

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended December 31, 2008



JOHN CHIANG
California State Controller

April 2009



JOHN CHIANG
California State Controller

April 30, 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 December 31, 2008.

The Lottery requested the transfer of \$249,777,404 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 charges in accounts existed when compared with prior periods. On March 30, 2009, \$249,777,403.17 was transferred to the Lottery Education Fund. The difference of \$0.83 is due to rounding errors in the prior quarters.

Our review disclosed that only 33.74% of revenues was transferred to public education for the six-month period ended December 31, 2008. However, the Lottery transferred 34.25% of revenues for the three-month period of October 1 through December 31, 2008, to public education. If the Lottery continues this trend, the Lottery should meet the 34% annual statutory requirement. To ensure compliance with the statutory requirement, the Lottery should continue to closely monitor its prize payments and administrative costs in relationship to sales, and make appropriate adjustments before the end of the fiscal year.

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
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 February 26, 2009, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$249,777,404 to the Lottery Education Fund for disbursement to public education. The SCO's review disclosed that this amount was supported by the Lottery's accounting records. In addition, our review noted that only 33.74% of revenues was transferred to public education for the six-month period ended December 31, 2008. However, the Lottery transferred 34.25 % of revenues for the three-month period of October 1 through December 31, 2008, to public education. If the Lottery continues this trend, the Lottery should meet the 34% annual statutory requirement. To ensure compliance with the statutory requirement, the Lottery should continue to closely monitor its prize payments and administrative costs in relationship to sales, and make appropriate adjustments before the end of the fiscal year.

The SCO's analytical review did not disclose any unexplained changes in accounts in a comparison with prior periods. Accordingly, on March 30, 2009, \$249,777,403.17 was transferred to the Lottery Education Fund. The difference of \$0.83 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 performed this analysis of the quarterly transfer of funds to public education in order to determine whether:

- Transferred 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 December 31, 2008, we determined that the Lottery's request to transfer \$249,777,404 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 \$509,987,720 for the six-month period ended December 31, 2008. Of this amount, \$263,819,934 (an additional \$3,609,618 of adjustments were transferred which were related to the fourth quarter of fiscal year 2007-08) was transferred to the Lottery Education Fund on December 30, 2008, leaving a balance of \$249,777,404. This balance was transferred to the Lottery Education Fund on March 30, 2009.

The Lottery transferred only 33.74% of revenues to public education for the six-month period ended December 31, 2008. However, the Lottery transferred 34.25 % of revenues for the three-month period of October 1 through December 31, 2008, to public education. If the Lottery continues this trend, the Lottery should meet the 34% annual statutory requirement. 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 12.77% 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 53.49% of the total quarterly revenues to the public in the form of prizes.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

April 30, 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%	\$		\$	
Prizes	\$ 406,906,177	53.82%	\$ 783,073,238	53.49%	\$		\$	
Administration	\$ 97,556,880	12.91%	\$ 186,963,275	12.77%	\$		\$	
Available for Education	\$ 251,535,992	33.27%	\$ 494,027,062	33.74%	\$		\$	
Other Income ²	8,674,324		15,960,658					
Adjustment	3,609,618 ⁵		—					
Transfer to Education	\$ 263,819,934		\$ 509,987,720		\$		\$	

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 February 26, 2009**

600 North Tenth Street
Sacramento, CA 95811
calottery.com

calottery

February 26, 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 \$249,777,404. This figure represents:

Operating income for the six months ended December 31, 2008	\$ 494,027,062
SMIF interest earned	5,231,834
Other Income	241,090
Unclaimed prizes	<u>10,487,734</u>
	<u>\$ 509,987,720</u>
Less: Transfer for the three months ended September 30, 2008	\$ 260,210,316
	<u>\$ 249,777,404</u>

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the six months ended December 31, 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 Six Months Ending December 31, 2008

Lottery sales	\$1,464,063,575
Prizes	783,073,238
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Sales after prizes	\$680,990,337
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Less game costs:	
Retailer costs	\$103,660,493
On-line game costs	16,628,239
Off-line game costs	8,164,075
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Total game costs	\$128,452,807
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Income before operating expenses	\$552,537,530
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Operating expenses:	
Salaries, wages and benefits	\$22,741,160
Advertising	12,845,620
Promotion, public relations and point of sale	8,913,215
Other professional services	2,731,538
Depreciation and amortization	4,579,793
Other general and administrative expenses	6,699,142
	<hr/>
Total operating expenses	\$58,510,468
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Operating income	\$494,027,062
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Non-operating (expenses) revenues:	
Investment earnings (Note 9)	\$110,813,994
Other income	241,090
Allocation to Education Fund (Note 7)	(499,499,986)
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Total non-operating (expenses) revenues	(\$388,644,902)
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Changes in net assets	\$105,382,160
Total net assets-beginning of year	165,083,079
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Total net assets-end of year	\$270,465,239
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**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

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