

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended December 31, 2007



JOHN CHIANG
California State Controller

June 2008



JOHN CHIANG
California State Controller

June 25, 2008

Joan M. Borucki, Director
California Lottery
600 North Tenth Street
Sacramento, California 95814

Dear Ms. Borucki:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to public education for the quarter ended December 31, 2007.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$265,807,229 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 call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/sk

cc: John Mass, Commissioner
California Lottery Commission
Cynthia Flores, Commissioner
California Lottery Commission
Rachel Montes, Commissioner
California Lottery Commission
Manuel Ortega, Commissioner
California Lottery Commission
Patrick Meroney, Acting Deputy Director
Finance Division
California Lottery
Robert Zavala, Chief
Internal Audits
California Lottery

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Report of Analysis

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Report of Analysis

Summary

In a letter dated February 21, 2008, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$265,807,229 to the Lottery Education Fund for disbursement to public education. Our review disclosed that the Lottery's accounting records supported this amount and that the Lottery is on target to comply with the annual statutory percentages for prizes, education, and administration. Our analytical review did not disclose any unexplained changes in accounts in a comparison with prior periods. Accordingly, on March 28, 2008, \$265,807,228.10 was transferred to the Lottery Education Fund. The difference of \$.90 is due to rounding errors in prior quarters.

Introduction

This report presents the results of our analysis of the Lottery's quarterly request that the SCO transfer funds to public education. This analysis is part of our responsibility under the California State Lottery Act (Lottery Act). We performed this analysis to determine if the transfer of funds to public education 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.

Background

In 1984, California voters passed an initiative, which, by amending the State Constitution, authorized a state-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of net revenues to public education, 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.

Each quarter, the Lottery requests that the SCO transfer net revenues to public education (see Attachment). The Lottery request usually occurs eight to ten weeks after the close of the quarter.

Objectives, Scope, and Methodology

We performed this analysis of the quarterly transfer of funds to public education in order to determine whether:

- Transfer amounts are supported by the Lottery's accounting records; and
- The Lottery is on target to meet the annual allocation requirements specified in the Lottery Act.

We traced the transfer amount to Lottery financial statements and accounting records, and applied analytical review procedures to the lottery fund accounts by comparing them with those from the prior quarter and the prior year. To monitor progress in meeting the annual statutory requirements, we reviewed the actual costs for prizes and administration, as well as the quarterly fund transfer to public education.

Results

After reviewing the Lottery's unaudited financial statements and supporting records for the quarter ended December 31, 2007, we determined that the Lottery's request to transfer \$265,807,229 to the Lottery Education Fund was supported by formal accounting records.

According to the Lottery's unaudited financial statements, the total amount available for transfer to education was \$572,476,778 for the six-month period ended December 31, 2007. Of this amount, \$306,669,549 (an additional \$18,060,789 of adjustments were transferred which were related to the fourth quarter of fiscal year 2006-07) was transferred to the Lottery Education Fund on December 28, 2007, leaving a balance of \$265,807,229. This balance was transferred to the Lottery Education Fund on March 28, 2008.

The amount transferred to public education was 34.87% of the total revenue for the quarter. The Lottery Act requires the Lottery to transfer at least 34% of the total annual revenue to the benefit of public education. All other income and unclaimed prizes were transferred to public education.

The Lottery complied with the statutory requirement that administrative expenses not exceed 16% of sales. Administrative expenses for the quarter were 11.69% of sales. To the extent that expenses are less than 16% of total annual revenues, the Lottery Act requires the surplus funds to be allocated to benefit public education. The surplus administrative funds were used to increase the prizes to the public. The Lottery returned 53.44% of the total quarterly revenues to the public in form of prizes.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

June 25, 2008

Schedule 1— Summary of Lottery Transfers and Status of Compliance with Statutory Requirements

| Fiscal Year 2006-07 | Quarter Ended | | | | | | | |
|---------------------------|-------------------------|---------|------------------|---------|------------|---|------------|---|
| | 09/30/2007 | % | 12/31/2007 | % | 03/31/2008 | % | 06/30/2008 | % |
| Sales ¹ | \$ 827,465,875 | 100.00% | \$ 1,568,732,800 | 100.00% | | | | |
| Prizes | \$ 439,733,766 | 53.14% | \$ 838,191,741 | 53.44% | | | | |
| Administration | \$ 95,226,483 | 11.51% | \$ 183,456,973 | 11.69% | | | | |
| Available for Education | \$ 292,505,626 | 35.35% | \$ 547,084,086 | 34.87% | | | | |
| Other Income ² | 14,163,923 | | 25,392,692 | | | | | |
| Adjustment | 3,997,089 ⁴ | | — | | | | | |
| Adjustment | 14,063,700 ⁵ | | — | | | | | |
| Transfer to Education | \$ 324,730,338 | | \$ 572,476,778 | | | | | |

| Fiscal Year 2006-07 | Quarter Ended | | | | | | | |
|---------------------------|------------------------|---------|------------------|---------|------------------|---------|--------------------------|---------|
| | 09/30/2006 | % | 12/31/2006 | % | 03/31/2007 | % | 06/30/2007 | % |
| Sales ¹ | \$ 790,585,222 | 100.00% | \$ 1,604,229,558 | 100.00% | \$ 2,540,930,473 | 100.00% | \$ 3,318,346,505 | 100.00% |
| Prizes | \$ 424,411,747 | 53.68% | \$ 864,608,763 | 53.89% | \$ 1,359,562,937 | 53.51% | \$ 1,765,643,368 | 53.21% |
| Administration | \$ 93,397,271 | 11.82% | \$ 193,449,040 | 12.06% | \$ 306,246,677 | 12.05% | \$ 414,334,148 | 12.49% |
| Available for Education | \$ 272,776,204 | 34.50% | \$ 546,171,755 | 34.05% | \$ 875,120,859 | 34.44% | \$ 1,138,368,989 | 34.30% |
| Other Income ² | 13,223,148 | | 553,314 | | 38,965,434 | | | |
| Adjustment | 3,909,760 ³ | | — | | — | | (3,997,089) ⁴ | |
| Transfer to Education | \$ 289,909,112 | | \$ 546,725,069 | | \$ 914,086,293 | | \$ 1,188,086,293 | |

Annual Statutory Requirements

Prizes = Approximately 50% of sales
Administration = No more than 16% of sales
Available for education = At least 34% of sales
Other income = 100% due to education

Note: The actual percentage allocation is computed on an annual basis when determining whether the Lottery has met the allocation requirements. The percentages shown above indicate the Lottery's year-to-date progress toward meeting these requirements.

¹ Quarterly amounts represent fiscal year-to-date totals.

² Includes interest income, other income, and unclaimed prizes.

³ This amount represents the \$3,909,760 withheld in the fourth quarter of FY 2005-06, pending the financial audit and resolution of accounting issues.

⁴ The amount represents the \$3,997,089 withheld in the fourth quarter of FY 2006-07, pending the financial audit and resolution of accounting issues.

⁵ The amount represents the \$14,063,700 audit adjustment for the fourth quarter FY 2006-07, due to reduction in on-line direct ticket costs.

**Attachment—
California Lottery's
Transfer Request of February 21, 2008**



California Lottery
Headquarters
600 North Tenth Street
Sacramento, CA 95814
www.calottery.com

February 21, 2008

Mr. John A. Korach, Accounting Division Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 500
Sacramento, CA 95816

Dear Mr. Korach:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$265,807,229. This figure represents:

| | |
|--|-----------------------|
| Operating income for the six months ended December 31, 2007 | \$ 547,084,086 |
| SMIF interest earned | 11,189,170 |
| Other Income | 577,193 |
| Unclaimed prizes | <u>13,626,329</u> |
| | <u>\$ 572,476,778</u> |
| | |
| Less: Transfer for the three months ended September 30, 2007: | \$ 306,669,549 |
| | <u>\$ 265,807,229</u> |

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the six months ended December 31, 2007, prepared from books without audit, for your files.

Sincerely,

Patrick Meroney, Acting Deputy Director
Finance Division

Attachment

cc: Joan Borucki, Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Six Months Ending December 31, 2007

| | |
|---|---------------|
| Lottery sales | 1,568,732,800 |
| Prizes | 838,191,741 |
| | <hr/> |
| Sales after prizes | 730,541,059 |
| | <hr/> |
| Less game costs: | |
| Retailer costs | 109,649,277 |
| On-line game costs | 18,388,263 |
| Off-line game costs | 8,207,592 |
| | <hr/> |
| Total game costs | 136,245,132 |
| | <hr/> |
| Income before operating expenses | 594,295,927 |
| | <hr/> |
| Operating expenses: | |
| Salaries, wages and benefits | 21,692,088 |
| Advertising | 7,330,989 |
| Promotion, public relations and point of sale | 4,470,017 |
| Other professional services | 3,207,987 |
| Depreciation and amortization | 4,276,888 |
| Other general and administrative expenses | 6,234,072 |
| | <hr/> |
| Total operating expenses | 47,211,841 |
| | <hr/> |
| Operating income | 547,084,086 |
| Non-operating (expenses) revenues: | |
| Investment earnings (Note 9) | 89,126,812 |
| Other income | 577,193 |
| Allocation to Education Fund (Note 7) | (558,850,449) |
| | <hr/> |
| Total non-operating (expenses) revenues | (469,146,444) |
| | <hr/> |
| Changes in net assets | 77,937,642 |
| Total net assets-beginning of year | 95,315,400 |
| | <hr/> |
| Total net assets-end of year | \$173,253,042 |
| | <hr/> <hr/> |

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

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