

**REPORT OF THE AUDIT OF THE
KENTUCKY LOTTERY CORPORATION**

**For The Years Ended
June 30, 2020 and 2019**



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MIKE HARMON
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To the People of Kentucky
Honorable Andy Beshear, Governor
Honorable Robert Stivers, President, Kentucky Senate
Honorable David Osborne, Speaker of the House, Kentucky House of Representatives
Board of Directors, Kentucky Lottery Corporation

The enclosed report prepared by Harding, Shymanski and Company, P.S.C, presents the financial and compliance audit of the books and records of the Kentucky Lottery Corporation for the years ended June 30, 2020 and 2019, as required by KRS 154A.130.

We engaged Harding, Shymanski and Company, P.S.C to perform the audit in accordance with auditing standards generally accepted in the United States of America. We worked closely with the firm during our report review process.

Respectfully Submitted

Mike Harmon
Auditor of Public Accounts

Enclosure





***Fueling Imagination.
Funding Education.***

Financial Report

June 30, 2020 and 2019

KENTUCKY LOTTERY CORPORATION

ANNUAL FINANCIAL REPORT

June 30, 2020 and 2019

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INDEPENDENT AUDITOR'S REPORT



**HARDING, SHYMANSKI
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To the Auditor of Public Accounts,
the Commonwealth of Kentucky, and
the Board of Directors of the
Kentucky Lottery Corporation
Louisville, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the Kentucky Lottery Corporation (KLC), a component unit of the Commonwealth of Kentucky, as of and for the years ended June 30, 2020 and 2019, and the related notes to the financial statements, which collectively comprise the KLC's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Opinion

In our opinion, the financial statements referred to on the previous page present fairly, in all material respects, the financial position of KLC, as of June 30, 2020 and 2019, and the changes in financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on Pages 3 through 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2020 on our consideration of KLC'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* in considering KLC's internal control over financial reporting and compliance.

Wardig, Skymanski & Company, P. S. C.

Louisville, Kentucky
September 18, 2020

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Our discussion of the Kentucky Lottery Corporation's (KLC) financial performance provides an overview of the KLC's financial activities for the fiscal years ended June 30, 2020 and 2019. Please read it in conjunction with the financial statements, which follow.

Financial Highlights for Fiscal Year 2020

- Record operating revenues of \$1.2 billion were achieved in 2020, an increase of \$73.9 million or 6.5 percent over last year's previous sales record of \$1.13 billion. 2020 represents the tenth consecutive year of record sales for the KLC, and the fourth time that sales of more than \$1 billion have been achieved.
- Instant ticket sales increased \$71.9 million or 10.7 percent to a record \$741.1 million. 2020 represents the sixth consecutive year the KLC has achieved record instant ticket sales. The KLC introduced a second \$30 price point game in February 2020, which contributed to the \$50.9 million sales increase over last year at that price point.
- Draw game sales decreased \$14.0 million or 3.2 percent from 2019 to \$429.1 million. Much of that decrease can be attributed to the Powerball and Mega Millions games, which had declines in sales as a result of a lack of large jackpots. Mega Millions sales totalled \$37.0 million, a decrease from prior year of \$26.1 million or 41.4 percent. Powerball sales totalled \$49.9 million, a decrease from prior year of \$23.6 million or 32.1 percent.
- Keno generated sales of \$78.8 million, a decrease from prior year by \$5.5 million or 6.5 percent. This is the first year Keno sales have decreased since sales began in fiscal year 2014. The decline began in March 2020 when many bars and restaurants closed in response to COVID-19.
- Pick 3 and Pick 4 games had strong sales this year. In total, these games accounted for a \$23.7 million increase in sales compared to prior year.
- iLottery instant play games generated sales of \$33.2 million, exceeding prior year by \$15.9 million or 91.9 percent.

The KLC is accounted for as an enterprise fund, reporting on all of the activity's assets and liabilities using the accrual basis of accounting much like a private business activity. As such, this annual financial report consists of a series of financial statements, along with explanatory notes to the financial statements.

To assess the KLC's financial position and financial health, the reader of these statements should pay particular attention to changes in the components of assets and liabilities as set forth on the Statements of Net Position, and in changes in operating revenues and expenses as set forth in the Statements of Revenues, Expenses, and Changes in Net Position.

Total Assets

Total assets consist primarily of cash and equivalents, investments, accounts receivable, capital assets and deposits. As shown in Table 1, the KLC's total assets increased \$7.5 million to \$99.2 million in 2020. Total assets increased \$16.2 million to \$91.7 million in 2019 from \$75.5 million in 2018. Investments consist of U.S. Treasury zero-coupon bonds and other U.S. Government agency securities carried at fair value. Accounts receivable represents revenue to be collected primarily from the sale of draw and instant game tickets. Accounts receivable increased \$19.6 million to \$56.9 million in 2020. Accounts receivable increased \$5.7 million to \$37.3 million in 2019 from \$31.6 million in 2018. This increase from 2019 is the result of a significant increase in sales in June 2020 compared to June 2019. In fact, June 2020 marked the second highest sales month in the history of the lottery.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Capital Assets

The KLC's investment in capital assets, net of accumulated depreciation in 2020 and 2019, was \$5.6 and \$5.7 million, respectively. The investment in capital assets includes buildings, game equipment, data processing equipment and software, automobiles, furniture, and fixtures. The total decrease in the KLC's investment in capital assets for 2020 was \$0.1 million or 1.8 percent compared to an increase of \$0.3 million or 5.6 percent in 2019. Additional information on the KLC's investment in capital assets can be found in Note 6 to the financial statements.

TABLE 1
NET POSITION
(In millions)

	2020	Increase (Decrease)	2019	Increase (Decrease)	2018
Current and other assets	\$ 79.9	\$ 9.1	\$ 70.8	\$ 16.0	\$ 54.8
Investments (noncurrent)	7.7	(1.4)	9.1	(1.0)	10.1
Capital assets, net	5.6	(0.1)	5.7	0.3	5.4
Deposits with Multi State Lottery Assoc.	<u>6.0</u>	<u>(0.1)</u>	<u>6.1</u>	<u>0.9</u>	<u>5.2</u>
Total assets	<u>99.2</u>	<u>7.5</u>	<u>91.7</u>	<u>16.2</u>	<u>75.5</u>
Current liabilities	69.6	8.5	61.1	17.9	43.2
Long-term liabilities	<u>10.9</u>	<u>(1.4)</u>	<u>12.3</u>	<u>(1.7)</u>	<u>14.0</u>
Total liabilities	<u>80.5</u>	<u>7.1</u>	<u>73.4</u>	<u>16.2</u>	<u>57.2</u>
Net position components					
Net investment in capital assets	5.6	(0.1)	5.7	0.3	5.4
Unrestricted - accumulated unrealized gains on investments	1.5	0.2	1.3	0.1	1.2
Unrestricted	<u>11.6</u>	<u>0.2</u>	<u>11.4</u>	<u>(0.3)</u>	<u>11.7</u>
Net position	<u>\$ 18.7</u>	<u>\$ 0.3</u>	<u>\$ 18.4</u>	<u>\$ 0.1</u>	<u>\$ 18.3</u>

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Liabilities

TABLE 2
LIABILITIES
(In millions)

	Current			Long-Term		
	2020	2019	2018	2020	2019	2018
Accounts payable and other liabilities	\$9.0	\$5.9	\$6.0	\$0.4	\$0.7	\$1.1
Prize liabilities	49.9	38.2	31.1	10.5	11.6	12.9
Due to Commonwealth	10.7	17.0	6.1	0.0	0.0	0.0
Total liabilities	<u>\$69.6</u>	<u>\$61.1</u>	<u>\$43.2</u>	<u>\$10.9</u>	<u>\$12.3</u>	<u>\$14.0</u>

Total current liabilities increased \$8.5 million or 13.9 percent in 2020 and \$17.9 million or 41.4 percent in 2019. The account titled "Due to Commonwealth" decreased \$6.3 million in 2020 and increased \$10.9 million in 2019. This represents payments due to the General Fund and the Kentucky Educational Excellence Scholarship Reserve Account after the fiscal year-end.

Long-term liabilities consist principally of prize liabilities for prizes paid in installments over several years and the noncurrent portion of accrued compensated absences. Long-term liabilities decreased \$1.4 million or 11.4 percent in 2020 and decreased \$1.7 million or 12.1 percent in 2019. The decrease is attributable to the maturing of long-term prize liabilities. More detailed information can be obtained in Note 8 to the financial statements.

Net Position

As shown in Table 1 on page 4, the KLC's net position in 2020 increased \$0.3 million. This change was attributable to the increase in the accumulated unrealized gains on investments the KLC holds to maturity to fund future payments due on annuitized lottery prizes. Accounting principles dictate the KLC record the unrealized gain or loss related to the change in market value of these investments. Zero-coupon U.S. Government bonds have been purchased for the payment of installment prize awards and are generally held to maturity. The change in the market value of these investments (i.e. the unrealized gains on investments) was recorded as an increase in unrestricted net position. Total net position of \$18.7 million included the KLC's net investment in capital assets of \$5.6 million and \$13.1 million in unrestricted net position. Unrestricted net position was comprised of \$1.5 million in accumulated unrealized gains on investments and \$11.6 million in working capital and cash flow that is utilized in the KLC's day-to-day operations. In 2019, the KLC's net position increased \$0.1 million to \$18.4 million due to the increase in the accumulated unrealized gains on investments.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Changes in Net Position

TABLE 3
CHANGES IN NET POSITION
(In millions)

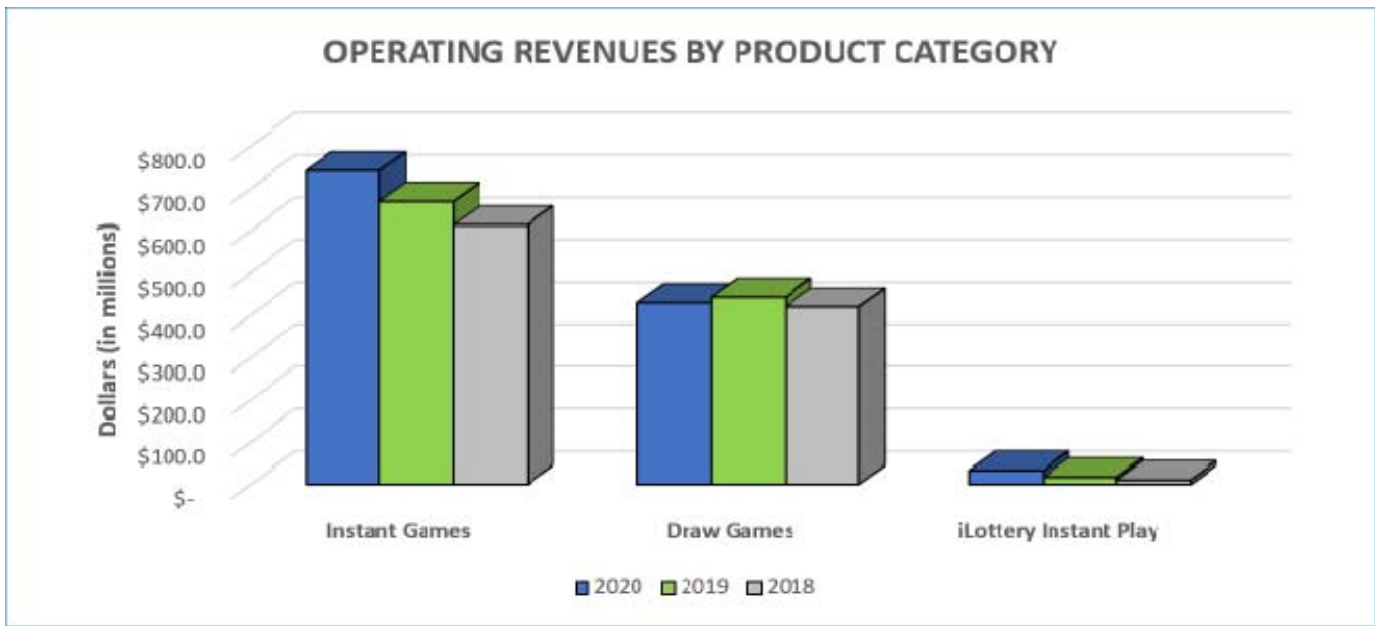
	2020	Increase (Decrease)	2019	Increase (Decrease)	2018
Operating revenues					
Instant games	\$741.1	\$ 71.9	\$ 669.2	\$ 56.1	\$ 613.1
Draw games	429.1	(14.0)	443.1	24.0	419.1
iLottery instant play games	33.2	15.9	17.3	7.0	10.3
Less: tickets provided as prizes	<u>0.0</u>	<u>0.1</u>	<u>(0.1)</u>	<u>7.2</u>	<u>(7.3)</u>
Total operating revenues	1,203.4	73.9	1,129.5	94.3	1,035.2
Direct costs and operating expenses					
Direct costs:					
Prize expense	801.2	76.4	724.8	67.4	657.4
Payments to retailers	71.0	4.0	67.0	5.9	61.1
Draw game and iLottery vendor expense	15.5	1.8	13.7	2.3	11.4
Instant ticket costs	<u>10.7</u>	<u>1.7</u>	<u>9.0</u>	<u>0.5</u>	<u>8.5</u>
Total direct costs	898.4	83.9	814.5	76.1	738.4
Operating expenses	<u>33.1</u>	<u>1.1</u>	<u>32.0</u>	<u>1.1</u>	<u>30.9</u>
Total direct costs and operating expenses	931.5	85.0	846.5	77.2	769.3
Non-operating expenses (revenue)	(0.6)	0.1	(0.7)	(0.9)	0.2
Payments to the Commonwealth of Kentucky	<u>272.2</u>	<u>(11.4)</u>	<u>283.6</u>	<u>17.2</u>	<u>266.4</u>
Total expenses	<u>1,203.1</u>	<u>73.7</u>	<u>1,129.4</u>	<u>93.5</u>	<u>1,035.9</u>
Changes in net position	0.3	0.2	0.1	0.8	(0.7)
Net position at beginning of year	<u>18.4</u>	<u>0.1</u>	<u>18.3</u>	<u>(0.7)</u>	<u>19.0</u>
Net position at end of year	<u>\$ 18.7</u>	<u>\$ 0.3</u>	<u>\$ 18.4</u>	<u>\$ 0.1</u>	<u>\$ 18.3</u>

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Operating Revenues and Prize Expense

Operating Revenues

In 2020, operating revenues consisted of ticket sales from three product categories; instant games, draw games, and iLottery instant play games. In 2020, the KLC generated record ticket sales of \$1.2 billion, an increase of \$73.9 million or 6.5 percent when compared to 2019. In 2019, the KLC generated ticket sales of \$1.13 billion, an increase of \$94.3 million or 9.1 percent when compared to 2018. Free tickets provided as prizes were phased out in fiscal year 2020. Total ticket sales for 2019 and 2018, net of \$0.1 million and \$7.3 million of tickets provided as prizes, were \$1.13 billion and \$1.04 billion, respectively.



Instant Games

Record KLC instant ticket sales of \$741.1 million were achieved in 2020 and accounted for 61.6 percent of all KLC sales, or an increase of \$71.9 million or 10.7 percent over 2019. Instant ticket sales of \$669.2 million were achieved in 2019, and accounted for 59.2 percent of all KLC sales, or an increase of \$56.1 million or 9.2 percent over 2018.

2020 sales growth within the instant product category occurred at the \$3, \$5, \$10, \$20, and \$30 price points, which saw increases of 64.3 percent, 9.3 percent, 11.9 percent, 12.7 percent, and 114.9 percent, respectively. 2020 was the first full year of sales for the \$30 price point ticket as it was introduced in late February 2019. In 2020 it achieved \$95.2 million in sales.

2020 sales decreases were recognized at the \$1 price point, which saw a decrease of 4.0 percent; the \$2 price point with a decrease of 13.2 percent; and the \$25 price point with a decrease of 74.6 percent. There is only one \$25 game available for sale, which launched in 2018, so sales continue to decline.

2019 sales growth within the instant product category occurred at the \$3, \$5, and \$20 price points, which saw increases of 0.4 percent, 5.1 percent, and 77.0 percent, respectively. A \$30 price point ticket was launched in late February 2019 and achieved \$44.3 million in sales during the fiscal year.

2019 sales decreases were recognized at the \$1 price point, which saw a decrease of 12.5 percent; the \$2 price point with a decrease of 10.2 percent; the \$10 price point with a decrease of 1.9 percent; and the \$25 price point with a decrease of 45.0 percent.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Instant Games (Continued)

Table 4 and the accompanying chart compares sales for each instant game price point for 2020, 2019, and 2018.

TABLE 4
INSTANT SALES BY PRICE POINT
(In millions)

Price Point	Increase		Increase		2018
	2020	(Decrease)	2019	(Decrease)	
\$1	\$21.4	\$(0.9)	\$22.3	\$(3.2)	\$25.5
\$2	42.0	(6.4)	48.4	(5.5)	53.9
\$3	41.9	16.4	25.5	0.1	25.4
\$5	200.4	17.0	183.4	8.9	174.5
\$10	172.9	18.4	154.5	(3.0)	157.5
\$20	153.4	17.3	136.1	59.2	76.9
\$25	13.9	(40.8)	54.7	(44.7)	99.4
\$30	<u>95.2</u>	<u>50.9</u>	<u>44.3</u>	<u>44.3</u>	-

Totals	<u>\$741.1</u>	<u>\$71.9</u>	<u>\$669.2</u>	<u>\$56.1</u>	<u>\$613.1</u>
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KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Draw Games

Draw games sales were \$429.1 million in 2020, a decrease of \$14.0 million or 3.2 percent when compared to 2019. Draw games sales accounted for 35.6 percent of all 2020 sales, and consisted of Powerball, KY Cash Ball, KY Quick Bucks, Pick 4, Pick 3, Mega Millions, 5 Card Cash, Keno, Lucky for Life, Fast Play, and Cash Pop.

Draw game sales were \$443.1 million in 2019, an increase of \$24.0 million or 5.7 percent when compared to 2018. Draw games sales accounted for 39.2 percent of all 2019 sales, and consisted of Pick 3, Pick 4, KY Cash Ball, Powerball, Mega Millions, 5 Card Cash, Keno, Lucky for Life, KY Quick Bucks, and Win Place Show.

Sales increases were recognized in Pick 3, Pick 4, and KY Cash Ball when compared to 2019. Pick 3 sales saw a 11.6 percent increase. Pick 4 sales saw a 14.1 percent increase. KY Cash Ball sales saw an increase of 14.2 percent. Additionally, during 2020 the KLC added Fast Play and Cash Pop to the draw games portfolio. Sales of \$14.5 million and \$3.4 million were achieved, respectively.

Sales decreases were recognized in Powerball at 32.1 percent, Mega Millions at 41.4 percent, Keno at 6.5 percent, 5 Card Cash at 21.7 percent, KY Quick Bucks at 16.7 percent, and Lucky for Life at 4.0 percent. The KY Quick Bucks game was ended in March 2020.

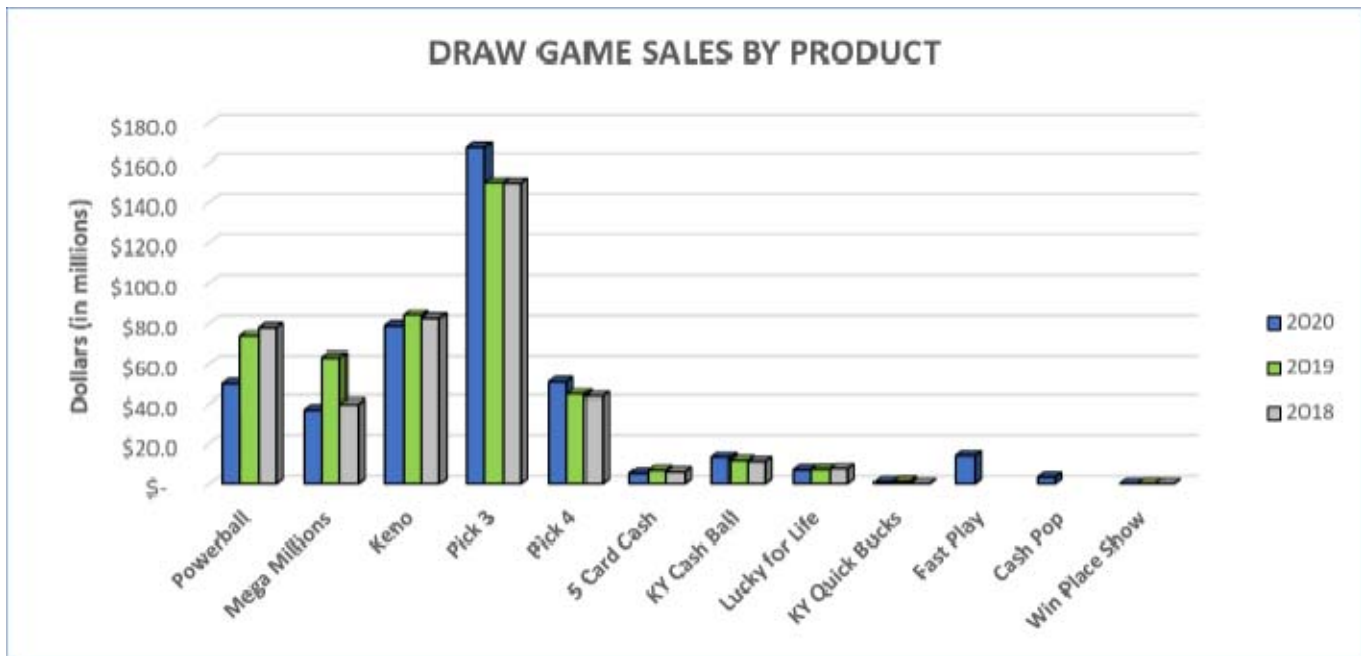
Table 5 and the accompanying chart compares draw game sales by product for 2020, 2019, 2018.

TABLE 5
DRAW GAME SALES BY PRODUCT
(In millions)

Product	2020	Increase (Decrease)	2019	Increase (Decrease)	2018
Powerball	\$49.9	\$(23.6)	\$73.5	\$(4.4)	\$77.9
Mega Millions	37.0	(26.1)	63.1	23.3	39.8
Keno	78.8	(5.5)	84.3	1.5	82.8
Pick 3	167.3	17.4	149.9	0.2	149.7
Pick 4	50.9	6.3	44.6	1.1	43.5
5 Card Cash	5.4	(1.5)	6.9	0.8	6.1
KY Cash Ball	13.7	1.7	12.0	0.5	11.5
Lucky for Life	7.2	(0.3)	7.5	(0.3)	7.8
KY Quick Bucks	1.0	(0.2)	1.2	1.2	-
Fast Play	14.5	14.5	-	-	-
Cash Pop	3.4	3.4	-	-	-
Win Place Show	-	(0.1)	0.1	0.1	-
Totals	<u>\$429.1</u>	<u>\$(14.0)</u>	<u>\$443.1</u>	<u>\$24.0</u>	<u>\$419.1</u>

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
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Draw Games (Continued)



iLottery Instant Play Games

iLottery instant play sales were \$33.2 million, an increase of \$15.9 million when compared to the \$17.3 million achieved in 2019. iLottery instant play sales accounted for 2.8 percent of all 2020 sales and 1.5 percent of all 2019 sales.

Prize Expense and Game Margin

In general, prize expense by game should increase or decrease from year-to-year in proportion to the increase or decrease in sales for a particular game. However, except for the instant game product category, prize expense is also impacted by the luck of the draw. Prize expense for the instant game product category is controllable, to a large degree, by printing a predetermined number and value of winning tickets in the production of each instant game. Prize expense for draw games is not predetermined. While each of the draw games is designed to yield a certain ratio of prizes to sales revenue over a large number of drawings, actual prize payout is determined by lottery players' luck in matching the particular set of numbers randomly selected in each drawing for each game. Similar to draw games, prize expense for iLottery instant play games is designed to yield a certain percent of prizes to sales revenue. The actual prize payout is determined at the time these games are played and the outcome is revealed. These are games of chance, and actual prize payout may vary from the designed payout based on players' luck.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
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Prize Expense and Game Margin (Continued)

The following is a discussion of prize expense within certain product categories. With that background, Table 6 compares the 2020 budgeted gross prize payout percentages for each product category, as well as the actual gross payout percentages for 2020, 2019, and 2018.

**TABLE 6
GROSS PRIZE PAYOUT PERCENTAGES
ALL PRODUCTS**

	BUDGET	ACTUAL	ACTUAL	ACTUAL
	<u>2020</u>	<u>2020</u>	<u>2019</u>	<u>2018</u>
Instant Games	71.4%	71.1%	70.9%	70.1%
Draw Games:				
Powerball	50.0%	49.6%	49.8%	50.4%
Mega Millions	50.0%	50.5%	50.1%	50.2%
Pick 3	60.0%	60.6%	58.5%	58.3%
Pick 4	50.0%	64.1%	42.1%	46.1%
KY Cash Ball	53.8%	49.5%	42.0%	51.2%
5 Card Cash	65.5%	63.7%	64.3%	59.3%
Keno	65.6%	65.3%	65.1%	65.4%
Lucky for Life	59.4%	54.7%	61.9%	60.1%
Ky Quick Bucks	64.0%	58.2%	58.7%	0.0%
Fast Play	68.7%	67.9%	0.0%	0.0%
Cash Pop	67.0%	66.4%	0.0%	0.0%
Win Place Show	55.0%	0.0%	48.1%	0.0%
Draw Games	57.6%	59.6%	55.2%	56.0%
iLottery Instant Play	79.0%	78.0%	76.3%	79.6%
Total Gross Prize Payout Percentage	66.4%	67.2%	64.8%	64.5%
Less: Unclaimed Prizes	<u>(-0.8%)</u>	<u>(-0.6%)</u>	<u>(-0.6%)</u>	<u>(-1.0%)</u>
Net Prize Payout Percentage	65.6%	66.6%	64.2%	63.5%

For 2020, gross prize expense (excluding unclaimed prizes) of \$808.3 million, reflects a 76.1 million or 10.4 percent increase from 2019. Gross prize expense for 2019 (not including unclaimed prizes) of \$732.2 million, reflects a 64.5 million or 9.7 percent increase from 2018 gross prize expense of \$667.7 million.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Prize Expense and Game Margin (Continued)

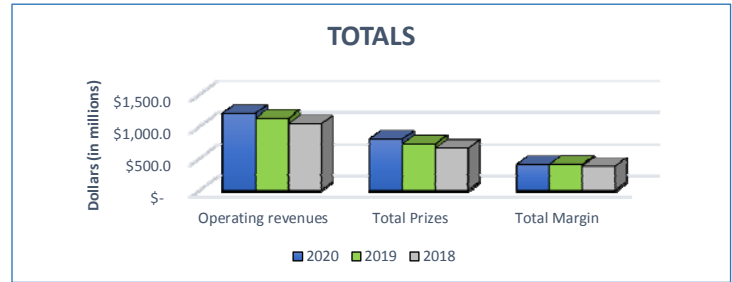
Net prize expense in 2020 was \$801.2 million or 66.6 percent of total operating revenues compared to \$724.8 million or 64.2 percent in 2019 and compared to \$657.4 million or 63.5 percent in 2018. Unclaimed prizes in 2020 were \$7.1 million and in 2019 were \$7.4 million compared to \$10.3 million in 2018.

Total game margin in 2020 decreased to \$402.2 or 33.4 percent of total operating revenues compared to \$404.7 million or 35.8 percent of total operating revenues in 2019. 2018 gross margin was \$377.8 million or 36.5 percent of operating revenues.

Table 7 and the accompanying chart compares total operating revenues, prize expense, and game margin for 2020, 2019, and 2018.

TABLE 7
TOTAL OPERATING REVENUES, PRIZE EXPENSE, AND GAME MARGIN
(In millions)

Totals			
	2020	2019	2018
Operating revenues	\$ 1,203.4	\$ 1,129.6	\$ 1,042.5
Less: instant tickets provided as prizes	0.0	(0.1)	(7.3)
Total operating revenues	1,203.4	1,129.5	1,035.2
Gross prize expense	808.3	732.2	667.7
Less: unclaimed prizes	(7.1)	(7.4)	(10.3)
Total prize expense	801.2	724.8	657.4
Game margin	\$ 402.2	\$ 404.7	\$ 377.8



Instant Prize Expense and Game Margin

In 2020, gross prize expense for instant games increased to \$526.8 million or 71.1 percent of total instant game operating revenues compared to 70.9 percent in 2019 and 70.1 in 2018. The KLC budgeted 71.4 percent in 2020.

Net prize expense for instant games increased to \$523.7 million or 70.7 percent of total instant game operating revenues compared to \$471.5 million or 70.5 percent in 2019, and \$418.9 million or 69.1 percent in 2018.

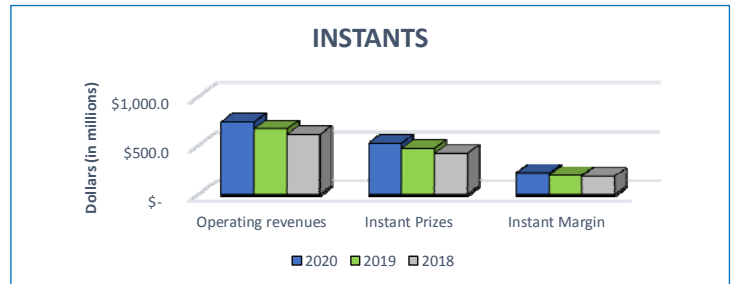
Instant game margin increased to \$217.4 million or 29.3 percent of total instant game operating revenues compared to \$197.6 million or 29.5 percent in 2019, and \$186.9 million or 30.9 percent in 2018. The decrease in margin as a percentage of sales is a reflection of more play at the higher price points, which have higher prize payouts.

Table 8 and the accompanying chart compares instant game operating revenues, prize expense, and game margin for 2020, 2019, and 2018.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

TABLE 8
INSTANT GAME OPERATING REVENUES, PRIZE EXPENSE, AND GAME MARGIN
(In millions)

Instants			
	2020	2019	2018
Instant game operating revenues	\$ 741.1	\$ 669.2	\$ 613.1
Less: instant tickets provided as prizes	0.0	(0.1)	(7.3)
Total operating revenues	741.1	669.1	605.8
Gross prize expense	526.8	474.5	424.6
Less: unclaimed prizes	(3.1)	(3.0)	(5.7)
Total prize expense	523.7	471.5	418.9
Instant game margin	\$ 217.4	\$ 197.6	\$ 186.9



Draw Game Prize Expense and Game Margin

In 2020, gross prize expense for draw games was \$255.6 million or 59.6 percent of total draw game operating revenues compared to \$244.5 million or 55.2 percent in 2019 and \$234.9 million or 56.0 percent in 2018. The KLC budgeted 57.6 percent in 2020.

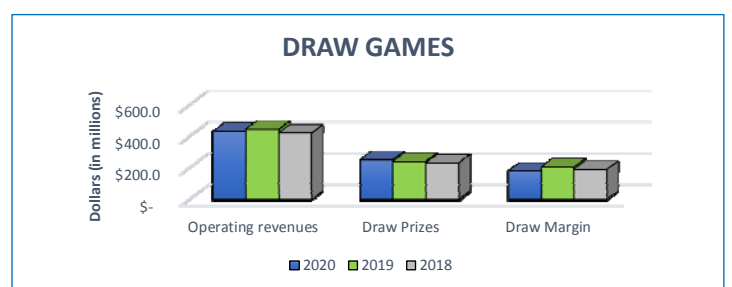
Net prize expense for draw games increased to \$251.6 or 58.6 percent of total draw game operating revenues in 2020 compared to \$240.1 million or 54.2 percent in 2019, and \$230.3 million or 55.0 percent in 2018.

Draw game margin decreased to \$177.5 million or 41.4 percent of total draw game operating revenues in 2020 compared to \$203.0 million or 45.8 percent in 2019 and \$188.8 million or 45.0 percent in 2018. The decrease in margin as a percentage of sales is partly due to lower Powerball and Mega Millions sales, which have the lowest prize payouts. In addition, Pick 3 and Pick 4 prize payouts were significantly higher than the payouts in 2019.

Table 9 and the accompanying chart compares draw game operating revenues, prize expense, and game margin for 2020, 2019, and 2018.

TABLE 9
DRAW GAME OPERATING REVENUES, PRIZE EXPENSE, AND GAME MARGIN
(In millions)

Draw Games			
	2020	2019	2018
Draw game operating revenues	\$ 429.1	\$ 443.1	\$ 419.1
Less: instant tickets provided as prizes	0.0	0.0	0.0
Total operating revenues	429.1	443.1	419.1
Gross prize expense	255.6	244.5	234.9
Less: unclaimed prizes	(4.0)	(4.4)	(4.6)
Total prize expense	251.6	240.1	230.3
Draw game margin	\$ 177.5	\$ 203.0	\$ 188.8



iLottery Instant Play Prize Expense and Game Margin

In 2020, iLottery Instant Play gross and net prize expense was \$25.9 million or 78.0 percent of total iLottery Instant Play operating revenues compared to \$13.2 million or 76.3 percent in 2019 and \$8.2 million or 79.6 percent in 2018. The KLC budgeted 79.0 percent in 2020.

iLottery Instant Play game margin increased to \$7.3 million or 21.9 percent of iLottery Instant Play operating revenues in 2020 compared to \$4.1 million or 23.7 percent 2019 and compared to \$2.1 million or 20.4 percent in 2018.

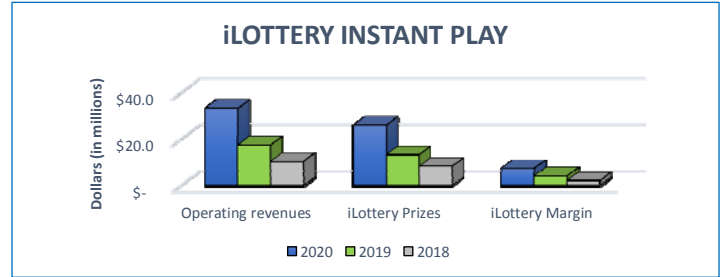
KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

iLottery Instant Play Prize Expense and Game Margin (Continued)

Table 10 and the accompanying chart compares iLottery Instant Play operating revenues, prize expense, and game margin for 2020, 2019, and 2018.

TABLE 10
iLOTTERY INSTANT PLAY OPERATING REVENUES, PRIZE EXPENSE, AND GAME MARGIN
(In millions)

iLottery Instant Play			
	2020	2019	2018
iLottery instant play operating revenues	\$ 33.2	\$ 17.3	\$ 10.3
Less: instant tickets provided as prizes	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Total operating revenues	33.2	17.3	10.3
Gross prize expense	25.9	13.2	8.2
Less: unclaimed prizes	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Total prize expense	<u>25.9</u>	<u>13.2</u>	<u>8.2</u>
iLottery instant play game margin	<u>\$ 7.3</u>	<u>\$ 4.1</u>	<u>\$ 2.1</u>



Other Expenses

TABLE 11
PAYMENTS TO RETAILERS, OPERATING, AND NON-OPERATING EXPENSES (REVENUE)
(In millions)

	2020	Increase (Decrease)	2019	Increase (Decrease)	2018
Payments to retailers	\$71.0	\$ 4.0	\$ 67.0	\$ 5.9	\$ 61.1
Draw game and iLottery vendor expense	15.5	1.8	13.7	2.3	11.4
Instant Ticket costs	10.7	1.7	9.0	0.5	8.5
Operating expenses	33.1	1.1	32.0	1.1	30.9
Non-operating (revenue) expenses	(0.6)	0.1	(0.7)	(0.9)	0.2

Payments to retailers cover base selling and cashing commissions as well as a retailer incentive plan based on the sale of Instant and Keno tickets. Payments to retailers for 2020 and 2019 were 5.9 percent of total operating revenues. Draw game and iLottery vendor expenses for 2020 and 2019 were 1.3 percent and 1.2 percent of total operating revenues, respectively. Instant ticket costs include the cost to acquire and ship instant tickets to retailers and were 0.9 percent and 0.8 percent of total operating revenues in 2020 and 2019, respectively. Operating expenses were 2.7 percent and 2.8 percent of total operating revenues for 2020 and 2019, respectively.

Non-operating (revenue) expenses, which includes investment income, interest expense, and other income, decreased \$0.1 million in 2020 and increased \$0.9 million in 2019.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Investment Income (Loss)

TABLE 12
INVESTMENT INCOME (LOSS)
(In millions)

	2020	Increase (Decrease)	2019	Increase (Decrease)	2018
Unrealized change in fair value of investments	\$ 0.3	\$ 0.2	\$ 0.1	\$ 0.8	\$(0.7)
Accretion of investments	0.5	(0.1)	0.6	0.0	0.6
Security lending income	0.0	0.0	0.0	(0.1)	0.1
Interest income	0.1	(0.2)	0.3	0.1	0.2
Total investment income	\$ 0.9	\$ (0.1)	\$ 1.0	\$ 0.8	\$ 0.2

Unrealized change in fair value of investments represents the impact on income of recording investments at their fair value compared to the historical cost method. Accretion of investments reflects the net increase in the accreted cost of the investment.

Interest income consists principally of interest on the KLC's cash balance, which is invested in short-term investments. A slight decrease in interest income in 2020 reflects the federal government's policy to lower short-term interest rates in 2020.

Payments to the Commonwealth of Kentucky

In 2020 and 2019, payments to the Commonwealth of Kentucky represent a transfer or an accrual of funds from the KLC to the Commonwealth's general fund and to the Kentucky Educational Excellence Scholarship (KEES) Reserve Account. Payments to the general fund, which are approved by the Board of Directors and remitted to the Commonwealth on a monthly basis, are predominantly used by the General Assembly to provide funding for postsecondary education and literacy development. Payments to the KEES Reserve Account represent prizes of instant and draw games that expired (went unclaimed) during the fiscal year. Payments to the Commonwealth of Kentucky in 2020 were \$272.2 million which consisted of \$265.1 million or a decrease of \$11.1 million to the Commonwealth's general fund and \$7.1 million or a decrease of \$0.3 million to the KEES Reserve Account. Payments in 2019 were \$283.6 million, which consisted of \$276.2 million to the Commonwealth's general fund and \$7.4 million the KEES Reserve Account.

Currently Known Facts, Decisions, or Conditions

KLC's mission is to produce the maximum net revenues for the Commonwealth by offering the best lottery games to its citizens, games of the highest quality and integrity, which are consistent with good public policy and social responsibility, and to operate within the framework of public accountability. To achieve this mission, the KLC will continue to introduce new and/or enhanced instant, draw, and iLottery instant play product offerings to further increase sales in fiscal year 2021.

Instant sales are budgeted to produce sales of \$774.2 million during fiscal year 2021, an increase of \$33.1 million or 4.5 percent.

- The KLC will deploy 575 new Game Touch 28 vending machines, with expected completion in November 2020. These additional facings should lead to sales increases in fiscal year 2021.
- The KLC will have a full year of sales from the 125 Game Touch 20 vending machines. These self-service machines contain 20 instant ticket bins and sell the KLC's draw games in this highly populated retail space and should lead to sales increases in fiscal year 2021.
- A third \$30 scratch-off game will be introduced in February 2021 and the KLC will have a full year of two available games at this price point.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2020 and 2019

Currently Known Facts, Decisions, or Conditions (Continued)

- Cashless functionality will be rolled out at 1470 vending machines. Pilot locations will start in the second quarter and full deployment will be completed in the fourth quarter.
- More unique games will be available in the vending machines at the \$5, \$10, and \$20 price points.

Draw game sales are budgeted to produce sales of \$439.8 million during fiscal year 2021, an increase of \$10.7 million or 2.5 percent.

- The KLC will have a full year of 300 Gemini Game Touch Draw self-service vending machines and Keno monitors. These machines will support sales of all KLC draw games. In addition, the new 575 Game Touch 28 vending machines noted above support draw game sales.
- The KLC will have a full year of the Fast Play games launched in October 2019 and the Cash Pop game launched in March 2020.
- A new draw game, Win Place Show, will be launched in August 2020.
- The Lucky for Life draw game will have daily drawings beginning in March 2021, an increase from the current two drawings per week.

iLottery instant play sales are budgeted to produce sales of \$62.0 million during fiscal year 2020, an increase of \$28.7 million or 86.4 percent.

- The KLC will launch at least one new game each month with a payout at 80 percent.
- KLC will trial 85 percent payout for the holiday instant play games.
- Players will enjoy a full year of the new version of the KLC's mobile app, which was released in May 2020.

Contacting the KLC's Financial Management

This financial report is designed to provide the public and other interested parties with an overview of the financial results of the KLC's activities, and to show the KLC's accountability for the revenue that it generates. If you have any questions about this report or need additional financial information, contact the KLC's Public Relations Department at the Kentucky Lottery Corporation, 1011 West Main Street, Louisville, Kentucky 40202.

KENTUCKY LOTTERY CORPORATION

STATEMENTS OF NET POSITION

June 30, 2020 and 2019

(dollars in thousands)

	2020	2019
ASSETS		
Current Assets		
Cash and equivalents	\$ 17,458	\$ 28,547
Cash and equivalents, annuitants	2,600	2,600
Investments at fair value, current portion	2,203	1,623
Accounts receivable, net	56,862	37,269
Prepaid PowerPlay License, current portion	0	45
Other assets	824	718
Total current assets	<u>79,947</u>	<u>70,802</u>
Noncurrent Assets		
Investments at fair value, less current portion	7,701	9,138
Capital assets, net	5,592	5,727
Deposits with Multi-State Lottery Association	5,951	6,127
Total noncurrent assets	<u>19,244</u>	<u>20,992</u>
Total assets	<u>99,191</u>	<u>91,794</u>
LIABILITIES		
Current Liabilities		
Accounts payable, accrued expenses, and compensated absences, current portion	8,946	5,886
Due to the Commonwealth of Kentucky	10,693	16,956
Estimated prize liability, current portion	49,928	38,268
Total current liabilities	<u>69,567</u>	<u>61,110</u>
Noncurrent Liabilities		
Accrued compensated absences, less current portion	399	630
Estimated prize liability, less current portion	10,553	11,623
Total noncurrent liabilities	<u>10,952</u>	<u>12,253</u>
Total liabilities	<u>80,519</u>	<u>73,363</u>
NET POSITION		
Net investment in capital assets	5,592	5,727
Unrestricted	13,080	12,704
Net position	<u>\$ 18,672</u>	<u>\$ 18,431</u>

See accompanying notes.

KENTUCKY LOTTERY CORPORATION

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION For the Years Ended June 30, 2020 and 2019 (dollars in thousands)

	2020	2019
Operating revenues		
Instant games	\$ 741,063	\$ 669,212
Draw games	429,116	443,088
iLottery instant play games	33,263	17,355
Less instant tickets provided as prizes	0	(111)
Total operating revenues	<u>1,203,442</u>	<u>1,129,544</u>
Direct costs		
Prizes expense		
Instant games	523,684	471,513
Draw games	251,615	240,051
iLottery instant play games	25,942	13,248
Total prize expense	<u>801,241</u>	<u>724,812</u>
Payments to retailers	71,045	67,004
Draw game and iLottery vendor expense	15,473	13,737
Instant ticket costs	10,706	8,974
Total direct costs	<u>898,465</u>	<u>814,527</u>
Operating revenues net of direct costs	<u>304,977</u>	<u>315,017</u>
Operating expenses		
Advertising and promotion	11,561	11,484
Salaries, wages, and benefits	16,268	14,913
Contracted and professional services	2,196	2,440
Depreciation	1,108	1,202
Other general and administrative	1,957	1,916
Total operating expenses	<u>33,090</u>	<u>31,955</u>
Operating income	<u>271,887</u>	<u>283,062</u>
Non-operating revenue (expense)		
Payments to the Commonwealth of Kentucky	(272,223)	(283,611)
Investment income	872	1,049
Interest expense	(495)	(566)
Other income	200	201
Total non-operating expense	<u>(271,646)</u>	<u>(282,927)</u>
Change in net position	<u>241</u>	<u>135</u>
Net position at beginning of year	<u>18,431</u>	<u>18,296</u>
Net position at end of year	<u>\$ 18,672</u>	<u>\$ 18,431</u>

See accompanying notes.

KENTUCKY LOTTERY CORPORATION

STATEMENTS OF CASH FLOWS For the Years Ended June 30, 2020 and 2019 (dollars in thousands)

	2020	2019
Cash Flows from Operating Activities		
Cash received from customers	\$ 1,183,849	\$ 1,123,903
Cash receipts (payments) for deposits at the Multi-State Lottery Association	176	(945)
Cash payments to prize winners	(790,651)	(718,889)
Cash payments to suppliers	(111,216)	(106,362)
Cash payments to employees for services	(15,717)	(14,973)
Net cash provided by operating activities	<u>266,441</u>	<u>282,734</u>
Cash Flows from Noncapital Financing Activities		
Payments to the Commonwealth of Kentucky	<u>(278,486)</u>	<u>(272,786)</u>
Cash Flows from Capital and Related Financing Activities		
Purchases of capital assets	<u>(973)</u>	<u>(1,586)</u>
Cash Flows from Investing Activities		
Proceeds from sale of investments	1,594	1,859
Investment income	335	644
Net cash provided by investing activities	<u>1,929</u>	<u>2,503</u>
Increase (decrease) in cash and equivalents	(11,089)	10,865
Cash and equivalents at beginning of year	<u>31,147</u>	<u>20,282</u>
Cash and equivalents at end of year	<u>\$ 20,058</u>	<u>\$ 31,147</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	<u>\$ 271,887</u>	<u>\$ 283,062</u>
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,108	1,202
Provision for losses on accounts receivable	198	152
Increase (decrease) in cash due to changes in:		
Accounts receivable, net	(19,770)	(5,760)
Prepaid PowerPlay License	45	67
Other assets	(106)	230
Deposits with Multi-State Lottery Association	176	(945)
Accounts payable, accrued expenses, and compensated absences	2,808	(631)
Estimated prize liability	<u>10,095</u>	<u>5,357</u>
Total adjustments	<u>(5,446)</u>	<u>(328)</u>
Net cash provided by operating activities	<u><u>\$ 266,441</u></u>	<u><u>\$ 282,734</u></u>

Noncash capital and investing activities:

The accretion of interest on investments held to fund grand prizes, which increased prize liability for the years ended June 30, 2020 and 2019 totaled \$495 and \$566, respectively.

The unrealized fair value of investments increased \$241 and \$135 for the year ended June 30, 2020 and 2019, respectively.

See accompanying notes.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 1 – Organization

The Kentucky Lottery Corporation (KLC) was created with the enactment of House Bill No. 1 in December 1988 as an independent de jure municipal corporation and political subdivision of the Commonwealth of Kentucky (Commonwealth). The KLC is to be managed in such a manner that enables the people of the Commonwealth to benefit from its profits and to enjoy the best possible lottery games. The operations of the KLC are separate and distinct from other operations of the Commonwealth.

The KLC commenced operations on April 4, 1989 with the sale of instant game tickets. Sales of draw games began October 16, 1989. In January 1991, the KLC joined the Multi-State Lottery Association (MUSL), a group of states that combine lottery sales for draw games.

Note 2 – Summary of Significant Accounting Policies

Reporting Entity

The KLC has adopted the provisions of Government Accounting Standards Board (GASB) Section 2100: *Defining the Financial Reporting Entity*, under which the financial statements include all the organizations, activities, functions, and component units for which the KLC is financially accountable. Financial accountability is defined as (1) the appointment of a voting majority of the potential component unit's Board, and either (a) the KLC's ability to impose its will over the potential component unit, or (b) the possibility that the potential component unit will provide a financial benefit to or impose a financial burden on the KLC, or (2) the potential component unit is fiscally dependent on the KLC, and will provide a financial benefit to or impose a financial burden on the KLC.

The KLC has determined that no outside agency meets the above criteria; therefore, no other agency has been included as a component unit in the KLC's financial statements. In addition, since the KLC provides a financial benefit for the Commonwealth, the KLC is part of the reporting entity of the Commonwealth and is, therefore, included in the Commonwealth's Comprehensive Annual Financial Report as a discretely presented component unit. The accompanying financial statements are not intended to present the financial position or the results of operations and cash flows of the Commonwealth or its proprietary funds.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 2 – Summary of Significant Accounting Policies (Continued)

Basis of Presentation

The KLC is accounted for as an enterprise fund. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial statements are reported using the economic resources measurement focus. The financial statements include the accounts of KLC and have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred.

As an enterprise fund, the KLC distinguishes *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and delivering goods in connection with the KLC's principal ongoing operations. The principal operating revenues of the KLC are sales of lottery products. Operating expenses include the cost of sales and services, selling and administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Revenue and Accounts Receivable Recognition

Revenue and accounts receivable for draw games are recognized when tickets are sold to the public by contracted retailers.

Revenue and accounts receivable for instant games are recognized at the time packs of tickets are marked due or upon activation, whichever is sooner. Beginning in fiscal year 2009, the KLC implemented instant games that include instant tickets provided as prizes, which entitle the holder to exchange one instant ticket for another of equal value. The redemption of these instant tickets is netted against total operating revenue. These free ticket prizes were phased out in fiscal year 2020.

Revenue and accounts receivable for iLottery instant play games are recognized when games are sold to players on the iLottery portal. These games are played and results are revealed immediately after purchase.

Allowance for Doubtful Accounts

The KLC uses the allowance method to account for uncollectible accounts receivable. Trade receivables are written-off when deemed uncollectible. Recoveries of trade receivables previously written-off are recorded when received. KLC wrote off approximately \$21 and \$33 for the years ended June 30, 2020 and 2019, respectively. A trade receivable is considered uncollectible if a payment has not been received in 90 days or if KLC determines it is uncollectible based on pertinent facts and circumstances.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 2 – Summary of Significant Accounting Policies (Continued)

Prizes

Prize expense for instant ticket games is recorded as an estimate at the time the related revenue is recognized based on the predetermined prize structure for each game; after the last date to claim has passed, the prize expense is adjusted, if necessary, to reflect amounts actually won. Prize expense for draw games is recorded after each draw and is based on actual draw results. Prize expense for iLottery instant play games is recorded at the time of the purchase, when the outcome is determined.

Estimated Prize Liability

A liability for grand prize winners electing annual installments is recorded based on the cost of U.S. Treasury zero-coupon bonds and other U.S. Government agency securities purchased to fund the liability, adjusted for the accretion of interest based upon the purchased yield and maturity date. The estimated prize liability is presented in the statement of net position, net of this imputed interest. Imputed interest is amortized to interest expense over the life of the annuity utilizing the effective interest method. Grand prizes with annual installment options are awarded related to the Win for Life, Lucky for Life, Powerball, Mega Millions, and certain scratch-off games.

Win for Life draw grand prizes are paid in quarterly installments for the life of a winner. Initial prize liability for grand prize winners was based on an actuarial study. The KLC reviews those statistics to actual results for any changes that needed to be made based on the age of the winner. The KLC ended participation in the Win for Life draw game in January 2011 but continues to have financial obligations to nine past winners.

Lucky for Life grand prizes and second tier prizes are paid in annual installments for the life of a winner, or a minimum of 20 years. A single lump-sum cash payment is also available. As of June 30, 2020, the KLC did not have any grand prize winners elect the grand prize annuity option.

Powerball grand prizes are paid in 30 annual installments or in a single lump-sum payment equal to the estimated present cash value of 30 annual payments. The KLC has one grand prize winner that elected the annuity option and continues to be paid annually.

Mega Millions grand prizes are paid in 30 annual installments or in a single lump-sum payment equal to the estimated present cash value of 30 annual payments. The KLC does not have any grand prize winners currently being paid.

Various instant games have grand prizes with annuity options, paid quarterly or annually for varying amounts and time periods. The KLC has nine grand prize winners that elected the annuity option and continue to be paid quarterly or annually.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS June 30, 2020 and 2019 (dollars in thousands)

Note 2 – Summary of Significant Accounting Policies (Continued)

Cash and Equivalents

For financial statement purposes, the KLC considers all highly liquid investments with an original maturity of less than 90 days to be cash equivalents. Cash equivalents are reported at cost.

Investments

Investments consist of U.S. Treasury zero-coupon bonds and other U.S. Government agency securities carried at fair value in accordance with GASB Statement No. 72, *Fair Value Measurement and Application*. Fair value of investments is based on quoted market prices or matrix pricing. Investments are in U.S. Treasury zero-coupon bonds and other U.S. Government backed securities and are purchased to meet future installment payments to grand prize winners. There are generally no realized gains or losses on investments, as it is the KLC's policy to hold the investments to maturity.

Capital Assets

Capital assets are carried at cost less accumulated depreciation. The KLC defines capital assets as assets with an initial, individual cost of more than \$5 and an estimated useful life in excess of one year. Depreciation is computed using the straight-line method over estimated lives of the assets. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations in the period of disposal. The estimated useful lives by general classification are as follows:

Buildings	30 years
Game equipment	5 years
Data processing equipment and software	5 years
Automobiles, furniture, and fixtures	3 - 5 years
Computer software	7 years

Interest related to construction of capital assets is capitalized. No interest was capitalized for the years ended June 30, 2020 and 2019.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 2 – Summary of Significant Accounting Policies (Continued)

Deposits with MUSL

Deposits are carried at cost. MUSL is a non-profit, government-benefit association created for the purpose of administering joint lottery games, such as Powerball. In January 2010, the Mega Millions states and MUSL signed an agreement for cross-selling of each other's products. MUSL currently includes 35 state lottery entities, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. The chief executive officer of each member lottery serves on the MUSL Board of Directors. As a member of MUSL, the KLC is required to contribute to various prize reserve funds maintained by MUSL. The prize reserve funds serve as a contingency reserve to protect MUSL from unforeseen prize liabilities.

All prize reserve funds remitted, and the related interest earnings, will be returned to the KLC upon leaving MUSL, less any portion of unanticipated prize claims which may have been paid from the fund.

Net Position

Net position of the KLC is classified and displayed as three components:

- Net investment in capital assets - Consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted net position - Consists of assets with constraints placed on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- Unrestricted net position - All other net position that does not meet the definition of "net investment in capital assets" or "restricted".

As of June 30, 2020 and 2019, the KLC had no restricted net position.

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 as of the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Accordingly, actual results could differ from those estimates.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 2 – Summary of Significant Accounting Policies (Continued)

Subsequent Events Evaluation

Since the KLC is part of the reporting entity of the Commonwealth and is included in the Commonwealth's Comprehensive Annual Financial Report as a discretely presented component unit, management has evaluated subsequent events through September 18, 2020 and will re-evaluate subsequent events before the Commonwealth completes its Comprehensive Annual Financial Report in December 2020.

Pending Accounting Pronouncements Not Yet Adopted

The GASB has issued the following statement not yet implemented by the KLC:

GASB Statement No. 87, *Leases*, issued June 2017. The provisions of this statement require governments to recognize certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of this statement are effective for reporting periods beginning after December 15, 2021. This statement is not expected to have a material impact on the KLC's financial position or results of operations.

GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*, issued May 2020. The provisions of this statement require governments with subscription-based information technology arrangements to recognize a right-to-use subscription asset (an intangible asset) and a corresponding subscription liability. This statement is effective for fiscal years beginning after June 15, 2022 and all reporting periods thereafter. This statement is not expected to have a material impact on the KLC's financial position or results of operations.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 3 – Cash and Equivalents

The components of cash and equivalents for the years ended June 30, 2020 and 2019 consisted of the following:

	<u>2020</u>	<u>2019</u>
Cash on deposit in banks	\$ 21,323	\$ 32,761
Checks issued against cash on deposit	<u>(1,265)</u>	<u>(1,614)</u>
	<u>\$ 20,058</u>	<u>\$ 31,147</u>

All of the KLC's deposits are either insured or collateralized. All deposits exceeding the federal depository insurance coverage level are collateralized with securities held by the KLC's agents in the KLC's name. The KLC's policy regarding custodial credit risk for cash on deposit in banks is to be fully collateralized by U.S. Government securities held by the KLC or by the KLC's agent in the KLC's name.

Note 4 – Investments

The KLC categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The hierarchy is based on the valuation inputs to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The KLC's investments in U.S. Treasury Strips are valued using quoted market prices (Level 1 inputs) and U.S. Government backed investments are valued using similar assets using matrix pricing (Level 2 inputs).

At June 30, 2020, the KLC's investment balances were as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Maturity</u>
U.S. Treasury Strips	\$ 6,625	\$ 6,625	\$ 0	Weighted average maturity of 4.24 years
Other U.S. Government backed	<u>3,279</u>	<u>0</u>	<u>3,279</u>	Weighted average maturity of 3.25 years
Total	<u>\$ 9,904</u>	<u>\$ 6,625</u>	<u>\$ 3,279</u>	

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 4 – Investments (Continued)

At June 30, 2019, the KLC's investment balances were as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Maturity</u>
U.S. Treasury Strips	\$ 7,141	\$ 7,141	\$ 0	Weighted average maturity of 4.46 years
Other U.S. Government backed	<u>3,620</u>	<u>0</u>	<u>3,620</u>	Weighted average maturity of 3.71 years
Total	<u>\$ 10,761</u>	<u>\$ 7,141</u>	<u>\$ 3,620</u>	

Credit Rating – U.S. Treasury obligations which are backed by the full faith and credit of the U.S. Government are not rated. For 2020, \$2,736 of the other U.S. Government backed investments are not rated and the remaining \$543 are all rated AAA. For 2019, \$2,565 of the other U.S. Government backed investments are not rated, and the remaining \$1,055 are all rated AAA. Ratings are provided by Moody's.

Interest Rate Risk – The KLC has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. It is the policy of the KLC to hold investments to maturity.

Credit Risk – This is the risk that a counter party will fail to fulfil its obligation. The KLC mitigates this risk through its investment policy, which limits the purchase of investments to U.S. Treasury Strips or other debt securities backed by the U.S. Government.

Concentration of Credit Risk – The KLC's general investment policy is to take a very conservative approach when investing KLC money. The policy requires 100 percent of KLC's investments must be in U.S. Treasuries or other debt securities backed by the U.S. Government. For 2020 and 2019, approximately 18 and 15 percent of total investments were in Resolution Funding Corporation Strips, respectively, and 5 and 10 percent in Israel Bonds, respectively, all of which are U.S. Government backed.

Custodial Credit Risk – The custodial credit risk for investments is the risk that in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investments or collateral securities that are in the possession of another party. A trust agreement documenting the custody arrangement is executed between the custodian and the KLC. Such agreement provides, among other stipulations, that the securities are not assets of the custodian subject to disposition in the event of the insolvency of the custodian.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 4 – Investments (Continued)

The net change in the fair value of investments includes all changes in fair value that occurred during the year. The calculation of realized gains and losses is independent of the calculation of the change in the fair value of investments. Realized gains of the current period include unrealized amounts from prior periods. The components of investment income for the years ended June 30, 2020 and 2019 consisted of the following:

	<u>2020</u>	<u>2019</u>
Unrealized change in fair value of investments	\$ 241	\$ 135
Accretion of investments	495	566
Security lending income	2	4
Interest income	<u>134</u>	<u>344</u>
 Total investment income	 <u>\$ 872</u>	 <u>\$ 1,049</u>

When compared to the historical cost method, recording investments at fair value results in an increase in income by approximately \$241 and \$135 in 2020 and 2019, respectively.

Unrestricted net position at June 30, 2020 and 2019 is as follows:

	<u>2020</u>	<u>2019</u>
Unrestricted net position excluding unrealized gains on investments	\$ 11,547	\$ 11,412
Accumulated unrealized gains on investments	<u>1,533</u>	<u>1,292</u>
 Total unrestricted net position	 <u>\$ 13,080</u>	 <u>\$ 12,704</u>

The KLC is authorized by state statutes and investment policies approved by the Board of Directors to lend its investment securities. The lending is managed by the Commonwealth's securities lending agent. The KLC's securities are co-mingled with the rest of the Commonwealth's securities. Refer to the Commonwealth of Kentucky's Comprehensive Annual Financial Report for details. All loans can be terminated on demand by either the KLC or the borrowers, although the average term of loans is approximately one day.

The Commonwealth's securities lending agent and its affiliates are prohibited from borrowing the KLC's securities. The Commonwealth's securities lending agent lends KLC's securities in exchange for cash. The cash is used to invest in repurchase agreements and securities are pledged as collateral. There are no restrictions on the amount of securities that can be lent at one time or to one borrower. The KLC cannot pledge or sell collateral securities unless the borrower defaults. The agent indemnifies the KLC from any losses from borrowers.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 4 – Investments (Continued)

At June 30, 2020 and 2019, the KLC had loaned investments with fair values of approximately \$250 and \$383, respectively, to authorized brokers for a fee. Cash received from securities loans is invested in repurchase agreements with at least 100 percent collateral pledge. Cash collateral for 2020 and 2019 was over 101 percent. The repurchase agreements have carrying values of approximately \$255 and \$387 at June 30, 2020 and 2019, respectively, which are held by the KLC's securities custodian. At June 30, 2020 and 2019, the KLC had no credit risk exposure to borrowers because the amounts the KLC owed to borrowers exceeded the amounts the borrowers owed to the KLC. The KLC loaned investments are included in the investments reported in the financial statements rather than the securities received in the exchange.

Note 5 – Accounts Receivable

Accounts receivable at June 30, 2020 and 2019 consisted of the following:

	<u>2020</u>	<u>2019</u>
Accounts receivable	\$ 57,440	\$ 37,670
Allowance for doubtful accounts	<u>(578)</u>	<u>(401)</u>
Accounts receivable, net	<u>\$ 56,862</u>	<u>\$ 37,269</u>

Balances due from retailers for the sales of lottery tickets make up more than 98 percent of the accounts receivable balance above.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 6 – Capital Assets

Capital asset activity for the year ended June 30, 2020 was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets not being depreciated				
Land	<u>\$ 423</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 423</u>
Net capital assets, non-depreciable	<u>423</u>	<u>0</u>	<u>0</u>	<u>423</u>
Capital assets being depreciated				
Buildings	8,111	429		8,540
Game equipment	488			488
Data processing equipment and software	6,028	45		6,073
Automobiles, furniture, and fixtures	<u>2,357</u>	<u>499</u>	<u>(59)</u>	<u>2,797</u>
Total other capital assets at cost	<u>16,984</u>	<u>973</u>	<u>(59)</u>	<u>17,898</u>
Less accumulated depreciation for				
Buildings	(5,347)	(337)		(5,684)
Game equipment	(432)	(8)		(440)
Data processing equipment and software	(3,827)	(581)		(4,408)
Automobiles, furniture, and fixtures	<u>(2,074)</u>	<u>(182)</u>	<u>59</u>	<u>(2,197)</u>
Total accumulated depreciation	<u>(11,680)</u>	<u>(1,108)</u>	<u>59</u>	<u>(12,729)</u>
Net capital assets, depreciable	<u>5,304</u>	<u>(135)</u>	<u>0</u>	<u>5,169</u>
Total capital assets, net	<u>\$ 5,727</u>	<u>\$ (135)</u>	<u>\$ 0</u>	<u>\$ 5,592</u>

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 6 – Capital Assets (Continued)

Capital asset activity for the year ended June 30, 2019 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated				
Land	\$ 423	\$ 0	\$ 0	\$ 423
Net capital assets, non-depreciable	423	0	0	423
Capital assets being depreciated				
Buildings	8,079	147	(115)	8,111
Game equipment	562	66	(140)	488
Data processing equipment and software	4,962	1,066	0	6,028
Automobiles, furniture, and fixtures	2,405	307	(355)	2,357
Total other capital assets at cost	16,008	1,586	(610)	16,984
Less accumulated depreciation for				
Buildings	(5,092)	(272)	17	(5,347)
Game equipment	(561)	(11)	140	(432)
Data processing equipment and software	(3,143)	(684)	0	(3,827)
Automobiles, furniture, and fixtures	(2,194)	(235)	355	(2,074)
Total accumulated depreciation	(10,990)	(1,202)	512	(11,680)
Net capital assets, depreciable	5,018	384	(98)	5,304
Total capital assets, net	\$ 5,441	\$ 384	\$ (98)	\$ 5,727

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 7 – Compensated Absences

It is the KLC’s policy to permit employees to accumulate earned but unused paid time off benefits. In January 2019, KLC implemented a new paid time off policy with all hours combined into one paid time off category. At this time, all earned but unused vacation and floating holiday hours were rolled into the new paid time off category, along with new hours awarded. Accumulated and unused sick leave hours remained in a separate category and can still be used, but no new hours were awarded. There is no liability recorded for unpaid accumulated sick leave hours since the KLC does not have a policy to pay unused amounts when employees separate from service. Employees can accrue no more than 696 hours of paid time off. Accrued paid time off at June 30, 2020 and 2019, included in accrued compensated absences in the accompanying Statements of Net Position, consisted of the following:

	2020	2019
Current	\$ 1,375	\$ 905
Compensated absences, less current portion	399	630
 Total compensated absences	 \$ 1,774	 \$ 1,535

Years Ended June 30,	Beginning Balance	Increases	Decreases	Ending Balance
2020	\$ 1,535	\$ 1,362	\$ (1,123)	\$ 1,774
2019	1,364	1,295	(1,124)	1,535

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS
June 30, 2020 and 2019
(dollars in thousands)

Note 8 – Estimated Prize Liability

Estimated prize liability at June 30, 2020 and 2019 consisted of the following:

	<u>2020</u>	<u>2019</u>
Current:		
Grand prizes	\$ 1,459	\$ 1,669
Other prizes	<u>48,469</u>	<u>36,599</u>
Total current portion	<u>49,928</u>	<u>38,268</u>
Long-term:		
Grand prizes	<u>10,553</u>	<u>11,623</u>
Total prize liability	<u><u>\$ 60,481</u></u>	<u><u>\$ 49,891</u></u>

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 8 – Estimated Prize Liability (Continued)

Liability activity of grand prize awards payable was as follows:

<u>Years Ended June 30,</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
2020	\$ 13,292	\$ 524	\$ (1,804)	\$ 12,012
2019	14,841	584	(2,133)	13,292

Liabilities for future payments of grand prize liabilities are summarized as follows:

<u>Years Ending June 30,</u>	
2021	\$ 1,459
2022	1,407
2023	1,355
2024	1,355
2025	1,305
2026 through 2030	3,321
2031 through 2035	2,143
2036 through 2040	1,527
2041 through 2045	728
2046 through 2050	<u>416</u>
Total	15,016
Less unamortized discount	<u>(3,004)</u>
Total at present value	12,012
Less current portion	<u>(1,459)</u>
Total long-term portion at present value	<u><u>\$ 10,553</u></u>

Estimated prize liability for grand prizes is based on the cost of U.S. Treasury zero-coupon bonds and other U.S. Government agency securities purchased to fund the liability, adjusted for the accretion of interest based upon the purchased yield and maturity date. This adjustment of approximately \$495 and \$566 in 2020 and 2019, respectively, is included in interest expense. These amounts comprise the entire amounts of interest expense for the years ended June 30, 2020 and 2019.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 9 – Retirement Plan

Kentucky Revised Statute (KRS) 154A.080 states, "The Corporation shall provide a retirement plan for its employees." The KLC Board of Directors has the authority to establish contribution requirements and amend any of the plan's provisions. The KLC has a money-purchase retirement plan (Plan) covering eligible employees that is a Defined Contribution plan. The Plan is currently administered by Fidelity Investments. The fair value of investments is determined by the quoted market prices for each investment at the close of market.

Prior to April 1, 2007, under the terms of the Plan, the KLC and employees each contribute 6.2 percent (Mandatory and Supplemental Contributions) of the employee's compensation for the calendar year, not to exceed the Taxable Wage Base as defined by the Plan. Employees become eligible for participation and are fully vested at the date of employment for this portion of the Plan. On and after April 1, 2007, a participant, as defined by the Plan, who makes and for whom the employer makes payments into the Social Security System under the Federal Insurance Contributions Act, shall not be eligible for the Mandatory and Supplemental Contributions.

The KLC also makes a contribution (Basic Contribution) equal to eight percent of the employee's earned annual base salary. Employees become eligible one year after the date of employment and are fully vested after five years of service, or at normal retirement age defined in the Plan, providing participation requirements are met.

During 2020 and 2019, the KLC's contributions were calculated using the eligible compensation amount for eligible employees of \$5,094 and \$5,573, respectively, for the 6.2 percent employer contribution (Mandatory and Supplemental Contributions), and \$10,218 and \$9,550, respectively, for the 8 percent employer contribution (Basic Contributions). Employer contributions actually made to the Plan were approximately \$1,133 and \$1,110 in 2020 and 2019, respectively. Employee contributions to the Plan were approximately \$316 and \$346 in 2020 and 2019, respectively. At June 30, 2020 and 2019, the KLC had an outstanding liability of approximately \$32 and \$21, respectively, owed to the Plan, as part of the accrued salaries balance.

During 2020 and 2019, forfeitures of \$22 and \$0, respectively, were reflected as a reduction to retirement plan expense.

In addition to the Plan, the KLC's employees are also eligible to participate in two deferred compensation plans sponsored by the Commonwealth. These plans are organized as a Section 457 plan and as a Section 401(k) plan under the Internal Revenue Code. Both plans permit employees to defer a portion of their salary until future years. The Commonwealth's Comprehensive Annual Financial Reports should be referred to for further disclosures related to the deferred compensation plans. The KLC provides no matching of contributed funds to the deferred compensation plans.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 10 – Leases

The KLC has entered into operating leases for the rental of lottery vending machines and monitors, as part of the lottery gaming system contract with International Game Technologies (IGT). The terms of the leases are up to seven years.

Approximate minimum payments are:

<u>Years Ending June 30,</u>	<u>Vending Machines</u>	<u>Monitors</u>	<u>Total</u>
2021	\$ 4,094	\$ 85	\$ 4,179
2022	3,834	23	3,857
2023	3,695	5	3,700
2024	3,301	0	3,301
2025	3,167	0	3,167
Thereafter	<u>1,769</u>	<u>0</u>	<u>1,769</u>
Total	<u>\$ 19,860</u>	<u>\$ 113</u>	<u>\$ 19,973</u>

Total expense for 2020 and 2019 was approximately \$3,584 and \$2,547, respectively.

Note 11 – Payments to the Commonwealth

Payments to the Commonwealth represent transfers of funds from the KLC to the Commonwealth's General Fund and the Kentucky Educational Excellence Scholarship (KEES) Reserve Account. The payments to the General Fund, which are approved by the Board of Directors and remitted to the Commonwealth on a monthly basis, are used to pay for college scholarships, grants, and education programs. The payments to the KEES Reserve Account are used to provide college or technical school scholarships to Kentucky high school students. The amounts payable to the KEES Reserve Account result from unclaimed prizes on instant and draw games. Prizes not claimed within 180 days of the drawing date for draw games or game ending date for instant tickets are forfeited and considered unclaimed. In accordance with KRS 154A.110(3), any unclaimed prize money from these games may be retained by the KLC and added to the pool from which future prizes are to be awarded or used for special prize promotions, or may be appropriated by the General Assembly directly from the KLC for any public purpose. During the years ended June 30, 2020 and 2019, all unclaimed prize money was transferred to the KEES Reserve Account as required by HB 368 of the 2020 Regular Session. Payments are made after the end of each quarter.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 11 – Payments to the Commonwealth (Continued)

Payments, including amounts accrued, to the Commonwealth for the years ended June 30, 2020 and 2019 included payments to the following funds:

	<u>2020</u>	<u>2019</u>
General Fund	\$ 265,105	\$ 276,163
KEES Scholarship Reserve Fund	<u>7,118</u>	<u>7,448</u>
	<u>\$ 272,223</u>	<u>\$ 283,611</u>

Note 12 – Risk Management

The KLC is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; data breach; and natural disasters. The KLC has purchased commercial insurance to cover these risks except for workers' compensation and damage to buildings and personal property for which the KLC utilizes the Commonwealth's Risk Management Fund to cover the exposure to these potential losses. The Commonwealth's Comprehensive Annual Financial Reports should be referred to for additional disclosures related to the Risk Management Fund. The amount of commercial coverage has not decreased nor has the amount of settlements exceeded coverage.

Note 13 – Commitments and Contingencies

The Lottery has contracted with IGT to provide for the operation of the gaming system, with an initial term of July 10, 2011 through July 9, 2021. Through contract negotiations, this contract was amended September 30, 2019 and extended five years, from July 10, 2021 through July 9, 2026. Effective July 12, 2020, the weekly fees paid to IGT will decrease by five percent. The commission paid to IGT for draw game lottery sales will decrease from 1.5395 percent to 1.4625 percent of gross draw sales. The commission paid to IGT for scratch-off lottery sales will decrease from 0.438 percent to 0.416 percent of net scratch-off sales. In addition, and in consideration of the additional products and services provided by IGT under the contract amendment and extension, KLC will pay IGT a fixed fee of \$250,000 per month, beginning August 12, 2020. IGT receives compensation of \$56.37 per retail location, per month, for retail communications network and management, plus an additional \$18.25 for locations with dual communication.

The Lottery has also contracted with IGT to provide an iLottery system, game content, and related services, with an initial term of December 23, 2014 through April 16, 2020, with a sales start date of April 17, 2016. Through contract negotiations, this contract was extended for an additional two years to April 16, 2022. KLC pays commission to IGT for these services equal to 16.99 percent of net iLottery sales, defined as gross instant play and draw game sales, minus the statistical payout for each game.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2020 and 2019

(dollars in thousands)

Note 13 – Commitments and Contingencies (Continued)

The Lottery contracted with Scientific Games International, Inc. (SG) to provide ticket production and cooperative services, including ticket ordering and distribution functions, with a contract extension term of March 9, 2018 through June 25, 2026. The rate paid on ticket production services is 0.8617 percent of net scratch-off sales of SG games. The rate paid on cooperative services is 0.43 percent of net scratch-off sales of all games.

The KLC is a party to various litigation and other claims in the ordinary course of business. KLC management is of the opinion, based upon the advice of legal counsel, that the ultimate resolution of these matters will not have a material effect on the financial statements of the KLC.

**INDEPENDENT AUDITOR’S 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**



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RSM US Alliance

Auditor of Public Accounts,
the Commonwealth of Kentucky, and
the Board of Directors of the
Kentucky Lottery Corporation
Louisville, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Statement of Net Position, Statement of Revenues, Expenses and Changes in Net Position, and the Statement of Cash Flows of the Kentucky Lottery Corporation, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2020 and the related notes to the financial statements, and have issued our report thereon dated September 18, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Kentucky Lottery Corporation’s internal control over financial reporting (internal control) to determine audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Kentucky Lottery Corporation’s internal control. Accordingly, we do not express an opinion on the effectiveness of Kentucky Lottery Corporation’s internal control.

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



**INDEPENDENT AUDITOR'S 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
(CONTINUED)**

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Wardig, Skymanski & Company, P. S. C.

Louisville, Kentucky
September 18, 2020

KENTUCKY LOTTERY CORPORATION

SCHEDULE OF FINDINGS **Year Ended June 30, 2020**

Schedule of auditor's results

We have issued an unmodified opinion, dated September 18, 2020, on the financial statements of the Kentucky Lottery Corporation as of and for the year ended June 30, 2020.

Our audit disclosed no instances of noncompliance which are material to the Kentucky Lottery Corporation's financial statements.

Findings relating to the financial statements

Our audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.

KENTUCKY LOTTERY CORPORATION

SCHEDULE OF PRIOR AUDIT FINDINGS AND THEIR RESOLUTIONS

Year Ended June 30, 2020

The prior year's audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.