

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended June 30, 2009



JOHN CHIANG
California State Controller

December 2009



JOHN CHIANG
California State Controller

December 11, 2009

John Mass, Chair
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 June 30, 2009.

The California Lottery requested the transfer of \$259,000,000 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 did not disclose any unexplained changes in accounts in comparison with prior periods. On September 30, 2009, \$259,000,000 was transferred to the Lottery Education Fund.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$259,000,000, 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, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/sk:vb

cc: Cynthia Flores, 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

Contents

Report of Analysis

| | |
|---|---|
| Summary | 1 |
| Introduction | 1 |
| Background | 1 |
| Objectives, Scope, and Methodology | 1 |
| Results | 2 |
| Schedule 1—Summary of Lottery Transfers and Status of Compliance with Statutory Requirements | 3 |
| Attachment—California Lottery’s Transfer Request of September 23, 2009 | |

Report of Analysis

Summary

In a letter dated September 23, 2009, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$259,000,000 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 compared with prior periods. Accordingly, on September 30, 2009, \$259,000,000 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 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 performed 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 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 June 30, 2009, we determined that the Lottery's request to transfer \$259,000,000 to the Lottery Education Fund is supported by formal accounting records.

According to the Lottery's unaudited financial statements, the total amount available for transfer to education was \$1,041,396,616 for the year ended June 30, 2009. Of this amount, \$263,819,934 was transferred to the Lottery Education fund on December 30, 2008; \$249,777,404 was transferred on March 30, 2009; and \$267,988,581 was transferred on June 29, 2009; with a net of \$810,697 in audit adjustments for the year, leaving a balance of \$259,000,000. This balance was transferred to the Lottery Education Fund on September 30, 2009.

The amount transferred to public education was 34.04% of the total revenue for the 12 months ended June 30, 2009. 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 13.30% 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.

Subsequent to the transfer to education, we compared the unaudited Statement of Revenues, Expenses, and Changes in Net Assets with the audited Statement of Revenues, Expenses, and Changes in Net Assets received on October 30, 2009. We noticed an increase in the Allocation to Education line item; this adjustment was the result of the Lottery's "Investment Restructuring Program" that allowed the Lottery to realize gains on the sale of its investment portfolio totaling \$16,132,183. Of this amount, \$5,484,942 (which represents 34% of the \$16,132,183) was paid to Education; resulting in a balance owed to Education in the amount of \$10,647,241. The \$10,647,241 is offset by a \$3,350,040 impairment loss on the destruction of a portion of its current headquarters, resulting in a net adjustment of \$7,297,200 due to education. This amount will be added to the First Quarter Transfer for 2009-2010.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

December 11, 2009

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

| 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 ² | 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 | |

| Fiscal Year 2007-08 | Quarter Ended | | | | | | | |
|---------------------------|-------------------------|---------|------------------|---------|------------------|---------|--------------------------|---------|
| | 09/30/2007 | | 12/31/2007 | | 03/31/2008 | | 06/30/2008 | |
| | | % | | % | | % | | % |
| Sales ¹ | \$ 827,465,875 | 100.00% | \$ 1,568,732,800 | 100.00% | \$ 2,359,593,377 | 100.00% | \$ 3,049,620,915 | 100.00% |
| Prizes | \$ 439,733,766 | 53.14% | \$ 838,191,741 | 53.44% | \$ 1,260,396,296 | 53.42% | \$ 1,619,473,498 | 53.10% |
| Administration | \$ 95,226,483 | 11.51% | \$ 183,456,973 | 11.69% | \$ 278,729,972 | 11.81% | \$ 380,245,309 | 12.47% |
| Available for Education | \$ 292,505,626 | 35.35% | \$ 547,084,086 | 34.87% | \$ 820,467,109 | 34.77% | \$ 1,049,902,108 | 34.43% |
| Other Income ² | 14,163,923 | | 25,392,692 | | 36,868,582 | | 45,043,201 | |
| Adjustment | 3,997,089 ³ | | — | | — | | — | |
| Adjustment | 14,063,700 ⁴ | | — | | — | | — | |
| Adjustment | — | | — | | — | | (3,609,618) ⁵ | |
| Transfer to Education | \$ 324,730,338 | | \$ 572,476,778 | | \$ 857,335,691 | | \$ 1,091,335,691 | |

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 fourth quarter of FY 2008-09 includes proceeds from investments.

³ The amount represents the \$3,997,089 withheld in the fourth quarter of FY 2006-07, pending the financial audit and resolution of accounting issues.

⁴ The amount represents the \$14,063,700 audit adjustment for the fourth quarter FY 2006-07, due to reduction in on-line direct ticket costs.

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 September 23, 2009**

600 North Tenth Street
Sacramento, CA 95811
calottery.com



calottery

September 23, 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 \$259,000,000. This figure represents:

| | |
|--|------------------------|
| Operating income for the year ended June 30, 2009 | \$1,005,877,934 |
| Proceeds from investments | 5,484,942 |
| SMIF interest earned | 8,660,794 |
| Other Income | 408,089 |
| Unclaimed prizes | <u>20,964,857</u> |
| | <u>\$1,041,396,616</u> |
| | |
| Less: Transfer for the nine months ended March 31, 2009 | \$ 777,976,301 |
| | |
| Amount withheld pending audit | <u>(4,420,315)</u> |
| | <u>\$ 259,000,000</u> |

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the year ended June 30, 2009, prepared from books without audit, for your files.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael Ota".

Michael Ota, Deputy Director
Finance Division

Addressee

2

9/23/2009

Attachment

cc: Joan Borucki, Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Twelve Months Ending June 30, 2009

| | |
|---|-------------------|
| Lottery sales | \$2,954,839,094 |
| Prizes | 1,556,120,634 |
| | ----- |
| Sales after prizes | \$1,398,718,460 |
| | ----- |
| Less game costs: | |
| Retailer costs | \$208,105,703 |
| On-line game costs | 33,687,063 |
| Off-line game costs | 17,217,368 |
| | ----- |
| Total game costs | \$259,010,134 |
| | ----- |
| Income before operating expenses | \$1,139,708,326 |
| | ----- |
| Operating expenses: | |
| Salaries, wages and benefits | \$49,167,677 |
| Advertising | 42,184,700 |
| Promotion, public relations and point of sale | 14,064,197 |
| Other professional services | 7,449,016 |
| Depreciation and amortization | 9,615,027 |
| Other general and administrative expenses | 11,349,775 |
| | ----- |
| Total operating expenses | \$133,830,392 |
| | ----- |
| Operating income | \$1,005,877,934 |
| Non-operating (expenses) revenues: | |
| Investment earnings (Note 9) | \$6,747,951 |
| Other Income | 408,089 |
| Allocation to Education Fund (Note 7) | (1,020,431,759) |
| | ----- |
| Total non-operating (expenses) revenues | (\$1,013,275,719) |
| Changes in net assets | (\$7,397,785) |
| Total net assets-beginning of year | 165,083,079 |
| | ----- |
| Total net assets-end of year | \$157,685,294 |
| | ===== |

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

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