

CALIFORNIA LOTTERY

Audit Report

SAM 20000 AUDIT: CASH DISBURSEMENTS CYCLE

January 1, 2006, through December 31, 2007



JOHN CHIANG
California State Controller

August 2007



JOHN CHIANG
California State Controller

August 22, 2007

Joan M. Borucki, Director
California Lottery
600 North Tenth Street
Sacramento, CA 95814

Dear Ms. Borucki:

The State Controller's Office audited the Cash Disbursements Cycle as part of our process of studying and evaluating the accounting and administrative controls of the California Lottery for the biennial period ending December 31, 2007. The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Cash Disbursements Cycle.

Our audit did not disclose any significant internal control problems and weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Cash Disbursements Cycle. However, our audit disclosed that the lottery is not properly processing uncashed or unclaimed Revolving Fund and General Cash checks.

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/jj

cc: John Mass, Chairman
California Lottery Commission
Rachel Montes, Commissioner
California Lottery Commission
Manuel Ortega, Commissioner
California Lottery Commission
Patt Eberhart, Director
Finance and Administration
California Lottery
Cathleen Dinubilo, Chief
Internal Audits Office
California Lottery

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Audit Report

Summary

The State Controller's Office (SCO) is in the process of studying and evaluating the internal accounting and administrative controls of the California State Lottery (Lottery) in accordance with State Administrative Manual Section 20060 (Internal Control Reporting) for the biennial period ending December 31, 2007. The SCO has concluded the audit for the Cash Disbursements Cycle. The last day of fieldwork was January 3, 2007.

The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Cash Disbursements Cycle. Any reportable weaknesses identified by our audit are disclosed in this report.

Our audit did not disclose any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Cash Disbursements Cycle. However, our audit disclosed that the Lottery is not processing uncashed or unclaimed Revolving Fund and General Cash checks according to applicable regulations.

Background

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.

The Lottery Act created a special fund, known as the State Lottery Fund, within the State Treasury. The State Lottery Fund operates as an enterprise fund and is required to be entirely self-funded from Lottery sales. The Lottery Act further stipulates that 50% of lottery sales proceeds are to be allocated to prizes, and that no more than 16% are to be used for administrative costs. The remaining proceeds from lottery sales, a minimum of 34%, are to be directed to the benefit of public education.

State Administrative Manual (SAM) section 8090 (General Cash) states:

General cash consists of cash collected by or temporarily on deposit in an agency account (1) pending its remittance to the State Treasury or (2) pending its refund to payers, as authorized by law.

The Lottery maintains a General Cash account from which the Lottery disburses cash by preparing and issuing warrants. The majority of disbursements from General Cash are payments to the Bank of America for non-sufficient fund balances encountered during the electronic transfers of sales revenue from retailer accounts. The Lottery's Accounting Operations and Tax Bureau (AOTB) is responsible for all General Cash disbursements.

Authority

SAM section 20060 (Internal Control Reporting) states:

Pursuant to the FISMA [*Financial Integrity and State Manager's Accountability Act of 1983*], the head of each state entity shall prepare and submit a report on the adequacy of their entity's internal control on December 31 of each odd numbered fiscal year. . . . The report shall consist of a certification letter, the most recent audit report on internal accounting and administrative controls, and management's response to the audit report.

The Lottery delegated the duty of performing the biennial audit of internal controls to the SCO in a letter dated September 6, 2002.

Objectives, Scope, and Methodology

We studied and evaluated the accounting and administrative controls of the Lottery's Cash Disbursements Cycle in effect as of January 3, 2007. We conducted our study and evaluation in accordance with the *Standards for the Professional Practice of Internal Auditing*, issued by the Institute of Internal Auditors, and included testing that we considered necessary to determine whether accounting and administrative controls are in place and operative.

Lottery management is responsible for establishing and maintaining adequate internal controls. This responsibility, in accordance with Government Code sections 13402 et seq., includes documenting internal control, communicating requirements to employees, and ensuring that internal control is functioning as prescribed. To fulfill its responsibility, Lottery management must assess the expected benefits and related costs of control procedures.

The objectives of accounting and administrative controls are to provide management with reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition;
- Transactions are executed in accordance with management's authorization and recorded properly, so as to permit the preparation of reliable financial statements; and
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

The specific objectives of the audit were to determine whether:

- Established policies and procedures exist for cash disbursements;
- Adequate separation of duties exists for cash disbursements;
- Cash disbursements are properly authorized and made only for proper purposes;
- Cash disbursements journals, ledger accounts, and bank accounts are posted accurately and promptly and reconciled with control accounts, and are periodically reconciled;

- Adequate safeguards exist over check-signing activities; and
- Payments for purchases are accurate and are processed and recorded promptly.

The audit procedures were performed to determine whether:

- Documentation of internal controls is maintained;
- Adequate separation of duties exists over cash disbursements functions;
- Updated authorizations are maintained;
- Bank reconciliations are prepared and reviewed monthly;
- Blank checks and check-signing machines are safeguarded from unauthorized use;
- Full accountability of checks is maintained; and
- Cash disbursements are properly recorded in the accounting records.

The audit procedures performed included:

- Analyzing and evaluating the internal controls for the cash disbursements cycle by identifying the strengths and weaknesses;
- Performing tests to determine whether control objectives are being properly achieved; and
- Documenting the internal controls over the Cash Disbursements Cycle encompassing the Lottery's policies and procedures.

Conclusion

Our study and evaluation did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Cash Disbursements Cycle. However, our audit disclosed that uncashed agency checks are not being processed according to applicable regulations. The Finding and Recommendation section of this report provides a detailed explanation of the audit finding.

In our opinion, the Lottery's accounting and administrative controls over the Cash Disbursements Cycle in effect as of January 3, 2007, taken as a whole, were sufficient to meet the objectives stated above.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all of these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

**Views of
Responsible
Official**

We issued a draft audit report on March 16, 2007. Joan M. Borucki, Director, responded by letter dated March 30, 2007 (Attachment), agreeing with the audit results. This final audit report includes the Lottery's response.

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 this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

Finding and Recommendation

**FINDING—
Lack of controls over
uncashed agency checks**

The Lottery is not properly processing uncashed or unclaimed Revolving Fund and General Cash checks. Specifically, The Lottery is not reviewing the outstanding checks listing and stopping payment on checks one week prior to the end of the one-year period of negotiability.

State Administrative Manual (SAM) section 8042 states:

Agencies will send Stop Payment Request form, STD 432, to the STO for all uncashed checks timed to arrive at least one week prior to the end for the one-year period of negotiability. The STO is able to stop payment of stale date checks only through the receipt of stop payment requests from agencies.

SAM section 8045 states:

A Stop Payment Requests form, STD 432 must be sent to the STO one week before the stale date of all uncashed agency checks.

This is a repeat finding from the prior SAM 20000 audit.

Recommendation

The Lottery should include a review of outstanding checks during the bank reconciliation and stop payment on stale-dated checks in accordance with SAM sections 8042 and 8045.

Lottery's Response

As of April 1, 2007 the Lottery has modified the stop payment process for agency checking accounts. The Finance Department's Accounts Payable Section will be responsible for issuing the stop payment requests to the Treasurer's Office for uncashed agency checks at least one week prior to the end of the one-year period of negotiability.

SCO's Comment

We have no further comment, as the Lottery modified its stop payment process for agency checking accounts to comply with SAM sections 8042 and 8045.

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



California State Lottery

Headquarters

600 North Tenth Street

Sacramento, CA 95814

March 30, 2007

Mr. Andy Finlayson, Chief
Operations Audit Bureau
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250-5874

Dear Mr. Finlayson:

The following is the California State Lottery's (Lottery) response to the finding and recommendation contained in the State Controller's Office SAM 20000 Cash Disbursements Cycle draft audit report dated March 16, 2007:

SCO Finding – The Lottery is not properly processing uncashed or unclaimed Revolving Fund and General Cash checks. Specifically, the Lottery is not reviewing the outstanding checks listing and stopping payment on checks one week prior to the end of the one-year period of negotiability.

SCO Recommendation – The Lottery should include a review of outstanding checks during the bank reconciliation and stop payment on stale-dated checks in accordance with SAM Sections 8042 and 8045.

Lottery Response to SCO Recommendation:

As of April 1, 2007 the Lottery has modified the stop payment process for agency checking accounts. The Finance Department's Accounts Payable Section will be responsible for issuing the stop payment requests to the Treasurer's Office for uncashed agency checks at least one week prior to the end of the one-year period of negotiability.

Sincerely,

A handwritten signature in cursive script that reads 'Joan M. Borucki'.
Joan M. Borucki, Director
California State Lottery

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

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