

CALIFORNIA LOTTERY

Audit Report

SAM 20000 AUDIT: REVOLVING FUND CYCLE

January 1, 2006, through December 31, 2007



JOHN CHIANG
California State Controller

September 2007



JOHN CHIANG
California State Controller

September 19, 2007

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

Dear Ms. Borucki:

The State Controller's Office audited the Revolving Fund 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 Revolving Fund 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 Revolving Fund 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/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

Contents

Audit Report

Summary	1
Background	1
Authority	2
Objectives, Scope, and Methodology	2
Conclusion	3
Views of Responsible Official	3
Restricted Use	3

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 Revolving Fund Cycle. The last day of fieldwork was July 17, 2007.

The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Revolving Fund 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 Revolving Fund 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.

California Government Code section 16400 established an agency's ability to draw from their appropriation an amount that can be used as a revolving fund. Government Code section 46401 states that "Any revolving fund draw . . . may only be used in accordance with law for payment of compensation earned, traveling expenses, traveling expense advances, or where immediate payment is otherwise necessary."

SAM Section 8100 identifies the overall policies and procedures for Revolving Fund disbursements and accounting procedures.

The Lottery currently has an \$8,000,000 revolving fund allowance. It has approximately 15 cash funds, which it issues to Lottery employees. The Lottery issues a cash fund to each of the district offices, and the remaining funds to different divisions within Lottery headquarters. Most of these funds only have a balance of \$100, with the remaining funds ranging from \$200 to \$500.

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 Revolving Fund Cycle in effect as of July 17, 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:

- Written policies and procedures exist for properly administering and controlling the Revolving Fund;
- Advances to the Revolving Fund are properly administered;
- Revolving Fund is used for authorized purposes;
- Accountability for the Revolving Fund is maintained; and
- Revolving Fund reimbursement claims are properly supported.

The audit procedures performed included:

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

In our opinion, the Lottery's accounting and administrative controls over the Revolving Fund Cycle in effect as of July 17, 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 Kathy Millikan, Accounting Administrator, Accounting Operations and Tax Bureau, on July 17, 2007. Ms. Millikan 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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