

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended June 30, 2017



BETTY T. YEE
California State Controller

July 2018



BETTY T. YEE
California State Controller

July 16, 2018

California Lottery Commission
700 North Tenth Street
Sacramento, California 95811
ATTN: Gregory Ahern, Chair

Dear Commissioners:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to the public education community for the quarter ended June 30, 2017. Our analysis found that the transfer amount of \$386,000,000 is supported by the Lottery's accounting records, and that the Lottery complied with the annual statutory revenue allocation percentages for prize payouts, funds to education, and administrative expenses.

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

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/as

cc: Connie M. Perez-Andreesen, Vice Chair
California Lottery Commission
Nathaniel Kirtman III, Commissioner
California Lottery Commission
Rowena Libang-Bobila, Commissioner
California Lottery Commission
Hugo López, Director
California Lottery
Nicholas Buchen, Deputy Director, Finance Division
California Lottery
Roberto Zavala, Deputy Director, Internal Audits
California Lottery
James Shannon, Audit Manager, Internal Audits
California Lottery

Contents

Report of Analysis

Introduction	1
Summary	1
Background	1
Objectives, Scope, and Methodology	1
Results	2
Schedule—Fiscal Years 2016-17 and 2015-16 Year-to-Date Lottery Revenue Allocations	4
Attachment—California Lottery’s Transfer Request of December 13, 2017	

Report of Analysis

Introduction

This report presents the results of our analysis of the California Lottery's (Lottery) quarterly request that the State Controller's Office (SCO) transfer funds to the Lottery Education Fund for disbursement to the public education community.

Summary

The Lottery requested that the SCO transfer \$386,000,000 to the Lottery Education Fund for disbursement to the public education community for the quarter ended June 30, 2017. Based on the work performed, we determined that the requested transfer amount of \$386,000,000 was supported by the Lottery's accounting records. In addition, we determined that the Lottery complied with 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, 2017.

Background

In 1984, California voters passed an initiative that authorized a state-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of a portion of revenues to the public education community and established the allocation percentages for lottery revenues. 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.

The Act requires revenues from the Lottery to be allocated to maximize the amount of funding allocated to the public education community. The 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 prizes and funds to education and not more than 13% be allocated for Lottery expenses. Furthermore, the Act specifies that not less than 50% of the total annual Lottery revenues, in an amount to be determined by the Lottery Commission, be returned to the public in the form of prize payouts. In addition, the Lottery 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 (see Attachment). The Lottery's request usually occurs eight to ten weeks after the close of each quarter.

Objectives, Scope, and Methodology

The objectives of the analysis were to determine whether:

- The requested transfer amount was supported by the Lottery's accounting records; and
- The Lottery complied with the annual revenue allocation percentages specified in the Lottery Act for the fiscal year ended June 30, 2017.

We performed this analysis for the fourth quarter ended June 30, 2017. To achieve the objectives, we:

- Compared current fiscal year audited income statement balances with prior-year audited income statement balances and performed analytical procedures for variances over ten percent;
- Traced amounts reported in the income statement to the Lottery's accounting records;
- Determined that the Lottery met the annual revenue allocation requirements specified in the Lottery Act;
- Reviewed a selection of accruals and determined that they were adequately supported, accurately calculated, and recorded in the correct period;
- Determined that the requested transfer amount to the Lottery Education Fund occurred; and
- Verified that 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 \$386,000,000 for the fourth quarter ended June 30, 2017 was supported by the Lottery's accounting records. In addition, we determined that the Lottery complied with 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, 2017.

In a letter dated September 15, 2017, the Lottery requested that the SCO transfer \$386,000,000 to the Lottery Education Fund for disbursement to the public education community. On September 29, 2017, the SCO transferred \$386,000,000 to the Lottery Education Fund, and as a result of the SCO's apportionment process, the entire balance of the Fund except \$6.87 was disbursed to the public education community. This remainder was apportioned during the subsequent quarterly transfer.

On December 13, 2017, the Lottery submitted a revision to the September 15, 2017 letter (see Attachment). The revision reported a decrease in the Lottery's operating income for the fiscal year ended June 30, 2017 but did not change the requested transfer amount of \$386,000,000. Despite the revisions, the Lottery met annual revenue allocation requirements specified in the Lottery Act.

For the 12 months ended June 30, 2017, of the total revenues from ticket sales:

- 63.58% was returned to the public in the form of prize payouts;
- 23.97% was transferred to the public education community; and
- 12.45% was used for administrative expenses.

The Lottery returned 87.55% of the total revenues from the sales of tickets to the public in the form of prize payouts and funds to education. The Lottery complied with the annual allocation requirements specified in the Lottery Act. See Schedule for a summary of Lottery transfers and allocation percentages.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

July 16, 2018

Schedule—
Fiscal Years 2016-17 and 2015-16
Year-to-Date Lottery Revenue Allocations

Fiscal Year 2016/2017	Three Months Ended 9/30/2016	% of Sales ¹	Six Months Ended 12/31/2016	% of Sales ¹	Nine Months Ended 3/31/2017	% of Sales ¹	Twelve Months Ended 6/30/2017	% of Sales ¹
Sales	\$ 1,520,852,245	100.00%	\$ 3,007,995,704	100.00%	\$ 4,591,845,645	100.00%	\$ 6,233,468,423	100.00%
Prizes	\$ 956,786,575	62.91%	\$ 1,901,324,398	63.21%	\$ 2,913,889,187	63.46%	\$ 3,963,453,360	63.58%
Operating income to education	\$ 379,715,792	24.97%	\$ 741,824,148	24.66%	\$ 1,118,104,575	24.35%	\$ 1,494,177,874	23.97%
Revenues returned to public	\$ 1,336,502,367	87.88%	\$ 2,643,148,546	87.87%	\$ 4,031,993,762	87.81%	\$ 5,457,631,234	87.55%
Administrative expenses	\$ 184,349,878	12.12%	\$ 364,847,158	12.13%	\$ 559,851,883	12.19%	\$ 775,837,189	12.45%
Miscellaneous income ²	\$ 21,348,557		\$ 33,795,876		\$ 41,386,230		\$ 51,347,608	
Adjustment	\$ -		\$ 8,764,910 ³		\$ -		\$ (34,677) ⁶	
Education Fund Allocation Amount⁵	\$ 401,064,349		\$ 784,384,934		\$ 1,159,490,805		\$ 1,545,490,805	

Fiscal Year 2015/2016	Three Months Ended 9/30/2015	% of Sales ¹	Six Months Ended 12/31/2015	% of Sales ¹	Nine Months Ended 3/31/2016	% of Sales ¹	Twelve Months Ended 6/30/2016	% of Sales ¹
Sales	\$ 1,457,390,634	100.00%	\$ 2,887,389,853	100.00%	\$ 4,736,844,778	100.00%	\$ 6,275,597,288	100.00%
Prizes	\$ 932,898,902	64.01%	\$ 1,859,560,540	64.40%	\$ 2,988,377,257	63.09%	\$ 3,955,791,373	63.03%
Operating income to educations	\$ 342,467,357	23.50%	\$ 668,910,184	23.17%	\$ 1,186,816,830	25.06%	\$ 1,559,668,537	24.85%
Revenues returned to public	\$ 1,275,366,259	87.51%	\$ 2,528,470,724	87.57%	\$ 4,175,194,087	88.14%	\$ 5,515,459,910	87.89%
Administrative expenses	\$ 182,024,375	12.49%	\$ 358,919,129	12.43%	\$ 561,650,691	11.86%	\$ 760,137,378	12.11%
Miscellaneous income ²	\$ 5,932,311		\$ 11,616,162		\$ 16,834,859		\$ 27,748,062	
Adjustment	\$ -		\$ 7,237,006 ⁴		\$ -		\$ (8,764,910) ³	
Education Fund Allocation Amount⁵	\$ 348,399,668		\$ 687,763,352		\$ 1,203,651,689		\$ 1,578,651,689	

Annual Statutory Revenue Allocation Percentage Requirements

Prizes – Not less than 50% of sales

Administrative expenses – Not more than 13% of sales

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

Other income – 100% to education

¹Statutory 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.

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

³This amount was withheld from the fiscal year (FY) 2015-16 fourth-quarter transfer and was adjusted in the FY 2016-17 second-quarter transfer after the completion of the financial statement audit and resolution of accounting issues.

⁴This amount was withheld from the previous fourth-quarter transfer and was included in this quarter's transfer after the completion of the financial statement audit and resolution of accounting issues. Except in the quarter it was presented, this amount was not included in the year-to-date Education Fund allocation amounts.

⁵The Education Fund allocation amount is sales plus miscellaneous income, plus/less the adjustment amount, less prizes, and less administrative expenses.

⁶This amount was withheld from the FY 2016-17 fourth-quarter transfer and will be adjusted in a subsequent quarter transfer after the completion of the financial statement audit and resolution of accounting issues.

**Attachment—
California Lottery's
Transfer Request of December 13, 2017**



December 13, 2017

Ms. Jill Kanemasu, Acting Chief
Local Government Programs and Services Division
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Ms. Kanemasu:

On October 13, 2017, the California Lottery received pension reporting allocations from the State Controller's Office, which impact the Lottery's operating income for the fiscal year ended June 30, 2017. As a result, we are submitting this revision to the letter dated September 15, 2017, previously submitted to you.

<u>Revised</u> Operating income for the year ended June 30, 2017	\$ 1,494,177,874
SMIF interest earned	4,732,680
Other income	93,932
Unclaimed prizes	<u>46,520,996</u>
	\$ 1,545,525,482
 Less: Transfer for the nine months ended March 31, 2017	 1,159,490,805
 <u>Revised</u> Amount withheld pending audit	 <u>34,677</u>
	<u>\$ 386,000,000</u>

We have attached a revised copy of the Statement of Revenues, Expenses, and Changes in Net Position for the year ended June 30, 2017, for your files.

Sincerely,

Nicholas Buchen, Deputy Director
Finance Division

Attachment
cc: Hugo López, Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Position
For the Twelve Months Ending June 30, 2017
REVISED

Lottery sales	\$6,233,468,423
Prizes	3,963,453,360

Sales after prizes	\$2,270,015,063

Less game costs:	
Retailer costs	\$433,656,258
On-line game costs	81,566,527
Off-line game costs	34,819,169

Total game costs	\$550,041,954

Income before operating expenses	\$1,719,973,109

Operating expenses:	
Salaries, wages and benefits	\$91,254,303
Advertising	76,690,663
Promotion, public relations and point of sale	8,657,038
Other professional services	14,266,694
Depreciation and amortization	16,889,648
Other general and administrative expenses	18,036,889

Total operating expenses	\$226,795,235

Operating income	\$1,494,177,874
Non-operating (expenses) revenues:	
Investment earnings	(\$54,067,893)
Other income	93,932
Allocation to Education Fund	(1,499,004,486)

Total non-operating (expenses) revenues	(\$1,552,978,447)
Changes in net assets	(\$58,800,573)
Total net assets-beginning of year	55,962,547

Total net assets-end of year	(\$2,838,026)

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

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