STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Financial Audit

For the Year Ended June 30, 2012

Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

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AGENCY OFFICIALS

Superintendent	Victor Golden (acting) – July 1, 2011 to October 9, 2011 Michael Jones – effective October 10, 2011 (confirmed by Illinois State Senate February 8, 2012)
Deputy Superintendent	Victor Golden – effective July 1, 2011
Chief of Staff	Vacant – July 1, 2011 to January 16, 2012 Sara Barnett – effective January 17, 2012
Chief Financial Officer	Vacant – September 1, 2011 (date established) to April 1, 2012 James Scroggins – effective April 2, 2012
Chief Operations Officer	Michele Eichhorn (acting) effective July 1, 2011
General Counsel	Vacant – November 1, 2011 (date established) to February 13, 2012 Agostino Lorenzini – effective February 14, 2012
Chief Internal Auditor	Vacant

Agency offices are located at:

101 West Jefferson Street
Springfield, Illinois 62702

100 West Randolph Street 7th Floor
Chicago, Illinois 60601

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying basic financial statements of the State of Illinois Department of the Lottery (Department) was performed by KPMG LLP.

Based on their audit, the auditors expressed an unqualified opinion on the Department's basic financial statements.

SUMMARY OF FINDINGS

The auditors identified matters involving the Department's internal control over financial reporting that they considered to be material weaknesses. The material weaknesses are described in the accompanying Schedule of Findings as findings 12-01 and 12-02.

Finding No.	Page No.	Description	Finding Type
12-01	24	Weaknesses in Preparation of Accurate GAAP Reporting Forms submitted to the Illinois Office of the Comptroller and Preparation of Year-End Department Financial Statements	Material weakness
12-02	28	Weaknesses in the General IT Control Environment over Key Systems	Material weakness

EXIT CONFERENCE

The Department elected to waive a formal exit conference.

The responses to the recommendations were provided by Brett Finley, Finance Manager, in an email dated May 24, 2013.

KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

Independent Auditors' Report

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying basic financial statements of the State of Illinois Department of the Lottery (the Department), as of and for the year ended June 30, 2012. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2(a), the financial statements of the Department are intended to present the financial position and changes in financial position of only that portion of the business-type activities of the State of Illinois that is attributable to the transactions of the Department. They do not purport to, and do not; present fairly the financial position of the State of Illinois as of June 30, 2012, and the changes in its financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Illinois Department of the Lottery as of June 30, 2012, and the changes in its financial position and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2(m), the Illinois Department of Revenue transferred all functions performed for the Illinois Lottery to the newly established State of Illinois Department of the Lottery effective October 15, 2011. The beginning net assets (July 1, 2011) have been restated to reflect the transfer of operations as a change in reporting entity.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 29, 2013, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Department has omitted a management's discussion and analysis that U.S. generally accepted accounting principles require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The combining schedules on pages 20 and 21 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

This report is intended solely for the information and use of the Illinois Auditor General, the Illinois General Assembly, the Illinois Legislative Audit Commission, the Illinois Governor, the Illinois Comptroller, and Department management, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

Chicago, Illinois
May 29, 2013

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY
Statement of Net Assets
June 30, 2012
(In thousands of dollars)

Assets		
Current assets:		
Cash equity in State Treasury	$	141,986
Cash and cash equivalents		13,024
Investments, short-term		58,064
Accounts receivable, net of allowance of $8,485		22,106
Total current assets		235,180
Noncurrent assets:		
Investments		302,031
Capital assets being depreciated, net		229
Total noncurrent assets		302,260
Total assets		537,440
Liabilities		
Current liabilities:		
Prizes payable		151,565
Accounts payable and accrued liabilities		34,679
Due to other Government – Federal		27
Due to other State funds		18,624
Unearned revenue		5,427
Other liabilities		1,113
Current portion of long-term annuity prizes payable		57,110
Total current liabilities		268,545
Noncurrent liabilities:		
Noncurrent portion of long-term annuity prizes payable		243,609
Noncurrent other		920
Total noncurrent liabilities		244,529
Total liabilities		513,074
Net Assets		
Invested in capital assets		229
Unrestricted		24,137
Total net assets	$	24,366

The accompanying notes to the financial statements are an integral part of this statement.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Revenues, Expenses, and Changes in Net Assets

For the year ended June 30, 2012

(In thousands of dollars)

Operating revenues:		
Charges for sales and services	$	2,676,996
Other		5,378
Total operating revenues		2,682,374
Operating expenses:		
Cost of sales and services		151,421
Prizes and claims		1,620,405
General and administrative		152,210
Depreciation		107
Total operating expenses		1,924,143
Operating income		758,231
Nonoperating revenues (expenses):		
Investment income		37,633
Interest expense		(17,192)
Total nonoperating revenues (expenses), net		20,441
Change in net assets before transfers		778,672
Transfers to other State funds		(758,236)
Change in net assets		20,436
Net assets, July 1, 2011, as restated (note 2(m))		3,930
Net assets, June 30, 2012	$	24,366

The accompanying notes to the financial statements are an integral part of this statement.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

For the year ended June 30, 2012

(In thousands of dollars)

Cash flows from operating activities:		
Cash received from sales and services	$	2,669,984
Cash receipts from other operating activities		5,351
Cash payments for commissions and bonuses		(151,421)
Cash payments for general and administrative expenses		(123,459)
Cash payments for lottery prizes		(1,561,172)
Net cash provided by operating activities		839,283
Cash flows from noncapital financing activities:		
Cash transfers-out to other funds		(708,477)
Net cash used by noncapital financing activities		(708,477)
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets		(71)
Net cash used by capital and related financing activities		(71)
Cash flows from investing activities:		
Interest and dividends on investments		11
Purchase of investments		(19,814)
Proceeds from investment maturities		68,653
Cash paid for long-term annuity prizes payable		(68,653)
Net cash provided by investing activities		(19,803)
Net increase in cash and cash equivalents		110,932
Cash and cash equivalents, July 1, 2011, as restated (note 2(m))		44,078
Cash and cash equivalents, June 30, 2012	$	155,010
Reconciliation of cash and cash equivalents to the statement of net assets:		
Total cash and cash equivalents per the statement of net assets	$	13,024
Add: Cash equity in State Treasury		141,986
Cash and cash equivalents, June 30, 2012	$	155,010

(Continued)

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Statement of Cash Flows

For the year ended June 30, 2012

(In thousands of dollars)

Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	758,231
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		107
Provision for uncollectible accounts		779
Changes in assets and liabilities:		
Increase in accounts receivable		(9,523)
Decrease in inventory		248
Decrease in prepaid expenses		120
Increase in prizes payable		39,011
Increase in accounts payable and accrued liabilities		28,953
Increase in intergovernmental payables		27
Increase in unearned revenues		1,642
Decrease in other liabilities		(257)
Increase in long-term annuity prizes payable		19,814
Other		131
Net cash provided by operating activities	$	839,283
Noncash investing, capital and financing activities:		
Increase in unrealized gains on investments	$	20,436
Interest accreted on investments		17,186
Interest accretion on long-term annuity prizes payable		(17,186)
Transfer of assets to other State funds		(4)

The accompanying notes to the financial statements are an integral part of this statement.

(1) Organization

The Department of the Lottery (the Department) is a part of the executive branch of government of the State of Illinois (State) and operates under the authority of and reviews by the Illinois General Assembly. The Department operates under a budget approved by the General Assembly in which resources primarily from the State Lottery Fund are appropriated for the use of the Department. Activities of the Department are subject to the authority of the Office of the Governor, the State's chief executive officer, and other departments of the executive and legislative branches of government (such as the Department of Central Management Services, the Governor's Office of Management and Budget, the State Treasurer's Office, and the State Comptroller's Office) as defined by the Illinois General Assembly. All funds appropriated to the Department and all other cash received are under the custody and control of the State Treasurer, with the exception of the security deposits for Lottery agents.

Effective October 15, 2011, the Department of Revenue transferred all functions performed for the Illinois Lottery and all associated powers, duties, rights and responsibilities to the Department in accordance with Public Act 97-0464. As a means of easing the transition of accounting records between the entities, management elected to use an effective transition date of July 1, 2011. Accordingly, these financial statements include all of fiscal year 2012 activity for the funds administered by the Department of the Lottery. The transfer has been reflected as a restatement of beginning net assets in the accompanying financial statements.

The Department is organized to provide for administering and overseeing the operations of the Illinois Lottery with the assistance of a private manager under a management agreement.

Financial Reporting Entity

As defined by U.S. generally accepted accounting principles (GAAP), the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
2) Fiscal dependency on the primary government.

Based upon the required criteria, the Department has no component units and is not a component unit of any other entity. However, because the Department is not legally separate from the State of Illinois, the financial statements of the Department are included in the financial statements of the State of Illinois. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Division of Financial Reporting, 325 West Adams Street, Springfield, Illinois, 62704-1871.

(2) Summary of Significant Accounting Policies

The financial statements of the Department have been prepared in accordance with GAAP, as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

(a) Basis of Accounting and Presentation

The financial statements of the State of Illinois, Department of the Lottery, are intended to present the financial position, changes in financial position, and cash flows of only that portion of the activities of the State of Illinois that are attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Illinois as of June 30, 2012, the changes in financial position and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The basic financial statements provide information about the Department's proprietary (enterprise) fund. Proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the GASB. The State also has the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The State has elected not to follow subsequent private-sector guidance as it relates to the Department's operations.

The Department of the Lottery accounts for operations of the State Lottery in which a statutorily defined amount of the net income is used for the support of the State's Common School Fund. Any net income remaining after the required transfers to Common School Fund is transferred to the State's Capital Projects Fund. Certain ticket sales are dedicated for other State funds prior to the determination of the net income available for transfers to the Common School Fund or the Capital Projects Fund.

(b) Cash and Cash Equivalents

Cash equivalents are defined as short-term, highly liquid investments readily convertible to cash with maturities of less than 90 days at time of purchase. Cash and cash equivalents include cash on hand and cash in banks for locally held funds.

(c) Investments

Investments are reported at fair value based on quoted market prices.

(d) Allowance for Doubtful Accounts

The allowance for doubtful accounts at June 30, 2012 is based on an analysis of the historical collection experience for accounts receivable, which considers the age of the receivable and current economic conditions.

(Continued)

(e) Interfund Transactions

The Department has the following types of interfund transactions between Department funds and funds of other State agencies:

Services provided and used—sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the statements of net assets.

Transfers—flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported after nonoperating revenues and expenses.

(f) Capital Assets

Capital assets, which consist of equipment, automobiles and internally developed computer software, are reported at cost. Contributed assets are reported at estimated fair value at the time received. Capital assets are depreciated using the straight-line method. The capitalization threshold for capital assets is $5,000 and the estimated useful life is 3–15 years.

(g) Compensated Absences

The liability for compensated absences reported in the statement of net assets consists of unpaid, accumulated vacation and sick leave balances for Department employees. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees’ current salary level and includes salary related costs (e.g., social security and Medicare tax).

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees’ Retirement System members at December 31, 1997. Employees continue to accrue 12 sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between January 1, 1984 and December 31, 1997 (with a 50 percent cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

(h) Net Assets

In the statement of net assets, equity is displayed in three components as applicable:

Invested in Capital Assets – This consists of capital assets, net of accumulated depreciation.

Restricted – This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the State’s policy to use restricted resources first, then unrestricted resources when they are needed. There are no restricted net assets as of June 30, 2012.

Unrestricted – This consists of net assets that do not meet the definition of “restricted” or “invested in capital assets.”

(i) Classification of Revenues and Expenses

The Department classifies its revenues and expenses as either operating or nonoperating in the statement of revenues, expenses, and changes in net assets according to the following criteria:

Revenue

Operating revenues, such as sale of lottery tickets, result from exchange transactions associated with the principal activity of the fund. Nonoperating revenues, such as investment income, result from nonexchange transactions or ancillary activities.

Expenses

All expenses are classified as operating, except for interest expense and losses on disposal of capital assets which are classified as nonoperating.

(j) Lottery Revenue

Draw Games

Revenue from ticket sales for Lotto, Pick 3, PowerBall and other draw games is recognized when the related drawing takes place. Receipts from subscription sales and other ticket sales for future drawings are recorded as unearned revenue and will not be recognized as revenue until the related drawing takes place.

Instant Games

Revenue from instant games is recognized based on the dollar value of the total number of tickets sold. Tickets are available for sale upon being activated at the retailer locations.

(k) Prizes and Claims – Ticket Expense

Prize expense is accrued for instant game sales at a percentage equivalent to the total prizes included in all tickets printed for each game. Prize expense and prizes payable are reduced for an estimate of prizes that will go unclaimed and increased if amounts claimed exceed the amounts accrued (i.e., early redemption expense). Instant games are closed at the end of the final redemption period and any remaining net payable accrued in prior periods is reversed and recorded as a reduction to prize expense.

(l) Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(m) Accounting Change

The Illinois Department of Revenue transferred all functions performed for the Illinois Lottery to the newly established State of Illinois Department of the Lottery effective October 15, 2011. The beginning net assets (July 1, 2011) of $3.9 million have been restated to reflect the transfer of operations as a change in reporting entity.

(n) Future Adoption of GASB Statements

GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, will be effective for the Department beginning with its year-end June 30, 2013. The objective of the Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in FASB pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements.

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* will be effective for the Department beginning with its year-end June 30, 2013. The objective of this statement is to provide financial reporting guidance for deferred outflows and inflows of resources and to rename the residual measure from "Net Assets" to "Net Position."

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, will be effective for the Department beginning with its year-end June 30, 2014. The objective of this statement is to establish accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions,* will be effective for the Department beginning with its year-end June 30, 2015. The objective of this statement is to improve accounting and financial reporting by state and local governments for pensions.

The Department has not yet determined the impact these statements will have on financial reporting.

(3) Deposits and Investments

The State Treasurer is the custodian of the Department's deposits and investments for funds maintained in the State Treasury. These amounts are classified as "Cash equity in State Treasury" on the statement of net assets. The Department independently manages deposits and investments maintained outside the State Treasury.

(a) Deposits

Deposits in the custody of the State Treasurer in the amount of $142 million are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Details on the nature of these deposits and investments are available within the State of Illinois' Comprehensive Annual Financial Report.

Bank deposits for the enterprise fund held outside of the State Treasury were $13 million as of June 30, 2012. The bank balances are fully insured under the Dodd-Frank Wall Street Reform and Consumer Protection Act through December 31, 2012.

(b) Investments

As of June 30, 2012, the Department had the following investments outside of the State Treasury:

		Fair value (thousands)	Weighted average maturity (years)
Annuities	$	531	5.037
U.S. Treasury bonds		359,564	6.497
Total	$	360,095	

Interest Rate Risk: The Department does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: The Department is limited to investing in direct obligations of the United States of America or backed by the full faith and credit of the United States of America. The Department's investments in annuities are not rated.

(4) Interfund Balances and Activity

(a) Balances Due from /to Other Funds

The following balances (amounts expressed in thousands) at June 30, 2012 represent amounts due to other State funds.

Fund		Due to other State funds	Description/Purpose
Lottery	$	18,624	Due to other State funds for allocation of lottery proceeds.

(b) Transfers to Other Funds

The Department reports transfers out in the statement of revenues, expenses, and changes in net Assets, for the amounts required by statute to be transferred to the Common School Fund, Capital Projects Fund, and other State funds set forth by statute for special purposes designated lottery games. The following balances (amounts expressed in thousands) for the year ended June 30, 2012 represent amounts transferred to other State funds:

Fund	Transfers out to Other State funds		Amount	Description/Purpose
Lottery	Common School	$	639,875	Transfers to Common School, Capital Projects, and other State funds pursuant to statutory requirements.
	Capital Projects		115,009	
	Other State funds		3,352	
		$	758,236	

(5) Capital Assets

Capital asset activity (amounts expressed in thousands) for the year ended June 30, 2012 was as follows:

		Balance July 1, 2011 (As restated)	Additions	Deletions	Net transfers	Balance June 30, 2012
Capital assets being depreciated:						
Equipment	$	2,033	71	129	(58)	1,917
Less accumulated depreciation		(1,764)	(107)	(129)	54	(1,688)
Total capital assets, net	$	269	(36)	—	(4)	229

(6) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2012 were as follows:

	Balance July 1, 2011 (As restated)	Additions	Deletions	Balance June 30, 2012	Amounts due within one year
Compensated absences	$ 1,416	502	928	990	70
Obligations to Lottery prize winners - group contracts	525	6	—	531	60
Obligations to Lottery prize winners – annuities	331,779	19,814	51,405	300,188	57,050
Total long-term obligations	$ 333,720	20,322	52,333	301,709	57,180

(b) Obligations to Lottery Prize Winners

The Department has obligations to certain lottery prize winners for awards payable in annual installments ranging from 19 years to the life of the prize winner, with the first payment made shortly after the claim is presented for payment.

For certain prize winners, annuities were purchased in the name of the State for which the State has retained the rights of ownership. The present value of these annuities and the related liability installments owed to prize winners were as follows:

Present value of investment annuities and related prize liabilities

Fiscal year	Current	Long-term	Total
2013	$ 62	—	62
2014	—	62	62
2015	—	62	62
2016	—	62	62
2017	—	62	62
2018 - 2022	—	298	298
Total future prize payments	62	546	608
Less: present value adjustments	2	75	77
Present value at June 30, 2012	$ 60	471	531

Effective July 30, 1985, State law provides that the State Treasurer, with the consent of the Director of the Lottery, may contract to invest in securities, which provide payments corresponding to the Department's obligation to these winners. The Department has provided for other payments corresponding to the Department’s obligation to other prize winners through the purchase of direct obligations of the federal government, primarily in the form of United States Treasury zero coupon bonds. As established by State law, such securities shall be maintained separate and apart from all public money or funds of the State. These investments are purchased in amounts to provide for annual annuity payments to the prize winner(s) of each qualifying individual drawing.

The fair value of the investments of the fund were $360 million at June 30, 2012. Interest rates range from 2.6 percent to 9.4 percent, and prizes payable are scheduled annually through 2036 as follows:

Fiscal year	Current	Long-term	Total
2013	$ 58,188	—	58,188
2014	—	47,560	47,560
2015	—	36,902	36,902
2016	—	31,963	31,963
2017	—	24,263	24,263
2018 - 2036	—	213,643	213,643
Total future prizes	58,188	354,331	412,519
Less present value adjustments	1,138	111,193	112,331
Present value of future prizes	57,050	243,138	300,188
Add adjustment to fair value	954	58,422	59,376
Fair value of future prizes at June 30, 2012	$ 58,004	301,560	359,564

The amortized discount on the prizes payable reflects the interest rates earned by the investments held to fund the related liabilities. The amortization of discount is recorded as investment expense in the statement of revenues, expenses, and changes in net assets and amounted to $17.2 million for the year ended June 30, 2012.

(7) Pension Plan

Substantially all of the Department's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer defined benefit public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers’, General Assembly, and Judges’ Retirement Systems. The financial position and results of operations of the SERS are included in the State of Illinois’ Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2012. The SERS issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

A summary of SERS benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the SERS’ CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

The Department pays employer retirement contributions based upon an actuarially determined percentage of their payrolls. For fiscal year 2012, the employer contribution rate was 34.19 percent.

(8) Post-employment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for postemployment benefits if they eventually become annuitants of one of the State-sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed healthcare plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employees Retirement System, do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with 20 or more years of credited service to not have to contribute towards health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes $5,000.

The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including postemployment health, dental, vision, and life insurance benefits, is recognized as an expense by the State in the Illinois CAFR. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of postemployment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois, 62763-3838.

(9) Risk Management

The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; workers' compensation; and natural disasters. The State retains the risk of loss (i.e., self-insured) for these risks.

The Department's risk management activities are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the general fund of the State. The claims are not considered to be a liability of the Department; and accordingly, have not been reported in the Department's financial statements for the year ended June 30, 2012.

(10) Private Management Agreement

The State of Illinois (acting through the Department) entered into a 10-year private management agreement (PMA) with Northstar Lottery Group, LLC effective January 18, 2011 for the purpose of providing all equipment, services and functions necessary to operate the Lottery for the State, except for those specifically retained by the State as defined within the PMA. Under the terms of the agreement, effective July 1, 2011, the compensation to be paid under the PMA is comprised of the reimbursement of operating expenses and incentive compensation payments. Incentive compensation is subject to annual adjustments in accordance with the agreement. For the year ended June 30, 2012, total compensation for reimbursement of operating expense to Northstar under the PMA was $128.7 million. Of this amount, $31.4 million was outstanding at June 30, 2012.

Subject to certain annual net income targets, the PMA also provides for Northstar to pay to the State a shortfall payment amounting to 50 percent of the difference between the target and the actual net income amounts. The first year's net income results relative to this calculation are pending litigation as noted below. The State can terminate the PMA with a 90-day advance notice.

(11) Commitments and Contingencies

(a) Lease Commitments

The Department leases certain facilities and equipment necessary for operations, primarily from other State funds. All leases are operating leases and the majority are month-to-month. Total lease costs for the year ended June 30, 2012 amounted to $711thousand.

(b) Litigation

The Department is routinely involved in a number of legal proceedings and claims that cover a wide range of matters. In particular, the Department has pending legal proceedings related to the Lottery PMA with Northstar Lottery Group, LLC (Northstar). Two of the proceedings related to proposed adjustments to net income in the PMA, one proposed upward adjustment from the Department and one proposed downward adjustment from Northstar. The PMA requires that the Department and Northstar select a third party to opine on the proposed adjustments. As these proceedings have yet to begin and thus no discovery has occurred, the Department is unable to express an opinion as to the outcome. Non-binding mediation between the Department and Northstar for another pending dispute regarding the methodology used to calculate net income according to the PMA has been initiated. Discovery has not commenced in this proceeding so the Department is unable to express an opinion as to the outcome. In the opinion of management, the outcome of matters not related to the PMA is not expected to have any material adverse effect on the financial position or results of operations of the Department.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Combining Schedule of Net Assets

June 30, 2012

(In thousands of dollars)

Assets	State Lottery (0711)	Deferred Prize Winners (0978)	Lottery Security Deposits (1309)	Eliminations	Total
Current assets:					
Cash equity in State Treasury	$ 141,435	551	—	—	141,986
Cash and cash equivalents	12,088	—	936	—	13,024
Investments, short-term	60	58,004	—	—	58,064
Accounts receivable, net of allowance of $8,485	22,106	—	—	—	22,106
Due from other Department funds	444	—	—	(444)	—
Total current assets	176,133	58,555	936	(444)	235,180
Noncurrent assets:					
Investments	471	301,560	—	—	302,031
Capital assets being depreciated, net	229	—	—	—	229
Total noncurrent assets	700	301,560	—	—	302,260
Total assets	176,833	360,115	936	(444)	537,440
Liabilities					
Current liabilities:					
Prizes payable	151,565	—	—	—	151,565
Accounts payable and accrued liabilities	34,679	—	—	—	34,679
Due to other Government - Federal	27	—	—	—	27
Due to other Department funds	—	444	—	(444)	—
Due to other State funds	18,624	—	—	—	18,624
Unearned revenue	5,427	—	—	—	5,427
Other liabilities	70	107	936	—	1,113
Current portion of long-term annuity prizes payable	60	57,050	—	—	57,110
Total current liabilities	210,452	57,601	936	(444)	268,545
Noncurrent liabilities:					
Noncurrent portion of long-term annuity prizes payable	471	243,138	—	—	243,609
Noncurrent other	920	—	—	—	920
Total noncurrent liabilities	1,391	243,138	—	—	244,529
Total liabilities	211,843	300,739	936	(444)	513,074
Net Assets (Deficit)					
Invested in capital assets	229	—	—	—	229
Unrestricted (deficit)	(35,239)	59,376	—	—	24,137
Total net assets (deficit)	$ (35,010)	59,376	—	—	24,366

See accompanying independent auditors' report.

STATE OF ILLINOIS
DEPARTMENT OF THE LOTTERY

Combiinng Schedule of Revenues, Expenses and Changes in Net Assets

For the year ended June 30, 2012

(In thousands of dollars)

	State Lottery (0711)	Deferred Prize Winners (0978)	Eliminations	Total
Operating revenues:				
Charges for sales and services	$ 2,676,996	—	—	2,676,996
Other	5,378	—	—	5,378
Total operating revenues	2,682,374	—	—	2,682,374
Operating expenses:				
Cost of sales and services	151,421	—	—	151,421
Prizes and claims	1,620,405	—	—	1,620,405
General and administrative	152,210	—	—	152,210
Depreciation	107	—	—	107
Total operating expenses	1,924,143	—	—	1,924,143
Operating income	758,231	—	—	758,231
Nonoperating revenues (expenses):				
Investment income	11	37,622	—	37,633
Interest expense	(6)	(17,186)	—	(17,192)
Total nonoperating revenues (expenses), net	5	20,436	—	20,441
Change in net assets (deficit) before transfers	758,236	20,436	—	778,672
Transfers to other State funds	(758,236)	—	—	(758,236)
Change in net assets (deficit)	—	20,436	—	20,436
Net assets (deficit), July 1, 2011, as restated (note 2(m))	(35,010)	38,940	—	3,930
Net assets (deficit), June 30, 2012	$ (35,010)	59,376	—	24,366

See accompanying independent auditors' report.

KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the State of Illinois Department of the Lottery (the Department) as of and for the year ended June 30, 2012, and have issued our report thereon dated May 29, 2013, which included an emphasis paragraph stating that the financial statements have been restated as of the beginning of the year to reflect the transfer of all functions performed for the Illinois Lottery from the Illinois Department of Revenue to the newly established State of Illinois Department of the Lottery. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Department is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies in the Department's internal control over financial reporting described in findings 12-01 and 12-02 in the accompanying schedule of findings to be material weaknesses.

KPMG

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Department's responses to the findings identified in our audit are described in the accompanying schedule of findings. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Illinois Auditor General, the Illinois General Assembly, the Illinois Legislative Audit Commission, the Illinois Governor, the Illinois Comptroller, and Department management, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

Chicago, Illinois
May 29, 2013

Finding 12-01 - Weaknesses in Preparation of Accurate GAAP Reporting Forms Submitted to the Illinois Office of the Comptroller and Preparation of Year-End Department Financial Statements

The Department of the Lottery's (Department or Lottery) year-end financial reporting in accordance with generally accepted accounting principles (GAAP) to the Illinois Office of the Comptroller contained numerous errors/inaccuracies and incomplete data.

Effective October 15, 2011, the Department of Revenue transferred all functions performed for the Illinois Lottery and all associated powers duties, rights and responsibilities to the Department of the Lottery in accordance with Public Act 97-0464. As a means of easing and transitioning, management elected to use an effective date of July 1, 2011 for the financial accounting and reporting.

During the audit of the June 30, 2012 Lottery financial statements the auditors noted errors in the GAAP Reporting forms and Department financial statements and deficiencies in internal controls over financial reporting as follows:

- During planning for the financial audit, the auditors inquired of Lottery management to obtain an understanding of the general control environment over financial reporting. Though the Lottery has formal procedures related to the accumulation and processing of financial information, the auditors noted weaknesses during and for the fiscal year ended June 30, 2012. Specifically, the auditors noted that (1) not all manual journal entries were reviewed by a person other than the preparer, (2) certain account reconciliations were not prepared or maintained, (3) account reconciliations, when performed, did not document that they had been reviewed by a person other than the preparer, and (4) supporting documentation that agreed to amounts in the financial records was not always readily available.
- During the course of the audit, the auditors noted a number of the general ledger accounts did not reconcile or agree to supporting documentation. As part of their testing, the auditors identified numerous, significant errors/inaccuracies in account balances. The errors and inaccuracies were the result of internal control deficiencies which included the following:
- Historically, Lottery had made cash transfers to the Common School Fund in excess of their income before transfers. These excess cash transfers were reported as "Due from Other State funds" in the Lottery's financial statements. During testing, the auditors noted the "Due from other State funds", did not meet the criteria for being reported/recorded as a receivable. Subsequently, the Lottery, in conjunction with the Illinois Office of the Comptroller, concluded the balance should be eliminated and considered a prior period transfer. This account was reported in the Lottery's accounting records to the auditors with a balance of approximately $69.9 million.
- Incorrect data utilized in the reconciliation process; during testing, the auditors noted the prizes payable liability balance recorded in the accounting records did not agree to supporting documentation and data. As Department management continued to analyze and reconcile the balance to underlying/supporting data, they identified numerous differences which resulted in a net decrease to the Online prizes payable of $10.4 million and a net decrease to the Instant prizes payable of $3.6 million.

- The auditors noted the trial balance contained an erroneous credit balance in accounts receivable of $35.5 million. Department management had taken this into consideration in the preparation of the financial statements but had not posted an adjustment to remove it from the trial balance. An adjustment was subsequently made to the trial balance but was made to the wrong account. Department management subsequently identified the correct accounts receivable balance to be a debit of $18.7 million and corrected the balance. An effectively designed and performed management review process would likely detect an error of this size and nature.

- During testing of the estimate of the prizes payable liability for instant games, the auditors noted errors in how underlying amounts for securities purchased to fund annuities were recorded. The errors resulted in prize expense and the associated liability being overstated. Subsequently, Lottery management recorded securities purchased to fund annuities as a reduction of prizes payable. The entry recorded reduced the liability by $9.1 million.

- Inaccurate or missing reconciling items; the auditors noted the prizes payable liability did not agree to underlying/supporting records. During Department management's subsequent review of the data, missing reconciling items were identified. One item identified related to a prize winner who elected a discounted lump-sum payment; however, the discount was not noted in the reconciliation, which resulted in an overstatement of the liability of $30.3 million. Department management appropriately recorded an entry to account for this reconciling item.

- In prior years, the Lottery had reported certain vendor bonuses in Prize expense while others were reported in Cost of sales. During testing, the auditors noted that vendor bonus expense reported in the Lottery accounting records did not agree to the underlying details. Department management noted $17.3 million of the vendor bonus expense was being included in Prize expense instead of Cost of sales. Subsequently, Department management reclassified the balance to appropriately reflect all vendor commission and bonus expense as Cost of sales.

- Transfers to Capital Projects Fund; The Illinois Lottery Law (20 ILCS 1605/9.1(o), as amended by Public Act 96-0034 effective July 1, 2009, requires the Lottery to distribute all proceeds of lottery tickets and shares sold in a specific priority and manner. The last priority requires the Lottery to transfer any remaining proceeds to the Capital Projects Fund on or before the last day of each fiscal year. Since the change in the Lottery Law, the Lottery has made an estimate of the remaining proceeds and made the required transfer based on that estimate. As a result of normal end-of-year financial adjustments and completion of the annual audit, there has been a difference between transfers of estimated remaining proceeds and actual net income. As of June 30, 2012, the Lottery has recorded a balance of $18.6 million due to the Capital Projects Fund, reflecting actual net income in excess of amounts previously transferred to the Capital Projects Fund through that date. The Lottery needs to establish a policy to allow for amounts deposited into the Capital Projects Fund at the end of each fiscal year to be adjusted in the subsequent fiscal year to reflect the final distributions due. This amount should be based upon the actual results of operations for such fiscal year. The policy should be supported by the Lottery Law and legal determinations.

The aggregate impact of all of the adjustments made since the initial June 30, 2012 GAAP Reporting forms were submitted to the Illinois Office of the Comptroller was a $63.0 million increase in assets, a $45.7 million decrease in liabilities, a $106.3 decrease in expenses and a $1.5 million increase in revenue.

Lottery management indicated the errors and inaccuracies noted were due to the fact that during fiscal year 2012 the Lottery began efforts to deconsolidate from the Department of Revenue. A number of retirements and turnover of staff created opportunities for a lack of continuity of key processes and procedures. Also, the Lottery was in transition to a Private Management Agreement with a third-party vendor to market and sell Lottery tickets and a new gaming computer system, which also created additional challenges. In addition, the Lottery also transitioned to a new data reporting system that resulted in the Lottery receiving data in report formats that did not mirror the previous system reports and led to initial inaccuracies and delays in data presentation.

The Illinois Office of the Comptroller requires State agencies to prepare GAAP Reporting Packages for each of their funds to assist in the annual preparation of the Statewide financial statements and the Lottery financial statements. GAAP Reporting Package instructions are specified in the Comptroller's Statewide Accounting Management System (SAMS) Manual, Chapter 27.

In addition, the Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies to establish and maintain a system of internal fiscal and administrative controls which shall provide assurance that revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial and statistical reports and to maintain accountability over the State's resources.

Because of the significance of the errors and inaccuracies noted, we consider this to be a material weakness in the Lottery's internal control over financial and fiscal operations. A material weakness is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will occur and not be prevented or detected and corrected on a timely basis.

The errors and inaccuracies noted, if not detected and corrected, could materially misstate the Lottery's financial statements and negatively impact the statewide financial statements. Accurate and timely preparation of the Lottery's financial information for GAAP reporting purposes is important due to the impact Lottery adjustments have on the statewide financial statements. (Finding Code No. 12-01)

Recommendation:

We recommend the Lottery implement procedures to ensure GAAP Reporting Packages and financial statements are prepared in an accurate and complete manner. This should include allocating sufficient staff resources and following formal procedures to ensure GAAP financial information is prepared and submitted to the Illinois Office of the Comptroller in an accurate manner, and that supporting documentation be maintained in a contemporaneous manner to support the financial information being reported.

(Continued)

Lottery Response:

The Lottery agrees. The Lottery will review current procedures to ensure they are up-to-date and implement any additional procedures, as necessary, to ensure GAAP financial reporting and financial statements are prepared completely, accurately and timely with appropriate supporting documentation. The Lottery will also ensure sufficient staff resources are allocated to this process and procedures are properly followed.

(Continued)

Finding 12-02: - Weaknesses in the General IT Control Environment over Key Systems

The Department of the Lottery (Department or Lottery) had not implemented controls over its computing environment to ensure sufficient protection from unauthorized access or inappropriate changes.

During the audit of the June 30, 2012 financial statements, the auditors noted a number of control deficiencies related to the various computer systems utilized by the Department. Several of the Department's computer systems generate reports that are used to process, accumulate and analyze financial information. Specific weaknesses identified are as follows:

- **Change Management -** A system-generated list of changes from one system was not available. A change ticketing tool is not in use and there is no change logging feature in the application. Without systematic logging of change, it is possible that an unauthorized change may be moved to production undetected.
- **Segregation of Duties -** For one system, there is one user who is responsible for both developing and migrating changes to production. Segregation of duties is a key control for change management and users who develop changes should not have access to migrate changes to production, unless there are other mitigating controls in place, such as reviewing a log of all production changes on a periodic basis.
- **Documented Access Reviews -** Access reviews are not documented and retained for four computer systems. Auditors noted that although access is reviewed on an ad hoc basis for two systems, evidence of the review is not retained. Auditors identified exceptions in administrative access for one of the four systems reviewed. Access reviews are considered to be a key control in assessing the appropriateness of user access in financially significant systems.
- **Password Complexity -** One system does not enforce password complexity and another system does not have password configurations which comply with Lottery Password Policy.
- **Security Policy -** There is no security policy in place for one application. While there are procedures in place for the application, there is no documented security policy.
- **Excessive Access Rights to the Drawing Room -** Twenty maintenance employees have 24/7 access to the high-security Drawing Room. A compensating control is the requirement for an escort to accompany maintenance employees during visits. However, 24/7 badge access for the maintenance employees creates an unnecessary risk of unauthorized access.

Department management indicated that during fiscal year 2012, the Lottery began efforts to deconsolidate from the Department of Revenue. A number of retirements and turnover of staff created opportunities for a lack of continuity of key processes and procedures.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) requires all State agencies to establish and maintain a system or systems, of internal fiscal and administrative controls, which shall provide assurance that: funds, property, and other assets and resources are safeguarded against waste, loss unauthorized use, and misappropriation. In addition, generally accepted information technology guidance endorses the implementation

 (Continued)

of suitable controls for change management, logical access rights, security parameters, and physical access controls.

Because of the severity of the deficiencies noted above, auditors were unable to rely on the IT system internal controls. Taking into consideration the number of control deficiencies noted, auditors consider this to be a material weakness in the Department's internal control over financial and fiscal operations. (Finding Code No. 12-02)

Recommendation:

We recommend the Department implement and document the controls over its computing environment and ensure the controls provide sufficient protection against unauthorized access and inappropriate changes. Specifically, we recommend the Department:

- Implement a method of logging to track any system changes migrated to production over a given period of time and verify that changes were tested and approved appropriately. Any changes moved to production should be supported by documentation with testing evidence and business approvals. In addition, we recommend that the key logging software being used should be documented, and access to the log limited, reviewed, and retained.
- Segregate the development activities from migration activities. If segregation of duties is not feasible, compensating controls should be developed and implemented.
- Review system access rights on a periodic basis by management. Evidence of review should be retained and any changes noted as a result of the review should be documented and applied timely.
- Ensure password requirements such as length, expiration, lockout, and complexity adhere to Department policy.
- Develop a security policy for all applications.
- Eliminate 24/7 access to the Drawing Room for maintenance employees.

Lottery Response:

The Lottery agrees.

<u>System Change Control and Segregation of Development Activities</u>

Our ICS system as designed did not include a formal change logging capability. In addition our system manager has a small staff and as a result performs the dual roles of developer and mover to production and doesn't have the capability to segregate duties. Lottery has taken steps to mitigate those control risks. The ICS system by its nature can be considered a change control system in some respects. Its purpose is to request, reprocess and compare all transactions from the Central Gaming System (CGS). This audit function assures the Lottery of the gaming system's integrity by recording and demanding reconciliation of any anomalies that appear during the daily balancing process between the ICS and the CGS. Any unauthorized changes to either system would create an anomaly that would not allow the systems to balance. Also, Lottery now has the ability to control access to the production environment in ICS. The system manager cannot make any changes without getting access from the Lottery. Changes are thoroughly tested and release notes are prepared and approved prior to installation. The system also has key logging functionality that enables tracking of key logs made by a user. In addition the system manager provides before and after hash files from the ICS that indicates what changed in the program code during a change.

Access Reviews

Lottery performs periodic access reviews of key systems. Ensuring proper related documentation is kept has been incorporated as an important component of the process.

Password Configuration and Complexity, Security Policy

Lottery is currently reviewing and updating its IT security policies. However, Lottery does not administer or manage the Quickbooks application and thus is not responsible for writing policy regarding the use and security of it. User rights are controlled by the administrator of Quickbooks. The functionality of the Quickbooks application limits administratively what can be done to enforce password complexity. However to mitigate the control risks as a user, we do in practice, appropriately provision the application to ensure only authorized users from Lottery are able to gain access to it. This coupled with the fact that the application is only accessible through our network that has additional security controls in place that do enforce network access password complexity provides a second tier of access control. In addition, our users are also only provided read-only access to the application.

In the case of our ICS system, it was designed to specific requirements that did not included password complexity enforcement that mirrors our internal policy. However as with Quickbooks, the ICS system is only accessible through our network that has additional security controls in place to enforce network access password complexity that provides a second tier of access control. There are also plans in place to change the system to include password complexity enforcement.

Draw Room Access

The Lottery was unable to verify the finding as stated. Our records did not indicate a list of maintenance personnel with access. We have Security, Investigations, related IT Staff, select Lottery personnel and draw room operators that currently have access. There may have been some confusion with the room identified. The draw room is located within the Revenue computer room. Both rooms have key pad access. That notwithstanding, there are plans to relocate our draw room and redesign our security protocols to further limit access.