOR YEAR FINDINGS

See Schedule of Prior Year Findings and Responses



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INDEPENDENT AUDITORS' REPORT

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the accompanying financial statements of the Kansas Lottery (the Lottery), a component unit of the State of Kansas, as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit

We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Kansas Lottery and do not purport to, and do not, present fairly the financial position of the State of Kansas as of June 30, 2011, and the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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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, 2011 and 2010, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2011, on our consideration of the Lottery's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and the schedule of funding progress as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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.

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

October 28, 2011



**KANSAS LOTTERY
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010**

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, 2011 and 2010. We encourage readers to consider this information in conjunction with the Lottery's financial statements and notes, which follow the MD&A. The financial statements reflect only the activities of the Kansas Lottery, which is a component unit of the State of Kansas.

Fiscal Year Financial Highlights

- Online and instant Lottery sales for fiscal year 2011 were \$232.4 million reflecting a decrease of \$3.0 million or 1.3% compared to fiscal year 2010.
- The State's first casino, the Boot Hill Casino and Resort was in operations for the full fiscal year, having opened in December 2009. The Lottery is responsible for distributing the net revenues of the casino in accordance with the Expanded Lottery Act. For 2011, Expanded Lottery net revenues totaled \$40.1 million. Transfers totaling \$8.8 million from Expanded Lottery activities were made to the State General Fund. An increase of \$4.3 million over the prior fiscal year.
- Transfers to the State Gaming Revenue Fund (SGRF) totaled \$71.5 million in 2011, an increase of \$3.7 million over 2010.

Using this Financial Report

This report consists of a series of financial statements and reflects the self-supporting activities of the Kansas Lottery. The Balance Sheets provide information about the Lottery's assets and liabilities and reflects the Lottery's financial position as of June 30, 2011 and 2010. The Statement of Revenues, Expenses, and Changes in Net Assets report the activities of selling online and instant lottery tickets for the 12 month periods ended June 30, 2011 and 2010 as well as the Expanded Lottery casino gaming activities for the 12 months ended June 30, 2011 and the 7 months ended June 30, 2010. Lastly, the Statements of Cash Flows reflect the cash inflows and outflows attributed to the sales of lottery tickets for the same 12 month periods, as well as the cash inflows and outflows of the Expanded Lottery casino activity for the 12 months ended June 30, 2011 and the 7 months ended June 30, 2010.

Summary of Balance Sheets

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

	2011	2010	2009
Current and other assets	\$ 18.2	\$ 18.0	\$ 15.8
Capital assets	6.2	8.3	0.5
Total assets	<u>\$ 24.4</u>	<u>\$ 26.3</u>	<u>\$ 16.3</u>
Current liabilities	<u>\$ 15.8</u>	<u>\$ 12.4</u>	<u>\$ 13.2</u>
Net assets			
Invested in capital assets	6.2	8.3	0.5
Unrestricted	2.4	5.6	2.6
Total net assets	<u>8.6</u>	<u>13.9</u>	<u>3.1</u>
Total liabilities and net assets	<u>\$ 24.4</u>	<u>\$ 26.3</u>	<u>\$ 16.3</u>

Current and other assets consist primarily of cash balances for operations, expanded lottery and prizes, accounts receivable from Lottery retailers for lottery ticket sales activity, and instant ticket inventory. During fiscal year 2011, current and other assets increased \$0.2 million due to an increase in accounts receivable of \$0.6 million and a decrease in instant ticket inventory of \$0.3 million.

For fiscal year 2010, current and other assets increased \$2.2 million due to an increase in cash balances of \$1.5 million of which \$0.7 million is attributable to the Expanded Lottery and an increase in accounts receivable of \$0.7 million over the prior year.

Capital assets decreased \$2.1 million from 2011 as a result of recording depreciation on contributed capital assets related to Expanded Lottery activities. Additional detailed information on capital assets may be found in notes 1 and 3 of the notes to the financial statements.

Current liabilities consist of accounts payable and accrued liabilities, transfers due to the State of Kansas, and prize liabilities. The increase in current liabilities from 2010 is attributable to an increase in amounts due to the State of Kansas of \$1.5 million, and increases in prize liability of \$2.2 million, and a decrease of \$0.4 million in accounts payable and accrued liabilities from 2010.

For fiscal year 2010, the current liabilities decrease of \$0.8 million from 2009 is attributable to a decrease in amounts due to the State of Kansas of \$1.2 million which offset increases in accounts payable and accrued liabilities from 2009.

Summary of Revenue, Expenses, and Changes in Net Assets

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenues:			
Net Lottery game revenues	\$ 232.4	\$ 235.4	\$ 230.5
Expanded lottery net revenues	40.1	20.7	-
Reimbursements and other	2.3	2.4	1.6
Total operating revenues	<u>274.8</u>	<u>258.5</u>	<u>232.1</u>
Operating expenses:			
Lottery	165.2	166.0	165.0
Expanded lottery	33.8	17.9	-
Total operating expenses	<u>199.0</u>	<u>183.9</u>	<u>165.0</u>
Operating income	<u>75.8</u>	<u>74.6</u>	<u>67.1</u>
Non-operating revenues (expenses):			
Lottery	(71.5)	(67.9)	(68.2)
Expanded lottery	(9.6)	(5.0)	-
Total non-operating revenues (expenses)	<u>(81.1)</u>	<u>(72.9)</u>	<u>(68.2)</u>
Income (loss) before contributions	(5.3)	1.7	(1.1)
Capital contributions	<u>-</u>	<u>9.1</u>	<u>-</u>
Change in net assets	(5.3)	10.8	(1.1)
Net assets, beginning of year	<u>13.9</u>	<u>3.1</u>	<u>4.2</u>
Net assets, end of year	<u>\$ 8.6</u>	<u>\$ 13.9</u>	<u>\$ 3.1</u>

The change in net assets between fiscal year 2011 and fiscal year 2010 represents a decrease of \$5.3 million. The decrease is the result of the decrease in sales revenue in excess of corresponding increases in operating expenses, as well as an increase in contribution to the State Gaming Revenue Fund.

The change in net assets between fiscal year 2010 and fiscal year 2009 was an increase of \$10.8 million. The increase is the result of the increase in sales revenue in excess of increases in operating expenses, as well as capital assets contributions related to Expanded Lottery activities.

Lottery Game Revenues

Presented in millions of dollars, the following table compares online and instant Lottery sales by game type between fiscal years 2011 and 2010:

Type of Game	2011	2010	Increase (Decrease)	Percentage Change
Instant	\$ 118.6	\$ 114.5	\$ 4.1	3.6%
Pull-Tabs	8.1	9.6	(1.5)	-15.6%
Powerball	32.6	41.0	(8.4)	-20.5%
Mega Millions	11.4	3.9	7.5	192.3%
2 by 2	1.8	1.7	0.1	5.9%
Super Kansas Cash	14.9	14.8	0.1	0.7%
Keno	24.0	26.6	(2.6)	-9.8%
Pick 3	5.8	6.1	(0.3)	-4.9%
Holiday Raffle	3.0	3.0	-	0.0%
Hot Lotto	8.8	10.7	(1.9)	-17.8%
Kansas Hold'Em	3.4	3.5	(0.1)	-2.9%
Total	<u>\$ 232.4</u>	<u>\$ 235.4</u>	<u>\$ (3.0)</u>	<u>1.3%</u>

Fiscal year 2011 sales were \$232.4 million compared to \$235.4 million in fiscal year 2010. Revenues from the sales on online and instant lottery tickets for the fiscal year ended June 30, 2011 decreased 1.3% or \$3.0 million compared to the previous year. A decrease of \$8.4 million in Powerball sales was offset by an increase of \$7.5 million for Mega Millions, which was its first full year of sales in Kansas.

Presented in millions of dollars, the following table compares online and instant Lottery sales by game types between fiscal years 2010 and 2009:

Type of Game	2010	2009	Increase (Decrease)	Percentage Change
Instant	\$ 114.5	\$ 115.7	\$ (1.2)	-1.0%
Pull-Tabs	9.6	8.8	0.8	9.1%
Powerball	41.0	40.0	1.0	2.5%
Mega Millions	3.9	-	3.9	0.0%
2 by 2	1.7	1.7	-	0.0%
Super Kansas Cash	14.8	14.8	-	0.0%
Keno	26.6	28.4	(1.8)	-6.3%
Pick 3	6.1	6.0	0.1	1.7%
Holiday Raffle	3.0	-	3.0	0.0%
Hot Lotto	10.7	10.7	-	0.0%
Kansas Hold'Em	3.5	4.4	(0.9)	-20.5%
Total	<u>\$ 235.4</u>	<u>\$ 230.5</u>	<u>\$ 4.9</u>	<u>2.1%</u>

Revenues from the sale of online and instant lottery tickets for the fiscal year ended June 30, 2010 increased by 2.1% or \$4.9 million compared to the previous year. Fiscal year 2010 sales were \$235.4 million compared to \$230.5 million in fiscal year 2009. Two new online games were added during the fiscal year 2010 including the Mega Millions (a MUSL game) with \$3.9 million in sales, and the Holiday Raffle game as a sell-out of \$3.0 million. Powerball had increased sale of \$1.0 million while Super Kansas Cash, Pick 3, and 2 by 2 had minor increases. Instant sales decreased \$1.2 million from 2009. Increases in overall sales were accomplished by providing new games to the public as well as entering into partnerships with Bass Pro Shops, Cabels's, Buick LaCross, Kansas speedway, Kansas State Fair, the 3i Show, and other businesses, in special games promotions. Pulltab sales had an increase of \$0.8 million. A third series of the Mid-West Millions with the State of Iowa was successfully completed. Increases in these games were offset by decreases in Keno of \$1.8 million and Kansas Hold 'Em of \$0.9 million, respectively.

Lottery Expenses

Game Related

The following table compares the Lottery's game-related expenses between fiscal year 2011 and fiscal year 2010. The expenses are shown in millions of dollars:

Description	2011	2010	Increase (Decrease)	Percentage Change
Game Prizes	\$ 132.3	\$ 132.6	\$ (0.3)	-0.2%
Retailer commissions	13.8	13.7	0.1	0.7%
Online Games Service Bureau	5.3	5.6	(0.3)	-5.4%
Instant Ticket Printing Cost	3.8	3.8	-	0.0%
Total	<u>\$ 155.2</u>	<u>\$ 155.7</u>	<u>\$ (0.5)</u>	<u>-0.3%</u>

The overall decrease in game prizes was the result of the decrease in sales compared to those in fiscal year 2011. The online games service bureau cost decreased as a result of less online sales.

Non-game Related

Of the \$10.0 million of fiscal year 2011 lottery operating expenses that were non-game related, \$4.6 million was for employees' salaries and wages, \$2.9 was spent for games and promotional advertising, and other administrative expenses accounted for \$2.5 million. In fiscal year 2010, these same expenses totaled \$10.3 including \$4.4 million for employees' salaries and wages, \$2.9 million for games and promotional advertising, and \$3.0 million for other administrative expenses.

The following table compares the lottery game-related expenses between fiscal year 2010 and fiscal year 2009. The expenses are shown in millions of dollars:

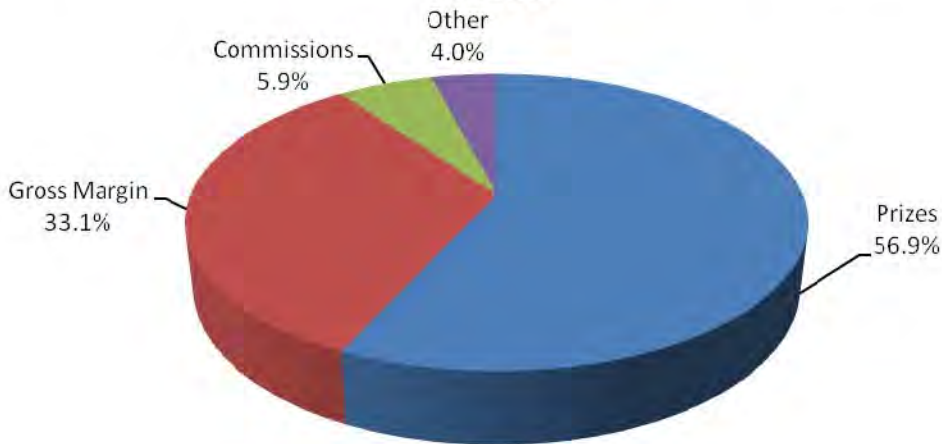
Description	2011	2010	Increase (Decrease)	Percentage Change
Game Prizes	\$ 132.6	\$ 130.9	\$ 1.7	1.3%
Retailer commissions	13.7	13.5	0.2	1.5%
Online Games Service bureau	5.6	5.3	0.3	5.7%
Instant Ticket Printing Costs	3.8	4.8	(1.0)	-20.8%
	<u>\$ 155.7</u>	<u>\$ 154.5</u>	<u>\$ 1.2</u>	<u>0.8%</u>

The overall increase in game prizes was the result of the increase in sales compared to those of fiscal year 2009. The online games service bureau cost increased as a result of more online sales. Instant ticket printing cost for fiscal year 2010 decreased due to the relative cost per ticket being less for the games issued during the year.

Of the \$10.3 million of fiscal year 2010 lottery operating expenses that were not game-related, \$4.4 million, was for employee's salaries and wages, \$2.9 million was spent for games and promotional advertising, and other administrative expenses accounted for \$3.0 million. In fiscal year 2009, these games expenses totaled \$10.5 million including \$4.2 million for employee's salaries and wages \$3.3 million for games and promotional advertising, and \$3.0 million for other administrative expenses.

Kansas Lottery
 Graphs of Financial Highlights
 For the Fiscal Year Ended June 30, 2011

Game Related Expense as a Percent of Lottery Sales



To depict compliance with the not less than 45% prize payment statute and the retailers' commissions rules.

Expenses by Type



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

Transfer to the State Gaming Revenues Fund and State General Fund

Pursuant to the Lottery Act, the Director of Accounts and Reports of the State of Kansas shall transfer monies in the Lottery Operating Fund to the State Gaming Revenue Fund (SGRF), at least monthly, in the amount equal to the monies in such fund in excess of those needed for payment of Lottery expenses, payment of compensation to retailers and transfers to the Prize Payment Fund as certified by the Execution 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 2011, the legislature again waived the percentage of sales transfer requirement for a minimum transfer of \$70 million originally with a minimum monthly transfer of \$4.5 million. For 2011, transfers to the SGRF were \$71.5 million an increase of \$3.7 million over 2010. The fiscal year 2010 transfer of \$67.8 was \$0.5 million more than the fiscal year 2009.

Expanded Lottery

The 2007 Legislature passed Senate Bill 66, the Expanded Lottery Act. The Act provides for the Kansas Lottery to own and operate electronic gaming machines at County voter approved Kansas horse and dog racetracks. Currently there are no active horse or dog racetracks in the State. The Expanded Lottery Act also allows for the Lottery, upon County voter approval, to operate lottery gaming facilities in four specific gaming zones. The Expanded Lottery Act establishes the distribution requirement of net gaming revenues.

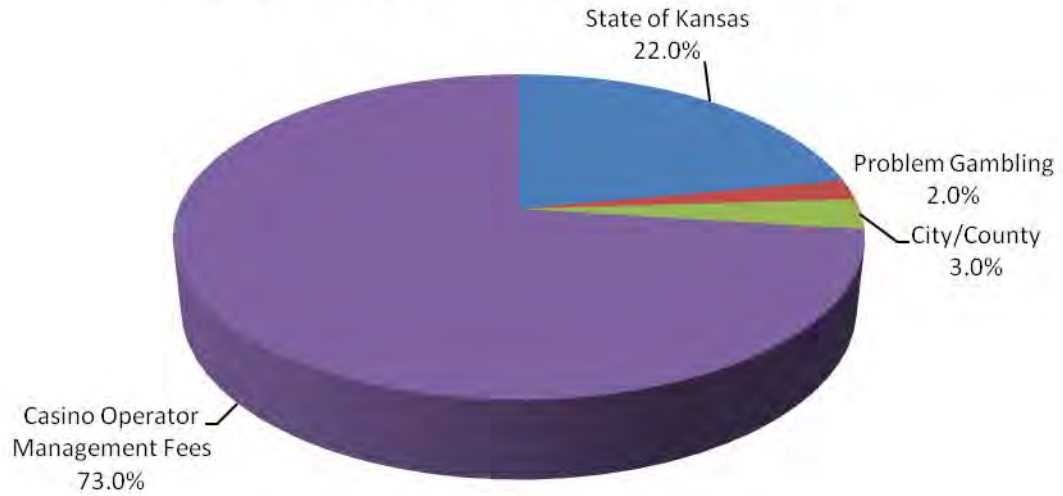
Expanded Lottery Revenues and Expenses

The Boot Hill Casino and Resort represents the State's first casino which opened Mid-December 2009. The net revenue and related expenses are as follows (shown in millions of dollars):

	<u>2011 *</u>	<u>2010 *</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
Net Revenue	<u>\$ 40.1</u>	<u>\$ 20.7</u>	<u>\$ 19.4</u>	<u>93.7%</u>
Expenses:				
State of Kansas	8.8	4.6	4.2	91.3%
Problem Gambling	0.8	0.4	0.4	100.0%
City and County	1.2	0.6	0.6	100.0%
Management Fees	<u>29.3</u>	<u>15.1</u>	<u>14.2</u>	<u>94.0%</u>
Total	<u>\$ 40.1</u>	<u>\$ 20.7</u>	<u>\$ 19.4</u>	<u>93.7%</u>

* - The net revenue for 2010 reflects operations for 7 months of operations. The net revenue for 2011 is for the fiscal year ended June 30, 2011.

Expanded Lottery Distributions



To depict the distribution of net revenue as set forth in the 2007 Legislature enacting the Expanded Lottery Act.

Contacting the Lottery's Financial Management

This management's discussion and analysis report is designed to provide Kansas citizens, Kansas government officials, players, retailer and other interested parties with a general overview of the Lottery's financial activity for the fiscal years ended June 30, 2011 and 2010 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 Carolyn Brock, Director of Finance or Wayne Regnier, Fiscal Manager at 128 N Kansas Avenue, Topeka, KS 66603.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
BALANCE SHEETS
JUNE 30, 2011 and 2010

<u>ASSETS</u>	2011	2010
Current Assets:		
Cash:		
Operating fund	\$ 6,151,008	\$ 5,533,496
Prize payment fund	167,052	895,529
Accounts receivable, net of allowance for doubtful accounts of \$349,123 and \$618,583 at 2011 and 2010, respectively	3,869,022	3,507,672
Accounts receivable - unbilled	5,935,433	5,897,136
Other receivable	364,100	153,378
Instant ticket game inventory	1,730,739	2,014,378
Total current assets	18,217,354	18,001,589
Capital assets, net of depreciation:		
Property and equipment - Lottery	385,479	442,494
Property and equipment - Expanded Lottery	5,786,413	7,889,090
Total capital assets	6,171,892	8,331,584
Total assets	\$ 24,389,246	\$ 26,333,173
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 2,092,741	\$ 2,481,796
Due to the State of Kansas	6,090,202	4,562,056
Due to Problem Gambling Fund	8,200	5,641
Prize liability	7,587,466	5,358,996
Total current liabilities	15,778,609	12,408,489
Net assets:		
Invested in capital assets	385,479	442,494
Invested in capital assets - restricted	5,786,413	7,889,090
Unrestricted	2,438,745	5,593,100
Total net assets	8,610,637	13,924,684
Total liabilities and net assets	\$ 24,389,246	\$ 26,333,173

See accompanying notes to financial statements.

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Net game revenues	\$ 232,372,510	\$ 235,414,168
Expanded lottery revenues	40,055,280	20,663,987
Expanded lottery reimbursements	1,282,191	983,472
Phone reimbursements	947,390	951,265
Retailer fees and miscellaneous income	139,773	481,220
	<u>274,797,144</u>	<u>258,494,112</u>
Operating expenses:		
Game prizes	132,332,017	132,609,974
Casino operator management fee	29,240,354	15,084,710
Retailer commissions	13,783,253	13,670,875
On-line games service bureau	5,299,915	5,611,400
Salaries and benefits	5,098,242	4,872,223
Cost of instant tickets	3,761,082	3,819,565
Advertising	2,867,437	2,935,830
Other administrative expenses	1,999,348	2,662,389
Depreciation	2,254,972	1,348,980
City and County expanded lottery fees	1,201,658	619,920
Professional services	480,216	310,282
On-line service bureau - expanded lottery	403,683	212,094
Telecommunications	265,205	183,950
	<u>198,987,382</u>	<u>183,942,192</u>
Operating income	<u>75,809,762</u>	<u>74,551,920</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(71,500,000)	(67,750,000)
Transfers to the State General Fund	(8,822,703)	(4,572,975)
Transfers to the Problem Gambling Fund	(801,106)	(413,280)
Write-off and adjustment of capital assets	-	(137,756)
	<u>(81,123,809)</u>	<u>(72,874,011)</u>
Income (loss) before contributions	(5,314,047)	1,677,909
Capital contributions	-	9,115,652
Change in net assets	(5,314,047)	10,793,561
Net assets, beginning of year	<u>13,924,684</u>	<u>3,131,123</u>
Net assets, end of year	<u>\$ 8,610,637</u>	<u>\$ 13,924,684</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, 2011 AND 2010

	2011	2010
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 274,186,775	\$ 257,809,117
Cash paid for prizes, commissions, and other expenses	(189,511,114)	(177,287,265)
Cash paid to employees	(5,098,242)	(4,872,223)
Net cash provided by operating activities	79,577,419	75,649,629
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(70,000,000)	(69,000,000)
Payments to State General Fund	(8,794,557)	(4,510,919)
Payments to State Problem Gambling Fund	(798,547)	(407,639)
Net cash used by noncapital financing activities	(79,593,104)	(73,918,558)
Cash flows from capital and related financing activities:		
Purchases of capital assets	(95,280)	(237,926)
Net cash used by capital and related financing activities	(95,280)	(237,926)
Net increase (decrease) in cash	(110,965)	1,493,145
Cash, beginning of year	6,429,025	4,935,880
Cash, end of year	\$ 6,318,060	\$ 6,429,025
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 75,809,762	\$ 74,551,920
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,254,972	1,348,980
Changes in operating assets and liabilities:		
Accounts receivable	(480,988)	(744,193)
Other receivable	(129,381)	59,198
Instant ticket game inventory	283,639	(6,111)
Accounts payable and accrued liabilities	(389,055)	875,077
Prize liability	2,228,470	(435,242)
Net cash provided by operating activities	\$ 79,577,419	\$ 75,649,629
Noncash capital and related financing activities:		
Contributed capital assets	\$ -	\$ 9,115,652

See accompanying notes to financial statements.

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1 - Summary of Significant Account Policies

Reporting Entity

In November 1986, a constitutional amendment was approved by the Kansas voters authorizing a State Lottery. During the 1987 Legislative session, the State Legislature adopted the Lottery Act (the Act), and created the Kansas Lottery (the Lottery) as an independent component unit of the State of Kansas to operate lottery games. The 2007 Legislative session continued the Lottery until July 1, 2022. The Kansas Lottery Act abolishes the Lottery on July 1, 2022 unless the Legislature reaches an affirmative vote to continue the Lottery.

The Lottery was organized on March 19, 1987 and commenced administrative operations on May 21, 1987 but was strictly in the development stage through fiscal year 1987. Instant win tickets games began November 12, 1987. On February 2, 1988, the Lottery began participating in Lotto America, a multi-state on-line game now called Powerball. Additional games offered by the Lottery include Mega Millions, Kansas Cash, Keno, Pick 3, 2 by 2, Hot Lotto, Kansas Hold 'Em, Raffle, and Pull Tabs.

The 2007 Legislature passed Senate Bill 66, the 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 facilities in the northeast and the south central gaming zones are in the construction stage at June 30, 2011.

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. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed by the Lottery to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Lottery has elected not to follow subsequent private-sector guidance.

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Basic of Accounting

The financial statements of the Lottery have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of accounting refers to when revenues, expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Measurement focus refers to what is being measured. The financial statements of the proprietary funds are prepared on the accrual basis of accounting and on an economic resources measurement focus in accordance with GAAP.

The Lottery distinguishes operating revenue and expenses from non operating items. The principal revenue of the Lottery is primarily comprised of sales from instant and on-line tickets, and expanded lottery casino gaming revenues. Operating expenses mainly consist of payments to prize winners, commissions to retailer agents, expanded lottery, and payments to vendors and employees.

Revenue Recognition

Lottery Games

Lottery games are sold to the public by contracted retailers. The Lottery utilizes an on-line instant ticket validation system. This system utilizes a bar code system to activate and validate instant win tickets which are consigned to retailers. The activated and unsettled instant win ticket packets are reflected in revenues in the current period and are carried on the balance sheet as accounts receivable-unbilled. Consigned instant win and pull tab ticket packets at the retailer that have not been activated are reflected on the financial statements in ticket inventory at original cost.

Certain instant ticket games include tickets which entitle the holder to exchange the ticket for another ticket ("free ticket"). Such tickets are deemed to be replacements and, therefore, are not included in sales. On-line game revenue is recognized in the period in which tickets are sold.

Expanded Lottery

Electronic-game slots and table games net revenue is the amounts played less amounts paid to players. The net gaming revenue is recognized based upon the gaming date.

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Retailer commissions

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

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

Retailer Fees

Licensed retailers are charged a one-time fee 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 2011 and 2010 were \$1,282,191 and \$983,472, respectively.

Accounts Receivable

Accounts receivable represent amounts to be collected from retailers and casino management companies and are shown net of an allowance for doubtful accounts. The allowance for doubtful accounts is based on an analysis of accounts receivable, which considers the age of the accounts and current economic conditions. Generally accounts greater than 60 days old are included in the allowance for doubtful accounts.

Instant Ticket Game Inventory

Instant ticket game inventory consists of tickets stored in the main warehouse and consigned tickets at the retailers. Inventories are carried at cost based on the specific identification method. Tickets are charged to expense when activated by a licensed retailer. Unsold tickets are charged to expense at the end of each instant ticket game.

Kansas Lottery
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Capital Assets

Lottery

Capital assets, which include property and equipment, are defined by the State of Kansas as assets with an initial, individual cost of more than \$5,000. Such assets are recorded at historical cost or at fair value if donated. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized. Depreciation is computed on the straight-line basis using estimated useful lives of three to five years for lottery activities.

Expanded Lottery

In accordance with Kansas Statutes and the gaming facility management agreement, the facility manager must purchase or lease on behalf of the State of Kansas, for the Kansas Lottery, all facility games and other related gaming equipment. Accordingly, certain equipment agreements considered to qualify as a purchase of such equipment have been recorded at the fair value of the equipment at the date of the agreement as a capital contribution from the manager and a capital asset of the Lottery. As discussed in Note 4, if the Expanded Lottery Gaming Facility Management Agreement is terminated, the ownership of such equipment will be transferred to the facility manager. For the years ended June 30, 2011 and June 30 2010, the amount of expanded lottery equipment contributed to the Lottery was \$0 and \$9,115,652, respectively. Depreciation is computed using the straight-line depreciation method using the estimated useful lives of three to five years.

Certain other equipment agreements qualify as short-term operating leases that carry month-to-month rental terms beyond the initial term of the lease. Rent payments paid by the facility manager on behalf of the Lottery were approximately \$775,000 for the year ended June 30, 2011, and approximately \$400,000 for the year ended June 30, 2010.

Real estate

Additionally, the 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.

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

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

Prize expense for on-line games is recorded based on ticket sales. Prizes which are not claimed within one year after the drawing remain in the prize pool, and future prizes will be increased accordingly through special prize promotions.

Compensated Absences

Under the terms of the Lottery's personnel policy, employees are granted vacation and sick leave in varying amounts based upon length of service. In the event of termination or separation, an employee is generally paid for accumulated vacation up to 144 hours for service less than five years; 176 hours for service between five and ten years; 208 hours for service between ten and fifteen years; and 240 hours if service exceeds fifteen years (K.A.R.1-9-4). Accordingly, it is the Lottery's policy to record vacation pay as an expense as it is earned. The amount of earned but unused accumulated vacation is included as an accrued liability in the accompanying financial statements.

Retiring employees are paid a portion of their accumulated sick leave in excess of 100 or more days, depending upon the total number of accumulated days and years of service. The minimum payable is 30 days, and the maximum is limited to 60 days. The amount of earned but unused accumulated sick leave is paid from the State Leave Payment Reserve fund to which the Lottery makes payroll contributions.

Budget

The Lottery prepares an annual budget of expenses which is approved by the State Legislature of Kansas. Any changes in the budget must also be approved by the State Legislature. Such budgets are adopted on a cash plus encumbrance basis, which differs from accounting principles generally accepted in the United States of America. Encumbrances represent commitments relating to unperformed contracts for goods or services. All budgeted, unencumbered funds lapse at fiscal year-end.

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The operating and cost of sales (COS) expenses are currently on a no-limit basis, with the exception of official hospitality line items. The no-limit allows the budget to be prepared to reflect the operating and COS requirements of increasing sales and doing business as a lottery. The prize fund has a no-limit appropriation allowing the flexibility needed for paying winners' claims. Each year the current year budget is revised and the next year's budget is prepared. The completed budget document is submitted to the Department of Budget, and must have the approval of the Governor and Legislature.

Statement of Cash Flows

For purposes of the statement of cash flows, cash includes cash on hand, in banks, and amounts deposited with the Treasurer of the State of Kansas.

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

Certain reclassifications have been made to the 2010 financial statements to conform to the 2011 financial statement presentation. These reclassifications had no effect on net assets or changes in net assets.

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. Earning on investments are retained by the State of Kansas. At June 30, 2011 and 2010, the Lottery's share in the State's common cash pool was \$6,198,041 and \$6,283,284 respectively.

Kansas Lottery
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3 - Capital Assets

Property and equipment consisted of the following at June 30, 2011:

	Beginning Balances	Increases	Decreases	Ending Balances
Lottery:				
Equipment, furnishing and software	\$ 1,316,649	\$ 32,639	\$ 74,330	\$ 1,274,958
Vehicles	664,651	63,592	41,628	686,615
Total Lottery capital assets	<u>1,981,300</u>	<u>96,231</u>	<u>115,958</u>	<u>1,961,573</u>
Accumulated depreciatiion	<u>(1,538,806)</u>	<u>(152,295)</u>	<u>115,007</u>	<u>(1,576,094)</u>
Lottery capital assets, net of depreciation	<u>442,494</u>			<u>385,479</u>
Expanded Lottery:				
Expanded Lottery equipment	9,115,652	-	-	9,115,652
Accumulated depreciation	<u>(1,226,562)</u>	<u>(2,102,677)</u>	-	<u>(3,329,239)</u>
Expanded Lottery capital assets, net of depreciation	<u>7,889,090</u>			<u>5,786,413</u>
Total capital assets, net of depreciation	<u>\$ 8,331,584</u>			<u>\$ 6,171,892</u>

4 - Commitments

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

2012	\$ 644,049
2013	659,161
2014	675,479
2015	671,796
2016	684,717
2017-2021	3,692,517
2022-2023	<u>1,203,845</u>
	<u>\$ 8,231,564</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 \$665,690 and \$557,999 under operating leases for the years ended June 30, 2011 and 2010, respectively.

The Lottery has contracted with a service bureau which provides computer services for on-line games and instant-win validation. The contract provides that the Lottery pay a fee of net on-line sales to the service bureau, and the duration of the current contract is through June 30, 2018. Fees were \$5,299,915 and \$5,611,400 for the years ended June 30, 2011 and 2010, respectively. Future fees are based on 4.9999 percent of net on-line sales.

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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 \$403,683 and \$212,094 for the years ended June 30, 2011 and 2010, 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.

Expanded Lottery Gaming Facility Management Agreements

Southwest Gaming Zone

In 2008, the Lottery entered into a facility management agreement (the agreement) with a third party to develop, construct, and manage the lottery casino gaming facility in the southwest gaming zone, the gaming business of which is owned and operated by the Lottery. The agreement will terminate 15 years after the commencement date, as defined in the agreement, or by operation of law, unless the agreement is terminated earlier, renegotiated or renewed. The agreement also contains provisions in which the facility manager, based on meeting certain performance levels, may owe a net incentive payment to the State of Kansas. 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 purchase land and constructed the building used for the purposes of the casino. As discussed in Note 1, casino gaming equipment was contributed to and is owned by the Lottery.

The facility manager is compensated for their managing the operations of the casino by receiving 73% of the lottery gaming facility net revenue, defined as amounts played less amounts paid to players, as a casino operator management fee (fee). For the year ended June 30, 2011 and 2010, the fee was \$29,240,354 and \$15,084,710 as is recorded in the statements of revenues, expenses, and changes in net assets.

Northeast Gaming Zone

In 2009, the Lottery entered into a facility management agreement (northeast gaming zone agreement) with a third party to develop, construct, and manage the lottery casino gaming facility in the northeast gaming zone. The terms of the northeast gaming zone agreement are similar in nature to the terms of the agreement that the Lottery entered into related to the southwest gaming zone described above. The casino gaming facility in the northeast gaming zone was in the construction stage at June 30, 2011.

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South Central Gaming Zone

In 2011, the Lottery entered into a facility management agreement (south central gaming zone agreement) with a third party to develop, construct, and manage the lottery casino gaming facility in the south central gaming zone. The terms of the south central gaming zone agreement are similar in nature to the terms of the agreement that the Lottery entered into related to the other two gaming zones described above. The casino gaming facility in the south central gaming zone was in the construction stage at June 30, 2011.

5 - Contingencies

Zero Coupon Bonds

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

Prior to 1998, MUSL had purchased zero coupon bonds for the Lottery to fund future installment payment aggregating \$224,979,000. The total purchase price of these bonds was \$117,288,823. During fiscal year 2001, a cash out option was offered to these prize winners as a result of Congressional changes in the United States Internal Revenue Code of 1986, as amended, specifically Section 451(h). These cash out options were taken by six prize winners in the amount of approximately \$43,500,000. Total future installment outstanding at June 30, 2011 and 2010 are \$6,939,000 and \$8,746,000, respectively.

MUSL Prize Reserves

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

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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. KPERs provides retirement benefits, life insurance, disability income benefits, and death benefits, Kansas law establishes and amends benefits provisions. KPERs issues a publicly available financial report that includes financial statements and required supplementary information. This report may be obtained by writing to KPERs (611 S. Kansas Avenue, Suite 100, Topeka, KS 66603-3803) or by calling 1-800-228-0366.

Funding policy

K.S.A 74-4919 establishes the KPERs member-employee contribution rate at four and six percent of covered salary for Tier 1 and Tier 2 employees, respectively. Effective July 1, 2009 KPERs became a two tier plan with immediate participation. Tier 1 is the active members hired before July 1, 2009 under the original statute, and Tier 2 employees are hired on or after July 1, 2009. The employer collects and remits member-employee contributions according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rate be determined annually based on the results of an annual actuarial valuation. KPERs is funded on an actuarial reserve basis. State law sets a limitation on annual increases in the contribution rates for KPERs employers. The employer rates established by statute for calendar years 2011 and 2010 are 8.17 and 7.57 percent, respectively. The Lottery contributions to KPERs for the years ending June 30, 2011, 2010 and 2009, were approximately \$327,760, \$284,000, and \$277,000, respectively, equal to 100% of the statutorily required contributions for each year.

10 - Other Postemployment Healthcare Benefits

Description

Kansas statutes provide that postemployment healthcare benefits be extended to retired employees who have met age and/or service eligibility requirements. The health insurance benefit generally provides the same coverage for retirees and their dependents as for active employees and their dependents. The health insurance benefit plan is a single employer defined benefit plan administered by Kansas Health Policy Authority. The benefit is available for selection at retirement and is extended to retirees and their dependents for life. Non-Medicare participants are subsidized by the State, thus resulting in a liability to the State. The accounting for the health insurance for retirees is included in the State's Self-insurance Health fund, with the subsidy provided from the Self-Insurance Health fund. The Plan does not issue a stand-alone financial report.

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Funding Policy

The State provides health insurance benefits to retirees and their dependents in accordance with Kansas law (K.S.A. 75-6511). Kansas statutes, which may be amended by the state legislature, established that participating retirees contribute to the employee group health fund benefits plan, including administrative costs. The State appropriates funds annually for the costs associated with this retirement benefit and provides funding for the expenditure on a pay-as-you-go basis through the Self-Insurance Fund. In fiscal years 2011 and 2010, the Lottery did not contribute to the plan.

Annual OPEB Cost and Net OPEB Obligation

The Lottery's annual Other Post Employment Benefits (OPEB) cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities over a period of not to exceed thirty years. The following table presents the components of the Lottery's annual OPEB cost for the year, the contributions to the plan, and changes in the Lottery's net OPEB obligation.

Annual required Contribution (ARC)	\$ 73,130
Interest in the net OPEB obligation	7,853
Adjustment to the ARC	<u>(11,582)</u>
Annual OPEB cost (expense)	69,401
Net Employer contributions	<u>-</u>
Increase in net OPEB obligation	69,401
Net OPEB obligation, beginning of year	<u>203,970</u>
Net OPEB obligation, end of year	<u><u>\$ 273,371</u></u>

	Fiscal Year	Annual OPEB Cost	Net Employer Contributions	Percentage Contributed	End of Year Net OPEB Obligation
Kansas Lottery	2009	\$ 60,595	\$ -	0%	\$ 140,632
Kansas Lottery	2010	63,338	-	0%	203,970
Kansas Lottery	2011	69,402	-	0%	273,371

Kansas Lottery
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June 30, 2011 and 2010

Funded Status and Funding Progress

As of January 1, 2011, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$733,663. The Lottery's policy is to fund the benefits on a pay as you go basis, resulting in an unfunded actuarial accrued liability (UAAL) of \$733,663. The covered payroll (annual payroll of active employees covered by the plan) was \$3,865,681, and the ratio of the UAAL to covered payroll was 18.97 percent.

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

Actuarial Methods and Assumptions

Projections of benefits for reporting purposes are based on the substantive plan and include the types of benefits provided at the time of valuation and the historical pattern of sharing of benefit cost between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and actuarial value as assets, consistent with the long-term perspective of calculations.

In the January 1, 2011 actuarial valuation, the projected unit credit cost method was applied. The actuarial assumptions included a 3.85 percent investment rate of return, which is a blended rate of the expected long-term investment returns on the State's pooled funds and investments. The valuation assumed annual healthcare cost trend rates of 5 to 9 percent in the next seventeen years. The UAAL is being amortized over a 30 year open period in level dollar amounts.

11 - Privilege Fee Payments

The Lottery assesses a privilege fee on applicants who would like to be considered as a potential expanded gaming facility manager. The privilege fee acts as a deposit showing the management company's interest in managing one of the four gaming facilities throughout the State of Kansas. Privilege fees assessed are \$25,000,000 per applicant for the southeast, south-central, and northeast regions and \$5,500,000 per applicant for the southwest region. If an applicant is not awarded the contract for the region, the privilege fee is reimbursed in full. When a contract becomes binding the privilege fee is transferred to the State's general fund immediately. During the FY 2011 the State of Kansas received from the south central zone \$25,000,000 privilege fees when the contractual agreement became binding.

Kansas Lottery
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12 - Subsequent Event

The Lottery has evaluated subsequent events through the date of the independent auditors' report which is the date the financial statements are available to be issued.

The northeast and the south central gaming zones are in different stages of construction. Both casinos have plans to begin operations during the fiscal year ending June 30, 2012.

Kansas Lottery
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Schedule of Funding Progress

Health Insurance Post Employment Benefits

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percent of Covered Payroll (b-a)(c)
1/1/2011	\$ -	\$ 733,663	\$ 733,633	0%	\$ 3,865,681	18.97%
1/1/2010	-	652,394	652,394	0%	3,745,917	17.42%
1/1/2009	-	595,029	595,029	0%	3,859,388	15.42%

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING BALANCE SHEET
JUNE 30, 2011

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2011
<u>ASSETS</u>			
Current Assets:			
Cash:			
Operating fund	\$ 5,807,319	\$ 343,689	\$ 6,151,008
Prize payment fund	167,052	-	167,052
Accounts receivable, net of allowance for doubtful accounts of \$349,123	3,869,022	-	3,869,022
Accounts receivable - unbilled	5,935,433	-	5,935,433
Other receivable	212,330	151,770	364,100
Instant ticket game inventory	1,730,739	-	1,730,739
 Total current assets	 <u>17,721,895</u>	 <u>495,459</u>	 <u>18,217,354</u>
Capital assets, net of depreciation:			
Property and equipment - Lottery	385,479	-	385,479
Property and equipment - Expanded Lottery	-	5,786,413	5,786,413
 Total capital assets	 <u>385,479</u>	 <u>5,786,413</u>	 <u>6,171,892</u>
 Total assets	 <u><u>\$ 18,107,374</u></u>	 <u><u>\$ 6,281,872</u></u>	 <u><u>\$ 24,389,246</u></u>
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Accounts payable and accrued liabilities	\$ 1,695,684	\$ 397,057	\$ 2,092,741
Due to the State of Kansas	6,000,000	90,202	6,090,202
Due to Problem Gambling Fund	-	8,200	8,200
Prize liability	7,587,466	-	7,587,466
 Total current liabilities	 <u>15,283,150</u>	 <u>495,459</u>	 <u>15,778,609</u>
Net assets:			
Invested in capital assets	385,479	-	385,479
Invested in capital assets - restricted	-	5,786,413	5,786,413
Unrestricted	2,438,745	-	2,438,745
 Total net assets	 <u>2,824,224</u>	 <u>5,786,413</u>	 <u>8,610,637</u>
 Total liabilities and net assets	 <u><u>\$ 18,107,374</u></u>	 <u><u>\$ 6,281,872</u></u>	 <u><u>\$ 24,389,246</u></u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2011

	Kansas Lottery		Total 2011
	Lottery	Expanded Lottery	
Operating revenues:			
Net game revenues	\$ 232,372,510	\$ -	\$ 232,372,510
Expanded lottery revenues	-	40,055,280	40,055,280
Expanded lottery reimbursements	-	1,282,191	1,282,191
Phone reimbursements	947,390	-	947,390
Retailer fees and miscellaneous income	139,773	-	139,773
Total operating revenues	233,459,673	41,337,471	274,797,144
Operating expenses:			
Game prizes	132,332,017	-	132,332,017
Casino operator management fee	-	29,240,354	29,240,354
Retailer commissions	13,783,253	-	13,783,253
On-line games service bureau	5,299,915	-	5,299,915
Salaries and benefits	4,609,625	488,617	5,098,242
Cost of instant tickets	3,761,082	-	3,761,082
Advertising	2,867,437	-	2,867,437
Other administrative expenses	1,709,086	290,262	1,999,348
Depreciation	152,295	2,102,677	2,254,972
City and County expanded lottery fees	-	1,201,658	1,201,658
Professional services	385,097	95,119	480,216
On-line service bureau - lottery gaming	-	403,683	403,683
Telecommunications	260,695	4,510	265,205
Total operating expenses	165,160,502	33,826,880	198,987,382
Operating income	68,299,171	7,510,591	75,809,762
Nonoperating revenues (expenses):			
Transfers to the State Gaming Revenue Fund	(71,500,000)	-	(71,500,000)
Transfers to the State General Fund	(10,541)	(8,812,162)	(8,822,703)
Transfers to the Problem Gambling Fund	-	(801,106)	(801,106)
Total nonoperating revenues (expenses)	(71,510,541)	(9,613,268)	(81,123,809)
Change in net assets	(3,211,370)	(2,102,677)	(5,314,047)
Net assets, beginning of year	6,035,594	7,889,090	13,924,684
Net assets, end of year	\$ 2,824,224	\$ 5,786,413	\$ 8,610,637

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2011

	Kansas Lottery		
	Lottery	Expanded Lottery	Total 2011
Cash flows from operating activities:			
Cash received from sales and reimbursements	\$ 232,919,733	\$ 41,267,042	\$ 274,186,775
Cash paid for prizes, commissions, and other expenses	(157,939,762)	(31,571,352)	(189,511,114)
Cash paid to employees	(4,609,625)	(488,617)	(5,098,242)
Net cash provided by operating activities	<u>70,370,346</u>	<u>9,207,073</u>	<u>79,577,419</u>
Cash flows from noncapital financing activities:			
Payments to State Gaming Revenue Fund	(70,000,000)	-	(70,000,000)
Payments to State General Fund	(10,541)	(8,784,016)	(8,794,557)
Payments to State Problem Gambling Fund	-	(798,547)	(798,547)
Net cash used by noncapital financing activities	<u>(70,010,541)</u>	<u>(9,582,563)</u>	<u>(79,593,104)</u>
Cash flows from capital and related financing activities:			
Purchases of capital assets	(95,280)	-	(95,280)
Net cash used by capital and related financing activities	<u>(95,280)</u>	<u>-</u>	<u>(95,280)</u>
Net increase (decrease) in cash	264,525	(375,490)	(110,965)
Cash, beginning of year	<u>5,709,846</u>	<u>719,179</u>	<u>6,429,025</u>
Cash, end of year	<u>\$ 5,974,371</u>	<u>\$ 343,689</u>	<u>\$ 6,318,060</u>
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	\$ 68,299,171	\$ 7,510,591	\$ 75,809,762
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	152,295	2,102,677	2,254,972
Changes in operating assets and liabilities:			
Accounts receivable	(480,988)	-	(480,988)
Other receivable	(58,952)	(70,429)	(129,381)
Instant ticket game inventory	283,639	-	283,639
Accounts payable and accrued liabilities	(53,289)	(335,766)	(389,055)
Prize liability	2,228,470	-	2,228,470
Net cash provided by operating activities	<u>\$ 70,370,346</u>	<u>\$ 9,207,073</u>	<u>\$ 79,577,419</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
BALANCE SHEETS - LOTTERY
JUNE 30, 2011 AND 2010

	Lottery	
<u>ASSETS</u>	2011	2010
Current Assets:		
Cash:		
Operating fund	\$ 5,807,319	\$ 4,814,317
Prize payment fund	167,052	895,529
Accounts receivable, net of allowance for doubtful accounts of \$349,123 and \$618,583 at 2011 and 2010, respectively	3,869,022	3,426,331
Accounts receivable - unbilled	5,935,433	5,897,136
Other receivable	212,330	153,378
Instant ticket game inventory	1,730,739	2,014,378
Total current assets	17,721,895	17,201,069
Capital assets, net of depreciation:		
Property and equipment - Lottery	385,479	442,494
Total assets	\$ 18,107,374	\$ 17,643,563
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,695,684	\$ 1,748,973
Due to the State of Kansas	6,000,000	4,500,000
Prize liability	7,587,466	5,358,996
Total current liabilities	15,283,150	11,607,969
Net assets:		
Invested in capital assets	385,479	442,494
Unrestricted	2,438,745	5,593,100
Total net assets	2,824,224	6,035,594
Total liabilities and net assets	\$ 18,107,374	\$ 17,643,563

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULES OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS - LOTTERY
YEARS ENDED JUNE 30, 2011 AND 2010

	Lottery	
	<u>2011</u>	<u>2010</u>
Operating revenues:		
Net game revenues	\$ 232,372,510	\$ 235,414,168
Phone reimbursements	947,390	951,265
Retailer fees and miscellaneous income	139,773	481,220
	<u>233,459,673</u>	<u>236,846,653</u>
Total operating revenues		
Operating expenses:		
Game prizes	132,332,017	132,609,974
Retailer commissions	13,783,253	13,670,875
On-line games service bureau	5,299,915	5,611,400
Salaries and benefits	4,609,625	4,440,779
Cost of instant tickets	3,761,082	3,819,565
Advertising	2,867,437	2,935,830
Other administrative expense	1,709,086	2,464,705
Depreciation	152,295	122,418
Professional services	385,097	168,032
Telecommunications	260,695	183,950
	<u>165,160,502</u>	<u>166,027,528</u>
Total operating expenses		
Operating income	<u>68,299,171</u>	<u>70,819,125</u>
Nonoperating revenues (expenses):		
Transfers to the State Gaming Revenue Fund	(71,500,000)	(67,750,000)
Transfers to the State General Fund	(10,541)	(26,898)
Write-off and adjustment of capital assets	-	(137,756)
	<u>(71,510,541)</u>	<u>(67,914,654)</u>
Total nonoperating revenues (expenses)		
Change in net assets	(3,211,370)	2,904,471
Net assets, beginning of year	<u>6,035,594</u>	<u>3,131,123</u>
Net assets, end of year	<u>\$ 2,824,224</u>	<u>\$ 6,035,594</u>

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULES OF CASH FLOWS - LOTTERY
YEARS ENDED JUNE 30, 2011 AND 2010

	Lottery	
	2011	2010
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 232,919,733	\$ 236,242,999
Cash paid for prizes, commissions, and other expenses	(157,939,762)	(161,763,430)
Cash paid to employees	(4,609,625)	(4,440,779)
Net cash provided by operating activities	<u>70,370,346</u>	<u>70,038,790</u>
Cash flows from noncapital financing activities:		
Payments to State Gaming Revenue Fund	(70,000,000)	(69,000,000)
Payments to State General Fund	(10,541)	(26,898)
Net cash used by noncapital financing activities	<u>(70,010,541)</u>	<u>(69,026,898)</u>
Cash flows from capital and related financing activities:		
Purchases of capital assets	(95,280)	(237,926)
Net cash used by capital and related financing activities	<u>(95,280)</u>	<u>(237,926)</u>
Net increase in cash	264,525	773,966
Cash, beginning of year	<u>5,709,846</u>	<u>4,935,880</u>
Cash, end of year	<u>\$ 5,974,371</u>	<u>\$ 5,709,846</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 68,299,171	\$ 70,819,125
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	152,295	122,418
Changes in operating assets and liabilities:		
Accounts receivable	(480,988)	(662,852)
Other receivable	(58,952)	59,198
Instant ticket game inventory	283,639	(6,111)
Accounts payable and accrued liabilities	(53,289)	142,254
Prize liability	2,228,470	(435,242)
Net cash provided by operating activities	<u>\$ 70,370,346</u>	<u>\$ 70,038,790</u>

**KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
BALANCE SHEETS - EXPANDED LOTTERY
JUNE 30, 2011 AND 2010**

	Expanded Lottery	
<u>ASSETS</u>	2011	2010
Current Assets:		
Cash:		
Operating fund	\$ 343,689	\$ 719,179
Other receivable	151,770	81,341
	495,459	800,520
Total current assets		
Capital assets, net of depreciation:		
Property and equipment - Expanded Lottery	5,786,413	7,889,090
	5,786,413	7,889,090
Total capital assets		
	\$ 6,281,872	\$ 8,689,610
	\$ 6,281,872	\$ 8,689,610
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 397,057	\$ 732,823
Due to the State of Kansas	90,202	62,056
Due to Problem Gambling Fund	8,200	5,641
	495,459	800,520
Total current liabilities		
Net assets:		
Invested in capital assets - restricted	5,786,413	7,889,090
Unrestricted	-	-
	5,786,413	7,889,090
Total net assets		
	\$ 6,281,872	\$ 8,689,610
Total liabilities and net assets	\$ 6,281,872	\$ 8,689,610

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULES OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2011 AND 2010

	Expanded Lottery	
	2011	2010 **
Operating revenues:		
Expanded lottery revenues	\$ 40,055,280	\$ 20,663,987
Expanded lottery reimbursements	1,282,191	983,472
Total operating revenues	<u>41,337,471</u>	<u>21,647,459</u>
Operating expenses:		
Casino operator management fee	29,240,354	15,084,710
Salaries and benefits	488,617	431,444
Other administrative expenses	290,262	197,684
Depreciation	2,102,677	1,226,562
City and County expanded lottery fees	1,201,658	619,920
Professional services	95,119	142,250
On-line service bureau - expanded lottery	403,683	212,094
Telecommunications	4,510	-
Total operating expenses	<u>33,826,880</u>	<u>17,914,664</u>
Operating income	<u>7,510,591</u>	<u>3,732,795</u>
Nonoperating revenues (expenses):		
Transfers to the State General Fund	(8,812,162)	(4,546,077)
Transfers to the Problem Gambling Fund	(801,106)	(413,280)
Total nonoperating revenues (expenses)	<u>(9,613,268)</u>	<u>(4,959,357)</u>
Income (loss) before contributions	(2,102,677)	(1,226,562)
Capital contributions	-	9,115,652
Change in net assets	(2,102,677)	7,889,090
Net assets, beginning of year	<u>7,889,090</u>	-
Net assets, end of year	<u>\$ 5,786,413</u>	<u>\$ 7,889,090</u>

** Expanded Lottery operations reflect only the operations from opening date in December 2009 through June 30, 2010

KANSAS LOTTERY
(A COMPONENT UNIT OF THE STATE OF KANSAS)
SCHEDULES OF CASH FLOWS - EXPANDED LOTTERY
YEARS ENDED JUNE 30, 2011 AND 2010

	Expanded Lottery	
	2011	2010**
Cash flows from operating activities:		
Cash received from sales and reimbursements	\$ 41,267,042	\$ 21,566,118
Cash paid for prizes, commissions, and other expenses	(31,571,352)	(15,523,835)
Cash paid to employees	(488,617)	(431,444)
Net cash provided by operating activities	<u>9,207,073</u>	<u>5,610,839</u>
Cash flows from noncapital financing activities:		
Payments to State General Fund	(8,784,016)	(4,484,021)
Payments to State Problem Gambling Fund	(798,547)	(407,639)
Net cash used by noncapital financing activities	<u>(9,582,563)</u>	<u>(4,891,660)</u>
Net increase (decrease) in cash	(375,490)	719,179
Cash, beginning of year	<u>719,179</u>	<u>-</u>
Cash, end of year	<u>\$ 343,689</u>	<u>\$ 719,179</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 7,510,591	\$ 3,732,795
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,102,677	1,226,562
Changes in operating assets and liabilities:		
Other receivable	(70,429)	(81,341)
Accounts payable and accrued liabilities	(335,766)	732,823
Net cash provided by operating activities	<u>\$ 9,207,073</u>	<u>\$ 5,610,839</u>
Noncash capital and related financing activities:		
Contributed capital assets	<u>\$ -</u>	<u>\$ 9,115,652</u>

** Expanded Lottery operations reflect only the operations from opening date in December 2009 through June 30, 2010



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**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:

We have audited the financial statements of the Kansas Lottery (the Lottery), a component unit of the State of Kansas, as of and for the year ended June 30, 2011, and have issued our report thereon dated October 28, 2011. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs as finding 2011-1 that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a 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.

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Compliance and Other Matters

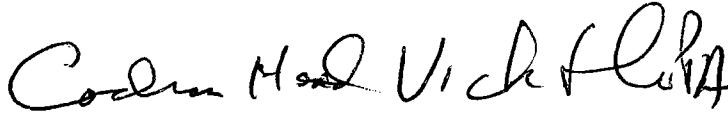
As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Lottery, in a separate letter dated October 28, 2011.

The Lottery's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit Library's response and, accordingly, we express no opinion on it.

This information is intended solely for the use of the Legislative Post Audit Committee, Kansas Lottery Commission and management of the Kansas Lottery and is not intended to be and should not be used by anyone other than these specified parties.

October 28, 2011

A handwritten signature in black ink, appearing to read "Gordon H. Vick". The signature is written in a cursive style with a large, stylized initial "G".

Kansas Lottery
(A Component Unit of the State of Kansas)
Schedule of Findings and Responses
Year Ended June 30, 2011

Finding 2011-1 – Significant Deficiency

Financial Statement Preparation

Condition - Under our professional standards, we are required to assess the Lottery's controls over financial statement preparation including assessing the controls necessary to prevent, detect, and correct misstatements. As part of our audit, we reviewed and assisted management with changes to a draft of the financial statements which management prepared. Management reviewed, approved, and accepted responsibility for those statements prior to their issuance. The outsourcing of these services is not unusual; however, we cannot be considered part of the Lottery's internal control over financial reporting.

Our audit procedures identified certain financial statement misstatements indicating that certain amounts did not agree to the underlying supporting documentation provided to us. Additionally, we noted that certain accrual basis financial reporting aspects of new accounting system used by the Lottery and the State during 2011 were not fully implemented by the Lottery. During our audit, we noted that the Lottery currently recorded year end accrual entries outside of the new accounting system and then created a reconciliation in order to generate a trial balance. In addition to these year end accrual entries, the reconciliation included two separate reports that were exported from the new accounting system.

Criteria - A system of internal control over financial reporting includes controls over financial statement preparation, including footnote disclosures.

Cause - The Lottery does not have adequate controls over the preparation of the financial statements including disclosures which would prevent or detect a misstatement in the financial statements.

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

Recommendation – Due to the complexities of financial statement reporting including inclusion of required disclosures, we recommend that management explore various alternatives to improving the controls over financial reporting including the use of continuing education and training courses and the use of reference guides provided by the Government Finance Officers Association, (GFOA), the American Institute of Certified Public Accountants, (AICPA), the Governmental Accounting Standards Board (GASB) and other various financial publishing companies. We recommend that management review processes for making year-end closing entries and review account balances to ensure that accounts agree to reconciliations and underlying supporting documentation, in particular the Lottery's accounts receivable. Performing more frequent reconciliations will allow staff to more easily identify differences as they occur, and quickly make adjusting entries to correct if necessary. We also recommend lottery personnel obtain additional guidance and instructions to assistance in implementing the accrual basis aspect of new accounting system to facilitate preparation of accrual basis trial balances and financial statements.

Management's Response (Unaudited)-

We continue working with what is available in SMART, such as the Trail Balance by fund and the CAFR_FULL report. The year-end accrual entries will be made into the CAFR_FULL journal in the SMART system.

The Division of General Services has had software developers from Oracle in-house working on the financial statement templates for the four agencies that have GAPP basis financials. The statements may be available by the end of fiscal year 2012. They were working on the Lottery's in October, and we hope to see an example to test soon.

Kansas Lottery
(A Component Unit of the State of Kansas)
Schedule of Prior Year Findings and Responses
Year Ended June 30, 2011

Finding 2010-1

Condition – In the prior year, management requested that we prepare a draft of the financial statements. Also, certain financial statement adjustments were required in order to accurately report the Lottery's financial information and to agree balances to the underlying supporting documentation provided to us.

Recommendation – We recommended that management review processes for making year-end closing entries and reviewing account balances to ensure that accounts agree to reconciliations and underlying supporting documentation. We also recommended that management explore various alternatives to improving the controls over financial reporting including the use of continuing education, training courses and the use of reference guides.

Current Status – Significant improvement was noted in the current year as there was no material financial statement adjustments identified and management provided a draft of the financial statements. Comment was partially repeated in the current year. See finding 2011-1.

Finding 2010-2

Condition – We noted that journal entries were not formally reviewed and approved prior to being entered into the general ledger. Additionally, we noted that there was no formal process for documenting journal entries and the related support.

Recommendation – We recommended that management review and revise current policies and procedures to require formal supervisory review and approval of all journal entries. We also recommended formalization of this process by developing a standard journal entry form to use for all journal entries that would document approval and would include supporting documentation.

Current Status – During the year, the Lottery changed to new financial software that includes a formal approval process for posting journal entries.

Finding 2010-3

Condition – The Lottery is responsible for the collection and distribution of Expanded Lottery revenues and for the operations of gaming facilities under the Kansas Lottery Act. We noted that certain internal control reports completed by both the Kansas Racing and Gaming Commission (KRGC) and the gaming facility's internal audit department were not requested or provided to the Lottery.

Recommendation – We recommended that Lottery management obtain and review all internal control related reports prepared by either KRGC or the gaming facilities internal audit department to evaluate and monitor any process or control changes related to significant findings or other recommendations.

Current Status – Recommendation was implemented in the current year.

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

REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2011

Kansas Lottery

**Required Communications
For the Year Ended June 30, 2011**

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COCHRAN HEAD VICK & CO., P.A.

& Co

Certified Public Accountants

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October 28, 2011

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the financial statements of the Kansas Lottery (the Lottery), a component unit of the State of Kansas, as of and for the year ended June 30, 2011. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter to you dated May 5, 2011. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Lottery are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2011. We noted no transactions entered into by the Lottery during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the Lottery's financial statements were the actuarial assumptions and methods used by the actuary to prepare the annual actuarial valuation report related to the other postemployment healthcare benefits plan, the allowance for doubtful accounts, the estimate useful lives of capital assets, and prize liabilities. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

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

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Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management corrected one such misstatement. The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 28, 2011.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Information in Documents Containing Audited Financial Statements

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

In planning and performing our audit of the financial statements of the Lottery as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the Lottery's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we consider the deficiency described in our 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* and the related Schedule of Findings and Responses as item 2011-1 and included at page 42 in the Lottery's Financial Compliance and Audit Report for the Year ended June 30, 2011 to be a significant deficiency.

A significant deficiency is a deficiency, or a 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.

As part of our annual audit, we try to identify opportunities for improving the management of financial resources and for improving the internal controls over financial reporting. We are submitting, for your consideration, our observations and recommendations with regard to these matters.

Current Year Comments

Expanded Lottery

During fiscal year 2012, two new gaming facilities are expected to be opened related to Expanded Lottery activities. Due to the nature of these facilities, there are expected to be new lease agreements that will require a significant amount of new equipment to be reported on the Lottery's financial statements. We recommend that management review and evaluate procedures in place to timely identify and account for any agreements related to these facilities in order to properly report their impact on the Lottery's financial statements.

Future Accounting Pronouncements

The GASB has recently issued the following statements which may impact the Lottery's financial reporting requirements in the future:

- GASB Statement 60 – Accounting and Financial Reporting for Service Concession Arrangements, effective for the fiscal year beginning July 1, 2012
- GASB Statement 61 – *The Financial Reporting Entity – Omnibus*, effective for the fiscal year beginning July 1, 2012.
- GASB Statement 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective for the fiscal year beginning July 1, 2012.
- GASB Statement 63 – *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective for the fiscal year beginning July 1, 2012
- GASB Statement 64 – *Derivative Instruments: Application of Hedge Accounting Termination Provisions – and amendment to GASB statement No. 53*, effective for the fiscal year beginning July 1, 2011

We recommend management review these standards to determine the impact they may have on the Lottery's financial reporting.

Prior Year Comments

In the prior year, we issued certain comments and recommendations in regard to the Lottery's accounting, internal control and financial reporting issues. The following table summarizes the nature of these comments issued, the significance of the comments as described in the prior year's reports and our determination of the status of those comments.

<u>Prior Year Comment Description</u>	<u>Significance</u>	<u>Current Year Status</u>
Financial Statement Preparation	We identified certain financial statement misstatements which required adjustment in order to accurately report the Lottery's financial information and to agree balances to the underlying supporting documentation provided to us. We recommend that management review processes for making year-end closing entries and reviewing account balances to ensure that accounts agree to reconciliations and underlying supporting documentation. We also recommend that management perform more frequent reconciliations for significant accounts, in particular the Lottery's cash accounts and accounts receivable.	While we noted improvements in financial statement preparation over the prior year, certain recommendations have been repeated in the current year. See finding 2011-1.
Journal Entry and Approval	We noted that journal entries are not formally reviewed and approved prior to being entered into the general ledger. Additionally, we noted there is no formal process for documenting journal entries and the related support. We recommend that management review and revise current policies and procedures to require formal supervisory review and approval of all journal entries.	A formal review and approval process was implemented in the current year.
Expanded Lottery Monitoring	We understand that certain reports related to internal control activities either prepared by KRGC or the gaming facility's internal audit department were not requested by or provided to Lottery management. We have also been informed that certain required gaming facility manager's internal audit reports are behind schedule. We recommend that Lottery management obtain and review all internal control related reports prepared by either the KRGC or the gaming facility's internal audit department to evaluate and monitor any process or control changes related to significant findings or recommendations contained in the reports.	Recommendation implemented in the current year.

CONCLUSION

Our audit procedures required us to obtain an understanding of controls over primary systems affecting the financial statement amounts. The Lottery may be able to benefit from additional, in-depth reviews of internal controls in other areas. We look forward to discussing opportunities to continue to assist the Lottery.

This information is intended solely for the use of the Legislative Post Audit Committee, Kansas Lottery Commission and management of the Kansas Lottery and is not intended to be and should not be used by anyone other than these specified parties.

October 28, 2011

Cochran Head V. Kelly PA.

LISTING OF UNCORRECTED MISSTATEMENTS

Kansas Lottery
Listing of Uncorrected Misstatements
June 30, 2011

#	Description	Adjustments on financial statement captions				
		Change in Net Assets			Balance Sheet	
		Unadjusted audit differences arising in			Net Assets	Current Assets
Current Period	Prior Period	Total				
	Adjustments:					
1	Net game revenues Accounts receivable, net Reversal of 2010 unadjusted entry to A/R	-	(105,761)	(105,761)		
2	Net game revenues Accounts receivable, net To adjust ending A/R balance to actual	(59,060)		(59,060)	(59,090)	(59,090)
	Effect of adjustments not recorded	(59,060)	(105,761)	(164,821)	(59,090)	(59,090)
	Financial statement amounts	(5,314,047)	(5,314,047)	(5,314,047)	8,610,637	18,217,354
	Effect as a percentage of f/s amounts	1.11%	1.99%	3.10%	-0.69%	-0.32%