

# CALIFORNIA LOTTERY

Audit Report

## OFFICE REVOLVING FUND EXPENDITURES

*July 1, 2003, through December 31, 2007*



JOHN CHIANG  
California State Controller

December 2008



**JOHN CHIANG**  
**California State Controller**

December 17, 2008

Joan M. Borucki, Director  
California Lottery  
600 North Tenth Street  
Sacramento, CA 95811

Dear Ms. Borucki:

The State Controller's Office (SCO) audited the California Lottery's (Lottery) office revolving fund expenditures for the period of July 1, 2003, through December 31, 2007.

Our audit of the Lottery's office revolving fund disclosed that the Lottery did not submit revolving fund expenditures to the SCO for review and approval in a timely manner. Furthermore, our audit disclosed that the Lottery inappropriately used state funds for non-business-related expenses and improperly reimbursed travel expense claims. In addition, the Lottery asserted that it is exempt from having to obtain prior approval from the Department of Personnel Administration for excess lodging costs. However, it did not provide any legal basis or documentation in support of this assertion.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD**  
Chief, Division of Audits

JVB/vb

cc: John Mass, Chairman  
California Lottery Commission  
Cynthia Flores, Commissioner  
California Lottery Commission  
Rachel Montes, Commissioner  
California Lottery Commission  
Manuel Ortega, Commissioner  
California Lottery Commission  
Michael T. Ota, Deputy Director  
Finance Division  
California Lottery  
Roberto Zavala, Chief  
Internal Audits  
California Lottery

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# Audit Report

## Summary

The State Controller's Office (SCO) audited the California Lottery's (Lottery) office revolving fund expenditures for the period of July 1, 2003, through December 31, 2007.

Our audit of the Lottery's office revolving fund disclosed that the Lottery did not submit revolving fund expenditures to the SCO for review and approval in a timely manner. Furthermore, our audit disclosed that the Lottery inappropriately used state funds for non-business-related expenses and improperly reimbursed travel expense claims. In addition, the Lottery asserted that it is exempt from having to obtain prior approval from the Department of Personnel Administration for excess lodging costs. However, it did not provide any legal basis or documentation in support of this assertion.

## Background

By authority of the California Constitution, Government Code section 12410 states, "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provision of law for payment." In addition, Government Code section 12411 stipulates that "... the Controller shall suggest plans for the improvement and management of revenues."

Proposition 37, the California State Lottery Act of 1984 (Lottery Act), amended the California Constitution to authorize the establishment of a statewide lottery, to create the California Lottery Commission, and to give the commission broad powers to oversee the operation of a statewide lottery.

Pursuant to Government Code section 8880.67, the SCO may conduct other special post-audits of the Lottery, as the State Controller deems necessary. The Controller or his/her agents conducting an audit under this chapter shall have access and authority to examine any and all records of the California Lottery Commission.

California Government Code section 1640 established an agency's ability to draw from their appropriation an amount that can be used as a revolving fund. Government Code section 1401 states that "Any revolving fund draw . . . may only be used in accordance with the law for payment of compensation earned, traveling expense, traveling expense advances, or where immediate payment is otherwise necessary."

State Administrative Manual (SAM) section 8100 identifies the overall policies and procedures for revolving fund disbursements and accounting procedures.

## **Objectives, Scope, and Methodology**

The purpose of this audit was to determine if the Lottery's expenditures processed through its office revolving fund are adequately controlled and comply with sound financial and program management practices.

We conducted this performance audit in accordance with generally accepted government auditing standards. We did not audit the Lottery's financial statements. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of our audit were to determine whether the Lottery's:

- Fiscal controls over the office revolving fund expenditures are adequate;
- Advances from the office revolving fund are properly administered;
- The office revolving fund is used for authorized purposes; and
- Accountability for the office revolving fund is maintained.

The procedures performed in the audit included:

- Reviewing the California State Lottery Act, SAM, Government Code and any other applicable rules and regulations related to the revolving fund;
- Reviewing work performed by any external audit organization, by the Lottery's Internal Audits Office, or by any other Lottery unit;
- Analyzing and evaluating processes and procedures related to the revolving fund; and
- Performing tests of procedural compliance and propriety of the expenditures processed through the revolving fund.

## **Conclusion**

Our audit of the California Lottery's office revolving fund disclosed that the Lottery did not submit revolving fund expenditures totaling \$267,218 to the SCO for review and approval in a timely manner. These expenditures were 60 days outstanding as of the end of the review period, December 31, 2007, as described in Finding 1.

In addition, the Lottery inappropriately expended \$20,287 of public funds as described in Findings 2, 3, and 4. These costs did not fit the mission of the Lottery and are an inappropriate use of public funds.

## **Views of Responsible Official**

The SCO issued a draft report to the Lottery dated October 24, 2008. Joan Borucki responded by the attached letter dated November 14, 2008. Ms. Borucki agreed with all four findings.

**Restricted Use**

This report is intended for the information and use of the California Lottery, the California Lottery Commission, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of the final report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

December 17, 2008

# Findings and Recommendations

## **FINDING 1— Revolving fund expenditures not submitted to SCO in a timely manner**

The Lottery does not maintain procedures over, or a review process for, the aged unscheduled revolving fund expenditure. Unscheduled revolving fund expenditures are those invoices that are being held by the Lottery pending submission to the SCO for payment. Our audit disclosed that 119 of 497 (24%) unscheduled revolving fund expenditures totaling \$267,218 of \$584,660 (46%) were more than 60 days outstanding as of the end of the review period, December 31, 2007. By September 10, 2008, 52 of the 119 revolving fund expenditures totaling \$206,430 of the \$267,218 in outstanding balance was scheduled and submitted to the SCO for reimbursement. The remaining 67 revolving fund expenditures, totaling \$60,788, had not been submitted to the SCO more than eight months after December 31, 2007.

- 34 of 67 (51%) revolving fund expenditures, totaling \$43,123, were outstanding. The Lottery could not provide documentation to show why most of the \$43,123 was expended. Five of the 34 revolving fund expenditures, totaling \$23,523, have been outstanding since January 1999.
- 33 of 67 (49%) revolving fund expenditures, totaling \$17,665, were for employee travel expenses. The Lottery withheld these expenditures for reimbursement until the Lottery could determine if the travel expenses were allowable.

After incurring expenditures through its office revolving fund, the Lottery should have submitted the invoices and other supporting documentation to the SCO in the form of a claim schedule for review. If the SCO review found the expenditures to be proper and legal, the SCO would have reimbursed the office revolving fund for the amount claimed. Under State Administrative Manual (SAM) section 8112.5, departments are supposed to submit invoices to the SCO at least once each month. While the Lottery did comply with the SAM section 8112.5 requirement by seeking reimbursement at least monthly, the Lottery did not always include all transactions in the claim schedules.

California Government Code section 13403(a)(3) specifies that elements of a satisfactory system of internal accounting and administrative control, shall include, but are not limited to:

A system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.

In addition, good internal control dictates that safeguarding of assets include policies and procedures that an entity has implemented to reasonably prevent or promptly detect unauthorized acquisition, use, or disposition of assets.

Recommendation

The Lottery should:

1. Establish procedures for reviewing unscheduled revolving fund payments that are aged beyond 60 days;
2. Determine what the unscheduled revolving expenditures represent; and
3. Schedule unscheduled revolving expenditures for reimbursement or if necessary submit them as write-offs to the Board of Control.

Lottery’s Response

The Lottery has been reducing the number of unscheduled revolving fund expenditures as noted in the draft report. The Lottery recognizes the importance of reconciling the Office Revolving Fund and will take the following steps in addressing this finding:

1. Follow established procedures outlined in the State Administrative Manual.
2. Determine the circumstance of each remaining unscheduled revolving fund expenditure and schedule for reimbursement.

SCO’s Comment

The Lottery concurs with SCO’s finding and recommendation.

**FINDING 2—  
Inappropriate use  
of state funds for  
non-business-related  
expenses**

As referenced in the background section of our “\$20 Billion to Education Employee Recognition Event” report dated March 26, 2008, the Lottery spent \$60,078. Of that amount, \$19,395 was reimbursed through the office revolving fund on prior anniversary employee recognition events for the years 2003 through 2007. These costs were for rental of outside event setup items such as tents, tables, chairs, props, stages, costumes, and decorations. In addition, the Lottery purchased key chains, trophies, medals, gift cards, and catered food for the employees. These costs were originally reimbursed by the SCO because they appeared to be for normal types of promotional or employee meeting expenses. These costs were incurred for the employees’ benefit; therefore, these items do not fit the mission of the Lottery and are an inappropriate use of public funds.

Year of Event	Anniversary Events Office Revolving Fund Costs Identified
2003	\$ 405
2004	2,598
2005	10,624
2006	5,234
2007	534
Total	\$ 19,395

Government Code section 8880.64 states in part:

Expenses of the lottery shall include all costs incurred in the operation and administration of the lottery and all costs resulting from any contracts entered into for the purchase or lease of goods and services

required by the lottery including but not limited to, the costs of supplies, materials, tickets, independent audit services, independent studies, data transmission, advertising, promotion, incentives, public relations, communication, compensation paid to Lottery game retailers, and reimbursement of costs of services provided to the lottery by other governmental entities, and for the costs for any other goods and services necessary for effectuating the purposes of this chapter.

The reference to promotions and incentives in Government Code section 8880.64 regards the promotion of Lottery sales and does not provide for entertainment costs and gifts to employees. When public funds are used, they must be necessary and reasonable relative to the mission of the entity incurring the expense. The costs incurred appear to be overwhelmingly for the benefit of Lottery employees. As the Lottery was not able to provide any specific statute or regulation allowing it to incur these costs, the costs constitute an improper gift of public funds and thus are unallowable.

In addition, we found that the Lottery inappropriately used State funds for non-business-related expenses in two cases totaling \$744. A refrigerator in the amount of \$679 and a kitchen cart in the amount of \$65 were purchased to supply the employee break room. These purchased items are not part of the Lottery's mission.

Department of General Services, Purchasing Authority Manual, Chapter 2, Section 2.A2.2, specifies:

Departments may not procure personal items such as Kleenex, aspirin, glass wipes and/or appliances that are not part of the department's mission.

#### Recommendation

The Lottery should establish policies and procedures such as those adopted by the Lottery Commission on May 20, 2008, to ensure that expenditures are for appropriate Lottery business-related expenses.

The May 20, 2008, regulations establish an employee recognition program for California Lottery employees; however, the regulations require the program to be similar to those at other state agencies and the payments for this purpose are not to exceed in value those allowed by California Government Code section 19823. In addition, the regulations allow for 25 years of state service awards not to exceed in value that allowed by California Government Code section 19849.9.

#### Lottery's Response

As the SCO noted in their audit finding, the Lottery Commission has adopted regulations concerning employee recognition programs.

#### SCO's Comment

The Lottery concurs with SCO's finding and recommendation.

**FINDING 3—  
Inadequate review of  
reimbursement travel  
expense claims**

Our audit disclosed that the Lottery did not follow procedures in place to ensure accurate processing of employee travel expense claims (TECs). We found errors in eight of the 403 TECs tested. The sample of 403 TECs represent approximately 4% of 8,559 TECs processed during our audit period. The eight errors resulted in unallowable reimbursement expenses totaling \$598.92. The disallowed reimbursements are as follows:

1. The Lottery overpaid a TEC by \$211. A Lottery employee reported mileage expense of \$282.74, when only \$71.74 (211 miles × \$0.34) was reimbursable for mileage. However, the 211 miles were improperly included on the TEC as a dollar figure and added to the reimbursable mileage amount.

In another case, the Lottery overpaid a TEC by \$18 for the cost of transportation that exceeded the receipt amount. The Lottery did not follow proper procedures to ensure TECs were accurate.

Government Code section 8880.64 states, in part, “Expenses of the Lottery shall include costs incurred.”

2. The Lottery reimbursed two TEC claims for Lottery employee parking for career-related education courses totaling \$145. The Lottery overpaid one TEC by \$26 and another by \$119.

DPA Rule 599.819(a)(3) specifies:

When an employee participates in career-related or upward mobility training, with the approval of the appointing power, reimbursement may be made for tuition, books, and supplies. Reimbursement for travel and per diem should not be allowed.

3. In two cases, the Lottery paid for business-related lunches that exceeded the allowable per diem rates by \$79.99 and \$25.58. In another case, an employee received a gratuitous business-related meal and was also reimbursed \$10 for the lunch on his/her TEC.

SAM section 0727 specifies:

The cost of business-related meals may not exceed the allowable per diem rates.

DPA Rule 599.619(a)(1) specifies:

The employee will be reimbursed for actual costs up to the maximum allowed for each meal.

4. The Lottery overpaid incidentals on two TECs for \$8 and \$39. The overpayment was for tipping costs that exceeded the daily incidental allowance.

DPA Rule 599.619 specifies:

Tipping costs are included in the daily incidental allowance for which the employees were reimbursed (\$6 per 24 hour period).

5. In two cases, the Lottery exceeded the maximum allowable cost of mementos awarded to retired employees by \$25.20 and \$37.15.

Government Code section 19849.9 specifies:

The cost of mementos awarded to retiring employees may not exceed \$90.

#### Recommendation

The Lottery should ensure that it consistently follows appropriate review procedures to ensure that travel claims are accurately processed in accordance with applicable State laws and regulations.

#### Lottery's Response

The Lottery acknowledges the 8 instances out of the 403 claim schedules sampled where employees' travel expense claims were reimbursed erroneously. While the Lottery considers this error rate to be small it does not excuse the importance of following appropriate review procedures to ensure that travel claims are accurately processed in accordance with applicable State laws and regulations. The Lottery recognizes its responsibility to conduct complete and thorough reviews of travel expense claims and will reassess its procedures in this area.

#### SCO's Comment

The Lottery concurs with the finding noting that the employees' travel expenses were reimbursed erroneously and recognizes its responsibility to conduct thorough reviews of travel expense claims.

#### **FINDING 4— No prior approval obtained for excess lodging costs**

Our audit disclosed that the Lottery did not obtain prior approval from the Department of Personnel Administration (DPA) for excess lodging costs; one claim exceeded the State maximum rate by \$89. The Lottery asserted that it was exempt from obtaining DPA approval. Despite our request, the Lottery could not provide the legal basis supporting this assertion or documentation that granted it exemption from obtaining approval from DPA.

In addition, the Lottery's form for excessive lodging request for approval is deficient by not including the same information as required as DPA's Excess Lodging Rate Request/Approval form (STD 255C). The Lottery's Request/Approval For In-State Lodging Allowance did not include the same information as DPA's (STD 255C) form. The Lottery's form (CSL 0776) does not document the "good faith" effort to obtain lodging from three vendors at or below the State rate.

DPA Rule 599.619 specifies:

Exceptions to reimburse in excess of the maximum lodging rate may be granted by the Appointing Power only in an emergency, or when there is no lodging available at the State maximum rate or when it is cost effective.

State of California Memorandum, Reference Code 2001-014 specifies:

When requesting an exception, departments are to use the STD 255C, Excess Lodging Rate Request/Approval, or a departmental form that includes the same information. All exception requests are to include a list of the moderately-priced establishments contacted, dates of the contacts, and the results of the contacts. The request must also be approved in advance and signed by the appointing authority. Exception requests are to be completed and forwarded to DPA prior to travel.

#### Recommendation

The Lottery should adhere to DPA rules unless it can provide the legal basis or evidence of DPA's approval for exemption from the requirement to obtain prior approval for excess lodging costs.

#### Lottery's Response

Since its inception in 1985, it was the Lottery's and the Department of Personnel Administration's (DPA) understanding that the Lottery was exempt from DPA approval when a traveler exceeds standard lodging rates. Neither the Lottery nor DPA were successful in producing a document that memorialized this long-standing practice. Moreover, travel expense claims containing excess lodging have been previously submitted to and reimbursed by the SCO since 1985 without DPA approval. It is important to note that the SCO is not questioning past excess lodging costs; on that, the Lottery should request DPA approval prior to travel.

The Lottery has implemented procedures that conform to DPA requirements regarding pre-approval of excess lodging rates. These procedures include securing DPA's approval via the Excess Lodging Rate Request/Approval form (STD 255C) prior to travel occurring.

#### SCO's Comment

The Lottery concurs with SCO's finding and recommendation by stating that it will conform to DPA requirements regarding pre-approval for excess lodging.

**Attachment—  
California Lottery’s  
Response to Draft Report**

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*California State Lottery*

*Headquarters*

*600 North Tenth Street*

*Sacramento, CA 95814*

November 14, 2008

Andrew Finlayson, Chief  
State Agency Audits Bureau  
State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, California 94250-5874

Re: State Controller's Office Audit of the Office Revolving Fund Expenditures -  
July 1, 2003 through December 31, 2007

Dear Mr. Finlayson:

The California State Lottery (Lottery) offers the following general comments and specific points regarding the recently concluded audit conducted by the State Controller's Office (SCO). The audit scope was limited to an audit of the Lottery's Office Revolving Fund for the period of July 1, 2003 through December 31, 2007. The Lottery's Revolving Fund was previously audited by the State Controller's Office for the biennial period ending December 31, 2007 culminating in a report issued September 19, 2007. The audit did not disclose any significant internal control problems or weaknesses.

The Lottery takes its mission as a public agency very seriously. We also understand that it is an important part of this mission to perform its duties in a cost-effective and transparent manner to ensure that there has been no violation of the public trust. Further, as stated above, the focus of the audit was on the Lottery's Office Revolving Fund and we are pleased to note that in this area, after a lengthy and thorough review by the SCO, there are no findings that would hinder the Lottery's performance of its mission.

The draft report listed a number of recommendations for the Lottery to consider. Most of the recommendations call for the Lottery to enhance its internal control structure by updating policies and procedures and improving documentation and record keeping. The Lottery finds these recommendations useful. The Lottery continually evaluates and implements methods to improve its business practices and refine its internal control structure, and the Lottery intends to adopt recommendations that cost effectively improve business functions.

Andrew Finlayson  
November 14, 2008  
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Below are the Lottery's responses to the specific recommendations provided in the draft audit report. The Lottery will develop a work plan as part of the SCO follow-up process. As a note, because of the length of time since this audit began on February 26, 2008, many of the recommendations to the findings have been implemented.

FINDING 1 - Revolving fund expenditures not submitted to SCO in a timely manner.

RECOMMENDATION:

The Lottery should:

1. Establish procedures for reviewing unscheduled revolving fund payments that are aged beyond 60 days;
2. Determine what the unscheduled revolving expenditures represent; and
3. Schedule unscheduled revolving expenditures for reimbursement or if necessary submit them as write-off to the Board of Control.

RESPONSE:

The Lottery has been reducing the number of unscheduled revolving fund expenditures as noted in the draft report. The Lottery recognizes the importance of reconciling the Office Revolving Fund and will take the following steps in addressing this finding:

1. Follow established procedures outlined in the State Administrative Manual.
2. Determine the circumstance of each remaining unscheduled revolving fund expenditure and schedule for reimbursement.

FINDING 2 – Inappropriate use of State funds for non-business-related expenses.

RECOMMENDATION:

The Lottery should establish policies and procedures such as those adopted by the Lottery Commission on May 20, 2008, to ensure that expenditures are for appropriate Lottery business-related expenses.

The May 20, 2008, regulations establish an employee recognition program for California Lottery employees; however, the regulations require that program to be similar to those at other state agencies and the payments for this purpose are not to exceed in value those allowed by California Government Code section 19823. In addition, the regulations allow for 25 years of state service awards not to exceed in value that allowed by California Government Code section 19849.9.

Andrew Finlayson  
November 14, 2008  
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**RESPONSE:**

As the SCO noted in their audit findings the Lottery Commission has adopted regulations concerning employee recognition programs.

**FINDING 3 - Inadequate review of reimbursement travel expense claims**

**RECOMMENDATION:**

The Lottery should ensure that it consistently follows appropriate review procedures to ensure that travel claims are accurately processed in accordance with applicable State laws and regulations.

**REPOSE:**

The Lottery acknowledges the 8 instances out of the 403 claim schedules sampled where employees' travel expense claims were reimbursed erroneously. While the Lottery considers this error rate to be small it does not excuse the importance of following appropriate review procedures to ensure that travel claims are accurately processed in accordance with applicable State laws and regulations. The Lottery recognizes its responsibility to conduct complete and thorough reviews of travel expense claims and will reassess its procedures in this area.

**FINDING 4 – No prior approval obtained for excess lodging costs.**

**RECOMMENDATION:**

The Lottery should ensure that it consistently follow appropriate review procedures to ensure that travel claims are accurately processed in accordance with applicable State laws and regulations.

**RESPONSE:**

Since its inception in 1985, it was the Lottery's and the Department of Personnel Administration's (DPA) understanding that the Lottery was exempt from DPA approval when a traveler exceeds standard lodging rates. Neither the Lottery nor the DPA were successful in producing a document that memorialized this long standing practice. Moreover, travel expense claims containing excess lodging have been previously submitted and reimbursed by the SCO since 1985 without DPA approval. It is important to note that the SCO is not questioning past excess lodging costs; only that the Lottery should request DPA approval prior to travel.

Andrew Finlayson  
November 14, 2008  
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The Lottery has implemented procedures that conform to DPA requirements regarding pre-approval of excess lodging rates. These procedures include securing DPA's approval via the Excess Lodging Rate Request/Approval form (STD 255C) prior to travel occurring.

If you have any additional questions, please contact my Audit Chief, Roberto Zavala at (916) 323-7156.

Sincerely,



Joan M. Borucki  
Director

**State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, CA 94250-5874**

**<http://www.sco.ca.gov>**