

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

**For The Years Ended  
June 30, 2019 and 2018**



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**MIKE HARMON**  
**AUDITOR OF PUBLIC ACCOUNTS**

To the People of Kentucky  
Honorable Matt Bevin, 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, 2019 and 2018, 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, 2019 and 2018*

KENTUCKY LOTTERY CORPORATION

ANNUAL FINANCIAL REPORT

June 30, 2019 and 2018

***CONTENTS***

INDEPENDENT AUDITOR’S REPORT .....	1
MANAGEMENT’S DISCUSSION AND ANALYSIS .....	3
BASIC FINANCIAL STATEMENTS:	
STATEMENTS OF NET POSITION .....	17
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION ....	18
STATEMENTS OF CASH FLOWS .....	19
NOTES TO FINANCIAL STATEMENTS.....	20
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 <i>GOVERNMENT AUDITING STANDARDS</i> .....	38
SCHEDULE OF FINDINGS .....	40
SCHEDULE OF PRIOR AUDIT FINDINGS AND THEIR RESOLUTIONS.....	41

## INDEPENDENT AUDITOR'S REPORT



**HARDING, SHYMANSKI  
& COMPANY, P.S.C.**

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An Independently  
Owned Member,  
RSM US Alliance

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, 2019 and 2018, 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.



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## **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, 2019 and 2018, 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 27, 2019 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.

*Harding, Shymanski & Company, P.S.C.*

Louisville, Kentucky  
September 27, 2019

**Evansville, IN ■ Louisville, KY**

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, 2019 and 2018. Please read it in conjunction with the financial statements, which follow.

#### Financial Highlights for Fiscal Year (FY) 2019

- Record operating revenues, including instant tickets provided as prizes, of \$1.13 billion were achieved in 2019, an increase of \$87.1 million or 8.4 percent over last year's previous sales record of \$1.04 billion. 2019 represents the ninth consecutive year of record sales for the KLC and the third time that sales of more than \$1 billion have been achieved.
- Instant ticket sales increased \$56.1 million or 9.2 percent to a record \$669.2 million. 2019 represents the fifth consecutive year the KLC has achieved record instant ticket sales. The KLC introduced a \$30 price point ticket in February 2019 that generated sales of \$44.3 million.
- Draw game sales increased \$24.0 million or 5.7 percent over 2018, to a record \$443.1 million.
- Mega Millions generated sales of \$63.1 million, exceeding prior year by \$23.3 million or 58.5 percent.
- Keno generated sales of \$84.3 million, exceeding prior year by \$1.5 million or 1.8 percent. Keno sales have increased each year since sales began in FY 2014.
- iLottery instant play games generated sales of \$17.3 million, exceeding prior year by \$7.0 million or 68.0 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 cash equivalents, investments, accounts receivable, capital assets and deposits. As shown in Table 1, the KLC's total assets increased \$16.2 million to \$91.7 million in 2019. Total assets increased \$3.0 million to \$75.5 million in 2018 from \$72.5 million in 2017. 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 from the sale of draw and instant game tickets. Accounts receivable increased \$5.7 million to \$37.3 million in 2019. Accounts receivable increased \$6.9 million to \$31.6 million in 2018 from \$24.7 million in 2017. This increase was due to increased sales as well as the timing of the fiscal year-end billing cycle.



## Capital Assets

The KLC's investment in capital assets, net of accumulated depreciation in 2019 and 2018, was \$5.7 and \$5.4 million, respectively. The investment in capital assets includes buildings, game equipment, data processing equipment and software, automobiles, and furniture. The total increase in the KLC's investment in capital assets for 2019 was \$0.3 million or 5.3 percent compared to an increase of \$0.1 million or 2.4 percent in 2018. 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)**

	<b>2019</b>	<b>Increase (Decrease)</b>	<b>2018</b>	<b>Increase (Decrease)</b>	<b>2017</b>
Current and other assets	\$ 70.8	\$ 16.0	\$ 54.8	\$ 4.2	\$ 50.6
Investments (noncurrent)	9.1	(1.0)	10.1	(1.6)	11.7
Prepaid PowerPlay license	0.0	0.0	0.0	(0.1)	0.1
Capital assets, net	5.7	0.3	5.4	0.1	5.3
Deposits with Multi State Lottery Assoc.	<u>6.1</u>	<u>0.9</u>	<u>5.2</u>	<u>0.4</u>	<u>4.8</u>
<b>Total assets</b>	<b><u>91.7</u></b>	<b><u>16.2</u></b>	<b><u>75.5</u></b>	<b><u>3.0</u></b>	<b><u>72.5</u></b>
Current liabilities	60.4	17.2	43.2	4.4	38.8
Long-term liabilities	<u>12.9</u>	<u>(1.1)</u>	<u>14.0</u>	<u>(0.7)</u>	<u>14.7</u>
<b>Total liabilities</b>	<b><u>73.3</u></b>	<b><u>16.1</u></b>	<b><u>57.2</u></b>	<b><u>3.7</u></b>	<b><u>53.5</u></b>
<b>Net position</b>					
Net investment in capital assets	5.7	0.3	5.4	0.1	5.3
Unrestricted - accumulated unrealized gains on investments	1.3	0.1	1.2	(0.7)	1.9
Unrestricted	<u>11.4</u>	<u>(0.3)</u>	<u>11.7</u>	<u>(0.1)</u>	<u>11.8</u>
<b>Total net position</b>	<b><u>\$ 18.4</u></b>	<b><u>\$ 0.1</u></b>	<b><u>\$ 18.3</u></b>	<b><u>\$ (0.7)</u></b>	<b><u>\$ 19.0</u></b>

## Liabilities

**TABLE 2**  
**LIABILITIES**  
**(In millions)**

	Current			Long-Term		
	2019	2018	2017	2019	2018	2017
Accounts payable and other liabilities	\$ 5.2	\$ 6.0	\$ 6.3	\$ 1.3	\$ 1.1	\$ 1.2
Prize liabilities	38.2	31.1	30.0	11.6	12.9	13.5
Due to Commonwealth	17.0	6.1	2.5	0.0	0.0	0.0
<b>Total liabilities</b>	<b>\$ 60.4</b>	<b>\$ 43.2</b>	<b>\$ 38.8</b>	<b>\$ 12.9</b>	<b>\$ 14.0</b>	<b>\$ 14.7</b>

Total current liabilities increased \$17.2 million or 39.8 percent in 2019 and increased \$4.4 million or 11.3 percent in 2018. The account titled "Due to Commonwealth" increased \$10.9 million in 2019 and increased \$3.6 million in 2018. This represents payments due to the General Fund and the Kentucky Educational Excellence Scholarship Reserve Fund 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 \$1.1 million or 7.8 percent in 2019 and \$0.7 million or 4.8 percent in 2018. The decrease is attributable to the maturing of long-term prize liabilities. More detailed information can be obtained in Note 9 to the financial statements.

## Net Position

As shown in Table 1 on page 4, the KLC's net position in 2019 increased \$0.1 million to \$18.4 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 \$18.4 million included the KLC's net investment in capital assets of \$5.7 million and \$12.7 million in unrestricted net position. Unrestricted net position was comprised of \$1.3 million in accumulated unrealized gains on investments and \$11.4 million in working capital and cash flow that is utilized in the KLC's day-to-day operations. In 2018, the KLC's net position decreased \$0.7 million to \$18.3 million due to the reduction in the accumulated unrealized gains on investments the KLC holds to maturity to fund future payments due on annuitized lottery prizes.

Changes in Net Position

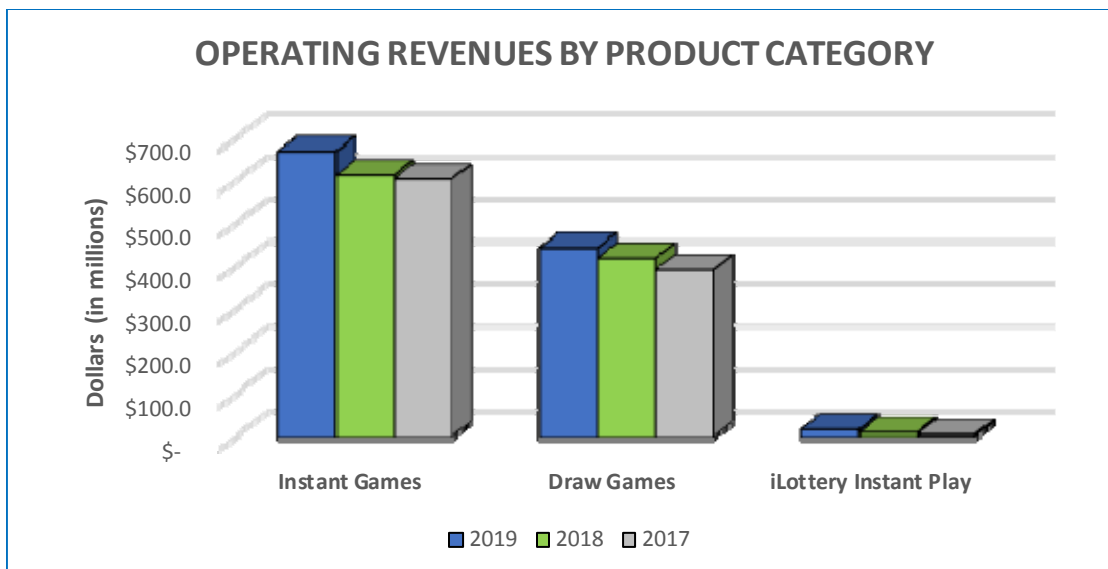
**TABLE 3**  
**CHANGES IN NET POSITION**  
**(In millions)**

	<u>2019</u>	<u>Increase</u> <u>(Decrease)</u>	<u>2018</u>	<u>Increase</u> <u>(Decrease)</u>	<u>2017</u>
Operating revenues					
Instant games	\$ 669.2	\$ 56.1	\$ 613.1	\$ 9.3	\$ 603.8
Draw games	443.1	24.0	419.1	27.6	391.5
iLottery instant play games	17.3	7.0	10.3	5.1	5.2
Less: tickets provided as prizes	<u>(0.1)</u>	<u>7.2</u>	<u>(7.3)</u>	<u>6.2</u>	<u>(13.5)</u>
Total operating revenues	1,129.5	94.3	1,035.2	48.2	987.0
Non-operating revenues	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>(0.1)</u>	<u>0.1</u>
Total revenues	<u>1,129.5</u>	<u>94.3</u>	<u>1,035.2</u>	<u>48.1</u>	<u>987.1</u>
Direct costs and operating expenses					
Direct costs:					
Prize expense	724.8	67.4	657.4	28.6	628.8
Payments to retailers	67.0	5.9	61.1	(0.6)	61.7
Draw game vendor expense	13.7	2.3	11.4	1.3	10.1
Instant ticket costs	<u>9.0</u>	<u>0.5</u>	<u>8.5</u>	<u>(0.4)</u>	<u>8.9</u>
Total direct costs	814.5	76.1	738.4	28.9	709.5
Operating expenses	<u>32.0</u>	<u>1.1</u>	<u>30.9</u>	<u>0.7</u>	<u>30.2</u>
Total direct costs and operating expenses	846.5	77.2	769.3	29.6	739.7
Non-operating expenses (revenue)	(0.7)	(0.9)	0.2	(0.4)	0.6
Payments to the Commonwealth of Kentucky	<u>283.6</u>	<u>17.2</u>	<u>266.4</u>	<u>17.8</u>	<u>248.6</u>
Total expenses	<u>1129.4</u>	<u>93.5</u>	<u>1035.9</u>	<u>47.0</u>	<u>988.9</u>
Changes in net position	0.1	0.8	(0.7)	1.1	(1.8)
Net position at beginning of year	<u>18.3</u>	<u>(0.7)</u>	<u>19.0</u>	<u>(1.8)</u>	<u>20.8</u>
Net position at end of year	<u>\$ 18.4</u>	<u>\$ 0.1</u>	<u>\$ 18.3</u>	<u>\$ (0.7)</u>	<u>\$ 19.0</u>

## Operating Revenues and Prize Expense

### Operating Revenues

In 2019, operating revenues consisted of ticket sales from three product categories, instant games, draw games, and iLottery instant play games. In 2019, the KLC generated record ticket sales of \$1.13 billion, an increase of \$94.3 million or 9.1 percent when compared to 2018. In 2018, the KLC produced ticket sales of \$1.04 billion, an increase of \$42.0 million or 4.2 percent when compared to 2017. 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. Total ticket sales for 2017, net of \$13.5 million of tickets provided as prizes, were \$987.0 million.



### Instant Games

Record KLC instant ticket sales of \$669.2 million were achieved in 2019, and accounted for 59.3 percent of all KLC sales, or an increase of \$56.1 million or 9.2 percent over 2018. 2018 instant ticket sales, which accounted for 58.8 percent of all KLC sales, were \$613.1 million, an increase of \$9.35 million or 1.5 percent over 2017.

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.

2018 sales growth within the instant product category occurred at the \$5, \$10, and \$25 price points, which saw increases of 2.0 percent, 3.8 percent, and 33.1 percent, respectively. Sales growth in the \$25 price point was mainly attributable to an increase in customer demand for higher price point tickets.

2018 sales decreases were recognized at the \$1 price point with a decrease of 18.0 percent; the \$2 price point with a decrease of 12.2 percent; the \$3 price point with a decrease of 22.3 percent; and the \$20 price point with a decrease of 5.2 percent.

Instant Games (Continued)

Table 4 and the accompanying chart compares sales for each instant game price point for 2019, 2018, and 2017.

**TABLE 4**  
**INSTANT SALES BY PRICE POINT**  
(In millions)

Price Point	Increase		Increase		2017
	2019	(Decrease)	2018	(Decrease)	
\$1	\$ 22.3	\$ (3.2)	\$ 25.5	\$ (5.6)	\$ 31.1
\$2	48.4	(5.5)	53.9	(7.5)	61.4
\$3	25.5	0.1	25.4	(7.3)	32.7
\$5	183.4	8.9	174.5	3.5	171.0
\$10	154.5	(3.0)	157.5	5.7	151.8
\$20	136.1	59.2	76.9	(4.2)	81.1
\$25	54.7	(44.7)	99.4	24.7	74.7
\$30	44.3	44.3	0	0	0
<b>Total</b>	<b>\$ 669.2</b>	<b>\$ 56.1</b>	<b>\$ 613.1</b>	<b>\$ 9.3</b>	<b>\$ 603.8</b>



## Draw Games

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, Cash Ball 225, Powerball, Mega Millions, 5 Card Cash, Keno, Lucky for Life, KY Quick Bucks, and Win Place Show.

Draw game sales were \$419.1 million in 2018, an increase of \$27.6 million or 7.0 percent when compared to 2017. Draw games sales accounted for 40.2 percent of all 2018 sales, and consisted of Pick 3, Pick 4, Cash Ball 225, Powerball, Mega Millions, 5 Card Cash, Keno, and Lucky for Life.

Sales increases were recognized in Mega Millions, Keno, Pick 3, Pick 4, 5 Card Cash, and Cash Ball 225 when compared to 2018. Mega Millions sales saw a 58.5 percent increase. Keno sales saw a 1.8 percent increase. Pick 3 sales saw a 0.1 percent increase. Pick 4 sales saw a 2.5 percent increase. 5 Card Cash sales saw a 13.1 percent increase. KY Cash Ball sales saw an increase of 4.3 percent. Additionally, during 2019 the KLC added KY Quick Bucks to the draw games portfolio, as well as a test pilot for the Win Place Show game. Sales of \$1.2 million and \$0.1 million were achieved, respectively.

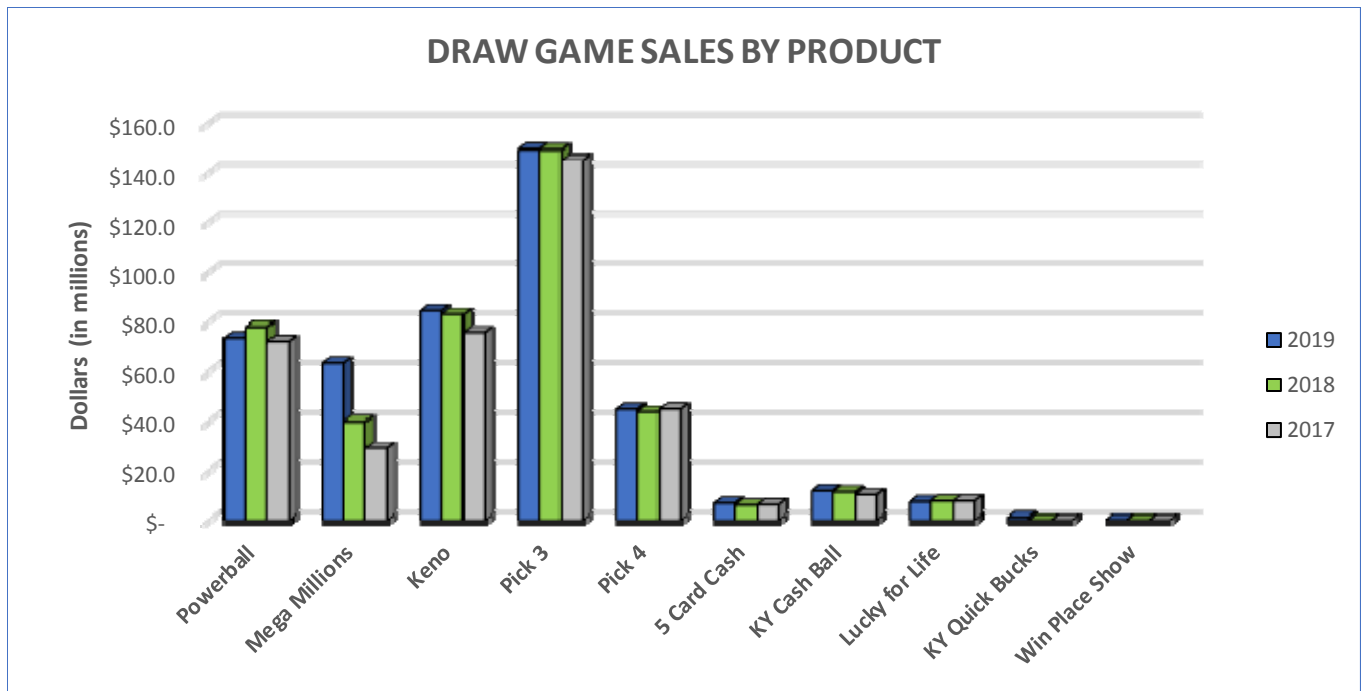
Sales decreases were recognized in Powerball and Lucky for Life, with decreases of 5.6 percent and 3.8 percent, respectively.

Table 5 and the accompanying chart compares draw game sales by product for 2019, 2018, and 2017.

**TABLE 5**  
**DRAW GAME SALES BY PRODUCT**  
(In millions)

<b>Product</b>	<b>2019</b>	<b>Increase (Decrease)</b>	<b>2018</b>	<b>Increase (Decrease)</b>	<b>2017</b>
Powerball	\$ 73.5	\$ (4.4)	\$ 77.9	\$ 5.8	\$ 72.1
Mega Millions	63.1	23.3	39.8	10.7	29.1
Keno	84.3	1.5	82.8	7.0	75.8
Pick 3	149.9	0.2	149.7	4.4	145.3
Pick 4	44.6	1.1	43.5	(1.2)	44.7
5 Card Cash	6.9	0.8	6.1	(0.2)	6.3
KY Cash Ball	12.0	0.5	11.5	1.1	10.4
Lucky for Life	7.5	(0.3)	7.8	0	7.8
KY Quick Bucks	1.2	1.2	0	0	0
Win Place Show	0.1	0.1	0	0	0
<b>Total</b>	<b><u>\$ 443.1</u></b>	<b><u>\$ 24.0</u></b>	<b><u>\$ 419.1</u></b>	<b><u>\$ 27.6</u></b>	<b><u>\$ 391.5</u></b>

## Draw Games (Continued)



### iLottery Instant Play Games

iLottery instant play sales were \$17.3 million, an increase of \$7.0 million when compared to the \$10.3 million achieved in 2018. iLottery instant play sales accounted for 1.5 percent of all 2019 sales, and 1.0 percent of all 2018 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.

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 2019 budgeted gross prize payout percentages for each product category, as well as the actual gross payout percentages for 2019, 2018, and 2017.

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

	<b>BUDGET</b>	<b>ACTUAL</b>	<b>ACTUAL</b>	<b>ACTUAL</b>
	<b>2019</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
Instant Games	71.4%	70.9%	70.1%	69.7%
Draw Games:				
Powerball	50.0%	49.8%	50.4%	49.8%
Mega Millions	50.0%	50.1%	50.2%	51.1%
Pick 3	60.0%	58.5%	58.3%	61.2%
Pick 4	50.0%	42.1%	46.1%	44.8%
KY Cash Ball	53.9%	42.0%	51.2%	59.1%
5 Card Cash	59.8%	64.3%	59.3%	59.3%
Keno	65.6%	65.1%	65.4%	65.4%
Lucky for Life	59.4%	61.9%	60.1%	59.2%
KY Quick Bucks	64.0%	58.7%	0.0%	0.0%
Win Place Show	0.0%	48.1%	0.0%	0.0%
Draw Games	57.3%	55.2%	56.0%	57.2%
iLottery Instant Play	79.0%	76.3%	79.6%	73.6%
Total Gross Prize Payout Percentage	66.0%	64.8%	64.5%	64.8%
Less: Unclaimed Prizes	<u>-(0.8%)</u>	<u>-(0.6%)</u>	<u>-(1.0%)</u>	<u>-(1.1%)</u>
Net Prize Payout Percentage	65.2%	64.2%	63.5%	63.7%

For 2019, gross prize expense (not including unclaimed prizes) of \$732.2 million, reflects a 9.7 percent increase from 2018 gross prize expense of \$667.7 million. Gross prize expense in 2018 of \$667.7 million, reflects a 4.4 percent increase from 2017 gross prize expense of \$639.4 million.



Prize Expense and Game Margin (Continued)

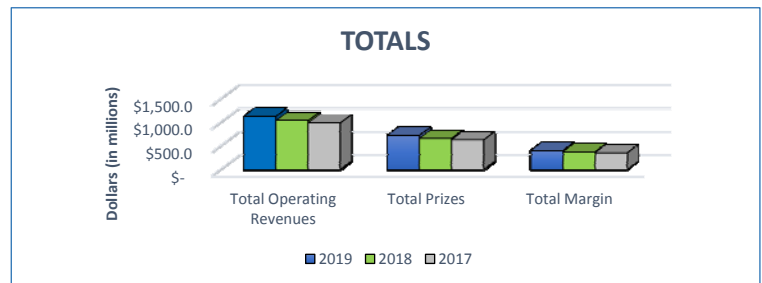
Net prize expense in 2019 was \$724.8 million or 64.2 percent of total operating revenues compared to \$657.4 million or 63.5 percent in 2018 and \$628.8 million or 63.7 percent in 2017. Unclaimed prizes in 2019 were \$7.4 million compared to \$10.3 million in 2018, and \$10.6 million in 2017.

Total game margin in 2019 increased to \$404.7 million or 35.8 percent of total operating revenues compared to \$377.8 million or 36.5 percent in 2018. 2017 gross margin was \$358.2 million or 36.3 percent of operating revenues.

Table 7 and the accompanying chart compares total operating revenues, prize expense, and game margin for 2019, 2018, and 2017.

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

Totals			
	2019	2018	2017
Operating revenues	\$ 1,129.6	\$ 1,042.5	\$ 1,000.5
Less: instant tickets provided as prizes	(0.1)	(7.3)	(13.5)
<b>Total operating revenues</b>	<b>1,129.5</b>	<b>1,035.2</b>	<b>987.0</b>
Gross prize expense	732.2	667.7	639.4
Less: unclaimed prizes	(7.4)	(10.3)	(10.6)
<b>Total prize expense</b>	<b>724.8</b>	<b>657.4</b>	<b>628.8</b>
<b>Game margin</b>	<b>\$ 404.7</b>	<b>\$ 377.8</b>	<b>\$ 358.2</b>



Instant Prize Expense and Game Margin

In 2019, gross prize expense (not including unclaimed prizes) for instant games increased to \$474.5 million or 70.9 percent of total instant game operating revenues compared to 70.1 percent in 2018, and 69.7 percent in 2017. The KLC budgeted 71.4 percent in 2019.

Net prize expense for instant games increased to \$471.5 million or 70.5 percent of total instant game operating revenues compared to \$418.9 million or 69.1 percent in 2018, and \$405.9 million or 68.8 percent in 2017.

Instant game margin increased to \$197.6 million or 29.5 percent of total instant game operating revenues compared to \$186.9 million or 30.9 percent in 2018. 2017 gross margin was \$184.4 million or 31.2 percent.

Table 8 and the accompanying chart compares instant game operating revenues, prize expense, and game margin for 2019, 2018, and 2017.

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

Instants			
	2019	2018	2017
Instant game operating revenues	\$ 669.2	\$ 613.1	\$ 603.8
Less: instant tickets provided as prizes	(0.1)	(7.3)	(13.5)
<b>Total operating revenues</b>	<b>669.1</b>	<b>605.8</b>	<b>590.3</b>
Gross prize expense	474.5	424.6	411.7
Less: unclaimed prizes	(3.0)	(5.7)	(5.8)
<b>Total prize expense</b>	<b>471.5</b>	<b>418.9</b>	<b>405.9</b>
<b>Instant game margin</b>	<b>\$ 197.6</b>	<b>\$ 186.9</b>	<b>\$ 184.4</b>



### Draw Game Prize Expense and Game Margin

In 2019, gross prize expense for draw games was \$244.5 million or 55.2 percent of total draw game operating revenues compared to \$234.9 million or 56.0 percent in 2018, and \$223.8 million or 57.2 percent in 2017. The KLC budgeted 57.3 percent in 2019.

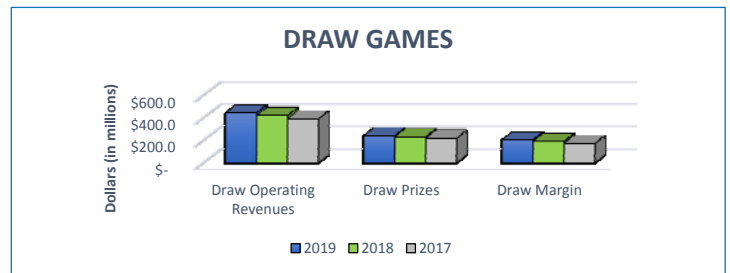
Net prize expense for draw games increased to \$240.1 million or 54.2 percent of total draw game operating revenues in 2019 compared to \$230.3 million or 55.0 percent in 2018, and \$219.0 million or 55.9 percent in 2017.

Draw game margin increased to \$203.0 million or 45.8 percent of total draw game operating revenues in 2019 compared to \$188.8 million or 45.0 percent in 2018. 2017 draw game margin was \$172.5 million or 44.1 percent.

Table 9 and the accompanying chart compares draw game operating revenues, prize expense, and game margin for 2019, 2018, and 2017.

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

Draw Games				
	2019	2018	2017	
Draw game operating revenues	\$ 443.1	\$ 419.1	\$ 391.5	
Less: instant tickets provided as prizes	0.0	0.0	0.0	
Total operating revenues	443.1	419.1	391.5	
Gross prize expense	244.5	234.9	223.8	
Less: unclaimed prizes	(4.4)	(4.6)	(4.8)	
Total prize expense	240.1	230.3	219.0	
Draw game margin	\$ 203.0	\$ 188.8	\$ 172.5	



### iLottery Instant Play Prize Expense and Game Margin

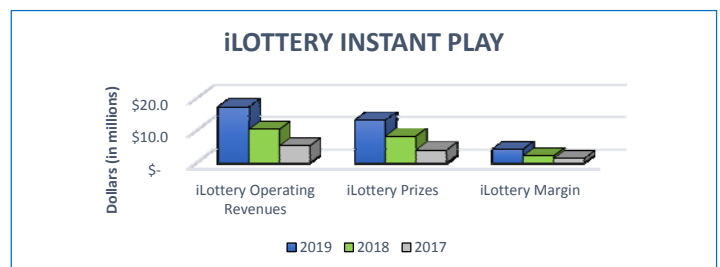
In 2019, gross iLottery Instant Play gross and net prize expense was \$13.2 million or 76.3 percent of total iLottery Instant Play operating revenues compared to \$8.2 million or 79.6 percent in 2018, and \$3.9 million or 75.0 percent in 2017. The KLC budgeted 79.0 percent in 2019.

iLottery Instant Play game margin increased to \$4.1 million or 23.7 percent of iLottery Instant Play operating revenues in 2019 compared to \$2.1 million or 20.4 percent in 2018, and \$1.3 million or 25.0 percent in 2017.

Table 10 and the accompanying chart compares iLottery Instant Play operating revenues, prize expense, and game margin for 2019, 2018, and 2017.

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

iLottery Instant Play				
	2019	2018	2017	
iLottery instant play operating revenues	\$ 17.3	\$ 10.3	\$ 5.2	
Less: instant tickets provided as prizes	0.0	0.0	0.0	
Total operating revenues	17.3	10.3	5.2	
Gross prize expense	13.2	8.2	3.9	
Less: unclaimed prizes	0.0	0.0	0.0	
Total prize expense	13.2	8.2	3.9	
iLottery instant play game margin	\$ 4.1	\$ 2.1	\$ 1.3	



Other Expenses

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

	Increase		Increase		
	<u>2019</u>	<u>(Decrease)</u>	<u>2018</u>	<u>(Decrease)</u>	<u>2017</u>
Payments to retailers	\$ 67.0	\$ 5.9	\$ 61.1	\$ (0.6)	\$ 61.7
Draw game vendor expense	13.7	2.3	11.4	1.3	10.1
Instant ticket costs	9.0	0.5	8.5	(0.4)	8.9
Operating expenses	32.0	1.1	30.9	0.7	30.2
Non-operating expenses (revenue)	(0.7)	(0.9)	0.2	(0.4)	0.6

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 2019 and 2018 were 5.9 percent of total operating revenues. Draw vendor expenses for 2019 and 2018 were 1.2 percent and 1.1 percent of total operating revenues, respectively. Instant ticket costs include the cost to acquire and ship instant tickets to retailers and were 1.2 percent and 0.8 percent of total operating revenues in 2019 and 2018, respectively. Operating expenses were 2.8 percent and 3.0 percent of total operating revenues for 2019 and 2018, respectively.

Non-operating expenses (income), which includes investment income, interest expense, and other income, decreased \$0.9 million in 2019 and \$0.4 million in 2018.

Investment Income (Loss)

**TABLE 12**  
**INVESTMENT INCOME (LOSS)**  
(In millions)

	Increase		Increase		
	<u>2019</u>	<u>(Decrease)</u>	<u>2018</u>	<u>(Decrease)</u>	<u>2017</u>
Unrealized change in fair value of investments	\$ 0.1	\$ 0.8	\$ (0.7)	\$ 0.3	\$ (1.0)
Accretion of investments	0.6	0.0	0.6	(0.1)	0.7
Security lending income	0.0	(0.1)	0.1	0.0	0.1
Interest income	<u>0.3</u>	<u>0.1</u>	<u>0.2</u>	<u>0.1</u>	<u>0.1</u>
<b>Total investment income (loss)</b>	<u>\$ 1.0</u>	<u>\$ 0.8</u>	<u>\$ 0.2</u>	<u>\$ 0.3</u>	<u>\$ (0.1)</u>

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 increase in interest income reflects the federal government's policy to raise short-term interest rates in 2019.

## Payments to the Commonwealth of Kentucky

In 2019 and 2018, 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") Program 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 Program Reserve Account represent prizes of instant and draw games that expired (went unclaimed) during the fiscal year. Payments to the Commonwealth of Kentucky in 2019 were \$283.6 million, which consisted of \$276.2 million or an increase of \$20.1 million to the Commonwealth's general fund and \$7.4 million or a decrease of \$2.9 million to the KEES Program Reserve Account. Payments in 2018 were \$266.4 million, which consisted of \$256.1 million to the Commonwealth's general fund and \$10.3 million to the KEES Program Reserve Account.

## Currently Known Facts, Decisions, or Conditions

The Kentucky Lottery Corporation'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 FY 2020.

Instant sales are budgeted to produce sales of \$725.0 million during FY 2020, an increase of \$46.0 million or 6.8 percent.

- The KLC plans to add 125 Game Touch 20 vending machines to approximately 80 "Big Box" retail locations throughout the Commonwealth. These self-service machines contain 20 instant ticket bins, as well as selling the KLC's draw games in this highly populated retail space, and should lead to sales increases in FY 2020.
- The KLC will continue to increase instant ticket facings, reduce/eliminate inventory out-of-stocks, and increase retailer activations of new games within the first three days of a game launch. New instant game launches will continue to occur every six weeks and include game-specific strategic marketing campaigns to increase product awareness.
- FY 2020 will be the first full year since the addition of the 270 new 28 game touch screen vending machines in retail locations throughout the Commonwealth.
- FY 2020 will see a full year of sales from the \$30 price point, including the launch of the KLC's second \$30 ticket in February 2020.
- FY 2020 will also mark the first full year of the KLC's instant ticket vendor providing internal sales and distribution functions for instant tickets.

Draw game sales are budgeted to produce sales of \$450.1 million during FY 2020, an increase of \$12.9 million or 2.9 percent.

- Deployment of 300 Gemini Game Touch Draw self-service vending machines and Keno monitors to 170 new Keno retail locations and 130 existing high-volume Keno retailers. These machines will support sales of all KLC draw games.
- Fast Play games – a new category of terminal/vending machine generated games will be launched in October 2019.
- Cash Pop – a new game in the monitor games category, with drawings every four minutes (like Keno), will be launched in March 2020.
- FY 2020 will see a full year of the Keno Bullseye feature, KY Quick Bucks game, and KY Cash Ball EZ Match feature.

iLottery instant play sales are budgeted to produce sales of \$25.0 million during FY 2020, an increase of \$10.7 million or 74.8 percent.

- The KLC will continue to move towards a flat prize payout strategy to increase player participation.
- A new version of the KLC's mobile app will be released during FY 2020 that will improve the player experience.
- The KLC will partner with retail to create an omnichannel experience for players around the planned Wheel of Fortune game and the Powerball "Rockin' New Year's Eve" promotion.

### 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, 2019 and 2018

(dollars in thousands)

	2019	2018
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 28,547	\$ 17,682
Cash and cash equivalents, annuitants	2,600	2,600
Investments at fair value, current portion	1,623	1,836
Accounts receivable, net	37,269	31,628
Prepaid PowerPlay License, current portion	45	67
Other assets	718	948
Total current assets	<u>70,802</u>	<u>54,761</u>
Noncurrent Assets		
Investments at fair value, less current portion	9,138	10,083
Prepaid PowerPlay License, less current portion	0	45
Capital assets, net	5,727	5,441
Deposits with Multi-State Lottery Association	6,127	5,182
Total noncurrent assets	<u>20,992</u>	<u>20,751</u>
Total assets	<u>91,794</u>	<u>75,512</u>
<b>LIABILITIES</b>		
Current Liabilities		
Accounts payable, accrued expenses, and compensated absences, current portion	5,188	5,981
Due to the Commonwealth of Kentucky	16,956	6,131
Estimated prize liability, current portion	38,268	31,061
Total current liabilities	<u>60,412</u>	<u>43,173</u>
Noncurrent Liabilities		
Accrued compensated absences, less current portion	1,328	1,136
Estimated prize liability, less current portion	11,623	12,907
Total noncurrent liabilities	<u>12,951</u>	<u>14,043</u>
Total liabilities	<u>73,363</u>	<u>57,216</u>
<b>NET POSITION</b>		
Net investment in capital assets	5,727	5,441
Unrestricted	12,704	12,855
Net position	<u>\$ 18,431</u>	<u>\$ 18,296</u>

See accompanying notes.

# KENTUCKY LOTTERY CORPORATION

## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION For the Years Ended June 30, 2019 and 2018 (dollars in thousands)

	<b>2019</b>	<b>2018</b>
<b>Operating revenues</b>		
Instant games	\$ 669,212	\$ 613,134
Draw games	443,088	419,126
iLottery instant play games	17,355	10,252
Less instant tickets provided as prizes	(111)	(7,309)
Total operating revenues	<u>1,129,544</u>	<u>1,035,203</u>
<b>Direct costs</b>		
Prizes expense		
Instant games	471,513	418,862
Draw games	240,051	230,337
iLottery instant play games	13,248	8,163
Total prize expense	<u>724,812</u>	<u>657,362</u>
Payments to retailers	67,004	61,138
Draw game vendor expense	13,737	11,370
Instant ticket costs	8,974	8,474
Total direct costs	<u>814,527</u>	<u>738,344</u>
<b>Operating revenues net of direct costs</b>	<u>315,017</u>	<u>296,859</u>
<b>Operating expenses</b>		
Advertising and promotion	11,484	10,268
Salaries, wages, and benefits	14,913	15,318
Contracted and professional services	2,440	2,374
Depreciation	1,202	1,186
Other general and administrative	1,916	1,769
Total operating expenses	<u>31,955</u>	<u>30,915</u>
<b>Operating income</b>	<u>283,062</u>	<u>265,944</u>
<b>Non-operating revenue (expense)</b>		
Payments to the Commonwealth of Kentucky	(283,611)	(266,417)
Investment income	1,049	176
Interest expense	(566)	(651)
Other income	201	235
Total non-operating expense	<u>(282,927)</u>	<u>(266,657)</u>
<b>Change in net position</b>	<u>135</u>	<u>(713)</u>
Net position at beginning of year	<u>18,296</u>	<u>19,009</u>
<b>Net position at end of year</b>	<u>\$ 18,431</u>	<u>\$ 18,296</u>

See accompanying notes.

# KENTUCKY LOTTERY CORPORATION

## STATEMENTS OF CASH FLOWS For the Years Ended June 30, 2019 and 2018 (dollars in thousands)

	2019	2018
<b>Cash Flows from Operating Activities</b>		
Cash received from customers	\$ 1,123,903	\$ 1,028,267
Cash payments for deposits at the Multi-State Lottery Association	(945)	(334)
Cash payments to prize winners	(718,889)	(656,841)
Cash payments to suppliers	(106,362)	(96,802)
Cash payments to employees for services	(14,973)	(14,935)
Net cash provided by operating activities	282,734	259,355
<b>Cash Flows from Noncapital Financing Activities</b>		
Payments to the Commonwealth of Kentucky	(272,786)	(262,841)
<b>Cash Flows from Capital and Related Financing Activities</b>		
Purchases of capital assets	(1,586)	(1,313)
<b>Cash Flows from Investing Activities</b>		
Proceeds from sale of investments	1,859	1,859
Investment income	644	473
Net cash provided by investing activities	2,503	2,332
<b>Increase (decrease) in cash and cash equivalents</b>	10,865	(2,467)
Cash and cash equivalents at beginning of year	20,282	22,749
<b>Cash and cash equivalents at end of year</b>	\$ 31,147	\$ 20,282
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Operating income	\$ 283,062	\$ 265,944
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,202	1,186
Provision for losses on accounts receivable	152	99
Increase (decrease) in cash due to changes in:		
Accounts receivable, net	(5,760)	(7,218)
Prepaid PowerPlay License	67	67
Other assets	230	(60)
Deposits with Multi-State Lottery Association	(945)	(334)
Accounts payable, accrued expenses, and compensated absences	(631)	(199)
Estimated prize liability	5,357	(130)
Total adjustments	(328)	(6,589)
Net cash provided by operating activities	\$ 282,734	\$ 259,355

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, 2019 and 2018 totaled \$566 and \$651, respectively.

The unrealized fair value of investments increased \$135 for the year ended June 30, 2019 and decreased \$713 for the year ended June 30, 2018.

See accompanying notes.



# **KENTUCKY LOTTERY CORPORATION**

## **NOTES TO FINANCIAL STATEMENTS**

June 30, 2019 and 2018

(dollars in thousands)

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### ***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, 2019 and 2018

(dollars in thousands)

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### ***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. Finally, for Activation-Based retailers, revenue is recognized upon activation. 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.

#### **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 \$33 and \$30 for the years ended June 30, 2019 and 2018, respectively. A trade receivable is considered uncollectible after no payment has been received in 90 days.

# **KENTUCKY LOTTERY CORPORATION**

## NOTES TO FINANCIAL STATEMENTS

June 30, 2019 and 2018

(dollars in thousands)

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### ***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.

#### **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 and scratch-off games 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 as well as the scratch-off game but continues to have financial obligations to 12 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, 2019, 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 scratch-off games have grand prizes with annuity options, paid annually for varying amounts and time periods. The KLC has eight grand prize winners that elected the annuity option and continue to be paid annually.

# KENTUCKY LOTTERY CORPORATION

## NOTES TO FINANCIAL STATEMENTS June 30, 2019 and 2018 (dollars in thousands)

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### *Note 2 – Summary of Significant Accounting Policies (Continued)*

#### Cash and Cash 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	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, 2019 and 2018.

# ***KENTUCKY LOTTERY CORPORATION***

## **NOTES TO FINANCIAL STATEMENTS**

June 30, 2019 and 2018

(dollars in thousands)

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### ***Note 2 – Summary of Significant Accounting Policies (Continued)***

#### **Deposits with MUSL**

Deposits are carried at cost. MUSL is a non-profit, government-benefit voluntary 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 33 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, 2019 and 2018, 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, 2019 and 2018

(dollars in thousands)

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### ***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 27, 2019, and will re-evaluate subsequent events before the Commonwealth completes its Comprehensive Annual Financial Report in December 2019.

#### **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, 2019. 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, 2019 and 2018

(dollars in thousands)

### *Note 3 – Cash and Cash Equivalents*

The components of cash and cash equivalents for the years ended June 30, 2019 and 2018 consisted of the following:

	2019	2018
Cash on deposits in banks	\$ 32,761	\$ 21,215
Checks issued against cash on deposit	(1,614)	(933)
	\$ 31,147	\$ 20,282

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, 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	3,620	0	3,620	Weighted average maturity of 3.71 years
Total	\$ 10,761	\$ 7,141	\$ 3,620	

# KENTUCKY LOTTERY CORPORATION

## NOTES TO FINANCIAL STATEMENTS

June 30, 2019 and 2018

(dollars in thousands)

### Note 4 – Investments (Continued)

At June 30, 2018, 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	\$ 7,964	\$ 7,964	\$ 0	Weighted average maturity of 4.57 years
Other U.S. Government backed	<u>3,955</u>	<u>0</u>	<u>3,955</u>	Weighted average maturity of 4.14 years
Total	<u>\$ 11,919</u>	<u>\$ 7,964</u>	<u>\$ 3,955</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 2019, \$2,565 of the other U.S. Government backed investments are not rated and the remaining \$1,055 are all rated Aaa. For 2018, \$2,406 of the other U.S. Government backed investments are not rated, and the remaining \$1,549 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 2019 and 2018, approximately 15 and 13 percent of total investments were in Resolution Funding Corporation Strips, respectively, and 10 and 13 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, 2019 and 2018

(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 and losses of the current period include unrealized amounts from prior periods. The components of investment income (loss) for the years ended June 30, 2019 and 2018 consisted of the following:

	<u>2019</u>	<u>2018</u>
Unrealized change in fair value of investments	\$ 135	\$ (713)
Accretion of investments	566	651
Security lending income	4	10
Interest income	<u>344</u>	<u>228</u>
Total investment income	<u>\$ 1,049</u>	<u>\$ 176</u>

When compared to the historical cost method, recording investments at fair value results in an increase in income by approximately \$135 in 2019 and a decrease in income by approximately \$713 in 2018, respectively.

Unrestricted net position at June 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Unrestricted net position excluding unrealized gains on investments	\$ 11,412	\$ 11,698
Accumulated unrealized gains on investments	<u>1,292</u>	<u>1,157</u>
Total unrestricted net position	<u>\$ 12,704</u>	<u>\$ 12,855</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, 2019 and 2018 (dollars in thousands)

### *Note 4 – Investments (Continued)*

At June 30, 2019 and 2018, the KLC had loaned investments with fair values of approximately \$383 and \$1,171, respectively, to authorized brokers for a fee. Cash received from securities loans is invested in repurchase agreements with at least 102 percent collateral pledge. The repurchase agreements have carrying values of approximately \$387 and \$1,186 at June 30, 2019 and 2018, respectively, which are held by the KLC's securities custodian. At June 30, 2019 and 2018, 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, 2019 and 2018 consisted of the following:

	<u>2019</u>	<u>2018</u>
Accounts receivable	\$ 37,670	\$ 31,910
Allowance for doubtful accounts	<u>(401)</u>	<u>(282)</u>
Accounts receivable, net	<u>\$ 37,269</u>	<u>\$ 31,628</u>

Balances due from retailers for the sales of lottery tickets make up over 99% of the accounts receivable balance above.

**KENTUCKY LOTTERY CORPORATION**

NOTES TO FINANCIAL STATEMENTS

June 30, 2019 and 2018

(dollars in thousands)

**Note 6 – Capital Assets**

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, 2019 and 2018

(dollars in thousands)

**Note 6 – Capital Assets (Continued)**

Capital asset activity for the year ended June 30, 2018 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	7,925	154	0	8,079
Game equipment	562	0	0	562
Data processing equipment and software	17,230	1,043	(13,311)	4,962
Automobiles, furniture, and fixtures	3,238	116	(949)	2,405
Total other capital assets at cost	28,955	1,313	(14,260)	16,008
Less accumulated depreciation for				
Buildings	(4,826)	(266)	0	(5,092)
Game equipment	(555)	(6)	0	(561)
Data processing equipment and software	(15,732)	(722)	13,311	(3,143)
Automobiles, furniture, and fixtures	(2,951)	(192)	949	(2,194)
Total accumulated depreciation	(24,064)	(1,186)	14,260	(10,990)
Net capital assets, depreciable	4,891	127	0	5,018
Total capital assets, net	\$ 5,314	\$ 127	\$ 0	\$ 5,441

**KENTUCKY LOTTERY CORPORATION**

NOTES TO FINANCIAL STATEMENTS

June 30, 2019 and 2018

(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, except for certain alternate schedule employees who can accrue up to 804 hours. Accrued paid time off at June 30, 2019 and 2018, included in accrued compensated absences in the accompanying Statements of Net Position, consisted of the following:

	2019	2018
Current	\$ 207	\$ 228
Compensated absences, less current portion	1,328	1,136
Total compensated absences	\$ 1,535	\$ 1,364

Years Ended June 30,	Beginning Balance	Increases	Decreases	Ending Balance
2019	\$ 1,364	\$ 500	\$ (329)	\$ 1,535
2018	1,322	203	(161)	1,364

# KENTUCKY LOTTERY CORPORATION

## NOTES TO FINANCIAL STATEMENTS

June 30, 2019 and 2018

(dollars in thousands)

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### *Note 8 – Severance*

On March 9, 2018, KLC announced that it was outsourcing and eliminating certain positions. KLC designed a severance plan for eliminated positions, payable based on years of service. Employees were provided one week of pay for every year of service, with a minimum of eight weeks and maximum of 26 weeks. To receive the severance, employees must have been employed as of an agreed-upon date.

Accrued severance at June 30, 2018 was included in accrued expenses in the accompanying Statements of Net Position, classified as current. Severance payments were made in fiscal year 2019, after each employee's termination date, totaling \$231.

### *Note 9 – Estimated Prize Liability*

Estimated prize liability at June 30, 2019 and 2018 consisted of the following:

	<u>2019</u>	<u>2018</u>
Current:		
Grand prizes	\$ 1,669	\$ 1,934
Other prizes	<u>36,599</u>	<u>29,127</u>
Total current portion	<u>\$ 38,268</u>	<u>\$ 31,061</u>
Long-term:		
Grand prizes	<u>\$11,623</u>	<u>\$ 12,907</u>

# KENTUCKY LOTTERY CORPORATION

## NOTES TO FINANCIAL STATEMENTS

June 30, 2019 and 2018

(dollars in thousands)

### *Note 9 – 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>
2019	\$ 14,841	\$ 584	\$ (2,133)	\$ 13,292
2018	15,325	1,450	(1,934)	14,841

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

<u>Years Ending June 30,</u>	
2020	\$ 1,669
2021	1,407
2022	1,407
2023	1,355
2024	1,355
2025 through 2029	4,187
2030 through 2034	2,195
2035 through 2039	1,731
2040 through 2044	832
2045 through 2049	468
2050	<u>52</u>
Total	16,658
Less unamortized discount	<u>(3,366)</u>
Total at present value	13,292
Less current portion	<u>(1,669)</u>
Total long-term portion at present value	<u><u>\$ 11,623</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 \$566 and \$651 in 2019 and 2018, respectively, is included in interest expense. These amounts comprise the entire amounts of interest expense for the years ended June 30, 2019 and 2018.

# **KENTUCKY LOTTERY CORPORATION**

## NOTES TO FINANCIAL STATEMENTS

June 30, 2019 and 2018

(dollars in thousands)

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### ***Note 10 – 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 providing participation requirements are met.

During 2019 and 2018, the KLC's contributions were calculated using the eligible compensation amount for eligible employees of \$5,573 and \$6,132, respectively, for the 6.2 percent employer contribution (Mandatory and Supplemental Contributions), and \$9,550 and \$10,371, respectively, for the eight percent employer contribution (Basic Contributions). Employer contributions actually made to the Plan were approximately \$1,110 and \$1,210 in 2019 and 2018, respectively. Employee contributions to the Plan were approximately \$346 and \$380 in 2019 and 2018, respectively. At June 30, 2019 and 2018, the KLC had an outstanding liability of approximately \$21 and \$24, respectively, owed to the Plan, as part of the accrued salaries balance.

During 2019 and 2018, there were no forfeitures, which would have been 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, 2019 and 2018

(dollars in thousands)

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### *Note 11 – Leases*

The KLC has entered into operating leases for the rental of office equipment and office and storage space under initial lease terms of one to seven years.

Approximate minimum rental payments are:

<u>Years Ending June 30,</u>	
2020	\$ 96
2021	60
2022	10
2023	<u>10</u>
	<u>\$ 176</u>

Total rental expense for 2019 and 2018 was approximately \$134 and \$155, respectively.

### *Note 12 – 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) Program 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 Program Reserve Account are used to provide college or technical school scholarships to Kentucky high school students. The amounts payable to the KEES Program 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, 2019 and 2018, all unclaimed prize money was transferred to the KEES Program Reserve Account as required by HB 247 of the 2018 Regular Session. Payments are made after the end of each quarter.

**KENTUCKY LOTTERY CORPORATION**

NOTES TO FINANCIAL STATEMENTS  
June 30, 2019 and 2018  
(dollars in thousands)

***Note 12 – Payments to the Commonwealth (Continued)***

Payments, including amounts accrued, to the Commonwealth for the years ended June 30, 2019 and 2018 included payments to the following funds:

	<u>2019</u>	<u>2018</u>
General Fund	\$ 276,163	\$ 256,146
KEES Scholarship Reserve Fund	<u>7,448</u>	<u>10,271</u>
	<u>\$ 283,611</u>	<u>\$ 266,417</u>

***Note 13 – 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 14 – Commitments and Contingencies***

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.



**HARDING, SHYMANSKI  
& COMPANY, P.S.C.**

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***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***

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, 2019 and the related notes to the financial statements, and have issued our report thereon dated September 27, 2019.

**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 misstatement 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, Szymanski & Company, P. S. C.*

Louisville, Kentucky  
September 27, 2019

# ***KENTUCKY LOTTERY CORPORATION***

## **SCHEDULE OF FINDINGS Year Ended June 30, 2019**

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### Schedule of auditor's results

We have issued an unmodified opinion, dated September 27, 2019, on the financial statements of the Kentucky Lottery Corporation as of and for the year ended June 30, 2019.

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, 2019

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