

CALIFORNIA STATE LOTTERY

Review Report

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended June 30, 2020



BETTY T. YEE
California State Controller

November 2021



BETTY T. YEE
California State Controller

November 17, 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 June 30, 2020. Our review found that the transfer amount of \$330,000,000 was supported by the Lottery's accounting records, and that the Lottery complied with annual revenue allocation requirements for prize payouts, funds to education, and administrative expenses as specified in the California State Lottery Act of 1984 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

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/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
Sara Sheikholislam, Deputy Director, Internal Audits
California State Lottery

Contents

Review Report

Summary	1
Background	1
Review Authority	1
Objective, Scope, and Methodology	1
Results	2
Views of Responsible Officials	3
Restricted Use	3
Schedule—FY 2019-20 and FY 2018-19 Year-to-Date Lottery Revenue Allocations.....	4
Attachment—California State Lottery’s Transfer Request Dated May 26, 2021	

Review Report

Summary

The California State Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$330,000,000 to the Lottery Education Fund for disbursement to the public education community for the quarter ended June 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 complied with 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 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 was supported by accounting records; and
- The Lottery complied with the annual allocation requirements specified in the Lottery Act.

We performed this analysis for the fourth quarter ended June 30, 2020. 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;
- Reviewed a selection of accruals and determined whether they were adequately supported, accurately calculated, and correctly recorded;
- 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 \$330,000,000 for the fourth quarter ended June 30, 2020, 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, 2020.

On May 26, 2021, the Lottery submitted a final revision (Attachment) to the September 21, 2020 transfer request. The revision reported an increase in the Lottery's operating income for the fiscal year ended June 30, 2020, but did not change the requested transfer amount of \$330,000,000. Despite the revisions, the Lottery complied with annual revenue allocation requirements specified in the Lottery Act.

For the 12 months ended June 30, 2020, of the total revenues from ticket sales:

- 66.50% was returned to the public in the form of prize payouts;
- 21.52% was transferred to the public education community; and
- 11.98% was used for administrative expenses.

The Lottery returned 88.02% of total revenues from ticket sales in the form of prize payouts and funds to education. The Lottery complied with annual allocation requirements specified in the Lottery Act. See the Schedule for a summary of Lottery revenue allocations and allocation percentages.

In our prior quarterly reports, we disclosed the following issue, which we also disclose in this report because it was corrected during this review period.

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

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, Local Government Programs and Services Division (LGPSD) staff 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 miscalculations, totaling \$5,196,819, to all educational entities that receive Lottery funding. LGPSD staff indicated that process changes had been implemented to minimize the potential for future ADA transposition errors.

**Views of
Responsible
Officials**

We discussed our results with Lottery representatives via email on August 6, 2021. As there are no findings, the Lottery waived the exit conference and the draft report, and agreed that the report could 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.

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

November 17, 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%	\$ 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 ⁵		\$ (19,050,946) ⁶	
Allocation to Education Fund ⁴	\$ 417,662,032		\$ 803,180,819		\$ 1,187,009,513		\$ 1,493,529,416	

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	\$ 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.

⁶ 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 May 26, 2021**



May 26, 2021

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

Dear Ms. Sidarous:

On February 17, 2021, the California Lottery received pension reporting allocations from the State Controller's Office, and on April 2, 2021, we received final other postemployment benefits allocations. As each of these adjustments impact the Lottery's operating income for the fiscal year ended June 30, 2020, we are submitting this revision to the letter dated February 26, 2021, previously submitted.

<u>Revised</u> Operating income for the year ended June 30, 2020	\$ 1,425,154,855
SMIF interest earned	11,833,269
Other income	195,722
Unclaimed prizes	<u>75,396,516</u>
	\$ 1,512,580,362
Less: Transfer for the nine months ended March 31, 2020	1,163,529,416
<u>Revised</u> Amount withheld pending audit	<u>19,050,946</u>
	<u>\$ 330,000,000</u>

We have attached a revised copy of the Statement of Revenues, Expenses, and Changes in Net Position for the year ended June 30, 2020, for your files.

Sincerely,

DocuSigned by:

A handwritten signature in black ink, appearing to read 'Nicholas Buchen', is written over a white signature line.

76B135F3ECC14F5...
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 Twelve Months Ended June 30, 2020

Operating revenues: Lottery sales	\$	6,622,003,405
Prizes	\$	<u>4,403,715,159</u>
Sales after prizes	\$	<u>2,218,288,246</u>
Less game costs:		
Retailer costs	\$	460,706,639
Gaming System costs	\$	82,692,866
Scratchers® game costs	\$	<u>36,567,321</u>
Total game costs	\$	<u>579,966,826</u>
Income before operating expenses	\$	<u>1,638,321,420</u>
Operating expenses:		
Salaries, wages and benefits	\$	111,146,383
Advertising	\$	40,856,926
Promotion, public relations and point of sale	\$	9,385,619
Other professional services	\$	16,225,755
Depreciation and amortization	\$	18,428,535
Other general and administrative expenses	\$	<u>17,123,347</u>
Total operating expenses	\$	<u>213,166,565</u>
Operating income	\$	<u>1,425,154,855</u>
Non-operating (expenses) revenues:		
Investment earnings (Note 9)	\$	82,091,722
Other Income	\$	195,722
Allocation to Education Fund (Note 7)	\$	<u>(1,437,183,846)</u>
Total non-operating (expenses) revenues	\$	<u>(1,354,896,402)</u>
Changes in net position	\$	70,258,453
Total net position - beginning of year	\$	<u>(151,715,806)</u>
Total net position - ending balance	\$	<u><u>(81,457,353)</u></u>

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

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