



National Audit Office

Report

by the Comptroller
and Auditor General

Department for Digital, Culture, Media & Sport

Investigation: National Lottery funding for good causes

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National Audit Office

Department for Digital, Culture, Media & Sport

Investigation: National Lottery funding for good causes

Report by the Comptroller and Auditor General

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National Audit Act 1983 for presentation to the House of
Commons in accordance with Section 9 of the Act

Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

8 December 2017

This report investigates the fall in National Lottery income for good causes in 2016-17. It reviews the trends in total National Lottery sales and income for good causes, focusing on the six distributors with the largest share of National Lottery income and the way they have managed the balances within the National Lottery Distribution Fund.

Investigations

We conduct investigations to establish the underlying facts in circumstances where concerns have been raised with us, or in response to intelligence that we have gathered through our wider work.

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What this investigation is about

1 The Department for Digital, Culture, Media & Sport (the Department) launched the National Lottery (the Lottery) in November 1994. The Lottery, currently run by Camelot UK Lotteries Limited (Camelot), aims to raise money for good causes in the arts, sports, heritage, health, education, environment and charitable sectors. A proportion of proceeds from the Lottery is paid into the National Lottery Distribution Fund (the Fund). This money is drawn on by 12 non-departmental public bodies (the distributors) that make payments to good causes.

2 This investigation looks into concerns discussed at board level by Lottery distributors since April 2016. These concerns include:

- the recent fall in Lottery income for good causes;
- the impact of reduced funding on distributors' ability to meet future spending commitments and the work being done to model the potential further impact; and
- the amount of information given to distributors to help them plan their future awards.

3 This investigation sets out the facts relating to Lottery income for good causes and the way balances in the Fund are managed. It covers:

- trends in Lottery funding over time and how Lottery income for good causes varies across Lottery games;
- research into the impact on Lottery income of competition and changes in player behaviour, among other factors;
- information provided by the Department, the Gambling Commission and Camelot to assist Lottery distributors in their planning; and
- work done by distributors to model the impact of reduced Lottery funding on their ability to meet spending commitments.

4 Our investigation covers the six distributors with the largest share of Lottery income in 2016-17. These received a total of 94% of Lottery income for good causes in 2016-17 and held 91% of the Fund balance at 31 March 2017. Our work does not assess the value for money of Lottery distributors' expenditure.

5 Our investigation covers the period from 2004, when we published our report on the management of Fund balances. Key events and the trends in Lottery income for good causes since 2004 are set out in **Figure 1** on pages 5 and 6. Appendix One sets out our methodology.

Figure 1
Timeline of key events and total National Lottery income for good causes since 2004

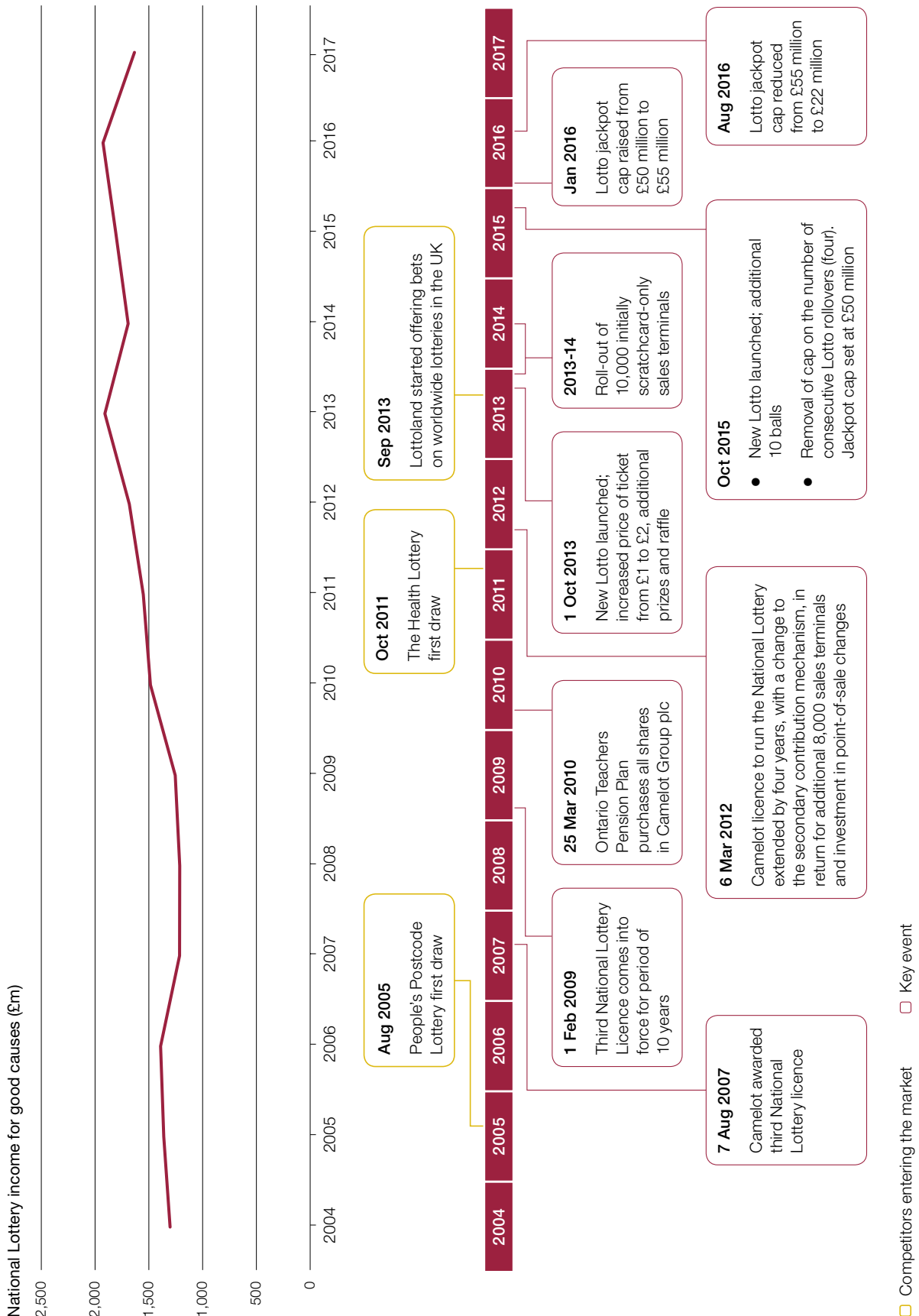


Figure 1 *continued*

Timeline of key events and total National Lottery income for good causes since 2004

Notes

- 1 The graph shows National Lottery Distribution Fund account figures for National Lottery income for good causes and excludes investment income. Economic factors influence investment income, which was £156 million in 2003-04 and £5 million in 2016-17.
- 2 Secondary contribution relates to Camelot's profits. When Camelot makes a profit greater than the one that it had predicted in its bid, it will share this profit with the good causes.
- 3 Most of the terminals rolled out in 2013-14 have recently been upgraded to offer some draw-based games, but do not offer the full range of games offered by Camelot.
- 4 Figures are expressed in nominal terms and therefore not adjusted for inflation.

Source: National Audit Office

Summary

Key findings

Income for good causes

1 National Lottery (the Lottery) income for good causes increased between 2004-05 and 2015-16, but fell in 2016-17. Lottery income for good causes rose by 42% from £1.36 billion in 2004-05 to £1.93 billion in 2015-16. However, in the 12 months from 1 April 2016, income for good causes fell by 15% to £1.63 billion at the same time as Lottery sales fell by 9% to £6.93 billion, compared with the previous year. Camelot predicts a further fall in sales and income for good causes in 2017-18 (paragraph 2.7 and Figure 8).¹

2 In 2016-17, Lottery sales decreased by 13% on draw-based games and 2% on scratchcards and instant-win games (instants). The Department for Digital, Culture, Media & Sport (the Department), the Gambling Commission (the Commission) and Camelot have identified some possible reasons for the fall in sales, including consumers' reaction to recent changes to Lottery games, increased competition and consumers moving away from playing draw-based games. They have not been able to establish the financial impact of these individual factors (paragraphs 2.7 and 2.14, and Figures 7 and 8).

3 Returns for good causes are higher from sales of draw-based games. The rate of return for good causes varies across different Lottery games. As at February 2017, for each pound spent on the Lottery, the approximate returns for good causes ranged from 34p for draw-based games bought online to 10p for scratchcards, with some scratchcards returning as little as 5p. Camelot told us that instants return less to good causes due to the need to offer a higher proportion of proceeds as prizes for instants to encourage consumers to participate. In 2016-17 the prize fund accounted for approximately 68% of gross sales for scratchcards, compared with 49% for draw-based games. The calculation of the amount that goes to good causes is set in Camelot's operating licence and depends on a number of factors including the level of sales, what is paid out in prizes, Camelot's retention and retailers' commission (paragraph 2.8 and Figure 9).

¹ Throughout this report we use Camelot to refer to both Camelot UK Lotteries Limited and the former Camelot Group plc. Camelot UK Lotteries Limited has been the operator of the National Lottery since 2010 following the purchase of Camelot Group plc by Ontario Teachers' Pension Plan.

4 Increases in Camelot's profits have been proportionately greater than increases in both Lottery sales and returns for good causes. Camelot's accounts show that, comparing 2009-10 and 2016-17, Lottery sales increased by 27% (£1.5 billion) to £6.9 billion. Comparing the same dates, returns for good causes increased by 2% (£31 million) to £1.5 billion and Camelot's profit attributable to its shareholders increased by 122% (£39 million) to £71 million.² The amount that Camelot keeps to cover costs and profit was set in 2009, in the third operating licence, and is a percentage of both gross and net sales, rather than a direct linear relationship to what has been raised for good causes (paragraphs 2.4, 2.10 and Figure 6).

5 The method of calculating returns for good causes was set in Camelot's 2009 licence and does not reflect subsequent changes in sales across different types of Lottery games. The Lottery's overarching objective is to maximise returns for good causes through selling Lottery products in an efficient and socially responsible way. The relative decline in sales of draw-based games compared with instant games has led to a lower rate of return to good causes. The licence terms were set in 2009 and Camelot's current licence term ends in 2023. Any changes to the basis for calculating returns for good causes prior to 2023 would need to be agreed by the Commission and Camelot (paragraphs 1.2, 2.3 and 2.9 and Figure 10).

Management of balances in the National Lottery Distribution Fund

6 Half of the six largest Lottery distributors increased their grant commitments in 2016-17 at the same time as Lottery income fell. Funding liabilities of the six largest distributors increased by a total of £88 million compared with the prior year. At 31 March 2017, distributors' liabilities as a percentage of their National Lottery Distribution Fund (the Fund) balance ranged from 19% for UK Sport to 342% for the Big Lottery Fund. Distributors often have commitments spanning many years, so it is likely that commitments will exceed their Fund balance at a given date. However, between 2009-10 and 2016-17, the total available Fund balance increased by 18% (to £1.54 billion) while total grant liabilities increased by 37% (to £3.04 billion) (paragraphs 3.4, 3.6 and Figures 12 and 13).

7 The Fund balance at 31 March 2004 was sufficient to cover 96% of total liabilities raised by distributors; at 31 March 2017 this figure had fallen to 51%. At 31 March 2017, Fund balances were £1.5 billion compared to distributors' grant liabilities of £3.0 billion. In July 2005, the Committee of Public Accounts recommended that the Department should set a target to reduce the Fund balance (which stood at £2.7 billion at 31 March 2004). Fund balances are determined by how much money is raised by the Lottery for good causes and how much is paid out by distributors. Since distributors have no control over Lottery income, they manage their balances by planning their grant awards using available information on future Lottery income (paragraphs 3.2, 3.4, 3.7 and 3.8).

² Camelot account figures of funding for good causes exclude income from unclaimed prizes.

8 Since the fall in Lottery income for good causes, distributors have been given more sophisticated information, including short-term forecasts from Camelot. In June 2016, Camelot began to provide distributors with short-term, commercially sensitive forecasts of future Lottery income for good causes. Prior to this, until October 2015, the Department shared with distributors projections of future income for good causes based purely on projecting historical trends. In June 2017, the Department gave all distributors an external consultancy's analysis that modelled future income for good causes up to 2019-20. Distributors have raised concerns that the modelling makes no adjustment for the impact of any structural changes in the Lottery, such as game changes to address the recent fall in sales. The Department told us that the modelling work will be repeated following Camelot's recent strategic review of its business and it did not believe it would have been helpful to model the impact of potential game changes prior to Camelot's review, given the wide range of potential variables. The six largest distributors have modelled different scenarios of potential income when setting future years' grant budgets. Many distributors continue to use their own estimates of future income for good causes informed by the data sources available, causing some duplication (paragraphs 3.11 and 3.14 to 3.16).

9 The Department gives distributors information to help them manage their balances; but distributors told us they do not get all the information they need. The Department can request any data it wishes from the Commission, in accordance with its management agreement, and receives detailed information, including weekly sales by game and monthly returns for good causes. The Department does not give the distributors weekly sales figures split by game, even though they have asked for them. Distributors have told us that prompt sharing of such data allows them to spot declining or increasing income early, helping them to plan their future grant awards. The Department believes that weekly sales data does not provide a clear indication of trends due to the range of factors that may cause Lottery sales to fluctuate from week to week (paragraph 3.18).

Part One

About the National Lottery

The National Lottery was set up to raise money for good causes

1.1 This part sets out the background to the National Lottery (the Lottery), how Lottery money gets from players to good causes and how it is different from other lotteries. The first Lottery draw took place in November 1994. To date, the Lottery has raised more than £37 billion for good causes, and reports that it has funded more than 525,000 projects in the arts, sports, heritage, health, education, environment and charitable sectors.³ **Figure 2** shows income for good causes since 2004-05.

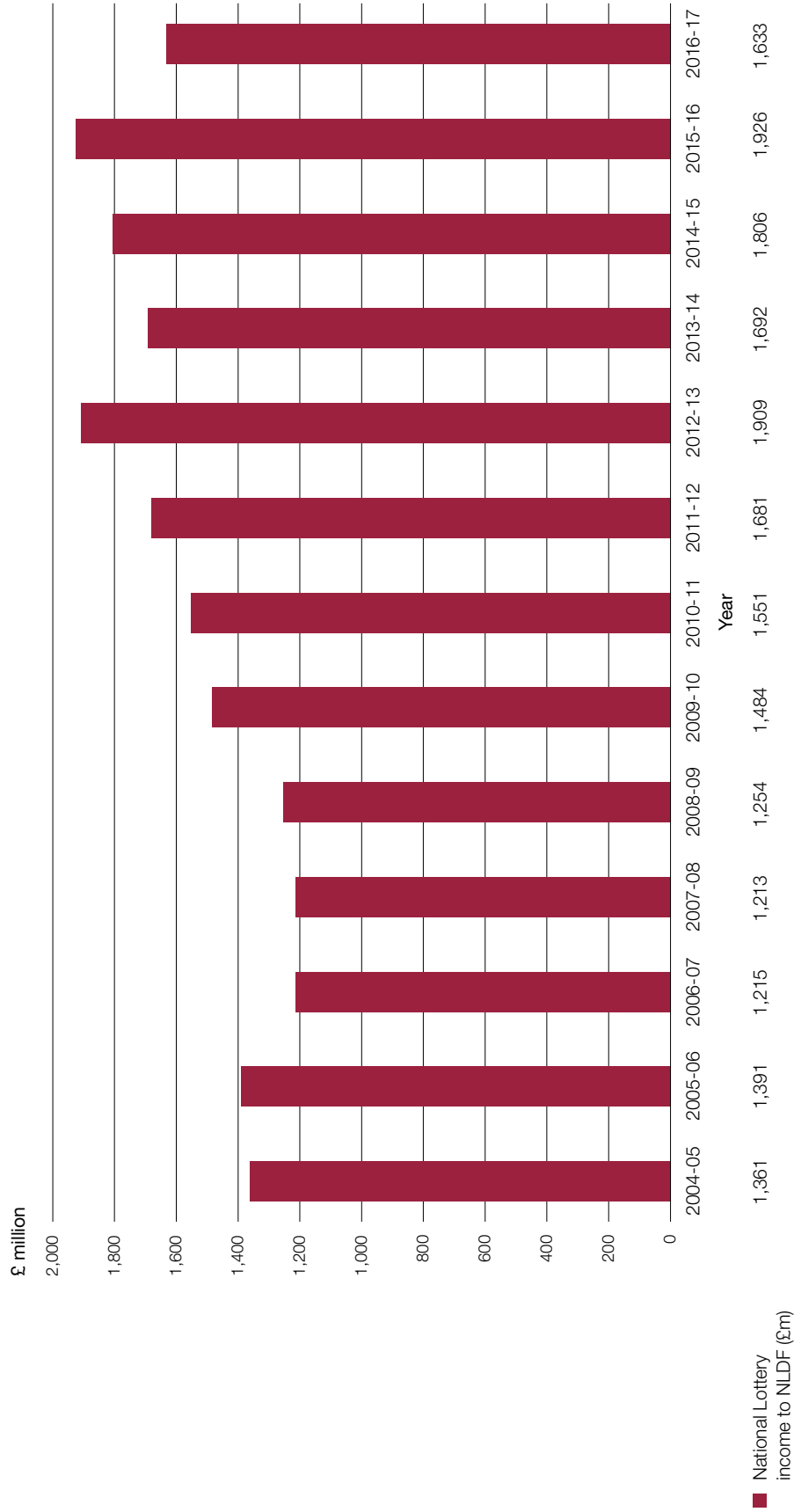
1.2 Camelot has operated the Lottery since its launch. On 1 February 2009, Camelot's third Section 5 operating licence (the licence) came into force. This was granted by the National Lottery Commission, then the regulator of the Lottery.⁴ In March 2010, it was announced that Camelot was to be purchased by Ontario Teachers' Pension Plan, and the acquisition was completed in July 2010. In March 2012, the licence was extended by four years to run to 2023 in exchange for Camelot investing in the roll-out of 8,000 new Lottery sales terminals. The Lottery's overarching objective is to maximise returns for good causes through selling Lottery products in an efficient and socially responsible way.

1.3 Projects benefiting from Lottery funding range from large awards to flagship projects and bodies, such as the Angel of the North and the Royal Shakespeare Company, to small grants for local community groups or individuals. The Lottery also funds one-off events. It awarded £2.7 billion for projects to mark the new millennium and contributed almost £2.2 billion towards the costs of staging the 2012 London Olympic and Paralympic Games.

3 Source data of money raised for good causes is the National Lottery Distribution Fund annual report and accounts from 1994-95 to 2016-17 and Gambling Commission published data on funding for good causes from 1 April 2017 to 30 September 2017. Figure includes investment income. The Lottery also raised £2.2 billion through Lottery games set up solely to raise funds for the 2012 London Olympic and Paralympic Games. The source of this data is the Olympic Lottery Distribution Fund annual report and accounts. The National Lottery reporting of projects funded is available at: www.lotterygoodcauses.org.uk.

4 The Gambling Commission has been the regulator of the National Lottery since October 2013 when the National Lottery Commission and Gambling Commission formally merged.

Figure 2
 Total National Lottery income for good causes from 2004-05 to 2016-17
 Before 2016-17 Lottery income for good causes was on an overall upward trend



Notes

- 1 National Lottery Distribution Fund income shown excludes investment income.
- 2 The third Section 5 operating licence for the National Lottery came into force in February 2009.
- 3 Figures are expressed in nominal terms and therefore not adjusted for inflation.

Source: National Audit Office analysis of National Lottery Distribution Fund annual report and accounts

1.4 There are two main types of Lottery game: draw-based games, and non-draw-based games called ‘instants’ (scratchcards and interactive instant-win games). The Gambling Commission (the Commission) reports that, in 2015-16, for every £1 of ticket sales, on average 25p was given to good causes, 53p was spent on prizes, 12p was spent on Lottery duty, 4p went to Lottery retailers and 5p was retained to contribute towards Camelot’s costs (approximately 4p) and its profits (approximately 1p).⁵

Lottery money raised for good causes is paid into the National Lottery Distribution Fund

1.5 The responsibilities of those involved and the process by which money flows from players to good causes is outlined in **Figure 3** on pages 14 and 15. The National Lottery Distribution Fund (the Fund) was set up under the National Lottery etc. Act 1993 and is maintained under the control and management of the Secretary of State for Digital, Culture, Media & Sport (the Culture Secretary).⁶ The Fund’s accounting officer is the Permanent Secretary of the Department for Digital, Culture, Media & Sport (the Department).

Lottery money is given to good causes by 12 distributors

1.6 Our investigation covers the six distributors with the largest share of Lottery income in 2016-17. These distributors receive 94% of income for good causes (**Figure 4** on page 16). The distributors are non-departmental public bodies, which operate at arm’s-length from the government. The chief executive of each distributor is designated as accounting officer and is responsible for ensuring that Lottery funds are distributed with due regard to propriety, regularity and achieving value for money.

1.7 The Department sets the policy and financial framework within which the distributing bodies operate, including the factors that distributors should take into account when deciding who receives funding and what it should be used for. The Culture Secretary issues policy and financial directions to distributing bodies, except for the devolved bodies and for grants spent in the devolved nations awarded from UK-wide distributors.

⁵ The total is 99p due to rounding in each category. Data are published at: www.gamblingcommission.gov.uk/for-the-public/National-Lottery/About-the-National-Lottery.aspx.

⁶ Revised under National Lottery Act 2006.

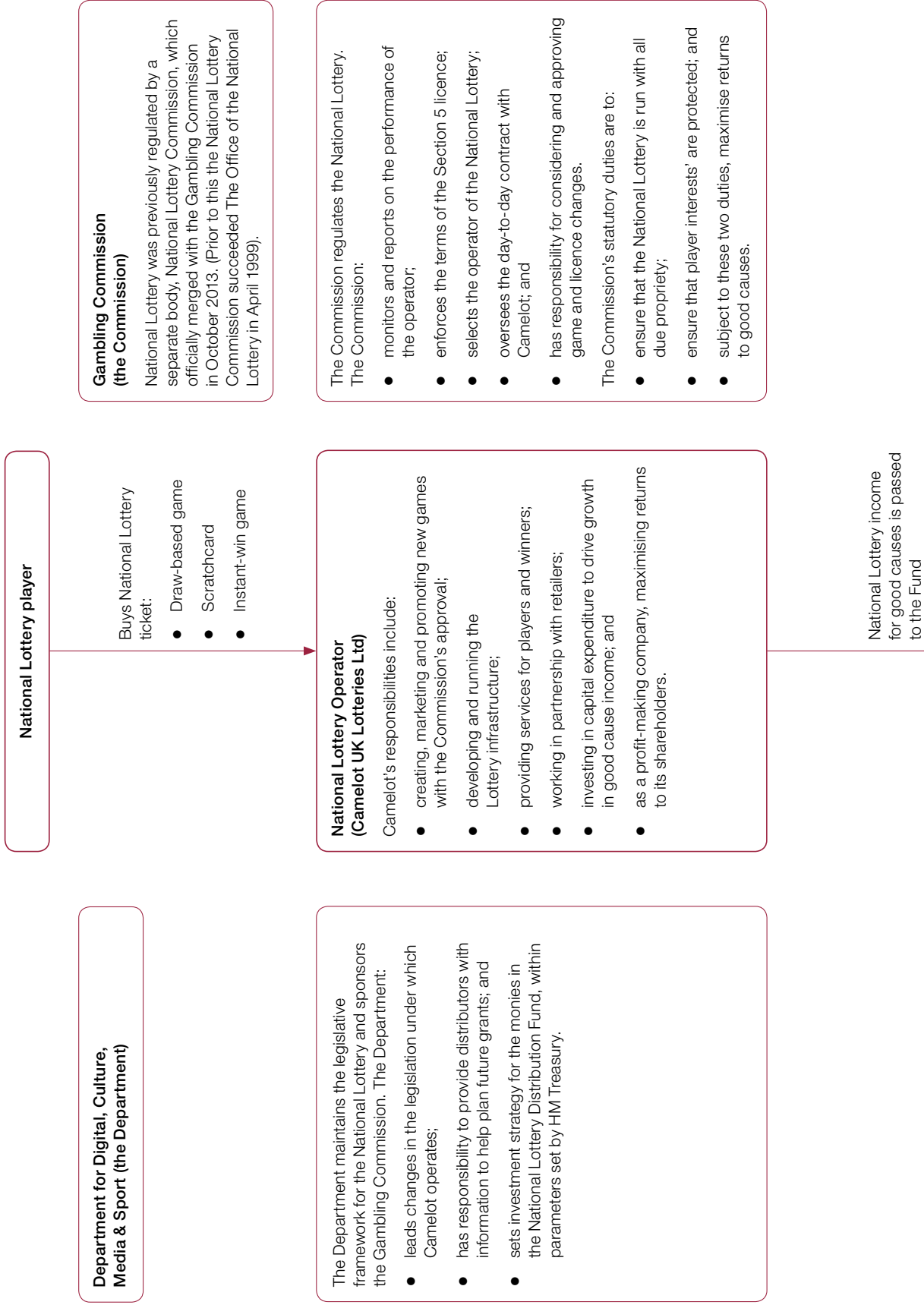
The Lottery faces competition from the wider gambling and lottery sectors

1.8 Although it is a monopoly, the Lottery faces some competition from society lotteries and gambling companies that offer bets on lotteries. Society lotteries include the People's Postcode Lottery and the Health Lottery, which is made up of a number of society lotteries.⁷ The Commission defines society lotteries as lotteries promoted for the benefit of a non-commercial society that are established and conducted for any purpose other than private gain. Another competitor, Lottoland, enables players to bet on the outcome of official Lottery draws around the world, including non-UK Euromillions draws. The Gambling Act 2005 prohibits betting on the outcome of Lottery draws in the UK. In March 2017, the Department launched a consultation on prohibiting third-party bets on non-UK Euromillions draws. **Figure 5** on page 17 compares the Lottery with three competitors that are considerably smaller in size, recording £325 million of ticket sales compared with Lottery ticket sales of £6.9 billion in 2016-17. The Lottery faces a different regulatory structure from its competitors. Society lotteries operate under regulations that restrict the volume of ticket sales and size of prizes and must return at least 20% of their proceeds to good causes. Lottoland pays nothing to good causes. The Lottery pays 12% Lottery duty on its sales proceeds, where the society lotteries are exempt and Lottoland pays 15% remote betting and gaming duty on its profits (sales less winnings paid out). The Department has stated that it is not aware of any evidence of significant substitution of sales between the Lottery and society lotteries to date.

⁷ Society lottery players must be resident in England, Scotland or Wales. National Lottery players must be resident in the United Kingdom or Isle of Man.

Figure 3

How National Lottery money gets from players to good causes



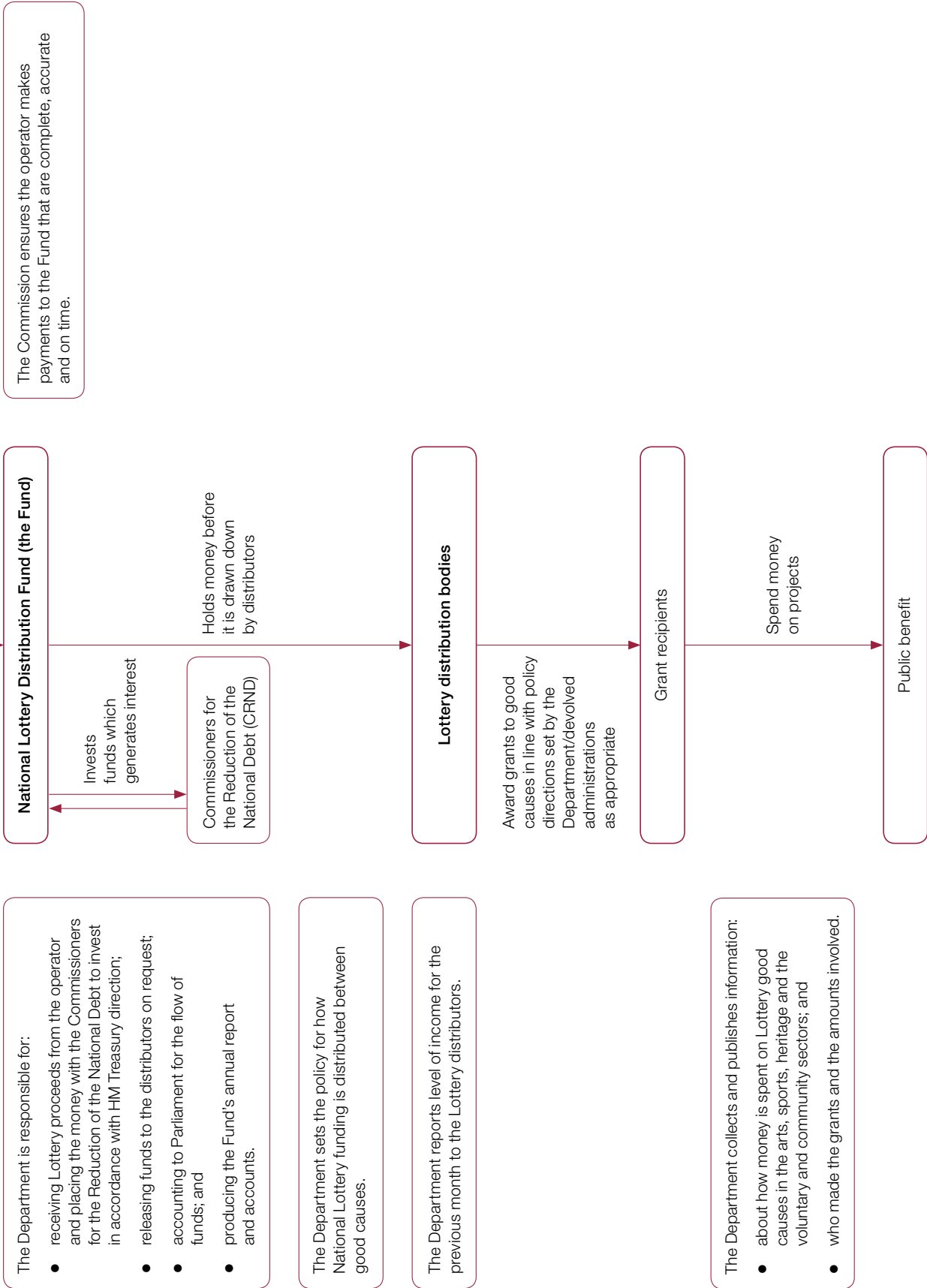


Figure 4
National Lottery distributors

Distributors by cause	Share of National Lottery income for good causes arising from ticket sales 2016-17 (%)
The arts	20
Arts Council England	14
British Film Institute	3
Other ¹	3
Sport	20
Sport England	12
UK Sport	5
Other ²	3
National heritage	20
Heritage Lottery Fund	20
Charity, education, environment and health	40
Big Lottery Fund	40

Notes

- 1 Arts Council of Wales, Arts Council of Northern Ireland and Creative Scotland.
- 2 Sport Scotland, Sport Northern Ireland and Sport Wales.
- 3 Figures rounded to the nearest percentage point.

Source: National Audit Office analysis of National Lottery Distribution Fund annual report and accounts

Figure 5
National Lottery and three competitors

	National Lottery	People's Postcode Lottery	The Health Lottery	Lottoland
First draw	November 1994	August 2005	October 2011	September 2013 ¹
Legislation	National Lottery etc. Act 1993 ²	Gambling Act 2005	Gambling Act 2005	Gambling Act 2005
Licensed and regulated	UK Gambling Commission	UK Gambling Commission	UK Gambling Commission	UK Gambling Commission
Gross ticket sales 2016-17	£6.9 billion	£251 million	£58 million	£15.5 million ³
Maximum prize payout in a single lottery	Differs across games Lotto: £22m ⁴	£400,000 ⁵	£400,000 ⁵	Not applicable
Regulation on yearly ticket sales	Unregulated	Maximum £10 million per promoting society	Maximum £10 million per promoting society	Not applicable
Regulation on marketing expenditure	Minimum set in licence	Monitored by the Gambling Commission ⁶	Monitored by the Gambling Commission ⁶	Not applicable
Regulation on investment expenditure	Minimum set in licence	Monitored by the Gambling Commission	Monitored by the Gambling Commission	Not applicable
Returns for good causes per pound	2015-16 average return: 25p ⁷	Minimum 20p ⁸ Actual 31p ⁹	Minimum 20p ⁸ Actual 20p ⁹	Nil
Lottery duty	12% of sales proceeds	Exempt	Exempt	Exempt – pays remote betting and gaming duty at 15% of profit (sales less winnings paid out)

Notes

- 1 Lottoland started offering bets on worldwide lotteries in the UK.
- 2 More recently revised: National Lottery Act 2006.
- 3 Gross lotto betting sales. Lotto betting is betting on the result of official Lottery draws around the world.
- 4 Lotto jackpot cap is £22 million. If it reaches £22 million, the game is able to roll one more time before it must be won.
- 5 Gambling Act 2005: Society lotteries maximum prize in a single Lottery is £25,000 or 10% of the proceeds up to £4 million (giving a maximum theoretical prize of £400,000), whichever is greater.
- 6 Gambling Act 2005 removed, for society lotteries, the cap of 35% on marketing expenditure.
- 7 National Lottery 2015-16 average return for good causes published at www.gamblingcommission.gov.uk/for-the-public/National-Lottery/About-the-National-Lottery.aspx
- 8 Gambling Act 2005 requires all society lotteries to give a minimum 20% to good causes.
- 9 Actual returns for good causes are rounded to the nearest whole pence.

Source: National Audit Office

Part Two

Income for good causes

2.1 This part sets out how returns for good causes are determined and details the historical and current trends in National Lottery (the Lottery) income for good causes. It covers the regulatory framework and the differences in returns for good causes across the Lottery games. It also sets out details of the projections of future income for good causes that the Department for Digital, Culture, Media & Sport (the Department) gives to Lottery distributors to help them manage their funds, as well as Camelot's forecasts.

Historical National Lottery sales and income for good causes

2.2 In February 2009, Camelot's third Section 5 operating licence (the licence) came into force for a period of 10 years. Camelot was awarded the licence by the National Lottery Commission in 2007.⁸ In March 2012, the licence was extended by four years to run to 2023. The calculation of the level of returns for good causes forms part of the terms of the licence and depends on the following for each type of game and channel it is sold through:

- ticket sales;
- prize payments;
- Lottery duty;
- Camelot's gross sales retention (set to cover Camelot's variable costs);
- Camelot's net sales retention (set to cover Camelot's fixed costs and profit); and
- retailers' commission.

The decision on how returns are calculated was made during the process for the third licence competition and provided a common frame for bidders to bid against. This process took place in the period before 2009 when the licence was originally awarded.

⁸ The Gambling Commission has been the regulator of the National Lottery since October 2013 when the National Lottery Commission and Gambling Commission formally merged.

2.3 Since 2009, the environment in which the Lottery takes place has changed considerably, affecting the level of sales and the mix of sales. This includes:

- a shift in consumer preferences, with scratchcards and instant-win games becoming more popular compared with draw-based games; the latter provide a higher level of returns for good causes per pound spent by customers; and
- an increasingly competitive marketing environment as other lotteries and organisations offering bets on lotteries have been set up and grown in size.

The Gambling Commission (the Commission) told us that, although the Lottery's operating environment has changed, the terms of Camelot's licence and wider factors (largely legal implications) mean that it would be challenging to change the calculation of returns for good causes before the current licence term ends in 2023. Any changes would need to be agreed by the Commission and Camelot.

2.4 Since the start of Camelot's third licence, annual Lottery sales, income for good causes and Camelot's profits have all risen but not in the same proportion. Lottery sales were 27% higher in 2016-17 than in 2009-10, while income raised for good causes was 2% higher (**Figure 6** overleaf). Camelot's shareholder profit was 122% higher in 2016-17 than in 2009-10. Under the terms of the licence, Camelot's retention – what it keeps to cover costs and profit – is calculated as a proportion of gross and net sales, rather than the income raised for good causes. In general, Camelot keeps a greater share of net sales as the sales volumes of each game increase. There is not a direct linear relationship between the overall returns to good causes and the profit Camelot generates from operating the Lottery.

2.5 In recent years, there has been a trend of rapidly increasing sales of scratchcards and instant-win games (instants sales) but much smaller changes in sales of draw-based games. Between 2009-10 and 2016-17, instants sales increased by 118% from £1.33 billion to £2.90 billion; however, sales of draw-based games decreased by 2% from £4.12 billion to £4.02 billion. Gross sales of £6.93 billion in 2016-17 (2009-10: £5.45 billion) comprised:⁹

- 58% draw-based games (2009-10: 76%); and
- 42% instants sales (2009-10: 24%), see **Figure 7** on page 21.

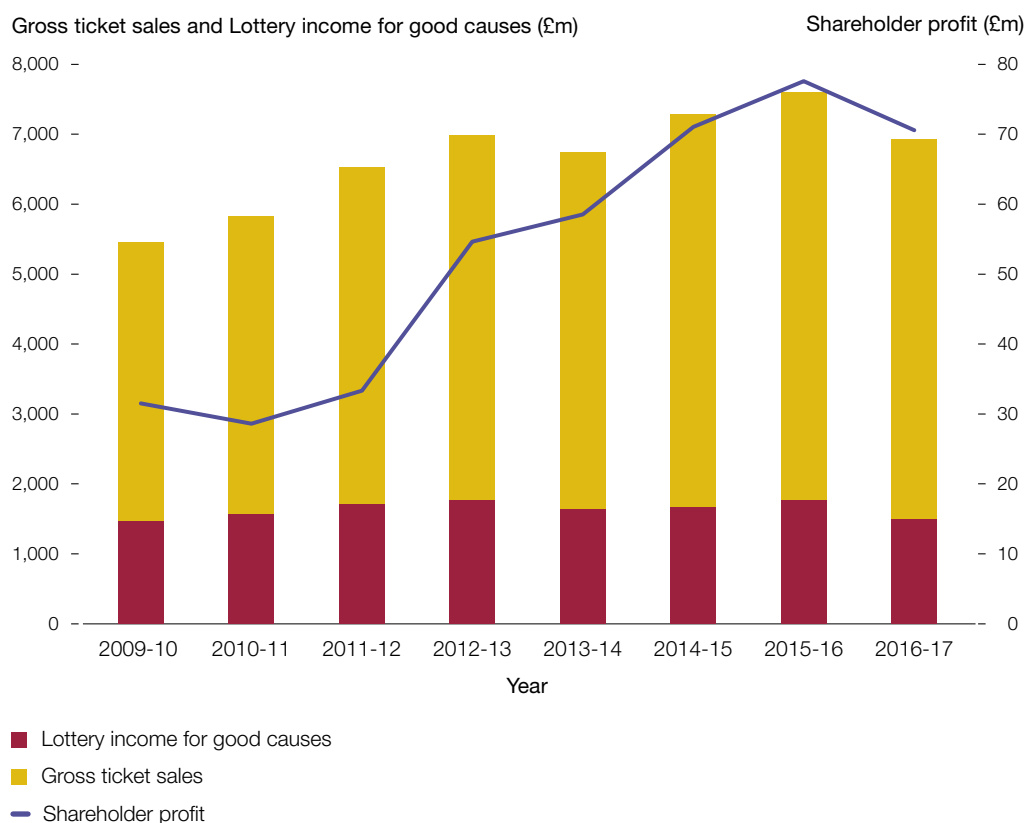
Research conducted by Camelot has identified a global decline in sales of draw-based games such as Lotto, suggesting a shift in consumer preference away from draw-based games.

⁹ Gross sales for 2016-17 is not the exact sum of draw-based game and instants sales due to rounding.

Figure 6

National Lottery account figures between 2009-10 and 2016-17

Between 2009-10 and 2016-17 the increases in Camelot's shareholder profits have been proportionately greater than the increases in both Lottery sales and returns for good causes



	2009-10 (£m)	2016-17 (£m)	Movement (£m)	Change (%)
Gross ticket sales	5,452	6,925	1,473	27
Prizes	2,789	3,943	1,154	41
Lottery income for good causes	1,465	1,496	31	2
Shareholder profit	32	71	39	122

Notes

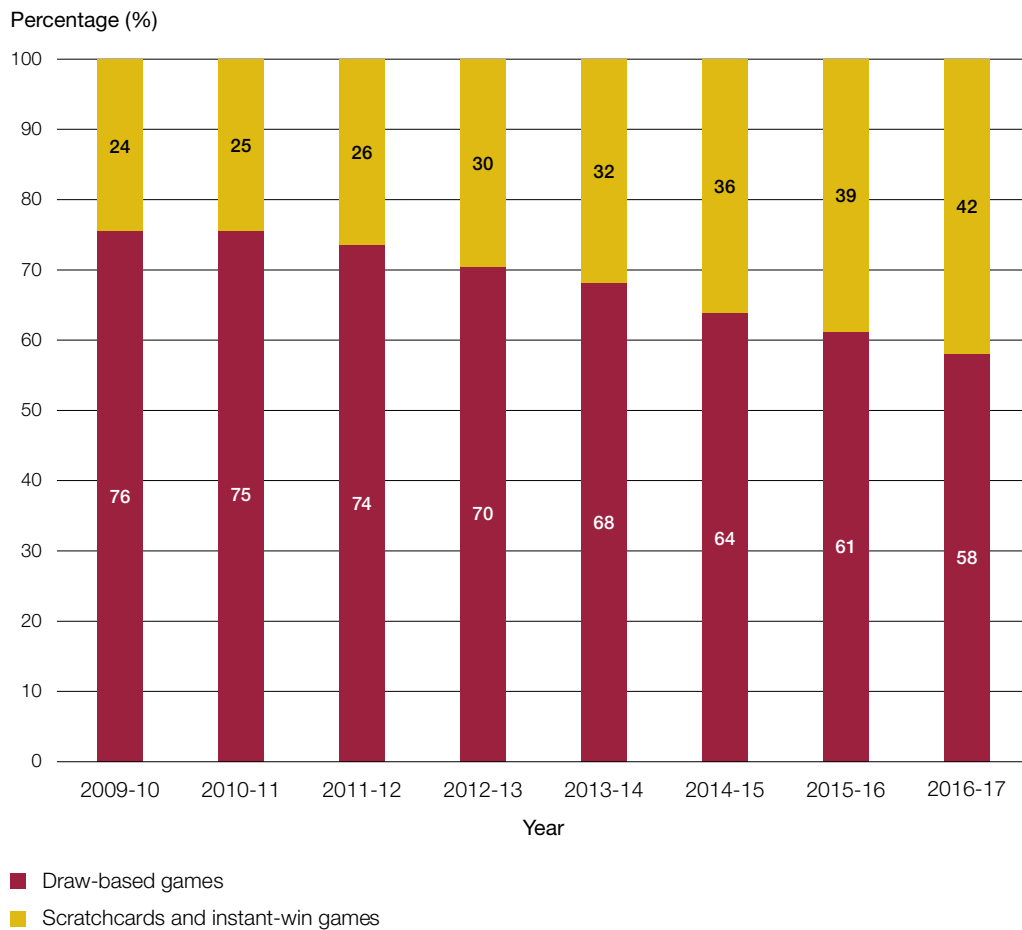
- 1 Camelot's figures for Lottery income for good causes exclude money from unclaimed prizes and investment returns, which are reflected in the National Lottery Distribution Fund annual report and accounts.
- 2 Shareholder profit is the total income attributable to the owners of the company.
- 3 Figures are expressed in nominal terms and therefore not adjusted for inflation.
- 4 Camelot paid corporation tax at a rate of 28% in 2009-10 and 20% in 2016-17.

Source: National Audit Office analysis of Camelot UK Lotteries Limited annual report and accounts

Figure 7

Total National Lottery sales split by type of game from 2009-10 to 2016-17

Sales of draw-based games make up a significantly smaller proportion of total sales in 2016-17, compared with 2009-10



Source: National Audit Office analysis of Camelot UK Lotteries Limited annual report and accounts

2.6 Most Lottery funding for good causes comes from ticket sales, defined as primary contribution. In 2016-17, primary contribution made up 91% of total income for good causes and unclaimed prizes made up 8%.¹⁰ Under the terms of the operating licence, the Commission cannot cap Camelot's total rate of return for operating the Lottery. However, the second and the third operating licences included an element of profit-sharing with good causes if Camelot makes a profit, greater than the one that it had predicted in its bid. This share is based on a formula that varies depending on how much actual profit before interest and tax varies from the forecast. This is known as the secondary contribution and, since 2009-10, it has generated £42 million of income for good causes. Changes to the calculation of secondary contribution were made in March 2012 when the latest licence was extended, allowing Camelot to retain more of the additional profits that are shared with good causes through the secondary contribution. This was to reflect Camelot's additional investment in the Lottery by providing an extra 8,000 sales terminals. Camelot told us that, between 2009-10 and 2016-17, it had invested £181.2 million in capital expenditure, which was £98 million (118%) more than the sum set out within its third licence business plan for the same period.

Current figures

2.7 Since 2004, Lottery income going to good causes has been on an overall upward trend, but in 2016-17 Lottery sales and income for good causes fell compared with the previous year (**Figure 8**). Since 2004, Lottery income for good causes has risen by 42% from £1.36 billion in 2004-05 to £1.93 billion in 2015-16. However, in the 12 months from 1 April 2016, sales fell by 9% compared with the previous year. Sales of draw-based games fell by a greater proportion than instants sales: 13% compared with 2%. During this period, income for good causes fell by 15% compared with the previous year. Camelot predicts a further fall in sales and income for good causes in 2017-18.

Figure 8

National Lottery performance for 12 months from 1 April 2016

	2015-16 (£m)	2016-17 (£m)	Movement (£m)	Change (%)
Gross ticket sales	7,595	6,925	-670	-9
Draw-based games	4,643	4,023	-620	-13
Instants	2,952	2,902	-50	-2
Lottery income for good causes	1,926	1,633	-293	-15

Notes

- 1 National Lottery income for good causes figures are from the National Lottery Distribution Fund accounts. They include money for good causes from unclaimed prizes and exclude investment income; all other data is from Camelot's annual report and accounts.
- 2 Figures are expressed in nominal terms and therefore not adjusted for inflation.

Source: National Audit Office analysis of National Lottery Distribution Fund and Camelot UK Lotteries Limited annual report and accounts

¹⁰ The remaining 1% is made up of secondary contribution, licensee penalty payments, income from ancillary activities and other items.

Returns across games

2.8 Returns for good causes vary across the Lottery games. As at February 2017, the approximate returns for good causes per £1 spent by customers were:

- draw-based games purchased online: 34p;
- draw-based games purchased in a shop: 28p;
- interactive instant-win games: 14p (range from 10p to 21p); and
- scratchcard games: 10p (range from 5p to 16p).

Returns are set in Camelot's licence according to a complex calculation. They depend first on actual sales, and then on what is paid out in prizes, Lottery duty to the government, Camelot's retention and retailers' commission. Camelot told us it offers a higher proportion of proceeds as prizes for instants, to encourage consumers to participate, resulting in lower returns for good causes from instants. In 2016-17, the prize fund accounted for approximately 68% of gross sales for instants, compared with 49% for draw-based games (**Figure 9** overleaf).

Regulatory framework

2.9 In 2009, the Commission said that the third licence competition was used to ensure increased 'generosity' to good causes.¹¹ This would vary depending on sales levels, the mix of games and distribution channels and the timing of new games. Between the third licence coming into effect in February 2009 and 2016-17, returns for good causes increased overall from £1.48 billion in 2009-10 to £1.63 billion in 2016-17 (Figure 2 on page 11).¹² However, the reduction in the relative popularity of draw-based games has contributed to a significant fall in returns for good causes per pound spent by customers (**Figure 10** on page 25). Between 2009-10 and 2016-17, the returns for good causes per pound spent fell from 26.9p to 21.6p.

2.10 Camelot's retention rate – what it keeps to cover costs and profit – was set in 2009 in the third operating licence. It is a percentage of both gross sales and net sales, rather than returns for good causes, for each type of game and sales channel.¹³ The sum retained from gross sales is intended to cover Camelot's variable costs, with the retention from net sales contributing towards its fixed costs and profits. The retention structure is intended to incentivise Camelot to achieve higher levels of sales and in turn lead to higher returns for good causes. Based on the mid-2016-17 sales mix, Camelot retains 3% from additional net sales of draw-based games bought in a shop and 7% from additional net sales of scratchcards.

¹¹ 'Generosity' was defined as two variables that drive returns to good causes: "the level of sales and the proportion of proceeds which the operator has committed to deliver at that level of sales".

¹² Figures from the National Lottery Distribution Fund annual report and accounts include money raised for good causes from unclaimed prizes. Figure for 2009-10 excludes money raised through Lottery games solely set up to raise funds for the 2012 London Olympic and Paralympic Games and declared in the Olympic Lottery Distribution Fund annual report and accounts.

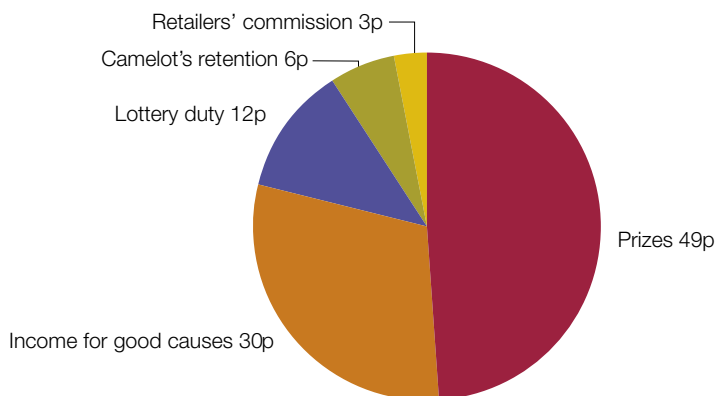
¹³ Net sales is the total value of tickets sold, less Lottery duty, prize payments, gross sales retention and retailer commission.

Figure 9

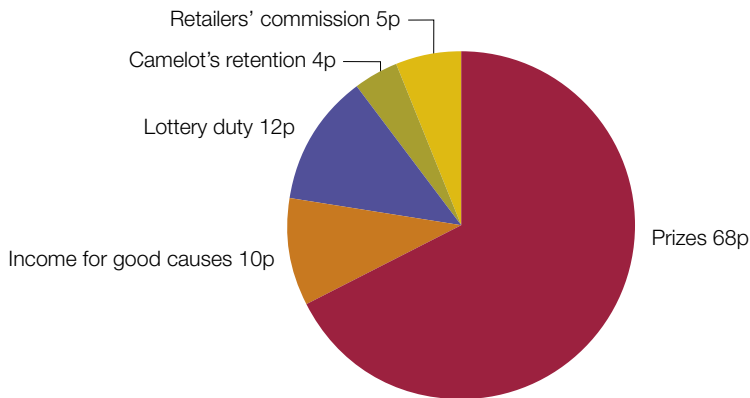
Destination of each pound spent on National Lottery games in 2016-17

For every £1 of ticket sales, the amount raised for good causes and paid out in prizes varies significantly between draw-based games and scratchcards and instant-win games

Draw-based games



Scratchcards and instant-win games



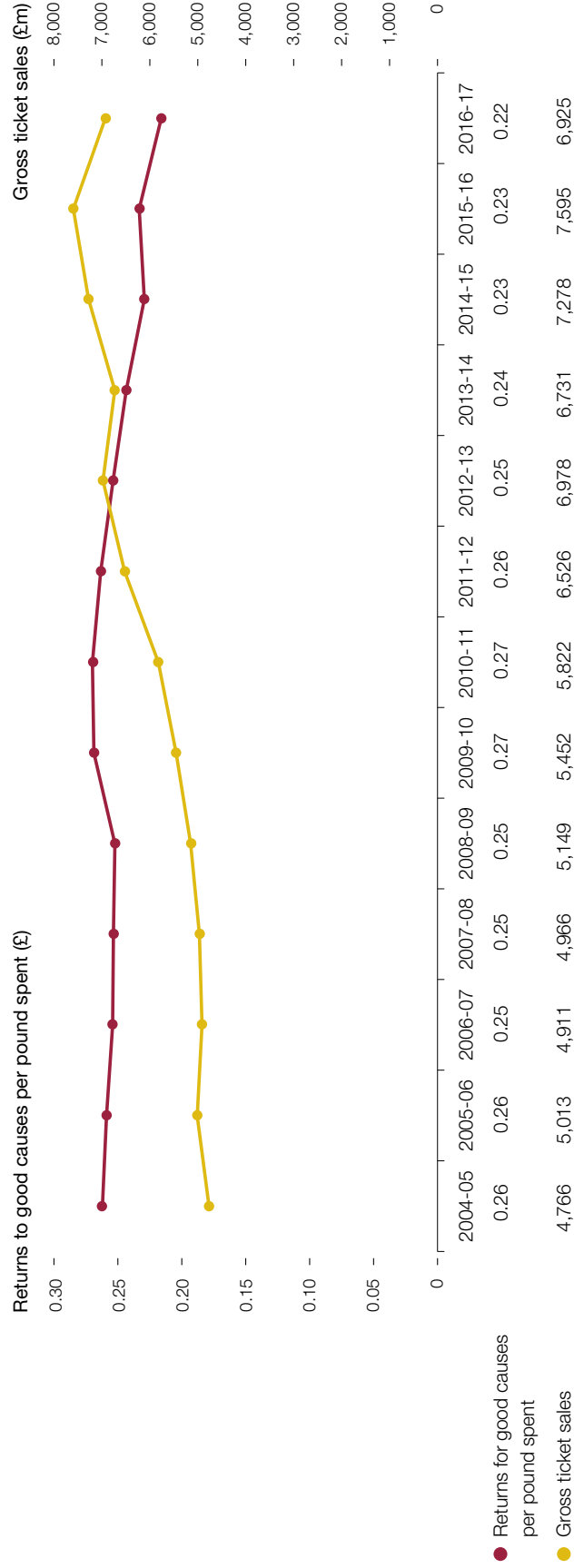
Notes

- 1 Pie chart data labels for scratchcards and instant win games sum to 99p due to rounding.
- 2 Camelot's retention is what it keeps to cover its costs and profit.
- 3 Camelot's account figures of Lottery income for good causes exclude money raised for good causes from unclaimed prizes.

Source: National Audit Office analysis of Camelot UK Lotteries Limited 2016-17 annual report and accounts

Figure 10
Returns for good causes from each pound spent by customers on National Lottery games and gross ticket sales from 2004-05 to 2016-17

Since 2009-10 there has been a significant fall in returns for good causes per pound spent over the same period as Lottery sales have increased



Notes

- 1 Camelot's account figures of Lottery income for good causes differ from the National Lottery Distribution Fund figures as Camelot's figures exclude money raised for good causes from unclaimed prizes, among other differences.
- 2 Figures are expressed in nominal terms and therefore not adjusted for inflation.

Source: National Audit Office analysis of Camelot UK Lotteries Limited annual report and accounts

Game changes

2.11 For each major game change, Camelot submits a business case to the Commission for approval. In October 2015, the Commission approved changes aimed at combating the decline in Lotto sales. The number of balls was increased from 49 to 59, to create bigger jackpots through the game rolling over. The quadruple rollover cap was replaced with a jackpot cap of £50 million.¹⁴ This was based on research indicating that good causes would benefit incrementally from the changes.

2.12 On 9 January 2016, a record £66 million jackpot was won following 15 consecutive rollovers, and the jackpot cap was further raised to £55 million. Subsequent jackpots have not triggered a comparable increase in sales. Following the subsequent fall in sales, Camelot was granted approval to reduce the cap from £55 million to £22 million from August 2016 to regulate the size of the rollover series.

Research

2.13 Analysis by the Commission, the Department and Camelot has not identified a single cause of the fall in Lottery income. The Department identifies the drop in participation in Lotto as the main reason for the fall in Lottery income to good causes but has not been able to determine the individual financial impact of a number of potential contributory factors, including:

- consumer reaction to recent game changes, which has led to a fall in positivity towards the Lottery brand;
- the long-term decline in participation in draw-based games, which research shows to be a global trend;
- competition from society lotteries and other gambling products;
- economic factors; and
- changes in general consumer behaviours – how consumers spend their time and money.

2.14 Lower participation in draw-based games, which give higher returns for good causes per pound spent by customers, has had a particularly significant impact on income for good causes. We did not find evidence that research has been carried out to identify broader causes of this trend, or how it might be arrested, although we have seen research that underpinned the Lotto game changes in 2013-14 and 2015-16, which were intended to boost Lottery sales. The Commission and Camelot have informed us that the trend has been considered as part of Camelot's strategic review of its business, which was completed in November 2017.

2.15 The Department and Camelot are keen to improve the marketing links between the Lottery and the good causes it supports through grant awards from Lottery distributors, particularly since the fall in Lottery sales.

¹⁴ Once the jackpot reaches the cap the game is able to roll one more time before it must be won.

Part Three

Management of balances in the National Lottery Distribution Fund

3.1 This part sets out historical and current balances in the National Lottery Distribution Fund (the Fund) and how distributors manage their balances within the Fund. It also sets out the work being done by distributors to model the potential impact of reduced funding and the role of the Department for Digital, Culture, Media & Sport (the Department) in providing information to help distributors plan their future grant awards.

National Lottery Distribution Fund balances

3.2 Balances in the Fund peaked at £3.7 billion in 1999, and fell to £1.3 billion in 2010, their lowest level since 1995. At 31 March 2017, Fund balances were £1.5 billion (**Figure 11** overleaf). Fund balances are determined by how much money is raised by the National Lottery (the Lottery) for good causes and how much is paid out by distributors. Since distributors have no control over Lottery income, they manage their balances by planning their grant awards on available information on future Lottery income.

Management of grant awards

3.3 Since 2014-15, the accounting policy for each of the distributors is to recognise unpaid grant awards as liabilities in their accounts only if:

- the distributor has formally decided to make the award; and
- the award has been notified to the intended recipient; and
- the award is free from any condition under the control of the distributor.

Historical trends indicate a lag between Lottery income and expenditure arising. In particular, there can be a considerable gap between a grant being awarded and the project incurring expenditure and drawing down funds.

Figure 11

Distributors' National Lottery Distribution Fund balances at 31 March 2017

Distributor	Fund balance (£m)	Percentage of Fund balance (%)
Heritage Lottery Fund	497	32
Big Lottery Fund	399	26
Arts Council England	315	20
Sport England	97	6
British Film Institute	58	4
UK Sport	42	3
Other ²	134	9
Total	1,540	100

Notes

1 Figures do not add up to the totals due to rounding.

2 Arts Council of Wales, Arts Council of Northern Ireland, Creative Scotland, Sport Scotland, Sport Northern Ireland and Sport Wales.

Source: National Audit Office analysis of National Lottery Distribution Fund annual report and accounts

3.4 Compared with historical figures, grant liabilities are high compared with Fund balances (**Figure 12**). Distributors often have commitments spanning many years, so it is understandable that commitments may exceed available cash balances in the Fund at a given date. Between 2009-10 and 2016-17, the Fund's balance increased by 18%, from £1.31 billion to £1.54 billion, but liabilities have increased by 37%, from £2.22 billion to £3.04 billion. All liabilities have increased since 2009-10, despite the change to a more restrictive accounting policy in 2014-15.¹⁵

3.5 Distributors' funding commitments compared to their Fund balance vary widely (**Figure 13** on page 30). At 31 March 2017, half of the distributors we examined had liabilities in excess of their Fund balance:

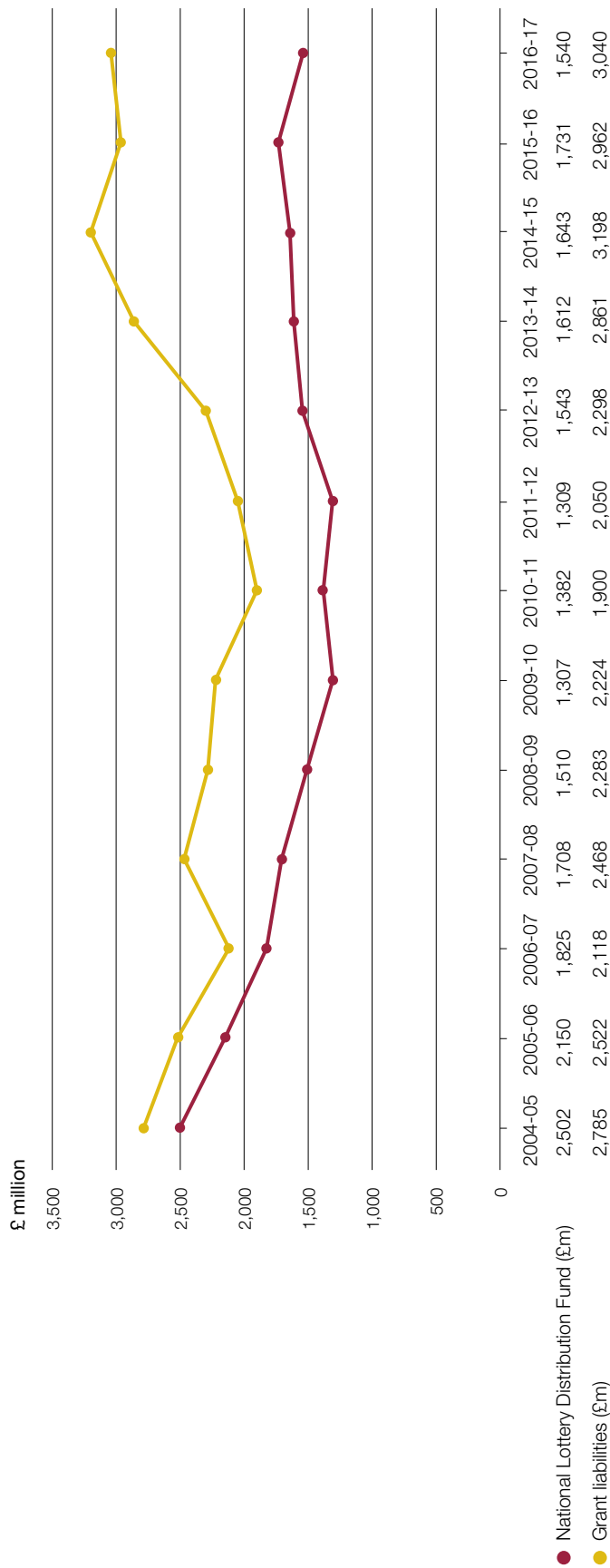
- Big Lottery Fund: 342%;
- Sport England: 268%; and
- Heritage Lottery Fund: 206%.

This percentage is determined by the size of the distributor's Fund balance and its funding liabilities, and influenced by its business model. For example, the British Film Institute mainly funds short-term film projects, and can avoid an 'over-commitment' of available funds. The Big Lottery Fund has liabilities spanning up to seven years and, although it receives 40% of Lottery income, it held only 26% of Fund balances at 31 March 2017.

¹⁵ 2013-14 figures were restated in Lottery distributors' 2014-15 accounts.

Figure 12
National Lottery distributors' grant liabilities and National Lottery Distribution Fund balance from 2004-05 to 2016-17

Recent grant liabilities are high compared with the Fund balance



Notes

- 1 Fund balances are at market value.
- 2 Figure includes grant liabilities and National Lottery Distribution Fund data for all Lottery distributors.
- 3 In 2014-15 there was a change to a more restrictive accounting policy for recognising grant liabilities.
- 4 Figures are expressed in nominal terms and therefore not adjusted for inflation.

Source: National Audit Office analysis of National Lottery Distribution Fund annual report and accounts

Figure 13

Distributors' liabilities at 31 March 2017 compared with National Lottery Distribution Fund balance

At 31 March 2017, half of the distributors we examined had liabilities in excess of their Fund balance

Distributor	Fund balance	Liabilities falling due within one year	Total liabilities	Liabilities falling due within one year as a percentage of the Fund balance	Total liabilities as a percentage of the Fund balance
	(£m)	(£m)	(£m)	(%)	(%)
Big Lottery Fund	399	550	1,366	138	342
Sport England	97	170	260	175	268
Heritage Lottery Fund	497	362	1,023	73	206
Arts Council England	315	216	280	69	89
British Film Institute	58	31	31	53	53
UK Sport	42	5	8	12	19
Total	1,407	1,334	2,968	95	211

Notes

- 1 Figures do not add up to the totals due to rounding.
- 2 Figure includes the six distributors with the largest share of Lottery income in 2016-17.

Source: National Audit Office analysis of National Lottery Distribution Fund annual report and accounts

3.6 The six largest Lottery distributors increased their overall funding liabilities by £88 million in 2016-17 compared with the previous year, over the same period as Lottery income for good causes fell. At 31 March 2017, all distributors we looked at had a lower Fund balance and three out of the six distributors had greater liabilities at 31 March 2017, compared with the previous year. Between 31 March 2016 and 31 March 2017, these distributors' grant liabilities compared with their Fund balance increased:

- Sport England: from 208% to 268% (liabilities increased by £4 million);
- Big Lottery Fund: from 303% to 342% (liabilities increased by £112 million); and
- Heritage Lottery Fund: from 167% to 206% (liabilities increased by £27 million).

Some distributors, such as Sport England, have targets to reduce Fund balances. This has contributed to higher liabilities as a percentage of their Fund balance.

3.7 Distributors have previously been advised to reduce their Fund balances, by increasing grant commitments that benefit the public. In March 2002, the Secretary of State for the Department announced a target for the total Fund balance (which then stood at £3.6 billion) to be halved by 2004. In 2004, Fund balances had fallen by £0.9 billion (25%) to £2.7 billion, and we reported that there was scope for distributors to reduce their Fund balances by making more grant commitments.¹⁶ In October 2005, the Committee of Public Accounts recommended that the Department should set a target and clear milestones for reducing the balance in the Fund and that distributors should make grant commitments up to the maximum allowed by the policies they had set.¹⁷

3.8 The current total Fund balance is much lower than 2004 figures: £1.5 billion at 31 March 2017 (£2.7 billion at 31 March 2004). Also, at 31 March 2004, total Fund balances were high compared with grant commitments: 96% compared with 51% at 31 March 2017. In February 2012, the Permanent Secretary of the Department wrote to the Chair of the Lottery Forum to say that overall commitment levels should rise significantly and quickly to ensure efficient, effective and timely use of public funds. The letter recognised that, in 2012, Lottery income for good causes was increasing, and the Department had recently increased its projections of future Lottery good cause income to reflect the continuing increase in Lottery ticket sales.

3.9 Distributor grant award letters specify that grants depend on adequate Lottery funding being available. As at February 2017, none of the distributors we examined had invoked affordability clauses. Some distributors had implemented other options to reduce costs, including scaling back grants made in 2016-17, and were considering options for future grants to give them more flexibility in managing their available funds. Treasury management policies varied across distributors; some set a minimum and maximum Fund balance they wished to operate within, but others did not.

3.10 Some distributors are less exposed to reductions in Lottery income than others. UK Sport told us that it had assessed the cost of achieving success in winning medals at the next Olympic Games in Tokyo and documented the likely medal outcomes of various income scenarios. This enabled it to articulate to the government the impact of reduced Lottery income on team performance. In December 2016, the Department agreed to underwrite up to £25 million a year to cover any shortfalls in Lottery income for UK Sport over the 2017–2020 Tokyo Olympic and Paralympic cycle and to maintain comparable levels of funding to previous Olympic and Paralympic cycles. This was to allow the UK Sport Board to make necessary funding decisions for the whole of the Tokyo Olympic and Paralympic cycle.

¹⁶ Comptroller and Auditor General, *Managing National Lottery Distribution Fund balances*, Session 2003-04, HC 875, National Audit Office, July 2004.

¹⁷ Committee of Public Accounts, *Managing National Lottery Distribution Fund balances*, First Report of Session 2005-06, HC 408, October 2005.

Income projections

3.11 The Department does not produce forecasts of future returns for good causes by modelling variables that would affect the level of income. It told us it did not have the data needed to produce this information. Instead it has produced projections of around five years, based only on historical trends in income. Lottery distributors face inherent uncertainties relating to future income and expenditure. Distributors have grants that span up to seven years and require information about their future income to plan effectively. Most distributors have relied heavily on the Department's projections in planning their future grant awards. In line with its engagement plan, the Department initially provided these projections quarterly. The most recent long-term projection was provided to distributors in October 2015.

3.12 In 2004, we recommended that the Department should:

- produce projections on time each quarter; and
- review periodically the accuracy of projections and report this to distributors.¹⁸

In 2005, the Committee of Public Accounts recommended that the Department should provide regular and reliable projections of Lottery income.¹⁹ The Department told us that it paused providing projections to review the methodology used for producing them, in response to the Lotto game changes in 2015 and 2016. During this period, Camelot began to provide short-term forecasts of future Lottery income for good causes. The Department discontinued its long-term projections in favour of more accurate short-term information provided by Camelot. The Department first provided Camelot's forecast to distributors in June 2016.

3.13 The Department last reported to distributors on the accuracy of its projections in January 2014 and shared a review of its projection methodology with distributors in October 2016. This indicated that it had underestimated its income projections for the years 2005-06 to 2012-13 by 8% on average. **Figure 14** shows the accuracy of projections since 2012-13, indicating sizeable variation in the level of accuracy. In October 2015, the Department projected that £1.815 billion would be available for good causes in 2016-17. Actual good cause income was £1.633 billion, meaning that the Department's original figure overestimated the amount available for good causes by £182 million (10%).²⁰ Inaccuracies are expected as projections are based only on past trends. Game changes, among other factors, can cause inaccuracies between projected and actual Lottery sales, because projections are based on past trends.

¹⁸ See footnote 16.

¹⁹ See footnote 17.

²⁰ Both projection and actual figures exclude investment income. Actual figures are from National Lottery Distribution Fund annual report and accounts.

Figure 14
Accuracy of projected National Lottery income for good causes from 2005-06 to 2016-17

The Department's projections have often underestimated Lottery good cause returns, but in 2016-17 Lottery good cause returns were considerably lower than the Department's projection



Notes

- 1 Years 2005-06 to 2012-13: Department for Digital, Culture, Media & Sport's (the Department) own analysis of accuracy based on averages of projections. Actual and projected figures are from the Department's January 2014 projection letter sent to Lottery distributors. Actual figures include investment income, revaluation gain/loss on investments and operational costs, among other elements.
- 2 Years 2013-14 to 2016-17: Projections of income is from the Department's projection letters sent to Lottery distributors and actual income is from National Lottery Distribution Fund annual report and accounts. Projections and actual figures include investment income.
- 3 Figures are expressed in nominal terms and therefore not adjusted for inflation.

Source: Department for Digital, Culture, Media & Sport's own analysis and National Lottery Distribution Fund annual report and accounts

3.14 Camelot produces commercially sensitive forecasts of future Lottery income for good causes, and informally shares with distributors guidance on likely short-term outturn versus the Department's projections in regular meetings with the Lottery Forum.²¹ The Department communicated to distributors Camelot's forecasts of the shortfall in income compared with its £1.815 billion 2016-17 projection:

- June 2016: £50 million to £130 million shortfall; and
- November 2016: £165 million to £215 million shortfall.

The actual shortfall in income compared with the Department's £1.815 billion projection was £182 million.

3.15 At the Lottery Forum in March 2017, the Department shared with distributors Camelot's 2017-18 forecast of good cause returns. This showed a further fall in returns compared with 2016-17. The Department asked the Gambling Commission (the Commission) to engage an external consultancy to model future returns for good causes up to 2019-20 and provided the findings of this work to distributors in June 2017.²² Distributors told us that early sharing of long-term forecasts and their underlying assumptions would help them plan future grant awards.

Modelling

3.16 All six distributors with the largest share of Lottery income in 2016-17 have modelled the impact of reduced Lottery income on their ability to meet future spending commitments to good causes. Distributors have evaluated multiple scenarios of potential income when setting future years' grant budgets. Up to June 2017 they based scenarios on Camelot's 2016-17 and 2017-18 forecasts and their own predictions for future years. In June 2017, the Department provided distributors with an external consultancy's analysis that modelled future returns for good causes up to 2019-20. Distributors told us that they have started to use these figures in their scenario planning. Distributors have raised concerns, however, that the modelling makes no adjustment for the impact of any structural changes in the Lottery, such as possible game changes to address the fall in sales. The Department told us that the modelling work will be repeated following Camelot's recent strategic review of its business and it did not believe it would have been helpful to model the impact of potential game changes prior to Camelot's review, given the wide range of potential variables. Many distributors continue to use their own estimates of future income for good causes, informed by the external consultancy's report and other data sources, causing some duplication of analysis. Distributors told us that as further insight and data are gathered, early sharing of such data will help them plan future grant awards.

21 The Lottery Forum is formed of the Lottery distributors' chief executive officers.

22 Commissioned modelling work was conducted by an economic consultancy.

3.17 We saw examples of distributors tracking important ratios such as liabilities to income and long-term cash-flow forecasts. For one distributor, the cash-flow forecast showed its Fund balance falling to nil in 2020 if its current award programme remained unchanged and recent trends in Lottery income continued. This distributor told us that it was monitoring Lottery income and its projected grant expenditure and there would be scope to reduce grant expenditure in future years if necessary.

The Department's role

3.18 Distributors told us that their future grant awards are planned using the available data on Lottery income raised for good causes including:

- actual monthly good cause income, provided by the Department;
- projected Lottery good cause income up to five years from October 2015, provided by the Department;
- forecast Lottery income for good causes for 2017-18, provided by Camelot;
- modelling of future returns for good causes up to 2019-20, provided by an external consultancy; and
- weekly sales by game, published on Camelot's website three months in arrears.

The Department can request any data it wishes from the Commission, in accordance with its management agreement. It receives detailed information from the Commission including Camelot's weekly ticket sales figures by game and monthly good cause returns. The Department provides distributors with figures on monthly good cause returns and a brief narrative explaining possible reasons for variances against the previous month and previous year. Since April 2017, the Department has provided distributors with a monthly analysis of actual income for good causes against Camelot's forecast for 2017-18. The Department does not provide the distributors with real-time weekly sales figures by game even though they have asked for them. Distributors have told us that prompt sharing of such data allows them to spot declining or increasing income early, which helps them to plan their future grant awards. The Department gave a presentation to distributors in January 2017 that included these data, but has not provided this information since then for commercial reasons. The Department believes that weekly sales data does not provide a clear indication of trends due to the range of factors that may cause Lottery sales to fluctuate from week to week.

Appendix One

Our investigative approach

Scope

- 1 We conducted an investigation into three specific concerns. These were:
 - the recent fall in National Lottery income for good causes;
 - the impact of reduced funding on distributors' ability to meet future spending commitments and the work being done to model the potential further impact; and
 - the amount of information given to distributors to help them plan their future grant awards.

Methods

- 2 In examining these issues, we drew on a variety of evidence sources.
- 3 We met with staff from Lottery Policy and Finance teams from the Department for Digital, Culture, Media & Sport, the department responsible for government's relationship with the Lottery. We also met staff from the Gambling Commission, which is the regulator of the National Lottery operator, Camelot.
- 4 We interviewed key individuals and reviewed financial information and other documents. These included internal briefings, research and modelling, correspondence between the Department and the distributors and financial data showing returns for good causes.
- 5 We interviewed representatives of six distributors to identify the impact of reduced income on their spending commitments and to obtain details of information provided to them. Between them, these distributors received more than 90% of the Lottery income for good causes in 2016-17.
- 6 We reviewed Camelot's annual report and accounts to obtain financial data, including data on sales and returns for good causes.
- 7 We also reviewed other documents relating to Lottery income for good causes. We obtained these publicly available documents via the Camelot, government and Gambling Commission websites.

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