

CALIFORNIA STATE LOTTERY

Review Report

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended September 30, 2019



BETTY T. YEE
California State Controller

February 2021



BETTY T. YEE
California State Controller

February 23, 2021

Alva Vernon Johnson, Director
California State Lottery
700 North Tenth Street
Sacramento, CA 95811

Dear Mr. Johnson:

The State Controller's Office reviewed the financial documentation supporting the California State Lottery's (Lottery) transfer of funds to the public education community for the quarter ended September 30, 2019. Our review found that the transfer amount of \$417,662,032 is supported by the Lottery's accounting records, and that the Lottery was on target to meet annual revenue allocation requirements for prize payouts, funds to education, and administrative expenses as specified in the Lottery Act for the fiscal year ended June 30, 2020.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, by telephone at (916) 324-6310, or by email at afinlayson@sco.ca.gov.

Sincerely,

Original signed by

MICHAEL REEVES, CPA
ACTING CHIEF, DIVISION OF AUDITS

MR/as

cc: Gregory Ahern, Chair
California State Lottery Commission
Nathaniel Kirtman III, Commissioner
California State Lottery Commission
Keetha Mills, Commissioner
California State Lottery Commission
Peter Stern, Commissioner
California State Lottery Commission
Nicholas Buchen, Deputy Director, Finance Division
California State Lottery
James Shannon, Audit Manager, Internal Audits
California State Lottery

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Attachment—California State Lottery’s Transfer Request Dated November 25, 2019

Review Report

Summary

The California State Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$417,662,032 to the Lottery Education Fund for disbursement to the public education community for the quarter ended September 30, 2019. Based on the work performed, we determined that the requested transfer amount was supported by the Lottery's accounting records. In addition, we determined that the Lottery was on target to meet annual revenue allocation requirements for prize payouts, funds to education, and administrative expenses as specified in the California State Lottery Act of 1984 (Lottery Act) for the fiscal year ended June 30, 2020.

Background

On November 6, 1984, California voters passed Proposition 37, the Lottery Act, which authorized the creation of a state-operated lottery. The Lottery Act is found in Chapter 12.5, section 8880 et seq., of the Government Code.

The Lottery Act requires revenues from the Lottery to be allocated to maximize the amount of funding allocated to the public education community. The Lottery Act requires that not less than 87% of the total annual revenues from Lottery ticket sales be returned to the public in the form of prize payouts and funds to education and not more than 13% be allocated for administrative expenses. Furthermore, the Lottery Act requires that not less than 50% of the total annual Lottery revenues, in an amount to be determined by the California State Lottery Commission (Commission), be returned to the public in the form of prize payouts. In addition, the Commission must establish the percentages to be allocated to the benefit of public education.

Government Code section 8880.46.6 (the Lottery Act) states in part that the SCO shall conduct quarterly and annual audits of all accounts and transactions of the Commission and other special audits as the State Controller deems necessary. The Controller has the authority to examine any and all records of the Commission, its distributing agencies, Lottery contractors, and Lottery retailers.

Each quarter, the Lottery requests that the SCO transfer funds to the Lottery Education Fund (Attachment). The Lottery's request usually occurs eight to 10 weeks after the close of each quarter.

Objectives, Scope, and Methodology

The objectives of our analysis were to determine whether:

- The requested transfer amount is supported by accounting records; and
- The Lottery was on target to meet the annual allocation requirements specified in the Lottery Act.

We performed this analysis for the first quarter ended September 30, 2019. To achieve our objectives, we:

- Compared current fiscal year audited income statement balances with prior fiscal year audited income statement balances and performed analytical procedures for variances over 15%;
- Traced amounts reported in the income statement to the Lottery's accounting records;
- Judgmentally selected sales and expense items, based on dollar amount and type, and traced them to supporting documentation;¹
- Determined whether the Lottery met the annual revenue allocation requirements specified in the Lottery Act;
- Determined whether the requested transfer amount to the Lottery Education Fund occurred; and
- Verified that the funds were transferred from the Lottery Education Fund to the public education community for the current quarter.

Results

Based on the work performed, we determined that the requested transfer amount of \$417,662,032 for the first quarter ended September 30, 2019, is supported by the Lottery's accounting records. In addition, we determined that the Lottery was on target to meet annual revenue allocation requirements for prize payouts, funds to education, and administrative expenses as specified in the Lottery Act for the quarter ended September 30, 2019.

In a letter dated November 25, 2019, the Lottery requested that the SCO transfer \$417,662,032 to the Lottery Education Fund for disbursement to the public education community. On December 30, 2019, the SCO's Local Government Programs and Services Division (LGPSD) transferred \$417,662,032 from the State Lottery Fund to the Lottery Education Fund.

In our prior quarterly reports, dated November 17, 2020, and September 17, 2020, we disclosed the following issue, which we also disclose in this report because it remained uncorrected during this review period. During the fiscal year (FY) 2018-19 first-quarter allocation calculations, while updating the average daily attendance (ADA) figures for approximately 2,500 educational entities, LGPSD transposed ADA numbers for some schools in two counties. LGPSD collected the overpayments from the two counties as soon as the errors were discovered. The ADA errors resulted in misallocations, totaling \$5,196,819, to all educational entities that receive Lottery funding. LGPSD reallocated the overpayments and adjustments on June 26, 2020. LGPSD staff indicated that process changes are being implemented to minimize the potential for future ADA transposition errors.

¹ As non-statistical sampling methods were used, the results were not projected to the intended population.

For the three months ended September 30, 2019, of the total revenues from ticket sales:

- 66.51% was returned to the public in the form of prize payouts;
- 21.61% was transferred to the public education community; and
- 11.88% was used for administrative expenses.

The Lottery returned 88.12% of total revenues from ticket sales in the form of prize payouts and funds to education. The Lottery was on target to meet annual allocation requirements specified in the Lottery Act. See the Schedule for a summary of Lottery revenue allocations and allocation percentages.

**Views of
Responsible
Officials**

We discussed our results with Lottery representatives via email on January 5, 2021. As there are no findings, the Lottery waived the exit conference and draft report. We agreed that the report would be issued as final.

Restricted Use

This report is intended for the information and use of the Lottery, the Commission, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record, and is available on the SCO website at www.sco.ca.gov.

Original signed by

MICHAEL REEVES, CPA
Acting Chief, Division of Audits

February 23, 2021

Schedule—
FY 2019-20 and FY 2018-19
Year-to-Date Lottery Revenue Allocations

Fiscal Year 2019/2020	Three Months Ended 9/30/2019	% of Sales ¹	Six Months Ended 12/31/2019	% of Sales ¹	Nine Months Ended 3/31/2020	% of Sales ¹	Twelve Months Ended 6/30/2020	% of Sales ¹
Sales	\$ 1,663,239,267	100.00%						
Prizes	\$ 1,106,200,805	66.51%						
Operating income to education	\$ 359,504,052	21.61%						
Revenues returned to public	\$ 1,465,704,857	88.12%						
Administrative expenses	\$ 197,534,410	11.88%						
Miscellaneous income ²	\$ 58,157,980							
Adjustment	\$ -							
Allocation to Education Fund ⁴	\$ 417,662,032							

Fiscal Year 2018/2019	Three Months Ended 9/30/2018	% of Sales ¹	Six Months Ended 12/31/2018	% of Sales ¹	Nine Months Ended 3/31/2019	% of Sales ¹	Twelve Months Ended 6/30/2019	% of Sales ¹
Sales	\$ 1,632,006,024	100.00%	\$ 3,717,330,531	100.00%	\$ 5,562,239,364	100.00%	\$ 7,388,050,316	100.00%
Prizes	\$ 1,046,074,342	64.10%	\$ 2,340,130,361	62.95%	\$ 3,526,400,829	63.40%	\$ 4,715,592,673	63.83%
Operating income to education	\$ 393,824,838	24.13%	\$ 945,471,555	25.43%	\$ 1,390,758,881	25.00%	\$ 1,809,721,391	24.50%
Revenues returned to public	\$ 1,439,899,180	88.23%	\$ 3,285,601,916	88.39%	\$ 4,917,159,710	88.40%	\$ 6,525,314,064	88.32%
Administrative expenses	\$ 192,106,844	11.77%	\$ 431,728,615	11.61%	\$ 645,079,654	11.60%	\$ 862,736,252	11.68%
Miscellaneous income ²	\$ 15,409,724		\$ 30,919,170		\$ 41,508,306		\$ 61,025,893	
Adjustment	\$ -		\$ -		\$ 2,803,132 ³		\$ (23,480,097) ⁵	
Allocation to Education Fund ⁴	\$ 409,234,562		\$ 976,390,725		\$ 1,435,070,319		\$ 1,847,267,187	

Annual Statutory Revenue Allocation Percentage Requirements

Prize payouts – Not less than 50% of sales

Administrative expenses – Not more than 13% of sales

Prize payouts and funds to education – Not less than 87% of sales

Other income – 100% to education

¹ Statutory compliance is determined on an annual basis at fiscal year-end. The percentages displayed in the first three quarters are presented to show the Lottery's year-to-date progress toward meeting annual statutory requirements.

² Miscellaneous income includes Surplus Money Investment Fund interest earned, unclaimed prizes, and other income.

³ This amount was withheld from the FY 2017-18 fourth quarter transfer and was adjusted in the FY 2018-19 third quarter transfer after the completion of the financial statement audit and resolution of accounting issues.

⁴ The Education Fund allocation amount is sales plus miscellaneous income, plus the adjustment amount, less prizes, and less administrative expenses.

⁵ This amount was withheld from the FY 2018-19 fourth quarter transfer and was adjusted in a subsequent quarter transfer after the completion of the financial statement audit and resolution of accounting issues.

**Attachment—
California State Lottery's
Transfer Request Dated November 25, 2019**

700 North Tenth Street
Sacramento, CA 95811
calottery.com



November 25, 2019

Natalie Sidarous, Chief
Local Government Programs and Services Division
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Ms. Sidarous:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$417,662,032. This figure represents:

Operating income for the three months ended September 30, 2019	\$ 359,504,052
SMIF interest earned	4,058,137
Other income	6,183
Unclaimed prizes	<u>54,093,660</u>
	<u>\$ 417,662,032</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the three months ended September 30, 2019, prepared from books without audit, for your files.

Please note, the amount withheld from the 2018-19 transfer pending audit will be included in the second quarter transfer after the June 2019 audit is complete.

Sincerely,

Nicholas Buchen, Deputy Director
Finance Division

Attachment
cc: Alva V. Johnson, Director

California State Lottery Fund
Statement of Revenues, Expenses, and Changes in Net Fund Position
For the Three Months Ended September 30, 2019

Operating revenues: Lottery sales	\$	1,663,239,267
Prizes	\$	<u>1,106,200,805</u>
Sales after prizes	\$	<u>557,038,462</u>
Less game costs:		
Retailer costs	\$	115,701,762
Gaming System costs	\$	20,964,780
Scratchers@ game costs	\$	<u>9,424,107</u>
Total game costs	\$	<u>146,090,649</u>
Income before operating expenses	\$	<u>410,947,813</u>
Operating expenses:		
Salaries, wages and benefits	\$	22,141,952
Advertising	\$	12,956,502
Promotion, public relations and point of sale	\$	1,953,531
Other professional services	\$	5,321,500
Depreciation and amortization	\$	4,632,192
Other general and administrative expenses	\$	<u>4,438,084</u>
Total operating expenses	\$	<u>51,443,761</u>
Operating income	\$	<u>359,504,052</u>
Non-operating (expenses) revenues:		
Investment earnings (Note 9)	\$	22,500,296
Other Income	\$	6,183
Allocation to Education Fund (Note 7)	\$	<u>(363,568,372)</u>
Total non-operating (expenses) revenues	\$	<u>(341,061,893)</u>
Changes in net position	\$	18,442,159
Total net position - beginning of year	\$	<u>(151,715,806)</u>
Total net position - ending balance	\$	<u><u>(133,273,647)</u></u>

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

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