

CALIFORNIA STATE LOTTERY

Review Report

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended March 31, 2019



BETTY T. YEE
California State Controller

September 2020



BETTY T. YEE
California State Controller

September 17, 2020

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 March 31, 2019. Our review found that the transfer amount of \$458,679,594 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, 2019.

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

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/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
Roberto Zavala, Deputy Director, Internal Audits
California State Lottery
James Shannon, Audit Manager, Internal Audits
California State Lottery

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Review Report

Summary

The California State Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$458,679,594 to the Lottery Education Fund for disbursement to the public education community for the quarter ended March 31, 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 Lottery Act for the fiscal year ended June 30, 2019.

Background

On November 6, 1984, California voters passed Proposition 37, the California State Lottery Act of 1984 (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 states that the State Controller shall conduct quarterly and annual audits of all accounts and transactions of the Commission and other special audits as the 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 review were to determine whether:

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

We performed this review for the third quarter ended March 31, 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 all variances over 15%;
- Traced amounts reported in the income statement to the Lottery's accounting records;
- Traced a sample of sales and expense items 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 \$458,679,594 for the third quarter ended March 31, 2019, 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 for the fiscal year ended June 30, 2019, as specified in the Lottery Act.

In a letter dated May 17, 2019, the Lottery requested that SCO transfer \$458,679,594 to the Lottery Education Fund for disbursement to the public education community. On June 26, 2019, SCO's Local Government Programs and Services Division (LGPSD) transferred \$455,876,642 from the State Lottery Fund to the Lottery Education Fund. The remaining balance of \$2,803,132 is a year-end adjustment amount that was withheld from the fiscal year (FY) 2017-18 fourth-quarter transfer, pending completion of the financial statement audit and resolution of accounting issues.

The year-end adjustment is typically transferred to the Lottery Education Fund for disbursement to the public education community in the following year's second- or third-quarter transfer. However, this adjustment of \$2,803,132 was not disbursed until the FY 2018-19 fourth-quarter transfer due to SCO mainframe computer system issues. In addition, in the FY 2018-19 third-quarter transfer, LGPSD transferred \$180 more than the requested amount. This error was corrected in the FY 2018-19 fourth-quarter transfer.

During our review, we were notified that during the FY 2018-19 first-quarter allocation calculation, while updating the average daily attendance (ADA) figures for approximately 2,500 educational entities, LGPSD had transposed ADA numbers for some schools in two counties. LGPSD

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

collected the overpayments from the two counties as soon as the errors were discovered. The ADA errors resulted in misallocations, with a total of \$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.

For the nine months ended March 31, 2019, of the total revenues from ticket sales:

- 63.4% was returned to the public in the form of prize payouts;
- 25.0% was transferred to the public education community; and
- 11.6% was used for administrative expenses.

The Lottery returned 88.4% 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 August 20, 2020. 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

JIM L. SPANO, CPA
Chief, Division of Audits

September 17, 2020

Schedule—
Fiscal Years 2018-19 and 2017-18
Year-to-Date Lottery Revenue Allocations

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%		
Prizes	\$ 1,046,074,342	64.10%	\$ 2,340,130,361	62.95%	\$ 3,526,400,829	63.40%		
Operating income to education	\$ 393,824,838	24.13%	\$ 945,471,555	25.43%	\$ 1,390,758,881	25.00%		
Revenues returned to public	\$ 1,439,899,180	88.23%	\$ 3,285,601,916	88.39%	\$ 4,917,159,710	88.40%		
Administrative expenses	\$ 192,106,844	11.77%	\$ 431,728,615	11.61%	\$ 645,079,654	11.60%		
Miscellaneous income ²	\$ 15,409,724		\$ 30,919,170		\$ 41,508,306			
Adjustment	\$ -		\$ -		\$ 2,803,132 ³			
Allocation to Education Fund ⁵	\$ 409,234,562		\$ 976,390,725		\$ 1,435,070,319			

Fiscal Year 2017/2018	Three Months Ended 9/30/2017	% of Sales ¹	Six Months Ended 12/31/2017	% of Sales ¹	Nine Months Ended 3/31/2018	% of Sales ¹	Twelve Months Ended 6/30/2018	% of Sales ¹
Sales	\$ 1,790,096,218	100.00%	\$ 3,415,927,725	100.00%	\$ 5,217,090,830	100.00%	\$ 6,965,792,113	100.00%
Prizes	\$ 1,132,243,981	63.25%	\$ 2,180,378,533	63.83%	\$ 3,329,801,682	63.82%	\$ 4,476,580,353	64.27%
Operating income to education	\$ 444,919,295	24.85%	\$ 831,785,924	24.35%	\$ 1,284,284,601	24.62%	\$ 1,656,055,189	23.77%
Revenues returned to public	\$ 1,577,163,276	88.10%	\$ 3,012,164,457	88.18%	\$ 4,614,086,283	88.44%	\$ 6,132,635,542	88.04%
Administrative expenses	\$ 212,932,942	11.90%	\$ 403,763,268	11.82%	\$ 603,004,547	11.56%	\$ 833,156,571	11.96%
Miscellaneous income ²	\$ 5,905,268		\$ 13,561,293		\$ 30,848,873		\$ 44,881,417	
Adjustment	\$ -		\$ 34,677 ⁴		\$ -		\$ (2,803,132) ³	
Allocation to Education Fund ⁵	\$ 450,824,563		\$ 845,381,894		\$ 1,315,133,474		\$ 1,698,133,474	

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 complying with 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 fiscal year (FY) 2017-18 fourth-quarter transfer and was included in the FY 2018-19 third-quarter transfer after the completion of the financial statement audit and resolution of accounting issues.

⁴ This amount was withheld from the FY 2016-17 fourth-quarter transfer and was included in the FY 2017-18 second-quarter 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 Lottery Education Fund allocation amounts.

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

**Attachment—
California State Lottery's
Transfer Request Dated May 17, 2019**

700 North Tenth Street
Sacramento, CA 95811
calottery.com



May 17, 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 \$458,679,594. This figure represents:

Operating income for the nine months ended March 31, 2019	\$ 1,390,758,881
SMIF interest earned	11,304,005
Other income	11,806
Unclaimed prizes	<u>30,192,495</u>
	\$ 1,432,267,187
Less: Transfer for the six months ended December 31, 2018	<u>976,390,725</u>
	\$ 455,876,642
Add: Amount withheld from 2017-18 fiscal year pending audit	<u>2,803,132</u>
	<u>\$ 458,679,594</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the nine months ended March 31, 2019, prepared from books without audit, 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 Fund Position
For the Nine Months Ended March 31, 2019

Operating revenues: Lottery sales	\$	5,562,239,364
Prizes	\$	<u>3,526,400,829</u>
Sales after prizes	\$	<u>2,035,838,535</u>
Less game costs:		
Retailer costs	\$	379,632,660
Gaming System costs	\$	69,566,089
Scratchers® game costs	\$	<u>28,918,050</u>
Total game costs	\$	<u>478,116,799</u>
Income before operating expenses	\$	<u>1,557,721,736</u>
Operating expenses:		
Salaries, wages and benefits	\$	73,325,521
Advertising	\$	50,981,144
Promotion, public relations and point of sale	\$	6,081,507
Other professional services	\$	11,420,930
Depreciation and amortization	\$	14,128,559
Other general and administrative expenses	\$	<u>11,025,194</u>
Total operating expenses	\$	<u>166,962,855</u>
Operating income	\$	<u>1,390,758,881</u>
Non-operating (expenses) revenues:		
Investment earnings (Note 9)	\$	28,038,364
Other Income	\$	11,806
Allocation to Education Fund (Note 7)	\$	<u>(1,402,074,692)</u>
Total non-operating (expenses) revenues	\$	<u>(1,374,024,522)</u>
Changes in net position	\$	16,734,359
Total net position - beginning of year	\$	<u>(189,412,778)</u>
Total net position - ending balance	\$	<u><u>(172,678,419)</u></u>

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

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