

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

**For The Years Ended
June 30, 2022 and 2021**



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

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 MCM CPAs and Advisors, LLP presents the financial and compliance audit of the books and records of the Kentucky Lottery Corporation for the years ended June 30, 2022 and 2021, as required by KRS 154A.130.

We engaged MCM CPAs and Advisors, LLP 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,

Farrah Petter, CPA
Assistant Auditor of Public Accounts

Enclosure

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Financial Report

June 30, 2022 and 2021

KENTUCKY LOTTERY CORPORATION

ANNUAL FINANCIAL REPORT

June 30, 2022 and 2021

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Independent Auditor's Report

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

Opinion

We have audited the financial statements of the Kentucky Lottery Corporation, a component unit of the Commonwealth of Kentucky as of and for the years ended June 30, 2022 and 2021, and the related notes to the financial statements, which collectively comprise Kentucky Lottery Corporation's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Kentucky Lottery Corporation, as of June 30, 2022 and 2021, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America ("GAAS") and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Kentucky Lottery Corporation and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

The Kentucky Lottery Corporation's management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Kentucky Lottery Corporation's ability to continue as a going concern for one year after the date that the financial statements are issued.

Independent Auditor's Report (Continued)

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Kentucky Lottery Corporation's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Kentucky Lottery Corporation's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Emphasis of Matter

During the fiscal year ended June 30, 2022, the Kentucky Lottery Corporation implemented Government Accounting Standards ("GASB") Statement No. 87 - *Leases*. The financial statements of the fiscal year ended June 30, 2021 have been restated to present an intangible right of use lease asset and a corresponding lease liability; however, financial position as of June 30, 2021, was not impacted by the implementation of the standard.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 18 be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Independent Auditor's Report (Continued)

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2022 on our consideration of the Kentucky Lottery Corporation'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 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Kentucky Lottery Corporation's internal control over financial reporting and compliance.

MCM CPAs & Advisors LLP

Louisville, Kentucky
September 23, 2022

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

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, 2022 and 2021. Please read it in conjunction with the financial statements, which follow.

Financial Highlights for Fiscal Year 2022

- Record operating revenues of \$1.677 billion were achieved in 2022, an increase of \$90.2 million or 5.7 percent over last year's previous sales record of \$1.586 billion. 2022 represents the eleventh consecutive year of record sales for the KLC.
- Sales at retail totalled \$1.426 billion and accounted for 85 percent of total sales. iLottery sales totalled \$250.5 million and made up the remaining 15 percent of sales for the year.
- Instant sales totalled \$963.5 million, which is a \$1.8 million increase over last year. A total of 47 new games were launched in 2022 and the KLC focused on maximizing vending machine placement at retail locations.
- Draw sales decreased \$19.1 million to \$486.9 million. Mega Millions sales accounted for most of the negative variance, declining \$14.7 million from last year. 2022 Mega Millions jackpot levels did not reach the \$1 billion level from January 2021.
- iLottery instant play sales hit a record \$226.1 million. This was a \$107.5 million or 90.6 percent increase over last year. New game play styles and price points were offered this year and all games had an 85 percent prize payout.
- Operating expenses totalled \$36.4 million which accounted for 2.2 percent of sales.
- Record dividend transfers to the state of \$359.3 million, an increase of \$4.2 million or 1.2 percent over last year.

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.

The KLC implemented GASB Statement No. 87, Leases, which resulted in a restatement of the prior periods presented. The lease assets and liabilities are reflected in the Statement of Net Position. Additional information about the KLC's leases can be found in Notes 2 and 10 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, operating lease assets, capital assets and deposits. As shown in Table 1, the KLC's total assets decreased \$2.5 million to \$127.8 million in 2022. Total assets increased \$14.4 million to \$130.3 million in 2021 from \$115.9 million in 2020. Investments consist of U.S. Treasury zero-coupon bonds and other U.S. Government backed 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 \$9.8 million to \$75.0 million in 2022. Accounts receivable increased \$8.3 million to \$65.2 million in 2021. Operating lease assets represent right-of-use assets related to equipment leases. Additional information on the KLC's lease can be found in Note 10 to the financial statements.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Capital Assets

The KLC's investment in capital assets, net of accumulated depreciation in 2022 and 2021, was \$4.6 and \$5.2 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 2022 was \$0.6 million or 11.5 percent compared to a decrease of \$0.4 million or 7.1 percent in 2021. 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)

	2022	Increase (Decrease)	Restated 2021	Increase (Decrease)	Restated 2020
Current and other assets	\$ 103.0	\$ 3.6	\$ 99.4	\$ 19.5	\$ 79.9
Investments (noncurrent)	5.3	(1.8)	7.1	(0.6)	7.7
Operating Lease Assets	9.6	(3.4)	13.0	(3.7)	16.7
Capital assets, net	4.6	(0.6)	5.2	(0.4)	5.6
Deposits with Multi State Lottery Association	<u>5.3</u>	<u>(0.3)</u>	<u>5.6</u>	<u>(0.4)</u>	<u>6.0</u>
Total assets	<u>127.8</u>	<u>(2.5)</u>	<u>130.3</u>	<u>14.4</u>	<u>115.9</u>
Current liabilities	95.3	2.4	92.9	19.1	73.8
Long-term liabilities	<u>15.0</u>	<u>(4.2)</u>	<u>19.2</u>	<u>(4.2)</u>	<u>23.4</u>
Total liabilities	<u>110.3</u>	<u>(1.8)</u>	<u>112.1</u>	<u>14.9</u>	<u>97.2</u>
Net position components					
Net investment in capital assets	4.6	(0.6)	5.2	(0.4)	5.6
Unrestricted - accumulated unrealized gains on investments	0.3	(0.7)	1.0	(0.5)	1.5
Unrestricted	<u>12.6</u>	<u>0.6</u>	<u>12.0</u>	<u>0.4</u>	<u>11.6</u>
Net position	<u>\$ 17.5</u>	<u>\$ (0.7)</u>	<u>\$ 18.2</u>	<u>\$ (0.5)</u>	<u>\$ 18.7</u>

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Liabilities

TABLE 2
LIABILITIES
(In millions)

	Current			Long-Term		
	Restated		Restated	Restated		Restated
	<u>2022</u>	<u>2021</u>	<u>2020</u>	<u>2022</u>	<u>2021</u>	<u>2020</u>
Accounts payable and other liabilities	\$ 12.0	\$ 13.4	\$ 9.0	\$ 0.5	\$ 0.5	\$ 0.4
Prize liabilities	70.1	64.4	49.9	8.5	9.8	10.5
Due to Commonwealth	9.5	11.0	10.7	0.0	0.0	0.0
Operating Lease Liabilities	<u>3.7</u>	<u>4.1</u>	<u>4.2</u>	<u>6.0</u>	<u>8.9</u>	<u>12.5</u>
Total liabilities	<u>\$ 95.3</u>	<u>\$ 92.9</u>	<u>\$ 73.8</u>	<u>\$ 15.0</u>	<u>\$ 19.2</u>	<u>\$ 23.4</u>

Total current liabilities increased \$2.4 million or 2.6 percent in 2022 and \$19.1 million or 25.9 percent in 2021. The account titled "Due to Commonwealth" decreased \$1.5 million in 2022 and increased \$300,000 in 2021. This represents payments due to the General Fund and the Kentucky Educational Excellence Scholarship Reserve Account after the fiscal year-end.

Long-term liabilities decreased \$4.2 million or 21.9 percent in 2022 and decreased \$4.2 million or 17.9 percent in 2021. Long-term liabilities consist principally of prize liabilities for prizes paid in instalments over several years and the noncurrent portion of accrued compensated absences. More detailed information can be obtained in Note 8 to the financial statements. Operating lease liabilities represent the present value of future payments related to equipment leases. Additional information on the KLC's lease can be found in Note 10 to the financial statements.

Net Position

As shown in Table 1 on page 5, the KLC's net position in 2022 decreased \$0.7 million. This change was attributable to the decrease 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 decrease in unrestricted net position. Total net position of \$17.5 million included the KLC's net investment in capital assets of \$4.6 million and \$12.9 million in unrestricted net position. Unrestricted net position was comprised of \$300,000 in accumulated unrealized gains on investments and \$12.6 million in working capital and cash flow that is utilized in the KLC's day-to-day operations. In 2021, the KLC's net position decreased \$0.5 million to \$18.2 million due to the decrease in the accumulated unrealized gains on investments.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Net Position (Continued)

TABLE 3
CHANGES IN NET POSITION
(In millions)

	2022	Increase (Decrease)	2021	Increase (Decrease)	2020
Total operating revenues	\$ 1,676.5	\$ 90.2	\$ 1,586.3	\$ 382.9	\$ 1,203.4
Direct costs and operating expenses:					
Direct costs					
Prize expense	1,152.0	84.6	1,067.4	266.2	801.2
Other direct costs	129.0	(1.7)	130.7	33.5	97.2
Total direct costs	1,281.0	82.9	1,198.1	299.7	898.4
Operating expenses	36.4	3.2	33.2	0.1	33.1
Total direct costs and operating expenses	1,317.4	86.1	1,231.3	299.8	931.5
Non-operating expense (revenue)	0.5	0.1	0.4	1.0	(0.6)
Payments to the Commonwealth of Kentucky	359.3	4.2	355.1	82.9	272.2
Total expenses	1,677.2	90.4	1,586.8	383.7	1,203.1
Changes in net position	(0.7)	(0.2)	(0.5)	(0.8)	0.3
Net position at beginning of year	18.2	(0.5)	18.7	0.3	18.4
Net position at end of year	<u>\$ 17.5</u>	<u>\$ (0.7)</u>	<u>\$ 18.2</u>	<u>\$ (0.5)</u>	<u>\$ 18.7</u>

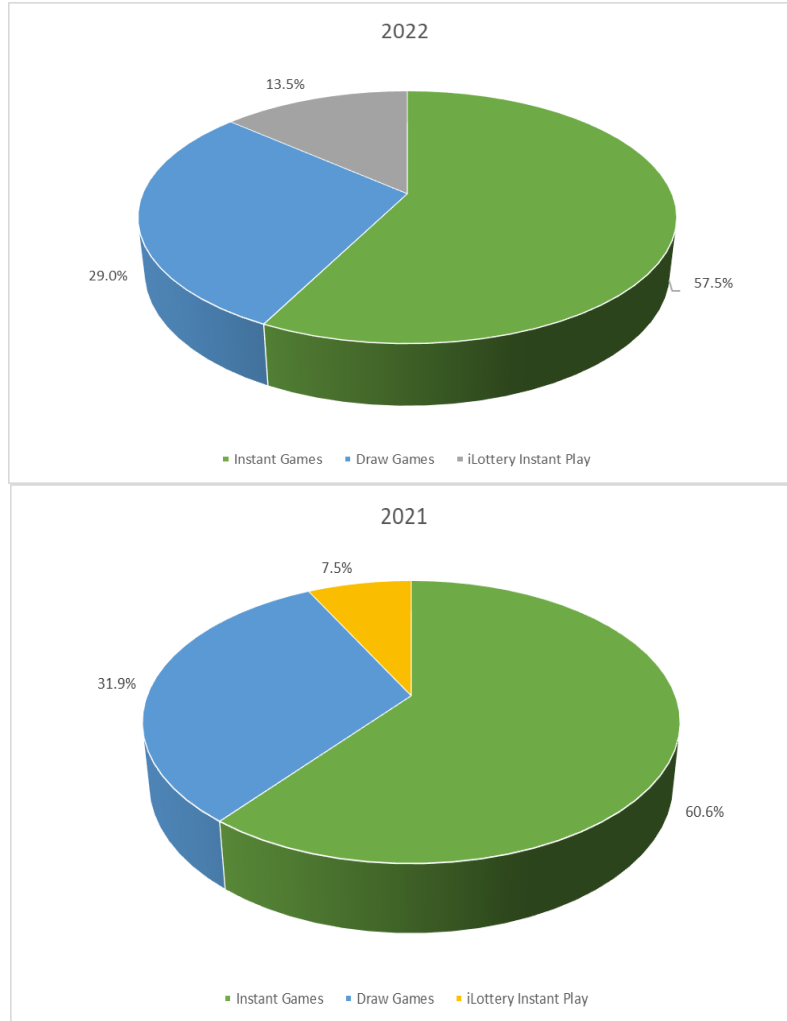
KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Operating Revenues and Prize Expense

Operating Revenues

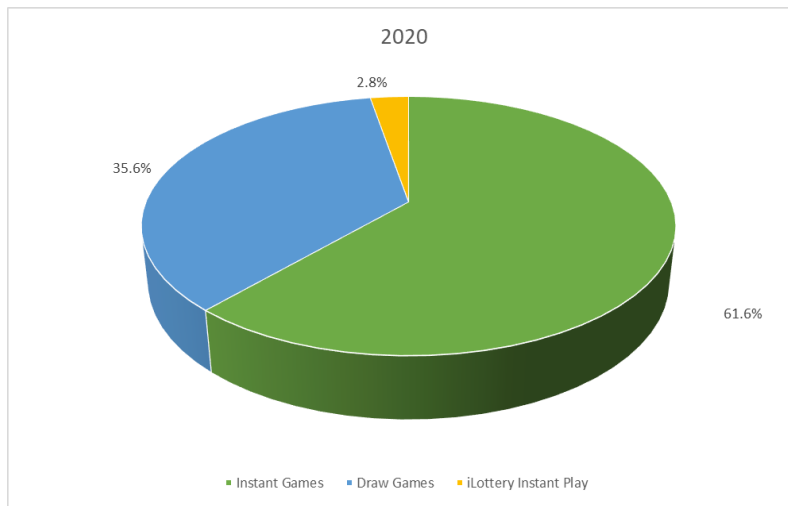
In 2022, operating revenues consisted of ticket sales from three product categories, instant, draw, and iLottery instant play. In 2022, the KLC generated record ticket sales of \$1.677 billion, an increase of \$90.2 million or 5.7 percent when compared to 2021. In 2021, the KLC generated ticket sales of \$1.586 billion, an increase of \$382.9 million or 31.8 percent when compared to 2020.

SALES BY PRODUCT CATEGORY AS A PERCENT OF SALES



KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Operating Revenues (Continued)



Instant Games

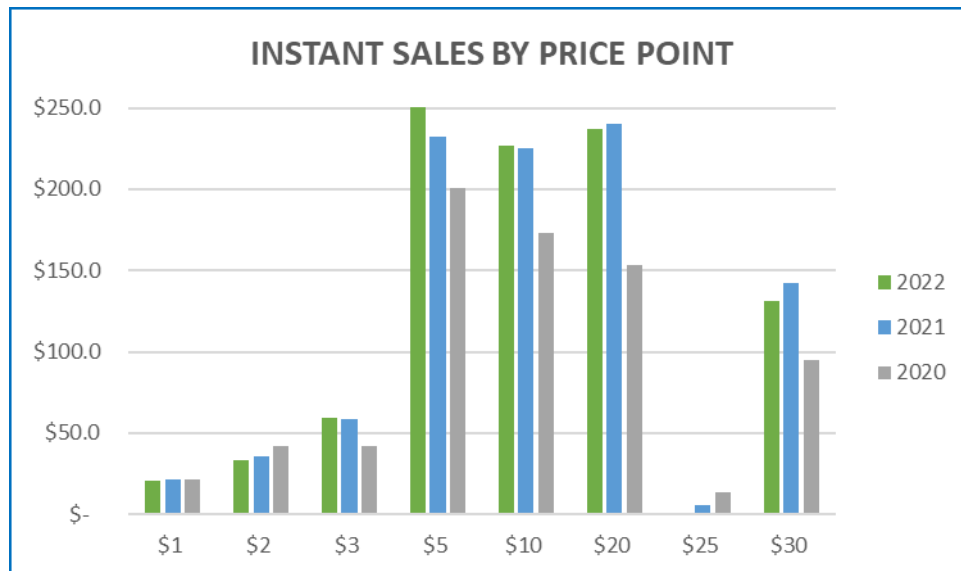
Table 4 and the accompanying chart compares sales for each instant game price point for 2022, 2021, and 2020.

TABLE 4
INSTANT SALES BY PRICE POINT
(In millions)

Price Point	2022			2021			2020	
	Sales	% of Total	Increase (Decrease)	Sales	% of Total	Increase (Decrease)	Sales	% of Total
\$1	\$ 20.8	2.2%	\$ (0.9)	\$ 21.7	2.3%	\$ 0.3	\$ 21.4	2.9%
\$2	33.1	3.4%	(2.8)	35.9	3.7%	(6.1)	42.0	5.7%
\$3	59.7	6.2%	0.9	58.8	6.1%	16.9	41.9	5.7%
\$5	254.5	26.4%	22.1	232.4	24.2%	32.0	200.4	27.0%
\$10	226.6	23.5%	1.3	225.3	23.4%	52.4	172.9	23.3%
\$20	237.3	24.6%	(2.6)	239.9	24.9%	86.5	153.4	20.7%
\$25	-	0.0%	(5.6)	5.6	0.6%	(8.3)	13.9	1.9%
\$30	131.5	13.7%	(10.6)	142.1	14.8%	46.9	95.2	12.8%
Totals	\$ 963.5	100.0%	\$ 1.8	\$ 961.7	100.0%	\$ 220.6	\$ 741.1	100.0%

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Instant Games (Continued)



Record KLC instant ticket sales of \$963.5 million were achieved in 2022 and accounted for 57.5 percent of all KLC sales, or an increase of \$1.8 million or 0.2 percent over 2021. Instant ticket sales of \$961.7 million were achieved in 2021, and accounted for 60.6 percent of all KLC sales, or an increase of \$220.6 million or 29.8 percent over 2020.

Sales growth in 2022 within the instant product category occurred at the \$3, \$5, and \$10 price points, which saw increases of \$0.9 million, \$22.1 million, and \$1.3 million respectively.

Sales decreases in 2022 were recognized at the \$1, \$2, \$20, and \$30 price point with a decrease of 0.9 percent, 2.8 percent, 2.6 percent, and 10.6 percent respectively. The Lottery industry had seen a shift away from the lower price points.

Sales growth in 2021 within the instant product category occurred at the \$1, \$3, \$5, \$10, \$20, and \$30 price points, which saw increases of 1.4 percent, 40.3 percent, 16.0 percent, 30.3 percent, 56.4 percent and 49.3 percent, respectively.

Sales decreases in 2021 were recognized at the \$2 price point with a decrease of 14.5 percent; and the \$25 price point with a decrease of 59.7 percent. The final \$25 game available for sale ended on June 30, 2021.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Draw Games

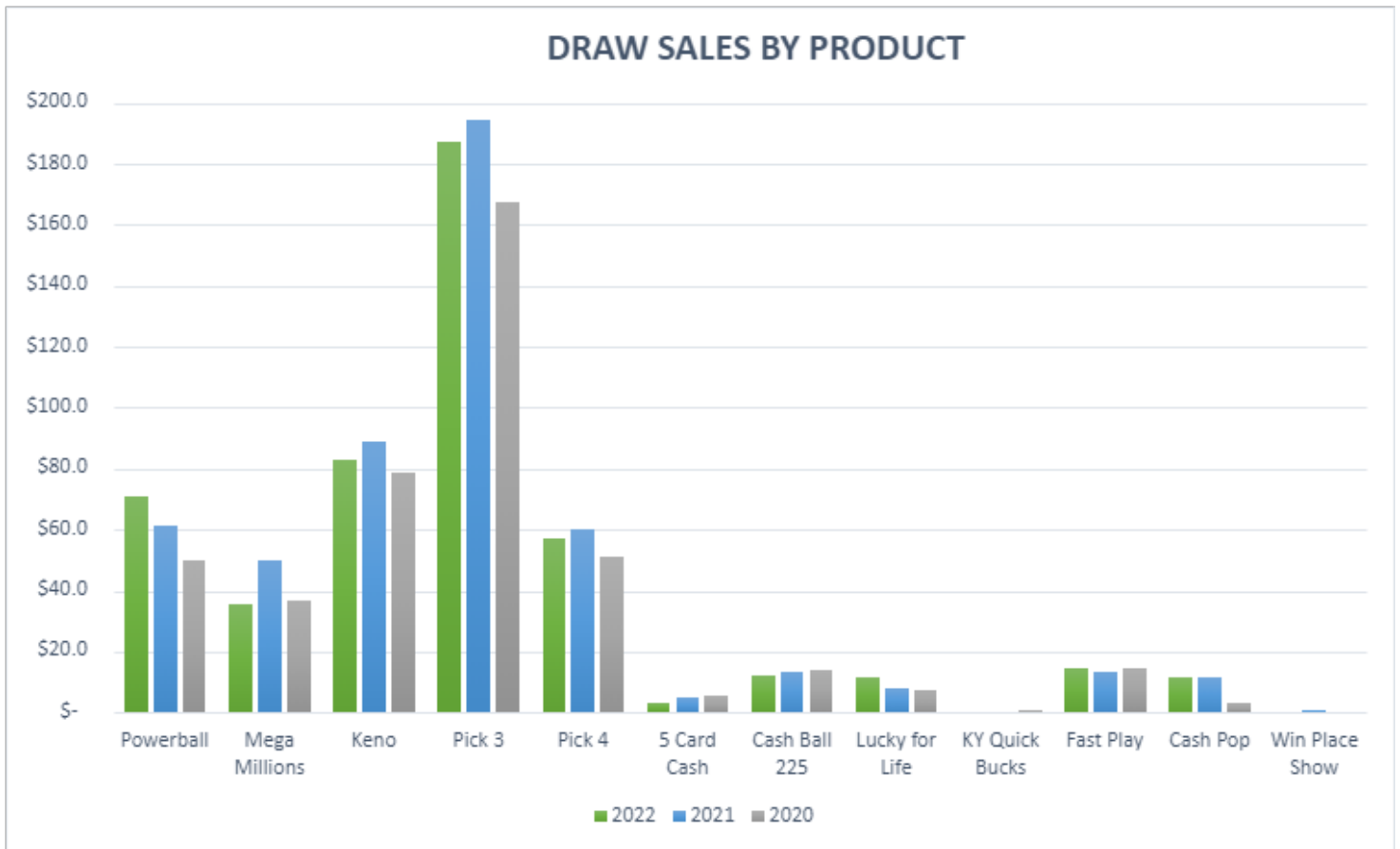
Table 5 and the accompanying chart compares draw sales by product for 2022, 2021, 2020.

TABLE 5
DRAW SALES BY PRODUCT
(In millions)

Product	2022			2021			2020		
	Sales	% of Total	Increase (Decrease)	Sales	% of Total	Increase (Decrease)	Sales	% of Total	
Powerball	\$ 71.1	14.6%	\$ 9.8	\$ 61.3	12.1%	\$ 11.4	\$ 49.9	11.6%	
Mega Millions	35.5	7.3%	(14.7)	50.2	9.9%	13.2	37.0	8.6%	
Keno	83.1	17.1%	(5.5)	88.6	17.5%	9.8	78.8	18.4%	
Pick 3	187.1	38.4%	(7.1)	194.2	38.4%	26.9	167.3	39.0%	
Pick 4	57.1	11.7%	(3.1)	60.2	11.9%	9.3	50.9	11.8%	
5 Card Cash	3.3	0.7%	(1.7)	5.0	1.0%	(0.4)	5.4	1.3%	
Cash Ball 225	11.9	2.4%	(1.4)	13.3	2.6%	(0.4)	13.7	3.2%	
Lucky for Life	11.7	2.4%	3.9	7.8	1.5%	0.6	7.2	1.7%	
KY Quick Bucks	-	0.0%	-	-	0.0%	(1.0)	1.0	0.2%	
Fast Play	14.6	3.0%	1.0	13.6	2.7%	(0.9)	14.5	3.4%	
Cash Pop	11.5	2.4%	-	11.5	2.3%	8.1	3.4	0.8%	
Win Place Show	-	0.0%	(0.3)	0.3	0.1%	0.3	-	0.0%	
Totals	\$ 486.9	100.0%	\$ (19.1)	\$ 506.0	100.0%	\$ 76.9	\$ 429.1	100.0%	

KENTUCKY LOTTERY CORPORATION
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 June 30, 2022 and 2021

Draw Games (Continued)



Draw sales were \$486.9 million in 2022, a decrease of \$19.1 million or 3.8 percent when compared to 2021. Draw games sales accounted for 29.0 percent of all 2022 sales, and consisted of Powerball, Mega Millions, Keno, Pick 3, Pick 4, 5 Card Cash, Cash Ball 225, Lucky for Life, Fast Play, and Cash Pop. Sales ended for 5 Card Cash in March 2022.

Draw games sales were \$506.0 million in 2021, an increase of \$76.9 million or 17.9 percent when compared to 2020. Draw games sales accounted for 31.9 percent of all 2021 sales, and consisted of Powerball, Mega Millions, Keno, Pick 3, Pick 4, 5 Card Cash, Cash Ball 225, Lucky for Life, Fast Play, Cash Pop, and Win Place Show.

Sales increases were recognized in Powerball, Lucky for life, and Fast Play when compared to 2021. During 2022 the KLC transitioned to three Powerball drawings per week and daily Lucky for Life drawings. Powerball sales totalled \$71.1 million and Lucky for Life sales totalled \$11.7 million.

Sales decreases were recognized in all other draw games. Mega Millions sales fell \$14.7 million or 29.3 percent from last year. Last year's sales were especially high due to the \$1 billion jackpot, while 2022 jackpots only exceeded \$400 million once.

iLottery Instant Play Games

iLottery instant play 2022 sales were \$226.1 million, an increase of \$107.5 million when compared to the \$118.6 million achieved in 2021. iLottery instant play sales accounted for 13.5 percent of all 2022 sales and 7.5 percent of all 2021 sales. Instant play games consist of a variety of play styles and price points, ranging from \$0.02 to \$20.00.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Prize Expense

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. Payouts range from 62 percent to 77 percent, depending on the game price point. 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 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. Actual prize payout may vary from the designed payout.

The following is a discussion of prize expense within certain product categories. With that background, Table 6 compares the actual gross payout percentages for 2022, 2021, and 2020.

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

	ACTUAL 2022	ACTUAL 2021	ACTUAL 2020
Instant Games	71.4%	71.5%	71.1%
Draw Games:			
Powerball	49.9%	50.6%	49.6%
Mega Millions	50.6%	50.0%	50.5%
Keno	65.4%	65.2%	65.3%
Pick 3	59.7%	55.9%	60.6%
Pick 4	47.3%	56.7%	64.1%
5 Card Cash	69.8%	60.6%	63.7%
Cash Ball 225	51.7%	56.0%	49.5%
Lucky for Life	60.4%	68.1%	54.7%
Ky Quick Bucks	0.0%	0.0%	58.2%
Fast Play	70.0%	68.2%	67.9%
Cash Pop	67.4%	66.6%	66.4%
Win Place Show	0.0%	47.6%	0.0%
Draw Games	57.5%	57.2%	59.6%
iLottery Instant Play	86.7%	84.2%	78.0%
Total Gross Prize Payout Percentage	69.4%	67.9%	67.2%
Less: Unclaimed Prizes	-0.7%	-0.6%	-0.6%
Total Prize Payout Percentage	68.7%	67.3%	66.6%

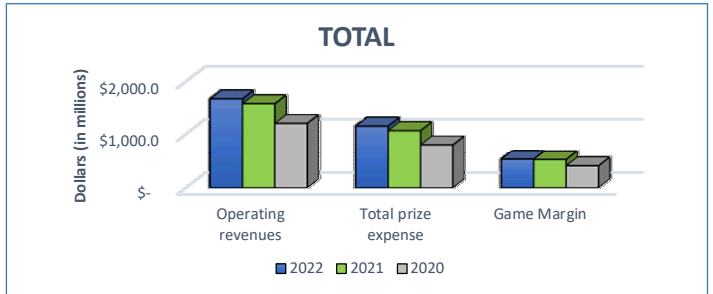
KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Game Margin for Total Products

Table 7 and the accompanying chart compares game margin for total products for 2022, 2021, and 2020. Game margin is operating revenues less total prize expense.

**TABLE 7
GAME MARGIN FOR TOTAL PRODUCTS
(In millions)**

Total Products			
	2022	2021	2020
Operating revenues	\$ 1,676.5	\$ 1,586.3	\$ 1,203.4
Gross prize expense	1,164.0	1,077.2	808.3
Less: unclaimed prizes	(12.0)	(9.8)	(7.1)
Total prize expense	<u>1,152.0</u>	<u>1,067.4</u>	<u>801.2</u>
Game margin	<u>\$ 524.5</u>	<u>\$ 518.9</u>	<u>\$ 402.2</u>



For 2022, gross prize expense (excluding unclaimed prizes) of \$1.164 billion, reflects a \$86.8 million or 8.1 percent increase from 2021 of \$1.077 billion.

Total prize expense in 2022 was \$1.152 billion or 68.7 percent of total operating revenues compared to \$1.067 billion or 67.3 percent in 2021.

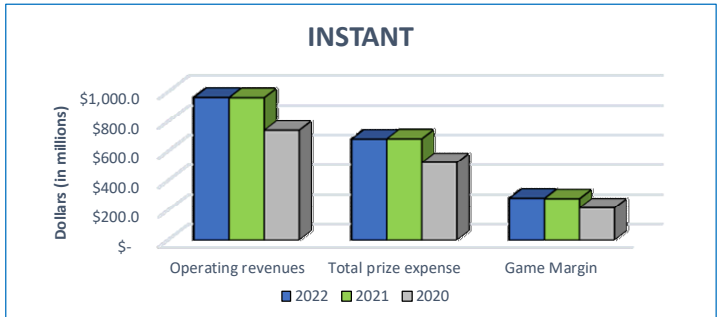
Total game margin in 2022 increased to \$524.5 or 31.3 percent of total operating revenues compared to \$518.9 million or 32.7 percent of total operating revenues in 2021. The increase in total game margin is \$5.6 million or 1.1 percent more than 2021.

Game Margin for Instant Games

Table 8 and the accompanying chart compares game margin for instant games 2022, 2021, and 2020.

**TABLE 8
GAME MARGIN FOR INSTANT GAMES
(In millions)**

Instant Games			
	2022	2021	2020
Operating revenues	\$ 963.5	\$ 961.7	\$ 741.1
Gross prize expense	687.8	687.9	526.8
Less: unclaimed prizes	(6.9)	(5.5)	(3.1)
Total prize expense	<u>680.9</u>	<u>682.4</u>	<u>523.7</u>
Game margin	<u>\$ 282.6</u>	<u>\$ 279.3</u>	<u>\$ 217.4</u>



In 2022, gross prize expense for instant games decreased to \$687.8 million or 71.4 percent of total instant game operating revenues compared to 71.5 percent in 2021.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Game Margin for Instant Games (Continued)

Total prize expense for instant games decreased to \$680.9 million or 70.7 percent of total instant game operating revenues compared to \$682.4 million or 71.0 percent in 2021.

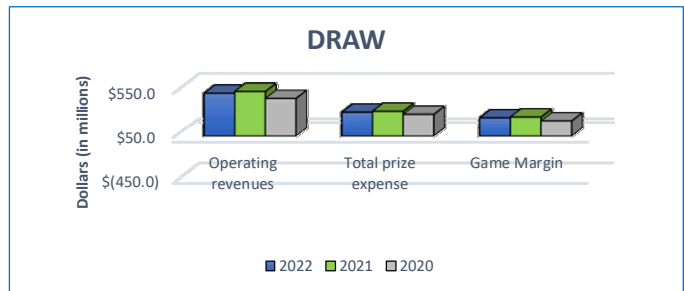
Game margin for instant games increased to \$282.6 million or 29.3 percent of operating revenues for instant games compared to \$279.3 million or 29.0 percent in 2021. This increase in game margin is \$3.3 million or 1.2 percent more than 2021.

Game Margin for Draw Games

Table 9 and the accompanying chart compares game margin for draw games for 2022, 2021, and 2020.

TABLE 9
GAME MARGIN FOR DRAW GAMES
(In millions)

Draw Games			
	2022	2021	2020
Operating revenues	\$ 486.9	\$ 506.0	\$ 429.1
Gross prize expense	280.1	289.4	255.6
Less: unclaimed prizes	(5.1)	(4.3)	(4.0)
Total prize expense	<u>275.0</u>	<u>285.1</u>	<u>251.6</u>
Game margin	<u>\$ 211.9</u>	<u>\$ 220.9</u>	<u>\$ 177.5</u>



In 2022, gross prize expense for draw games was \$280.1 million or 57.5 percent of operating revenues for draw games compared to \$289.4 million or 57.2 percent in 2021.

Total prize expense for draw games decreased to \$275.0 or 56.5 percent of operating revenues for draw games in 2022 compared to \$285.1 million or 56.3 percent in 2021.

Game margin decreased to \$211.9 million or 43.5 percent of operating revenues for draw games in 2022 compared to \$200.9 million or 43.7 percent in 2021. This decrease in game margin is a \$9.0 million or 4.1 percent decrease from 2021.

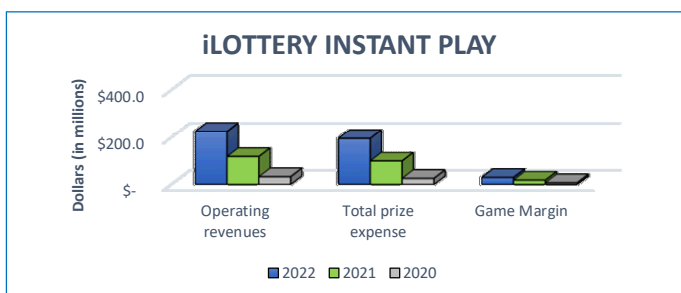
KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Game Margin for iLottery Instant Play Games

Table 10 and the accompanying chart compares operating revenues, prize expense, and game margin for iLottery instant play games for 2022, 2021, and 2020.

TABLE 10
GAME MARGIN FOR ILOTTERY INSTANT PLAY GAMES
(In millions)

iLottery Instant Play Games			
	2022	2021	2020
Operating revenues	\$ 226.1	\$ 118.6	\$ 33.2
Gross prize expense	196.1	99.9	25.9
Less: unclaimed prizes	0.0	0.0	0.0
Total prize expense	196.1	99.9	25.9
Game margin	\$ 30.0	\$ 18.7	\$ 7.3



In 2022, net prize expense for iLottery instant play games was \$196.1 million or 86.7 percent of operating revenues for iLottery instant play games compared to \$99.9 million or 84.2 percent in 2021.

Game margin for iLottery instant play games increased to \$30.0 million or 13.3 percent of operating revenues for iLottery instant play games in 2022 compared to \$18.7 million or 15.8 percent 2021. This increase in game margin is \$11.3 million or 60.4 percent more than 2021.

Other Expenses

TABLE 11
OTHER DIRECT COSTS, OPERATING, AND NON-OPERATING EXPENSE (REVENUE)
(In millions)

	Increase		Increase		
	2022	(Decrease)	2021	(Decrease)	2020
Payments to retailers	\$ 87.1	\$ (3.5)	\$ 90.6	\$ 19.6	\$ 71.0
Draw games and iLottery vendor expense	26.4	2.1	24.3	8.8	15.5
Instant ticket costs	15.5	(0.3)	15.8	5.1	10.7
Total other direct costs	129.0	(1.7)	130.7	33.5	97.2
Operating expenses	36.4	3.2	33.2	0.1	33.1
Non-operating expense (revenue)	0.5	0.1	0.4	1.0	(0.6)

Payments to retailers cover base selling and cashing commissions as well as a retailer incentive plan based on the sale of Instant tickets. Payments to retailers for 2022 and 2021 were 5.2 and 5.7 percent of total operating revenues. Draw games and iLottery vendor expenses for 2022 and 2021 were 1.6 percent and 1.5 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 1.0 percent of total operating revenues in 2022 and 2021, respectively. Operating expenses were 2.2 percent and 2.1 percent of total operating revenues for 2022 and 2021, respectively.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

Other Expenses (Continued)

Non-operating expense (revenue), which includes investment income, accretion of investments, and other income, increased \$0.1 million in 2022 and \$1.0 million in 2021.

Investment Income (Loss)

TABLE 12
INVESTMENT INCOME (LOSS)
(In millions)

	2022	Increase (Decrease)	2021	Increase (Decrease)	2020
Unrealized change in fair value of investments	\$ (0.7)	\$ (0.2)	\$ (0.5)	\$ (0.8)	\$ 0.3
Accretion of investments	0.4	0.0	0.4	(0.1)	0.5
Interest income	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>(0.1)</u>	<u>0.1</u>
Total investment income (loss)	<u>\$ (0.3)</u>	<u>\$ (0.2)</u>	<u>\$ (0.1)</u>	<u>\$ (1.0)</u>	<u>\$ 0.9</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.

Payments to the Commonwealth of Kentucky

In 2022 and 2021, payments to the Commonwealth of Kentucky represent transfers and an accrual of funds from the KLC to the Commonwealth's general fund, Trust and Agency account, 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 pay for college scholarships, grants, and education programs. 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 2022 were \$359.3 million which consisted of \$347.3 million or an increase of \$2.0 million to the Commonwealth's general fund and Trust and Agency account and \$12.0 million or an increase of \$2.2 million to the KEES Reserve Account. Payments in 2021 were \$355.1 million, which consisted of \$345.3 million to the Commonwealth's general fund and \$9.8 million the KEES Reserve Account.

KENTUCKY LOTTERY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2022 and 2021

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. The lottery faces challenges with increased gaming competition and inflation. To achieve KLC's mission and overcome these obstacles, 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 2023.

Budgeted sales for fiscal year 2023 total \$1.803 billion. Retail sales total \$1.5 billion and iLottery sales total \$296.5 million.

Instant sales are budgeted to produce sales of \$1.05 billion during fiscal year 2023, an increase of \$86.0 million or 8.9 percent.

- The KLC will introduce its first \$50 scratch-off game in October 2022 and two new \$30 games during the year.
- The KLC will continue to focus on increasing facings, through vending placement and new retail locations.

Draw game sales are budgeted to produce sales of \$483.1 million during fiscal year 2023, a decrease of \$3.8 million or 0.8 percent.

- A new game, Kentucky 5, will be introduced in November 2022. This will fill the gap in the portfolio of draw games from the 5 Card Cash game, which ended in March 2022.
- The KLC will have a full year of three Powerball drawings per week and daily Lucky for Life drawings.
- The KLC anticipates decreased retail sales from the Pick 3, Pick 4, Keno and Cash Pop games. While promotions will focus on monitor games, like Keno and Cash Pop, we do not anticipate sales will meet FY2022 levels.

iLottery instant play sales are budgeted to produce sales of \$270.0 million during fiscal year 2023, an increase of \$43.9 million or 19.4 percent.

- KLC will continue player promotions to attract new players and retain existing players.

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, 2022 and 2021

(dollars in thousands)

	2022	Restated 2021
ASSETS		
Current Assets		
Cash and equivalents	\$ 22,895	\$ 29,143
Cash and equivalents, annuitants	2,639	2,600
Investments at fair value, current portion	1,384	1,383
Accounts receivable, net	74,956	65,193
Other assets	<u>1,120</u>	<u>1,096</u>
Total current assets	<u>102,994</u>	<u>99,415</u>
Noncurrent Assets		
Investments at fair value, less current portion	5,330	7,068
Operating Lease Assets	9,638	13,033
Capital assets, net	4,577	5,212
Deposits with Multi-State Lottery Association	<u>5,268</u>	<u>5,582</u>
Total noncurrent assets	<u>24,813</u>	<u>30,895</u>
Total assets	<u>127,807</u>	<u>130,310</u>
LIABILITIES		
Current Liabilities		
Accounts payable, accrued expenses, and compensated absences, current portion	12,018	13,359
Due to the Commonwealth of Kentucky	9,545	11,030
Estimated prize liability, current portion	70,071	64,447
Operating Lease Liability, current Portion	<u>3,667</u>	<u>4,086</u>
Total current liabilities	<u>95,301</u>	<u>92,922</u>
Noncurrent Liabilities		
Accrued compensated absences, less current portion	539	512
Estimated prize liability, less current portion	8,547	9,764
Operating Lease Liability, noncurrent portion	<u>5,971</u>	<u>8,947</u>
Total noncurrent liabilities	<u>15,057</u>	<u>19,223</u>
Total liabilities	<u>110,358</u>	<u>112,145</u>
NET POSITION		
Net investment in capital assets	4,577	5,212
Unrestricted	<u>12,872</u>	<u>12,953</u>
Net position	<u>\$ 17,449</u>	<u>\$ 18,165</u>

See accompanying notes.

KENTUCKY LOTTERY CORPORATION

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION For the Years Ended June 30, 2022 and 2021 (dollars in thousands)

	2022	2021
Operating revenues		
Instant games	\$ 963,495	\$ 961,683
Draw games	486,945	506,009
iLottery instant play games	226,062	118,633
Total operating revenues	<u>1,676,502</u>	<u>1,586,325</u>
Direct costs		
Prizes expense		
Instant games	680,908	682,351
Draw games	275,028	285,195
iLottery instant play games	196,071	99,900
Total prize expense	<u>1,152,007</u>	<u>1,067,446</u>
Payments to retailers	87,135	90,606
Draw games and iLottery vendor expense	26,377	24,275
Instant ticket costs	15,453	15,820
Total direct costs	<u>1,280,972</u>	<u>1,198,147</u>
Operating revenues net of direct costs	<u>395,530</u>	<u>388,178</u>
Operating expenses		
Advertising and promotion	12,991	11,166
Salaries, wages, and benefits	17,941	17,091
Contracted and professional services	2,314	1,997
Depreciation	1,142	1,159
Other general and administrative	2,027	1,812
Total operating expenses	<u>36,415</u>	<u>33,225</u>
Operating income	<u>359,115</u>	<u>354,953</u>
Non-operating (expense) revenue		
Payments to the Commonwealth of Kentucky	(359,333)	(355,100)
Investment loss	(353)	(67)
Accretion of investments	(363)	(421)
Other income	218	128
Total non-operating expense	<u>(359,831)</u>	<u>(355,460)</u>
Change in net position	<u>(716)</u>	<u>(507)</u>
Net position at beginning of year	<u>18,165</u>	<u>18,672</u>
Net position at end of year	<u>\$ 17,449</u>	<u>\$ 18,165</u>

See accompanying notes.

KENTUCKY LOTTERY CORPORATION

STATEMENTS OF CASH FLOWS For the Years Ended June 30, 2022 and 2021 (dollars in thousands)

	2022	2021
Cash Flows from Operating Activities		
Cash received from customers	\$ 1,666,739	\$ 1,577,994
Cash receipts for deposits at the Multi-State Lottery Association	314	369
Cash payments to prize winners	(1,147,623)	(1,053,716)
Cash payments to suppliers	(148,603)	(141,667)
Cash payments to employees for services	(17,312)	(17,285)
Net cash provided by operating activities	<u>353,515</u>	<u>365,695</u>
Cash Flows from Noncapital Financing Activities		
Payments to the Commonwealth of Kentucky	<u>(360,819)</u>	<u>(354,763)</u>
Cash Flows from Capital and Related Financing Activities		
Purchases of capital assets	<u>(531)</u>	<u>(836)</u>
Cash Flows from Investing Activities		
Proceeds from sale of investments	1,384	1,384
Investment income	<u>242</u>	<u>205</u>
Net cash provided by investing activities	<u>1,626</u>	<u>1,589</u>
(Decrease) Increase in cash and equivalents	(6,209)	11,685
Cash and equivalents at beginning of year	<u>31,743</u>	<u>20,058</u>
Cash and equivalents at end of year	<u>\$ 25,534</u>	<u>\$ 31,743</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 359,115	\$ 354,953
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,142	1,159
Provision for losses on accounts receivable	34	193
Increase (decrease) in cash due to changes in:		
Accounts receivable, net	(9,797)	(8,524)
Other assets	(24)	(272)
Deposits with Multi-State Lottery Association	314	369
Accounts payable, accrued expenses, and compensated absences	(1,290)	4,508
Estimated prize liability	<u>4,021</u>	<u>13,309</u>
Total adjustments	<u>(5,600)</u>	<u>10,742</u>
Net cash provided by operating activities	<u>\$ 353,515</u>	<u>\$ 365,695</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, 2022 and 2021 totaled \$363 and \$421, respectively.

The unrealized fair value of investments decreased for the years ended June 30, 2022 and 2021 by \$716 and \$507, respectively.

See accompanying notes.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2022 and 2021

(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 Annual Comprehensive 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 (CONTINUED)

June 30, 2022 and 2021

(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 and direct costs from *non-operating* items. Operating revenues and expenses and direct costs 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. Direct expenses include the cost of sales and services and operating expenses include 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.

Revenue and accounts receivable for instant games are recognized at the time packs of tickets are marked due or upon activation, whichever is sooner.

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 \$146 and \$21 for the years ended June 30, 2022 and 2021, respectively. A trade receivable is considered uncollectible based on pertinent facts and circumstances.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(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 accretion of investments 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 eight 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, 2022, the KLC did not have any grand prize or second tier 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 (CONTINUED)

June 30, 2022 and 2021
(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	3 - 5 years
Automobiles, furniture, and fixtures	3 - 5 years
Computer software	7 years

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(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, 2022 and 2021, 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 (CONTINUED)

June 30, 2022 and 2021

(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 Annual Comprehensive Financial Report as a discretely presented component unit, management has evaluated subsequent events through September 23, 2022, and will re-evaluate subsequent events before the Commonwealth completes its Annual Comprehensive Financial Report in December 2022.

Recently Adopted Accounting Pronouncements

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. Changes adopted to conform to the provisions of this statement have been retroactively applied. The 2021 Statement of Net Position was restated to reflect the Lease Assets and Liabilities in the amount of \$13,033. The implementation of this statement did not have a material impact on the KLC's financial position or results of operations.

Pending Accounting Pronouncements Not Yet Adopted

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

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 operation.

In June 2022, the GASB issued Statement No. 101, *Compensated Absences*. The provisions of the statement are effective for fiscal years beginning after December 15, 2023. The objective of this Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. This Statement requires that liabilities for compensated absences be recognized for leave that has not been used and leave that has been used but not yet paid in cash or settled through noncash means when certain defined circumstances exist. 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 (CONTINUED)

June 30, 2022 and 2021

(dollars in thousands)

Note 3 - Cash and Equivalents

The components of cash and equivalents for the years ended June 30, 2022 and 2021 consisted of the following:

	2022	2021
Cash on deposit in banks	\$ 26,528	\$ 33,057
Checks issued against cash on deposit	(994)	(1,314)
	\$ 25,534	\$ 31,743

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. The cash and cash equivalents, annuitants amount represents funds earmarked for future annuity prize payments. The balance is equal to the difference in the recorded annuity liability balance and the related investment balance.

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, 2022, 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	\$ 4,634	\$ 4,634	\$ 0	Weighted average maturity of 3.23 years
Other U.S. Government backed	2,080	0	2,080	Weighted average maturity of 2.24 years
Total	\$ 6,714	\$ 4,634	\$ 2,080	

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(dollars in thousands)

Note 4 - Investments (Continued)

At June 30, 2021, 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	\$ 5,721	\$ 5,721	\$ 0	Weighted average maturity of 3.74 years
Other U.S. Government backed	<u>2,730</u>	<u>0</u>	<u>2,730</u>	Weighted average maturity of 2.76 years
Total	<u>\$ 8,451</u>	<u>\$ 5,721</u>	<u>\$ 2,730</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 2022, \$1,556 of the other U.S. Government backed investments are not rated and the remaining \$524 is rated Aaa. For 2021, \$2,184 of the other U.S. Government backed investments are not rated and the remaining \$546 is rated Aaa.

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 2022 and 2021, approximately 17 and 21 percent of total investments were in Resolution Funding Corporation Strips, respectively, 8 and 6 percent in Israel Bonds, respectively, and 6 and 5 in Federal Judiciary Bonds, respectively, all of which are U.S. Government backed. The remaining 69 and 68 percent were in U.S. Treasuries for 2022 and 2021, respectively.

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 (CONTINUED)

June 30, 2022 and 2021

(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 loss for the years ended June 30, 2022 and 2021 consisted of the following:

	<u>2022</u>	<u>2021</u>
Unrealized change in fair value of investments	\$ (716)	\$ (507)
Accretion of investments	363	421
Security lending income	0	1
Interest income	<u>0</u>	<u>18</u>
Total investment loss	<u>\$ (353)</u>	<u>\$ (67)</u>

When compared to the historical cost method, recording investments at fair value results in a decrease in income of approximately \$716 and \$507 in 2022 and 2021, respectively.

Unrestricted net position at June 30, 2022 and 2021 is as follows:

	<u>2022</u>	<u>2021</u>
Unrestricted net position excluding unrealized gains on investments	\$ 12,562	\$ 11,927
Accumulated unrealized gains on investments	<u>310</u>	<u>1,026</u>
Total unrestricted net position	<u>\$ 12,872</u>	<u>\$ 12,953</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 Annual Comprehensive 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. During 2021, the Commonwealth ended their securities lending contract.

At June 30, 2022 and June 30, 2021 the KLC had no loaned investments.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(dollars in thousands)

Note 5 - Accounts Receivable

Accounts receivable at June 30, 2022 and 2021 consisted of the following:

	<u>2022</u>	<u>2021</u>
Accounts receivable	\$ 75,593	\$ 65,942
Allowance for doubtful accounts	<u>(637)</u>	<u>(749)</u>
Accounts receivable, net	<u>\$ 74,956</u>	<u>\$ 65,193</u>

Balances due from retailers for the sales of lottery tickets make up 98 percent of the accounts receivable balances above for both 2022 and 2021.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(dollars in thousands)

Note 6 - Capital Assets

Capital asset activity for the year ended June 30, 2022 was as follows:

	Beginning Balance	Additions	Disposals	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	8,544	86		8,630
Game equipment	569			569
Data processing equipment and software	6,311	217	(165)	6,363
Automobiles, furniture, and fixtures	3,025	228	(75)	3,178
Total other capital assets at cost	18,449	531	(240)	18,740
Less accumulated depreciation for				
Buildings	(5,952)	(285)		(6,237)
Game equipment	(466)	(49)		(515)
Data processing equipment and software	(4,734)	(565)	160	(5,139)
Automobiles, furniture, and fixtures	(2,508)	(243)	56	(2,695)
Total accumulated depreciation	(13,660)	(1,142)	216	(14,586)
Net capital assets, depreciable	4,789	(611)	(24)	4,154
Total capital assets, net	\$ 5,212	\$ (611)	\$ (24)	\$ 4,577

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(dollars in thousands)

Note 6 - Capital Assets (Continued)

Capital asset activity for the year ended June 30, 2021 was as follows:

	Beginning Balance	Additions	Disposals	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	8,540	23	(19)	8,544
Game equipment	488	81		569
Data processing equipment and software	6,073	504	(266)	6,311
Automobiles, furniture, and fixtures	2,797	228		3,025
Total other capital assets at cost	17,898	836	(285)	18,449
Less accumulated depreciation for				
Buildings	(5,684)	(269)	1	(5,952)
Game equipment	(440)	(26)		(466)
Data processing equipment and software	(4,408)	(553)	227	(4,734)
Automobiles, furniture, and fixtures	(2,197)	(311)		(2,508)
Total accumulated depreciation	(12,729)	(1,159)	228	(13,660)
Net capital assets, depreciable	5,169	(323)	(57)	4,789
Total capital assets, net	\$ 5,592	\$ (323)	\$ (57)	\$ 5,212

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(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. Employees can accrue no more than 696 hours of paid time off. Accrued paid time off at June 30, 2022 and 2021, included in accrued compensated absences in the accompanying Statements of Net Position, consisted of the following:

	2022	2021
Current	\$ 1,449	\$ 1,391
Compensated absences, less current portion	539	512
 Total compensated absences	 \$ 1,988	 \$ 1,903

Years Ended June 30,	Beginning Balance	Increases	Decreases	Ending Balance
2022	\$ 1,903	\$ 1,469	\$ (1,384)	\$ 1,988
2021	\$ 1,774	\$ 1,425	\$ (1,296)	\$ 1,903

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(dollars in thousands)

Note 8 - Estimated Prize Liability

Estimated prize liability at June 30, 2022 and 2021 consisted of the following:

	<u>2022</u>	<u>2021</u>
Current:		
Grand prizes	\$ 1,407	\$ 1,459
Other prizes	<u>68,664</u>	<u>62,988</u>
Total current portion	<u>70,071</u>	<u>64,447</u>
Long-term:		
Grand prizes	<u>8,547</u>	<u>9,764</u>
Total prize liability	<u>\$ 78,618</u>	<u>\$ 74,211</u>

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(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>
2022	\$ 11,223	\$ 381	\$ (1,650)	\$ 9,954
2021	12,012	455	(1,244)	11,223

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

<u>Years Ending June 30,</u>	
2023	\$ 1,407
2024	1,355
2025	1,305
2026	1,255
2027	593
2028 through 2032	2,351
2033 through 2037	2,039
2038 through 2042	1,090
2043 through 2047	624
2048 through 2050	<u>208</u>
Total	12,227
Less unamortized discount	<u>(2,273)</u>
Total at present value	9,954
Less current portion	<u>(1,407)</u>
Total long-term portion at present value	<u>\$ 8,547</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 \$363 and \$421 in 2022 and 2021, respectively, is included in accretion of investments.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(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 2022 and 2021, the KLC's contributions were calculated using the eligible compensation amount for eligible employees of \$4,803 and \$5,205, respectively, for the 6.2 percent employer contribution (Mandatory and Supplemental Contributions), and \$11,120 and \$11,575, respectively, for the 8 percent employer contribution (Basic Contributions). Employer contributions actually made to the Plan were approximately \$1,187 and \$1,249 in 2022 and 2021, respectively. Employee contributions to the Plan were approximately \$298 and \$323 in 2022 and 2021, respectively. At June 30, 2022 and 2021, the KLC had an outstanding liability of approximately \$40 and \$39, respectively, owed to the Plan, as part of the accrued salaries balance.

During 2022 and 2021, forfeitures of \$45 and \$26, 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 Annual Comprehensive 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 (CONTINUED)

June 30, 2022 and 2021

(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.

We recognize right-of-use assets and liabilities for equipment leases. As of June 30, 2022, and June 30, 2021, these amounts were as follows:

	2022	2021
Operating lease assets	\$ 9,638	\$ 13,033
Current portion of operating lease liabilities	3,667	4,086
Operating lease liabilities, net of current portion	5,971	8,947
Total operating lease liabilities	\$ 9,638	\$ 13,033

Liabilities for future equipment lease liabilities are summarized as follows:

Years Ending June 30,	Vending Machines	Monitors	Total
2023	\$ 3,656	\$ 11	\$ 3,667
2024	3,301	-	3,301
2025	3,168	-	3,168
2026	1,769	-	1,769
2027	567	-	567
Total			12,472
Less amortization expense			(2,834)
Total discounted operating lease liabilities			\$ 9,638

Total expense for 2022 and 2021 was approximately \$4,086 and \$4,276, respectively.

Other information related to equipment leases was as follows:

	2022	2021
Weighted-average remaining lease term (years)	3.73	4.58
Weighted-average discount rate	4.37%	4.37%

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021

(dollars in thousands)

Note 11 - Payments to the Commonwealth

Payments to the Commonwealth represent transfers of funds from the KLC to the Commonwealth's General Fund, Trust and Agency account, and the Kentucky Educational Excellence Scholarship ("KEES") Reserve Account. The payments to the General Fund and Trust and Agency account, 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 cover any funding shortfalls to the merit-based KEES program, which provides 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. During the years ended June 30, 2022 and 2021, all unclaimed prize money was transferred to the KEES Reserve Account as required by HB 192 of the 2021 Regular Session. Payments are made after the end of each quarter.

Payments, including amounts accrued, to the Commonwealth for the years ended June 30, 2022 and 2021 included payments to the following funds:

	<u>2022</u>	<u>2021</u>
General Fund and Trust and Agency Account	\$ 347,291	\$ 345,343
KEES Scholarship Reserve Fund	<u>12,042</u>	<u>9,757</u>
	<u>\$ 359,333</u>	<u>\$ 355,100</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 Annual Comprehensive Financial Reports should be referred to for additional disclosures related to the Risk Management Fund. The amount of commercial coverage has decreased, but is still adequate to protect against exposure and risk. The amount of settlements has not exceeded coverage.

KENTUCKY LOTTERY CORPORATION

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

June 30, 2022 and 2021
(dollars in thousands)

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 decreased by five percent. The commission paid to IGT for draw game lottery sales decreased from 1.5395 percent to 1.4625 percent of gross draw sales. The commission paid to IGT for scratch-off lottery sales decreased 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 pays IGT a fixed fee of \$250,000 per month, which began 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. IGT receives additional compensation of \$30.00 per retail location, per month, for cashless equipment 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 amended on April 17, 2020 and extended for an additional two years to April 16, 2022. The contract was amended again on December 18, 2020 and further extended until July 10, 2026. 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.

The Lottery contracted with Scientific Games, LLC (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***

To the 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 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 financial statements of the business-type activities of the Kentucky Lottery Corporation as of and for the year ended June 30, 2022, and the related notes to the financial statements, which collectively comprise the Kentucky Lottery Corporation's basic financial statements, and have issued our report thereon dated September 23, 2022.

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) as a basis for designing procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Kentucky Lottery Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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.

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.

**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* Matters (Continued)**

Internal Control over Financial Reporting (Continued)

As part of obtaining reasonable assurance about whether the Kentucky Lottery Corporation's financial statements are free from 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 financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the 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.

MCM CPAs & Advisors LLP

Louisville, Kentucky
September 23, 2022

KENTUCKY LOTTERY CORPORATION

SCHEDULE OF FINDINGS
Year Ended June 30, 2022

Schedule of auditor's results

We have issued an unmodified opinion dated September 23, 2022, on the financial statements of the Kentucky Lottery Corporation as of and for the year ended June 30, 2022.

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, 2022

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