CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended June 30, 2015

BETTY T. YEE

California State Controller

March 2016

BETTY T. YEE
California State Controller

March 4, 2016

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

Dear Mr. Kirtman:

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, 2015. Our analysis found that the transfer amount of $352,000,000 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, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/ls

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 California Lottery's (Lottery) quarterly request that the State Controller's Office (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, 2015, the Lottery requested that the SCO transfer $352,000,000 to the Lottery Education Fund for disbursement to the public education community. On February 26, 2016, the Lottery submitted to the SCO a revision to the September 8, 2015 letter. The revision stated an increase in the Lottery's operating income for the year ended June 30, 2015, but did not change the requested transfer amount of $352,000,000. 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 prized, education, and admission.

The total amount available for distribution to the education community for the quarter ended June 30, 2015, was $352,000,001.38, which includes $1.38 that remained from the prior quarter. On September 30, 2015, the SCO transferred $351,999,982.38 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except $19 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 June 30, 2015, in order to determine whether:

- The Lottery's requested transfer amount of $352,000,000 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 quarter ended June 30, 2015, was $352,000,001.38, which includes $1.38 that remained from the prior quarter. On September 30, 2015, the SCO transferred $351,999,982.38 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except $19 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, 2015, we determined that the Lottery's requested transfer amount of $352,000,000 to the Lottery Education Fund appears to be supported by accounting records.

For the fiscal year ended June 30, 2015, of the total revenues from ticket sales:

- 63.38% was returned to the public in the form of prizes;
- 24.67% was transferred to the public education community; and
- 11.94% was used for administrative expenses.

The Lottery returned 88.05% 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 4, 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[1]	Six Months Ended 12/31/2014	% of Sales[1]	Nine Months Ended 3/31/2015	% of Sales[1]	Twelve Months Ended 6/30/2015	% of Sales[1]
Sales	$ 1,238,505,486	100.00%	$ 2,550,665,325	100.00%	$ 4,045,291,144	100.00%	$ 5,524,850,593	100%
Prizes	$ 789,714,494	63.76%	$ 1,608,896,674	63.08%	$ 2,553,665,457	63.13%	$ 3,501,745,873	63.38%
Operating income to education	290,109,139	23.42%	631,975,901	24.78%	1,010,831,280	24.99%	1,363,241,580	24.67%
Revenues returned to public	$ 1,079,823,633	87.19%	$ 2,240,872,575	87.85%	$ 3,564,496,737	88.12%	$ 4,864,987,453	88.05%
Administrative expenses	$ 158,681,853	12.81%	$ 309,792,750	12.15%	$ 480,794,407	11.89%	$ 659,863,140	11.94%
Miscellaneous income[2]	$ 8,358,516		$ 14,959,794		$ 21,650,740		$ 28,477,446	
Adjustment	$ 6,619,810 [4]		$ –		$ –		$ (7,237,006)	
Allocation to Education Fund[5]	$ 305,087,465		$ 646,935,695		$ 1,032,482,020		$ 1,384,482,020	

Fiscal Year 2013-14	Three Months Ended 9/30/2013	% of Sales[1]	Six Months Ended 12/31/2013	% of Sales[1]	Nine Months Ended 3/31/2014	% of Sales[1]	Twelve Months Ended 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	

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

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[1] 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.

[2] Miscellaneous income includes Surplus Money Investment Fund interest earned, unclaimed prizes, and other income.

[3] 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.

[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. Except in the first quarter, this amount was not included in the year-to-date Education Fund allocation amounts.

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

Attachment—
California Lottery's
Revised Transfer Request of February 26, 2016

700 North Tenth Street
Sacramento, CA 95811
calottery.com

calottery

Revised

February 26, 2016

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:

On January 22, 2016, the California Lottery received revised pension reporting numbers from the State Controller's Office, which impact the Lottery's operating income for the fiscal year ended June 30, 2015. As a result, we are submitting this revision to the letter dated September 8, 2015, previously submitted to you.

Revised Operating income for the year ended June 30, 2015	$ 1,363,241,580
SMIF interest earned	1,247,278
Other income	53,155
Unclaimed prizes	27,177,013
	$ 1,391,719,026
Less: Transfer for the nine months ended March 31, 2015	$ 1,032,482,020
Revised Amount withheld pending audit	7,237,006
	$ 352,000,000

We have attached a revised copy of the Statement of Revenues, Expenses, and Changes in Net Position for the year ended June 30, 2015, for your files.

Sincerely,

Nicholas Buchen, Deputy Director
Finance Division

Attachment
cc: Hugo López, Director

CALIFORNIA STATE LOTTERY FUND

Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ending June 30, 2015
Revised

Lottery sales	$5,524,850,593
Prizes	3,501,745,873
Sales after prizes	$2,023,104,720
Less game costs:	
Retailer costs	$380,344,945
On-line game costs	68,881,598
Off-line game costs	29,990,183
Total game costs	$479,216,726
Income before operating expenses	$1,543,887,994
Operating expenses:	
Salaries, wages and benefits	$70,480,064
Advertising	62,273,530
Promotion, public relations and point of sale	10,664,151
Other professional services	11,843,044
Depreciation and amortization	8,950,492
Other general and administrative expenses	16,435,133
Total operating expenses	$180,646,414
Operating income	$1,363,241,580
Non-operating (expenses) revenues:	
Other income	53,155
Allocation to Education Fund	(1,364,542,013)
Total non-operating (expenses) revenues	($1,370,122,178)
Changes in net position	($6,880,598)
Total net position-beginning of year, as previously reported	101,108,957
Cummulative effect of accounting changes (GASB 68)	(90,210,412)
Total net position-beginning of year, restated	10,898,545
Total net position-end of year	$4,017,947

State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874

http://www.sco.ca.gov

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