

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended June 30, 2012



JOHN CHIANG
California State Controller

October 2013



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California State Controller

October 28, 2013

California Lottery Commission
700 North Tenth Street
Sacramento, California 95811

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, 2012.

Our analysis found that the transfer amount of \$279,000,000 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/sk

cc: Phil Tagami, Commissioner
California Lottery Commission
Nathaniel Kirtman III, Commissioner
California Lottery Commission
John Smolin, Commissioner
California Lottery Commission
Connie M. Perez, Commissioner
California Lottery Commission
Gregory Ahern, Commissioner
California Lottery Commission
Paula D. LaBrie, Acting Director
California Lottery
Nicholas Buchen, Deputy Director, Finance
California Lottery
Roberto Zavala, Chief Internal Auditor
California Lottery

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Report of Analysis

Summary

In a letter dated September 12, 2012, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$279,000,000 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.

On September 28, 2012, the SCO transferred \$279,000,000 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except \$4.58 were disbursed to the public education community. This balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

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 if the transfer of funds to the public education community was supported by amounts recorded in the Lottery's accounting records and to determine if the Lottery complied with the annual Lottery Education Fund allocation requirements contained in the Lottery Act.

Background

In 1984, California voters passed an initiative, which, by amending the State Constitution, 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 public education. 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 request usually occurs eight to ten weeks after the close of the quarter.

Objectives, Scope, and Methodology

We performed this analysis of the quarterly transfer of funds to the public education community in order to determine if:

- The Lottery's requested transfer amount of \$279,000,000, for the quarter ended June 30, 2012, 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 the lottery fund accounts by comparing them with those from the prior year.

Results

On September 28, 2012, the SCO transferred \$279,000,000 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except \$4.28 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, 2012, we determined that the requested transfer amount of \$279,000,000 to the Lottery Education Fund appears to be supported by formal accounting records.

For the quarter ended June 30, 2012, of the total revenues from ticket sales:

- 58.57% was returned to the public in the form of prizes,
- 29.70% was transferred to the public education community, and
- 11.73% was used for administrative expenses.

The Lottery returned 88.27% 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

October 28, 2013

Schedule 1— Summary of Lottery Transfers and Allocation Percentages

Fiscal Year 2011-12	Quarter Ended ¹							
	09/30/2011	%	12/31/2011	%	03/31/2012	%	06/30/2012	%
Sales	\$ 869,113,412	100.00%	\$ 1,971,252,588	100.00%	\$ 3,330,793,946	100.00%	\$ 4,371,491,746	100.00%
Prizes	\$ 494,773,562	56.93%	\$ 1,146,667,271	58.17%	\$ 1,936,723,462	58.15%	\$ 2,560,306,589	58.57%
Administration	\$ 105,050,044	12.09%	\$ 224,397,328	11.38%	\$ 374,310,153	11.24%	\$ 512,935,953	11.73%
Available for Education	\$ 269,289,806	30.98%	\$ 600,187,989	30.45%	\$ 1,019,760,331	30.61%	\$ 1,298,249,204	29.70%
Prizes and Available for Education	764,063,368	87.91%	1,746,855,260	88.62%	2,956,483,793	88.76%	3,858,555,793	88.27%
Other Income ²	7,960,834		12,916,600		17,251,082		22,477,351	
Adjustment	4,999,206 ⁵		—		—		(4,715,142) ⁶	
Transfer to Education	\$ 282,249,846		\$ 613,104,589		\$ 1,037,011,413		\$ 1,316,011,413	

Fiscal Year 2010-11	Quarter Ended ¹							
	09/30/2010	%	12/31/2010	%	03/31/2011	%	06/30/2011	%
Sales	\$ 755,772,046	100.00%	\$ 1,588,919,168	100.00%	\$ 2,560,108,514	100.00%	\$ 3,438,577,998	100.00%
Prizes	\$ 410,400,634	54.30%	\$ 871,070,040	54.82%	\$ 1,414,508,447	55.25%	\$ 1,904,787,955	55.39%
Administration	\$ 96,130,047	12.72%	\$ 202,106,959	12.72%	\$ 315,783,600	12.34%	\$ 432,972,750	12.59%
Available for Education	\$ 249,241,365	32.98%	\$ 515,742,169	32.46%	\$ 829,816,467	32.41%	\$ 1,100,817,293	32.01%
Prizes and Available for Education	659,641,999	87.28%	1,386,812,209	87.28%	2,244,324,914	87.66%	3,005,605,248	87.41%
Other Income ²	4,301,850		17,480,033		21,735,572		27,733,952	
Adjustment	4,990,627 ³		—		—		(4,999,206) ⁵	
Adjustment	(4,462,218) ⁴		—		—		—	
Transfer to Education	\$ 254,071,624		\$ 533,222,202		\$ 851,552,039		\$ 1,123,552,039	

Annual Statutory Requirements Before AB 142

Prizes = Approximately 50% of sales
Administration = No more than 16% of sales
Available for education = At least 34% of sales
Other income = 100% due education

Annual Statutory Requirements After AB 142 (enacted April 8, 2010)

Prizes = Not less than 50% of sales
Administration = No more than 13% of sales
Prizes and available for education = Not less than 87% of sales
Other income = 100% due education

Note: The actual percentage allocation is computed on an annual basis when determining whether the Lottery has met the allocation requirements. The percentages shown above indicate the Lottery's year-to-date progress toward meeting these requirements.

¹ Quarterly amounts represent fiscal year-to-date totals.

² Includes interest income, other income, and unclaimed prizes.

³ This represents the amount withheld in the fourth quarter of FY 2009-10, pending the financial audit and resolution of accounting issues.

⁴ This represents the amount of the FY 2009-10 audit adjustment.

⁵ This represents the amount withheld in FY 2010-11.

⁶ This represents the amount withheld in FY 2011-12, pending the financial audit and resolution of accounting issues.

**Attachment—
California Lottery's
Transfer Request of September 12, 2012**



September 12, 2012

Mr. George Lolas, Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Mr. Lolas:

This revised letter replaces the letter sent to you previously dated August 27, 2012. The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$279,000,000. This figure represents:

Operating income for the year ended June 30, 2012	\$ 1,298,249,204
SMIF interest earned	1,625,718
Other income	365,457
Unclaimed prizes	<u>20,486,176</u>
	<u>\$ 1,320,726,555</u>
Less: Transfer for the nine months ended March 31, 2012	\$ 1,037,011,413
Amount withheld pending audit	(4,715,142)
	<u>\$ 279,000,000</u>

We have attached a revised copy of the Statement of Revenues, Expenses, and Changes in Net Assets for the year ended June 30, 2012, prepared from books without audit, for your files.

Sincerely,

A handwritten signature in cursive script that reads 'Michael Ota'.

Michael Ota, Deputy Director
Finance Division

Attachment
cc: Robert O'Neill, Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Twelve Months Ending June 30, 2012
Revised

Lottery sales	\$4,371,491,746
Prizes	2,560,306,589

Sales after prizes	\$1,811,185,157

Less game costs:	
Retailer costs	\$295,829,989
On-line game costs	48,258,994
Off-line game costs	25,774,034

Total game costs	\$369,863,017

Income before operating expenses	\$1,441,322,140

Operating expenses:	
Salaries, wages and benefits	\$62,937,875
Advertising	47,833,141
Promotion, public relations and point of sale	6,264,927
Other professional services	13,400,277
Depreciation and amortization	7,750,918
Other general and administrative expenses	4,885,798

Total operating expenses	\$143,072,936

Operating income	\$1,298,249,204
Non-operating (expenses) revenues:	
Investment earnings	\$112,432,992
Interest expense imputed on annuitized prize liability	(58,226,190)
Other Income	365,457
Allocation to Education Fund	(1,300,240,379)

Total non-operating (expenses) revenues	(\$1,245,668,120)
Changes in net assets	\$52,581,084
Total net assets-beginning of year	103,016,471

Total net assets-end of year	\$155,597,555
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**State Controller's Office
Division of Audits
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<http://www.sco.ca.gov>