

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended June 30, 2014



BETTY T. YEE
California State Controller

March 2015



BETTY T. YEE
California State Controller

March 11, 2015

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 June 30, 2014. Our analysis found that the transfer amount of \$308,000,000 appears to be supported by the Lottery's accounting records and that the Lottery complied with the annual statutory percentages for prizes, education, and administration.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/kw

cc: Gregory Ahern, Commissioner
California Lottery Commission
Rowena Libang-Bobila, Commissioner
California Lottery Commission
Connie M. Perez, Commissioner
California Lottery Commission
John Smolin, Commissioner
California Lottery Commission
Paula D. LaBrie, Acting Director
California Lottery
Nicholas Buchen, Deputy Director, Finance Division
California Lottery
Roberto Zavala, Chief Internal Auditor
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 complied with the annual Lottery Education Fund allocation requirements contained in the Lottery Act.

Summary

In a letter dated September 8, 2014, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$308,000,000 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 complied with the annual statutory percentages for prizes, education, and administration.

The total amount available for distribution to the education community for the fourth quarter was \$308,000,014.44 (\$14.44 remained from the prior quarter). On September 30, 2014, the SCO transferred \$307,999,999.58 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except \$14.86 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, which 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 the Lottery Commission to 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 June 30, 2014, in order to determine whether:

- The Lottery's requested transfer amount of \$308,000,000 is supported by accounting records; and
- The Lottery is in compliance 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

The total amount available for distribution to the education community for the fourth quarter was \$308,000,014.44 (\$14.44 remained from the prior quarter). On September 30, 2014, the SCO transferred \$307,999,999.58 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except \$14.86 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 audited financial statements and supporting records for the quarter ended June 30, 2014, we determined that the Lottery's requested transfer amount of \$308,000,000 to the Lottery Education Fund appears to be supported by accounting records.

For the quarter ended June 30, 2014, of the total revenues from ticket sales:

- 61.22% was returned to the public in the form of prizes;
- 26.35% was transferred to the public education community; and
- 12.43% was used for administrative expenses.

The Lottery returned 87.57% of the total revenues from the sales of tickets to the public in the form of prizes and funds to education. The Lottery is in compliance 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

March 11, 2015

**Schedule 1—
Fiscal Years 2013-14 and 2012-13
Quarter-End Lottery Revenue Allocations**

Fiscal Year 20__ - __	Quarter Ended							
	9/30/2013	% of Sales ¹	12/31/2013	% of Sales ¹	3/31/2014	% of Sales ¹	6/30/2014	% of Sales ¹
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 ²	\$ 3,669,263		\$ 11,592,038		\$ 17,032,274		\$ 22,949,165	
Adjustment	\$ 5,720,287 ⁴		\$ —		\$ —		\$ (6,619,810) ³	
Allocation to Education Fund ⁵	\$ 327,400,485		\$ 680,303,219		\$ 1,034,981,253		\$ 1,342,981,253	

Fiscal Year 2012-13	Quarter Ended							
	9/30/2012	% of Sales ¹	12/31/2012	% of Sales ¹	3/31/2013	% of Sales ¹	6/30/2013	% of Sales ¹
Sales	\$ 1,008,382,162	100.00%	\$ 2,051,515,833	100.00%	\$ 3,153,730,899	100.00%	\$ 4,445,874,040	100.00%
Prizes	\$ 611,579,884	60.65%	\$ 1,245,909,894	60.73%	\$ 1,900,093,870	60.25%	\$ 2,652,095,102	59.65%
Operating income to education	\$ 277,570,269	27.53%	\$ 561,004,433	27.35%	\$ 883,957,405	28.03%	\$ 1,260,789,450	28.36%
Revenues returned to public	\$ 889,150,153	88.01%	\$ 1,806,914,327	88.08%	\$ 2,784,051,275	88.28%	\$ 3,912,884,552	88.01%
Administrative expenses	\$ 119,232,009	11.82%	\$ 244,601,506	11.92%	\$ 369,679,624	11.72%	\$ 532,989,488	11.99%
Miscellaneous income ²	\$ 10,591,621		\$ 15,064,526		\$ 19,693,087		\$ 23,581,329	
Adjustment	\$ 4,715,142 ⁴		\$ —		\$ —		\$ (5,720,287) ³	
Allocation to Education Fund ⁵	\$ 292,877,032		\$ 576,068,959		\$ 903,650,492		\$ 1,278,650,492	

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

¹ Statutory compliance is determined on an annual basis at fiscal year-end. The percentages displayed in quarters 1, 2, and 3 are presented to show the Lottery's year-to-date progress toward meeting annual statutory requirements.

² Miscellaneous income includes SMIF interest earned, unclaimed prizes, and other income.

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

⁴ 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.

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

**Attachment—
California Lottery's
Transfer Request of September 8, 2014**

700 North Tenth Street
Sacramento, CA 95811
calottery.com



September 8, 2014

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 \$308,000,000. This figure represents:

Operating income for the year ended June 30, 2014	\$ 1,326,651,898
SMIF interest earned	1,249,094
Other income	27,400
Unclaimed prizes	<u>21,672,671</u>
	\$ 1,349,601,063
Less: Transfer for the nine months ended March 31, 2014	\$ 1,034,981,253
Amount withheld pending audit	<u>6,619,810</u>
	<u>\$ 308,000,000</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the year ended June 30, 2014, 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 Twelve Months Ending June 30, 2014

Lottery sales	\$5,034,661,424
Prizes	3,082,376,405

Sales after prizes	\$1,952,285,019

Less game costs:	
Retailer costs	\$345,513,054
On-line game costs	70,486,877
Off-line game costs	29,540,698

Total game costs	\$445,540,629

Income before operating expenses	\$1,506,744,390

Operating expenses:	
Salaries, wages and benefits	\$66,108,672
Advertising	63,699,190
Promotion, public relations and point of sale	14,507,326
Other professional services	13,331,461
Depreciation and amortization	6,075,176
Other general and administrative expenses	16,370,667

Total operating expenses	\$180,092,492

Operating income	\$1,326,651,898
Non-operating (expenses) revenues:	
Investment earnings	\$290,350
Other Income	27,400
Allocation to Education Fund	(1,327,928,392)

Total non-operating (expenses) revenues	(\$1,327,610,642)
Changes in net position	(\$958,744)
Total net position-beginning of year	102,067,701

Total net position-end of year	\$101,108,957
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**State Controller's Office
Division of Audits
Post Office Box 942850
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<http://www.sco.ca.gov>