

Approved: February 22, 2000  
Date

## MINUTES OF THE HOUSE COMMITTEE ON FEDERAL & STATE AFFAIRS

The meeting was called to order by Chairman Tony Powell at 1:30 p.m. on January 18, 2000 in Room 313-S of the Capitol.

All members were present except:                      Representative Klein, Excused  
   Representative Vickrey, Excused.

Committee staff present:                                      Theresa Kiernan, Revisor of Statutes  
   Russell Mills, Legislative Research  
   Winnie Crapson, Committee Secretary

Conferees appearing before the committee:  
   Karen France, Kansas Association of Realtors  
   Steve Kearney, Petroleum Marketers and Convenience Store Association of Kansas  
   David Finley, Kansas Plumbing, Heating, Cooling Contractors Association  
   and Mechanical & Sheet Metal Contractors Association of Kansas

Others attending:    See attached list.

Chairman Powell opened the meeting with introduction of new members. He noted Committee Rules are similar to those of other Committees. It is his intention to proceed under unanimous consent for introduction of bills and approval of Committee Minutes without individual motion on each action. Objections will be called for and noted and as a matter of courtesy introduction of bill in question will not go forward.

Chairman Powell noted two major agenda items: Introduction of Bills and report from the Legislative Post Audit Review on Kansas Racing & Gaming Commission and Kansas Lottery.

By unanimous consent bill will be introduced concerning amendment of Kansas Real Estate Act (K.S.A. 58-3062) regarding inducements and after-the-fact referral fees as requested by Kansas Association of Realtors (Attachment #1). [See HB2687 introduced January 20.]

By unanimous consent bill will be introduced to prohibit gray marketing of tobacco products as requested by Petroleum Marketers and Convenience Store Association of Kansas (Attachment #2). [See HB2670 introduced January 20.]

By unanimous consent bill will be introduced to allow uniform licensing for every person legitimately engaged in plumbing, heating and cooling contracting and sheet metal contracting and requiring maintenance of their skill level as requested by the Kansas Plumbing, Heating, Cooling Contractors Association and the Mechanical & Sheet Metal Contractors Association of Kansas (Attachment #3). [See HB2686 introduced January 20.]

Randy Tongier, Audit Manager, **Legislative Division of Post Audit**, presented **Financial Compliance and Fiscal Year 1999 Audit Report of Kansas Racing and Gaming Commission (Attachment #4)** and of **Kansas Lottery (Attachment #5)**. Both Reports represent CPA-firm type audits required to be done annually and were done by Berberich Trahan & Co., Topeka, under contract with the Division of Post Audit. Mr. Tongier reported on the Audit Reports but suggested any questions about the agencies themselves could be better answered by the agency.

CONTINUATION SHEET

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The **Audit Report of the Kansas Racing and Gaming Commission** disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards and noted no matters involving the internal control over financial reporting and its operation considered to be material weaknesses the previous year.

Finding 1 identifies Untimely Completion of Background Investigations. The Agency is required by Tribal Compacts to provide a written report on background checks to the Tribes within 90 days. The Agency has 248 cases that are over the 90 day requirement. Through the addition of personnel, this figure has been reduced by 39% from the previous year. Within the current manpower the agency estimates that 500 to 600 cases can be timely processed each year. The most recent fiscal year had 725 cases. The Report recommends the **State Gaming Agency** continue to improve the timeliness for conducting background investigations.

The **Audit Report of the Kansas Lottery** indicates no material weaknesses relating to financial statements, compliances and internal control.

In response to questions, Mr. Tongier stated it was his understanding delays in conducting background checks were caused by lack of resources. Checks were previously done by the Kansas Bureau of Investigation. The Agency decided to bring the process in-house and it took some time to get the resources needed to do it on a timely basis.

Russell Mills, Legislative Research, responded to question that the parimutuels totally fund the Racing program. He understands that the Gaming program is funded by the four Tribes equally. Except for the start-up costs, no State General Funds are involved

In response to question, Mr. Tongier stated State law calls for the audit to be the responsibility of the Post Audit function. The Legislative Post Audit Committee sets the guidelines. Procedures are the "generally accepted Government Audit Standards" developed by the U.S. Government Office and adopted by the entire accounting profession and CPA firms that work in that field.

Chairman Powell revised schedule for this week. There will be no meeting on January 19, **SB 115** having been cancelled upon notice from the Realtors that they do not want the fee increase.

Committee adjourned at 2:15 p.m. Next meeting is scheduled for January 20, 2000.





Kansas Association of REALTORS®



TO: Federal and State Affairs Committee

FROM: Karen France, Director of Governmental Relations

Re: Request for introduction of legislation amending the Kansas Real Estate Salespersons and Brokers Act

Date: January 17, 2000

Thank you for the opportunity to present our request for legislation.

**INDUCEMENTS**

**The Problem**

As in all industries, the real estate industry is trying to meet the increased demand for customer service. Consumers involved in a real estate transaction are looking for the real estate professional who can offer them more services for their dollar. In response, many of our members are looking for ways to deliver that extra level of service.

For example, they have considered including a pre-sale home inspection, a pre-sale title search or a homebuyer's warranty in their service packages. Home inspections, title searches and homebuyer warranties are, for the most part, found in the typical real estate transaction in Wichita. Our members are considering offering them, in order to expedite the transaction or, in the case of the pre-sale home inspection pre-empt the discovery of a problem with the property just before closing.

However, in light of a 1998 Attorney General's interpretation of the law, a broker offering these services would be in violation of Kansas law. The current Kansas law provides:

**58-3062. Prohibited acts**

**(a) No licensee, whether acting as an agent or a principal, shall:**

**(11) Offer or give prizes, gifts or gratuities which are contingent upon an agency agreement or the sale, purchase or lease of real estate.**

Attorney General Opinion No. 98-53 concludes that "a real estate broker is prohibited from offering or giving anything of value, other than the broker's services as a broker, that is contingent upon an agency agreement with a client or the sale, purchase or lease of real estate". In defining broker's services, she opined, "a reasonable nexus must exist between the particular services and one or more of the primary broker activities specified in the statutory definition of broker." The underlying test then, is "Does an individual need a real estate license to offer these services or products?" If the answer is "no" then, a broker who offers them is in violation of the law. Under the examples given above, a real estate license is not required to sell a pre-sale home inspection, a pre-sale title search or a homebuyer's warranty. Therefore, if a broker pays for these services within their service package, they have violated the law.

We feel that the consumer is benefited—whether they are sellers or buyers, if they receive these services as part of a broker's service. The amount of time it takes from sales contract to the buyer getting possession of a home is shortened. Buyers, sellers and real estate agents have more information available and all can make informed choices.

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### KAR Solution

Our Governmental Affairs committee met with the Attorney General regarding the subject, in an effort to more fully explain the modern real estate marketplace and the potential benefits to consumers. Her recommendation was for us to come to the legislature to clarify the law as to what products and services would be considered legal. Our proposal:

Amend K.S.A. 58-3062 (a)

**(11) Offer or give prizes, gifts, or gratuities which are contingent upon an agency agreement or the sale, purchase or lease of real estate. Products or services which are offered or given pursuant to a licensee carrying out the duties of a seller's agent pursuant to 58-30,106, a buyer's agent pursuant to 58-30,107, or a transaction broker, pursuant to 58-30,113 shall not be considered to be a prize, gift, or gratuity.**

This would allow licensees to offer products and services that are directly related to the successful completion of the real estate sale. It would not allow them to give away turkeys or cars. It would allow them to provide products or services needed by a buyer or seller to complete a transaction. While some would like to remove the inducement prohibition completely, after lengthy discussions we feel this is the most reasonable approach to handling the problem.

### AFTER-THE-FACT REFERRAL FEES

#### The Problem

First, a definition. A referral fee, sometimes called a "cooperative broker referral fee" is the part of a commission one real estate broker pays to another, as a result of a sale consummated by the "paying" broker, on behalf of a client sent by the "receiving" broker.

Payment of referral fees has been an integral part of residential real estate practice for many years. Sometimes the relationship between the brokers is defined in a written contract, other times by a prior verbal agreement, and sometimes even by custom and practice of the area in which the brokers are located.

Whatever their form, referral fee agreements essentially are a contract between a real estate broker and an employer or relocation management company (both of which also must hold a real estate brokerage license) formalizing a referral fee arrangement.

When things go according to plan, generally there are no problems. The transferring employee chooses an agent from a broker with a referral agreement with his or her company, the sale takes place, and the referral fee is paid at or soon after the closing.

The problems generally arise when the transferring employee enters into an agreement with a real estate agent to list the home, or to find a home and the agent is unaware of a referral fee agreement between the employer and a broker in that area. This may occur because the transferring employee makes a mistake in choosing the agent or, perhaps, because the employee tries to get a "head start" on the relocation process. In any case, the agent, when the agreement is entered into, is unaware of an existing referral agreement. Only later does the agent learn of such an agreement.

In some cases, this happens early in the relationship, in others, it may occur much later, even after the closing. In both cases, brokers feel that they are being asked to give up a part of their commission, after-the-fact without prior arrangement with the employee. This demand for an after-the-fact referral fee interferes with contractual relations previously entered into with the transferring employee.

On its face, it would appear that the resolution would be easy. A listing agreement signed by a transferring employee with a brokerage firm is an enforceable contract. If it does not contain a provision for the payment of a referral fee, and if the broker does not have an independent agreement with the employer or relocation management company, then there exists no recognizable legal claim for payment of a referral fee. The employee is bound by the terms of the listing agreement, and the broker is not subject to suit for a referral fee.

In the real world, however, brokers are pressured to agree, after-the-fact, to pay a referral fee, because the relocation company threatens the agent by telling them the employee stands to lose some of his or her relocation benefits by virtue of failing to choose an approved broker. Additionally, the employer or relocation management company threatens to take any future relocation business to their competitor.

#### KAR Solution

Our members have no problems living up to contractual referral fee agreements. They struggle when having these entities interfere with legitimate contractual agreements. But the biggest frustration is when the employer or the relocation company informs the brokerage that the employee will be left out in the cold without their relocation package unless the broker agrees to pay this after-the-fact referral fee. Some of our members liken it to extortion.

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This practice of demanding after-the-fact referral fees is not just a Kansas problem. While numerous states are looking at statutory solutions to the problems; Iowa and Tennessee have already acted. We looked at the statutes and took the best parts of both of them to develop our solution. This is our conceptual amendment to the Kansas Real Estate Brokers and Salesperson's Act:

1. A broker licensed in this state or in another jurisdiction may not solicit a referral fee without reasonable cause.
2. Reasonable cause does not exist unless one of the following conditions exists:
  - a. An actual introduction of business has been made;
  - b. A contractual referral fee relation exists; or
  - c. A contractual cooperative brokerage relationship exists.
3. No licensee or anyone on behalf of any such licensee or firm, whether licensed in this state or in another shall:
  - a. Threaten to reduce or withhold employee relocation benefits or to take other action adverse to the interests of a client or customer of a real estate licensee; or
  - b. Counsel a client or customer of another real estate licensee on how to terminate or amend an existing agency agreement or sales contract. Communicating corporate relocation policy or benefits to a transferring employee shall not be considered a violation of this part, as long as the communication does not involve advice or encouragement on how to terminate or amend an existing agency contract.

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# Memo

**To:** Chairman Powell and members of the House Federal and State Affairs Committee  
**From:** Steve Kearney *SK*  
**Date:** 01/17/00  
**Re:** Grey marketing of tobacco products legislation

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I am requesting on behalf of the Petroleum Marketers and Convenience Store Association of Kansas introduction of legislation prohibiting the sale or distribution in Kansas of tobacco products intended for distribution outside the United States. A method of marketing tobacco products not intended for use or sale in the United States bearing statements like "For Export Only" and not complying with the Federal Law regarding warnings etc. has emerged and we are requesting it's prohibition in Kansas.

These products are intended for distribution overseas and are purchased and resold in the United States without regard for Federal, State or Local provisions, tax stamps or inclusion in the computation of tobacco settlement proceeds. They are sold at reduced prices and create an unfair trade environment for the ethical retailer who is complying with the law.

Such legislation should include:

1. Clear definition of the products prohibited from distribution;
2. Criminal Penalties for the unscrupulous retailer at the Class C misdemeanor level;
3. Administrative sanctions so the Department of Revenue may revoke or suspend a retailers license violating the Act; and,
4. Provide that violating the Act is an unfair trade practice as defined by current Kansas Law.

Thank you for your consideration of this matter.

1/18/00

January 18, 2000

Chairman Powell, Honorable Committee Members;

Thank you for the opportunity to speak to you today.

My name is David Finley, Executive Director for the Kansas Plumbing, Heating, Cooling, Contractors Association, and the Mechanical & Sheet Metal Contractors Association of Kansas. I am here on behalf of the plumbing and mechanical profession of our state.

For over one hundred years, our profession has proudly served the needs of the public. Turn of the century luxuries such as running water and indoor plumbing and later luxuries like refrigeration and central air are now considered basic necessities.

Like so many other professions, we are experiencing change as never before. Advancements in our industry are staggering. Technology is the engine driving those changes. Items such as ultra-high efficiency heating are on the market today. These new systems require entirely new methods of installation and service. They are safe and

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reliable when installed by trained professionals but potentially lethal when put in using traditional methods. The weak link is the human factor.

Unfortunately, our profession is one of the last, if not *the* last, which has yet to implement standardized state licensing with continuing education. Teachers, attorneys, doctors, architects, realtors, engineers, etc., are all licensed at the state level. Imagine the needless burden in both time and expense if instead of one uniform statewide license, each of these professions would have to maintain a separate license in each city or town in which they wished to practice. I venture that most of us would think that would be ridiculous. Unfortunately, that is the reality our profession has to live with daily.

Even more disturbing is the lack of continuing education. How comfortable would you feel going to the doctor if you knew once they were licensed, no further training would ever again be required? Again, I believe it is safe to say we all want our doctors to be knowledgeable with the latest developments in medicine. The same goes for all of the

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other professions in our state. Continuing education is vital to stay abreast of the changes in our respective fields.

Safety and efficiency are just two of the reasons our industry has come together to propose this legislation. Input and support came from trade associations such as the Air Conditioning Contractors Association (ACCA), Mechanical Contractors of Kansas (MCAK); cities such as Wellington, Topeka and Wichita; the State of Kansas Architect's office, people in the profession ranging from management and labor of large contracting companies to numerous family owned operations in towns like Ulysses and Cherryvale.

We believe this legislation to be simple and straightforward. By allowing every person in our state legitimately engaged in the profession to be uniformly licensed and require them to maintain their skill level, the public will benefit from the increased efficiencies and increased safety.

Thank you again for the opportunity to present to you this proposed legislation.

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FINANCIAL AND COMPLIANCE AUDIT REPORT  
KANSAS RACING AND GAMING COMMISSION  
FISCAL YEAR 1999

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KANSAS RACING AND GAMING COMMISSION  
FINANCIAL AND COMPLIANCE AUDIT REPORT

Year Ended June 30, 1999

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# KANSAS RACING AND GAMING COMMISSION

## INTRODUCTION

For the Year Ended June 30, 1999

The accompanying report presents the results of the financial and compliance audit of the operations of the Kansas Racing and Gaming Commission (Commission) for the fiscal year ended June 30, 1999.

Effective July 1, 1996 with the Governor's signing of the Senate Bills 410 and 495, the State Gaming Agency was attached to the Racing Commission and the agency's name was changed to the Kansas Racing and Gaming Commission.

The Commission comprises five members appointed by the Governor and confirmed by the Senate. The Governor also appoints an Executive Director for the Racing Commission and an Executive Director for the State Gaming Agency. Both of these appointments are subject to confirmation by the Senate. The Racing Commission's primary mission is the regulation of racing and parimutuel operations in Kansas. The Commission also promotes the development of the horse and dog industries, and ensures the health and safety of animals involved in racing.

The State of Kansas currently has four operating race tracks with parimutuel wagering:

- Kansas City
- Wichita
- Anthony
- Eureka

The Kansas City track has both horse and greyhound racing, while the Wichita track has only greyhound racing. The Anthony Fair Association holds annual races during the month of July at Anthony, Kansas. The Greenwood County Fair and Kansas Quarter Horse Association holds annual races during the months of May, June and July at Eureka, Kansas. By law, each track's operation comprises a nonprofit organization licensed to operate racing and parimutuel wagering, and a facility owner/manager licensed to own and operate the track facility itself. The Kansas nonprofit organization collects wagers, and from those moneys it pays winning bettors, contributes to race purses, pays management fees to the facility owner/manager, pays applicable taxes to the Racing and Gaming Commission, pays its own operating expenses, and distributes all remaining moneys to charitable organizations as specified by statutory requirements.

The State Gaming Agency fulfills the duties and obligations of the state as set forth in the tribal-state gaming compacts and the tribal-gaming oversight act. The compacts outline the duties of the Native American tribes and the State Gaming Agency regarding the operation and regulation of tribal gaming. These duties include conducting and reporting to the tribal gaming commissions regarding mandatory background investigations on specified gaming employees, monitoring compliance with internal control and gaming rules, and monitoring compliance with the compacts' licensing criteria. Additionally, the tribal-gaming oversight act authorizes the State Gaming Agency to exercise its law enforcement powers to perform the duties of the compacts and the tribal-gaming oversight act.

KANSAS RACING AND GAMING COMMISSION  
SCHEDULE OF FINDINGS AND RECOMMENDATIONS

For the Year Ended June 30, 1999

Finding 1 - Untimely Completion of Background Investigations

The State Gaming Agency (Agency) is required by the tribal State Gaming Compact to provide a written report on background checks to the Tribes within 90 days. The Agency has 248 cases that are over the 90 day requirement. Through the addition of personnel, this figure has been reduced by 39% from the previous year. With the current manpower the agency estimates that the agency can timely process 500 to 600 cases each year. The most recent fiscal year had 724 cases.

Recommendation: We recommend the State Gaming Agency continue to improve its timeliness for conducting background investigations.

KANSAS RACING AND GAMING COMMISSION

FOLLOW-UP ON PRIOR YEAR

FINDINGS AND RECOMMENDATIONS

For the Year ended June 30, 1999

Finding 1 - Untimely Transfer

KSA 74-8831(b)(1) requires 15% of all monies credited to the Kansas Greyhound Breeding Development Fund during a fiscal year to be transferred to the Kansas Greyhound Tourism Fund on June 30 of each year. However, the fiscal year 1998 transfer was not requested until July 23, 1998. Accordingly, there is no mandatory transfer reflected in these financial statements.

Current Status: Adequate resolution in current year.

Finding 2 - Untimely Completion of Background Investigations

The State Gaming Agency (Agency) is required by the Tribal State Gaming Compact to provide a written report on background checks to the Tribes within 90 days. However, their background checks are averaging 174 days. The Agency has decided to perform these investigations in-house rather than utilizing the Kansas Bureau of Investigation (KBI). In September of 1998, the Agency completely took over the Category II investigations and in June of 1999 the Agency began performing the Category I investigations. However, there are still 40 investigations that will be completed by the KBI. Additionally, because the Agency will no longer contract with the KBI for background investigations, the \$3,000 Tribal deposits will no longer be collected. Rather, the Agency has added the cost to their annual budget which is funded equally by the Tribes.

Current Status: See current year Finding No. 1.

Finding 3 - Fixed Asset Inventories

State Racing and Gaming Commission internal control policies and procedures require property to be inventoried and tagged as part of the safeguarding system. However, due to absence of personnel, the fixed asset inventories at both the Racing Commission and the Gaming Agency have not been kept up to date. Additionally, many fiscal year 1999 purchases have not been marked with identifying tags.

Current Status: Adequate resolution in current year.

MCBRIDE, LOCK & ASSOCIATES

INDEPENDENT AUDITOR'S REPORT

Legislative Division of Post Audit  
Kansas State Legislature

We have audited the accompanying Statement of Changes in Fund Balance of the Kansas Racing and Gaming Commission (Commission), as of and for the year ended June 30, 1999. This financial statement is the responsibility of the Commission's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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 statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, this financial statement was prepared in conformity with the cash basis and budget laws of the State of Kansas, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the fund balances of the Commission for the year ended June 30, 1999 and the changes therein for the year then ended in conformity with the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 24, 1999 on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations and contracts.

*McBride, Lock & Associates*  
McBride, Lock & Associates

September 24, 1999

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KANSAS RACING AND GAMING COMMISSION  
STATEMENT OF CHANGES IN FUND BALANCE  
FOR THE FISCAL YEAR ENDED JUNE 30, 1999

	State Racing Fund	Horse Fair Racing Benefit Fund	Horse Breeding Development Fund	Racing Investigative Expense Fund	Greyhound Breeding Development Fund	Racing Reimbursable Expense Fund	Racing Applicant Deposit Fund	State Gaming Fund	Commission Total
Beginning Balance on July 1, 1998	\$ 269,357	\$ 289,102	\$ 90,888	\$ 19,892	\$ 362,874	\$ 180,868	\$ 671	\$ 1,152,375	\$ 2,366,027
Prior Period Adjustments: (Note 5)									
Disencumber Balances	30,787	500	0	0	0	1,200	0	45,099	77,586
Receipts:									
Revenues	3,531,206	805,406	449,548	18,850	392,549	34,153	36	861,539	6,093,287
General Fund Transfer	0	0	0	0	0	0	0	450,000	450,000
Horse Fair Fund Transfer	60,557	0	0	0	0	0	0	0	60,557
Disbursements:									
Operating Expenditures	(2,792,912)	(663,991)	(438,560)	(18,850)	(353,102)	(36,134)	0	(1,052,140)	(5,355,689)
Gaming Fund Transfer	(646,697)	0	0	0	0	0	0	0	(646,697)
General Fund Transfer	0	0	0	0	0	(150,000)	0	(675,564)	(825,564)
Greyhound Tourism Fund Transfer	0	0	0	0	(112,684)	0	0	0	(112,684)
Racing Fund Transfer	0	(60,557)	0	0	0	0	0	0	(60,557)
Ending Fund Balance on June 30, 1999	<u>\$ 452,298</u>	<u>\$ 370,460</u>	<u>\$ 101,876</u>	<u>\$ 19,892</u>	<u>\$ 289,637</u>	<u>\$ 30,087</u>	<u>\$ 707</u>	<u>\$ 781,309</u>	<u>\$ 2,046,266</u>

The accompanying notes are an integral part of this financial statement.

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# KANSAS RACING AND GAMING COMMISSION

## NOTES TO FINANCIAL STATEMENT

For the Year Ended June 30, 1999

### 1 - Summary of Significant Accounting Policies

#### Basis of Accounting

These financial statements are presented in compliance with the cash basis and budget laws of the State of Kansas. Revenues, from racing, consisting primarily of taxes charged at the racing establishments and gaming's revenues from annual assessments of the Tribes, are recognized when received. Expenditures are recognized when paid or encumbered. Encumbrances represent commitments relating to unperformed contracts for goods or services. Accordingly, the statement of changes in fund balances is not intended to present the results of operations of financial position in accordance with generally accepted accounting principles.

#### Description of Funds

The number and types of funds of the Commission are controlled by legislative and state administrative actions. For purposes of the Central Accounting System for Kansas, the types or groups of funds within the Commission are as follows:

#### State Racing Fund

All taxes on live parimutuel wagering, admissions tax, application fees, license fees and fines which are collected by the Commission are credited to the State Racing Fund. Two-thirds of the parimutuel taxes on simulcast performances are credited to the State Racing Fund.

All operating expenses of the Commission are paid from the State Racing fund. Any money in the State Racing fund in excess of \$300,000 is transferred on a monthly basis to the State Gaming Revenue fund. However, for the period July 1, 1998 through June 30, 1999 this amount was \$250,000. Effective July 1, 1999 the maximum was set back to \$300,000.

#### Horse Fair Racing Benefit Fund

This fund's revenue is derived from 1/3 of the parimutuel taxes pools for simulcast races. Monies in the fund are allocated by the Commission for specific operating expenses related to horse race meetings conducted by a fair association or horsemen's nonprofit organization.

KANSAS RACING AND GAMING COMMISSION

NOTES TO FINANCIAL STATEMENT

For the Year Ended June 30, 1999

1 - Summary of Significant Accounting Policies (Continued)

Horse Breeding Development Fund

This fund's revenue is derived from breakage and unclaimed winning tickets from horse performances. The funds are distributed by the Commission to various breeds of horses which are participating in the races.

Racing Investigative Expense Fund

All expenses of investigation of an applicant's qualification for licensure are paid from this fund. Whenever another state agency assists the Commission in investigations and incurs costs in addition to those attributed to the operations of the agency, those costs are paid from this fund. The applicant reimburses the commission for all costs related to their investigation.

Greyhound Breeding Development Fund

This fund's revenue is derived from unclaimed winning tickets from greyhound races. Funds are distributed by the Commission as follows:

15% Greyhound Tourism  
35% Greyhound Research  
50% Supplement Kansas Bred Stakes Races

Racing Reimbursable Expense Fund

All fees for processing fingerprints of licensees are paid from the Racing Reimbursable Expense Fund and reimbursed by the licensee.

Racing Applicant Deposit Fund

An applicant proposing to construct a racetrack facility is required at the time of making application to make a deposit. If the racetrack is constructed in accordance with the terms of the application, the deposit and interest is refunded. If the applicant fails to complete the racetrack facility in accordance with terms, the deposit and interest are forfeited by the applicant.

KANSAS RACING AND GAMING COMMISSION

NOTES TO FINANCIAL STATEMENT

For the Year Ended June 30, 1999

1 - Summary of Significant Accounting Policies (Continued)

State Gaming Fund

This fund's primary revenues are derived from the annual assessments of the Tribes for the cost of oversight and mandatory background investigations.

2 - Cash Balances

Cash balances include both encumbered funds, reserved for payment of contracts, orders, or other obligations, and unencumbered monies. Ending encumbered and unencumbered cash balances at June 30, 1999, were as follows:

<u>Fund Types</u>	<u>Encumbered</u>	<u>Unencumbered</u>	<u>Total</u>
State Racing Fund	\$ 84,196	\$ 452,298	\$536,494
Horse Fair Racing Benefit Fund	1,500	370,460	371,960
Horse Breeding Development Fund	0	101,876	101,876
Racing Investigative Expense Fund	0	19,892	19,892
Greyhound Breeding Development Fund	0	289,637	289,637
Racing Reimbursable Expense Fund	0	30,087	30,087
Racing Applicant Deposit Fund	0	707	707
State Gaming Fund	<u>21,937</u>	<u>781,309</u>	<u>803,246</u>
	<u>\$107,633</u>	<u>\$2,046,266</u>	<u>\$2,153,899</u>

KANSAS RACING AND GAMING COMMISSION

NOTES TO FINANCIAL STATEMENT

For the Year Ended June 30, 1999

3 - Employees' Retirement System

Substantially all employees of the Commission are eligible to participate in the Kansas Public Employees' Retirement System (KPERS) after one year of employment. Employees who retire at or after age 65 or age 62 with ten years service credit or at any age when years of service plus age equal 85 "points" are entitled to a retirement benefit payable monthly for life, equal to 1 percent of their final average salary for each year of "prior" service, and 1.75 percent of each year of "participating" service. Final average salary is the employee's average salary over the higher of four years of credited service including add-ons such as accrued sick leave and vacation leave or a three year average without add-ons. For those hired July 1, 1993 or later, final average salary is a three year average with no add-ons. Benefits fully vest upon reaching 10 years of service. Vested employees may retire at age 55 and receive reduced retirement benefits. KPERS also provides death and disability benefits. Benefits are established by State of Kansas statute.

Covered employees are required by State to contribute 4 percent of their salary to the plan. The employer is required by the same statute to contribute the remaining amounts necessary to pay benefits when due.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess KPERS' funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among Public Employees Retirement Systems and employers. KPERS does not make separate measurements of assets and pension benefit obligation for individual employers. The pension benefit obligation at July 30, 1999 for KPERS as a whole, determined through an actuarial valuation performed as of that date, was \$9.99 billion. KPERS' net assets available for benefit obligation estimated at \$8.60 billion, leaving an unfunded pension benefit obligation estimated at \$1.40 billion. The contribution of the Commission for the period covered by this report represents less than 1 percent of total contributions required of all participating entries.

Ten-year historical trend information showing KPERS' progress in accumulating sufficient assets pay benefits when due to presented KPERS' 1999 Comprehensive Annual Financial Report.

KANSAS RACING AND GAMING COMMISSION

NOTES TO FINANCIAL STATEMENT

For the Year Ended June 30, 1999

4 - Economic Dependency

The racetrack in Kansas City, Kansas continues to experience a decrease in revenue. The decrease has been attributed to the opening of riverboat gambling in Missouri.

5 - Prior Period Adjustments

The differences between fiscal year 1998 encumbrances and actual amounts expended are as follows:

	<u>State Racing Fund</u>	<u>Horse Fair Racing Benefit Fund</u>	<u>Racing Reimbursable Expense Fund</u>	<u>State Gaming Fund</u>	<u>Commission Total</u>
Fiscal Year 1998 Encumbrances	\$41,299	\$ 500	\$1,200	\$52,359	\$ 95,358
Fiscal Year 1998 Disbursements in Fiscal Year 1999	<u>(10,512)</u>	<u>0</u>	<u>0</u>	<u>(7,260)</u>	<u>(17,772)</u>
Disencumbered Balances	<u>\$30,787</u>	<u>\$ 500</u>	<u>\$1,200</u>	<u>\$45,099</u>	<u>\$77,586</u>

Current year State Gaming Fund encumbrances include \$4,491 of duplicated encumbrances. This is anticipated to be corrected through the disencumbrance of unspent amounts in fiscal year 2000.

McBRIDE, LOCK & ASSOCIATES

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE  
AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Legislative Division of Post Audit  
Kansas State Legislature

We have audited the financial statement of the Kansas Racing and Gaming Commission (Commission) as of and for the year ended June 30, 1999, and have issued our report thereon dated September 24, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Commission's financial statement is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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This report is intended for the information of management and the Legislative Post Audit Committee, Kansas State Legislature. However, this report is a matter of public record and its distribution is not limited.

*McBride, Lock & Associates*  
McBride, Lock & Associates

September 24, 1999

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AUDITEE RESPONSE

KANSAS  
STATE GAMING AGENCY

November 10, 1999



Racing & Gaming Commission

Mr. Robert J. Lock  
McBride, Lock & Associates  
1221 Baltimore Avenue  
Kansas City, Missouri 64105

Dear Mr. Lock:

I have had an opportunity to review the Fiscal Year 1999 draft audit report and findings for the State Gaming Agency. I am making the following response in regards to Finding 1 - Untimely completion of Background Investigations.

The Tribal-State Compacts require the State Gaming Agency to perform background investigations for gaming employees who are to be licensed and allowed to work in the Tribal gaming facilities. The compacts provide that as soon as possible after a request to perform a background investigation is received by the State a report is to be provided. After a period of ninety (90) days after a request is received, if the State has not provided a background investigation report on an individual, then the State assents to the issuance of a temporary gaming license pending completion of the investigation. There is no actual requirement that the background investigation be completed within ninety (90) days as reflected in the finding.

Over time the issue of background investigations and the time required to complete background investigations has centered on the ninety (90) day time period and the language "as soon as possible" contained in the compacts. In an effort to meet this standard the State Gaming Agency provides tribal gaming commissions information regarding credit records, motor vehicle records, civil and criminal court records based upon places of residences, a check for any outstanding warrants and other gaming agencies when compiled. It is the goal of the agency to process all background investigation requests so that the issuance of temporary gaming licenses will not be necessary. The finding reflects the progress toward that goal.

In reviewing the actual statistics for Fiscal Year 1999, this agency determined that 859 requests to perform background investigations were submitted. This differs from the 724 reflected in your finding and is significantly higher than the amount which could be processed in accordance with the agency's goal and its current manpower.

Thank you for this opportunity to respond to the audit. If you have any questions, please contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Tracy T. Diel". The signature is stylized with a large, circular flourish at the end.

Tracy T. Diel  
Executive Director

jb:lock.wpd

KANSAS LOTTERY  
FINANCIAL AND COMPLIANCE AUDIT  
Years Ended June 30, 1999 and 1998

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KANSAS LOTTERY  
FINANCIAL AND COMPLIANCE AUDIT  
YEARS ENDED JUNE 30, 1999 AND 1998

# KANSAS LOTTERY

## INTRODUCTION

Years Ended June 30, 1999 and 1998

The accompanying report represents the results of the financial and compliance audit of the operations of the Kansas Lottery (Lottery) for the fiscal year ended June 30, 1999.

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

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KANSAS LOTTERY

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Year Ended June 30, 1999

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of the Kansas Lottery.
2. No material weaknesses relating to the audit of the financial statements are reported in the report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards*.
3. No instances of noncompliance material to the financial statements of the Kansas Lottery were disclosed during the audit.

B. FINDINGS - FINANCIAL STATEMENT AUDIT

None.

C. PRIOR YEAR FINDINGS

None.



# Berberich Trahan & Co., P. A.

Certified Public Accountants

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Facsimile 785 233 1768  
E-mail cpakansas@cpakansas.com

## INDEPENDENT AUDITORS' REPORT

Legislative Post Audit Committee  
Kansas State Legislature:

We have audited the accompanying financial statements of the Kansas Lottery, a component unit of the State of Kansas, as of and for the years ended June 30, 1999 and 1998, as listed in the table of contents. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Kansas Lottery and are not intended to present fairly the financial position of the State of Kansas, and the results of its operations and cash flows of its Proprietary fund types and nonexpendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Kansas Lottery, as of June 30, 1999 and 1998, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

The year 2000 supplementary information on page 20 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance that the Lottery is or will become year 2000 compliant, that the Lottery's year 2000 remediation effort will be successful in whole or in part, or that parties with which the Lottery does business are or will become year 2000 compliant.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 1999, on our consideration of the Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

*Berberich Trahan & Co., P.A.*

October 18, 1999

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KANSAS LOTTERY

BALANCE SHEETS

June 30, 1999 and 1998

	<u>1999</u>	<u>1998</u>
<u>ASSETS</u>		
Current assets:		
Cash (Note 3):		
Operating fund	\$ 1,805,671	\$ 3,583,768
Prize payment fund	1,054,054	478,137
Accounts receivable, net of allowance for doubtful accounts of \$ 92,516 and \$ 165,951	5,689,167	2,006,303
Accounts receivable - unbilled	7,363,597	6,473,249
Instant ticket game inventory	<u>986,326</u>	<u>701,562</u>
Total current assets	<u>16,898,815</u>	<u>13,243,019</u>
Property and equipment (Note 4)	3,335,204	3,099,942
Less accumulated depreciation	<u>2,784,763</u>	<u>2,554,918</u>
	<u>550,441</u>	<u>545,024</u>
Total assets	<u>\$ 17,449,256</u>	<u>\$ 13,788,043</u>
<u>LIABILITIES AND FUND EQUITY</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,955,233	\$ 1,137,741
Due to State Gaming Revenue fund (Note 8)	7,913,047	6,276,134
Prize liability	<u>5,756,364</u>	<u>3,887,711</u>
Total current liabilities	<u>15,624,644</u>	<u>11,301,586</u>
Fund equity:		
Retained earnings:		
Unreserved and undesignated	<u>1,824,612</u>	<u>2,486,457</u>
Total liabilities and fund equity	<u>\$ 17,449,256</u>	<u>\$ 13,788,043</u>

See accompanying notes to financial statements.

KANSAS LOTTERY

STATEMENTS OF REVENUES, EXPENSES, AND  
CHANGES IN RETAINED EARNINGS

Years Ended June 30, 1999 and 1998

	<u>1999</u>	<u>1998</u>
Operating revenues:		
Net game revenues	\$ 191,169,831	\$ 185,203,364
Net unsettled revenues	7,751,154	6,813,946
Retailer fees and miscellaneous income	67,640	38,177
Phone reimbursements	<u>903,036</u>	<u>910,730</u>
Total operating revenues	<u>199,891,661</u>	<u>192,966,217</u>
Operating expenses:		
Game prizes	107,079,089	101,688,863
Retailer commissions	11,133,848	10,935,736
Advertising	2,559,856	2,668,596
Cost of instant tickets	2,243,185	2,086,406
Depreciation	255,574	369,109
Professional services	77,125	173,378
On-line games service bureau	7,595,091	6,988,275
Salaries and benefits	3,666,313	3,428,587
Telecommunications	3,404,891	3,371,109
Other administrative expense	<u>1,568,157</u>	<u>1,446,807</u>
Total operating expenses	<u>139,583,129</u>	<u>133,156,866</u>
Income before operating transfers	<u>60,308,532</u>	<u>59,809,351</u>
Operating transfers out (Note 8):		
State Gaming Revenue fund	<u>60,970,377</u>	<u>59,930,874</u>
Net loss	(661,845)	(121,523)
Retained earnings, beginning of year	<u>2,486,457</u>	<u>2,607,980</u>
Retained earnings, end of year	<u>\$ 1,824,612</u>	<u>\$ 2,486,457</u>

See accompanying notes to financial statements.

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KANSAS LOTTERY

STATEMENTS OF CASH FLOWS

Years Ended June 30, 1999 and 1998

	<u>1999</u>	<u>1998</u>
Cash flows from operating activities:		
Income before operating transfers	\$ 60,308,532	\$ 59,809,351
Adjustments to reconcile net income before operating transfers to net cash provided by operating activities:		
Depreciation	255,574	369,109
Changes in assets and liabilities:		
Accounts receivable - net	(4,573,212)	(999,817)
Ticket inventory	(284,764)	(168,930)
Accounts payable and accrued liabilities	817,492	(858,008)
Due to State Gaming Revenue fund	1,636,913	(373,514)
Prize liability	<u>1,868,653</u>	<u>(3,442,909)</u>
Net cash provided by operating activities	<u>60,029,188</u>	<u>54,335,282</u>
Cash flows from noncapital financing activities:		
Transfers to State Gaming Revenue fund	<u>(60,970,377)</u>	<u>(59,930,874)</u>
Cash flows from capital and related financing activities:		
Purchase of equipment	<u>(260,991)</u>	<u>(416,245)</u>
Net decrease in cash	(1,202,180)	(6,011,837)
Cash, beginning of year	<u>4,061,905</u>	<u>10,073,742</u>
Cash, end of year	<u>\$ 2,859,725</u>	<u>\$ 4,061,905</u>

See accompanying notes to financial statements.

# KANSAS LOTTERY

## NOTES TO FINANCIAL STATEMENTS

June 30, 1999 and 1998

### 1 - Reporting Entity

In November 1986, a constitutional amendment was approved by the Kansas voters authorizing a State Lottery. During the 1987 Legislative session, the State Legislature adopted the Lottery Act (the Act), and created the Kansas Lottery (the Lottery) as an independent component unit of the State of Kansas to operate lottery games. The 1995 Legislative session continued the Lottery until June 30, 2002. The Kansas Lottery Act abolishes the Lottery on July 1, 2002, unless the Legislature reaches an affirmative vote to continue the Lottery during the 2001 Legislative session.

The Lottery was organized on March 19, 1987, and commenced administrative operations on May 21, 1987, but was strictly in the developmental stage through fiscal year 1987. Instant win ticket games began November 12, 1987. On February 2, 1988, the Lottery began participating in Lotto America, a multi-state on-line game, now called Powerball. Additional games offered by the Lottery include Kansas Cash, Keno, Pick 3 and Pull Tabs. Cash 4 Life, a multi-state on-line game, began on March 30, 1998.

The Lottery operates under the direction of the Executive Director of the Lottery and a five-member Lottery Commission appointed by the Governor. The Commission advises the Executive Director and reviews and approves Lottery games, rules, and regulations.

### 2 - Summary of Significant Accounting Policies

A summary of the Lottery's significant accounting policies follows:

#### Basis of Presentation

The Lottery is accounted for as a proprietary-type enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the intent is that the costs of providing goods and services to the general public on a continuing basis are to be financed through user charges or where the periodic determination of net income is considered appropriate. In reporting its financial activity, the Lottery applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements, Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

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KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS  
(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Basis of Accounting

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

Basis of accounting refers to when revenues, expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. The financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles.

Revenue Recognition

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

Certain instant ticket games include tickets which entitle the holder to exchange the ticket for another ticket ("free tickets"). Such tickets are deemed to be replacements and, therefore, are not included in sales. Pull tab game revenue is recognized when the games are delivered to the retailers. Pull tabs are purchased without a right of return. On-line game revenue is recognized in the period in which tickets are sold.

Retailer Commissions

Retailers receive a commission of five percent of ticket sales, which is recognized as expense when sales are recorded. In addition to the five percent commission on sales, retailers receive a one percent cashing bonus on instant win prizes less than \$ 600 that they redeem.

Retailers also receive a bonus of \$ 10,000 for selling the Powerball jackpot ticket, a \$ 2,500 bonus for selling a jackpot Cash 4 Life ticket, and a \$ 1,000 bonus for selling a Kansas Cash jackpot ticket, a \$ 100,000 Powerball ticket, or a \$ 100,000 Cash 4 Life ticket.

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS  
(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Retailer Fees

Licensed retailers are charged a one-time fee for the right to sell lottery tickets. Fees are recorded as income when received by the Lottery.

Accounts Receivable

Accounts receivable represent amounts to be collected from retailers and are shown as net of allowance for doubtful accounts. The allowance for doubtful accounts is based on an analysis of accounts receivable, which considers the age of the accounts and current economic conditions.

Ticket Inventory

Instant ticket game inventory consists of tickets stored in the main and regional warehouses, trunk stock of District Managers and consigned and inactivated tickets at the retailer. Inventories are carried at cost. Tickets are charged to cost of sales when activated by a licensed retailer. Unsold tickets are charged to cost of sales at the end of each instant ticket game.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation. Depreciation is computed on the straight-line basis using the group depreciation method and an estimated useful life of five years.

Prize Liability

The Act states, "as nearly as practical, an amount equal to not less than 45 percent of the total sales of lottery tickets or shares, computed on an annual basis, shall be allocated for payment of Lottery prizes." This amount is recognized and accrued as a prize liability. Actual prizes paid are treated as a reduction of the prize liability.

Prize expense for instant ticket games is recorded based on the predetermined prize structure for each game. Since instant prize tickets are randomly distributed throughout the tickets, there will be differences between amounts accrued and the amounts actually paid if all tickets for a game have not yet been sold. Prizes which are not claimed within 180 days after the termination of each game remain in the prize pool, and future prizes will be increased accordingly through special promotions.

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# KANSAS LOTTERY

## NOTES TO FINANCIAL STATEMENTS (Continued)

### 2 - Summary of Significant Accounting Policies (Continued)

#### Prize Liability (Continued)

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

#### Compensated Absences

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

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

#### Budgets

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

#### Cash Equivalents

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

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS  
(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3 - Cash

Cash, other than petty cash and imprest funds, is part of the common cash pool in the State Treasury. The Pooled Money Investment Board invests such cash in excess of that necessary to meet current obligations. Earnings on such investments are retained by the State of Kansas. At June 30, 1999 and 1998, the Lottery's share in the State's common cash pool was \$ 2,735,318 and \$ 3,924,799, respectively. The market value of such investments approximated the carrying value at June 30, 1999 and 1998.

4 - Property and Equipment

Property and equipment consisted of the following at June 30, 1999 and 1998:

	<u>1999</u>	<u>1998</u>
Data processing equipment	\$ 2,363,274	\$ 2,151,146
Office furniture, fixtures, and equipment	849,795	841,880
Vehicles and other	<u>122,135</u>	<u>106,916</u>
	<u>\$ 3,335,204</u>	<u>\$ 3,099,942</u>

Depreciation expense for the years ended June 30, 1999 and 1998 was \$ 255,574 and \$ 369,109, respectively.



KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS  
(Continued)

5 - Commitments

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

2000	\$ 368,496
2001	345,996
2002	<u>341,496</u>
Total minimum payments	\$ <u>1,055,988</u>

It is anticipated that as leases expire they will be replaced with new leases. The Lottery incurred office and warehouse rental expense of approximately \$ 331,500 and \$ 336,000, respectively, under operating leases for the years ended June 30, 1999 and 1998.

The Wichita office of the Lottery is located in a building owned by the State of Kansas. Rental payments are anticipated to be approximately \$ 80,000 for fiscal year 2000.

The Lottery has contracted with a service bureau which provides computer services for on-line games and instant-win validation. The duration of the contract is through June 30, 2002. Future fees, calculated on cumulative net on-line sales (gross, less cancels, coupons, free tickets and rejected tickets) through June 30, 2002, are 6.30 - 6.93 percent with no fee for validation of instant win games through June 30, 2002.

6 - Contingencies

Zero Coupon Bonds

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

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS  
(Continued)

6 - Contingencies (Continued)

Zero Coupon Bonds (Continued)

Prior to 1998, the MUSL had purchased zero coupon bonds for the Lottery to fund future installment payments aggregating \$ 224,979,000. The total purchase price of these bonds was \$ 117,288,823. Total future installments outstanding at June 30, 1999 and 1998, are \$ 135,471,000 and \$ 145,930,000, respectively.

MUSL Prize Reserves

The Lottery is a member of the MUSL, which consists of 21 state lotteries. MUSL operates the Powerball game, a semiweekly 5 out of 49 plus 1 out of 42 lotto game (5 out of 45 plus 1 out of 45 prior to November 2, 1997). The grand prize is determined on a parimutuel basis, payable over a set number of years. A cash option became available on November 2, 1997. The remaining prizes are set cash prizes. Each MUSL member sells Powerball tickets through its retailers and makes weekly wire transfers to the MUSL. The weekly transfer amount consists of 50 percent of weekly sales less actual set cash prizes paid by the Lottery. The prize pool for all Powerball prize categories consists of 50 percent of each drawing period's sales, until the grand prize is funded to the annuitized amount guaranteed by the MUSL. When the grand prize fund reaches the guaranteed annuitized amount, then 48 percent of sales becomes part of the prize pool and 2 percent of sales is placed in the prize reserve fund. The MUSL has placed a \$ 52,000,000 cap on the prize reserve account and a \$ 25,000,000 cap on the set prize reserve account. Once the prize reserve accounts exceed the designated caps, the excess will become part of the prize pool. The prize reserve account serves as a contingency reserve fund to protect the MUSL in case of unforeseen, but valid liabilities for grand prize claims or for set prizes. The unreserved account serves as a MUSL operations and Powerball promotions expense account.

The prize reserve and set prize reserve account monies are refundable to MUSL members if the MUSL disbands or if a member withdraws from MUSL. Members leaving MUSL must wait one year before receiving their refund. At June 30, 1999 and 1998, the prize reserve account had a balance of \$ 52,000,000 and \$ 51,703,883, respectively, of which the Lottery's contribution was \$ 2,164,128 each year. The set prize reserve at June 30, 1999 and 1998, had a balance of \$ 25,000,000 and \$ 24,802,825, respectively, of which the Lottery's contribution was \$ 1,007,528 each year. The unreserved account at June 30, 1999 and 1998, had a balance of \$ 12,732,249 and \$ 10,177,179, respectively, of which the Lottery's contribution was \$ 154,755 and \$ 80,390, respectively.

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS  
(Continued)

6 - Contingencies (Continued)

Cash 4 Life Reserve

MUSL also operates the Cash 4 Life game, a daily four of 100 lotto game, which started March 30, 1998. There are 11 state Lottery members (including Kansas) participating in the Cash 4 Life game. The grand prize is \$ 1,000 a week for the life of the winner, with guaranteed payments over a minimum of 10 years. Should there be more than three tickets matching four numbers in the grand prize category for a draw, those winners will share equally in a prize pool of three lifetime grand prizes. The remaining prizes are set cash prizes. Each member sells Cash 4 Life tickets through its retailers and makes weekly wire transfers to MUSL. The weekly transfer amount consists of 50 percent of the draw's sales less actual set cash prizes paid by the Lottery. The prize pool for all Cash 4 Life prize categories consists of 50 percent of each drawing period's sales, until the grand prize is funded to the guaranteed annuitized amount, then 48 percent of sales becomes part of the prize pool and 2 percent of sales is placed in the prize reserve fund. Once the prize reserve accounts exceed the designated caps, the excess will become part of the prize pool. The Cash 4 Life reserve account at June 30, 1999 and 1998 had a balance of \$ 6,042,746 and \$ 4,938,313 of which the Lottery's share was \$ 593,539 and \$ 162,138, respectively.

Win for Life

The Lottery purchases annuity contracts from insurance companies in the name of the Win for Life game jackpot prize winners. In the event an insurance company defaults on its payments, the Kansas Life and Health Insurance Guarantee Association (KLHIGA) will make the payments. The KLHIGA was statutorily created, as set forth in K.S.A. 40-3008, subsection (o), to provide coverage in the event an insurance company defaults. The Lottery remains contingently liable for the payment of the lifetime prizes in the event the insurance companies and the KLHIGA fail to meet their obligation.

Annuity contracts have been purchased for lifetime prize payments. The approximate remaining prize payments are \$ 679,500. Prize payments are due in varying amounts through August 2007 or the life of the individuals.

Litigation

The Lottery is aware of certain claims that may be made against it. The final outcome of any claim or lawsuit is not presently determinable. Management does not anticipate the resolution of these matters to have a material adverse effect on the financial condition of the Lottery.

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7 - Risk Management

The Lottery's risk management activities for workers' compensation and unemployment are recorded in the State Workers' Compensation Self-Insurance Fund and the Employment Security Fund, funds of the State of Kansas. The Lottery contributes to these funds based upon annual assessed rates.

Employees are offered various health insurance coverage programs of the State; the Lottery's contribution toward single member coverage ranges from 85 percent to 97 percent, based on salary level and tobacco usage of the employee.

State agencies are not allowed to purchase or carry insurance on any property owned by the State or its agencies, except as expressly and specifically authorized by statute. Currently, none of the exceptions apply to property of the Lottery. The State has had no problem in resolving losses in the past through utilization of resources available at the time the loss occurred. The Lottery retains liability for fixed asset damage.

Tort claims involving Lottery employees are subject to the Kansas Tort Claims Act (K.S.A. 75-6101, *et seq.*).

Employees' faithful performance is covered by commercial insurance. There has been no significant reduction in insurance coverage.

8 - Operating Transfers

Pursuant to the Act, the Director of Accounts and Reports of the State of Kansas shall transfer monies in the Lottery operating fund to the State Gaming Revenue fund, at least monthly, in an amount equal to the monies in such fund in excess of those needed for payment of Lottery expenses, payment of compensation to retailers and transfers to the prize payment fund as certified by the Executive Director of the Lottery. The accumulated year-to-date transfers must be in an amount not less than 30.75 and 31.25 percent of total revenues from the sales of Lottery tickets during the fiscal years 1999 and 1998, respectively. The percent is based on total revenues from the sales of lottery tickets during the fiscal year. Transfers to the State Gaming Revenue fund of \$ 60,970,377 and \$ 59,930,874 were made for the years ended June 30, 1999 and 1998, respectively. Transfers were based on accrual basis net games revenue, plus additional percentages as required by the Legislature.

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS  
(Continued)

9 - Pension Plan

*Plan description.* The Lottery participates in the Kansas Public Employees Retirement System (KPERS), a cost-sharing, multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, *et seq.* KPERS provides retirement benefits, life insurance, disability income benefits, and death benefits. Kansas law establishes and amends benefit provisions. KPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to KPERS (611 South Kansas Avenue, Suite 100; Topeka, Kansas 66603-3803) or by calling 1-800-228-0366.

*Funding policy.* K.S.A. 74-4919 establishes the KPERS member-employee contribution rate at four percent of covered salary. The employer collects and remits member-employee contributions according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rate be determined annually based on the results of an annual actuarial valuation. KPERS is funded on an actuarial reserve basis. State law sets a limitation on annual increases in the contribution rates for KPERS employers. The employer rates established by statute for calendar years 1999 and 1998, are 3.99 and 3.79 percent, respectively. The Lottery contributions to KPERS for the years ending June 30, 1999, 1998 and 1997, were approximately \$ 111,000, \$ 100,000 and \$ 87,000, respectively, equal to the statutory required contributions for each year.

10 - Budget and Actual Comparison

As discussed in Note 2, the Lottery prepares an annual budget of expenses on a cash plus encumbrance basis. Expenses may not exceed budgeted amounts for total operating expenses or certain line items.

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

10 - Budget and Actual Comparison (Continued)

At June 30, 1999, there were only two separate line items budgeted: official hospitality and Kansas Incentive Program (KSIP) appropriations. Actual expenses were \$ 7,535 for KSIP appropriations out of the budgeted amount of \$ 15,654. Actual expenses for official hospitality were \$ 4,293 out of the budgeted amount of \$ 5,000 on a budgetary basis for the year ended June 30, 1999.

The following table presents a comparison of the legally adopted budget with actual data on a budgetary basis for years ended June 30, 1999 and 1998. Because accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present financial statements in conformity with generally accepted accounting principles (GAAP), a reconciliation of resultant basis differences for the years ended June 30, 1999 and 1998, is also presented on the following page:

	<u>1999</u>	<u>1998</u>
Operating expenses excluding expenses for game prizes, retailer commissions, on-line games service bureau and on-line communications and ticket printing		
Actual	\$ <u>8,386,320</u>	\$ <u>8,037,656</u>
Budget	\$ <u>8,426,875</u>	\$ <u>8,077,361</u>

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS  
(Continued)

10 - Budget and Actual Comparison (Continued)

	<u>1999</u>	<u>1998</u>
Operating expenses, budgetary basis	\$ 8,386,320	\$ 8,037,656
Adjustments		
Add:		
Net increase in accruals	288,361	153,441
Prior year encumbrances incurred, net of unreleased encumbrances	384,161	723,465
Depreciation	255,574	369,109
Nonbudgeted expenses:		
1) Game prizes, retailer commissions, on- line games service bureau, on-line communications expenses, and ticket printing	89,319,941	82,795,968
2) Prizes paid from Prize fund	41,871,971	42,064,774
Deduct:		
Increase in ticket inventory	(284,764)	(168,930)
Encumbrances at end of period	(377,444)	(402,372)
Capitalized expenditures	<u>(260,991)</u>	<u>(416,245)</u>
Operating expenses, GAAP basis	<u>\$ 139,583,129</u>	<u>\$ 133,156,866</u>

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11 - Operating Segment Information

Operating segment information by games was as follows:

	For the Year Ended June 30, 1999							
	<u>Instant</u>	<u>Pull Tabs</u>	<u>Powerball</u>	<u>Cash 4 Life</u>	<u>Kansas Cash</u>	<u>Keno</u>	<u>Pick 3</u>	<u>Total</u>
Sales, net	\$ 86,462,574	\$ 1,328,028	\$ 50,393,345	\$ 4,621,489	\$ 17,226,121	\$ 34,020,595	\$ 4,868,833	\$ 198,920,985
Prizes, net	(50,039,411)	(799,767)	(24,707,859)	(2,241,423)	(8,440,799)	(18,366,725)	(2,483,105)	(107,079,089)
Retailer commissions	(5,027,527)	(66,401)	(2,739,667)	(294,792)	(966,806)	(1,785,213)	(253,442)	(11,133,848)
Gross margin	<u>\$ 31,395,636</u>	<u>\$ 461,860</u>	<u>\$ 22,945,819</u>	<u>\$ 2,085,274</u>	<u>\$ 7,818,516</u>	<u>\$ 13,868,657</u>	<u>\$ 2,132,286</u>	<u>\$ 80,708,048</u>

  

	For the Year Ended June 30, 1998							
	<u>Instant</u>	<u>Pull Tabs</u>	<u>Powerball</u>	<u>Cash 4 Life</u>	<u>Kansas Cash</u>	<u>Keno</u>	<u>Pick 3</u>	<u>Total</u>
Sales, net	\$ 82,755,224	\$ 1,138,032	\$ 42,638,203	\$ 2,603,755	\$ 23,036,942	\$ 34,496,218	\$ 5,348,936	\$ 192,017,310
Prizes, net	(47,447,021)	(693,959)	(20,353,146)	(1,301,878)	(10,942,547)	(18,382,823)	(2,567,489)	(101,688,863)
Retailer commissions	(4,881,226)	(57,751)	(2,322,466)	(155,188)	(1,151,847)	(2,024,811)	(342,447)	(10,935,736)
Gross margin	<u>\$ 30,426,977</u>	<u>\$ 386,322</u>	<u>\$ 19,962,591</u>	<u>\$ 1,146,689</u>	<u>\$ 10,942,548</u>	<u>\$ 14,088,584</u>	<u>\$ 2,439,000</u>	<u>\$ 79,392,711</u>

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## KANSAS LOTTERY

## YEAR 2000 SUPPLEMENTARY INFORMATION

Years Ended June 30, 1999 and 1998

The Kansas Lottery utilizes a number of computer programs across its entire operation and identified the "Year 2000" issue as a major project starting in fiscal year 1998. Any of the Lottery's computer programs that recognize a date using "00" as the year 1900 rather than the year 2000 could result in errors or system failures. The Kansas Lottery implemented a plan to identify all areas within their operation that could be affected by the Year 2000 issue and has taken aggressive action over the past two fiscal years to remedy any deficiencies. As part of the Multi-State Lottery Association (MUSL), the Kansas Lottery has followed the standard testing requirements as set forth by the MUSL Board. Additionally, the Lottery's Year 2000 status and plans have been independently reviewed by a consulting firm contract by the State's Chief Technology Officer.

The Lottery believes it has taken all reasonable actions and precautions to ensure that the transition into the year 2000 will not have a material adverse impact on the Lottery's financial position.

See accompanying independent auditors' report.



# Berberich Trahan & Co., P. A.

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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Legislative Post Audit Committee  
Kansas State Legislature:

We have audited the financial statements of the Kansas Lottery as of and for the year ended June 30, 1999, and have issued our report thereon dated October 18, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Kansas Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statements 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Kansas Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of management and the Legislative Post Audit Committee of the Kansas State Legislature and is not intended to be and should not be used by anyone other than those specified parties.

*Berberich Trahan & Co., P.A.*

October 18, 1999