

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended September 30, 2008



JOHN CHIANG
California State Controller

March 2009



JOHN CHIANG
California State Controller

March 13, 2009

Joan M. Borucki, Director
California Lottery
600 North Tenth Street
Sacramento, California 95811

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 September 30, 2008.

The Lottery requested the transfer of \$263,819,934 to the Lottery Education Fund for disbursement to public education. Our analysis determined that this amount was supported by the Lottery's accounting records. We also determined that no unexplained changes in accounts existed when compared with prior periods. On December 30, 2008, \$263,819,934.23 was transferred to the Lottery Education Fund. The difference of \$0.23 is due to rounding errors in the prior quarters.

We would like to bring to your attention that only 33.27% of revenues was transferred to public education for the first quarter ended September 30, 2008. The Lottery Act specifically requires that at least 34% of the total annual revenues be allocated to benefit public education. To ensure compliance with the statutory requirement, the Lottery should closely monitor its prize payments and administrative costs in relationship to sales and make appropriate adjustments during the second, third, and/or fourth quarters.

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:sr

cc: John Mass, Commissioner
California Lottery Commission
Cynthia Flores, Commissioner
California Lottery Commission
C.C. Yin, Commissioner
California Lottery Commission
Michael T. Ota, Deputy Director
Finance Division
California Lottery
Robert Zavala, Chief
Internal Audits
California Lottery

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Report of Analysis

Summary

In a letter dated November 19, 2008, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$263,819,934 to the Lottery Education Fund for disbursement to public education. The SCO's review disclosed that this amount was supported by the CSL accounting records. However, only 33.27% of revenues was transferred to public education for the three months ended September 30, 2008. The Lottery Act specifically requires that at least 34% of the total annual revenues be allocated to benefit public education. To ensure compliance with this statutory requirement, the Lottery should make the appropriate adjustments to prize payments or administrative costs during the second, third, and/or fourth quarter. The SCO's analytical review did not disclose any unexplained changes in accounts in a comparison with prior periods. Accordingly, on December 30, 2008, \$263,819,934.23 was transferred to the Lottery Education Fund. The difference of \$0.23 is due to rounding errors 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 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, 2008, we determined that the Lottery's request to transfer \$263,819,934 to the Lottery Education Fund is supported by formal accounting records.

According to the unaudited financial statements for the quarter ended September 30, 2008, the total amount available for transfer to education was \$260,210,316. In addition, the Lottery transferred the \$3,609,618 withheld from the last quarter of the 2007-08 fiscal year pending the annual financial statement audit and resolution of accounting issues.

The amount transferred to public education was 33.27% 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. To comply with this annual statutory requirement, the Lottery should increase the transfer in the second, third, and/or fourth quarters. The Lottery could have accomplished this goal by reducing prize payments and/or administrative costs in this quarter and allocating the excess funds to benefit public education.

The Lottery complied with the statutory requirement that administrative expenses not exceed 16% of sales. Administrative expenses for the quarter were 12.91% 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 53.82% of the total quarterly revenues to the public in the form of prizes.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

March 13, 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%	\$		\$		\$	
Prizes	\$ 406,906,177	53.82%	\$		\$		\$	
Administration	\$ 97,556,880	12.91%	\$		\$		\$	
Available for Education	\$ 251,535,992	33.27%	\$		\$		\$	
Other Income ²	8,674,324							
Adjustment	3,609,618 ⁵							
Transfer to Education	\$ 263,819,934		\$		\$		\$	

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.

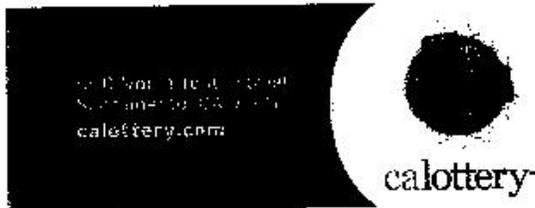
² Includes interest income, other income, and unclaimed prizes.

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.

**Attachment—
California Lottery's
Transfer Request of November 19, 2008**



November 19, 2008

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

Dear Mr. Korach:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$263,819,934. This figure represents:

Operating income for the three months ended September 30, 2008	\$ 251,535,992
SMIF interest earned	2,704,179
Other Income	124,129
Unclaimed prizes	<u>5,846,016</u>
	\$ <u>260,210,316</u>
Amount withheld from 2007-2008 fiscal year Pending audit:	\$ 3,609,618
	<u>\$ 263,819,934</u>

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the three months ended September 30, 2008, prepared from books without audit, for your files.

Sincerely,

Michael Ota

Michael Ota, Deputy Director
Finance Division

Attachment
cc: Joan Borucki, Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Three Months Ending September 30, 2008

Lottery sales	\$755,999,049
Prizes	406,906,177
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Sales after prizes	\$349,092,872
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Less game costs:	
Retailer costs	\$53,769,349
On-line game costs	8,274,145
Off-line game costs	4,204,005
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Total game costs	\$66,247,499
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Income before operating expenses	\$282,845,373
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Operating expenses:	
Salaries, wages and benefits	\$11,315,395
Advertising	7,016,723
Promotion, public relations and point of sale	5,979,441
Other professional services	1,256,969
Depreciation and amortization	2,250,172
Other general and administrative expenses	3,490,681
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Total operating expenses	\$31,309,381
	<hr/>
Operating income	\$251,535,992
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Non-operating (expenses) revenues:	
Investment earnings (Note 9)	\$9,087,138
Other Income	124,129
Allocation to Education Fund (Note 7)	(254,364,300)
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Total non-operating (expenses) revenues	(245,153,033)
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Changes in net assets	\$6,382,959
Total net assets-beginning of year	165,083,079
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Total net assets-end of year	\$171,466,038
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**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

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