

# CALIFORNIA LOTTERY

Audit Report

## **SAM 20000 AUDIT: CASH RECEIPTS CYCLE**

*January 1, 2006, through December 31, 2007*



**JOHN CHIANG**  
California State Controller

March 2007



**JOHN CHIANG**  
California State Controller

March 28, 2007

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

Dear Ms. Borucki:

The State Controller's Office audited the Cash Receipts 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 Receipts Cycle.

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 Receipts Cycle.

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

Sincerely,

*Original signed by*

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

JVB/ams:vb

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  
Stacy Matsunami, Director  
Special Projects, California Lottery  
Cathleen Dinubilo, Chief  
Internal Audits Office, California Lottery

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  
Stacy Matsunami, Director  
Special Projects  
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 Receipts Cycle. The last day of fieldwork was January 30, 2007.

The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Cash Receipts Cycle.

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 Receipts Cycle.

## 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.

Lottery fund cash receipts consist of:

- Electronic fund transfers (EFTs) for the sales of lottery tickets from retailer bank accounts (this category makes up the majority of the cash receipts);
- Checks received from retailers for nonsufficient funds encountered at the time of EFT; and
- Other miscellaneous payments received, such as refunds from vendors and lease payments.

The two Lottery units responsible for collecting and depositing cash receipts are the Revenue Collections Section and the Accounting Operations and Tax Bureau.

## Authority

*State Administrative Manual* 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 Receipts Cycle in effect as of January 30, 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* (SAM).

The specific objectives were to determine whether:

- Established policies and procedures exist for collecting, safeguarding, and depositing of cash receipts;
- Cash receipt duties are clearly defined and adequate separation of duties exists over cash receipts;
- All cash due is received and such amounts are authorized in accordance with state laws and regulations;

- Cash receipt transactions are correctly recorded in the accounting records, and accountability is maintained; and
- Subsidiary records are reconciled with control accounts and bank statements.

The audit procedures performed included:

- Analyzing and evaluating the internal controls for the Cash Receipts Cycle by identifying the strengths and weaknesses;
- Performing tests to determine if control objectives are being properly achieved; and
- Documenting a description of the internal controls over the Cash Receipts 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 Receipts Cycle.

In our opinion, the Lottery's accounting and administrative controls over the Cash Receipts Cycle in effect as of January 30, 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 discussed our audit results with Kathie Johnson, Audit Specialist, Internal Audits, on January 30, 2007. Ms Johnson agreed with the audit results. No findings were disclosed during our audit; therefore, a draft is not necessary and the report will be issued as final.

## **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

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

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