CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended September 30, 2014

BETTY T. YEE

California State Controller

June 2015

BETTY T. YEE
California State Controller

June 4, 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 September 30, 2014. Our analysis found that the transfer amount of $305,087,465 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, by telephone at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/ls

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, 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 November 20, 2014, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer $305,087,465 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 December 30, 2014, the SCO transferred $305,087,479.82 to the Lottery Education Fund. This amount includes $6,619,810 withheld from the prior fiscal year-end pending the financial statement audit and resolution of accounting issues. This amount also includes a remaining balance from the prior quarter in the amount of $14.86. Due to the SCO's apportionment process, all funds except $.04 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 September 30, 2014, in order to determine whether:

- The Lottery's requested transfer amount of $305,087,465 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 December 30, 2014, the SCO transferred $305,087,479.82 to the Lottery Education Fund. This amount includes $6,619,810 withheld from the prior fiscal year-end pending the financial statement audit and resolution of accounting issues. This amount also includes a remaining balance from the prior quarter in the amount of $14.86. Due to the SCO's apportionment process, all funds except $.04 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 September 30, 2014, we determined that the Lottery's requested transfer amount of $305,087,465 to the Lottery Education Fund appears to be supported by accounting records.

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

- 63.76% was returned to the public in the form of prizes;
- 23.42% was transferred to the public education community; and
- 12.81% was used for administrative expenses.

The Lottery returned 87.19% 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

June 4, 2015

Schedule 1—
Fiscal Years 2014-15 and 2013-14
Quarter-End Lottery Revenue Allocations

Fiscal Year 2014-15	Quarter Ended							
	9/30/2014	% of Sales[1]	12/31/2014	% of Sales[1]	3/31/2015	% of Sales[1]	6/30/2015	% of Sales[1]
Sales	$ 1,238,505,486	100.00%	$	%	$	%	$	%
Prizes	$ 789,714,494	63.76%	$	%	$	%	$	%
Operating income to education	290,109,139	23.42%		%		%		%
Revenues returned to public	$ 1,079,823,633	87.19%	$	%	$	%	$	%
Administrative expenses	$ 158,681,853	12.81%	$	%	$	%	$	%
Miscellaneous income[2]	$ 8,358,516		$		$		$	
Adjustment	$ 6,619,810 [4]		$		$		$ [3]	
Allocation to Education Fund[5]	$ 305,087,465		$		$		$	

Fiscal Year 2013-14	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	

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 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 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.

[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
Transfer Request of November 20, 2014

700 North Tenth Street
Sacramento, CA 95811
calottery.com

calottery

November 20, 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 $305,087,465. This figure represents:

Operating income for the three months ended September 30, 2014	$ 290,109,139
SMIF interest earned	268,277
Other income	8,937
Unclaimed prizes	8,081,302
	$ 298,467,655
Amount withheld from 2013-2014 fiscal year pending audit	$ 6,619,810
	$ 305,087,465

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the three months ended September 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 Three Months Ending September 30, 2014

Lottery sales	$1,238,505,486
Prizes	789,714,494
Sales after prizes	$448,790,992
Less game costs:	
Retailer costs	$86,923,697
On-line game costs	16,579,879
Off-line game costs	5,668,454
Total game costs	$109,172,030
Income before operating expenses	$339,618,962
Operating expenses:	
Salaries, wages and benefits	$16,220,961
Advertising	21,685,446
Promotion, public relations and point of sale	3,029,170
Other professional services	2,490,698
Depreciation and amortization	1,961,489
Other general and administrative expenses	4,122,059
Total operating expenses	$49,509,823
Operating income	$290,109,139
Non-operating (expenses) revenues:	
Investment earnings	$4,763,269
Other Income	8,937
Allocation to Education Fund	(290,386,353)
Total non-operating (expenses) revenues	($285,614,147)
Changes in net position	$4,494,992
Total net position-beginning of year	101,108,957
Total net position-end of year	$105,603,949

State Controller's Office
Division of Audits
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http://www.sco.ca.gov

S15-LOT-9003