

# **CALIFORNIA LOTTERY**

Report of Analysis

## **QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION**

*For the Quarter Ended March 31, 2014*



**JOHN CHIANG**  
California State Controller

December 2014



**JOHN CHIANG**  
California State Controller

December 9, 2014

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 March 31, 2014. Our analysis found that the transfer amount of \$354,678,034 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/sk

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  
California Lottery  
Roberto Zavala, Chief Internal Auditor  
California Lottery

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## Report of Analysis

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# Report of Analysis

## Summary

In a letter dated May 16, 2014, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$354,678,034 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 June 26, 2014, the SCO transferred \$354,678,034 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except \$14.44 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 amount to the public education community was supported by amounts recorded in the Lottery's accounting records and to determine if the Lottery is on target to comply 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 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 March 31, 2014, in order to determine if:

- The Lottery's requested transfer amount of \$354,678,034 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 June 26, 2014, the SCO transferred \$354,678,034 to the Lottery Education Fund. Due to the SCO's apportionment process, all funds except \$14.44 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 March 31, 2014, we determined that the Lottery's requested transfer amount of \$354,678,034 to the Lottery Education Fund appears to be supported by accounting records.

For the quarter ended March 31, 2014, of the total revenues from ticket sales:

- 60.96% was returned to the public in the form of prizes;
- 26.93% was transferred to the public education community; and
- 12.11% was used for administrative expenses.

The Lottery returned 87.89% 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 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

December 9, 2014

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

| Fiscal Year 2013-14                       | Quarter Ended             |                         |                  |                         |                  |                         |           |                         |
|-------------------------------------------|---------------------------|-------------------------|------------------|-------------------------|------------------|-------------------------|-----------|-------------------------|
|                                           | 9/30/2013                 | % of Sales <sup>1</sup> | 12/31/2013       | % of Sales <sup>1</sup> | 3/31/2014        | % of Sales <sup>1</sup> | 6/30/2014 | % of Sales <sup>1</sup> |
| Sales                                     | \$ 1,162,247,646          | 100.00%                 | \$ 2,450,157,700 | 100.00%                 | \$ 3,779,598,195 | 100.00%                 | \$        | %                       |
| Prizes                                    | \$ 699,802,713            | 60.21%                  | \$ 1,481,034,292 | 60.45%                  | \$ 2,303,991,703 | 60.96%                  | \$        | %                       |
| Operating income to education             | 318,010,935               | 27.36%                  | 668,711,181      | 27.29%                  | 1,017,948,979    | 26.93%                  |           | %                       |
| Revenues returned to public               | \$ 1,017,813,648          | 87.57%                  | \$ 2,149,745,473 | 87.74%                  | \$ 3,321,940,682 | 87.89%                  | \$        | %                       |
| Administrative expenses                   | \$ 144,433,998            | 12.43%                  | \$ 300,412,227   | 12.26%                  | \$ 457,657,513   | 12.11%                  | \$        | %                       |
| Miscellaneous income <sup>2</sup>         | \$ 3,669,263              |                         | \$ 11,592,038    |                         | \$ 17,032,274    |                         | \$        |                         |
| Adjustment                                | \$ 5,720,287 <sup>4</sup> |                         | \$ —             |                         | \$ —             |                         | \$        |                         |
| Allocation to Education Fund <sup>5</sup> | \$ 327,400,485            |                         | \$ 680,303,219   |                         | \$ 1,034,981,253 |                         | \$        |                         |

| Fiscal Year 2012-13                       | Quarter Ended             |                         |                  |                         |                  |                         |                             |                         |
|-------------------------------------------|---------------------------|-------------------------|------------------|-------------------------|------------------|-------------------------|-----------------------------|-------------------------|
|                                           | 9/30/2012                 | % of Sales <sup>1</sup> | 12/31/2012       | % of Sales <sup>1</sup> | 3/31/2013        | % of Sales <sup>1</sup> | 6/30/2013                   | % of Sales <sup>1</sup> |
| 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            | 88.18%                  | \$ 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%                  | \$ 224,601,506   | 11.92%                  | \$ 369,679,624   | 11.72%                  | \$ 532,989,488              | 11.99%                  |
| Miscellaneous income <sup>2</sup>         | \$ 10,591,621             |                         | \$ 15,064,526    |                         | \$ 19,693,087    |                         | \$ 23,581,329               |                         |
| Adjustment                                | \$ 4,715,142 <sup>4</sup> |                         | \$ —             |                         | \$ —             |                         | \$ (5,720,287) <sup>3</sup> |                         |
| Allocation to Education Fund <sup>5</sup> | \$ 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

<sup>1</sup> 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 towards meeting annual statutory requirements.

<sup>2</sup> Miscellaneous income includes SMIF interest earned, unclaimed prizes, and other income.

<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> 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 May 16, 2014**

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May 16, 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 \$354,678,034. This figure represents:

|                                                              |                         |
|--------------------------------------------------------------|-------------------------|
| Operating income for the nine months ended<br>March 31, 2014 | \$ 1,017,948,979        |
| SMIF interest earned                                         | 953,812                 |
| Other income                                                 | 35,238                  |
| Unclaimed prizes                                             | <u>16,043,224</u>       |
|                                                              | <u>\$ 1,034,981,253</u> |
| Less: Transfer for the six months ended<br>December 31, 2013 | \$ 680,303,219          |
|                                                              | <u>\$ 354,678,034</u>   |

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the nine months ended March 31, 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 Nine Months Ending March 31, 2014

|                                               |                   |
|-----------------------------------------------|-------------------|
| Lottery sales                                 | \$3,779,598,195   |
| Prizes                                        | 2,303,991,703     |
|                                               | -----             |
| Sales after prizes                            | \$1,475,606,492   |
|                                               | -----             |
| Less game costs:                              |                   |
| Retailer costs                                | \$259,403,971     |
| On-line game costs                            | 49,482,910        |
| Off-line game costs                           | 20,588,012        |
|                                               | -----             |
| Total game costs                              | \$329,474,893     |
|                                               | -----             |
| Income before operating expenses              | \$1,146,131,599   |
|                                               | -----             |
| Operating expenses:                           |                   |
| Salaries, wages and benefits                  | \$44,147,908      |
| Advertising                                   | 47,779,681        |
| Promotion, public relations and point of sale | 9,923,975         |
| Other professional services                   | 9,867,439         |
| Depreciation and amortization                 | 4,429,401         |
| Other general and administrative expenses     | 12,034,216        |
|                                               | -----             |
| Total operating expenses                      | \$128,182,620     |
|                                               | -----             |
| Operating income                              | \$1,017,948,979   |
| Non-operating (expenses) revenues:            |                   |
| Investment earnings                           | (\$9,617,517)     |
| Other Income                                  | 35,238            |
| Allocation to Education Fund                  | (1,018,938,029)   |
|                                               | -----             |
| Total non-operating (expenses) revenues       | (\$1,028,520,308) |
| Changes in net position                       | (\$10,571,329)    |
| Total net position-beginning of year          | 102,067,701       |
|                                               | -----             |
| Total net position-end of year                | \$91,496,372      |
|                                               | =====             |

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

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