

CALIFORNIA LOTTERY

Audit Report

SAM 2000 AUDIT: ACCOUNTS RECEIVABLE 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 Accounts Receivable 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 Accounts Receivable 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 Accounts Receivable Cycle. However, our audit disclosed that the Accounting Operations and Tax Bureau did not update the Epicor system's customer folder to reflect the issue date of the final dunning letter. Thus, the receivables were not referred to the Financial Reporting Bureau for further collection efforts.

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 Accounts Receivable Cycle. The last day of fieldwork was November 7, 2006.

The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Accounts Receivable Cycle. Any reportable weaknesses identified by our audit are disclosed in this report.

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 Accounts Receivable Cycle. However, our audit disclosed that the Accounting Operations and Tax Bureau did not update the system's customer folder to reflect the issue date of the final dunning letter. Thus, the receivables were not referred to the Financial Reporting Bureau for further collection efforts.

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.

Article 7, Section 8880.61, of the Lottery Act created a special fund with the State Treasury known as the State Lottery Fund (Fund). The Fund operates as an enterprise fund and is required by the Lottery Act to be entirely self-funded from Lottery sales.

Lottery receivables consist of the following.

- Moneys owed by retailers from the sale of lottery tickets. This category makes up the majority of the receivables.
- Other miscellaneous receivables, such as overpayments to employees and money owed by vendors.

Several Lottery units have responsibility for receivables.

- The Revenue Collections Section initiates collection procedures for retailers with non-sufficient funds in their accounts.
- The Accounting Operations and Tax Bureau records and initiates the collection procedures for other miscellaneous receivables.
- The Financial Reporting Bureau coordinates the efforts for collecting delinquent receivables.

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 Accounts Receivable Cycle in effect as of November 7, 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 the recording and collecting of receivables;
- Adequate separation of duties exists over the receivable function;
- Collection procedures ensure prompt follow-up on outstanding accounts; and
- Uncollectible accounts receive appropriate scrutiny prior to write-off and are subsequently accounted for.

The audit procedures performed included:

- Analyzing and evaluating the internal controls for the Accounts Receivable Cycle by identifying their strengths and weaknesses;
- Performing tests to determine if control objectives are being properly achieved; and
- Documenting a description of the internal controls over the Accounts Receivable 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 Accounts Receivable Cycle. However, our audit disclosed that the Accounting Operations and Tax Bureau did not update its Epicor system's customer folder to reflect the issue date of the final dunning letter. Thus, the receivables were not referred to the Financial Reporting Bureau for further collection efforts. The Finding and Recommendation section of this report provides a detailed explanation of the audit finding.

In our opinion, the Lottery's accounting and administrative controls over the Accounts Receivable Cycle in effect as of November 7, 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**

The SCO issued a draft report dated February 14, 2007. Joan M. Borucki, Director, California Lottery, responded by the attached letter dated March 9, 2007. Ms. Borucki agreed with the SCO's conclusions for the audit finding.

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— Lack of additional collection efforts

The audit disclosed that the Accounting Operations and Tax Bureau (AOTB) did not update the Epicor system's customer folder to reflect the issue date of the final dunning letter. Thus, the receivables were not referred to the Financial Reporting Bureau (FRB) for further collection efforts. Furthermore, the staff assigned to update the system with the issue date no longer has access to the appropriate folder. As a result, additional collection efforts have not been applied to the six receivables created during our audit period beginning January 1, 2006, as follows.

- Five files contained a third (final) dunning letter issued April 6, 2006. However, AOTB did not update the system's customer folder to reflect the issue date of the final dunning letters; therefore, the FRB has not submitted the receivables to the collection agency and/or to the FTB offset list.
- One file contained a third (final) dunning letter issued September 25, 2006. On October 3, 2006, we confirmed with the FRB that the AOTB did not update the system's customer folder to reflect the issue date of the final dunning letter; therefore, the FRB has not submitted the receivable to the collection agency and/or to the FTB offset list.

State Administrative Manual (SAM) Section 8776.6, Non-employee Accounts Receivable, states that if three collection letters are unsuccessful, departments will prepare an analysis to determine what additional collection efforts should be made.

Failure to make additional efforts to collect outstanding receivables may result in loss of otherwise collectible income. Additional efforts must be made promptly in order to increase the likelihood of collection.

Recommendation

The AOTB should update the Epicor system's customer folder with the issue date of the final dunning letters and create a checklist in each file to document the:

- Issue dates of the dunning letters;
- Date the receivable was deferred to FRB; and
- Date the receivable was settled or discharged.

In addition, AOTB staff should "cc" the final dunning letter to the AOTB Supervisor and/or FRB Collection Unit. The AOTB Supervisor and/or FRB Collection Unit should update/confirm that the Epicor system's customer folder contains the issue date of the final dunning letter.

Lottery's Response

The Lottery agreed with the finding and recommendation.

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



California State Lottery
Headquarters
600 North Tenth Street
Sacramento, CA 95814

March 9, 2007

Mr. Andy Finlayson, Chief
Operations Audit 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' SAM 20000 Accounts Receivable Cycle audit, dated February 14, 2007.

Our response to your finding and recommendation follows:

SCO Finding – The Accounting Operations and Tax Bureau (AOTB) did not update Epicor's customer folder to reflect the issue date of the final dunning letter. Thus, the receivables were not referred to the Financial Reporting Bureau (FRB) for further collection efforts. Furthermore, the staff assigned to update the system with the issue date no longer has access to the appropriate folder. As a result, additional collection efforts have not been applied to the six receivables created during our audit period beginning January 1, 2006.

SCO Recommendation – The AOTB should update the Epicor system's customer folder with the issue date of the final dunning letters and create a checklist in each file to document the:

- Issue dates of the dunning letters,
- Date the receivable was deferred to FRB, and,
- Date the receivable was settled or discharged.

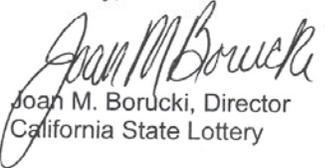
In addition, the AOTB staff should "cc" the final dunning letter to the AOTB Supervisor and/or FRB Collection Unit. The AOTB Supervisor and/or FRB Collection Unit should update/confirm that the Epicor system's customer folder contains the issue date of the final dunning letter.

Mr. Andy Finlayson, Chief
March 9, 2007
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CL Response to SCO Finding:

The Lottery agrees with the finding and began implementing the recommendations on March 8, 2007.

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>