

MINUTES OF THE HOUSE FED & STATE COMMITTEE

The meeting was called to order by Chairperson Doug Mays at 1:30 p.m. on January 16, 2001 in Room 313-S of the Capitol.

All members were present.

Committee staff present: Theresa Kiernan, Revisor of Statutes
Russell Mills, Legislative Research Department
Shelia Pearman, Committee Secretary

Conferees appearing before the committee: Randy Tongier, Legislative Post Audit
Russell Mills, Legislative Research

Others attending: See attached list

Without objection bill was introduced as requested by Representative Powell regarding prohibition of Internet lottery. [HB 2109]

Without objection bill was introduced as requested by Representative Powell regarding class action reform. [HB 2258]

Chairman Mays opened the hearing on HB 2038 - Lottery extension.

Mr. Tongier summarized the results of FY2000 financial compliance audit as required by state law annually (Attachment # 1). Berberich Trahan & Co., P.A. of Topeka was selected using contracting process. Thus, specific questions about conduct of audit would need to be directed to the C.P.A. firm

Audit addresses three primary areas:

1. Lottery's Financial Reporting - Review of financial statements are prepared by the Lottery staff and the auditors review those statements and processes used to complete statements.
2. Compliance with legal requirements as they apply to financial reporting Auditor's conclusions that the Lottery did comply with applicable legal requirements and can be found on page 20 of attached Audit Report
3. Internal Controls (page 20) Auditor's conclusion was there is no significant weaknesses specifically regarding financial reporting.

Mr. Tongier stated this audit was not authorized to address reported problems at the Lottery but was the annual audit. The firm conducting this audit was made aware of problems. He addressed additional questions from the committee. Impressed with adequate dealing with issues -- no continuing problems, therefore no current finding and recommendation in this audit. Procedures have been put in place to prevent similar occurrences in the future and that should the situation arise again, the Lottery's management would become aware of and be able to respond quicker. No additional financial audit is being conducted at this time, however a security audit is presently underway.

Mr. Mills discussed a Lottery packet (Attachment #2) distributed to committee. Pages 1-4 were covered in great detail. Lottery approved by voters in 1986 renewed by in 1990 and in 1992 Legislature. The 1995 Legislature continued the lottery with a sunset date of June 30, 2002. Revenues fund the State Gaming Revenue Fund (SGRF), Economic Development Initiatives Fund (EDIF), Problem Gambling Grant Fund established in 2000, Correctional Institutions Building Fund and transfer to State General Fund (SGF) in addition to operations of Lottery. The approved FY 2001 budget includes an estimated \$60.6 million from gaming revenues. Approximately \$22.1 million (46.7 percent of funds) are directed toward education via the Comprehensive Grant Program, Technology Innovation.

Grants for colleges and universities in addition to Area Vocational Schools and Technical Colleges receive funding from the Lottery proceeds. Other programs funded from lottery revenues are: Kansas

CONTINUATION SHEET

Industrial Training (KIT) and Kansas Industrial Retraining (KIR), Graduate Intern Program, Centers of Excellence Grants, Experimental Program to Stimulate Competitive Research National Guard Educational Assistance Program as well as additional programs discussed in this packet. Funding to K-12 education was questioned and will be researched.

While the public believes the Lottery was sold as funding for education, Mr. Mills' research found no newspaper articles to document this belief. However, the Missouri Lottery was also established about 1986 and their proceeds do fund education.

The hearing on **HB 2038** was closed.

The committee meeting adjourned at 2:55 p.m. The next schedule meeting is January 17, 2001.

HOUSE FEDERAL & STATE AFFAIRS COMMITTEE

COMMITTEE GUEST LIST

DATE: 1/16/01

NAME	REPRESENTING
Ed Van Patten	KS Lottery
Keith Kocher	KS Lottery
Phil Bradley	KLBA
Tracy Diehl	State Gaming Agency / KS Racing + Gaming Comm.
John Phil	Sharon Welber
George Wyzant	Kuffin
Tom Bruno	Alumni Assoc.
Stolley King	KSPE / Laches, Baden, Bankers Assoc.
Jim Edwards	KCCIL
R. Rice	KS Private Clubs & Assoc.
Clayton Shurley	GTECA



FINANCIAL AND COMPLIANCE AUDIT REPORT

Kansas Lottery

House Fed. &
State Affairs

Date 1/16/2001

Attachment No. 1

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A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit

State of Kansas
January 2001



Legislative Post Audit Committee

Legislative Division of Post Audit

The Legislative Post Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$8 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of government agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U. S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. These audit standards have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the representatives, three are appointed by the Speaker of the House and two are appointed by the House Minority Leader.

As part of its audit responsibilities, the Division is charged with meeting the requirements of the Legislative Post Audit Act which address audits of financial matters. Those requirements call for two major types of audit work.

First, the Act requires an annual audit of the State's financial statements. Those statements, prepared by the Department of Administration's Division of Accounts and Reports, are audited by a certified public accounting firm under contract with the Legislative Division of Post Audit. The firm is selected by the Contract Audit Committee, which comprises three members of the Legislative Post Audit Committee (including the Chairman and Vice-Chairman), the Secretary of Administration, and the Legislative Post Auditor. This audit work also meets

the State's audit responsibilities under the federal Single Audit Act.

Second, the Act provides for a regular audit presence in every State agency by requiring that audit work be conducted at each agency at least once every three years. Audit work done in addition to the annual financial statement audit focuses on compliance with legal and procedural requirements and on the adequacy of the audited agency's internal control procedures. These compliance and control audits are conducted by the Division's staff under the direction of the Legislative Post Audit Committee.

LEGISLATIVE POST AUDIT COMMITTEE

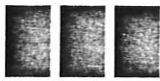
Senator Lana Oleen, Chair
Senator Anthony Hensley
Senator Pat Ranson
Senator Chris Steineger
Senator Ben Vidricksen

Representative Kenny Wilk, Vice-Chair
Representative Richard Alldritt
Representative John Ballou
Representative Lynn Jenkins
Representative Ed McKechnie

LEGISLATIVE DIVISION OF POST AUDIT

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Barbara J. Hinton, Legislative Post Auditor



Berberich Trahan & Co., P. A.

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Legislative Post Audit Committee
Kansas State Legislature:

Dear Committee Members:

In connection with our audit of the financial statements of the Kansas Lottery (Lottery), a component unit of the State of Kansas, as of and for the year ended June 30, 2000, this letter sets forth certain matters we wish to bring to your attention. This item is offered as constructive suggestions for the consideration of management as part of the process of modifying and improving financial and administrative practices and policies.

Internal Control

As was previously discussed with members of the Committee and management of the Lottery, in dealing with internal control concerns relating to the allegations surrounding a former Lottery employee, we performed additional procedures on internal controls as a part of our audit. These procedures included discussions with the IBM consultant hired by the Lottery to review and make recommendation regarding computer controls. We believe that the Lottery has taken reasonable steps to address, identify and deal with the situation.

Properly implemented internal controls provide some measure of security against fraud, both internally and externally perpetrated. They will not, however, guarantee that fraud will not occur. Collusion by several employees or circumvention of controls by an individual employee can occur even within a well designed internal control system. Oversight and involvement by management in addition to designed controls can help prevent fraud perpetrated through collusion and circumvention of controls.

* * * * *

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

Finally, we wish to express our appreciation to the Lottery personnel for their assistance and cooperation during our audit, and we look forward to working with you on future engagements.

Berberich Trahan & Co., P.A.

October 17, 2000

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KANSAS LOTTERY FINANCIAL SUMMARY
 Prepared by the Legislative Division of Post Audit

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
REVENUES (millions)	\$ 66.2	\$ 68.8	\$ 65.2	\$ 70.2	\$ 77.8	\$ 115.3	\$ 153.4	\$ 178.3	\$ 183.4	\$ 186.3	\$ 193.0	\$ 200.0	\$ 193.5
EXPENSES AS % OF REVENUES													
PRIZES	45 %	49 %	44 %	47 %	48 %	51 %	52 %	52 %	52 %	53 %	53 %	53 %	54 %
BASIC STATUTORY TRANSFER	17 %	31 %	30 %	30 %	30 %	30 %	31 %	30 %	30 %	31 %	31 %	31 %	30 %
OTHER EXPENSES	25 %	29 %	22 %	22 %	21 %	18 %	16 %	16 %	17 %	17 %	16 %	17 %	17 %
TOTAL	87 %	109 %	96 %	99 %	99 %	99 %	99 %	98 %	99 %	101 %	100 %	101 %	101 %
NET OPERATING INCOME	\$ 8.3	\$ -6.6	\$ 1.9	\$ 1.1	\$ 0.7	\$ 0.7	\$ 1.0	\$ 3.2	\$ 2.2	\$ -0.2	\$ -0.1	\$ -0.7	\$ -1.0
OTHER TRANSFERS (millions)													
STATE GENERAL FUND				\$ 1.5									
GAMING REVENUE FUND					\$ 2.8			\$ 1.4	\$ 3.4	\$ 0.3			
INVESTIGATIONS FEE FUND						\$ 0.2	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.2			
ENDING FUND BALANCE (millions)	\$ 8.1	\$ 1.6	\$ 3.4	\$ 3.0	\$ 1.0	\$ 1.7	\$ 2.7	\$ 4.5	\$ 3.3	\$ 2.6	\$ 2.5	\$ 1.8	\$ 0.8

NOTE: Based on the audited annual financial statements prepared by the Kansas Lottery

KANSAS LOTTERY
FINANCIAL AND COMPLIANCE AUDIT
Years Ended June 30, 2000 and 1999

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KANSAS LOTTERY

INTRODUCTION

Years Ended June 30, 2000 and 1999

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, 2000.

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.

KANSAS LOTTERY

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Year Ended June 30, 2000

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

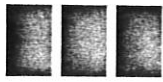
None.

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INDEPENDENT AUDITORS' REPORT

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the accompanying financial statements of the Kansas Lottery, a component unit of the State of Kansas, as of and for the years ended June 30, 2000 and 1999, 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, 2000 and 1999, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 17, 2000, 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 17, 2000

KANSAS LOTTERY

BALANCE SHEETS

June 30, 2000 and 1999

	<u>2000</u>	<u>1999</u>
<u>ASSETS</u>		
Current assets:		
Cash (Note 3):		
Operating fund	\$ 5,603,247	\$ 1,805,671
Prize payment fund	637,940	1,054,054
Accounts receivable, net of allowance for doubtful accounts of \$ 110,675 and \$ 92,516	538,497	5,689,167
Accounts receivable - unbilled	5,228,028	7,363,597
Instant ticket game inventory	<u>720,752</u>	<u>986,326</u>
Total current assets	<u>12,728,464</u>	<u>16,898,815</u>
Property and equipment (Note 4)	3,145,008	3,335,204
Less accumulated depreciation	<u>2,703,609</u>	<u>2,784,763</u>
	<u>441,399</u>	<u>550,441</u>
Total assets	<u>\$ 13,169,863</u>	<u>\$ 17,449,256</u>
<u>LIABILITIES AND FUND EQUITY</u>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,830,294	\$ 1,955,233
Due to State Gaming Revenue fund (Note 8)	6,034,376	7,913,047
Prize liability	<u>4,464,523</u>	<u>5,756,364</u>
Total current liabilities	<u>12,329,193</u>	<u>15,624,644</u>
Fund equity:		
Retained earnings:		
Unreserved and undesignated	<u>840,670</u>	<u>1,824,612</u>
Total liabilities and fund equity	<u>\$ 13,169,863</u>	<u>\$ 17,449,256</u>

See accompanying notes to financial statements.

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KANSAS LOTTERY

STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN RETAINED EARNINGS

Years Ended June 30, 2000 and 1999

	<u>2000</u>	<u>1999</u>
Operating revenues:		
Net game revenues	\$ 187,057,613	\$ 191,169,831
Net unsettled revenues	5,503,187	7,751,154
Retailer fees and miscellaneous income	40,896	67,640
Phone reimbursements	<u>945,915</u>	<u>903,036</u>
Total operating revenues	<u>193,547,611</u>	<u>199,891,661</u>
Operating expenses:		
Game prizes	104,377,074	107,079,089
Retailer commissions	11,086,788	11,133,848
Advertising	2,229,015	2,559,856
Cost of instant tickets	2,536,706	2,243,185
Depreciation	220,998	255,574
Professional services	83,413	77,125
On-line games service bureau	7,256,901	7,595,091
Salaries and benefits	3,666,730	3,666,313
Telecommunications	3,330,119	3,404,891
Other administrative expense	<u>1,975,569</u>	<u>1,568,157</u>
Total operating expenses	<u>136,763,313</u>	<u>139,583,129</u>
Income before operating transfers	56,784,298	60,308,532
Operating transfers out (Note 8):		
State Gaming Revenue fund	<u>57,768,240</u>	<u>60,970,377</u>
Net loss	(983,942)	(661,845)
Retained earnings, beginning of year	<u>1,824,612</u>	<u>2,486,457</u>
Retained earnings, end of year	<u>\$ 840,670</u>	<u>\$ 1,824,612</u>

See accompanying notes to financial statements.

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STATEMENTS OF CASH FLOWS

Years Ended June 30, 2000 and 1999

	<u>2000</u>	<u>1999</u>
Cash flows from operating activities:		
Income before operating transfers	\$ 56,784,298	\$ 60,308,532
Adjustments to reconcile net income before operating transfers to net cash provided by operating activities:		
Depreciation	220,998	255,574
Changes in assets and liabilities:		
Accounts receivable - net	7,286,239	(4,573,212)
Ticket inventory	265,574	(284,764)
Accounts payable and accrued liabilities	(124,939)	817,492
Due to State Gaming Revenue fund	(1,878,671)	1,636,913
Prize liability	<u>(1,291,841)</u>	<u>1,868,653</u>
Net cash provided by operating activities	<u>61,261,658</u>	<u>60,029,188</u>
Cash flows from noncapital financing activities:		
Transfers to State Gaming Revenue fund	<u>(57,768,240)</u>	<u>(60,970,377)</u>
Cash flows from capital and related financing activities:		
Purchase of equipment	<u>(111,956)</u>	<u>(260,991)</u>
Net increase (decrease) in cash	3,381,462	(1,202,180)
Cash, beginning of year	<u>2,859,725</u>	<u>4,061,905</u>
Cash, end of year	<u>\$ 6,241,187</u>	<u>\$ 2,859,725</u>

See accompanying notes to financial statements.

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KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS

June 30, 2000 and 1999

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.

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. Measurement focus refers to what is being measured. The financial statements are prepared on the accrual basis of accounting and on an economic resources measurement focus 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 for redeeming prizes that are less than \$ 600. Effective August 28, 1999, they also receive an additional one percent for redeeming Keno prizes and a bonus of one percent on instant and on-line tickets they sell that win over \$ 600, with a minimum of \$ 10 and a maximum of \$ 100 for each prize.

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NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Retailer Commissions (Continued)

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.

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 costing over \$ 2,000 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.

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NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Prize Liability (Continued)

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 prize promotions.

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

Compensated Absences

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

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

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - Summary of Significant Accounting Policies (Continued)

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 in banks and amounts deposited with the Treasurer of the State of Kansas.

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 cash in excess of that necessary to meet current obligations. Earnings on investments are retained by the State of Kansas. At June 30, 2000 and 1999, the Lottery's share in the State's common cash pool was \$ 6,136,214 and \$ 2,735,318, respectively. The market value of the investments approximated the carrying value at June 30, 2000 and 1999.

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)

4 - Property and Equipment

Property and equipment consisted of the following at June 30, 2000 and 1999:

	<u>2000</u>	<u>1999</u>
Data processing equipment	\$ 2,272,282	\$ 2,363,274
Office furniture, fixtures, and equipment	765,043	849,795
Vehicles and other	<u>107,683</u>	<u>122,135</u>
	<u>\$ 3,145,008</u>	<u>\$ 3,335,204</u>

Depreciation expense for the years ended June 30, 2000 and 1999 was \$ 220,998 and \$ 255,574, respectively.

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:

2001	\$ 380,412
2002	<u>380,412</u>
Total minimum payments	<u>\$ 760,824</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 \$ 292,000 and \$ 331,500, respectively, under operating leases for the years ended June 30, 2000 and 1999.

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 2001.

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.

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KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS (Continued)

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.

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, 2000 and 1999, are \$ 122,902,000 and \$ 135,417,000, 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. 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.

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KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)

6 - Contingencies (Continued)

MUSL Prize Reserves (Continued)

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, 2000 and 1999, the prize reserve account had a balance of \$ 52,000,000, of which the Lottery's contribution was \$ 2,164,128. The set prize reserve at June 30, 2000 and 1999, had a balance of \$ 25,000,000, of which the Lottery's contribution was \$ 1,007,528. The unreserved account at June 30, 2000 and 1999, had a balance of \$ 15,130,048 and \$ 12,732,249, respectively, of which the Lottery's contribution was \$ 208,886 and \$ 154,755, respectively.

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, 2000 and 1999 had a balance of \$ 6,557,320 and \$ 6,042,746 of which the Lottery's share was \$ 656,427 and \$ 593,539, 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.

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KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)

6 - Contingencies (Continued)

Win for Life (Continued)

Annuity contracts have been purchased for lifetime prize payments. The approximate remaining prize payments are \$ 661,500. 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.

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.

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS

(Continued)

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 30.00 and 30.75 percent of total revenues from the sales of Lottery tickets during the fiscal years 2000 and 1999, 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 \$ 57,768,240 and \$ 60,970,377 were made for the years ended June 30, 2000 and 1999, respectively. Transfers were based on accrual basis net games revenue, plus additional percentages as required by the Legislature.

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 2000 and 1999, are 4.19 and 3.99 percent, respectively. The Lottery contributions to KPERS for the years ending June 30, 2000, 1999 and 1998, were approximately \$ 110,000, \$ 111,000 and \$ 100,000, respectively, equal to the statutory required contributions for each year.

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)

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.

At June 30, 2000, there were only two separate line items budgeted: official hospitality and Kansas Incentive Program (KSIP) appropriations. Actual expenses were \$ 13,271 for KSIP appropriations out of the budgeted amount of \$ 31,434. Actual expenses for official hospitality were \$ 2,037 out of the budgeted amount of \$ 5,000 on a budgetary basis for the year ended June 30, 2000.

The following table presents a comparison of the legally adopted budget with actual data on a budgetary basis for years ended June 30, 2000 and 1999. 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, 2000 and 1999, is also presented on the following page:

	<u>2000</u>	<u>1999</u>
Operating expenses excluding expenses for game prizes, retailer commissions, on-line games service bureau and on-line communications and ticket printing		
Actual	\$ <u>7,607,050</u>	\$ <u>8,386,320</u>
Budget	\$ <u>8,648,421</u>	\$ <u>8,426,875</u>

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)

10 - Budget and Actual Comparison (Continued)

	<u>2000</u>	<u>1999</u>
Operating expenses, budgetary basis	\$ 7,607,050	\$ 8,386,320
Adjustments		
Net increase (decrease) in accruals	(297,665)	288,361
Prior year encumbrances incurred, net of unreleased encumbrances	757,446	384,161
Depreciation	220,998	255,574
Nonbudgeted expenses:		
1) Game prizes, retailer commissions, on- line games service bureau, on-line communications expenses, and ticket printing	62,940,117	89,319,941
2) Prizes paid from Prize fund	65,579,408	41,871,971
Decrease (increase) in ticket inventory	265,574	(284,764)
Encumbrances at end of period	(197,659)	(377,444)
Capitalized expenditures	<u>(111,956)</u>	<u>(260,991)</u>
Operating expenses, GAAP basis	<u>\$ 136,763,313</u>	<u>\$ 139,583,129</u>

KANSAS LOTTERY

NOTES TO FINANCIAL STATEMENTS
(Continued)

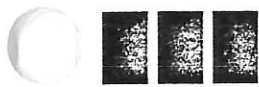
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11 - Operating Segment Information

Operating segment information by games was as follows:

	Year Ended June 30, 2000							
	Instant	Pull Tabs	Powerball	Cash 4 Life	Kansas Cash	Keno	Pick 3	Total
Sales, net	\$ 84,245,412	\$ 1,061,676	\$ 40,365,909	\$ 3,140,865	\$ 14,717,103	\$ 43,667,184	\$ 5,362,651	\$ 192,560,800
Prizes, net	(48,868,870)	(642,573)	(19,650,990)	(1,523,320)	(7,211,380)	(23,798,615)	(2,681,326)	(104,377,074)
Retailer commissions	(5,004,762)	(53,084)	(2,283,225)	(175,888)	(824,158)	(2,445,363)	(300,308)	(11,086,788)
Gross margin	<u>\$ 30,371,780</u>	<u>\$ 366,019</u>	<u>\$ 18,431,694</u>	<u>\$ 1,441,657</u>	<u>\$ 6,681,565</u>	<u>\$ 17,423,206</u>	<u>\$ 2,381,017</u>	<u>\$ 77,096,938</u>

	Year Ended June 30, 1999							
	Instant	Pull Tabs	Powerball	Cash 4 Life	Kansas Cash	Keno	Pick 3	Total
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>



**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, 2000, and have issued our report thereon dated October 17, 2000. 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 solely for the information and use 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 17, 2000



Bill Graves
Governor

Ed Van Petten
Executive Director

December 1, 2000

Ms. Karen L. Keehn, CPA
Shareholder
Berberich Trahan & Co., P. A.
800 SW Jackson Street, Suite 1300
Topeka, KS 66612-1268

Dear Ms. Keehn:

We have reviewed your draft of the Financial and Compliance Audit Report for the Kansas Lottery for the fiscal year ended June 30, 2000 and concur with the results of the audit.

We are very pleased that there were no "findings" to be reported.

As in the past, we certainly appreciate the professional manner in which you and your staff worked with our staff in the audit preparation.

Sincerely,


Ed Van Petten
Executive Director

December 8, 2000

KANSAS LOTTERY

Summary

Kansas statutes provide for collection and allocation of revenue from three types of gambling: bingo, parimutuel wagering on dog and horse races, and the Kansas Lottery. In addition, the state is reimbursed for certain expenditures made under provisions of the tribal/state gaming compacts which regulate Indian casino gaming. Slightly over 30 percent of state revenue from gambling is used to operate the state agencies charged with licensing, regulating, and conducting (in the case of the lottery) legal gambling in Kansas.

Lottery History. In 1986, a constitutional amendment to provide for a state-owned lottery was approved by the voters of Kansas by a vote of 515,893 to 291,411. The 1987 Kansas Legislature approved implementing legislation which created a new state agency, the Kansas Lottery, to operate the state lottery. The legislation also established a five-member Lottery Commission to oversee the operation of the lottery; required that at least 45 percent of the money collected from ticket sales be awarded as prizes and at least 30 percent of the money collected be transferred to the State Gaming Revenue Fund (SGRF); exempted lottery tickets from the sales tax; and allowed liquor stores to sell lottery tickets.

The constitutional amendment also contained a sunset provision which would have prohibited operation of the state lottery in 1990 unless a concurrent resolution authorizing such operation was adopted by both chambers of the Kansas Legislature during the 1990 Session. 1990 SCR 1646 was adopted by the Legislature to continue operation of the state lottery.

The state lottery was scheduled for abolition under the Kansas Sunset Law in 1992. The Legislature approved 1992 SB 472 which continued the Kansas Lottery until 1996. In turn, the 1995 Legislature approved HB 2077 which continued the Kansas Lottery in existence until 2002. In order to give the Lottery a one-year "wind down" period if it is not extended, the 2001 Legislature will address the issue of continuing the Kansas Lottery in existence beyond July 1, 2002.

Kansas Lottery

Lottery Revenue. Receipts from the sale of lottery tickets are deposited by the Executive Director of the Kansas Lottery in the Lottery Operating Fund in the state treasury. Statutorily, moneys in that fund are used to support operation of the Lottery; pay prizes to

lottery winners (via a transfer to the Lottery Prize Payment Fund); and provide funding for correctional and juvenile facilities, and economic development via the SGRF.

A minimum of 45 percent of net monthly receipts from the sale of lottery tickets must be awarded as prizes. The Lottery Act requires that a minimum of 30 percent of net monthly receipts from the sale of lottery tickets must be credited to the SGRF. However, the Legislature has frequently transferred additional amounts to the SGRF. For FY 1997 and FY 1999, the Legislature set the transfer at a minimum of 30.75 percent. For FY 1998 the transfer was set at a minimum of 31.25 percent. For FY 2000 and FY 2001, the transfer was set at 30.00 percent. The remainder of sales receipts may be used to operate the Lottery and to pay commissions to merchants who sell lottery tickets.

Lottery revenue has been used for other purposes over the years. During the first year of Lottery operation, FY 1988, a statutorily required transfer was made from the Lottery Operating Fund to repay to the State General Fund the amount utilized to establish the Lottery. (K.S.A. 74-8712) In FY 1989, a transfer was made from the Lottery Operating Fund directly to the County Reappraisal Fund. That amount was in addition to the statutorily set amount of the SGRF used to cover a portion of the cost of statewide reappraisal. Every year from FY 1993 through FY 1997, transfers were made from the Lottery Operating Fund to the Kansas Bureau of Investigation (KBI) to finance the KBI's gaming investigation unit. (These transfers ended in FY 1997.) In FY 1998, the Legislature authorized the transfer of \$253,195 from the KBI to the SGRF to repay FY 1996 lottery and racing moneys.

The 2000 Legislature approved a total budget for the Kansas Lottery of almost \$140.0 million, of which \$21.6 million is for operating the lottery and \$118.4 million is for prizes and retailers' commissions. The approved staffing level for FY 2001 is 93.0 positions.

State Gaming Revenue Fund. Some state revenue from both the Lottery and parimutuel wagering is transferred to the SGRF. That fund is used essentially as a holding fund from which further transfers are made on a monthly basis. No more than \$50 million can be credited to the SGRF in any fiscal year. Amounts in excess of \$50 million are credited to the State General Fund. FY 1994 was the first year during which transfers to the SGRF exceeded \$50 million. Since then, the \$50 million cap on the SGRF has resulted in \$61.0 million being transferred to the State General Fund.

Beginning on July 1, 1995, statutory transfers from the SGRF were established as follows¹:

- 85 percent to the Economic Development Initiatives Fund;
- 10 percent to the Correctional Institutions Building Fund; and
- 5 percent to the Juvenile Detention Facilities Fund.

Economic Development Initiatives Fund. Under current state law, the first \$50.0 million credited to the SGRF each year is divided as follows:

- \$5.0 million to the Correctional Institutions Building Fund to help offset State General Fund (SGF) expenditures in constructing and maintaining state prisons;
- \$2.5 million to the Juvenile Detention Facilities Fund to help local governments pay the cost of confining local juvenile offenders; and
- \$42.5 million to the Economic Development Initiatives Fund (EDIF).

Gaming revenues in excess of \$50.0 million are credited to the State General Fund, with the exception of a transfer of \$80,000 to the new Problem Gambling Grant Fund. The approved budget for FY 2001 includes an estimated \$60.6 million from gaming revenues. Appropriations from gaming revenues in support of education related programs are made from the EDIF.

A portion of the EDIF expenditures are used to support education. Approved FY 2001 expenditures from the EDIF in support of education are summarized below:

- State Board of Regents—\$10.05 million;

¹ Distribution of moneys credited to the State Gaming Revenue Fund has changed since the fund's inception. Prior to June 30, 1990, 30 percent of the State Gaming Revenue Fund was used to defray a portion of costs incurred by counties during statewide reappraisal, for a total of \$15.9 million. (In addition, for each of fiscal years 1991-1995, the Legislature appropriated approximately \$3 million, \$14.9 million total, to the Department of Revenue from the Economic Development Initiatives Fund for county reappraisal aid.) At that time, 60 percent of the fund was used to finance economic development projects and 10 percent financed correctional facilities.

From FY 1991 until the end of FY 1995, 90 percent of Gaming Fund revenue was earmarked for the Economic Development Fund and 10 percent for the Correctional Institutions Building Fund (to finance adult correctional facilities). (K.S.A. 79-4804)

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- Department of Commerce and Housing—\$4.38 million;
- Kansas Technology Enterprise Corporation—\$7.71 million; and
- Adjutant General—\$50,000.

Attached is a memorandum entitled "Current Utilization of Gaming Revenues for Education," which discusses these educational expenditures in more detail. This memorandum also includes a detailed table which indicates the total approved expenditures from the EDIF for FY 1999, FY 2000, and FY 2001.

November 8, 2000

To: Legislative Educational Planning Committee
From: Paul West, Senior Fiscal Analyst
Re: Current Utilization of Gaming Revenues for Education

Introduction

Since the creation in the mid-1980s of the Kansas Lottery and the legalization of parimutuel wagering in the state, the Kansas Legislature has chosen to use a significant portion of the net gaming proceeds to finance education related programs. This memorandum reviews the distribution of gaming revenues and education related programs financed by gaming revenues.

Where Does the Money Come From?

The proceeds from the sale of lottery tickets and taxes on parimutuel wagering, after paying prizes and the cost of administration, are credited to the State Gaming Revenue Fund. Under current state law, the first \$50.0 million credited to the State Gaming Revenues Fund is divided as follows:

- \$5.0 million to the Correctional Institutions Building Fund to help offset State General Fund (SGF) expenditures in constructing and maintaining state prisons;
- \$2.5 million to the Juvenile Detention Facilities Fund to help local governments pay the cost of confining local juvenile offenders; and
- \$42.5 million to the Economic Development Initiatives Fund (EDIF).

Gaming revenues in excess of \$50.0 million are credited to the State General Fund, with the exception of a transfer of \$80,000 to the new Problem Gambling Grant Fund. The approved budget for FY 2001 includes an estimated \$60.6 million from gaming revenues. Appropriations from gaming revenues in support of education related programs are made from the EDIF.

Where Does the EDIF Go?

The statutes governing the EDIF provide that it shall be used to finance programs "... supporting and enhancing the existing economic foundation of the state and fostering growth . . . to the state's economic foundation." With the exception of a statutory \$2.0 million transfer from the EDIF to the State Water Plan Fund, the Legislature annually appropriates the EDIF for individual projects and programs deemed to support and enhance the state's economic foundation. The attached table from the *2000-2001 Appropriations Report* summarizes the uses of the EDIF for fiscal years 1999 through 2001. The 2000 Legislature appropriated \$47.4 million from the EDIF for FY 2001, the difference from the \$42.5 million noted above being associated primarily with interest earnings and the liquidation of prior year encumbrances. Of this amount, \$22.1 million, or 46.7 percent of the available funding, was allocated to programs which may be viewed as supporting education.

The EDIF in Education

The following paragraphs provide a brief description of the FY 2001 appropriations from the EDIF which may be viewed as supporting education, either through a direct appropriation or through programs which are ultimately offered through an educational institution in the state or which enhance the knowledge base of Kansas citizens.

State Board of Regents. Some years ago a decision was made to shift certain appropriations for education to the EDIF in order to reduce overall expenditures from the SGF. The items selected generally pertained to area vocational schools and community colleges, the rationale being that the job training and retraining provided by those institutions bore a relation to the state's economic development effort and were appropriate expenditures from the EDIF.

All amounts shown below are approved for FY 2001.

- **Postsecondary Aid for Area Vocational Schools and Technical Colleges.** Postsecondary aid is appropriated to the State Board of Regents and is distributed on the basis of a statutory formula that results in a calculated local cost for each area vocational school and technical college. The local cost is divided by the number of hours taken by all students (secondary and postsecondary) to get a local cost per hour. This figure is multiplied by the number of hours enrolled in by postsecondary students and the state pays 85 percent of that amount. The postsecondary student pays the remaining 15 percent. (The costs incurred for secondary students are paid by the students' school districts.) The actual allocation of funding to the individual schools is made by the State Board of Regents, based on an approved operating budget for each school that is determined after it is known how much money is available. The total appropriation for postsecondary aid is split between the EDIF and the SGF. The total appropriation for FY 2001 is \$26.4 million, of which \$19.5 million is from the SGF and \$6.9 million is from the EDIF.

- **Vocational Education Capital Outlay Aid.** Vocational education capital outlay aid goes to area vocational schools, technical colleges, and community colleges that are designated area vocational schools. The statute that creates the program allows money to be spent for building construction and repairs and the acquisition of furniture and equipment, but the Legislature generally has restricted its use to instructional equipment. By proviso, state aid must be matched 50 percent at the local level. The approved amount for FY 2001 is \$2.7 million. (All money for the program is from the EDIF.)
- **Technology Innovation Grants.** The technology innovation program provides grants to area vocational schools, technical colleges, community colleges, and Washburn University for start-up support for innovative technical courses and programs in emerging technologies, manufacturing, and areas of skill shortages, and for internships for faculty of vocational education institutions to work in an industrial setting or for industrial employees to work at vocational education institutions. Receiving institutions must match the state grant 100 percent. The approved amount for FY 2001 is \$200,000. (All of the money for the program is from the EDIF.)
- **Comprehensive Grant Program.** The Comprehensive Grant Program provides need-based scholarship assistance to undergraduate Kansas students attending Kansas colleges and universities. The program is designed to provide up to one-half of the average tuition and fees of state educational institutions, but is subject to available appropriations. The approved budget for FY 2001 totals \$10.7 million, of which \$250,000 is from the EDIF. FY 2001 is the first year that EDIF financing has been utilized for this program.

Department of Commerce and Housing. As a part of its mission to assist in the growth of the state's economy, the Department of Commerce and Housing provides financial support to several programs designed to help focus the state's investment in human capital.

- **Kansas Industrial Training (KIT) and Retraining (KIR) Programs.** The KIT program provides grants to Kansas firms that are adding employees to help defray the costs of employee training. Similarly, the KIR program provides financial assistance for the training of employees of restructuring industries who are likely to be displaced because of obsolete or inadequate job skills. No matching funding is required of KIT participants while KIR grant recipients are required to provide a minimum match of 100 percent. Department of Commerce and Housing officials report that, on average, 90 percent of KIT and KIR grants are used to purchase services from community colleges and vocational education institutions. The approved FY 2001 budget for KIT and KIR is \$3.6 million, all of which is financed by the EDIF.

- **Training Equipment Grants.** The Training Equipment Grants program provides community colleges, area technical colleges, and area vocational technical schools with the means to acquire instructional equipment for training or retraining Kansas workers. (Successful applicants must provide a match of at least 100 percent of the state grant.) The approved FY 2001 budget for training equipment grants is \$277,500 from the EDIF.
- **Small Business Development Centers.** With locations at 22 universities and community colleges, the state's Small Business Development Centers (SBDCs) provide practical training and topical seminars for persons interested in operating a small business. The Department of Commerce and Housing's approved FY 2001 budget includes \$485,000 from the EDIF to support the SBDC network.

Kansas Technology Enterprise Corporation. As part of its mission to foster innovation in existing and developing businesses, the Kansas Technology Enterprise Corporation (KTEC) provides financial support to several programs designed to enhance the research capabilities of the state's universities.

- **Centers of Excellence Grants.** The Centers of Excellence are university-based research centers focusing on innovative research topics within each Center's area of specialization. The five Centers are located at Kansas State University, Wichita State University, Pittsburg State University, and the University of Kansas (which has two centers). The Centers have a diverse array of specialties, ranging from drug development to materials science to software development. In conjunction with research on potentially marketable products, the Centers provide education and compensation opportunities for university faculty and students. In FY 2000, the Centers of Excellence attracted \$27.2 million from nonstate sources. KTEC's approved FY 2001 budget includes \$3.5 million from the EDIF for core support of the Centers and \$797,785 from the Mid America Manufacturing Technology Center's EDIF allocation, for a total of \$4.3 million from the EDIF in support of the Centers of Excellence.
- **Experimental Program to Stimulate Competitive Research (EPSCoR).** Through EPSCoR, the State of Kansas and federal agencies provide joint funding to enhance the basic research capabilities of the state's universities in science and engineering. The state qualifies for federal EPSCoR funding by virtue of its universities historically receiving a disproportionately low per capita share of federal research funding. The federal funding match varies between specific projects but is at least 100 percent of the state's funding. In FY 2000, the EPSCoR program attracted \$5.5 million in federal and private sector support. For FY 2001, KTEC's approved budget includes \$3,200,000 from the EDIF to support EPSCoR.

- **Applied Research Matching Grant Program.** The Applied Research Matching Grant Program provides funding to companies seeking to turn new technologies into market driven products that will lead to the retention or expansion of the firm's market share and result in added skilled job opportunities in the state. KTEC officials estimate that 15 percent of the program awards are expended for contractual research at the state's universities for an estimated FY 2001 impact from the EDIF of \$186,900.
- **Graduate Intern Program.** KTEC offers graduate and undergraduate students in Kansas universities internships which are designed to provide the students an opportunity to gain real world business experience by interacting with KTEC client companies. Interns perform tasks such as market research, patent and trademark searches, financial analysis, and business plan editing and review. The approved FY 2001 budget for KTEC includes \$30,000 from the EDIF to support the internship program. In addition, KTEC officials report that at least five of KTEC's commercialization centers provide internship opportunities to Kansas university students, with an annual investment in interns of between \$8,000 and \$12,000 per year.

Adjutant General. The **National Guard Educational Assistance Program** provides state assistance for tuition and fees for eligible members of the Kansas Army National Guard and the Kansas Air National Guard who attend Kansas educational institutions. The approved FY 2001 budget for the program totals \$353,484, including \$50,000 from the EDIF. FY 2001 is the first year that EDIF financing has been utilized for this program.

Other Programs. The impact of the EDIF on education programs is not limited to the programs above. Other programs supported in whole or in part by the EDIF which could be viewed as contributing to the knowledge base of the state include research performed by Kansas, Inc; support for the State Fair, Public Television, and the Kansas Arts Commission; and grants to the Kansas Foundation for Agriculture, the Challenger Project, the Teachers Hall of Fame, the Eisenhower Museum, local libraries, and the Kansas Humanities Council. In addition, the State Water Plan Fund (which is financed in part by the EDIF) finances a broad range of environmental research, geographic information systems, and practical land use education. Finally, the EDIF has been used to offset all of the SGF financing which previously was allocated to economic development programs, thus freeing up these SGF resources for reallocation to other programs of state importance, which could include education.

TABLE F

**ACTUAL FY 1999, ESTIMATED FY 2000, AND APPROVED FY 2001
TRANSFERS AND EXPENDITURES FROM THE
ECONOMIC DEVELOPMENT INITIATIVES FUND**

Agency/Program	Actual FY 1999	Approved FY 2000	Approved FY 2001
Department of Commerce and Housing			
Agency Operations	\$ 7,928,640	\$ 7,006,215	\$ 8,609,757
Small Business Development Centers	525,000	485,000	485,000
Certified Development Companies	475,000	475,000	400,000
Kansas Industrial Training/Retraining	3,803,869	3,600,000	3,600,000
Trade Show Promotion Grants	219,460	150,000	150,000
Community Capacity Building Grants	250,000	197,000	197,000
Economic Initiative Opportunity Fund	8,075,546	5,000,000	3,500,000
Tourism Grants	602,100	952,100	1,052,100
Mid-America World Trade Center	50,000	41,889	42,000
Mainstreet Grant and Development Prog.	216,800	216,800	216,800
Existing Industry Expansion Prog.	695,763	800,000	500,000
Travel Information Centers	6,419	15,000	15,000
Training Equipment Grants	262,674	300,000	277,500
Film Industry Tax Refunds	26,673	75,000	75,000
Agriculture Products Dev.	540,000	540,000	540,000
Kansas Sports Hall of Fame	0	50,000	0
Eisenhower Museum Grant	0	300,000	300,000
Teachers Hall of Fame Grant	0	0	100,000
HOME Program	0	0	533,022
Subtotal - KDCH	\$ 23,677,944	\$ 20,204,004	\$ 20,593,179
Kansas Technology Enterprise Corporation			
Agency Operations	\$ 1,567,069	\$ 1,338,486	\$ 1,308,863
Centers of Excellence - Research	3,532,156	3,552,640	3,527,215
Research Matching Grants	1,378,500	969,196	1,246,000
Inventor Assistance	48,439	76,000	76,000
State Small Business Innovation Research Grants	375,000	300,000	300,000
Small Business Innovation Research Bridge Funds	42,560	140,000	140,000
Special Projects	50,593	79,303	79,303
Commercialization	1,660,000	1,490,000	1,156,664
Mid-America Manufac. Tech. Center (MAMTC)	1,000,000	1,000,000	950,931
Centers of Excellence - MAMTC	797,360	797,338	797,785
EPSCoR	3,693,735	3,200,000	3,200,000
Subtotal - KTEC	\$ 14,145,412	\$ 12,942,963	\$ 12,782,761
Kansas, Inc.			
Agency Operations	\$ 216,127	\$ 189,563	\$ 336,949
State Fair			
Operations	\$ 0	\$ 35,000	\$ 134,000
Capital Improvements	0	0	100,000
Subtotal - State Fair	\$ 0	\$ 35,000	\$ 234,000
Department of Education/Board of Regents			
Kansas Foundation for Agriculture	\$ 0	\$ 0	\$ 30,000
Challenger Project	0	0	50,000

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Agency/Program	Actual FY 1999	Approved FY 2000	Approved FY 2001
Technical Innovation and Internship Grants	199,414	200,000	200,000
Postsecondary Aid—AVTS	6,683,567	6,716,110	6,916,110
Capital Outlay—AVTS	3,000,000	2,000,000	2,700,000
Comprehensive Grant Scholarship Assistance	0	0	250,000
Subtotal - Education/Regents	<u>\$ 9,882,981</u>	<u>\$ 8,916,110</u>	<u>\$ 10,146,110</u>
Historical Society			
Other Operating Expenditures Fund	\$ 1,560	\$ 0	\$ 0
Visitor Donation Match Fund	30,000	40,000	60,000
Cyclical Maintenance Projects Fund (Ft. Hays)	50,000	0	0
First Territorial Capitol Renovation Project Fund	71,000	0	0
Completion of Historic Sites (Kaw Mission)	100,000	0	0
Friends of the Free State Capitol Grant Fund	30,000	0	0
Kansas Humanities Council	0	0	0
Subtotal - Historical Society	<u>\$ 282,560</u>	<u>\$ 40,000</u>	<u>\$ 95,000</u>
Arts Commission			
State Operations	\$ 0	\$ 0	\$ 119,110
State Library	\$ 0	\$ 0	\$ 170,000
Grants to Local Libraries	\$ 0	\$ 0	\$ 170,000
Department of Administration	\$ 116,800	\$ 0	\$ 350,000
Public Television Grants	\$ 116,800	\$ 0	\$ 350,000
Wildlife and Parks	\$ 116,800	\$ 0	\$ 350,000
Local Government Outdoor Recreation	\$ 500,000	\$ 500,000	\$ 500,000
Regents Institutions	\$ 500,000	\$ 500,000	\$ 500,000
KSU-Ag Extension—Irrigation Field Study	\$ 90,000	\$ 0	\$ 0
Adjutant General	\$ 90,000	\$ 0	\$ 0
Kansas National Guard Educational Assist. Program	\$ 0	\$ 0	\$ 50,000
State Water Plan Fund	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000
TOTAL EXPENDITURES	\$ 50,911,824	\$ 44,827,640	\$ 47,377,109

EDIF Resource Estimate—FY 2000 - FY 2001

	Approved FY 2000	Approved FY 2001
Beginning Balance	\$ 3,672,000	\$ 3,643,508
Gaming Revenue	42,500,000	42,500,000
Other Income	2,250,182	1,200,472
Total Available	<u>\$ 48,422,182</u>	<u>\$ 47,343,980</u>
Less: Expend. and Transfers*	44,778,674	47,343,980
ENDING BALANCE	<u><u>\$ 3,643,508</u></u>	<u><u>\$ 0</u></u>

* May not equal expenditures noted above. Detailed expenditures include expenditures from prior year EDIF allocations.

HOW ARE KANSAS LOTTERY PROCEEDS DISTRIBUTED?

In Fiscal Year 2000, 30 cents of every dollar spent on a Kansas Lottery ticket was transferred to the state of Kansas. The State Gaming Revenues Fund receives transfers from receipts generated by the Kansas Lottery and the Kansas Racing and Gaming Commission.



Transfers of up to \$50 million are made from the gaming fund according to the following breakdown:

- 85 percent - Economic Development Initiatives Fund
- 10 percent - Correctional Institutions Building Fund
- 5 percent - Juvenile Detention Facilities Fund

Transfers for these purposes are limited to \$50 million in a given fiscal year. Any receipts above that amount are transferred to the State General Fund.

The Kansas Legislature determines how Lottery proceeds are distributed each year.

In Fiscal Year 2000, the Lottery transferred \$59,646,911 (unaudited) to the state of Kansas.

ECONOMIC DEVELOPMENT INITIATIVES FUND DISTRIBUTION AS BUDGETED FOR FISCAL YEAR 2000

Department of Commerce and Housing

Small Business Development Centers	\$485,000
Certified Development Companies	\$475,000
Kansas Industrial Training/Retraining	\$3,600,000
Trade Show Promotion	\$150,000
Capacity Planning Grants	\$197,000
Tourism Promotion	\$952,100
Wichita World Trade Center	\$41,889
Training Equipment.....	\$300,000
Agriculture Product Development	\$540,000
Travel Information Centers	\$15,000
Economic Opportunity Initiatives Fund.....	\$5,000,000
Existing Industry Expansion	\$800,000
Main Street Development Grants.....	\$216,800
Motion Picture/Television Tax Rebate	\$75,000
Operations	\$7,006,215
Subtotal Commerce and Housing	\$19,854,004

Board of Regents

Matching Grants - AVTS	\$200,000
Post-secondary Aid - AVTS	\$6,707,144
Capital Outlay - AVTS	\$2,000,000
Subtotal Board of Regents	\$8,907,144

DISTRIBUTION OF ECONOMIC DEVELOPMENT INITIATIVES FUND - FY 2000
PAGE 2

Kansas Technology Enterprise Corporation	
Research Matching Grants	\$1,260,000
Business Innovative Research Grants	\$516,000
Centers of Excellence	\$3,552,640
EPSCoR	\$3,200,000
Special Projects	\$79,303
Commercialization Grants	\$1,690,000
Mid-America Manufacturing Technology Center	\$1,797,338
Operations	\$1,338,486
Subtotal KTEC	\$13,433,767
State Water Plan	\$2,000,000
Kansas, Inc.....	\$189,563
Wildlife and Parks--Local Outdoor Recreation	\$500,000
Eisenhower Museum Grant.....	\$300,000
State Fair.....	\$35,000
TOTAL BUDGETED EDIF EXPENDITURES FOR FISCAL YEAR 2000 -	\$45,219,478

This report was taken from:
The Governor's Budget Report; Volume 1; Recommendations and Budget Schedules; Fiscal Year 2001

THE KANSAS LOTTERY

Executive

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Division of Administration

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Director: Harvey Malter
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Division of Marketing

Director: Tom Hofts
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A state operated lottery was approved by Kansas voters in the 1986 elections. Based upon the approval, the Kansas Legislature implemented legislation authorizing the creation and powers of a state agency called the Kansas Lottery. Governor Mike Hayden signed the legislation March 12, 1987 which as approved:

- Created a separate state agency called the Kansas Lottery and an executive director to administer the agency;
- Established a five-member Kansas Lottery Commission with regulatory, advisory and major contract approval responsibility;
- Set aside an amount not less than 45 percent of the money collected from ticket sales for prizes and an amount not less than 30 percent to the State Gaming Revenues Fund.
- Exempted lottery tickets from sales tax;

- Allowed liquor stores to sell lottery tickets; and,
- Subsequent legislation required all prizes of \$50 or more payable by the Lottery were to be subject to the state set-off procedures.

-- Division of Administration -- responsible for providing the budgeting, accounting, purchasing, computer and personnel support for all components of the Kansas Lottery.

-- Division of Security -- responsible for planning, directing, organizing and implementing activities including background investigations of employees, vendors, and retailers, physical security of all Lottery offices and operations, and draw security.

-- Division of Sales -- responsible for the planning, direction, organization and execution of the Kansas Lottery's Sales Division. The Division also oversees three regional offices located across the state to ensure maximum execution of the Sales program.

-- Division of Marketing -- responsible for the planning, organizing, directing, and implementation of the Lottery's advertising, media relations, retailer projects, public events, public relations and game development.

Kansas Lottery

Expenditure	Actual FY 1999	Approved FY 2000	Approved FY 2001
EXPENDITURES:			
State Operations	\$ 21,882,179	\$ 21,229,494	\$ 21,586,681
Prizes and Retailer Commissions	116,349,037	117,316,370	118,386,153
Total—Operating	<u>\$ 138,231,216</u>	<u>\$ 138,545,864</u>	<u>\$ 139,972,834</u>
FINANCING:			
All Funds	\$ 138,231,216	\$ 138,545,864	\$ 139,972,834
State General Fund	0	0	0
PERCENT CHANGE:			
All Funds	3.3%	0.2%	1.0%
State General Fund	0.0	0.0	0.0
FTE Positions	89.0	88.0	88.0
Unclass. Temp. Positions	2.0	5.0	5.0
Total	<u>91.0</u>	<u>93.0</u>	<u>93.0</u>
Transfers to the SGRF	\$ 60,333,464	\$ 59,400,000	\$ 60,000,000

The 2000 Legislature approved sales by the Kansas Lottery of \$198 million in FY 2000 and \$200 million in FY 2001. Payments for prizes, retailer commissions, and certain categories of state operations fees (online telecommunications, online service contract, and instant ticket printing) are linked to the sales estimates and increase as sales projections increase. In FY 2001, the expenditure limitation for agency operations totals \$9,010,196.

There is a statutory minimum of 30 percent of lottery sales reserved for transfer to the State Gaming Revenues Fund (SGRF). The 1999 Legislature approved that 30.0 percent transfer rate in order to provide additional funds for prizes in FY 2000, and the 2000 Legislature extended the SGRF transfer rate of 30.0 percent for FY 2001. Prior to FY 2000, higher transfer rates often were approved by the Legislature since any excess funds above \$50 million accrue to the State General Fund.