

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended September 30, 2015



BETTY T. YEE
California State Controller

June 2016



BETTY T. YEE
California State Controller

June 30, 2016

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

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, 2015. Our analysis found that the requested transfer amount of \$348,399,668 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/rg

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, Chief Internal Auditor
California Lottery

Contents

Report of Analysis

Introduction	1
Summary	1
Background	1
Objectives, Scope, and Methodology	2
Results	2
Schedule 1—Fiscal Years 2015-16 and 2014-15 Year-to-Date Lottery Revenue Allocations	3
Attachment—California Lottery’s Transfer Request of November 20, 2015	

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 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, 2015, the Lottery requested that the SCO transfer \$348,399,668 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.

The total amount available for distribution to the education community for the quarter ended September 30, 2015, was \$348,399,687, which includes \$19 that remained from the prior quarter. On January 8, 2016, the SCO transferred \$348,399,686.98 to the Lottery Education Fund. As a result of the SCO's apportionment process, all funds except \$0.02 were disbursed to the public education community. The 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 a 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, 2015 in order to determine whether:

- The Lottery's requested transfer amount of \$348,399,668 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

The total amount available for distribution to the education community for the quarter ended September 30, 2015, was \$348,399,687, which includes \$19 that remained from the prior quarter. On January 8, 2016, the SCO transferred \$348,399,686.98 to the Lottery Education Fund. As a result of the SCO's apportionment process, all funds except \$0.02 were disbursed to the public education community. The 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, 2015, we determined that the Lottery's requested transfer amount of \$348,399,668 to the Lottery Education Fund appears to be supported by accounting records.

For the quarter ended September 30, 2015, of the total revenues from ticket sales:

- 64.01% was returned to the public in the form of prizes;
- 23.50% was transferred to the public education community; and
- 12.49% was used for administrative expenses.

The Lottery returned 87.51% 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 30, 2016

**Schedule 1—
Fiscal Years 2015-16 and 2014-15
Year-to-Date Lottery Revenue Allocations**

Fiscal Year 2015-16	Three Months Ended 9/30/2015	% of Sales ¹	Six Months Ended 12/31/2015	% of Sales ¹	Nine Months Ended 3/31/2016	% of Sales ¹	Twelve Months Ended 6/30/2016	% of Sales ¹
Sales	\$ 1,457,390,634	100.00%	\$	%	\$	%	\$	%
Prizes	\$ 932,898,902	64.01%	\$	%	\$	%	\$	%
Operating income to education	342,467,357	23.50%		%		%		%
Revenues returned to public	\$ 1,275,366,259	87.51%	\$	%	\$	%	\$	%
Administrative expenses	\$ 182,024,375	12.49%	\$	%	\$	%	\$	%
Miscellaneous income ²	\$ 5,932,311		\$		\$		\$	
Adjustment	\$ —		\$		\$		\$	
Allocation to Education Fund ⁵	\$ 348,399,668		\$		\$		\$	

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) ³	
Allocation to Education Fund ⁵	\$ 305,087,465		\$ 646,935,695		\$ 1,032,482,020		\$ 1,384,482,020	

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 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 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. Except in the quarter the amount was presented, 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
Transfer Request of November 20, 2015**

700 North Tenth Street
Sacramento, CA 95811
calottery.com



November 20, 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 \$348,399,668. This figure represents:

Operating income for the three months ended September 30, 2015	\$ 342,467,357
SMIF interest earned	384,158
Other income	1,832
Unclaimed prizes	<u>5,546,321</u>
	<u>\$ 348,399,668</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the three months ended September 30, 2015, prepared from books without audit, for your files.

Please note, the amount withheld from the 2014-15 transfer pending audit will be included in the second quarter transfer after the June 2015 audit is complete.

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 Three Months Ending September 30, 2015

Lottery sales	\$1,457,390,634
Prizes	992,898,902
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Sales after prizes	\$524,491,732
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Less game costs:	
Retailer costs	\$102,254,015
On-line game costs	19,113,848
Off-line game costs	9,819,922
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Total game costs	\$131,187,785
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Income before operating expenses	\$393,303,947
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Operating expenses:	
Salaries, wages and benefits	\$17,020,720
Advertising	20,987,435
Promotion, public relations and point of sale	3,377,458
Other professional services	2,688,754
Depreciation and amortization	3,047,315
Other general and administrative expenses	4,314,908
	<hr/>
Total operating expenses	\$50,836,590
	<hr/>
Operating income	\$342,467,357
Non-operating (expenses) revenues:	
Investment earnings	\$16,760,609
Other income	1,832
Allocation to Education Fund	(342,853,346)
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Total non-operating (expenses) revenues	(\$326,090,905)
Changes in net assets	\$16,376,452
Total net assets-beginning of year	(2,189,539)
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Total net assets-end of year	<u>\$14,186,913</u>

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

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