

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended June 30, 2006



JOHN CHIANG
California State Controller

March 2007



JOHN CHIANG
California State Controller

March 13, 2007

Joan M. Borucki
Acting Director
California Lottery
600 North Tenth Street
Sacramento, California 95814

Dear Ms. Borucki:

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 June 30, 2006.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$319,000,000, 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, Operations Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/vb

cc: John Mass, Commissioner
California Lottery Commission
Rachel Montes, Commissioner
California Lottery Commission
Manuel Ortega, Commissioner
California Lottery Commission
Patt Eberhart, Director
Finance and Administration
California Lottery
Stacy Matsunami, Director
Special Projects
California Lottery
Cathleen Dinubilo, Chief
Internal Audits Office
California Lottery

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Report of Analysis

Summary

In a letter dated August 25, 2006, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$319,000,000 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 complied with the annual statutory percentages for prizes, education, and administration. Our analytical review did not disclose any unexplained changes in accounts in a comparison with prior periods. Accordingly, on September 29, 2006, \$318,999,989.37 was transferred to the Lottery Education Fund. The difference of \$10.63 is due to rounding in prior quarters.

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 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 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 in compliance with 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

Results

statutory requirements, we reviewed the actual costs for prizes and administration, as well as the quarterly fund transfer to public education. After reviewing the Lottery's audited financial statements and supporting records for the year ended June 30, 2006, we determined that the Lottery's request to transfer \$319,000,000 to the Lottery Education Fund is supported by formal accounting records.

According to the Lottery's audited financial statements, the total amount available for transfer to education was \$1,287,998,079 for the year ended June 30, 2006. Of this amount, \$331,176,296 was transferred to the Lottery Education Fund on December 30, 2005, \$300,474,484 was transferred on March 30, 2006, and \$336,968,618 was transferred on June 28, 2006, with a net of \$378,681 in audit adjustments for the year, leaving a balance of \$319,000,000. This balance was transferred to the Lottery Education Fund on September 29, 2006.

The amount transferred to public education was 34.57% 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 11.52% 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 53.91% of the total quarterly revenues to the public in the form of prizes.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

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

Fiscal Year 2005-06	Quarter Ended							
	09/30/2005	%	12/31/2005	%	03/31/2006	%	06/30/2006	%
Sales ¹	\$ 884,100,492	100.00%	\$ 1,751,695,899	100.00%	\$ 2,679,710,604	100.00%	\$ 3,584,996,251	100.00%
Prizes	\$ 473,050,791	53.51%	\$ 948,661,697	54.16%	\$ 1,447,084,544	54.00%	\$ 1,932,721,443	53.91%
Administration	\$ 95,823,919	10.84%	\$ 198,884,893	11.35%	\$ 302,950,716	11.31%	\$ 413,062,844	11.52%
Available for Education	\$ 315,225,782	35.65%	\$ 604,149,309	34.49%	\$ 929,675,344	34.69%	\$ 1,239,211,964	34.57%
Other Income ²	12,419,435		23,970,392		35,412,975		48,786,115	
Adjustment	3,531,079 ⁴		—		—		(3,909,760) ⁵	
Transfer to Education	\$ 331,176,296		\$ 628,119,701		\$ 965,088,319		\$ 1,284,088,319	

Fiscal Year 2004-05	Quarter Ended							
	09/30/2004	%	12/31/2004	%	03/31/2005	%	06/30/2005	%
Sales ¹	\$ 853,243,096	100.00%	\$ 1,632,680,254	100.00%	\$ 2,518,845,464	100.00%	\$ 3,333,620,669	100.00%
Prizes	\$ 458,527,650	53.74%	\$ 882,042,739	54.02%	\$ 1,362,674,497	54.10%	\$ 1,795,254,439	53.85%
Administration	\$ 98,430,223	11.54%	\$ 187,276,925	11.47%	\$ 288,647,332	11.46%	\$ 400,439,863	12.01%
Available for Education	\$ 296,285,223	34.72%	\$ 563,360,590	34.51%	\$ 867,523,635	34.44%	\$ 1,137,926,367	34.14%
Other Income ²	8,786,242		17,769,673		28,739,541		37,867,888	
Adjustment	3,493,436 ³		—		—		(3,531,079) ⁴	
Transfer to Education	\$ 308,564,901		\$ 581,130,263		\$ 896,263,176		\$ 1,172,263,176	

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.

³ The amount represents the \$3,493,436 withheld in the fourth quarter of FY 2003-04, pending the financial audit.

⁴ The amount represents the \$3,531,079 withheld in the fourth quarter of FY 2004-05, pending the financial audit and resolution of accounting issues.

⁵ This amount represents the \$3,909,760 withheld in the fourth quarter of FY 2005-06, pending the financial audit and resolution of accounting issues.

**Attachment—
California Lottery's
Transfer Request of August 25, 2006**



California Lottery

Headquarters

600 North Tenth Street

Sacramento, CA 95814

August 25, 2006

Mr. John A. Korach, Accounting Division Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 500
Sacramento, CA 958163

Dear Mr. Korach:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$319,000,000. This figure represents:

Operating income for the year ended June 30, 2006	\$1,239,211,964
SMIF interest earned	18,442,836
Other income	853,117
Unclaimed prizes	<u>29,490,162</u>
	\$1,287,998,079
Less:	
Transfer for the nine months ended March 31, 2006	<u>965,088,319</u>
	\$ 322,909,760
Amount withheld pending audit	<u>(3,909,760)</u>
	<u>\$ 319,000,000</u>

We have completed the financial statements for the year ended June 30, 2006. We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets, prepared from books without audit, for your files.

Sincerely,

Patricia Eberhart
Patricia Eberhart, Director
Finance and Administration Division

Attachment

cc: Joan Borucki, Acting Director

CALIFORNIA STATE LOTTERY FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2006
Prepared From Books Without Audit

Operating revenues: Lottery sales	\$ 3,584,996,251
Prizes	<u>1,932,721,443</u>
Sales after prizes	<u>1,652,274,808</u>
Less game costs:	
Retailer costs	252,543,062
Draw game costs	37,277,061
Instant ticket game costs	<u>21,144,506</u>
Total game costs	<u>310,964,629</u>
Income before operating expenses	<u>1,341,310,179</u>
Operating expenses	
Salaries, wages, and benefits	41,201,111
Advertising	25,495,083
Promotion, public relations, and point of sale	9,307,150
Other professional services	5,959,870
Depreciation and amortization	8,745,427
Other general and administrative expenses	<u>11,389,575</u>
Total operating expenses	<u>102,098,215</u>
Operating income	1,239,211,964
Non-operating (expenses) revenues	
Investment earnings	(153,232,777)
Other income	853,117
Allocation to Education Fund	<u>(1,258,507,917)</u>
Total non-operating (expenses) revenues	(1,410,887,577)
Change in net assets	(171,675,613)
Total net assets - beginning balance	<u>275,906,630</u>
Total net assets - ending balance	<u>\$ 104,231,017</u>

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

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