

# CALIFORNIA LOTTERY

Report of Analysis

## QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

*For the Quarter Ended December 31, 2006*



**JOHN CHIANG**  
California State Controller

July 2007



**JOHN CHIANG**  
**California State Controller**

July 31, 2007

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, 2006.

Our review disclosed that the Lottery's accounting records supported the requested transfer of \$286,422,555, 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/vb

cc: John Mass, Commissioner  
California Lottery Commission  
Rachel Montes, Commissioner  
California Lottery Commission  
Manuel Ortega, Commissioner  
California Lottery Commission  
Patt Eberhart, Director  
Finance and Administration  
California Lottery  
Cathleen Dinubilo, Chief  
Internal Audits Office  
California Lottery

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# Report of Analysis

## Summary

In a letter dated February 27, 2006, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$286,422,555 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, 2007, \$286,422,555 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, 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 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 dated February 27, 2007, and the supporting records for the six-month period ended December 31, 2006, we determined that the Lottery's request to transfer \$286,422,555 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 \$572,421,907 for the six-month period ended December 31, 2006. Of this amount, \$285,999,352 was transferred to the Lottery Education Fund on September 30, 2006, leaving a balance of \$286,422,555. This balance was transferred to the Lottery Education Fund on March 30, 2007.

The amount transferred to public education was 34.05% of the total revenue for the six-month period ended December 31, 2006. 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 six-month period ended December 31, 2006 were 12.06% 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.

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

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

Fiscal Year 2006-07	Quarter Ended							
	09/30/2006	%	12/31/2006	%	03/31/2007	%	06/30/2007	%
Sales <sup>1</sup>	\$ 790,585,222	100.00%	\$ 1,604,229,558	100.00%	\$		\$	
Prizes	\$ 424,411,747	53.68%	\$ 864,608,763	53.89%	\$		\$	
Administration	\$ 93,397,271	11.82%	\$ 193,449,040	12.06%	\$		\$	
Available for Education	\$ 272,776,204	34.50%	\$ 546,171,755	34.05%	\$		\$	
Other Income <sup>2</sup>	13,223,148		553,314					
Adjustment	3,909,760 <sup>3</sup>		—					
Transfer to Education	\$ 289,909,112		\$ 546,725,069		\$		\$	

Fiscal Year 2005-06	Quarter Ended							
	09/30/2005	%	12/31/2005	%	03/31/2006	%	06/30/2006	%
Sales <sup>1</sup>	\$ 884,100,492	100.00%	\$ 1,751,695,899	100.00%	\$ 2,679,710,604	100.00%	\$ 3,584,996,251	100.00%
Prizes	\$ 473,050,791	53.51%	\$ 948,661,697	54.16%	\$ 1,447,084,544	54.00%	\$ 1,932,721,443	53.91%
Administration	\$ 95,823,919	10.84%	\$ 198,884,893	11.35%	\$ 302,950,716	11.31%	\$ 413,062,844	11.52%
Available for Education	\$ 315,225,782	35.65%	\$ 604,149,309	34.49%	\$ 929,675,344	34.69%	\$ 1,239,211,964	34.57%
Other Income <sup>2</sup>	12,419,435		23,970,392		35,412,975		48,786,115	
Adjustment	3,531,079 <sup>4</sup>		—		—		(3,909,760) <sup>3</sup>	
Transfer to Education	\$ 331,176,296		\$ 628,119,701		\$ 965,088,319		\$ 1,284,088,319	

### 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.

<sup>1</sup> Quarterly amounts represent fiscal year-to-date totals.

<sup>2</sup> Includes interest income, other income, and unclaimed prizes.

<sup>3</sup> 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.

<sup>4</sup> The amount represents the \$3,531,079 withheld in the fourth quarter of FY 2004-05, pending the financial audit and resolution of accounting issues.

**Attachment—  
California Lottery's  
Transfer Request of February 27, 2007**

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Headquarters  
600 North Tenth Street  
Sacramento, Ca 95834

IB/12  
Adler 4/1/07

February 27, 2007

Mr. John A. Korach, Accounting Division Chief  
Division of Accounting and Reporting  
State Controller's Office  
3301 C Street, Suite 500  
Sacramento, CA 958163

Dear Mr. Korach:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$286,422,555. This figure represents:

Operating income for the six months ended December 31, 2006	\$ 546,171,755
SMIF interest earned	11,226,004
Other Income	553,314
Unclaimed prizes	<u>14,470,834</u>
	<u>\$ 572,421,907</u>
Less: Transfer for the three months Ended September 30, 2006:	<u>285,999,352</u>
	<u>\$ 286,422,555</u>

We have attached a copy of the Statement of Revenues, Expenses and Changes in Net Assets for the six months ended December 31, 2006, prepared from books without audit, for your files.

Sincerely,

  
Patricia Eberhart, Director  
Finance and Administration Division

Attachment

cc: Joan Borucki, Director



1B/13  
Add 4/17/07

**CALIFORNIA STATE LOTTERY FUND**  
Statement of Revenues, Expenses, and Changes in Net Assets  
For the Six Months Ending December 31, 2006  
Prepared from Books without Audit

Lottery sales	
Prizes	\$1,604,229,558
	<u>864,608,763</u>
Sales after prizes	739,620,795
Less game costs:	
Retailer costs	113,709,724
On-line game costs	17,483,851
Off-line game costs	<u>9,862,441</u>
Total game costs	141,056,016
Income before operating expenses	598,564,779
Operating expenses:	
Salaries, wages and benefits	21,407,669
Advertising	13,895,565
Promotion, public relations and point of sale	3,913,080
Other professional services	2,750,547
Depreciation and amortization	4,626,522
Other general and administrative expenses	<u>5,799,641</u>
Total operating expenses	52,393,024
Operating income	546,171,755
Non-operating (expenses) revenues:	
Investment earnings (Note 9)	39,989,231
Other Income	553,314
Allocation to Education Fund (Note 7)	<u>(557,951,073)</u>
Total non-operating (expenses) revenues	(517,408,528)
Changes in net assets	28,763,227
Total net assets-beginning of year	104,231,017
Total net assets-end of year	<u>\$132,994,244</u>

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

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