

# **CALIFORNIA LOTTERY**

Report of Analysis

## **QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION**

*For the Quarter Ended March 31, 2017*



**BETTY T. YEE**  
California State Controller

October 2017



**BETTY T. YEE**  
California State Controller

October 18, 2017

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 March 31, 2017. Our analysis found that the transfer amount of \$383,870,781 appears to be supported by the Lottery's accounting records and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

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

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD, CPA**  
Chief, Division of Audits

JVB/rg

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

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# 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 public education community. This analysis is part of our responsibility under the California State Lottery Act (Lottery Act). We performed this analysis to determine whether the transfer amount to the public education community 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.

## Summary

In a letter dated May 17, 2017, the Lottery requested that the SCO transfer \$383,870,781 to the Lottery Education Fund for disbursement to the public education community. Our analysis found that the transfer amount appears to be supported by the Lottery's accounting records and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration.

On June 28, 2017, the SCO transferred \$383,870,773 to the Lottery Education Fund. As a result of the SCO's apportionment process, all requested funds except an immaterial amount were disbursed to the public education community. The balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

## 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 net revenues to the public education community 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.

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 prizes. 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 net revenues to the public education community (see Attachment). The Lottery's request usually occurs eight to ten weeks after the close of a quarter.

## Objectives, Scope, and Methodology

We performed this analysis of the transfer of funds to the public education community for the nine months ended March 31, 2017 in order to determine whether:

- The Lottery's requested transfer amount of \$383,870,781 is supported by accounting records; and
- The Lottery is on target to comply with the annual allocation requirements specified in the Lottery Act.

As part of our analysis, we traced the transfer amount to the Lottery's accounting records and applied analytical review procedures to Lottery fund accounts by comparing them with those from the prior year.

## Results

On June 28, 2017, the SCO transferred \$383,870,773 to the Lottery Education Fund. As a result of the SCO's apportionment process, all requested funds except an immaterial amount were disbursed to the public education community. The balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

After analyzing the Lottery's unaudited financial statements and supporting records for the quarter ended March 31, 2017, we determined that the Lottery's requested transfer amount of \$383,870,781 to the Lottery Education Fund appears to be supported by accounting records.

For the nine months ended March 31, 2017, of the total revenues from ticket sales:

- 63.46% was returned to the public in the form of prizes;
- 24.35% was transferred to the public education community; and
- 12.19% was used for administrative expenses.

The Lottery returned 87.81% of the total revenues from the sales of tickets to the public in the form of prizes and funds to education. The Lottery is on target to comply the annual allocation requirements specified in the Lottery Act. See Schedule 1 for a summary of Lottery transfers and allocation percentages.

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

October 18, 2017

**Schedule 1—  
Fiscal Years 2016-17 and 2015-16  
Year-to-Date Lottery Revenue Allocations**

Fiscal Year 2016-17	Three Months Ended 9/30/2016	% of Sales <sup>1</sup>	Six Months Ended 12/31/2016	% of Sales <sup>1</sup>	Nine Months Ended 3/31/2017	% of Sales <sup>1</sup>	Twelve Months Ended 6/30/2017	% of Sales <sup>1</sup>
Sales	\$ 1,520,852,245	100.00%	\$ 3,007,995,704	100.00%	\$ 4,591,845,645	100.00%		
Prizes	\$ 956,786,575	62.91%	\$ 1,901,324,398	63.21%	\$ 2,913,889,187	63.46%		
Operating income to education	\$ 379,715,792	24.97%	\$ 741,824,148	24.66%	\$ 1,118,104,575	24.35%		
Revenues returned to public	\$ 1,336,502,367	87.88%	\$ 2,643,148,546	87.87%	\$ 4,031,993,762	87.81%		
Administrative expenses	\$ 184,349,878	12.12%	\$ 364,847,158	12.13%	\$ 559,851,883	12.19%		
Miscellaneous income <sup>2</sup>	\$ 21,348,557		\$ 33,795,876		\$ 41,386,230			
Adjustment	\$ -		\$ 8,764,910 <sup>3</sup>					
<b>Allocation to Education Fund<sup>5</sup></b>	<b>\$ 401,064,349</b>		<b>\$ 784,384,934</b>		<b>\$ 1,159,490,805</b>			

Fiscal Year 2015-16	Three Months Ended 9/30/2015	% of Sales <sup>1</sup>	Six Months Ended 12/31/2015	% of Sales <sup>1</sup>	Nine Months Ended 3/31/2016	% of Sales <sup>1</sup>	Twelve Months Ended 6/30/2016	% of Sales <sup>1</sup>
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 education	\$ 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 <sup>2</sup>	\$ 5,932,311		\$ 11,616,162		\$ 16,834,859		\$ 27,748,062	
Adjustment	\$ -		\$ 7,237,006 <sup>4</sup>		\$ -		\$ (8,764,910) <sup>3</sup>	
<b>Allocation to Education Fund<sup>5</sup></b>	<b>\$ 348,399,668</b>		<b>\$ 687,763,352</b>		<b>\$ 1,203,651,689</b>		<b>\$ 1,578,651,689</b>	

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

<sup>1</sup>Statutory compliance is determined on an annual basis at fiscal year-end. The percentages displayed in the first three quarters show the Lottery's year-to-date progress toward meeting annual statutory requirements. The percentages may not total 100% due to rounding.

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

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

<sup>4</sup>This 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.

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

**Attachment—  
California Lottery's  
Transfer Request of May 17, 2017**

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May 17, 2017

Ms. Casandra Moore-Hudnall, Chief  
Division of Accounting and Reporting  
State Controller's Office  
3301 C Street, Suite 753  
Sacramento, CA 95816

Dear Ms. Moore-Hudnall:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$383,870,781. This figure represents:

Operating income for the nine months ended March 31, 2017	\$ 1,118,104,575
SMIF interest earned	3,186,987
Other income	66,682
Unclaimed prizes	<u>38,132,561</u>
	\$ 1,159,490,805
Less: Transfer for the six months ended December 31, 2016	<u>775,620,024</u>
	<u>\$ 383,870,781</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the nine months ended March 31, 2017, prepared from books without audit, for your files.

Sincerely,

A handwritten signature in blue ink, appearing to be "N. Buchen".

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, 2017

Operating revenues: Lottery sales		\$ 4,591,845,645
Prizes		2,913,889,187
		<u>1,677,956,458</u>
Sales after prizes		\$ 1,677,956,458
Less game costs:		
Retailer costs	\$	318,855,368
Gaming System costs		63,715,372
Scratchers@ game costs		26,504,646
		<u>409,075,386</u>
Total game costs	\$	409,075,386
Income before operating expenses		\$ 1,268,881,072
Operating expenses:		
Salaries, wages and benefits	\$	52,074,147
Advertising		54,395,901
Promotion, public relations and point of sale		7,689,803
Other professional services		10,927,815
Depreciation and amortization		12,538,014
Other general and administrative expenses		13,150,817
		<u>150,776,497</u>
Total operating expenses	\$	150,776,497
Operating income		\$ 1,118,104,575
Non-operating (expenses) revenues:		
Investment earnings	\$	(60,836,263)
Other Income		66,682
Allocation to Education Fund		(1,121,358,244)
		<u>(1,182,127,825)</u>
Total non-operating (expenses) revenues	\$	(1,182,127,825)
Changes in net position	\$	(64,023,250)
Total net position - beginning of year		55,962,547
Total net position - ending balance	\$	<u>(8,060,703)</u>

**State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, CA 94250-5874**

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