

# CALIFORNIA LOTTERY

Audit Report

## **SAM 20000 AUDIT: PERSONNEL AND PAYROLL CYCLE**

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



**JOHN CHIANG**  
California State Controller

April 2007



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

April 25, 2007

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

Dear Ms. Borucki:

The State Controller's Office audited the Personnel and Payroll 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 Personnel and Payroll 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 Personnel and Payroll Cycle. However, our audit disclosed that the Lottery could not locate the Employee Separation Notices for some employees. As a result, we never tested 4 of 21 notices requested because they could not be located. Additionally, of the 17 notices provided, 13 received clearance by the Accounting Operations and Tax Bureau after the employees' separation dates and 9 received property clearances after the employees' separation dates.

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/vb:ams

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 Personnel and Payroll Cycle. The last day of fieldwork was November 29, 2006.

The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Personnel and Payroll 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 Personnel and Payroll Cycle. However, our audit disclosed that the Lottery could not locate the Employee Separation Notices for some employees. As a result, we never tested 4 of 21 notices requested because they could not be located. Additionally, of the 17 notices provided, 13 received clearance by the Accounting Operations and Tax Bureau after the employees' separation dates and 9 received property clearances after the employees' separation dates.

## 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.

The Personnel Section is responsible for the personnel and payroll functions, located under the Finance and Administration Division within the Human Resources Department. In particular, the Personnel Section provides the personnel services mandated by state and federal laws under the direction of state control agencies, including the Department of Personnel Administration, the State Personnel Board and the State Controller's Office. The Personnel Section is divided into three units: Classification and Pay Unit, Examinations Services Unit, and Transactions Unit.

## 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 Personnel and Payroll Cycle in effect as of November 29, 2006. 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 initiating and processing personnel/payroll transactions;
- Adequate separation of duties exists over the personnel/payroll function;
- Personnel/payroll transactions are properly approved and certified by authorized personnel only;

- Payroll expenditures are recorded correctly, stay within budget, and are allocated to the correct fund and program;
- SCO directives are followed regarding the Direct Deposit program;
- State policies and procedures are followed regarding employee leave; and
- Adequate clearance procedures exist for separating employees.

The audit procedures performed included:

- Analyzing and evaluating the internal controls for the Personnel and Payroll 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 Personnel and Payroll 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 Personnel and Payroll Cycle. However, our audit disclosed that the Lottery could not locate the Employee Separation Notices for some employees. As a result, we never tested 4 of 21 notices requested because they could not be located. Additionally, of the 17 notices provided, 13 received clearance by the Accounting Operations and Tax Bureau after the employees' separation dates and 9 received property clearances after the employees' separation dates.

In our opinion, the Lottery's accounting and administrative controls over the Personnel and Payroll Cycle in effect as of November 29, 2006, 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 Officials**

We issued a draft report dated January 26, 2007. Joan M. Borucki, Director, responded by the attached letter dated February 23, 2007. Ms. Borucki partially agreed with the audit finding. In addition, Ms. Borucki's letter provided an explanation as to why some separation notices were not collected and stated that the Lottery will implement controls to ensure that separation notices are collected for all separated employees.

**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— Employee separation notices**

The Lottery does not maintain adequate controls for ensuring that clearances are made prior to an employee's separation from the Lottery. The Lottery uses an Employee Separation Notice as a checklist to collect funds or property due back to the State prior to the employee's separation date. Accounting and property clearances are either not being performed or are being performed after the employees' separation date.

We requested 21 notices from the Personnel Services Section; however, the Personnel Section could not provide four (19%) of the requested notices. Of the 17 notices provided, 13 received clearances by the Accounting Operations and Tax Bureau after the employees' separation dates and 9 received property clearances after the employees' separation dates.

*State Administrative Manual* Section 8580.4, Terminating Employees, states:

Salary warrants will not be distributed to terminating employees until the agency is assured that all outstanding travel and salary advances have been paid. This may be done by incorporating into a general "check-out" list the requirement that along with other acknowledgments for state-owned items such as credit cards, keys, all state records and equipment, that the revolving fund clerk's acknowledgment also be obtained prior to the release of the final warrant.

By not ensuring that all Employee Separation Notices are completed and accounted for by the Personnel Section prior to employee separation dates, the Lottery risks failing to collect funds or property due the State.

### Recommendation

The Lottery should institute controls to ensure that prior to employee separation dates, the Personnel Section receives and accounts for Employee Separation Notices and verifies that accounting and property clearances have been performed.

### Lottery's Response

The separation notices that were not collected prior to the employee's separation date were primarily due to separations of employees without notice (i.e., retirements without notice, AWOL separations, and adverse actions). To ensure that separation notices are collected on all separated employees, the Personnel Specialists have developed a method to follow-up with supervisors and managers on separation documents and ensure that Official Personnel Files are not forwarded or filed without the required separation notice. In addition to the current process for newly separated employees, a review will be implemented to verify that accounting and property clearances have been performed on the older separated employee's files and if necessary complete the Employee's Separation Notice.

SCO's Comment

The Lottery is implementing controls to ensure that separation notices will be collected on all separated employees. We will evaluate these controls that will be implemented in the next biennial FISMA audit.

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

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California State Lottery  
Headquarters  
600 North Tenth Street  
Sacramento, CA 95834

February 23, 2007

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

Dear Mr. Finlayson:

I am pleased to forward the California State Lottery's (Lottery) response to the State Controller's Office (SCO) draft audit of the Lottery's SAM 20000 Personnel and Payroll Cycle audit, dated January 26, 2007.

Our response to your finding and recommendation follows:

**SCO Finding** – The Lottery does not maintain adequate controls for ensuring that clearances are made prior to an employee's separation from the Lottery. The Lottery uses an Employee Separation Notice as a checklist to collect funds or property due back to the State prior to the employee's separation date. Accounting and property clearances are either not being performed or are being performed after the employees' separation date.

**SCO Recommendation** – The Lottery should institute controls to ensure that prior to employee separation dates, the Personnel Section receives and accounts for Employee Separation Notices and verifies that accounting and property clearances have been performed.

Lottery Response to SCO Finding:

The separation notices that were not collected prior to the employee's separation date were primarily due to separations of employees without notice (i.e., retirements without notice, AWOL separations, and adverse actions). To ensure that separation notices are collected on all separated employees, the Personnel Specialists have developed a method to follow-up with supervisors and managers on separation documents and ensure that Official Personnel Files are not forwarded or filed without the required separation notice. In addition to the current process for newly separated employees, a review will be implemented to verify that

Mr. Andy Finlayson, Chief  
February 23, 2007  
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accounting and property clearances have been performed on the older separated employee's files and if necessary complete the Employee's Separation Notice.

Sincerely,

  
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>**