

# **CALIFORNIA LOTTERY**

Review Report

## **OTTO CONSTRUCTION CONTRACT FOLLOW-UP REVIEW**

*October 1, 2010, through May 31, 2012*



**JOHN CHIANG**  
California State Controller

March 2013



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

March 15, 2013

Phil Tagami, Chairperson  
California Lottery  
700 North Tenth Street  
Sacramento, CA 95811

Dear Mr. Tagami:

The State Controller's Office (SCO) conducted a follow-up review of the California Lottery's (Lottery) implementation of the recommendations presented in our audit report of the Otto Construction contract dated December 16, 2011. The review period was October 1, 2010, through May 31, 2012.

The purpose of the review was to determine whether the Lottery implemented corrective actions that adequately addressed the findings and recommendations presented in the audit report dated December 16, 2011.

During our review, we noted the following deficiencies:

- The Lottery made inappropriate purchases, including dishwashers, ice machines, and an electric range. These expenditures totaled \$34,036.
- The Lottery built a gymnasium and made inappropriate purchases, including gymnasium equipment such as treadmills, elliptical machines, bicycles, and a gym system. These expenditures totaled \$29,952.

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, CPA**  
Chief, Division of Audits

JVB/ra

cc: Nathaniel Kirtman III, Commissioner  
California Lottery Commission  
John Smolin, Commissioner  
California Lottery Commission  
Gregory Ahern, Commissioner  
California Lottery Commission  
Connie M. Perez, Commissioner  
California Lottery Commission  
Robert T. O'Neill, Director  
California Lottery  
Nicholas Buchen, Deputy Director, Finance  
California Lottery  
Roberto Zavala, Chief Internal Auditor  
California Lottery  
Terry Murphy, Deputy Director of Operation  
California Lottery

# Contents

## **Audit Report**

<b>Summary</b> .....	1
<b>Background</b> .....	2
<b>Objectives, Scope, and Methodology</b> .....	2
<b>Conclusion</b> .....	3
<b>Views of Responsible Official</b> .....	3
<b>Restricted Use</b> .....	3
<b>Finding and Recommendation</b> .....	4
<b>Attachment—California Lottery’s Response to Draft Report</b>	

# Audit Report

## Summary

This report summarizes the findings and recommendations from the Otto Construction contract audit report dated December 16, 2011, and any changes to the contract.

The purpose of the review was to determine whether the Lottery implemented corrective actions that adequately addressed the findings and recommendations presented in the audit report dated December 16, 2011.

### **The majority of the SCO recommendations have been implemented.**

Of the five findings in the report, the Lottery implemented recommendations for, or resolved, the following four:

- Finding 2 – Lack of authorization for work

Preconstruction and construction services have been completed and authorization was provided for work

- Finding 3 – Lack of liability insurance coverage

The construction services continued without any interruption of services and the Lottery obtained copies of insurance certificates from the contractor

- Finding 4 – Noncompliance with as-built drawings and specifications

The payment applications included a memorandum stating that the contract manager has reviewed and approved the as-built drawings and specifications, as required by the contract.

- Finding 5 – Lack of contractor's daily reports

The Lottery maintains a superintendent's daily report log in a binder.

### **The Lottery partially or substantially implemented one of the SCO's recommendations.**

- Finding 1 – Improve oversight over invoice payment process.

The Lottery was using Otto Construction's job cost report to substantiate Otto Construction's self-performed work. The total amounts seem to be reasonably supported by the job costs report. The Lottery also implemented a payment reconciliation process. This process seems adequate for verifying that the claims presented to the Lottery for reimbursement are reasonable. However, during the follow-up review we noted the following deficiencies:

- The Lottery made inappropriate purchases, including dishwashers, ice machines, and an electric range. These expenditures totaled \$34,036.

- The Lottery built a gymnasium and made inappropriate purchases, including gymnasium equipment such as treadmills, elliptical machines, bicycles, and a gym system. These expenditures totaled \$29,952.

## Background

By authority of the California Constitution, Government Code section 12410 states, “The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provision of law for payment.” In addition, Government Code section 12411 stipulates that “. . . the Controller shall suggest plans for the improvement and management of revenues.”

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.

Pursuant to Government Code section 8880.46.6, the SCO may conduct other special post-audits of the Lottery, as the State Controller deems necessary. The Controller or his/her agents conducting an audit under this chapter shall have access and authority to examine any and all records of the California Lottery Commission.

The Lottery entered into a contract with Otto Construction (Contract No. 14379) to provide preconstruction and construction services for the new Lottery Headquarters Building in Sacramento. The contract was for the period of August 3, 2009, through December 31, 2012, with a guaranteed maximum price of \$63,800,000.

## Objectives, Scope, and Methodology

The purpose of the review was to determine whether the Lottery implemented corrective actions that adequately addressed the findings and recommendations presented in the audit report dated December 16, 2011.

The objectives of the review included, but were not limited to, determining if the Lottery:

- Implemented corrective actions that adequately resolved the findings;
- Made legal and proper contract payments; and
- Is monitoring the contract for compliance.

The review period was October 1, 2010, through May 31, 2012, and procedures performed included, but are not limited to, the following:

- Reviewing audit findings and recommendations from the SCO’s prior audit;

- Reviewing the Otto Construction contract, subcontracts, amendments, contract law, regulations, rules, Lottery policies, and related accounting records;
- Reviewing work performed by any external audit organization or subcontractors, or by any other Lottery unit; and
- Performing tests of procedural compliance relating to labor, materials, or equipment, and including tests of progress billings, as we deemed necessary.

We did not audit the Lottery's financial statements.

## **Conclusion**

Our review disclosed that the Lottery did not follow the terms and conditions stipulated in the Department of General Services' *Delegated Purchasing Authority State Contracting Manual*. These procedures ensure that payments are proper and legal, and that expenditures are necessary and reasonable relative to the mission of the entity.

The Lottery:

- Made inappropriate purchases, including dishwashers, ice machines, and an electric range. These expenditures totaled \$34,036.
- Built a gymnasium and made inappropriate purchases, including gymnasium equipment such as treadmills, elliptical machines, bicycles, and a gym system. These expenditures totaled \$29,952.

## **Views of Responsible Official**

The SCO issued a draft report to the Lottery dated January 23, 2013. Robert O'Neill, Director, responded by the attached letter dated February 11, 2013. Mr. O'Neill agreed with the finding and recommendation.

## **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 the final report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

March 15, 2013

# Finding and Recommendation

## **FINDING— Inappropriate purchases**

Our review noted that the Lottery inappropriately used public funds for non-business-related expenses. Our review found that the Lottery made inappropriate purchases under Otto Construction Contract No. 14379 for the following items:

- Breakroom appliances, including dishwashers, ice machines, and an electric range, for a total of \$34,036; and
- Gymnasium equipment, including treadmills, elliptical machine, bicycles, and a gym system, for a total of \$29,952.

The Lottery used public funds to make purchases that were inconsistent with the Lottery's mission, function, and purpose. The appliance and equipment purchases totaled \$63,988. These costs were incurred for Lottery employees' benefit; therefore, they do not fit the mission of the Lottery and are an inappropriate use of public funds.

Government Code section 8880.64 (Lottery Act) states, in part:

(a) Expenses of the lottery shall include all costs incurred in the operation and administration of the lottery and all costs resulting from any contracts entered into for the purchase or lease of goods and services required by the lottery, including, but not limited to, the costs of supplies, materials, tickets, independent audit services, independent studies, data transmission, advertising, promotion, incentives, public relations, communications, compensation paid to the lottery game retailers, bonding for lottery game retailers, printing, distribution of tickets or shares, reimbursement of costs of services provided to the lottery by other governmental entities, and for the costs of any other goods and services necessary for effectuating the purposes of this chapter. As a promotional expense, the commission may supplement the prize pool of a game or games upon its determination that a supplement will benefit the public purpose of this chapter.

Department of General Services *Delegated Purchasing Authority, State Contracting Manual*, Volume 2 states, in part:

Chapter 2.A2.3: In accordance with the California State Constitution, Article 16, section 6, any gift of public funds is strictly prohibited. All expenditures must support the department's mission (function and purpose) and benefit the State to not be considered gifts of public funds.

The Lottery should follow the Department of General Services guidelines, policies, and procedures to avoid misusing public funds.

Expenditures must be necessary and reasonable relative to the mission of the entity incurring the expense or they may be considered an inappropriate gift of public funds.

Recommendation

The Lottery should ensure that purchases are carefully reviewed, proper, and in compliance with the applicable laws, rules, and regulations, and that they support the Lottery's mission and function.

Lottery's Response

The California Lottery (Lottery) acknowledges that these purchases were made. As a note, these items were purchased under the direction of the Lottery Commission and Senior Management that have since left the organization. Nonetheless, the Lottery will continue to ensure that all purchases are carefully reviewed, proper, and in compliance with applicable laws, rules, and regulations and that they support the Lottery's mission and function.

SCO's Comment

The Lottery agreed with the finding and recommendation.

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

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February 11, 2013

Mr. Jeffrey V. Brownfield, Chief  
Division of Audits  
State Controller's Office  
P.O. Box 942850  
Sacramento, CA 94250-5874

Re: Otto Construction Contract Follow-up Review

Dear Mr. Brownfield,

Thank you for the opportunity to respond to your follow-up review on findings noted in the original audit report dated December 16, 2011. We are pleased that your follow-up found the majority of findings were adequately resolved and that no significant internal control issues were identified. However, during the follow-up review, you identified several items purchased under the Otto Construction Contract No. 14379 that were inappropriate.

The California Lottery (Lottery) acknowledges that these purchases were made. As a note, these items were purchased under the direction of the Lottery Commission and Senior Management that have since left the organization. Nonetheless, the Lottery will continue to ensure that all purchases are carefully reviewed, proper, and in compliance with applicable laws, rules, and regulations, and that they support the Lottery's mission and function.

If you have any additional questions, please contact the Audit Chief, Roberto Zavala at (916) 822-8358.

Sincerely,

A handwritten signature in blue ink, appearing to read 'R. T. O'Neill'.

Robert T. O'Neill  
Director

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

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