



STATE OF ILLINOIS
**OFFICE OF THE
 AUDITOR GENERAL**

Frank J. Mautino, Auditor General

SUMMARY REPORT DIGEST

DEPARTMENT OF THE LOTTERY

Financial Audit

Release Date: May 5, 2016

For The Year Ended June 30, 2015

Compliance Examination

For The Two Years Ended June 30, 2015

FINDINGS THIS AUDIT: 8	New	Repeat	Total	AGING SCHEDULE OF REPEATED FINDINGS			
				Repeated Since	Category 1	Category 2	Category 3
Category 1:	1	0	1			15-04, 15-05,	
Category 2:	1	6	7	2013		15-06, 15-07,	
Category 3:	<u>0</u>	<u>0</u>	<u>0</u>			15-08	
TOTAL	<u>2</u>	<u>6</u>	<u>8</u>	2012		15-01	
FINDINGS LAST AUDIT: 7*							

*- Prior report was the State Compliance Examination report for the two years ended June 30, 2013.

SYNOPSIS

- (15-01) The Department submitted to the Illinois Office of the Comptroller inaccurate year-end financial statements.
- (15-02) The Department inappropriately prepaid amounts from their fiscal year 2015 appropriation to fund fiscal year 2016 Multi-State Lottery Association payment obligations.
- (15-03) The Department and Lottery Control Board (Board) did not comply with various provisions of the Lottery Law.
- (15-06) The Department, including its Internal Audit function, failed to comply with the Fiscal Control and Internal Auditing Act or timely perform other required reporting and follow-up.
- (15-07) The Department failed to submit, or failed to submit timely, certain required reports and documentation to oversight entities.

Category 1: Findings that are **material weaknesses** in internal control and/or a **qualification** on compliance with State laws and regulations (material noncompliance).

Category 2: Findings that are **significant deficiencies** in internal control and **noncompliance** with State laws and regulations.

Category 3: Findings that have **no internal control issues but are in noncompliance** with State laws and regulations.

{Financial data and Activity Measures are summarized on next page.}

DEPARTMENT OF THE LOTTERY
FINANCIAL AUDIT (For the Year Ended June 30, 2015)
COMPLIANCE EXAMINATION (For the Two Years Ended June 30, 2015)

EXPENDITURE STATISTICS	FY 2015	FY 2014	FY 2013
Total Expenditures.....	\$ 988,013,872	\$ 787,302,387	\$ 797,523,655
OPERATIONS TOTAL.....	\$ 273,081,134	\$ 231,041,361	\$ 280,983,800
% of Total Expenditures.....	27.6%	29.3%	35.2%
Personal Services.....	10,017,939	9,915,005	9,827,220
Other Payroll Costs (FICA, Retirement, Insurance).....	7,696,610	7,618,444	7,895,812
Contractual Services.....	134,396,883	61,228,223	127,831,130
Purchase of Investments.....	120,469,111	151,652,907	134,843,471
All Other Operating Expenditures	500,591	626,782	586,167
AWARDS AND GRANTS			
% of Total Expenditures.....	67.6%	46.0%	40.6%
Lottery Prizes.....	\$ 667,111,928	\$ 361,861,026	\$ 323,682,854
REFUNDS			
% of Total Expenditures.....	0.0%	0.0%	0.0%
Refunds.....	\$ 47,191	\$ 10,506	\$ 17,567
NON-APPROPRIATED			
% of Total Expenditures.....	4.8%	24.7%	24.2%
Deposits into the Capital Projects Fund.....	\$ 8,000,000	\$ 145,000,000	\$ 135,000,000
Lottery Prizes.....	39,773,619	49,389,494	57,839,434
FINANCIAL OPERATIONS (amounts in thousands)	FY 2015	FY 2014	FY 2013
OPERATING REVENUE:			
Charges for sales and services.....	\$ 2,837,805	\$ 2,802,310	\$ 2,832,576
Private management contract fee.....	10,000	35,713	61,776
Other.....	6,487	4,484	8,006
Total Operating Revenues.....	<u>2,854,292</u>	<u>2,842,507</u>	<u>2,902,358</u>
OPERATING EXPENSES:			
Cost of sales and services.....	161,607	159,124	163,966
Prizes and claims.....	1,823,572	1,749,177	1,743,686
General and administrative.....	147,078	156,486	153,731
Provision for private management contract fee.....	(21,776)	-	21,776
Depreciation.....	55	73	99
Total Operating Expenses.....	<u>2,110,536</u>	<u>2,064,860</u>	<u>2,083,258</u>
Operating Income.....	<u>743,756</u>	<u>777,647</u>	<u>819,100</u>
NONOPERATING REVENUES (EXPENSES):			
Investment income.....	11,533	7,406	(9,354)
Interest expense.....	(12,298)	(13,124)	(14,347)
Other.....	(8)	(20)	-
Total Nonoperating Revenues (Expenses), net.....	<u>(773)</u>	<u>(5,738)</u>	<u>(23,701)</u>
Changes in Net Position Before Transfers.....	742,983	771,909	795,399
Transfers to other State funds.....	(743,905)	(777,440)	(819,390)
Change in Net Position.....	(922)	(5,531)	(23,991)
Net Position, July 1.....	(5,156)	375	24,366
Restatement to reflect adoption of GASB Statement No. 68.....	(53,647)	-	-
Net Position, June 30.....	<u>\$ (59,725)</u>	<u>\$ (5,156)</u>	<u>\$ 375</u>
SELECTED ACTIVITY MEASURES (unaudited)	2015	2014	2013
Average Number of Employees.....	145	144	155
Percentage of sales transferred to Common School Fund.....	23.9%	23.8%	23.1%
Percentage of sales paid in prizes.....	61.4%	60.7%	61.0%
DIRECTOR			
During Engagement Period: Michael Jones to 3-20-2015; Jayme Odom (Acting) 3-21-2015 to 4-5-2015;			
B.R. Lane (Acting) 4-6-2015			
Currently: B. R. Lane (Acting)			

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

ERRORS IDENTIFIED IN GAAP REPORTING FORMS SUBMITTED TO THE ILLINOIS OFFICE OF THE COMPTROLLER AND YEAR-END DEPARTMENT FINANCIAL STATEMENTS

The Department's year-end financial statements, prepared in accordance with generally accepted accounting principles (GAAP) and submitted to the Illinois Office of the Comptroller, contained errors in certain accounts and disclosures, which are considered to be deficiencies in internal control over financial reporting.

During the audit of the June 30, 2015 Department financial statements, auditors noted errors in the Department's GAAP Reporting forms submitted to the Office of the Comptroller and Department financial statements. Some of the errors are as follows:

- During testing of the Department's accounts receivable, auditors identified the Department incorrectly recorded a transfer of \$20.0 million to the Virginia Lottery to fund future multi-state lottery prize settlements in accounts receivable. The misclassification resulted in an overstatement of accounts receivable and an understatement of prepaid assets of \$20.0 million. This was discussed with Department management and they subsequently made a correcting entry.
- During testing of the Department's financial statements, particularly the notes, auditors identified the amount of annual compensation for reimbursement of operating expenses to the Private Manager under the private management agreement was overstated by \$8.8 million. This was discussed with Department management at which time they adjusted the disclosure.

In addition, \$3.8 million for the retroactive supply agreement reduction with the Private Manager was overstated by \$0.5 million. This was discussed with Department management at which time they adjusted the disclosure.

Because of the significance of the errors and inaccuracies noted, auditors consider this to be a significant deficiency in the Department's internal control over financial and fiscal operations. (Finding 1, pages 11 -12) **This finding has been repeated since 2012.**

We recommended the Department improve their preparation and review process of GAAP Reporting Packages and financial statements to ensure they are prepared in a complete and accurate manner.

\$20 million prepayment incorrectly recorded as an accounts receivable

Errors in financial statement note disclosures were identified

Lottery agrees with auditors

Lottery management agreed and will continue to review current procedures to ensure GAAP financial reporting and the financial statements are prepared completely and accurately. *(For the previous Department response, see Digest Footnote #1)*

INAPPROPRIATE PREPAYMENTS TO FUND OUT-OF-STATE PRIZE PAYMENT OBLIGATIONS

The Department inappropriately prepaid amounts from their fiscal year 2015 appropriation to the Multi-State Lottery Association to fund fiscal year 2016 Multi-State Lottery Association payment obligations in noncompliance with the State Finance Act (the Act) and Illinois Lottery Law (Law).

**\$20 million from FY 2015
appropriation paid for FY 2016
Multi-State Game expenses**

During testing of investment purchase expenditures, auditors noted that one expenditure for \$10,000,000 was made to fund future Multi-State game prize payment obligations (mega millions and power ball). Upon further testing, it was noted that another prepayment had been made. In total, two vouchers for \$20,000,000 were processed on June 30, 2015 to pay for Multi-State game expenses for fiscal year 2016.

The Act states, “[a]ll appropriations shall be available for expenditure for the fiscal year or for a lesser period if the Act making that appropriation so specifies.”

In addition, the Law allows the Department to enter into an agreement or agreements with other state lotteries for the purpose of creating and operating multi-state lottery games. The Law states, “No such agreement shall purport to pledge the full faith and credit of the State of Illinois, nor shall the Department expend State funds on a contractual basis in connection with any such game unless such expenditures are expressly authorized by the General Assembly...”

In discussing these conditions with Department management, they indicated that due to the lack of a fiscal year 2016 State budget, the Department sent additional funds to the multi-state clearing house to ensure the Department could continue to participate in the multi-state Lottery games. (Finding 2, pages 13-14)

We recommended the Department adhere to the Illinois laws prohibiting prepayment of future year obligations from the current year appropriation.

Lottery agrees with auditors

Department management agreed and indicated they will continue to review procedures to ensure it is in compliance with the Lottery Law.

NONCOMPLIANCE WITH THE ILLINOIS LOTTERY LAW

The Department and Lottery Control Board (Board) did not comply with various provisions of the Illinois Lottery Law (Lottery Law). Some of the items noted by the auditors during testing were as follows:

Lottery Control Board met only once during Fiscal year 2015

- There was only one scheduled meeting of the Board during the year ended June 30, 2015, and there was no review of major media campaigns conducted during that meeting.

Funds not deposited into Capital Projects Fund timely

- The Department did not deposit funds into the Capital Projects Fund in accordance with the Lottery Law in a timely manner. Auditors noted the Department owed approximately \$60 million to the Capital Projects Fund as of June 30, 2015.

Department paid for compliance examination that should have been paid by private manager

- During testing of the executed contract for services to be performed by an independent accounting firm in relation to the compliance examination of the private manager, auditors found the Department was identified as the party to be billed for such services, not the private manager. Lottery paid the independent accounting firm approximately \$147,000 for services related to investigation work in fiscal year 2015.

In discussing these conditions with Department management, they indicated the Lottery Control Board was unable to hold meetings due to not enough sitting board members to satisfy a quorum. The Department is currently seeking legislation to codify the current practice for the transfer to the Capital Projects Fund. The Department had not yet recouped the cost of the required investigation from the private manager due to staffing changes resulting in an oversight. (Finding 3, pages 15-16)

We recommended the Department adhere to the provisions of the Lottery Law and enhance its internal control procedures to ensure compliance. With regard to the transfer of amounts due to the Capital Projects Fund, we recommended the Department work to improve their process of estimating amounts owed to the Capital Projects Fund prior to the end of each fiscal year to minimize amounts owed subsequent to June 30, or seek legislative relief to allow a transfer after the Department has finalized their accounting records.

Lottery agrees with auditors

Department management agreed and noted they will review internal control procedures to ensure compliance with the Lottery Law. With regard to the transfer of amounts owed to the Capital Projects Fund, the Department is seeking legislative relief in an effort to codify the Department's current practice.

FAILURE TO COMPLY WITH THE FISCAL CONTROL AND INTERNAL AUDITING ACT AND OTHER REQUIRED REPORTING

The Department, including its Internal Audit function, did not comply with the Fiscal Control and Internal Auditing Act (Act) or timely perform other required reporting and follow-up. Some of the items the auditors noted during testing are as following:

All major systems of internal accounting and administrative control did not have internal audits during the examination period

- The Department's internal audit function did not perform internal audits of all of their major systems of internal accounting and administrative control during the period under audit. Auditors noted that Administrative Support Services; Purchasing, Contracting, and Leasing; Property, Equipment, and Inventories; Petty Cash and Local Funds; and Electronic Data Processing, each considered major systems of internal accounting and administrative control were not audited as required by the Act.

Department's certification of internal control not made timely

- The Department did not timely certify its internal controls for 2015 as required by the Act. This certification, which was due on May 1, 2015, was submitted on January 4, 2016, or 248 days late.

Department did not have a staffed internal audit function for approximately 4 months

- The Department did not maintain a full-time program of internal auditing during the examination period as required by the Act. The Department did not employ a Chief Internal Auditor or any internal audit staff from the period January 16, 2015 through May 31, 2015.

In discussing these conditions with Department management, they indicated the exceptions noted were due to unanticipated vacancies within the Internal Audit Division. (Finding 6, pages 21-22)

We recommended the Department comply with the required provisions of the Fiscal Control and Internal Auditing Act as well as other required reporting, and implement internal control procedures to ensure compliance.

Lottery agrees with auditors

Department management agreed and indicated the Internal Audit function was not operational for the full audit cycle but the Department will ensure all internal audits and required filings are performed timely in future periods.

FAILURE TO SUBMIT, OR TIMELY SUBMIT, REQUIRED REPORTS AND DOCUMENTATION

The Department failed to submit, or failed to submit timely, certain required reports and documentation to oversight entities. During testing of the statutes applicable to the Department, some of the exceptions noted by the auditors are as follows:

- There were no quarterly reports or an annual report on

No private manager activity reports submitted during fiscal year 2015

activities and actions of the private manager submitted to the Governor or the General Assembly during the fiscal year ended June 30, 2015 in accordance with the Illinois Lottery Law.

Required Agency Fee Imposition Reports not submitted for fiscal years 2014 and 2015

- The Department failed to submit their required 2014 and 2015 Agency Fee Imposition Reports to the Office of the Comptroller.

Annual reports for 2014 and 2015 regarding the work of the Lottery Control Board not submitted

- The Department failed to submit annual reports for 2014 and 2015 regarding the work of the Lottery Control Board (Board).

In discussing these conditions with Department management, they indicated the exceptions were due to ineffective oversight. (Finding 7, pages 23-24)

We recommended the Department comply with the applicable statutory requirements and submit the required reports, and documentation as required, and implement internal control procedures to ensure compliance.

Lottery agrees with auditors

Department management agreed and indicated they will review current processes and procedures to ensure all required reports and documentation are submitted timely.

OTHER FINDINGS

The remaining findings are reportedly being given attention by the Department. Auditors will review the Department's progress towards the implementation of all the recommendations in the next engagement.

AUDITOR'S OPINION

Our auditors state the financial statements of the Department of the Lottery as of June 30, 2015, and for the year then ended are fairly presented in all material respects.

ACCOUNTANT'S OPINION

The accountants conducted a compliance examination of the Department of the Lottery for the two years ended June 30, 2015, as required by the Illinois State Auditing Act. The auditors qualified their report on State Compliance for finding 2015-002. Except for the noncompliance described in this finding, the auditors state the Department complied, in all material respects, with the requirements described in the report.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

FJM:RPU

SPECIAL ASSISTANT AUDITORS

Our Special Assistant Auditors for this financial audit and compliance examination were KPMG LLP.

DIGEST FOOTNOTES

#1 – Errors Identified in GAAP Reporting Forms Submitted to the Illinois Office of the Comptroller and Year-End Department Financial Statements

2014: The Lottery agrees and will continue to review current procedures to ensure they are up-to-date and implement any additional procedures, as necessary, to ensure GAAP financial reporting and the 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.