

# **CALIFORNIA LOTTERY**

Report of Analysis

## **QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION**

*For the Quarter Ended June 30, 2008*



**JOHN CHIANG**  
California State Controller

December 2008



**JOHN CHIANG**  
California State Controller

December 12, 2008

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 June 30, 2008.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$234,000,000 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

cc: John Mass, Commissioner  
California Lottery Commission  
Cynthia Flores, Commissioner  
California Lottery Commission  
Manuel Ortega, 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 August 25, 2008, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$234,000,000 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 30, 2008, \$234,000,002.68 was transferred to the Lottery Education Fund. The difference of \$2.68 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 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 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 audited financial statements and supporting records for the year ended June 30, 2008, we determined that the Lottery's request to transfer \$234,000,000 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 \$1,091,335,691 for the year ended June 30, 2008. Of this amount, \$306,669,549 (an additional \$18,060,789 of adjustments were transferred that were related to the fourth quarter of fiscal year 2006-07) was transferred to the Lottery Education Fund on December 28, 2007, \$265,807,229 was transferred on March 28, 2008, and \$284,858,913 was transferred on June 27, 2008, leaving a balance of \$234,000,000. This balance was transferred to the Lottery Education Fund on September 30, 2008.

The amount transferred to public education was 34.43% 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 12.47% 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 53.10% of the total quarterly revenues to the public in the form of prizes.

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

December 12, 2008

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

Fiscal Year 2007-08	Quarter Ended							
	09/30/2007	%	12/31/2007	%	03/31/2008	%	06/30/2008	%
Sales <sup>1</sup>	\$ 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 <sup>2</sup>	14,163,923		25,392,692		36,868,582		45,043,201	
Adjustment	3,997,089 <sup>4</sup>		—		—		—	
Adjustment	14,063,700 <sup>5</sup>		—		—		—	
Adjustment	—		—		—		(3,609,618) <sup>6</sup>	
Transfer to Education	\$ 324,730,338		\$ 572,476,778		\$ 857,335,691		\$ 1,091,335,691	

Fiscal Year 2006-07	Quarter Ended							
	09/30/2006	%	12/31/2006	%	03/31/2007	%	06/30/2007	%
Sales <sup>1</sup>	\$ 790,585,222	100.00%	\$ 1,604,229,558	100.00%	\$ 2,540,930,473	100.00%	\$ 3,318,346,505	100.00%
Prizes	\$ 424,411,747	53.68%	\$ 864,608,763	53.89%	\$ 1,359,562,937	53.51%	\$ 1,765,643,368	53.21%
Administration	\$ 93,397,271	11.82%	\$ 193,449,040	12.06%	\$ 306,246,677	12.05%	\$ 414,334,148	12.49%
Available for Education	\$ 272,776,204	34.50%	\$ 546,171,755	34.05%	\$ 875,120,859	34.44%	\$ 1,138,368,989	34.30%
Other Income <sup>2</sup>	13,223,148		553,314		38,965,434		(3,997,089) <sup>4</sup>	
Adjustment	3,909,760 <sup>3</sup>		—		—			
Transfer to Education	\$ 289,909,112		\$ 546,725,069		\$ 914,086,293		\$ 1,188,086,293	

### 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.

<sup>1</sup> Quarterly amounts represent fiscal year-to-date totals.

<sup>2</sup> Includes interest income, other income, and unclaimed prizes.

<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> 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.

<sup>6</sup> 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 August 25, 2008**

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**California Lottery**

*Headquarters*

600 North Tenth Street

Sacramento, CA 95814

**August 25, 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 \$234,000,000. This figure represents:

Operating income for the year ended June 30, 2008	\$1,049,902,108
SMIF interest earned	18,575,657
Other Income	850,326
Unclaimed prizes	<u>25,617,218</u>
	<u>\$1,094,945,309</u>
Less: Transfer for the nine months ended March 31, 2008:	\$ 857,335,691
Amount withheld pending audit	<u>(3,609,618)</u>
	<u>\$ 234,000,000</u>

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

Please note that this request was held pending receipt of information from your agency regarding Governmental Accounting Standards Board Statement No. 45 reporting requirements that was received on August 22, 2008.

Sincerely,

*Michael Ota*

**Michael Ota, Deputy Director  
Finance Division**

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

Lottery sales	\$3,049,620,915
Prizes	1,619,473,498
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Sales after prizes	\$1,430,147,417
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Less game costs:	
Retailer costs	\$213,022,175
On-line game costs	37,250,758
Off-line game costs	15,780,718
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Total game costs	\$266,053,651
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Income before operating expenses	\$1,164,093,766
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Operating expenses:	
Salaries, wages and benefits	\$48,431,055
Advertising	26,790,304
Promotion, public relations and point of sale	9,035,786
Other professional services	7,703,086
Depreciation and amortization	9,069,714
Other general and administrative expenses	13,161,713
	<hr/>
Total operating expenses	\$114,191,658
	<hr/>
Operating income	\$1,049,902,108
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	\$68,343,337
Other Income	850,326
Allocation to Education Fund (Note 7)	(1,069,328,092)
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Total non-operating (expenses) revenues	(\$980,134,429)
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Changes in net assets	\$69,767,679
Total net assets-beginning of year	95,315,400
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Total net assets-end of year	\$165,083,079
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**State Controller's Office  
Division of Audits  
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Sacramento, CA 94250-5874**

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