

# **CALIFORNIA LOTTERY**

Report of Analysis

## **QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION**

*For the Quarter Ended March 31, 2015*



**BETTY T. YEE**  
California State Controller

February 2016



**BETTY T. YEE**  
California State Controller

February 23, 2016

California Lottery Commission  
700 North Tenth Street  
Sacramento, California 95811  
ATTN: Nathaniel Kirtman III, Chairperson

Dear Commissioners:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to the public education community for the quarter ended March 31, 2015. Our analysis found that the transfer amount of \$385,546,325 appears to be supported by the Lottery's accounting records and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/lis

cc: Gregory Ahern, Vice Chair  
California Lottery Commission  
Rowena Libang-Bobila, Commissioner  
California Lottery Commission  
Connie M. Perez, Commissioner  
California Lottery Commission  
John Smolin, Commissioner  
California Lottery Commission  
Hugo López, Director  
California Lottery  
Nicholas Buchen, Deputy Director, Finance Division  
California Lottery  
Roberto Zavala, Deputy Director, Internal Audits  
California Lottery

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# Report of Analysis

## Introduction

This report presents the results of our analysis of the Lottery's quarterly request that the SCO transfer funds to the public education community. This analysis is part of our responsibility under the California State Lottery Act (Lottery Act). We performed this analysis to determine whether the transfer amount to the public education community was supported by amounts recorded in the Lottery's accounting records and to determine whether the Lottery is on target to comply with the annual Lottery Education Fund allocation requirements contained in the Lottery Act.

## Summary

In a letter dated May 15, 2015, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$385,546,325 to the Lottery Education Fund for disbursement to the public education community. Our analysis found that the transfer amount appears to be supported by the Lottery's accounting records and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

On June 26, 2015, the SCO transferred \$385,546,325 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except \$1.38 were disbursed to the public education community. This balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

## Background

In 1984, California voters passed an initiative that authorized a state-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of net revenues to the public education community and established the allocation percentages for lottery funds. The Lottery Act also requires the SCO to conduct quarterly and annual post-audits of all accounts and transactions of the California Lottery Commission and other special post-audits as the State Controller deems necessary.

The Lottery Act was amended by Assembly Bill 142 on April 8, 2010. The bill was an urgency statute that went into effect immediately. Assembly Bill 142 requires revenues from the Lottery to be allocated to maximize the amount of funding allocated to the public education community. The bill requires that not less than 87% of the total annual revenues from Lottery ticket sales be returned to the public in the form of prizes and funds to education, and not more than 13% be allocated for Lottery expenses. The bill specified that not less than 50% of the total annual Lottery revenues, in an amount to be determined by the Lottery Commission, be returned to the public in the form of prizes. In addition, the bill requires that the Lottery Commission establish the percentages to be allocated to the benefit of public education.

Each quarter, the Lottery requests that the SCO transfer net revenues to the public education community (see Attachment). The Lottery's request usually occurs eight to ten weeks after the close of the quarter.

## Objectives, Scope, and Methodology

We performed this analysis of the transfer of funds to the public education community for the quarter ended March 31, 2015, in order to determine whether:

- The Lottery's requested transfer amount of \$385,546,325 is supported by accounting records; and
- The Lottery is on target to comply with the annual allocation requirements specified in the Lottery Act.

As part of our analysis, we traced the transfer amount to the Lottery's accounting records and applied analytical review procedures to Lottery fund accounts by comparing them with those from the prior year.

## Results

On June 26, 2015, the SCO transferred \$385,546,325 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except \$1.38 were disbursed to the public education community. This balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

After analyzing the Lottery's unaudited financial statements and supporting records for the quarter ended March 31, 2015, we determined that the Lottery's requested transfer amount of \$385,546,325 to the Lottery Education Fund appears to be supported by accounting records.

For the nine months ended March 31, 2015, of the total revenues from ticket sales:

- 63.13% was returned to the public in the form of prizes;
- 24.99% was transferred to the public education community; and
- 11.89% was used for administrative expenses.

The Lottery returned 88.12% of the total revenues from the sales of tickets to the public in the form of prizes and funds to education. The Lottery is on target to comply with the annual allocation requirements specified in the Lottery Act. See Schedule 1 for a summary of Lottery transfers and allocation percentages.

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

February 23, 2016

**Schedule 1—  
Fiscal Years 2014-15 and 2013-14  
Year-to-Date Lottery Revenue Allocations**

Fiscal Year 2014-15	Three Months Ended 9/30/2014	% of Sales <sup>1</sup>	Six Months Ended 12/31/2014	% of Sales <sup>1</sup>	Nine Months Ended 3/31/2015	% of Sales <sup>1</sup>	Twelve Months Ended 6/30/2015	% of Sales <sup>1</sup>
Sales	\$ 1,238,505,486	100.00%	\$ 2,550,665,325	100.00%	\$ 4,045,291,144	100.00%	\$	%
Prizes	\$ 789,714,494	63.76%	\$ 1,608,896,674	63.08%	\$ 2,553,665,457	63.13%	\$	%
Operating income to education	290,109,139	23.42%	631,975,901	24.78%	1,010,831,280	24.99%		%
Revenues returned to public	\$ 1,079,823,633	87.19%	\$ 2,240,872,575	87.85%	\$ 3,564,496,737	88.12%	\$	%
Administrative expenses	\$ 158,681,853	12.81%	\$ 309,792,750	12.15%	\$ 480,794,407	11.89%	\$	%
Miscellaneous income <sup>2</sup>	\$ 8,358,516		\$ 14,959,794		\$ 21,650,740		\$	
Adjustment	\$ 6,619,810 <sup>4</sup>		\$ —		\$ —		\$	
Allocation to Education Fund <sup>5</sup>	\$ 305,087,465		\$ 646,935,695		\$ 1,032,482,020		\$	

Fiscal Year 2013-14	Three Months Ended 9/30/2013	% of Sales <sup>1</sup>	Six Months Ended 12/31/2013	% of Sales <sup>1</sup>	Nine Months Ended 3/31/2014	% of Sales <sup>1</sup>	Twelve Months Ended 6/30/2014	% of Sales <sup>1</sup>
Sales	\$ 1,162,247,646	100.00%	\$ 2,450,157,700	100.00%	\$ 3,779,598,195	100.00%	\$ 5,034,661,424	100.00%
Prizes	\$ 699,802,713	60.21%	\$ 1,481,034,292	60.45%	\$ 2,303,991,703	60.96%	\$ 3,082,376,405	61.22%
Operating income to education	318,010,935	27.36%	668,711,181	27.29%	1,017,948,979	26.93%	1,326,651,898	26.35%
Revenues returned to public	\$ 1,017,813,648	87.57%	\$ 2,149,745,473	87.74%	\$ 3,321,940,682	87.89%	\$ 4,409,028,303	87.57%
Administrative expenses	\$ 144,433,998	12.43%	\$ 300,412,227	12.26%	\$ 457,657,513	12.11%	\$ 625,633,121	12.43%
Miscellaneous income <sup>2</sup>	\$ 3,669,263		\$ 11,592,038		\$ 17,032,274		\$ 22,949,165	
Adjustment	\$ 5,720,287 <sup>4</sup>		\$ —		\$ —		\$ (6,619,810) <sup>3</sup>	
Allocation to Education Fund <sup>5</sup>	\$ 327,400,485		\$ 680,303,219		\$ 1,034,981,253		\$ 1,342,981,253	

Annual Statutory Revenue Allocation Percentage Requirements

Prizes – Not less than 50% of sales

Administrative expenses – Not more than 13% of sales

Prizes and funds to education – Not less than 87% of sales

Other income – 100% to education

<sup>1</sup> Statutory compliance is determined on an annual basis at fiscal year-end. The percentages displayed in the first three quarters are presented to show the Lottery's year-to-date progress toward meeting annual statutory requirements.

<sup>2</sup> Miscellaneous income includes SMIF interest earned, unclaimed prizes, and other income.

<sup>3</sup> This amount was withheld from the fourth quarter transfer and was adjusted in the subsequent quarterly transfer, pending the financial statement audit and resolution of accounting issues.

<sup>4</sup> This amount was withheld from the previous quarterly transfer and was included in this quarter's transfer after the completion of the financial statement audit and resolution of accounting issues. Except in the first quarter, this amount was not included in the year-to-date Education Fund allocation amounts.

<sup>5</sup> The Education Fund allocation amount is sales plus miscellaneous income, plus the adjustment amount, less prizes, and less administrative expenses.

**Attachment—  
California Lottery’s  
Transfer Request of May 15, 2015**

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May 15, 2015

Ms. Casandra Moore-Hudnall, Chief  
Division of Accounting and Reporting  
State Controller's Office  
3301 C Street, Suite 700  
Sacramento, CA 95816

Dear Ms. Moore-Hudnall:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$385,546,325. This figure represents:

Operating income for the nine months ended March 31, 2015	\$ 1,010,831,280
SMIF interest earned	908,830
Other income	46,592
Unclaimed prizes	<u>20,695,318</u>
	<u>\$ 1,032,482,020</u>
Less: Transfer for the six months ended December 31, 2014	\$ 646,935,695
	<u>\$ 385,546,325</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the nine months ended March 31, 2015, prepared from books without audit, for your files.

Sincerely,

  
Nicholas Buchen, Deputy Director  
Finance Division

Attachment  
cc: Paula LaBrie, Acting Director

**CALIFORNIA STATE LOTTERY FUND**  
Statement of Revenues, Expenses, and Changes in Net Position  
For the Nine Months Ending March 31, 2015

Lottery sales	\$4,045,291,144
Prizes	2,553,665,457
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Sales after prizes	\$1,491,625,687
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Less game costs:	
Retailer costs	\$279,073,216
On-line game costs	62,330,739
Off-line game costs	21,029,277
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Total game costs	\$352,433,232
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Income before operating expenses	\$1,139,192,455
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Operating expenses:	
Salaries, wages and benefits	\$48,192,033
Advertising	47,031,278
Promotion, public relations and point of sale	6,999,625
Other professional services	8,387,837
Depreciation and amortization	6,142,446
Other general and administrative expenses	11,607,956
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Total operating expenses	\$128,361,175
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Operating income	\$1,010,831,280
Non-operating (expenses) revenues:	
Investment earnings	\$32,901,836
Other Income	46,592
Allocation to Education Fund	(1,011,786,702)
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Total non-operating (expenses) revenues	(\$978,838,274)
Changes in net position	\$31,993,006
Total net position-beginning of year	101,108,957
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Total net position-end of year	<u>\$133,101,963</u>

**State Controller's Office  
Division of Audits  
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Sacramento, CA 94250-5874**

**<http://www.sco.ca.gov>**