CALIFORNIA LOTTERY
Audit Report
PAYROLL PROCESS AUDIT
July 1, 2012, through June 30, 2015

BETTY T. YEE
California State Controller

February 2017
February 24, 2017

California Lottery Commission
700 North Tenth Street
Sacramento, CA  95811
Attn: Nathaniel Kirtman III, Chair

Dear Commissioners:

We audited the California Lottery’s (Lottery) payroll process for the period of July 1, 2012, through June 30, 2015. The purpose of the audit was to determine if the Lottery is maintaining effective systems of internal controls over the payroll process.

Based on our audit, we noted that:

• The Lottery lacked written procedures for the employee separation lump-sum payment process. Lump-sum calculations were not reviewed and calculation methods were inconsistent. As a result, 12 of 20 lump-sum payments tested were incorrectly paid: nine of 12 employees were underpaid a total of approximately $9,757, and three of 12 employees were overpaid a total of approximately $9,363;

• The Lottery did not properly review overtime payments, resulting in one of 20 overtime payments tested being overpaid by approximately $220;

• The Lottery did not ensure that proper justification was obtained for employees in a classification other than Personnel Specialist/Payroll Technician and who have a job duty requiring access to the payroll system. Of the six employees in a classification other than Personnel Specialist/Payroll Technician, one does not have a justification letter from the Authorizing Manager. In addition, two justification letters on file were signed by someone other than the Authorizing Manager; and

• The Lottery did not ensure that proper access was granted to the payroll system. A Staff Services Manager in the Personnel Services Section had improper access, allowing the ability to update employee history and the Master Payroll Certification System. Manager classifications should be allowed inquiry access only.
If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau by telephone at (916) 324-6310 or by email at afinlayson@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/rg

cc: Gregory Ahern, Vice Chair
    California Lottery Commission
    Rowena Libang-Bobila, Commissioner
    California Lottery Commission
    Connie M. Perez, Commissioner
    California Lottery Commission
    John Smolin, Commissioner
    California Lottery Commission
    Hugo López, Director
    California Lottery
    Dottie Wallace, Acting Deputy Director, Human Resources
    California Lottery
    Roberto Zavala, Deputy Director, Internal Audits
    California Lottery
    James Shannon, Audit Manager, Internal Audits
    California Lottery
# Contents

## Audit Report

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Summary</td>
<td>1</td>
</tr>
<tr>
<td>Background</td>
<td>1</td>
</tr>
<tr>
<td>Scope, Objectives, and Methodology</td>
<td>2</td>
</tr>
<tr>
<td>Conclusion</td>
<td>3</td>
</tr>
<tr>
<td>Views of Responsible Officials</td>
<td>4</td>
</tr>
<tr>
<td>Restricted Use</td>
<td>4</td>
</tr>
<tr>
<td>Findings and Recommendations</td>
<td>5</td>
</tr>
</tbody>
</table>

## Attachment—California Lottery’s Response to Draft Report
Audit Report

Summary

We audited the California Lottery’s (Lottery) payroll process audit for the period of July 1, 2012, through June 20, 2015. The purpose of the audit was to determine if the Lottery is maintaining effective systems of internal controls over the payroll process.

Our audit identified conditions over the payroll process that increase the Lottery’s risk of improper payments, unauthorized disclosure of payroll information, and noncompliance with state laws, rules, regulations, and collective bargaining agreements if not addressed.

Based on our audit, we noted that:

- The Lottery lacks written procedures for the employee separation lump-sum payment process. Lump-sum calculations were not reviewed and calculation methods were inconsistent. As a result, 12 of 20 lump-sum payments tested were incorrectly paid: nine of 12 employees were underpaid a total of approximately $9,757, and three of 12 employees were overpaid a total of approximately $9,363;

- The Lottery did not properly review overtime payments, resulting in one of 20 overtime payments tested being overpaid by approximately $220;

- The Lottery did not ensure that proper justification was obtained for employees in a classification other than Personnel Specialist/Payroll Technician and who have a job duty requiring access to the payroll system. Of the six employees in a classification other than Personnel Specialist/Payroll Technician, one does not have a justification letter from the Authorizing Manager. In addition, two justification letters on file were signed by someone other than the Authorizing Manager; and

- The Lottery did not ensure that proper access was granted to the payroll system. A Staff Services Manager of the Personnel Services Section had improper access, allowing the ability to update employee history and the Master Payroll Certification System. Manager classifications should be allowed inquiry access only.

Background

In 1984, Proposition 37 amended the California Constitution to authorize the establishment of a statewide lottery. As an initiative statute, the California State Lottery Act of 1984 created the California State Lottery Commission and gave it broad powers to oversee the operations of a statewide lottery. The purpose of the Lottery Act was to provide supplemental monies to benefit public education without the imposition of additional or increased taxes. The Lottery is administered by a five-person Commission appointed by the Governor and confirmed by the State Senate.
As of May 1, 2016, the Lottery’s Human Resources Division has 27 budgeted positions. The Division consists of eight sections, including: Personnel Services, Classification and Pay/Examinations, Transactions and Payroll, Health and Safety, EEO Services, Training, Special Projects, and Labor Relations. The Division provides services to all Lottery employees in the areas of hiring, examination, payroll and benefits administration, labor relations, equal employment opportunity, health and safety/return to work, and training.

The Transactions and Payroll Section handles employee pay and benefits and is responsible for processing payroll, attendance, and benefit-related information; maintaining employment history; and maintaining official personnel files and leave records. The section creates internal policies and procedures for the payroll process and also retains copies of the SCO’s policies and procedures, such as the Payroll Procedures Manual, Personnel Action Manual, and payroll calendars.

Government Code (GC) 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, GC section 12411 stipulates that “… the Controller shall suggest plans for the improvement and management of revenues.”

Pursuant to GC section 8880.46.6, the State Controller’s Office (SCO) may conduct 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.

**Scope, Objectives, and Methodology**

The audit period was July 1, 2012, through June 30, 2015. The purpose of the audit was to determine if the Lottery is maintaining effective systems of internal control over the payroll process.

The objectives of the audit were to determine whether:

- The Lottery complied with applicable state laws, rules, regulations, collective bargaining contracts, and policies and procedures related to the payroll process;
- The Lottery maintained adequate internal controls over the payroll process;
- Payroll transactions were properly approved and certified by authorized personnel;
- Payroll transactions were accurate and properly recorded; and
- Payroll systems, records, and files were adequately safeguarded.
To meet the objectives, we:

- Reviewed the Lottery Act, State Administrative Manual (SAM), collective bargaining contracts, Lottery policies and procedures, and any other applicable laws, rules, and regulations as they relate to the payroll process;
- Reviewed work performed by any external audit organization, the Lottery’s Internal Audits Office, or any other Lottery unit;
- Interviewed and observed individuals involved in processes related to payroll transactions;
- Analyzed and evaluated internal controls over the payroll process;
- Performed tests of procedural compliance of the payroll process; and
- Performed tests of payroll transactions.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We did not audit the Lottery’s financial statements. We limited our scope to planning and performing audit procedures necessary to achieve our audit procedures.

Conclusion

Our audit identified conditions over the payroll process that, if not addressed, increase the Lottery’s risk of improper payments; unauthorized disclosure of payroll information; and noncompliance with state laws, rules, regulations, and collective bargaining agreements. The Lottery is responsible for maintaining effective internal controls and evaluating those controls on an ongoing basis.

Based on our audit of the Lottery’s payroll process for the period of July 1, 2012, through June 30, 2015, we noted that:

- The Lottery lacks written procedures for the employee separation lump-sum payment process. Lump-sum calculations were not reviewed and calculation methods were inconsistent. As a result, 12 of 20 lump-sum payments tested were incorrectly paid: nine of 12 employees were underpaid a total of approximately $9,757, and three of 12 employees were overpaid a total of approximately $9,363. These incorrect payments resulted from incorrect beginning leave balances, miscalculated accrued leave credits, personal holiday units not being converted into hours, and erroneous data entry;
- The Lottery did not properly review overtime payments, resulting in one of 20 overtime payments tested being overpaid by approximately $220;
• The Lottery did not ensure that proper justification was obtained for employees in a classification other than Personnel Specialist/Payroll Technician and who have a job duty requiring access to the payroll system. Of the six employees in a classification other than Personnel Specialist/Payroll Technician, one does not have a justification letter from the Authorizing Manager. In addition, two justification letters on file were signed by someone other than the Authorizing Manager; and

• The Lottery did not ensure that proper access was granted to the payroll system. A Staff Services Manager of the Personnel Services Section had improper access, allowing the ability to update employee history and the Master Payroll Certification System. Manager classifications should be allowed inquiry access only.

Views of Responsible Officials

On December 2, 2016, Hugo López, Director, responded to the draft report on behalf of the Lottery. The response is included as an attachment to this report.

Restricted Use

This report is intended for the information and use of the Lottery, the 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

February 24, 2017
The Lottery lacks written procedures for the employee separation lump-sum payment process. Consequently, lump-sum calculations were not reviewed and calculation methods were inconsistent, resulting in incorrect payments.

Pursuant to collective bargaining agreements and state law, employees are entitled to receive cash for accrued eligible leave credits when separating from state employment. During the period of July 1, 2012, through June 30, 2015, the Lottery processed 122 employee separation lump-sum payments, for a total of $1,958,100. We tested the 20 largest payments, for a total of $985,140.24 and found that of 20 lump-sum payments, 12 were incorrectly calculated. Nine of 12 employees were underpaid a total of approximately $9,757, and three of 12 employees were overpaid a total of approximately $9,363. These incorrect payments resulted from incorrect beginning leave balances, miscalculated accrued leave credits, personal holiday units not being converted into hours, and erroneous data entry.

GC section 13401 states:

Each state agency must maintain effective systems of internal accounting and administrative control as an integral part of its management practices. The systems of internal accounting and administrative control of each state agency shall be evaluated on an ongoing basis and, when detected, weaknesses must be promptly corrected. All levels of management of the state agencies must be involved in assessing and strengthening the systems of internal accounting and administrative control to minimize fraud, errors, abuse, and waste of government funds.

If the Lottery does not maintain effective systems of internal control over the employee separation lump-sum payment process, it could increase its risk of error and noncompliance to collective bargaining agreements and state law.

Recommendations

The Lottery should strengthen its controls over the lump-sum separation payment process to minimize the risk of error and noncompliance to collective bargaining agreements and state law. The Lottery should:

- Establish and implement written procedures for the employee separation lump-sum payment process;
- Provide training to payroll staff members to ensure that they understand how to properly calculate employee separation lump-sum payments;
- Provide adequate oversight to ensure that employee separation lump-sum payments are properly paid; and
- Recover overpayments made to separated employees, in accordance with GC 19838 and SAM section 8776.6.
Lottery’s Response

The Lottery agrees with the finding and recommendation on both the previous lack of written procedures and the payment errors. In response, the Lottery developed and implemented written procedures for the employee separation lump-sum payment process. The new procedures require Personnel Specialists to use management approved tools and methods for lump-sum calculations. The procedures also require Personnel Specialists follow a quality assurance process including having their work reviewed and signed off by a Personnel Services Manager or Personnel Officer before a Personnel Action Request is executed.

With respect to the incorrect payments, the Lottery took immediate action to remedy former employees who were underpaid and collect overpayments from those overpaid. Moreover, the Lottery requested its Internal Audits conduct a review of lump-sum payments, not sampled by the State Controller’s Office (SCO) between July 2012 to January 31, 2016, to assure management that lump-sum payments were correctly calculated.

Lastly, the Lottery’s Human Resources Division, Transactions Staff completed the SCO’s Lump-Sum Deferral training on February 3, 2016.

SCO’s Comment

The Lottery has indicated that it has implemented corrective actions in response to the finding. We will follow up at the next payroll audit to ensure such corrective actions were adequate and appropriate.

During the period of July 1, 2012, to June 30, 2015, the Lottery had 2,384 overtime transactions (Type 1 payments), for a total of $896,190. Type 1 payments are usually for overtime but can include payments for compensating time off. Overtime is a payment that an employee is entitled to receive for all hours worked in excess of his/her normal work week in classes not eligible for exemptions.

We tested 20 Type 1 transactions (18 employees), for a total of $61,531. We determined that regular pay and overtime pay were properly authorized, calculated, and accurately paid. However, we found that one of 20 tested was overpaid by approximately $220. The employee who received this payment was paid 77 hours but was entitled to only 70 hours, resulting in an overpayment of seven hours. The overpayment was due to a keying error and improper review.

GC section 13401 states:

Each state agency must maintain effective systems of internal accounting and administrative control as an integral part of its management practices. The systems of internal accounting and administrative control of each state agency shall be evaluated on an ongoing basis and, when detected, weaknesses must be promptly corrected. All levels of management of the state agencies must be involved in assessing and strengthening the systems of internal accounting and administrative control to minimize fraud, errors, abuse, and waste of government funds.
If the Lottery does not maintain effective systems of administrative controls over the overtime payment process, it could increase its risk of error.

Recommendation

The Lottery should strengthen its administrative controls over the overtime (Type 1) payment process to minimize the risk of error. The Lottery’s staff should ensure that all Type 1 payments are accurate and properly reviewed before processing. The Lottery should recover the overpayment in accordance with GC 19838 and SAM section 8776.6.

Lottery’s Response

The Lottery agrees with the finding and recommendation that one of the 20 overtime payments audited was paid incorrectly. In response, the Lottery’s Human Resources Division (HR) conducted a limited review to ensure that overtime payments, not sampled by the State Controller’s Office, were calculated properly. This error appears to be an anomaly because our review did not find additional errors. Nevertheless, the HR Division will strengthen its administrative controls to minimize the risk of error.

SCO’s Comment

We will follow up at the next payroll audit to ensure that the Lottery has taken adequate and appropriate actions to remedy the finding.

FINDING 3—Improper justification letters and access to the payroll system payments

The Lottery did not ensure that proper justification was obtained for employees in a classification other than Personnel Specialist/Payroll Technician and who have a job duty requiring access to the payroll system.

The SCO maintains a decentralization security program designed to reduce the risk of careless, accidental, or intentional disclosure of confidential personnel and payroll information. The SCO houses numerous systems of records that contain confidential and sensitive data and restricts access to individuals who have a legal and legitimate business purpose in the performance of their governmental duties.

During the period of July 1, 2012, through June 30, 2015, the Lottery had 11 employees with access to the payroll system. Of the six employees in a classification other than Personnel Specialist/Payroll Technician, one does not have a justification letter from the Authorizing Manager, and two justification letters on file were signed by someone other than the Authorizing Manager.

In addition, a Staff Services Manager in the Personnel Services Section had improper access allowing the ability to update employee history and the Master Payroll Certification System. Manager classifications should be allowed inquiry access only.
The Decentralization Security Program Manual states, in part:

A request to grant access to an individual in a classification other than in the Personnel Specialist/Payroll Technician series to access... requires a written justification from the Authorizing Manager. The Justification must describe the individual’s specific job duties requiring the need to access system information. Managers classifications will be granted inquiry access only.

If the Lottery does not abide by the Decentralization Security Program Manual, it could increase its risk of improper disclosure of confidential payroll information.

Recommendations

- The Lottery should ensure that employees in a classification other than Personnel Specialist/Payroll Technician and who require payroll system access obtain proper justification from the Authorizing Manager.

- The Lottery’s Authorizing Manager should verify access and level-of-access of all employees listed on the Security Authorization Form, and the Security Monitor should periodically review system access to ensure compliance with the Decentralization Security Program Manual.

- The Lottery should ensure that managers are granted inquiry access only.

Lottery’s Response

The Lottery agrees with the findings and recommendations.

The two improper justification letters in question were signed by a Human Resources (HR) Manager who was acting in a backup capacity to the Authorizing Manager who was out of the office on long-term leave. While this was a temporary solution, the Lottery will prospectively work with the State Controller's Office (SCO) to ensure that employees that require payroll system access obtain the required justification from an appropriate Authorizing Manager, and retain Authorization Forms for audit purposes.

As noted above, a long-term absence by the Authorizing Manager necessitated that the Lottery utilize a proxy HR Manager, who possesses more than “inquiry only access” to the SCO’s payroll system, to serve as a backup to the Supervising Personnel Specialist. Due to current HR vacancies, the Lottery is experiencing a similar situation. For that reason, the Lottery consulted with SCO and received approval to allow the manager in question to continue to access the payroll system to meet operational needs of the Lottery. Once HR vacancies are addressed and the required training is received, the Lottery will request that SCO make all the appropriate adjustments to ensure that only those Lottery staff with proper authorization access their payroll system.

To reinforce internal controls over payroll system access, the Lottery’s Authorizing Manager will verify the access and level-of-access of all Lottery employees listed on Security Authorization Forms. Moreover,
the Lottery’s Security Monitor will periodically review system access to ensure compliance with the Decentralization Security Program Manual. As the Lottery continues to meet its payroll needs with limited staff, the Lottery will continue to consult the SCO on payroll access controls to ensure access requests submitted to SCO are consistent with the Decentralization Security Program Manual.

SCO’s Comment

The Lottery has indicated that it has implemented corrective actions in response to the finding. We will follow up at the next payroll audit to ensure such corrective actions are adequate and appropriate.
Attachment—
California Lottery’s
Response to Draft Report
December 2, 2016

Mr. Andrew Finlayson, Chief
State Agency Audits Bureau
State Controller’s Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250-5874

RE: Payroll Process Audit

Dear Mr. Finlayson,

The California Lottery (Lottery) offers the following comments regarding the recently concluded audit of the Lottery’s payroll process for the period of July 1, 2012, through June 30, 2015. As stated in the audit report dated November 8, 2016, the purpose of the audit was to determine if the Lottery is maintaining effective systems of internal accounting and administrative controls over the payroll process.

We thank you for the opportunity to respond to the draft audit report. We are pleased that the audit did not identify significant internal control issues; however, the audit did identify opportunities to improve the internal accounting and administrative controls over the payroll process.

Finding 1:

Lack of procedures for the employee separation lump-sum payment process, resulting in incorrect payments.

Recommendation:

The Lottery should strengthen its controls over the lump-sum separation payment process to minimize the risk of error and noncompliance to collective bargaining agreements and state law. The Lottery should:

- Establish and implement written procedures for the employee separation lump-sum payment process;
Payroll Process Audit  
December 2, 2016  
Page 2

- Provide training to payroll staff members to ensure that they understand how to properly calculate employee separation lump-sum payments;
- Provide adequate oversight to ensure that employee separation lump-sum payments are properly paid; and
- Recover overpayments made to separated employees, in accordance with GC 19838 and SAM section 8776.6.

Response:

The Lottery agrees with the finding and recommendation on both the previous lack of written procedures and the payment errors. In response, the Lottery developed and implemented written procedures for the employee separation lump-sum payment process. The new procedures require Personnel Specialists to use management approved tools and methods for lump sum calculations. The procedures also require that Personnel Specialists follow a quality assurance process including having their work reviewed and signed off by a Personnel Services Manager or Personnel Officer before a Personnel Action Request is executed.

With respect to the incorrect payments, the Lottery took immediate action to remedy former employees who were underpaid and collect overpayments from those overpaid. Moreover, the Lottery requested its Internal Audits conduct a review of lump sum payments, not sampled by the State Controller's Office (SCO) between July 2012 to January 31, 2016, to assure management that lump-sum payments were correctly calculated.

Lastly, the Lottery's Human Resources (HR) Division, Transactions staff completed the SCO's Lump-Sum Deferral training on February 3, 2016.

Finding 2:

Improper review of overtime (Type 1) payments, resulting in incorrect payment.

Recommendation:

The Lottery should strengthen its administrative controls over the overtime (Type 1) payment process to minimize the risk of error. The Lottery's staff should ensure that all Type 1 payments are accurate and properly reviewed before processing. The Lottery should recover the overpayment in accordance with GC 19838 and SAM section 8776.6.

Response:

The Lottery agrees with the finding and recommendation that one of the 20 overtime payments audited was paid incorrectly. In response, the Lottery's HR Division conducted a limited review to ensure that overtime payments, not sampled by SCO, were calculated properly. This error appears to be an anomaly because our review did not find additional
errors. Nevertheless, the HR Division will strengthen its administrative controls to minimize the risk of error.

Finding 3:

Improper justification letters and access to the payroll system payments.

Recommendation:

- The Lottery should ensure that employees in a classification other than Personnel Specialist/Payroll Technician and who require payroll system access obtain proper justification from the Authorizing Manager.
- The Lottery's Authorizing Manager should verify access and level-of-access of all employees listed on the Security Authorization Form, and the Security Monitor should periodically review system access to ensure compliance with the Decentralization Security Program Manual.
- The Lottery should ensure that managers are granted inquiry access only.

Response:

The Lottery agrees with the finding and recommendation.

The two improper justification letters in question were signed by an HR Manager who was acting in a backup capacity to the Authorizing Manager who was out of the office on a long-term leave. While this was a temporary solution, the Lottery will prospectively work with the SCO to ensure that employees that require payroll system access obtain the required justification from an appropriate Authorizing Manager, and retain Authorization Forms for audit purposes.

As noted above, a long-term absence by the Authorizing Manager necessitated that the Lottery utilize a proxy HR manager, who possesses more than “inquiry only access” to the SCO’s payroll system, to serve as a backup to the Supervising Personnel Specialist. Due to current HR vacancies, the Lottery is experiencing a similar situation. For that reason, the Lottery consulted with SCO and received approval to allow the manager in question to continue to access the payroll system to meet operational needs of the Lottery. Once HR vacancies are addressed and the required training is received, the Lottery will request that SCO make all the appropriate adjustments to ensure that only those Lottery staff with proper authorization access their payroll system.

To reinforce internal controls over payroll system access, the Lottery's Authorizing Manager will verify the access and level-of-access of all Lottery employees listed on Security Authorization Forms. Moreover, the Lottery's Security Monitor will periodically review system access to ensure compliance with the Decentralization Security Program Manual.
Payroll Process Audit
December 2, 2016
Page 4

As the Lottery continues to meet its payroll needs with limited staff, the Lottery will continue to consult with SCO on payroll access controls to ensure access requests submitted to SCO are consistent with the Decentralization Security Program Manual.

If you have any additional questions, please contact Roberto Zavala, Deputy Director, Internal Audits at (916) 822-8358.

Sincerely,

Hugo López
Director

cc: Nathaniel Kirtman III, Lottery Chair
    Gregory Ahern, Lottery Vice Chair
    Rowena Libang-Bobila, Commissioner
    Connie M. Perez, Commissioner
    John Smolin, Commissioner
    Dottie Wallace, Acting Deputy Director, Human Resources
    Roberto Zavala, Deputy Director, Internal Audits
    James Shannon, Audit Manager, Internal Audits