

REPORT DIGEST

DEPARTMENT OF THE LOTTERY FINANCIAL AND COMPLIANCE AUDIT FOR THE YEAR ENDED JUNE 30, 1995

SYNOPSIS

- The Department made electronic fund transfers to pay for various operating expenses without statutory authority and without adequate internal control.
- Internal controls over uncashed payroll warrants was inadequate.
- An independent Third Party Review to evaluate the adequacy of the general controls and processing at the on-line computer service contractor's operation had not been performed since April of 1993.
- The Department did not have formal security standards or an effective computer security administration function. In addition, security controls in some instances were not adequate.

{Expenditures and Activity Measures are summarized on the reverse page.}

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

LACK OF APPROPRIATION AND VOUCHERING CONTROLS

The Department made electronic funds transfers to pay various operating expenses without statutory authority. The operating expenses consisted of contractual payments to the Department's ticket distribution contractor, to its on-line computer service contractor, and also fixed monthly rental payments to the lessor of its instant ticket vending machines. In the current audit period, a total of \$23,680,110 was paid to these three contractors. These payments were not subject to appropriation control nor made through the vouchering process.

Department personnel believed the Illinois Lottery Law at 20 ILCS 1605/20 authorized these payments. This paragraph provides for the creation in the State Treasury of a State Lottery Fund and states in part: "Such fund shall consist of all revenues received from the sale of lottery tickets or shares, net of commissions, fees and prizes of less than \$600 which have been validly paid at the agent level... (emphasis added)."

The Department is in compliance with the law in allowing agents to retain from lottery sales revenue any amounts due to the agents for commissions and lottery prizes under \$600 paid directly by the agents. However, the questioned payments totalling \$23,680,110 were paid to Department contractors not to lottery agents.

Absent specific statutory authority to the contrary, the Department should comply with the provisions of the law requiring the deposit of State funds in the State Treasury and expenditure of those funds through the appropriation process.

Department officials strongly disagreed with this finding. Their complete response is a full two pages and is included in the Audit Report. As previously pointed out, the Department believed the authority for these transfers (payments) is found at 20 ILCS 1605/20. Furthermore, they said, "the General Assembly recognized when drafting the Lottery Act that a lottery is unlike any other governmental operation, and drafted the Act in such a way as to provide for a business-like operation which competes in the commercial marketplace."

We continue to stand by the finding and recommendation. Under the Department's interpretation they could pay any operating costs that could be labeled "fees" directly from lottery sales proceeds. In the current audit, those "fees" totalled almost \$24 million. Exceptions to the well-established public policy principles (that all moneys received by or on behalf of the State should be deposited into the State Treasury and that expenditures of State moneys should be made from a valid appropriation) are generally clearly given and explicitly limited. The language in 20 ILCS 1605/20 is not clear and does not contain any limitations on the amount or type of "fees" which are purportedly authorized. (Finding 1, page 10)

INADEQUATE CONTROL OVER ELECTRONIC FUNDS TRANSFERS

The Department did not have adequate internal control over electronic funds transfers. As discussed in the previous finding the Department made electronic funds transfers to pay for various operating expenses. During the current audit period, a total of \$23,680,110 was paid to three contractors. The transfers are made to accounts which are designated by the contractors. Notifications of accounts to be used are accepted by telephone and are authorized by a form prepared and signed by the deputy director, finance division. While the cash control section normally makes the transfers, the supervisor of the financial accounting section is authorized to make the transfers and does sometimes make them.

Good internal control includes a separation of duties among personnel having access to cash and those responsible for the accounting records. Without the separation of these duties, a person having access to the electronic transfer procedures and documents to authorize accounts to which funds may be transferred could divert State funds and possibly also alter accounting records to prevent detection on a timely basis.

The Department concurred with our finding and said transfer duties have been changed, and authorization for approving accounts has been delegated to the Deputy Director of Operations. (Finding 4, page 16)

INADEQUATE CONTROLS OVER UNCASHED PAYROLL WARRANTS

Internal controls over uncashed payroll warrants were inadequate. The Departments payroll procedures did not provide for custody of uncashed payroll warrants by persons independent of the payroll preparation and recording functions. Also, the Department did not have any written policy which addresses the procedures to follow in the event of unclaimed payroll warrants.

Inadequate segregation of duties does not provide adequate control to prevent the unauthorized misapplication of payroll warrants by persons who are in a position to prevent the detection of such misapplication.

Department officials concurred with our finding and said custody no longer resides with the payroll unit and that procedures have been developed for unclaimed payroll warrants. (Finding 3, page 15)

LACK OF AN ANNUAL THIRD PARTY REVIEW

An independent Third Party Review to evaluate the adequacy of the general controls and processing at the on-line computer service contractor's operation had not been performed since April of 1993.

The on-line computer service contractor was under contract with the Department to provide

computer services for processing all on-line lottery games and validation of all game winners. During the audit period, approximately one billion dollars in sales associated with the on-line games and 859 million dollars in prizes were validated on the contractor's computers. The annual cost of the contractor's services are approximately 20 million dollars.

The contracting of computer services may pose risk, control, security and audit considerations similar to those encountered with the Department's own computer environment. If services performed by the contractor were performed in-house, they would be subjected to review by internal auditors, external auditors and Department management.

Department officials concurred with our recommendation to provide for annual independent reviews of its computer services contractor. (Finding 5, page 17)

COMPUTER SECURITY ADMINISTRATION DEFICIENCIES

The Department did not have formal security standards or an effective computer security administration function. In addition, security controls in some instances were not adequate.

A review of the Department's mainframe and LANs security administration procedures revealed the following weaknesses:

- Some available security options to restrict access to the LAN and mainframe were not used effectively;
- Automatic logoffs after a period of inactivity were not used;
- Formal computer security policies and procedures outlining basic guidelines and specific responsibilities of mainframe and LAN security coordinators did not exist;
- A formal security awareness program did not exist; and
- There is a lack of consistency and coordination of security over mainframe and LANs. Coordination and consistency will become more critical with the planned move to a client server environment.

Due to the rapid development of the LAN/WAN networks and conversion of the mainframe, the Lottery has not kept pace with the coordination of security responsibilities, including the publication of security standards and the creation of a formal awareness program.

The Department concurred with our recommendation for the establishment of security policies and procedures in its standards manual and a formal security awareness program. They said, however, that many of the security procedures are in place, although not formalized and not at the same threshold as the recommendations.

OTHER FINDINGS

The remaining finding is less significant and has been given appropriate attention by the Department. We will review The Department's progress towards the implementation of our recommendations in our next audit.

Ms. Desiree Glapion Rogers, Director of the Department of the Lottery, provided the responses.

AUDITORS' OPINION

The auditors report that the financial statements of the Department of The Lottery at June 30, 1995 are fairly stated.

WILLIAM G. HOLLAND, Auditor General
WGH:TEE:pp

SUMMARY OF AUDIT FINDINGS

<u>Number of</u>	<u>This Audit</u>	<u>Prior Audit</u>
Audit findings	6	5
Repeated findings	0	1
Recommendations implemented or not repeated	5	5

SPECIAL ASSISTANT AUDITORS

Sleeper, Disbrow, Morrison, Tarro & Lively were our special assistant auditors for this audit.

DEPARTMENT OF THE LOTTERY
COMPLIANCE AUDIT
For The Year Ended June 30, 1995

EXPENDITURE STATISTICS	1995	1994	1993
●Total Expenditures (All Funds)	\$1,024,941,711	\$946,748,743	\$939,589,929
<u>OPERATIONS TOTAL</u>	\$59,393,365	\$52,963,132	\$53,728,876
% of Total Expenditures	5.8%	5.6%	5.7%
Personal Services	\$7,765,284	\$7,471,636	\$7,090,982
% of Operations Expenditures	13.1%	14.1%	13.2%
Average No. of Employees	294	292	291
Other Payroll Costs (FICA, Retirement)			
% of Operations Expenditures	\$2,318,519 3.9%	\$2,168,987 4.1%	\$2,193,762 4.1%
Contractual Services	\$25,367,434	\$22,050,350	\$21,018,860
% of Operations Expenditures	42.7%	41.6%	39.1%
Game Promotion	\$12,363,618	\$9,125,893	\$9,240,117
% of Operations Expenditures	20.8%	17.2%	17.2%
Electronic Data Processing	\$2,081,328	\$2,034,544	\$2,035,134
% of Operations Expenditures	3.5%	3.8%	3.8%
Telecommunications	\$8,111,698	\$8,705,140	\$10,687,649
% of Operations Expenditures	13.7%	16.5%	19.9%
All Other Operations Items	\$1,385,487	\$1,406,582	\$1,462,374
% of Operations Expenditures	2.3%	2.7%	2.7%
<u>COMMISSIONS AND FEES</u>	\$106,529,874	\$99,069,583	\$101,106,435
% of Total Expenditures	10.4%	10.5%	10.8%
<u>PRIZES</u>	\$859,018,472	\$794,716,028	\$784,754,618
% of Total Expenditures	83.8%	83.9%	83.5%
●Cost of Property and Equipment	\$4,756,687	\$4,331,184	\$4,396,210
		YEAR ENDED JUNE 30,	
SELECTED ACTIVITY MEASURES	1995	1994	1993
●Ticket Sales	\$1,574,384,917	\$1,472,626,392	\$1,507,033,033
●Operating Transfers To Common School Fund	\$584,907,500	\$557,068,720	\$589,443,800

AGENCY DIRECTOR(S)
During Audit Period: Desiree Glapion Rogers, Director Currently: Desiree Glapion Rogers, Director