

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended September 30, 2009



JOHN CHIANG
California State Controller

February 2010



JOHN CHIANG
California State Controller

February 19, 2010

John Mass, Chairperson
California Lottery Commission
600 North Tenth Street
Sacramento, California 95811

Dear Mr. Mass:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to public education for the quarter ended September 30, 2009.

The California Lottery requested the transfer of \$301,561,187 to the Lottery Education Fund for disbursement to public education. Our analysis determined that this amount was supported by the Lottery's accounting records, and that the Lottery complied with the annual statutory percentages for prizes, education, and administration. Our analysis also did not disclose any unexplained changes in accounts in comparison with prior periods. On December 30, 2009, \$301,561,187 was transferred to the Lottery Education Fund.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$301,561,187, 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
Chief, Division of Audits

JVB/sk

cc: John Menchaca, Commissioner
California Lottery Commission
Margaret Mims, Commissioner
California Lottery Commission
C.C. Yin, Commissioner
California Lottery Commission
Joan M. Borucki, Director
California Lottery
Michael T. Ota, Deputy Director
Finance Division, California Lottery
Robert Zavala, Chief, Internal Audits
California Lottery
Lottery Audit Committee
California Lottery

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Report of Analysis

Summary

In a letter dated November 16, 2009, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$301,561,187 to the Lottery Education Fund for disbursement to public education. Our review disclosed that the Lottery's accounting records supported this amount and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration. Our analytical review did not disclose any unexplained changes in accounts in comparison with prior periods. Accordingly, on December 30, 2009, \$301,561,187.01 (\$0.01 difference is immaterial) was transferred to the Lottery Education Fund.

Introduction

This report presents the results of our analysis of the Lottery's quarterly request that the SCO transfer funds to public education. 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 public education 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.

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 public education, 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.

Each quarter, the Lottery requests that the SCO transfer net revenues to public education (see Attachment). The Lottery request usually occurs eight to ten weeks after the close of the quarter.

Objectives, Scope, and Methodology

We perform this analysis of the quarterly transfer of funds to public education in order to determine whether:

- Transfer amounts are supported by the Lottery's accounting records; and
- The Lottery is on target to meet the annual allocation requirements specified in the Lottery Act.

We traced the transfer amount to Lottery financial statements and accounting records, and applied analytical review procedures to the lottery fund accounts by comparing them with those from the prior

quarter and the prior year. To monitor progress in meeting the annual statutory requirements, we reviewed the actual costs for prizes and administration, as well as the quarterly fund transfer to public education.

Results

After reviewing the Lottery's unaudited financial statements and supporting records for the quarter ended September 30, 2009, we determined that the Lottery's request to transfer \$301,561,187 to the Lottery Education Fund is supported by formal accounting records.

The letter requesting the transfer to education was received on November 16, 2009, with a draft interim Statement of Revenues, Expenses, and Changes in Net Assets for the three months ending September 30, 2009 (unaudited). On December 17, 2009, we received the final version of the interim financial statement (unaudited).

According to the unaudited financial statements for the quarter ended September 30, 2009, the total amount available for transfer to education was \$289,843,672. In addition, the Lottery transferred the \$4,420,315 withheld from the last quarter of the 2008-09 fiscal year pending the annual financial statement audit and resolution of accounting issues, and \$7,297,200 for the 2008-09 audit adjustment.

The amount transferred to public education was 34.62% of the total revenue for the quarter. The Lottery Act requires the Lottery to transfer at least 34% of the total annual revenue to the benefit of public education. All other income and unclaimed prizes were transferred to public education.

The Lottery complied with the statutory requirement that administrative expenses not exceed 16% of sales. Administrative expenses for the quarter were 11.79% of sales. To the extent that expenses are less than 16% of total annual revenues, the Lottery Act requires the surplus funds to be allocated to benefit public education. The surplus administrative funds were used to increase the prizes to the public. The Lottery returned 53.59% of the total quarterly revenues to the public in the form of prizes.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

February 19, 2010

Schedule 1— Summary of Lottery Transfers and Status of Compliance with Statutory Requirements

Fiscal Year 2009-10	Quarter Ended							
	09/30/2009	%	12/31/2009	%	03/31/2010	%	06/30/2010	%
Sales ¹	\$ 797,978,266	100.00%	\$	%	\$	%	\$	%
Prizes	\$ 427,670,458	53.59%	\$	%	\$	%	\$	%
Administration	\$ 94,051,992	11.79%	\$	%	\$	%	\$	%
Available for Education	\$ 276,255,816	34.62%	\$	%	\$	%	\$	%
Other Income ²	13,587,856							
Adjustment	4,420,315 ⁶							
Adjustment	7,297,200 ³							
Transfer to Education	\$ 301,561,187		\$		\$		\$	

Fiscal Year 2008-09	Quarter Ended							
	09/30/2008	%	12/31/2008	%	03/31/2009	%	06/30/2009	%
Sales ¹	\$ 755,999,049	100.00%	\$ 1,464,063,575	100.00%	\$ 2,208,959,936	100.00%	\$ 2,954,839,094	100.00%
Prizes	\$ 406,906,177	53.82%	\$ 783,073,238	53.49%	\$ 1,170,457,861	52.99%	\$ 1,556,120,634	52.66%
Administration	\$ 97,556,880	12.91%	\$ 186,963,275	12.77%	\$ 282,915,271	12.81%	\$ 392,840,526	13.30%
Available for Education	\$ 251,535,992	33.27%	\$ 494,027,062	33.74%	\$ 755,586,804	34.20%	\$ 1,005,877,934	34.04%
Other Income ⁴	8,674,324		15,960,658		22,389,497		35,518,682	
Adjustment	3,609,618 ⁵		—		—		(4,420,315) ⁶	
Transfer to Education	\$ 263,819,934		\$ 509,987,720		\$ 777,976,301		\$ 1,036,976,301	

Annual Statutory Requirements

Prizes = Approximately 50% of sales
Administration = No more than 16% of sales
Available for education = At least 34% of sales
Other income = 100% due to 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. The first quarter of FY 2009-10 includes proceeds from investments.

³ The amount represents the \$7,297,200 from the 2008-09 audit adjustment.

⁴ Includes interest income, other income, and unclaimed prizes. The fourth quarter of FY 2008-09 includes proceeds from investments.

⁵ This amount represents the \$3,609,618 withheld in the fourth quarter of FY 2007-08, pending the financial audit and resolution of accounting issues.

⁶ This amount represents the \$4,420,315 withheld in the fourth quarter of FY 2008-09, pending the financial audit and resolution of accounting issues.

**Attachment—
California Lottery's
Transfer Request of November 16, 2009**

600 North Tenth Street
Sacramento, CA 95811
calottery.com



November 16, 2009

Mr. Michael Havey, Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 500
Sacramento, CA 95816

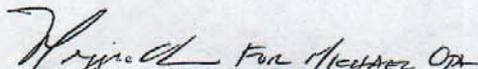
Dear Mr. Havey:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$301,561,187. This figure represents:

Operating income for the three months ended September 30, 2009	\$ 276,255,816
Proceeds from investments	8,264,760
SMIF interest earned	958,970
Other Income	68,170
Unclaimed prizes	<u>4,295,956</u>
	<u>\$ 289,843,672</u>
Amount withheld from 2008-09 fiscal year pending audit:	\$ 4,420,315
2008-2009 audit adjustment	<u>7,297,200</u>
	<u>\$ 301,561,187</u>

We have attached a draft copy of the Statement of Revenues, Expenses and Changes in Net Assets for the three months ended September 30, 2009, prepared from books without audit. The final copy will be available the first week of December. We do not anticipate the amount of the transfer detailed above to change.

Sincerely,


Michael Ota, Deputy Director
Finance Division

Attachment

cc: Joan Borucki, Director

CALIFORNIA STATE LOTTERY FUND
DRAFT - Statement of Revenues, Expenses, and Changes in Net Assets
For the Three Months Ending September 30, 2009

Lottery sales	\$797,978,266
Prizes	427,670,458
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Sales after prizes	\$370,307,808
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Less game costs:	
Retailer costs	\$56,593,913
On-line game costs	8,901,440
Off-line game costs	4,660,201
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Total game costs	\$70,155,554
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Income before operating expenses	\$300,152,254
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Operating expenses:	
Salaries, wages and benefits	\$10,174,669
Advertising	4,412,631
Promotion, public relations and point of sale	1,354,183
Other professional services	2,513,078
Depreciation and amortization	2,523,136
Other general and administrative expenses	2,918,741
	<hr/>
Total operating expenses	\$23,896,438
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Operating income	\$276,255,816
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	\$958,970
Other Income	68,170
Allocation to Education Fund (Note 7)	(285,547,716)
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Total non-operating (expenses) revenues	(\$284,520,576)
Changes in net assets	(\$8,264,760)
Total net assets-beginning of year	147,038,053
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Total net assets-end of year	\$138,773,293
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CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Three Months Ending September 30, 2009

Lottery sales	\$797,978,266
Prizes	427,670,458

Sales after prizes	\$370,307,808

Less game costs:	
Retailer costs	\$56,593,913
On-line game costs	8,901,440
Off-line game costs	4,660,201

Total game costs	\$70,155,554

Income before operating expenses	\$300,152,254

Operating expenses:	
Salaries, wages and benefits	\$10,174,669
Advertising	4,412,631
Promotion, public relations and point of sale	1,354,183
Other professional services	2,513,078
Depreciation and amortization	2,523,136
Other general and administrative expenses	2,918,741

Total operating expenses	\$23,896,438

Operating income	\$276,255,816
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	\$16,301,981
Other Income	68,170
Allocation to Education Fund (Note 7)	(285,547,716)

Total non-operating (expenses) revenues	(\$269,177,565)
Changes in net assets	\$7,078,251
Total net assets-beginning of year	147,038,053

Total net assets-end of year	\$154,116,304
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**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

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