

CALIFORNIA STATE LOTTERY

Review Report

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended September 30, 2020



BETTY T. YEE
California State Controller

May 2022



BETTY T. YEE
California State Controller

May 24, 2022

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, 2020. Our review found that the transfer amount of \$434,794,028 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, 2021.

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

Sincerely,

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/as

cc: Nicholas Buchen, Deputy Director, Finance Division
California State Lottery
Sara Sheikholislam, Deputy Director, Internal Audits
California State Lottery
Emily Ngyuen, Audit Manager, Internal Audits
California State Lottery
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

Contents

Review Report

Summary	1
Background	1
Review Authority	1
Objectives, Scope, and Methodology	1
Results	2
Views of Responsible Officials	3
Restricted Use	3
Schedule—Fiscal Year 2020-21 and Fiscal Year 2019-20 Year-to-Date Lottery Revenue Allocations	4
Attachment—California State Lottery’s Transfer Request Dated December 14, 2020	

Review Report

Summary

The California State Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$434,794,028 to the Lottery Education Fund for disbursement to the public education community for the quarter ended September 30, 2020. 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, 2021.

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 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.

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.

Review Authority

Government Code section 8880.46.6 (the Lottery Act, in part) states 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.

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, 2020. To achieve our objectives, we:

- Compared current fiscal year (FY) 2020-21 audited income statement balances with prior FY 2019-20 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 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 \$434,794,028 for the first quarter ended September 30, 2020, 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 Lottery Act for the quarter ended September 30, 2020.

In a letter dated December 14, 2020, the Lottery requested that the SCO transfer \$434,794,028 to the Lottery Education Fund for disbursement to the public education community. On December 30, 2020, the SCO's Local Government Programs and Services Division transferred \$437,794,028 from the State Lottery Fund to the Lottery Education Fund.

For the three months ended September 30, 2020, of the total revenues from ticket sales:

- 67.85% was returned to the public in the form of prize payouts;
- 20.97% was transferred to the public education community; and
- 11.18% was used for administrative expenses.

The Lottery returned 88.82% 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.

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

**Views of
Responsible
Officials**

We discussed our results with Lottery representatives via email on January 6, 2022. As there are no findings, the Lottery waived the exit conference and draft report. We agreed 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 review report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

May 24, 2022

Schedule—
FY 2020-21 and FY 2019-20
Year-to-Date Lottery Revenue Allocations

FY 2020-2021	Three Months Ended 9/30/2020	% of Sales¹	Six Months Ended 12/31/2020	% of Sales¹	Nine Months Ended 3/31/2021	% of Sales¹	Twelve Months Ended 6/30/2021	% of Sales¹
Sales	\$ 2,025,442,485	100.00%						
Prizes	\$ 1,374,317,474	67.85%						
Operating income	\$ 424,642,033	20.97%						
Revenues returned to public	\$ 1,798,959,507	88.82%						
Administrative expenses	\$ 226,482,978	11.18%						
Miscellaneous income ²	\$ 10,151,995							
Adjustment	\$ -							
Allocation to Education Fund ⁴	\$ 434,794,028		\$ -		\$ -		\$ -	

FY 2019-2020	Three Months Ended 9/30/2019	% of Sales¹	Six Months Ended 12/31/2019	% of Sales¹	Nine Months Ended 3/31/2020	% of Sales¹	Twelve Months Ended 6/30/2020	% of Sales¹
Sales	\$ 1,663,239,267	100.00%	\$ 3,355,739,201	100.00%	\$ 4,981,760,628	100.00%	\$ 6,622,003,405	100.00%
Prizes	\$ 1,106,200,805	66.51%	\$ 2,223,100,423	66.25%	\$ 3,300,388,515	66.25%	\$ 4,403,715,159	66.50%
Operating income	\$ 359,504,052	21.61%	\$ 728,641,946	21.71%	\$ 1,083,119,336	21.74%	\$ 1,425,154,855	21.52%
Revenues returned to public	\$ 1,465,704,857	88.12%	\$ 2,951,742,369	87.96%	\$ 4,383,507,851	87.99%	\$ 5,828,870,014	88.02%
Administrative expenses	\$ 197,534,410	11.88%	\$ 403,996,832	12.04%	\$ 598,252,777	12.01%	\$ 793,133,391	11.98%
Miscellaneous income ²	\$ 58,157,980		\$ 74,538,873		\$ 80,410,080		\$ 87,425,507	
Adjustment	\$ -		\$ -		\$ 23,480,097 ³		\$ (19,050,946) ⁵	
Allocation to Education Fund ⁴	\$ 417,662,032		\$ 803,180,819		\$ 1,187,009,513		\$ 1,493,529,416	

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 2018-19 fourth-quarter transfer and was adjusted in the FY 2019-20 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 2019-20 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 December 14, 2020**



December 14, 2020

Natalie Sidarous, Chief
Local Government Programs and Services Division
State Controller's Office
3301 C Street, Suite 740
Sacramento, CA 95816

Dear Ms. Sidarous:

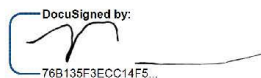
The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$434,794,028. This figure represents:

Operating income for the three months ended September 30, 2020	\$ 424,642,033
SMIF interest earned	1,162,503
Other income	12,223
Unclaimed prizes	<u>8,977,269</u>
	<u>\$ 434,794,028</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the three months ended September 30, 2020, prepared from books without audit, for your files.

Please note, the amount withheld from the 2019-20 transfer pending audit will be transferred in a subsequent quarter after the June 2020 audit is complete.

Sincerely,

DocuSigned by:

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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, 2020

Operating revenues: Lottery sales	\$	2,025,442,485
Prizes	\$	<u>1,374,317,474</u>
Sales after prizes	\$	<u>651,125,011</u>
Less game costs:		
Retailer costs	\$	143,322,168
Gaming System costs	\$	20,377,995
Scratchers® game costs	\$	<u>14,463,125</u>
Total game costs	\$	<u>178,163,288</u>
Income before operating expenses	\$	<u>472,961,723</u>
Operating expenses:		
Salaries, wages and benefits	\$	21,881,321
Advertising	\$	13,744,615
Promotion, public relations and point of sale	\$	389,656
Other professional services	\$	4,673,814
Depreciation and amortization	\$	4,286,403
Other general and administrative expenses	\$	<u>3,343,881</u>
Total operating expenses	\$	<u>48,319,690</u>
Operating income	\$	<u>424,642,033</u>
Non-operating (expenses) revenues:		
Investment earnings (Note 9)	\$	(2,558,408)
Other Income	\$	12,223
Allocation to Education Fund (Note 7)	\$	<u>(425,816,760)</u>
Total non-operating (expenses) revenues	\$	<u>(428,362,945)</u>
Changes in net position	\$	(3,720,912)
Total net position - beginning of year	\$	<u>(81,457,353)</u>
Total net position - ending balance	\$	<u><u>(85,178,265)</u></u>

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

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