

CALIFORNIA LOTTERY

Audit Report

SAM 20000 AUDIT: INFORMATION ACCESS/ DATA INTEGRITY CYCLE

January 1, 2006, through December 31, 2007



JOHN CHIANG
California State Controller

October 2007



JOHN CHIANG
California State Controller

October 24, 2007

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

Dear Ms. Borucki:

The State Controller's Office audited the Information Access/Data Integrity 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 Information Access/Data Integrity 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 Information Access/Data Integrity Cycle.

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
Rachel Montes, Commissioner
California Lottery Commission
Manuel Ortega, Commissioner
California Lottery Commission
Patt Eberhart, Director
Finance and Administration
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 Information Access/Data Integrity Cycle. The last day of fieldwork was July 20, 2007.

The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Information Access/Data Integrity 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 Information Access/Data Integrity 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.

Pursuant to Government Code section 1340(b)(1), each state agency must maintain effective systems of accounting and administrative controls as an integral part of its management practices.

The Lottery's Fiscal Systems Analysis Section with the Lottery's Finance Department is responsible for the application, control, and maintenance of a fully integrated accounting system. This section performs reviews and implements all application upgrades and "fixes," maintains a liaison with vendors whose applications comprise the accounting system, and facilitates and/or creates all customizations needed. Because this system has several automated interfaces, this unit is responsible for ensuring that the interfaces are compatible with the applications. This unit, through a formalized change control process, tracks all system problems and modifications.

The Lottery's primary fiscal system is Epicor. Within the Epicor accounting system, the Lottery uses eBackoffice for its fiscal functions and eProcurement for the purchasing functions. The other systems that interface with the Epicor accounting system are the following:

- Annuity Investment System—Information on annuity prize payments;
- On-line Claims Validation System—Information on on-line prize payments;
- Retailer Master System—Information on owners and retailers;
- Online Reporting Facility—Information on gaming system activity;
- Bank of America—Return items downloaded from Web site; and
- State Controller's Office—Personnel payroll, claims paid (warrants issued), and bank statement information.

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 Information Access/Data Integrity Cycle in effect as of July 20, 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:

- Access to accounting system hardware and software is adequately controlled;
- Adequate separation of duties exists over the information technology function;
- Data integrity is assured through input, processing, and output controls; and
- Continuity of procedures exist through written documentation and avoidance of key person dependency.

The audit procedures performed included:

- Documenting a description of the internal controls over the Information Access/Data Integrity Controls Cycle encompassing the Lottery's policies and procedures over the accounting system;
- Analyzing and evaluating the internal controls for the Information Access/Data Integrity Controls Cycle by evaluating the strengths and weaknesses that impact the accounting system; and
- Performing tests to determine if control objectives are being properly achieved.

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 Information Access/Data Integrity Cycle.

In our opinion, the Lottery's accounting and administrative controls over the Information Access/Data Integrity Cycle in effect as of July 20, 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 July 20, 2007. Ms. Johnson agreed with the audit results. No findings were disclosed during our audit; therefore, a draft report 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

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