

CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended September 30, 2007



JOHN CHIANG
California State Controller

April 2008



JOHN CHIANG
California State Controller

April 30, 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 September 30, 2007.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$324,730,338, 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
Roberto Zavala, Chief
Internal Audits Office
California Lottery

Contents

Report of Analysis

Summary	1
Introduction	1
Background	1
Objectives, Scope, and Methodology	1
Results	2
Schedule 1—Summary of Lottery Transfers and Status of Compliance with Statutory Requirements	3
Attachment—California Lottery’s Transfer Request of November 20, 2007	

Report of Analysis

Summary

In a letter dated November 20, 2007, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$324,730,338 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 December 28, 2007, \$324,730,344.60 was transferred to the Lottery Education Fund. The difference of \$6.60 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 the Lottery's 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 September 30, 2007, we determined that the Lottery's request to transfer \$324,730,338 to the Lottery Education Fund is supported by formal accounting records.

According to the unaudited financial statements for the quarter ended December 30, 2007, the total amount available for transfer to education was \$306,669,549. In addition, the Lottery transferred (1) the \$3,997,089 withheld from the last quarter of the 2006-07 fiscal year pending the annual financial statement audit and resolution of accounting issues, and (2) the \$14,063,700 resulting from an audit adjustment noted in the 2006-07 fiscal year financial statement audit.

The amount transferred to public education was 35.35% 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 11.51% of sales. If expenses are less than 16% of total annual revenues, the Lottery Act requires that the surplus funds be allocated to benefit public education. The surplus administrative funds were used to increase the prizes to the public. The Lottery returned 53.14% of the total quarterly revenues to the public in the form of prizes.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

April 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%						
Prizes	\$ 439,733,766	53.14%						
Administration	\$ 95,226,483	11.51%						
Available for Education	\$ 292,505,626	35.35%						
Other Income ²	14,163,923							
Adjustment	3,997,089 ⁴							
Adjustment	14,063,700 ⁵							
Transfer to Education	\$ 324,730,338							

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 September 30, 2007**



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

November 20, 2007

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 \$324,730,338. This figure represents:

Operating income for the three months ended September 30, 2007	\$ 292,505,626
SMIF interest earned	5,763,115
Other Income	315,313
Unclaimed prizes	<u>8,085,495</u>
	<u>\$ 306,669,549</u>
Amount withheld from 2006-07 fiscal year Pending audit:	3,997,089
2006-2007 audit adjustment	14,063,700
	<u>\$ 324,730,338</u>

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the three months ended September 30, 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 Three Months Ending September 30, 2007

Lottery sales	827,465,875
Prizes	439,733,766

Sales after prizes	387,732,109

Less game costs:	
Retailer costs	57,591,522
On-line game costs	9,649,647
Off-line game costs	4,186,538

Total game costs	71,427,707

Income before operating expenses	316,304,402

Operating expenses:	
Salaries, wages and benefits	10,788,915
Advertising	3,317,443
Promotion, public relations and point of sale	3,105,660
Other professional services	1,669,350
Depreciation and amortization	2,070,870
Other general and administrative expenses	2,846,538

Total operating expenses	23,798,776

Operating income	292,505,626
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	45,489,920
Other income	315,313
Allocation to Education Fund (Note 7)	(298,584,054)

Total non-operating (expenses) revenues	(252,778,821)
Changes in net assets	39,726,805
Total net assets-beginning of year	95,315,400

Total net assets-end of year	\$135,042,205
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**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, California 94250-5874**

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