

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended December 31, 2010



JOHN CHIANG
California State Controller

June 2011



JOHN CHIANG
California State Controller

June 22, 2011

John Mass, Chair
California Lottery Commission
600 North Tenth Street
Sacramento, California 95811

Dear Mr. Mass:

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, 2010.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$279,678,987, 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: Alex Fortunati, Commissioner
California Lottery Commission
John Menchaca, Commissioner
California Lottery Commission
Linh Nguyen, Acting Director
California Lottery
Michael T. Ota, Deputy Director
Finance Division, California Lottery
Roberto Zavala, Chief, Internal Audits
California Lottery

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Report of Analysis

Summary

In a letter dated February 25, 2011, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$279,678,987 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 30, 2011, \$279,678,987 was transferred to the Lottery Education Fund.

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 that, 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.

The Lottery Act was amended by Assembly Bill 142 on April 8, 2010. The bill was an urgency statute that went into effect immediately. Assembly Bill 142 requires revenues from the Lottery to be allocated to maximize the amount of funding allocated to public education. The bill requires that not less than 87% of the total annual revenues from Lottery ticket sales be returned to the public, and not more than 13% be allocated for Lottery expenses. The bill specifies that, of the 87%, 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 bill requires the Lottery Commission to establish the percentage to be allocated to the benefit of public education at a level that maximizes the total net revenues allocated to the benefit of public education.

Objectives, Scope, and Methodology

We perform 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, 2010, we determined that the Lottery's request to transfer \$279,678,987 to the Lottery Education Fund is supported by formal accounting records.

According to the Lottery's unaudited financial statements, the total amount available for transfer to education was \$533,222,202 for the six-month period ended December 31, 2010. Of this amount, \$253,543,215 (an additional \$528,409 withheld from the last quarter of FY 2009-10 pending annual financial statement audit and the FY 2009-10 audit adjustment) was transferred to the Lottery Education Fund on December 30, 2010. The balance of 279,678,987 was transferred to the Lottery Education Fund on March 30, 2011.

The Lottery returned 87.28% of the total revenues from the sales of tickets to the public for the quarter ended December 31, 2010. Of the 87.28%, 54.82% was returned to the public in form of prizes, and 32.46% was transferred to public education. The Lottery Act requires the Lottery to return no less than 87% of the total annual revenues from the sales of Lottery tickets or shares to the public in the form of prizes and net revenues to benefit public education. The Lottery commission determines the percentage of total annual revenues be returned to the public in form of prizes and to be transferred to public education. However, the percentage of total annual revenues for prizes shall not be less than 50%. All other income and unclaimed prizes were transferred to public education.

The Lottery complied with the statutory requirement that administrative expenses not exceed 13% of the total revenues from the sales of tickets. The Lottery administrative expenses for the quarter were 12.72% of the sales. To the extent that expenses are less than 13% of the total annual revenues, the Lottery Act requires any surplus funds to be allocated to benefit public education.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

June 22, 2011

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

Fiscal Year 2010-11	Quarter Ended							
	09/30/2010		12/31/2010		03/31/2011		06/30/2011	
		%		%		%		%
Sales ¹	\$ 755,772,046	100.00%	\$ 1,588,919,168	100.00%	\$	%	\$	%
Administration	\$ 96,130,047	12.72%	\$ 202,106,959	12.72%	\$	%	\$	%
Prizes	410,400,634	54.30%	871,070,040	54.82%		%		%
Available for education	249,241,365	32.98%	515,742,169	32.46%		%		%
Total prizes and available for education	\$ 659,641,999	87.28%	\$ 1,386,812,209	87.28%	\$		\$	
Other income ²	\$ 4,301,850		\$ 17,480,033		\$		\$	
Adjustment	\$ 4,990,627 ⁴		\$ —		\$		\$	
Adjustment	\$ (4,462,218) ⁵		\$ —		\$		\$	
Transfer to education	\$ 254,071,624		\$ 533,222,202		\$		\$	

Fiscal Year 2009-10	Quarter Ended							
	09/30/2009		12/31/2009		03/31/2010		06/30/2010 ⁷	
		%		%		%		%
Sales ¹	\$ 797,978,266	100.00%	\$ 1,493,295,907	100.00%	\$ 2,242,907,213	100.00%	\$ 3,040,959,866	100.00%
Prizes	\$ 427,670,458	53.59%	\$ 793,743,387	53.15%	\$ 1,194,510,180	53.26%	\$ 1,611,371,074	52.99%
Administration	\$ 94,051,992	11.79%	\$ 180,429,092	12.09%	\$ 273,754,469	12.20%	\$ 400,961,056	13.19%
Available for Education	\$ 276,255,816	34.62%	\$ 519,123,428	34.76%	\$ 774,642,564	34.54%	\$ 1,028,627,736	33.82%
Prizes and Available for Education	—		—		—		2,639,998,810	86.81%
Other Income ²	13,587,856		42,704,717		48,576,246		65,581,701	
Adjustment	4,420,315 ⁶		—		—		(4,990,627) ⁴	
Adjustment	7,297,200 ³		—		—		—	
Transfer to Education	\$ 301,561,187		\$ 561,828,145		\$ 823,218,810		\$ 1,089,218,810	

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 education

Annual Statutory Requirements With AB 142 (enacted April 8, 2010)

Prizes = Not less than 50% of sales
Administration = No more than 13% of sales
Prizes and available for education = Not less than 87% of sales
Other income = 100% due 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. The first quarter through the fourth quarter of fiscal year (FY) 2009-10 includes net proceeds from investment restructuring.

³ The amount represents the \$7,297,200 from the FY 2008-09 audit adjustment.

⁴ This amount represents the \$4,990,627 withheld in the fourth quarter of FY 2009-10, pending the financial audit and resolution of accounting issues.

⁵ This amount represents the \$4,462,218 from the FY 2009-10 audit adjustment.

⁶ This amount represents \$4,420,315 withheld in the fourth quarter of FY 2008-09, pending the financial audit and resolution of accounting issues.

⁷ AB 142 was enacted on April 8, 2010.

**Attachment—
California Lottery's
Transfer Request of February 25, 2011**

600 North Tenth Street
Sacramento, CA 95811
calottery.com



February 25, 2011

Mr. Michael Havey, Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Mr. Havey:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$279,678,987. This figure represents:

Operating income for the six months ended December 31, 2010	\$ 515,742,169
SMIF interest earned	943,780
Other income	38,155
Unclaimed prizes	<u>16,498,098</u>
	<u>\$ 533,222,202</u>
Less: Transfer for the three months ended September 30, 2010	253,543,215
	<u>\$ 279,678,987</u>

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the six months ended December 31, 2010, prepared from books without audit, for your files.

Sincerely,

Michael Ota

Michael Ota, Deputy Director
Finance Division

Attachment
cc: Linh Nguyen, Acting Director

CALIFORNIA STATE LOTTERY FUND
Statement of Revenues, Expenses, and Changes in Net Assets
For the Six Months Ending December 31, 2010

Lottery sales	\$1,588,919,168
Prizes	871,070,040

Sales after prizes	\$717,849,128

Less game costs:	
Retailer costs	\$108,438,063
On-line game costs	15,900,866
Off-line game costs	9,310,171

Total game costs	\$133,649,100

Income before operating expenses	\$584,200,028

Operating expenses:	
Salaries, wages and benefits	\$22,858,241
Advertising	25,810,063
Promotion, public relations and point of sale	3,666,879
Other professional services	4,461,533
Depreciation and amortization	3,584,283
Other general and administrative expenses	8,076,860

Total operating expenses	\$68,457,859

Operating income	\$515,742,169
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	(\$31,987,128)
Other Income	38,155
Allocation to Education Fund (Note 7)	(\$16,724,104)

Total non-operating (expenses) revenues	(\$548,673,077)
Changes in net assets	(\$32,930,908)
Total net assets-beginning of year	125,850,167

Total net assets-end of year	\$92,919,259
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**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

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