



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

Frank J. Mautino, Auditor General

SUMMARY REPORT DIGEST

DEPARTMENT OF THE LOTTERY

Compliance Examination
 For the Two Years Ended June 30, 2017

Release Date: May 30, 2018

FINDINGS THIS AUDIT: 6	AGING SCHEDULE OF REPEATED FINDINGS						
	New	Repeat	Total	Repeated Since	Category 1	Category 2	Category 3
Category 1:	2	1	3	2013	17-04		
Category 2:	3	0	3				
Category 3:	0	0	0				
TOTAL	5	1	6				
FINDINGS LAST AUDIT: 8							

SYNOPSIS

This digest covers the Department’s compliance examination for the two years ended June 30, 2017. A separate financial audit as of and for the year ended June 30, 2017, was previously released on January 31, 2018. In total, this report contains six findings, two of which were reported within the Department’s financial audit.

SYNOPSIS

- (17-03) The Department allocated unallowable overhead costs to specialty scratch-off tickets and had not performed a “true up” of estimated prize liabilities to prizes paid.
- (17-04) The Department did not comply with various statutory reporting responsibilities.

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.

{Expenditures and Activity Measures are summarized on next page.}

**DEPARTMENT OF THE LOTTERY
COMPLIANCE EXAMINATION
For the Two Years Ended June 30, 2017**

EXPENDITURE STATISTICS	2017	2016	2015
Total Expenditures.....	\$ 646,976,224	\$ 578,480,004	\$ 988,013,873
OPERATIONS TOTAL.....	\$ 138,295,570	\$ 140,188,812	\$ 160,612,024
% of Total Expenditures.....	21.4%	24.2%	16.3%
Personal Services.....	8,972,094	8,560,977	8,502,752
Other Payroll Costs (FICA, Retirement).....	7,551,214	7,310,630	6,611,676
Developing and Promoting Lottery Games.....	101,369,914	119,559,837	131,552,981
All Other Operating Expenditures.....	20,402,348	4,757,368	13,944,615
PRIZES.....	\$ 508,654,961	\$ 438,280,850	\$ 827,354,658
% of Total Expenditures.....	78.6%	75.8%	83.7%
REFUNDS.....	\$ 25,693	\$ 10,342	\$ 47,191
% of Total Expenditures.....	0.0%	0.0%	0.0%
Total Receipts.....	\$ 1,387,628,900	\$ 1,344,893,894	\$ 1,637,002,575
Average Number of Employees.....	151	149	145

SELECTED ACTIVITY MEASURES (Not Examined)	2017	2016	2015
Percentage of Sales:			
Paid in Prizes.....	64.3%	68.1%	61.0%
Paid as Retailer and Vendor Commissions.....	5.6%	5.6%	5.7%
Transferred to the Common School Fund.....	25.5%	24.1%	24.2%

DEPARTMENT DIRECTOR
During Examination Period: Ms. B.R. Lane (07/01/15 - 06/10/16) (Acting), Mr. Tim McDevitt 06/11/16 - 10/23/16), (Acting), and Mr. Greg Smith (10/24/16 - Present) (Acting)
Currently: Mr. Greg Smith (Acting)

**FINDINGS, CONCLUSIONS, AND
RECOMMENDATIONS**

INADEQUATE CONTROLS OVER SPECIALTY TICKETS

The Department of the Lottery (Department) allocated unallowable overhead costs to specialty scratch-off tickets and had not performed a “true up” of estimated prize liabilities to prizes paid.

Specialty tickets fund various causes

The Illinois Lottery Law (Law) requires the Department to offer specialty scratch-off games to fund:

- breast cancer research grants appropriated by the General Assembly to the Department of Public Health from the Carolyn Adams Ticket For The Cure Grant Fund;
- assistance for veterans appropriated by the General Assembly to the Department of Veterans’ Affairs for grants from the Illinois Veterans Assistance Fund;
- multiple sclerosis research grants appropriated by the General Assembly to the Department of Public Health from the Multiple Sclerosis Research Fund;
- HIV/AIDS prevention grants appropriated by the General Assembly to the Department of Public Health from the Quality of Life Endowment Fund; and,
- Special Olympics grants appropriated by the General Assembly to the Department of Human Services from the Special Olympics Illinois and Special Children's Charities Fund.

During testing, we noted the following:

Improper allocation of an overhead charge as opposed to actual costs

- The Department’s calculation of net proceeds for its specialty scratch-off games incorrectly included an allocated overhead charge as opposed to actual and identifiable direct administrative costs. The allocated overhead charge has varied over time, beginning at 3% through October 2007, falling to 2.7% from November 2007 through December 2011, and increasing to the current rate of 4.55% in January 2012. The following chart shows the amount of overhead improperly allocated since inception for each scratch-off game as of June 30, 2017:

Total improper overhead allocation exceeds \$6.3 million since inception

Inception	Cause	Amount
2006	Veterans' Assistance	\$ 1,910,132
2006	Breast Cancer	1,564,491
2008	HIV/AIDS Prevention	1,082,818
2009	Multiple Sclerosis	1,310,444
2015	Special Olympics	433,073
		6,300,958

Estimated prizes paid not adjusted to reflect actual prizes paid

Unable to quantify total error

Errors by the Department impact other agencies' financial reports

- The Department's estimate for its prize liabilities associated with its specialty scratch-off games had not been adjusted to reflect actual amounts paid for games ending on or before June 30, 2016, as of June 30, 2017. We were unable to quantify the impact of this error.
- The Department did not report accurate "accrual only" information to the Department of Public Health, the Department of Veterans' Affairs, and the Department of Human Services during the State's annual financial reporting process as it had not properly calculated "net revenues" or performed a "true up" for its prize liabilities. (Finding 3, pages 22-24)

We recommended the Department implement controls to calculate "net revenues" in accordance with the Law and correct its prior errors, or seek a legislative remedy. Further, we recommended the Department implement controls to perform a "true up" process in a timely manner for its prior period prize liability estimates to reflect actual prizes paid. Finally, we recommended the Department communicate with each "administering agency" receiving its "accrual only" information to correct any prior period errors.

Department response

The Department stated it recognizes the need to follow the Law and to accurately record our revenue and expenses. The vast majority of our actual administrative expenses for these games are incurred simultaneously with our administrative expenses incurred for all games – through instant ticket processes, marketing processes, and financial processes. We are certainly able to identify vendor charges for specific products or services, but the hourly efforts of Department staff and the Private Manager's staff will be costly to isolate. We agree with the recommendation regarding a potential legislative remedy that could result in an acceptable method for applying appropriate expenses against the game revenues. The table included in this finding shows the life-to-date amounts that have been allocated using the estimation approach, but should not be misinterpreted as amounts underpaid to the beneficiary organizations.

Accountants' Comment

In an accountant's comment, we noted the chart reflects indirect overhead costs improperly subtracted from each specialty ticket's revenue prior to the Department transferring the ticket's net revenue to other State funds for distribution to the beneficiary organizations. Until the Department can identify each specialty ticket's "actual administrative expenses of the Department solely related to the scratch-off game" or the Law is amended to allow for the subtraction of indirect overhead costs, these amounts represent an underpayment to the other State funds, which are ultimately distributed to the beneficiary organizations.

NONCOMPLIANCE WITH REPORTING REQUIREMENTS

The Department did not comply with various statutory reporting responsibilities.

During testing, we noted the following:

Reports Not Prepared

Annual reports not prepared

Three quarterly reports on the Private Manager were not prepared

Reports on the Lottery Control Board's work were not prepared

Corrected Agency Workforce Report was not prepared

- The Department's Director did not prepare an annual report including "a full and complete statement of lottery revenues, prize disbursements and other expenses" for the Governor and the Lottery Control Board (Board).
- The Department did not prepare three quarterly reports for the Governor and the General Assembly on the activities and actions of its Private Manager. These reports covered the first three quarters of Fiscal Year 2015.
- The Department did not submit an annual report for Fiscal Year 2016 or Fiscal Year 2017 regarding the work of the Board.
- The Department did not prepare a corrected Agency Workforce Report for Fiscal Year 2014 and submit it to the Governor and Secretary of State after the Department's Fiscal Year 2014 – Fiscal Year 2015 Compliance Examination identified errors in reporting the correct number of minorities and professional employees employed by the Department.

Annual report on the Private Manager submitted 162 days late

Untimely Reporting

- The Department's annual written report on the activities of the Private Manager for Fiscal Year 2017 was submitted on November 9, 2017, 162 days late.

Agency Workforce Report not correctly prepared

Inaccurate Reporting

- The Department's Agency Workforce Report for Fiscal Year 2015 did not include the correct number of professional employees employed by the Department.

Reports and publications not deposited in the State Library

Reports not posted on the Department's website

Noncompliance with Report Distribution Requirements

- Except for the Department's Fiscal Year 2016 Affirmative Action Plan, the Department has not made any report or publication deposits into the State Library during the examination period. Further, the Department did not post its reports on its website, outside of the Director's monthly sales, expenses and transfers report to the State Treasurer and the Board required by the Law. (Finding 4, pages 25-27) **This finding has been repeated since 2013.**

We recommended the Department take action to improve its reporting process by (1) identifying each reporting requirement and its associated deadline, (2) developing an internal control process to ensure each report is prepared using accurate information and reviewed by an independent person, and (3) implementing controls to ensure each report is timely submitted to its intended recipients, as required by State law. Further, we recommended the Department ensure all of its reports submitted to the General Assembly are posted to its website and sent to the State Government Report Distribution Center at the State Library and ensure all of its publications are provided to the State Library in a timely manner for its collection and exchange purposes. Finally, we recommended the Department prepare and submit a corrected Fiscal Year 2014 Agency Workforce Report and Fiscal Year 2015 Agency Workforce Report with the Governor and Secretary of State within 30 days from the release of this report, as required by the Illinois State Auditing Act.

Department officials agree

Department officials agreed with our recommendation. (*For the previous Department response, see Digest Footnote #1.*)

OTHER FINDINGS

The remaining findings pertain to noncompliance with various provisions of the Illinois Lottery Law governing the Lottery Control Board and liability certifications from employees assigned a State vehicle. We will review the Department's progress towards the implementation of our recommendations in our next compliance examination.

ACCOUNTANTS' OPINION

The accountants conducted a compliance examination of the Department for the two years ended June 30, 2017, as required by the Illinois State Auditing Act. The accountants qualified their report on State compliance for a matter described in the *Independent Accountants' Report* and the matters described in Findings 2017-001, 2017-003, and 2017-004. Except for the noncompliance described in these findings and the matter described in the *Independent Accountants' Report*, the accountants stated the Department complied, in all material respects, with the requirements described in the report.

This compliance examination was conducted by KPMG LLP.

SIGNED ORIGINAL ON FILE

JANE CLARK
Division Director

This report is transmitted in accordance with Section 3-14 of the Illinois State Auditing Act.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

FJM:djn

DIGEST FOOTNOTES

#1 – Noncompliance with Reporting Requirements – Previous Department Response

The Department agrees and will review current processes and procedures to ensure all required reports and documentation are submitted timely.