

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended March 31, 2007



JOHN CHIANG
California State Controller

September 2007



JOHN CHIANG
California State Controller

September 19, 2007

Joan M. Borucki, 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 March 31, 2007.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$341,664,386, 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/jj

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
Cathleen Dinubilo, Chief
Internal Audits Office
California Lottery

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Report of Analysis

Summary

In a letter dated May 21, 2007, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$341,664,386 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 a comparison with prior periods. Accordingly, on June 28, 2007, \$341,664,381.03 (the difference of \$4.97 is due to rounding errors in prior quarters) 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 dated May 21, 2007, and supporting records for the nine-month period ended March 31, 2007, we determined that the Lottery's request to transfer \$341,664,386 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 \$914,086,293 for the nine-month period ended March 31, 2007. Of this amount, \$285,999,352 was transferred to the Lottery Education Fund on December 28, 2006, and \$286,422,555 was transferred on March 30, 2007, leaving a balance of \$341,664,386. This balance was transferred to the Lottery Education Fund on June 28, 2007.

The amount transferred to public education was 34.44% 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 12.05% 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.

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 2006-07	Quarter Ended							
	09/30/2006	%	12/31/2006	%	03/31/2007	%	06/30/2007	%
Sales ¹	\$ 790,585,222	100.00%	\$ 1,604,229,558	100.00%	\$ 2,540,930,473	100.00%	\$	
Prizes	\$ 424,411,747	53.68%	\$ 864,608,763	53.89%	\$ 1,359,562,937	53.51%	\$	
Administration	\$ 93,397,271	11.82%	\$ 193,449,040	12.06%	\$ 306,246,677	12.05%	\$	
Available for Education	\$ 272,776,204	34.50%	\$ 546,171,755	34.05%	\$ 875,120,859	34.44%	\$	
Other Income ²	13,223,148		553,314		38,965,434			
Adjustment	3,909,760 ³		—		—			
Transfer to Education	\$ 289,909,112		\$ 546,725,069		\$ 914,086,293		\$	

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) ³	
Transfer to Education	\$ 331,176,296		\$ 628,119,701		\$ 965,088,319		\$ 1,284,088,319	

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 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.

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.

**Attachment—
California Lottery's
Transfer Request of March 31, 2007**



California Lottery
Headquarters
600 North Tenth Street
Sacramento, CA 95814

May 21, 2007

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 \$341,664,386. This figure represents:

Operating income for the nine months ended March 31, 2007	\$ 875,120,859
SMIF interest earned	17,002,640
Other Income	830,994
Unclaimed prizes	<u>21,131,800</u>
	<u>\$ 914,086,293</u>
Less: Transfer for the six months Ended December 31, 2006:	<u>572,421,907</u>
	<u>\$ 341,664,386</u>

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the nine months ended March 31, 2007, prepared from books without audit, for your files.

Sincerely,


Patricia Eberhart, Deputy Director
Finance and Administration Division

Attachment

cc: Joan Borucki, Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Nine Months Ending March 31, 2007
Prepared from Books without Audit

Lottery sales	\$2,540,930,473
Prizes	<u>1,359,562,937</u>
Sales after prizes	1,181,367,536
Less game costs:	
Retailer costs	178,657,191
On-line game costs	28,617,833
Off-line game costs	<u>14,398,235</u>
Total game costs	221,673,259
Income before operating expenses	959,694,277
Operating expenses:	
Salaries, wages and benefits	31,981,885
Advertising	26,448,495
Promotion, public relations and point of sale	6,643,490
Other professional services	4,407,337
Depreciation and amortization	6,895,173
Other general and administrative expenses	<u>8,197,038</u>
Total operating expenses	84,573,418
Operating income	875,120,859
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	43,988,856
Other Income	830,994
Allocation to Education Fund (Note 7)	<u>(892,954,493)</u>
Total non-operating (expenses) revenues	(848,134,643)
Changes in net assets	26,986,216
Total net assets-beginning of year	104,231,017
Total net assets-end of year	<u>\$131,217,233</u>

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

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