

CALIFORNIA STATE LOTTERY

Review Report

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended December 31, 2020



MALIA M. COHEN
California State Controller

November 2023



MALIA M. COHEN
CALIFORNIA STATE CONTROLLER

November 27, 2023

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 Lottery Education Fund for the quarter ended December 31, 2020. Our review found that the transfer amount of \$412,228,178 is supported by the Lottery's accounting records, and that the Lottery was on target to meet 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, 2021.

If you have any questions, please contact Roochel Espilla, Chief, State Agency Audits Bureau, by telephone at (916) 323-5744, or by email at respilla@sco.ca.gov.

Sincerely,

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/rs

Mr. Alva Vernon Johnson
November 27, 2023
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cc: Gregory Ahern, Chair

California State Lottery Commission

Tiffani Alvidrez, Commissioner

California State Lottery Commission

Anthony Garrison-Engbrecht, Commissioner

California State Lottery Commission

Keetha Mills, Commissioner

California State Lottery Commission

Alexandre Rasouli, M.D., Commissioner

California State Lottery Commission

Harjinder Shergill-Chima, Chief Deputy Director

California State Lottery

Nicholas Buchen, Deputy Director, Finance Division

California State Lottery

Sara Sheikholislam, Deputy Director, Internal Audits

California State Lottery

Emily Nguyen, Audit Manager, Internal Audits

California State Lottery

Mimi Alemu, External Audits Liaison, Internal Audits

California State Lottery

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Review Report

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Attachment—California State Lottery’s Transfer Request Dated March 9, 2021

Review Report

Summary

The California State Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$412,228,178 to the Lottery Education Fund for disbursement to the public education community for the quarter ended December 31, 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 was on target to meet 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, 2021.

Background

In 1984, California voters passed an initiative, Proposition 37, to authorize the creation of a state-operated lottery. The initiative created the Lottery Act, which is found in Chapter 12.5 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. The Lottery's request usually occurs eight to 10 weeks after the close of each quarter. The transfer request for the quarter ended December 31, 2020, is included as an attachment.

Review Authority

We conducted this review in accordance with Government Code section 8880.46.6, which authorizes the SCO to conduct quarterly and annual audits of all accounts and transactions of the Commission and other special audits as necessary. The SCO 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 review were to determine whether:

- The requested transfer amount was supported by accounting records; and
- The Lottery was on target to meet the annual allocation requirements specified in the Lottery Act.

We performed this review for the second quarter ended December 31, 2020. To achieve our objectives, we performed the following procedures:

- We compared fiscal year (FY) 2020-21 audited income statement balances with FY 2019-20 audited income statement balances and performed analytical procedures for variances over 15%.
- We traced amounts reported in the income statement to the Lottery's accounting records.
- We judgmentally selected sales and expense items, based on dollar amount and type, and traced to supporting documentation. Results were not projected to the intended (total) population.
- We determined whether the Lottery met the annual revenue allocation requirements specified in the Lottery Act.
- We determined whether the requested amount was transferred to the Lottery Education Fund.
- We verified that the funds were transferred from the Lottery Education Fund to the public education community for the quarter ended December 31, 2020.

Results

Based on the work performed, we determined that the requested transfer amount of \$412,228,178 for the second quarter ended December 31, 2020, was supported by the Lottery's accounting records. In addition, we determined that the Lottery was on target to meet annual revenue allocation requirements for prize payouts, funds to education, and administrative expenses as specified in the Lottery Act for the quarter ended December 31, 2020.

In a letter dated March 9, 2021, the Lottery requested that the SCO transfer \$412,228,178 to the Lottery Education Fund for disbursement to the public education community. On March 25, 2021, the SCO's Local Government Programs and Services Division transferred \$412,228,178 from the State Lottery Fund to the Lottery Education Fund.

For the six months ended December 31, 2020, of the total revenues from ticket sales:

- 67.33% was returned to the public in the form of prize payouts;
- 21.40% was transferred to the public education community; and
- 11.27% was used for administrative expenses.

The Lottery returned 88.73% of total revenues from ticket sales in the form of prize payouts and funds to education. The Lottery was on target to meet annual allocation requirements specified in the Lottery Act. See the Schedule for a summary of Lottery revenue allocations and allocation percentages.

**Views of
Responsible
Officials**

We discussed our results with Lottery representatives via email on May 9, 2023. As there are no findings, the Lottery waived the exit conference and draft report. We agreed the report would 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 and is available on the SCO website at www.sco.ca.gov.

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

November 27, 2023

Schedule—
Fiscal Year 2020-21 and Fiscal Year 2019-20
Year-to-Date Lottery Revenue Allocations

| Fiscal Year 2020-21 | Three Months Ended 9/30/2020 | % of Sales¹ | Six Months Ended 12/31/2020 | % of Sales¹ | Nine Months Ended 3/31/2021 | % of Sales¹ | Twelve Months Ended 6/30/2021 | % of Sales¹ |
|--|---|-----------------------------------|--|-----------------------------------|--|-----------------------------------|--|-----------------------------------|
| Sales | \$ 2,025,442,485 | 100.00% | \$3,890,623,608 | 100.00% | | | | |
| Prizes | 1,374,317,474 | 67.85% | 2,619,737,310 | 67.33% | | | | |
| Operating income | 424,642,033 | 20.97% | 832,487,855 | 21.40% | | | | |
| Revenues returned to public | 1,798,959,507 | 88.82% | 3,452,225,165 | 88.73% | | | | |
| Administrative expenses | 226,482,978 | 11.18% | 438,398,443 | 11.27% | | | | |
| Miscellaneous income ² | 10,151,995 | | 14,534,351 | | | | | |
| Adjustment | - | | - | | | | | |
| Allocation to Education Fund ⁴ | \$ 434,794,028 | | \$ 847,022,206 | | | | | |

| Fiscal Year 2019-20 | Three Months Ended 9/30/2019 | % of Sales¹ | Six Months Ended 12/31/2019 | % of Sales¹ | Nine Months Ended 3/31/2020 | % of Sales¹ | Twelve Months Ended 6/30/2020 | % of Sales¹ |
|--|---|-----------------------------------|--|-----------------------------------|--|-----------------------------------|--|-----------------------------------|
| 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 ³ | | (19,050,946) ⁵ | |
| Allocation to Education Fund ⁴ | \$ 417,662,032 | | \$ 803,180,819 | | \$1,187,009,513 | | \$1,493,529,416 | |

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 2018-19 fourth-quarter transfer, and was adjusted in the FY 2019-20 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 2019-20 fourth-quarter transfer, and will be 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 March 9, 2021**



March 9, 2021

Natalie Sidarous, Chief
Local Government Programs and Services Division
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Ms. Sidarous:

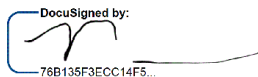
The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$412,228,178. This figure represents:

| | |
|---|-----------------------|
| Operating income for the six months ended December 31, 2020 | \$ 832,487,855 |
| SMIF interest earned | 2,052,480 |
| Other income | 18,348 |
| Unclaimed prizes | <u>12,463,523</u> |
| | \$ 847,022,206 |
| Less: Transfer for the three months ended September 30, 2020 | <u>434,794,028</u> |
| | <u>\$ 412,228,178</u> |

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Position for the six months ended December 31, 2020, prepared from books without audit, for your files.

Please note, the amount withheld from the 2019-20 transfer pending audit will be included in a subsequent transfer after the June 2020 audit is complete.

Sincerely,

DocuSigned by:

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 Six Months Ended December 31, 2020

| | |
|---|--------------------------------|
| Operating revenues: Lottery sales | \$ 3,890,623,608 |
| Prizes | <u>\$ 2,619,737,310</u> |
| Sales after prizes | <u>\$ 1,270,886,298</u> |
| Less game costs: | |
| Retailer costs | \$ 273,480,359 |
| Gaming System costs | \$ 43,814,374 |
| Scratchers® game costs | <u>\$ 25,178,176</u> |
| Total game costs | <u>\$ 342,472,909</u> |
| Income before operating expenses | <u>\$ 928,413,389</u> |
| Operating expenses: | |
| Salaries, wages and benefits | \$ 45,472,190 |
| Advertising | \$ 24,413,769 |
| Promotion, public relations and point of sale | \$ 1,952,798 |
| Other professional services | \$ 8,595,879 |
| Depreciation and amortization | \$ 8,547,912 |
| Other general and administrative expenses | <u>\$ 6,942,986</u> |
| Total operating expenses | <u>\$ 95,925,534</u> |
| Operating income | <u>\$ 832,487,855</u> |
| Non-operating (expenses) revenues: | |
| Investment earnings (Note 9) | \$ (16,491,356) |
| Other Income | \$ 18,348 |
| Allocation to Education Fund (Note 7) | <u>\$ (834,558,683)</u> |
| Total non-operating (expenses) revenues | <u>\$ (851,031,691)</u> |
| Changes in net position | \$ (18,543,836) |
| Total net position - beginning of year | <u>\$ (81,457,353)</u> |
| Total net position - ending balance | <u><u>\$ (100,001,189)</u></u> |

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

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