

CALIFORNIA STATE LOTTERY

Audit Report

OFFICE REVOLVING FUND AND TRAVEL EXPENSES

July 1, 2014, through June 30, 2018



BETTY T. YEE
California State Controller

April 2019



BETTY T. YEE
California State Controller

April 9, 2019

Hugo López, Director
California State Lottery
700 North Tenth Street
Sacramento, CA 95811

Dear Mr. López:

We audited the California State Lottery's (Lottery) Office Revolving Fund (ORF) and Travel Expenses for the period of July 1, 2014, through June 30, 2018. The objectives of the audit were to determine whether:

- The Lottery complied with applicable laws, rules, contracts, regulations, policies, and procedures as they relate to ORF transactions and travel expenses;
- The Lottery maintained adequate safeguards against abuse of the ORF and losses to the State;
- ORF transactions and travel expenses were appropriate, accurate, adequately supported, and properly authorized and recorded; and
- ORF receivables were collected in a timely manner, and collection efforts were properly supported.

Our audit found that the Lottery lacked adequate controls, including policies and procedures, over ORF and travel expenses. In addition, policies and procedures were not followed as a result of the Sales Division's directives and poor oversight (Finding 1). We identified \$240,934 in unallowable costs and \$64,088 in questioned costs (Schedule 1), as follows:

- Inappropriate and/or unnecessary employee travel expenses for Sales Division staff events, resulting in \$131,832 in unallowable costs (Finding 2);
- Inappropriate and/or unsupported travel expense claims, resulting in \$42,378 in unallowable costs and \$47,439 in questioned costs (Finding 3);
- Improperly authorized short-term rates for a long-term out-of-class assignment, resulting in \$28,320 in unallowable costs (Finding 5);
- Unallowable items purchased for Lottery staff at sales conferences, resulting in \$21,666 in unallowable costs (Finding 7);
- Improper food and beverage purchases for International Game Technology PLC (IGT)-hosted events, resulting in \$16,738 in unallowable costs (Finding 4); and
- Lack of review over IGT retailer trade show expenses, resulting in \$16,649 in questioned costs (Finding 10).

In addition, we identified issues that did not have a quantitative effect; however, if these issues are left uncorrected, the Lottery is at risk of improper payments, waste, and abuse, as follows:

- Inadequate controls over Sales Division vendor purchases (Finding 6);
- Transportation costs related to sales conferences and retailer trade shows were misclassified (Finding 8);
- Hotel agreements were improperly signed and associated costs were not properly authorized (Finding 9); and
- Excess Lodging Rate Request forms were not properly completed and submitted (Finding 11).

We recommend that the Lottery develop a detailed corrective action plan within six months of this report to address the findings noted in this report. We will perform a follow-up review of the Lottery's corrective action plan at that time.

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

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/lis

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Audit Report

Summary

We audited the California State Lottery's (Lottery) Office Revolving Fund (ORF) and Travel Expenses for the period of July 1, 2014, through June 30, 2018. Our audit found that the Lottery lacked adequate controls, including policies and procedures, over ORF and travel expenses. In addition, policies and procedures were not followed as a result of the Sales Division's directives and poor oversight (Finding 1). We identified \$240,934 in unallowable costs and \$64,088 in questioned costs (Schedule 1), as follows:

- Inappropriate and/or unnecessary employee travel expenses for Sales Division staff events, resulting in \$131,832 in unallowable costs (Finding 2);
- Inappropriate and/or unsupported travel expense claims (TECs), resulting in \$42,378 in unallowable costs and \$47,439 in questioned costs (Finding 3);
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- Hotel agreements were improperly signed and associated costs were not properly authorized (Finding 9); and
- Excess Lodging Rate Request forms were not properly completed and submitted (Finding 11).

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 money 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.

Office Revolving Fund

The ORF is used to draw funds for payment of compensation earned, travel expenses, travel advances, or where immediate payment is otherwise necessary. The Lottery has an \$8 million revolving fund allowance. The Lottery's Finance Division is responsible for processing payments and ensuring that the ORF is replenished in a timely manner. Payments that do not meet the criteria for the ORF must go through the regular claim schedule process.

California Automated Travel Expense Reimbursement System

The Lottery uses the California Automated Travel Expense Reimbursement System (CalATERS). CalATERS is a web-based application used by agencies to process travel advances and expense reimbursements. Travel advances are still paid through the Lottery's ORF, while expense reimbursements are issued from the SCO.

Sales Conferences

The Lottery holds annual sales conferences to educate and train all sales staff at a single location. This allows management to inform staff of new games, product merchandising plans, and upcoming market plans. The sales conferences also include general training sessions. Starting in 2016, the Lottery began holding two mid-year sales conferences in addition to its annual sales conference. One conference is held for northern California staff, and one is held for southern California staff. The Lottery holds these mid-year sales conferences a day prior to a retailer trade show. A majority of sales conference expenses are charged to a Lottery corporate card and paid through the ORF.

Retailer Trade Shows

The Lottery holds three to four retailer trade shows per year. Trade shows are held to educate retailers on marketing, new games, changes to processes and procedures, merchandising, and promotional programs to help maximize sales. Attendees are charged a registration fee of \$25 to \$30. A majority of retailer trade show expenses are charged to a Lottery corporate card and paid through the ORF.

SCO Audit Authority

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

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."

Objectives, Scope, and Methodology

The objectives of the audit were to determine whether:

- The Lottery complied with applicable laws, rules, contracts, regulations, policies, and procedures as they relate to ORF transactions and travel expenses;
- The Lottery maintained adequate safeguards against abuse of the ORF and losses to the State;
- ORF transactions and travel expenses were appropriate, accurate, adequately supported, and properly authorized and recorded; and
- ORF receivables were collected in a timely manner, and collection efforts were properly supported.

The audit period was July 1, 2014, through June 30, 2018.

To achieve our audit objectives, we:

- Reviewed the State Administrative Manual; the Lottery Act; the Lottery's policies and procedures; California Department of Human Resources (CalHR) rules; collective bargaining agreements; and contracts; as they relate to ORF transactions and travel expenses;
- Reviewed prior audits performed by the SCO and the Lottery's Internal Audits Office, and followed up on prior audit findings;
- Interviewed Finance Division staff to understand how TEC, corporate card payments, and vendor payments are processed, and to understand how expenses are recorded to the appropriate accounts;
- Interviewed Sales Division staff to gain an understanding of the review and approval process for TECs, sales conferences, retailer trade shows, and Sales Division staff meetings;
- Interviewed Legal Services and Contracts Development staff to understand their involvement in Sales Division-related agreements and approval of purchase orders (POs);
- Gained an understanding of internal controls over travel expenses and ORF transactions as they relate to the specific objectives and scope of the audit; and
- Upon gaining an understanding of internal controls over ORF transactions and travel expenses, we judgmentally selected transactions for testing. We:
 - Selected 42 of 88 (\$2,487,590 of \$4,441,368) ORF corporate credit card transactions, and reviewed invoices and other supporting documents to determine compliance with CalHR rules, the Lottery Act, the Lottery's policies and procedures, and the State Administrative Manual;
 - Selected 755 of 11,362 (\$408,325 of \$3,393,761) ORF travel expense payments. In addition, selected 23 of 1,317 CalATERS travel expense payments (\$5,564 of \$230,189) and reviewed TECs to determine compliance with CalHR rules and collective bargaining agreements;

- Selected 28 of 2,068 (\$8,293 of \$997,832) ORF travel advance payments to ensure that they were collected in a timely manner, and that collection efforts were properly supported;
- Selected 22 of 772 (\$7,654,860 of \$22,559,577) immediate vendor payments from the ORF register. In addition, selected all four vendor payments (\$48,544) from expense account 68400 Sales Conferences that were not paid through the ORF. Reviewed supporting documentation to determine compliance with Lottery's policies and procedures, the Lottery Act, and State Administrative Manual;
- Reviewed expense account transactions 68100 In-State Travel and 68400 Sales Conferences; and
- Selected one of five (\$92,658 of \$203,374) IGT billing packets and reviewed supporting documentation to ensure that IGT expenses were appropriate, supported, and in accordance with Lottery regulations.

In addition, we:

- Reviewed all 34 hotel agreements related to sales conferences and retailer trade shows; and
- Reviewed all 11 excess lodging forms for sales conferences and retailer trade shows for compliance with CalHR rules.

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 limited our review of internal control to gain an understanding of ORF and travel expense processes. We did not audit the Lottery's financial statements.

Conclusion

Our audit found that the Lottery lacked adequate controls, including policies and procedures, over ORF and travel expenses. In addition, policies and procedures were not followed as a result of the Sales Division's directives and poor oversight (Finding 1). As a result, we identified \$240,934 in unallowable costs and \$64,088 in questioned costs (Schedule 1), as follows:

- Inappropriate and/or unnecessary employee travel expenses for Sales Division staff events, resulting in \$131,832 in unallowable costs (Finding 2);
- Inappropriate and/or unsupported TECs, resulting in \$42,378 in unallowable costs and \$47,439 in questioned costs (Finding 3);
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- Transportation costs related to sales conferences and retailer trade shows were misclassified (Finding 8);
- Hotel agreements were improperly signed and associated costs were not properly authorized (Finding 9); and
- Excess Lodging Rate Request forms were not properly completed and submitted (Finding 11).

Follow-up on Prior Audit Findings

We performed an audit of the ORF for the period of January 1, 2008, through December 31, 2012; our report was issued in August 2014. Based on the work performed in the current audit, we noted that the Lottery has taken appropriate corrective action on prior audit findings.

We reviewed the Lottery's Travel Program Audit report for the period of February 1, 2010, through January 31, 2011, issued in March 2012; and the Lottery's Travel Program Audit Follow-up report, for the period of February 1, 2011, issued in October 2013. As the follow-up audit report noted that the Lottery implemented changes to address the prior issues, we did not consider another follow-up to be necessary.

We also reviewed the Lottery's Marketing Promotions Audit report for the period of October 1, 2015, through September 30, 2016, issued in March 2018. We identified a purchase noted in the audit report that did not comply with the Lottery's procurement policies. See Finding 6.

On September 25, 2018, the Lottery issued a Sales Procurement Process Audit Report for the period of January 1, 2017, through December 31, 2017. We identified the findings regarding weak controls over Sales Division procurement process, and lack of review and approval of IGT conference expenses to be applicable to our current audit. Based on the work performed in our current audit, we noted similar findings. See Finding 10.

**Views of
Responsible
Officials**

We issued a draft audit report on March 26, 2019. Hugo López, Director, responded by letter dated March 29, 2019, generally agreeing with the audit results. The Lottery's complete response is included as an attachment to this report.

Restricted Use

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

JIM L. SPANO, CPA
Chief, Division of Audits

April 9, 2019

Findings and Recommendations

FINDING 1— Sales Division management did not implement adequate controls over its operations

The Lottery’s Sales Division’s management did not implement adequate controls over its operations and ensure that the Sales Division adhered to the Lottery’s policies and procedures, CalHR rules, and collective bargaining agreements. Sales Division management’s directives and poor oversight resulted in unallowable costs, questioned costs, and control weaknesses. Specifically, we noted that Sales Division management:

- Approved 50-mile exception forms with improper justifications, resulting in inappropriate and/or unnecessary travel expenses. See Finding 2.
- Instructed staff to claim personal mileage that was not in accordance with CalHR and collective bargaining agreements and did not properly review TECs. See Finding 3.
- Inadequately reviewed invoices for sales conferences and retailer trade show costs, resulting in improper rooming, parking, and food and beverage charges. See Findings 2 and 4.
- Approved a long-term OOC assignment requiring long-term lodging expenses. However, the Sales and Finance Divisions improperly paid short-term lodging and per diem expenses. See Finding 5.
- Made purchases before obtaining approvals through the purchase order process. In addition, Sales Division management approved the purchase of unallowable items for Sales Division staff. See Findings 6 and 7.
- Did not adequately review IGT billings. See Finding 10.
- Improperly completed and submitted Excess Lodging Rate Request forms. In addition, documentation of “good faith” quotes were not provided to the Finance Division. See Finding 11.

If these issues are not mitigated, the Lottery is at risk of additional inappropriate spending and questioned costs.

GC section 13402 states:

Agency heads are responsible for the establishment and maintenance of a system or systems of internal control, and effective and objective ongoing monitoring of the internal controls within their state agencies. This responsibility includes documenting the system, communicating system requirements to employees, and ensuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

In addition, GC section 13403 states, in part:

(a) As used in this chapter, “internal control” means a process, including a continuous built-in component of operations, effected by a state agency’s oversight body, management, and other personnel that provide reasonable assurance that the state agency’s objectives will be achieved.

The following five components of internal control, if effectively designed, implemented, and operated in an integrated manner, constitute an effective internal control system:

(1) “Control environment” means the foundation for an internal control system that provides the discipline and structure to help a state agency achieve its objectives.

Recommendation

We recommend that:

- The Lottery’s Sales Division management set the tone and lead by example; strong and effective leadership is fundamental to an effective internal control system; and
- The Lottery regularly oversee and monitor the activities of the Sales Division to ensure that all applicable policies, procedures, rules, and regulations are being followed.

Lottery’s Response

The Lottery responded as follows:

The Lottery agrees with this finding and the SCO’s recommendations. The Lottery already has implemented several significant changes to the Sales Division and practices within the training unit of that division to address the issues noted in the finding...In addition, the Lottery has undertaken...audits, reviews, and training that will address various internal control deficiencies identified in the SCO audit.

See the Attachment for the Lottery’s complete response.

SCO Comment

We did not validate the implementation of the corrective actions noted in the Lottery’s response. We will follow up in a separate engagement to determine whether corrective actions were adequate and appropriate.

FINDING 2— Inappropriate and/or unnecessary employee travel expenses for Sales Division staff events

The Lottery lacked adequate controls to ensure that travel expenses for staff attending Sales Division events were necessary and appropriate. We identified inappropriate and/or unnecessary travel expenses totaling approximately \$131,832.

CalHR Human Resources Manual 2201 Travel and Relocation Policy, Travel Delegation – 50 Mile Limit provides the following guidance:

This delegation is for the approval of the reimbursement of meals and/or lodging within 50 miles of home or headquarters when the employee is conducting state business away from the headquarters location. This delegation does not extend to the approval of meals or lodging at either the headquarters or home location.

It is not unusual or extraordinary for state employees to commute 50 miles or longer from their home to headquarters and back again on a daily basis. An employee who does not live in the immediate vicinity of his/her headquarters is not eligible to receive meals and lodging when

required to work extended hours in the headquarters location. Likewise, an employee who must work at a site other than headquarters is not automatically considered to be eligible for meals and/or lodging simply by crossing the “50 mile line”.

For state controlled functions, state departments are expected to demonstrate that every consideration has been given to minimizing the cost to the state through responsible planning and scheduling.

We noted that Lottery Sales Division management did not properly apply this delegation for sales conferences, retailer trade shows, and Sales Division staff meetings. The Assistant Deputy Director of Sales approved accommodations for all sales staff employees to attend sales conferences and retailer trade shows regardless of where the employees lived.

Sales conferences and retailer trade shows

During the audit period, the Lottery held four annual sales conferences, six mid-year sales conferences, and 20 retailer trade shows. Costs for these events were charged to the Lottery’s corporate card, which is then paid by the ORF. Hotel lodging expenses associated with these events amounted to \$580,858. We tested all lodging expenses for these events to determine whether the stays were necessary and appropriate. We found the following:

- The Lottery booked unnecessary and/or inappropriate hotel stays for staff who worked and/or lived within 50 miles of the event locations, totaling \$83,411 (see Schedule 2). Associated per diem expenses are estimated at \$21,585.

The Sales Division allowed employees to lodge even though management was aware that the employees lived within 50 miles. The 50-mile exception forms included justifications such as the following:

It is important for the Sales staff to come together annually for team building, the environment promotes relationship development among team members. Staff is also able to share experiences and lessons learned from other offices, this has led to improved processes and consistency throughout our nine district offices.

For example, for the 2016 Sales Conference in Garden Grove, California, the Lottery’s *Request for 50-Mile Exception* form included a spreadsheet with the distance between each employee’s home to the conference. Most of the employees lived within 50 miles of the conference, with some as close as 10 miles. We identified one employee who lived only six miles from the conference but stayed at the hotel for three nights, costing \$536.

Per discussions with Sales Division management, employees were allowed to stay at the hotel for the conference due to Southern California traffic. However, a similar situation occurred in Sacramento, California. In 2017, the Lottery held a retailer trade show at the DoubleTree Hotel in Sacramento, California. We identified 22 employees who lived and/or worked within the Sacramento area but stayed overnight at the hotel. An employee who lived eight miles from the hotel stayed two nights.

Along with these unnecessary and/or inappropriate hotel stays, the Lottery also incurred additional meal and incidental expenses. We estimate the associated per diem expenses to be approximately \$21,585.

- The Lottery overbooked rooms resulting in cancellation and attrition fees totaling \$12,731. We noted 25 employee no-shows for three events, resulting in cancellation fees of \$3,865. In addition, as the Lottery did not meet the minimum room reservation for two events, it incurred an attrition fee of \$8,866 (See Schedule 3).

One such event was the 2018 retailer trade show in Modesto, California. Based on the agreement with the hotel, 230 room nights were reserved. The Lottery did not adequately plan the room reservation, resulting in the cancellation of 19 rooms and an attrition fee.

The minimum number of room nights to avoid the attrition fee was 207. Actual room nights charged totaled 154. If the Lottery had provided a more accurate number of room nights necessary for the event, \$10,553 in cancellation fees and attrition would not have been incurred.

- Six employees were double-booked or double-charged, costing \$1,134. We noted that four employees were double-booked at two hotels and two employees were charged twice; the Lottery did not detect these errors. The results are summarized as follows:

<u>Year</u>	<u>Hotel</u>	<u>Location</u>	<u>Double Charges</u>	<u>Amount</u>
2016	Hyatt Regency	Long Beach	2	\$ 280
2017	Hyatt Regency	Garden Grove	2	520
2018	Warner Center Marriott	Woodland Hills	1	161
	The Anza Hotel		1	173
Total				\$ 1,134

In 2016, two employees were double-booked at the Hyatt Regency and Queen Mary hotels. Both employees stayed at the Queen Mary, resulting in a no-show fee of \$280 for the Hyatt Regency. In 2018, two employees were double-booked at the Warner Center Marriott Woodland Hills and the Anza Hotel. One employee stayed at the Anza Hotel, while the other did not attend the event at all. For the 2017 Sales Conference, the hotel billed the Lottery twice for two employees, totaling \$520. The Lottery did not detect this error and paid the additional charges.

- The Lottery incurred inappropriate rooming and parking charges, totaling \$3,921. We identified 101 instances in which the Lottery incurred additional charges due to invoice errors, or employees used valet parking instead of self-parking. The Lottery did not adequately review the invoices and, therefore, overpaid \$3,921. The results are summarized as follows:

<u>Year</u>	<u>Location</u>	<u>Number of Invoice Errors</u>	<u>Amount</u>
2016	Long Beach	3	\$ 35
	Garden Grove	5	308
2017	San Diego	1	378
2018	Oakland	88	3,141
	Woodland Hills	1	18
	Modesto	3	41
	Total	101	\$ 3,921

For example, Oakland Marriott City Center hotel overcharged the room rate in 83 instances. The hotel charged \$179 per night instead of the contracted rate of \$150; for two instances, the hotel charged \$269 per night. This resulted in the Lottery being overcharged \$2,946 for rooms. In addition, the hotel charged above the agreed-upon parking rate of \$25 per day for five individuals. Incorrect parking rates ranged from \$40 to \$70.

In addition, the agreement with the Hyatt Regency hotel in Garden Grove, California stated that parking would total \$9 per day. We noted that five employees were charged above the agreed-upon rate. One employee was charged \$182 for two days of parking when the total should have been \$18.

Sales Division staff meetings

The Sales Division holds various meetings, including district office meetings and sales managers meetings. To accommodate a larger group, lodging is sometimes paid through the corporate credit card. Other times, lodging is paid through an individual's TEC. We noted costs associated with unnecessary stays through our testing of Sales Division corporate credit card transactions and TECs. We found a total in \$9,050 of inappropriate costs associated with sales meetings. Issues noted from the TECs are also included in Finding 3.

We tested 235 room nights associated with 94 individuals totaling \$34,015, for sales meetings paid through the corporate card. We identified four individuals who charged inappropriate stays for 11 room nights, totaling \$1,588. In addition, through our TEC testing, we identified an additional \$7,462 in inappropriate lodging and incidental costs for three of the four individuals. See the following table for details:

	TEC	Corporate Card	Total
Individual A	\$ 5,459	\$ 480	\$ 5,939
Individual B	934	524	1,458
Individual C	1,069	427	1,496
Individual D	-	157	157
Total	\$ 7,462	\$ 1,588	\$ 9,050

Individuals A, B, and C were Lottery Sales Managers (LSMs) who attended meetings located at, or within 50 miles of, their headquarters. For example, one LSM is headquartered at Lottery Headquarters (Lottery HQ) in Sacramento, California. From our testing, we identified four occasions in which the employee stayed overnight in Sacramento to attend meetings at Lottery HQ. The *Request for 50-Mile Exception* form for this employee was approved with a justification stating “Sales team meeting. Two night stay needed.” According to CalHR, the 50-mile limit delegation does not allow the approval of meals or lodging at the headquarters location. In addition, the Lottery could not identify Individual D as an employee of the Lottery or one of its contractors, but the individual’s lodging was included in the invoice and paid for.

Conclusion

The Lottery lacked adequate controls to ensure that travel expenses for staff were necessary and appropriate for Sales Division events. The Lottery did not have a review process in place to ensure that hotel charges on the corporate card were appropriate. If not mitigated, this control deficiency leaves the Lottery at risk of additional improper travel expenses.

GC sections 13402 through 13407 require state agencies to establish and maintain internal controls, including an effective system of internal review.

Recommendation

We recommend that the Lottery:

- Establish adequate controls to ensure that travel charges are appropriate and in accordance with CalHR rules;
- Recover overpayments from the hotels that made errors on billing invoices; and
- Consider recovering payment of unallowable lodging and per diem in accordance with GC section 19838.

Lottery's Response

The Lottery responded as follows:

The Lottery agrees in general that during the audit period, the Sales Division misapplied the 50-mile rule for lodging and per diem. In addition, the Lottery agrees that its Sales Division travel invoice review and approval processes need to be strengthened. In accordance with the SCO's recommendations, the Lottery already has taken...corrective actions.

See the Attachment for the Lottery's complete response.

SCO Comment

Regarding the room rate errors discussed in the Lottery's response, the Lottery stated that only one room was charged at a higher rate than the contracted rate. However, in 2018, the Oakland City Center Hotel overcharged all rooms (for a total of 83 room nights) above the \$150/night contract rate.

We did not validate the implementation of the corrective actions noted in the Lottery's response. We will follow up in a separate engagement to determine whether corrective actions were adequate and appropriate.

**FINDING 3—
Inadequate
controls over the
processing of
travel expense
claims**

We tested TECs of 44 employees, totaling \$413,889, and identified approximately \$72,036¹ in unallowable costs and \$47,439 in questioned costs. If not mitigated, this control deficiency leaves the Lottery at risk of additional improper payments.

Collective bargaining agreements and CalHR rules provide the policy for recovering reimbursement for travel expenses. CalHR Human Resources Manual 2202-Mileage Reimbursement for personal vehicle mileage reimbursement states, in part:

- When an employee is required to report to an alternate work location, the employee may be reimbursed for the number of miles driven in excess of his/her normal commute to work.
- Mileage to/from a Common Carrier – When the employee's use of a privately owned vehicle is authorized for travel to or from a common carrier terminal, and the employee's vehicle is not parked at the terminal during the period of absence, the employee may claim double the number of miles between the terminal and the employee's headquarters or residence, whichever is less, while the employee occupies the vehicle. Exception to "whichever is less": if the employee begins travel one hour or more before he normally leaves his home, or on a regularly scheduled day off, mileage may be computed from his/her residence.

¹Includes \$7,462 in unallowable costs for Sales Division staff meetings reported in Finding 2 and \$22,196 in unallowable lodging and per diem costs reported in Finding 5.

During the audit period, the Lottery processed 12,679 travel expense payments from the ORF and CalATERS. We tested 457 payments to 10 employees, totaling \$167,959. In addition, we selected 321 travel expense payments for 34 employees based on dollar amount and job classification, totaling \$245,930. Overall, we tested 778 travel expense payments from 44 employees, totaling \$413,889.

We found that of the 44 employees we tested, 35 had unallowable or questioned costs in their TECs. Specifically, we found approximately \$72,036² in unallowable costs; of that total, approximately \$40,764 was unallowable mileage and \$1,614 was miscellaneous unallowable costs. In addition, we questioned approximately \$47,439 due to inadequate documentation to support mileage claims. The issues are as follows:

- Sales Division staff did not claim personal mileage in accordance with collective bargaining agreements and CalHR rules. In addition, the review process to approve these claims was inadequate. This resulted in questioned costs totaling \$47,439.

CalHR rules allow employees to claim miles driven in excess of their normal commute to work. For example, an employee's normal commute from home to headquarters is 20 miles, but for one day, the employee reports to an alternate location, thus driving a total of 100 miles. According to CalHR rules, the employee can claim 80 miles for reimbursement. Sales Division management instructed staff to claim mileage starting from first retailer location to last retailer location; stopping at headquarters in between retailers would be included. Staff were instructed to not claim mileage from home to the first retailer and last retailer back to home. The Lottery could not provide any written policy regarding this instruction, nor could we verify whether staff applied this verbal instruction consistently.

Sales Division TEC approvers did not have an adequate process by which to verify whether mileage claimed by employees was accurate. Approvers did not require maps or logs to be submitted with the TECs. In addition, TEC descriptions of locations traveled were at times vague. As we could not re-calculate most of the mileage from the descriptions on the TECs or determine the mileage claimed to be appropriate, we questioned approximately \$47,439 of mileage over the normal commute³.

- Several LSMs and key accounts staff members improperly claimed personal mileage totaling approximately \$40,764 by misapplying CalHR rules. See specific examples below:

²See footnote 1.

³Based on verbal instruction by management, employees claimed most of their normal commute miles. As the majority of TECs were vague, we could not calculate the exact number of unallowable miles. We calculated unallowable mileage costs by deducting the employee's normal commute miles from the mileage claimed each day. We questioned any mileage in excess of normal commute miles that did not have supporting documentation.

Lottery Sales Manager No. 1

One LSM claimed mileage en route to headquarters or home by stopping at retailer locations. The LSM lives approximately 75 miles from the district office. The LSM would stop at various retailer locations en route to headquarters and claim 95 miles. The LSM should have claimed only 20 miles, the mileage in excess of the LSM's normal commute.

In addition, it appears that the LSM also misapplied the common carrier policy. An employee can claim mileage from home to an airport if he or she leaves one hour earlier than usual. The LSM misapplied this rule by claiming mileage from home for any travel where the LSM left home one hour earlier than usual. We found instances in which the LSM left home at 6:30 a.m. for a meeting at Lottery HQ and claimed the entire distance of 70 miles for the one-way trip. As Lottery HQ is closer to the LSM's home, no mileage should have been claimed. The Lottery Travel Unit did not detect this error.

For this LSM, we found approximately \$14,667 in unallowable costs, \$13,280 of which are unallowable mileage costs. The LSM claimed 29,593 miles during the audit period. We determined that approximately 24,069 miles (81%) were unallowable. The remaining \$1,387 in unallowable costs was due to unallowable lodging and per diem⁴. We also questioned approximately \$1,974 for mileage due to insufficient supporting documentation.

Lottery Sales Manager No. 2

Another LSM also claimed mileage en route to headquarters or home by stopping at retailer locations. This LSM lives approximately 101 miles away from the district office. We noted, in various instances, that the LSM claimed the entire route to the district office from home. This practice was not in line with the instruction given by Sales Division management for claiming mileage.

For example, on one TEC, the LSM indicated a retailer stop in City A and continued on to the district office. The LSM claimed 126 miles. The LSM included a map with the TEC, calculating the mileage from the LSM's home to City A to the district office, to support the 126 miles claimed. The LSM is entitled to only 25 miles for reimbursement. The LSM also claimed round-trip mileage from home to Lottery HQ, although this was less than the LSM's normal commute. The TEC and supporting documentation clearly indicated that the LSM had incorrectly applied the mileage policy. Neither the supervising approver nor the Travel Unit denied this claim.

⁴\$1,069 of the \$1,387 in unallowable lodging and per diem was noted in Finding 2 under *Sales Division Staff Meetings*.

We found approximately \$12,487 in unallowable costs for this LSM. Specifically, \$5,785 was for unallowable lodging and per diem costs⁵ and \$6,702 was for unallowable normal commute miles. The LSM claimed 13,466 miles during the audit period. We determined that approximately 12,491 miles (93%) were unallowable.

Lottery Sales Manager No. 3

A third LSM lives approximately 35 miles away from the designated district office. Based on the selected TECs tested, we noted that the LSM regularly started and/or ended travel in the city of residence. For example, the April 2016 TEC submitted included 11 work days of travel. For all 11 days, the LSM either indicated the LSM's home city as the start and/or end destination. This would indicate that the LSM regularly visited retailer locations in the LSM's home city, claiming a large portion of the LSM's normal commute. The LSM should have claimed only the mileage in excess of the LSM's normal commute to the district office.

We tested \$4,317 in TECs and estimated approximately \$1,936 in unallowable mileage costs. For the \$1,936, we noted that the LSM submitted duplicate January 2016 TECs, one in January and one in February. The approving supervisor did not detect the duplicate claims and overpaid the employee \$226. In addition, we questioned approximately \$191 in mileage for TECs with no supporting documentation. We did not test all TECs for this LSM, and there could be additional improper payments.

Key Account Specialists

Key Account Specialists (KAS) in the Retailer Recruitment Unit travel to various potential retailer locations to open new accounts. The KASs' used their personal cars and claimed mileage. Based on the KAS TECs, mileage calculations were inconsistent for each employee; we also could not determine whether mileage calculations were in accordance with the verbal instruction from management.

For example, one KAS is headquartered at the San Diego District Office. The TECs for this KAS did not provide much detail as to locations traveled. The KAS indicated only "San Diego to San Diego" for each day claimed. We requested a printout of the KAS's Outlook calendar for the specific week associated with one TEC. On Friday of that week, the KAS claimed 90 miles. The KAS's Outlook calendar noted only one potential retailer location visit. The potential retailer was located less than 10 miles away from the San Diego District Office. We could not validate whether the KAS traveled to other locations. We tested \$5,034 in TECs and estimated approximately \$1,730 in unallowable mileage costs. We questioned \$3,133 in mileage costs.

In addition, we noted that one KAS claimed mileage for the same day on two different TECs, claiming an additional \$72.

⁵\$5,459 of the \$5,785 in unallowable lodging and per diem was noted in Finding 2 under *Sales Division Staff Meetings*.

As we did not test all TECs for KASs, there could be additional improper payments.

- We noted \$1,614 in miscellaneous unallowable costs. These costs consisted of unallowable meals, incidentals, lodging expenses, or errors in mileage reimbursement rates.

The examples noted clearly indicate a systemic issue, caused by a lack of controls over TECs, that is serious and pervasive and which resulted in the waste of state funds.

Recommendation

We recommend that, to prevent improper TEC payments from recurring, the Lottery:

- Establish adequate internal controls to ensure that payments for TEC claims are accurate and comply with collective bargaining agreements and CalHR rules;
- Provide training to the Travel Unit staff who process TECs to ensure that they understand the requirements under collective bargaining agreements and CalHR rules; and
- Maintain supporting documentation for mileage claims on TECs for future audits.

Lottery's Response

The Lottery responded as follows:

The Lottery agrees that it did not properly apply the rule to limit reimbursement for certain Sales Division staff to only the miles driven in excess of the normal commute for employees claiming privately-owned vehicle mileage and also misapplied the rule allowing mileage to be claimed from/to home when using a privately-owned vehicle to travel to/from a common carrier. The Lottery has since provided instruction to all Lottery employees clarifying both of these rules.

See the Attachment for the Lottery's complete response.

SCO Comment

The Lottery stated that mileage claims for recruiters were only allowed for miles driven from the first retailer visited through the last retailer visited when recruiting prospective retailers. The Lottery could not provide written policies for this instruction or supporting documentation related to the TECs for us to verify that this practice was actually in place. Therefore, we were unable to verify that TEC approvers ensured that staff used this practice. The Lottery also stated that recruiters' work requires daily travel to alternate locations instead of working from their "headquarters," and therefore recruiters do not have a "normal commute." When recruiters worked at headquarters for the day, they did not claim mileage for their "normal commute." Therefore, recruiters do have a "normal commute." As these recruiters are covered by the Memorandum of Understanding for Bargaining Unit 01, the mileage reimbursement provisions therein must be followed. In addition, we found that not only recruiters but also Lottery

Sales Managers were using these Lottery mileage reimbursement practices. Lottery Sales Managers have a “normal commute” and therefore should have followed CalHR rules, not the Lottery’s past practice.

We did not validate the implementation of the corrective actions noted in the Lottery’s response. We will follow up in a separate engagement to determine whether corrective actions were adequate and appropriate.

**FINDING 4—
Improper food
and beverage
purchases for
IGT-hosted events**

We tested all sales conference and retailer trade show costs that were charged on the Lottery corporate card and paid through the ORF, totaling \$1,473,708. Our audit found that the Lottery improperly paid for food and beverages for IGT-hosted events, totaling \$16,738.

In our review of sales conference and retailer trade show costs, we noted that at the 2016 and 2017 sales conferences, IGT reception and Q&A events were held at the same hotel as the sales conferences. These events provided an opportunity for Lottery staff to learn more about OnePlace, IGT’s sales force automation software. The events were held after work hours, and attendance was not mandatory. Our review of the Banquet Event Order (BEO), which outlines the details of events held at the hotels, showed that the Sales Division selected the appetizers and beverages (non-alcoholic) for these events. The food and beverage charges for 2016 totaled \$7,279; the 2017 charges totaled \$9,459.

The invoices provided to the Finance Division did not include the details for the food and beverage charges. The invoices included only a summary of the charges with “General Session” and “Reception” as the description. “General Session” was for the sales conference room rentals, and “Reception” was for the food and beverage charges. The Lottery should have billed IGT for these costs. However, the Sales Division did not instruct the Finance Division to bill IGT, nor did the Finance Division adequately review the hotel invoices and question the “Reception” charges.

GC section 8880.64 (Lottery Act) states in part:

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.

GC sections 13402 and 13403 require state agencies to establish and maintain internal controls, including an effective system of internal review.

These expenses were not necessary to support the operation and administration of Lottery activities and functions; therefore, the Lottery should not have incurred these costs. We notified the Lottery of these improper payments during fieldwork. In December 2018, the Lottery sought and received reimbursement from IGT for these costs.

Recommendation

We recommend that the Lottery:

- Establish adequate internal controls to ensure that payments for corporate card charges comply with state law to prevent improper corporate card charges or payments; and
- Provide adequate oversight to ensure that accounts payable staff processes only valid and authorized payments that comply with state law.

Lottery's Response

The Lottery responded, "The Lottery agrees with the finding and recommendations. The Lottery has received full reimbursement from IGT for this expense."

SCO Comment

In December 2018, the Lottery provided us with a copy of the reimbursement checks from IGT, dated December 3, 2018.

FINDING 5— Improperly authorized short- term rates for a long-term out-of- class assignment

The Lottery inappropriately paid short-term lodging and per diem costs for a long-term OOC assignment. Our audit identified \$28,320⁶ in unallowable short-term lodging and per diem costs for this OOC; however, we estimate that the Lottery paid a total of approximately \$51,321 in unallowable short-term and per diem costs.

The Sales Division's management approved an OOC assignment for a district sales supervisor to work as the LSM for one of the Lottery's district offices from January 1, 2015, through December 31, 2015. Although this was a long-term assignment, we found that the Sales and Finance Divisions improperly paid short-term lodging and per diem rates for the entire duration of the assignment. On August 25, 2015, the Acting Lottery Director issued a memorandum to the Finance Deputy Director authorizing the use of short-term rates from the beginning of the assignment. However, the memorandum was issued nearly nine months after the start of the assignment. In addition, the memorandum included incorrect information. It stated that the hotel did not offer certain long-term amenities. However, based on the invoices, the employee stayed at a Homewood Suites by Hilton, which caters to extended-stay travelers; this hotel offers full kitchen amenities, such as refrigerator, microwave, stove, and dishwasher.

⁶\$22,196 out of \$28,320 in unallowable short-term lodging and per diem costs are included in the \$72,036 in unallowable costs noted in Finding 3.

We tested \$38,193⁷ in travel costs for the employee, paid either through the Lottery's corporate card or through TEC reimbursements. Based on our testing, we identified \$24,347 in unallowable short-term lodging, and \$3,973 in unallowable per diem costs. Based on short-term lodging and per diem rates during the time of this OOC, we estimate that the Lottery paid a total of approximately \$51,321 in inappropriate lodging costs to the employee.

CalHR Human Resources Manual 2201 – Long Term Travel states, in part:

Employees on full long-term travel who live at the long-term location may claim either:

- Reimbursement for actual individual expense, substantiated by receipts, for lodging, water, sewer, gas and electricity, up to a maximum of \$1,130 per calendar month while on long-term assignment, and actual expenses up to \$10 for meals and incidentals, for each period of twelve (12) to twenty-four (24) hours and up to \$5 for actual meals and incidentals for each period of less than twelve (12) hours at the long-term location, or
- Long-term subsistence rates of \$24 for actual meals and incidentals and \$24 for receipted lodging for travel of twelve (12) hours up to twenty-four (24) hours; either \$24 for actual meals or \$24 for receipted lodging for travel less than twelve (12) hours when the employee incurs expenses in one location comparable to those arising from the use of establishments catering to the long-term visitor.

Recommendation

For future long-term assignments, we recommend that the Lottery comply with the long-term travel provisions set forth in collective bargaining agreements and the CalHR Human Resources Manual.

Lottery's Response

The Lottery responded as follows:

The Lottery agrees with the finding and recommendation but was unable to find suitable long-term lodging for the subject employee in San Francisco within the allowable rate of \$1,130 per month. Additionally, the Lottery had approved the short-term per diem rate reimbursement based on a misunderstanding of the facilities available at the selected hotel.

See the Attachment for the Lottery's complete response.

SCO Comment

The Lottery did not contact CalHR regarding long-term lodging rates until June 2015, six months after the start of this assignment. The Lottery's Acting Director issued the memorandum approving the short-term rates after CalHR stated that the rules do not allow the usage of short-term rates

⁷Amount tested includes other travel costs not associated with the OOC assignment.

for a long-term assignment. The employee was lodging at Homewood Suites eight months before the memorandum was issued approving the use of short-term per diem rates; therefore, short-term per diem rates were being allowed before the approval was received. In addition, had the Lottery researched Homewood Suites by Hilton, the Lottery would have found information showing that the hotel offered long-term amenities.

**FINDING 6—
Inadequate
controls over Sales
Division vendor
purchases**

The Lottery failed to follow procurement procedures for Sales Division purchases. Our audit found that the Sales Division did not obtain approvals through the PO process for 12 purchases, totaling \$93,715. Even though the purchases were approved after-the-fact, of the \$93,715, we found \$21,666 to be unallowable as discussed in Finding 7.

During the audit period, the Lottery made 772 immediate vendor payments through the ORF, totaling \$22,559,557. We judgmentally selected 22 vendor payments, based on dollar amount and type of purchase totaling \$7,654,860. In addition, because sales conferences and retailer trade show expenses are high-risk expenses, we reviewed expense account 68400 for all sales conference and retailer trade show expenses. We identified and selected four additional vendor payments that were not paid through the ORF, amounting to \$48,544. The 26 vendor payments tested total \$7,703,404. Of the 26 vendor payments tested, we identified 12 that did not comply with the Lottery’s procurement policies, totaling \$93,715. All 12 purchases were related to the Sales Division, and were made prior to receiving approval through POs. Examples are shown in the following table:

Vendor	PO Date	Invoice Date	Days After Invoice
Just Call Inc.	August 9, 2016	July 28, 2016	12
Just Call Inc.	August 23, 2017	August 17, 2017	6
Just Call Inc.	September 5, 2017	August 24, 2017	12

Contract Development Services (CDS) reviews and approves all Lottery POs. The division requesting the purchase provides CDS with the required documentation, including written price proposals for purchases over \$10,000. For the invoices noted in the table above, two were over \$10,000. The Sales Division provided quotes from other vendors to CDS, but also included the invoices from the chosen vendor, so CDS was aware that these purchases were made before the POs were issued. In addition, for the Just Call Inc. purchase made in 2016, mathematical errors and items of non-comparable value were included in one of the quotes.

Executing purchases before obtaining approvals through the PO process exposes the Lottery to the risk of improper and unallowable purchases.

The Lottery’s Operating Manual (LOM) for preparing procurement POs indicates that procurement staff should review and approve the procurement requests, with the CDS Manager reviewing and signing the PO. In addition, the LOM, states in part, “For purchase orders of \$10,000 and above, written price proposals must be submitted to [CDS] with a Procurement Request Justification Memo.”

GC sections 13402 and 13403 require state agencies to establish and maintain internal controls, including an effective system of internal review.

Recommendation

We recommend that the Lottery strengthen its internal controls over the PO process and ensure that procurement procedures are followed by each division as well as by CDS.

Lottery’s Response

The Lottery responded as follows:

The Lottery agrees that documentation for the questioned purchases does not adequately reflect whether appropriate approvals were obtained prior to the orders being placed with the vendors and agrees with the recommendation to strengthen and ensure compliance with procurement process internal controls and procedures.

SCO Comment

We will follow up in a separate engagement to determine whether corrective actions were adequate and appropriate.

**FINDING 7—
Unallowable items
purchased for
Lottery staff at
sales conferences**

We tested 26 vendor payments as described in Finding 6, totaling \$7,703,404. We found \$21,666 for items given to staff at the 2016 and 2017 sales conferences to be unallowable.

The Lottery had different themes for its sales conferences. The 2016 theme was “California Lottery University,” and the 2017 theme was “Camp Lottery.” After reviewing the planning documents for the events, we noted that the Sales Division purchased items described as “learning aids” or “training tools” for staff; these items appeared to correspond with sales conference themes.

2016 California Lottery University

<u>Items Purchased</u>	<u>Quantity</u>	<u>Amount</u>
iPad portfolios with Lottery logo	400	\$ 6,964
Backpacks with Lottery logo	400	4,060
T-shirts with “Lottery University” logo	118	912
Retractable badges with “Lottery University” logo	400	372
Lanyards	400	180
Tax		1,061
Total		<u>\$ 13,549</u>

2017 Camp Lottery

<u>Items Purchased</u>	<u>Quantity</u>	<u>Amount</u>
Sling backpacks with Lottery logo	500	\$ 3,675
T-shirts with "Camp Lottery" logo	200	1,446
First-aid kits	500	830
Neck wallets	300	558
Lip balm	500	395
Shipping and handling		661
Tax		552
Total		<u>\$ 8,117</u>

These items did not appear to facilitate staff training or serve as "learning aids" during the sales conferences. The purchases do not appear to be expenses that support the operation and administration of Lottery activities and functions; therefore, the Lottery should not have incurred these costs.

GC section 8880.64 (Lottery Act) states, in part:

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.

Recommendation

We recommend that the Lottery adhere to GC section 8880.64 to ensure that Sales Division purchases are necessary and appropriate.

Lottery's Response

The Lottery responded, "The Lottery agrees with the finding and recommendation."

FINDING 8— Misclassification of transportation costs related to sales conferences and retailer trade shows

The Lottery lacked adequate controls to ensure that transportation costs related to sales conferences and retailer trade shows were classified to the proper accounts. We identified approximately \$106,447 in airfare and rental costs that were misclassified.

The Lottery uses Expense Account 68400 *Sales Conferences* (Account 68400) to track all costs, including travel, for sales conferences and retailer trade shows. Expense Account 68100 *In-State Travel* (Account 68100) tracks all other in-state travel costs. We reviewed Expense Account 68400 transactions during the audit period and noted that there were no airfare or rental charges recorded in the account in 2017 or 2018.

The Lottery held six retailer trade shows, four mid-year sales conferences and one annual sales conference from 2017 to the end of our audit period. Due to the limitations of the Lottery’s accounting system, we could not easily identify all entries for airfare or rental costs. The Finance Division maintained spreadsheets for retailer trade show and mid-year sales conferences airfare and rental costs, but not for annual sales conferences. Therefore, we calculated transportation costs for the 2017 Sales Conference by reviewing Citibank statements and Enterprise Rent-a-Car invoices. We found that the Lottery misclassified approximately \$37,484 in airfare and rental costs to Expense Account 68100 instead of recording them to Expense Account 68400. We relied on the Finance Division’s spreadsheets to estimate the misclassification for the retailer trade shows and mid-year sales conferences and found that approximately \$68,963 was also misclassified to Expense Account 68100.

Following is a breakdown of expenses for the fiscal years affected:

<u>Expense Accounts</u>	<u>FY 2016-17 Misclassified Costs</u>	<u>FY 2017-18 Misclassified Costs</u>	<u>Total Misclassified Costs</u>
68100 In-State Travel	\$ 42,747	\$ 63,700	\$ 106,447
68400 Sales Conference	\$ (42,747)	\$ (63,700)	\$ (106,447)

Due to the misclassification of costs, year-end expenditures were incorrect for each expense account. When we performed the adjustments, Expense Account 68400 for sales conferences and retailer trade shows was over-expended for both fiscal years as a result of the misclassification, as shown in the following table:

<u>Fiscal Year</u>	<u>Expense Account</u>	<u>Annual Budget</u>	<u>Year-end Expenditures</u>	<u>Adjustments</u>	<u>Year-end Adjusted Expenditures</u>	<u>Over/(Under) Budget</u>
2016-17	68100 In-State Travel	\$ 1,044,800	\$ 960,114	\$ (42,747)	\$ 917,367	\$ (127,433)
	68400 Sales Conferences	\$ 400,000	\$ 369,278	\$ 42,747	\$ 412,025	\$ 12,025
2017-18	68100 In-State Travel	\$ 998,000	\$ 1,098,661	\$ (63,700)	\$ 1,034,961	\$ 36,961
	68400 Sales Conferences	\$ 400,000	\$ 344,228	\$ 63,700	\$ 407,928	\$ 7,928

One employee from the Finance Division is responsible for entering transportation costs in the correct accounts. The Lottery relies solely on the employee to determine which transportation charges on the Citibank statements and Enterprise Rent-a-Car invoices are for sales conferences and retailer trade shows. If the employee is not notified of the travel dates, all costs will be allocated to Expense Account 68100. We found no indication that these transactions were subject to periodic supervisory review, and the Lottery did not detect these errors. Incorrect financial information may lead to misinformed management decisions.

GC section 13402 states:

Agency heads are responsible for the establishment and maintenance of a system or systems of internal control, and effective and objective ongoing monitoring of the internal controls within their state agencies. This responsibility includes documenting the system, communicating system requirements to employees, and ensuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

GC section 13403 also states, in part:

(b) The elements of a satisfactory system of internal control, shall include, but are not limited to, the following:

...(6) An effective system of internal review.

Recommendation

We recommend that the Lottery:

- Provide training to staff and implement adequate oversight over the allocation of transportation expenses; and
- Monitor expenses on a regular basis to identify any irregularities.

Lottery's Response

The Lottery responded as follows:

The Lottery agrees with the finding that certain travel expenditures associated with sales training seminars and retailer trade shows were mistakenly charged to the incorrect expense accounts. The Lottery also agrees with the SCO's recommendations with respect to this finding. The Lottery has provided additional training to staff to ensure that expenditures are charged to the correct accounts in the future.

SCO Comment

We will follow up in a separate engagement to determine whether corrective actions were adequate and appropriate.

FINDING 9— Improperly signed and authorized hotel agreements and costs

The Lottery lacked adequate controls to ensure that the appropriate individuals signed and authorized hotel costs over \$50,000. Of the 34 hotel agreements for sales conferences and retailer trade shows, we identified eight that were improperly signed. In addition, costs associated with six hotel agreements were not properly authorized.

The Lottery entered into agreements with hotels to secure event space and lodging for sales conferences and retailer trade shows. We reviewed all 34 agreements executed during the audit period and calculated the values based on room nights, room rentals, food and beverage minimums, service charges, fees, and tax. We identified eight agreements that were valued at over \$50,000. The CDS Manager or the Chief Counsel (now Former Chief Counsel) signed these agreements; however, their delegated authority is to enter into contracts for less than \$50,000. The Lottery Director is required to sign contracts for greater than \$50,000.

In addition, these signatories did not adequately review the value of the agreements before signing them. For example, the hotel agreement for the 2017 sales conference indicated 551 guest rooms at \$148 for single occupancy. Without considering tax, the total amounts to \$81,548, well above \$50,000. Improperly executed agreements may result in disputes or cancellations.

We also identified six hotel agreements that were valued at less than \$50,000 but exceeded \$50,000 in actual costs. For example, the 2018 DoubleTree Hilton Modesto agreement was valued at \$38,801. However, actual costs amounted to \$64,413, over \$25,000 more than the agreement value. The Lottery had no review or approval procedure for when actual expenses exceeded the delegated individual's authority.

The following table lists the 14 hotel agreements that exceeded \$50,000 in value and/or actual costs:

Year	Event	Hotel	Estimated Agreement Value	Actual Costs
2014	Retailer Trade Show	Hilton Orange County/Costa Mesa	\$ 69,597	\$ 70,235
	Retailer Trade Show	Marriott Santa Clara	\$ 46,817	\$ 60,239
2015	Retailer Trade Show	Marriott Los Angeles Airport	\$ 33,572	\$ 53,558
	Retailer Trade Show	Marriott San Diego	\$ 59,210	\$ 74,456
	Sales Conference	Hilton Palm Springs Resort	\$ 70,292	\$ 73,450
2016	Retailer Trade Show	Marriott Santa Clara	\$ 53,940	\$ 67,067
	Retailer Trade Show	Sheraton Fairplex Hotel	\$ 35,267	\$ 50,881
	Sales Conference	Hyatt Regency Orange County	\$ 107,473	\$ 138,359
2017	Retailer Trade Show	Sheraton Fairplex Hotel	\$ 57,899	\$ 65,860
	Retailer Trade Show	DoubleTree Hilton Sacramento	\$ 45,883	\$ 55,724
	Sales Conference	Hyatt Regency Orange County	\$ 116,989	\$ 147,659
2018	Retailer Trade Show	Marriott Oakland	\$ 40,606	\$ 65,451
	Retailer Trade Show	Warner Center Marriott Woodland Hills	\$ 86,762	\$ 99,371
	Retailer Trade Show	DoubleTree Hilton Modesto	\$ 38,801	\$ 64,413

The Lottery's Memorandum titled Delegation of Authority to Enter Into Contracts Valued at Less Than \$50,000, dated March 5, 2014, delegated two individuals to sign such agreements, the CDS Manager and the Chief Counsel (now Former Chief Counsel).

GC section 13402 states:

Agency heads are responsible for the establishment and maintenance of a system or systems of internal control, and effective and objective ongoing monitoring of the internal controls within their state agencies. This responsibility includes documenting the system, communicating system requirements to employees, and ensuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

GC section 13403 also states, in part:

(b) The elements of a satisfactory system of internal control, shall include, but are not limited to, the following:

...(6) An effective system of internal review.

Recommendation

We recommend that the Lottery implement:

- Procedures to ensure that the appropriate individual signs contracts, including hotel agreements; and
- A review and approval procedure for when actual costs exceed the delegated signatory's authority.

Lottery's Response

The Lottery responded as follows:

The Lottery agrees that, in some cases, Lottery staff executed hotel contracts exceeding the signers' delegated authority. All of the contracts noted in this finding, however, had been reviewed and approved through proper channels and their terms and conditions were reviewed and negotiated by the Lottery Legal Office. None of the contracts contained terms that were materially adverse to the Lottery.

We agree with the recommendations of this finding. Although the Lottery does not anticipate the scope and scale of hotel contracts as in the past, it will require any hotel costs to be clearly identified prior to contract execution to ensure approval at the appropriate level.

SCO Comment

We could not verify that contracts had been reviewed and approved through proper channels, based on the information and documentation provided by Lottery staff. As stated in the finding, the appropriate individual did not sign these agreements; therefore, the agreements were not approved through proper channels. We will follow up in a separate engagement to determine whether corrective actions were adequate and appropriate.

FINDING 10— Lack of review over IGT retailer trade show expenses

The Lottery lacked an adequate review process to ensure that IGT expenses, claimed against the \$200,000 IGT reimbursement, were appropriate and supported. Out of \$92,658 tested, we questioned \$16,649. Some of the issues we noted were reported in Lottery's Internal Audit's *Sales Procurement Process Audit* report.

Per IGT Contract Amendment A10, signed on April 15, 2013, IGT develops and provides training conferences for Lottery retailers and district sales representatives with costs not to exceed \$200,000 per year. These services are to remain in effect until the expiration of the contract on October 13, 2019. Each year, IGT submits to the Lottery a summary spreadsheet with its expenses, along with supporting documentation, to claim against the \$200,000. The Lottery then bills IGT the remaining amount for reimbursement to cover its expenses for the retailer trade shows. The Lottery incurred the remaining expenses over the \$200,000 threshold.

During the audit period, five IGT billings were associated with the \$200,000 reimbursement. IGT expenses associated with the retailer trade shows totaled \$203,374. We judgmentally selected the billing with the highest IGT expenses for testing, totaling \$92,658.

We noted the following:

- The Lottery's lack of review of IGT's submitted expenses resulted in \$16,649 in unsupported costs. We found no indication that the Sales Division reviewed the IGT billings.

A price quote of \$2,439 was included to support the purchase of 200 duffel bags at a unit price of \$9.99. The quote was dated January 25, 2017. However, two invoices, dated March 1, 2017, were provided for the purchase of 1,812 duffel bags at a unit price of \$6.15. We could not determine whether IGT purchased the 200 duffel bags or if the quote was only part of the procurement process for purchasing the 1,812 duffel bags at a lower price.

IGT did not include the invoice for the purchase of 5,000 baseball caps from Cal Graphics for \$14,066. However, the Lottery obtained the invoices from IGT during our engagement, and IGT credited the Lottery \$101.01, due to a miscalculation.

On the IGT summary spreadsheet, IGT claimed \$1,338 for an employee's airfare costs. However, airfare receipts provided supported only \$1,194, a variance of \$144.

GC section 13402 states:

Agency heads are responsible for the establishment and maintenance of a system or systems of internal control, and effective and objective ongoing monitoring of the internal controls within their state agencies. This responsibility includes documenting the system, communicating system requirements to employees, and ensuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

GC section 13403 also states, in part:

(b) The elements of a satisfactory system of internal control, shall include, but are not limited to, the following:

...(6) An effective system of internal review.

Recommendation

We recommend that the Lottery adequately review IGT invoices and supporting documentation for any expenses claimed by IGT.

Lottery's Response

The Lottery responded as follows:

The Lottery agrees with the finding and, as discussed above, has already curtailed purchases of branded promotional items and the use of IGT contract funds for such purposes. We agree with the recommendations regarding vendor purchase oversight. The Lottery recognizes that a more robust review and pre-approval process is needed for these expenditures.

SCO Comment

We will follow up in a separate engagement to determine whether corrective actions were adequate and appropriate.

**FINDING 11—
Excess Lodging
Rate Request
forms were not
properly
completed and
submitted**

The Sales Division submitted 11 Excess Lodging Rate Request (STD 255C) forms to the Accounting Section for lodging rates in hotel agreements that exceeded the state rate. We noted that the Sales Division did not properly complete and submit any of the 11 STD 255C forms.

CalHR Manual, section 2201 states, in part:

If the base (nightly) room rate exceeds the current state rate, then an Excess Lodging Rate Approval Request (STD 255C) must be submitted by the employee and approved by the employee's department and, if required, by the California Department of Human Resources (CalHR), before the trip takes place.

As noted on the STD 255C, Excess Lodging Rate Requests must include three "good faith" quotes (such as Concur printouts) for the requested travel dates and justification for the lodging rate requested.

We noted the following:

- All 11 STD 255C forms were completed and approved after the hotel agreements were signed. The Sales Division did not request approval for the rates exceeding current state rate before executing the agreements. Gaining approval for the forms after the fact does not fulfill the intent of the form;
- All 11 STD 255C forms were submitted without documentation to support three "good faith" quotes. The forms listed only the names of hotels and rates for each. We could not determine whether the quotes were obtained before or after the executed agreements; and
- Five STD 255C forms were approved either the same day or after the start of the event.

The Lottery could not demonstrate that the lodging rates obtained were in the best interest of the state.

Recommendation

We recommend that the Lottery:

- Ensure that STD 255C forms are adequately supported and submitted in a timely manner; and
- Excess lodging requests should be approved before execution of agreement.

Lottery's Response

The Lottery responded as follows:

We agree with the finding and the recommendations. In addition, as noted, the Lottery is seeking more efficient and effective ways to conduct sales staff and retailer training in the future and intends to significantly reduce the number of Sales Division staff who will be authorized to travel to meetings and training throughout the state. Also, the upcoming mandatory travel training refresher for all Lottery supervisors and managers will cover, among other topics, excess lodging, including the timing for submittal of the STD 255C forms and the required accompanying documentation.

SCO Comment

We will follow up in a separate engagement to determine whether corrective actions were adequate and appropriate.

Schedule 1— Summary of Unallowable and Questioned Costs

Finding Number	Finding	Unallowable costs	Questioned costs
1	Sales management did not implement adequate controls over its operations	\$ -	\$ -
2	Inappropriate and/or unnecessary employee travel expenses for Sales Division staff events	131,832	-
3	Inadequate controls over the processing of travel expense claims	42,378	47,439
4	Improper food and beverage purchases for IGT-hosted events	16,738	-
5	Improperly authorized short-term rates for a long-term out-of-class assignment	28,320	-
6	Inadequate controls over Sales Division vendor purchases	-	-
7	Unallowable items purchased for Lottery staff at sales conferences	21,666	-
8	Misclassification of transportation costs related to sales conferences and retailer trade shows	-	-
9	Improperly signed and authorized hotel agreements and costs	-	-
10	Lack of review over IGT retailer trade show expenses	-	16,649
11	Excess Lodging Rate Request forms were not properly completed and submitted	-	-
	Total	<u>\$ 240,934</u>	<u>\$ 64,088</u>

* All amounts are rounded to the nearest dollar.

Schedule 2— Unallowable Lodging Costs

Year	Event	Location	Date	Total Lodging Costs ¹	Total Room Nights	Unallowable Room Nights	Unallowable Lodging Costs
2014	Retailer Trade Show	Costa Mesa	6/3/2014	\$ 7,833	56	3	\$ 447
	Retailer Trade Show	Universal City	6/5/2014	6,515	44	2	315
	Retailer Trade Show	Santa Clara	6/12/2014	6,325	46	0	-
	Sales Conference	Sacramento	7/15-17/2014	40,662	361	2	243
2015	Retailer Trade Show	Fresno	1/8/2015	6,774	72	0	-
	Retailer Trade Show	Los Angeles	1/13/2015	7,809	54	0	-
	Retailer Trade Show	Ontario	1/15/2015	5,636	56	5	410
	Retailer Trade Show	San Diego	1/22/2015	9,039	61	0	-
	Retailer Trade Show	Concord/Walnut Creek	1/27/2015	4,996	49	0	-
	Retailer Trade Show	San Francisco	1/29/2015	7,902	55	0	-
	Sales Conference	Palm Springs	8/4-6/2015	67,523	542 ²	0	-
2016	Retailer Trade Show/Mid-Year Sales Conference	Fresno	1/21/2016	16,428	159	0	-
	Retailer Trade Show	Santa Clara	1/28/2016	11,851	76	0	-
	Retailer Trade Show/Mid-Year Sales Conference	Pomona	2/4/2016	20,339	151	14	1,853
	Retailer Trade Show	Long Beach	2/11/2016	12,507	79	4	601
	Sales Conference	Garden Grove	9/7-9/2016	95,713	547	148	26,089
2017	Retailer Trade Show/Mid-Year Sales Conference	Pomona	3/8/2017	35,436	230	84	12,409
	Retailer Trade Show	San Diego	3/29/2017	15,955	106	1	156
	Retailer Trade Show/Mid-Year Sales Conference	Sacramento	4/18/2017	17,146	103	25	4,263
	Sales Conference	Garden Grove	8/29-31/2017	96,900	549	143	25,342
2018	Retailer Trade Show	Oakland	3/20/2018	18,500	83	6	1,392
	Retailer Trade Show/Mid-Year Sales Conference	Woodland Hills	3/27/2018	37,891	151	54	9,891
	Retailer Trade Show/Mid-Year Sales Conference	Modesto	4/19/2018	31,178	154	0	-
Totals				<u>\$ 580,858</u>			<u>\$ 83,411</u>

¹ Total lodging costs consist of room nights, parking, cancellation fees, and attrition.

² For this sales conference, two hotels were used. Based on the hotel invoices, we could determine the number of room nights only for one hotel.

**Schedule 3—
Hotel Cancellation and Attrition Fees**

Year	Event	Location	Number of No Shows	No Show/Cancellation Fees	Attrition	Total
2016	Retailer Trade Show	Long Beach	2	\$ 280	\$ 1,094	\$ 1,374
2018	Retailer Trade Show/Mid-Year Sales Conference	Woodland Hills	4	804	-	804
2018	Retailer Trade Show/Mid-Year Sales Conference	Modesto	19	2,781	7,772	10,553
			<u>25</u>	<u>\$ 3,865</u>	<u>\$ 8,866</u>	<u>\$ 12,731</u>

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



March 29, 2019

Andrew Finlayson, Bureau Chief
Division of Audits
State Controller's Office
Post Office Box 942850
Sacramento, California 94250-5874

Re: ORF-TEC Audit

Dear Mr. Finlayson:

The California State Lottery (Lottery) would like to thank the State Controller's Office (SCO) for providing the Lottery with a draft report of its audit of the Lottery's Office Revolving Fund (ORF) and certain travel expenses for the period July 1, 2014, through June 30, 2018.

The SCO's audit reinforced the findings of the Lottery's internal audit of its Sales Division's¹ procurement and expense practices for the period from January 1 – December 31, 2017. The internal audit was requested in September 2017 when executive management first became aware that certain Sales Division activities may not have been vetted, reviewed, or approved at the appropriate management levels using established Lottery processes.

The Lottery's audit findings, provided to SCO upon initiation of SCO's audit, identified problem areas within the Sales Division which are echoed in the SCO report. Specifically, the Lottery's internal audit found: (a) weak controls over the Sales Division's procurement processes; (b) lack of documentation in planning sales training seminars; (c) inadequate oversight for Lottery vendor IGT Global Solutions Corporation's (IGT) retailer trade show expenses; and (d) lack of guidelines for conducting Sales Division training programs. Consequently, when the SCO audit was initiated, the Lottery had already begun to implement several changes to the Sales Division's seminar planning and expenditure practices.

¹ Note: References herein to "Sales Division" mean and refer to the Lottery Sales and Marketing Division. The Sales unit (which was the subject of this audit) is a unit within the Sales and Marketing Division.

Since commencement of the SCO audit, the Lottery has eliminated all large-format biannual sales seminars and retailer trade shows. Sales staff training has been centralized in the Lottery's Human Resources Division and will be provided in a more efficient manner with minimal travel. Retail partners will receive relevant training and information using new Lottery equipment and other alternative methods available to the Lottery. These changes address the majority of the SCO's audit findings.

The Lottery generally agrees with the findings and recommendations set forth in the SCO's draft report.

It is important to note that the SCO did not discover any instances of fraud and has not questioned the necessity or value of the Lottery's retailer trade shows and employee training seminars throughout the state.

The Lottery takes seriously the need to adhere to Government Code section 13402. This is evidenced by actions taken by the Lottery prior to the commencement of the SCO audit, including: (1) initiating its own internal audit of various Sales Division expenditures and functions nearly a year before the SCO audit; (2) repurposing a CEA position to provide focused oversight to Sales Division administration and operations; (3) implementing enhanced review and approval processes for Sales Division travel and procurements in response to the Lottery's internal audit findings; (4) requiring the Sales and Marketing Division to justify all expenditures annually in advance of budget approval beginning in fiscal year 2018-19; and (5) adhering to State Leadership Accountability Act requirements for monitoring and reporting on internal departmental controls.

The Lottery will continuously monitor the areas audited by the SCO and will perform further internal audits where indicated. Moreover, the Lottery will pursue available avenues to seek reimbursement of overpayments identified by the SCO and the Lottery's own audits.

The Lottery is proud to have provided more than \$1.7 billion to California public education in fiscal year 2017-18 and appreciates the SCO's focus on business processes that could be improved, thus helping the Lottery to ensure that contributions to education are maximized each year.

Following are the Lottery's responses to the specific SCO findings and recommendations provided in the audit report.

FINDING 1 – Sales Division management did not implement adequate controls over its operations

RECOMMENDATION:

The SCO recommends that:

- The Lottery's Sales Division management set the tone and lead by example; strong and effective leadership is fundamental to an effective internal control system; and
- The Lottery regularly oversee and monitor the activities of the Sales Division to ensure that all applicable policies, procedures, rules, and regulations are being followed.

RESPONSE:

The Lottery agrees with this finding and the SCO's recommendations. The Lottery already has implemented several significant changes to the Sales Division and practices within the training unit of that division to address the issues noted in the finding. Specifically:

1. In 2018 the Lottery repurposed a vacant CEA position within the Sales Division. This CEA's role is to provide strong oversight, structure, and control, particularly in the areas of administration and personnel. The position is functioning as intended, providing necessary guidance and discipline to the Sales Division's operations.
2. The Lottery cancelled a scheduled August 2018 Sales Division training seminar and has since determined that sales seminars/retailer trade shows as previously conducted would be eliminated. Instead, training for Lottery sales staff and retailers will be conducted in a different manner utilizing existing resources from the Lottery's gaming system vendor, IGT (within the \$200,000 allocated contractual vendor obligation), using webinars and more localized venues, without necessitating nearly as much employee travel. Any Sales Division training events will require pre-approval at the Directorate level with appropriate justification and explanation of all anticipated costs.
3. The functions of the former Lottery Sales Training Unit, including scheduling, arranging, booking, and contracting for lodging, meeting rooms, and related procurements for the Sales Division, have been centralized

within the Lottery's Training Unit for increased oversight and process controls.

4. As of March 2018, the Lottery began implementing additional justification requirements and review procedures for approving all Sales Division travel requests. For example, the traveler must clearly articulate the specific work they will be performing and demonstrate how the travel is in the Lottery's best interests and supports the Lottery's mission of providing supplemental funding to public education.

In addition, the Lottery has undertaken the following audits, reviews, and training that will address various internal control deficiencies identified in the SCO audit:

- Inventory audit of promotional items. The purpose of the review is to eliminate unnecessarily large procurements of promotional items as noted in the SCO audit.
- Reconcile hotel billings. The purpose is to review all Sales Division hotel billings received during the SCO audit period that were not tested by the SCO to determine if the Lottery was billed appropriately. Identified billing errors will be addressed with the individual hotels.
- Review additional Sales Division TECs not tested by the SCO for accuracy and appropriateness.
- Audit of Contract Development Services (CDS) review of Sales Division procurements.
- Improved Sales Division contract manager training.
- Enhanced travel training. The purpose of the training is to ensure all supervisors and managers are aware of all pertinent state travel rules. Training will also be extended to staff that processes travel expense reimbursement claims to ensure the appropriateness of expenditures and compliance with applicable rules.
- Annual budget justification requirement for the Sales and Marketing Division was implemented in fiscal year 2018-19. Effective with the 2018-19 fiscal year, Sales and Marketing Division expenditures must be justified in advance of Lottery budget approval (also known as "zero-based budgeting"). The Lottery will roll this effort out to the remaining divisional budgets beginning with the 2020-21 fiscal year.

FINDING 2 – Inappropriate and/or unnecessary employee travel expenses for Sales Division staff events

RECOMMENDATION:

To address Sales Division deficiencies and overpayments, the SCO recommends that the Lottery:

- Establish adequate controls to ensure that travel charges are appropriate and in accordance with CalHR rules;
- Recover overpayments from the hotels that made errors on billing invoices; and
- Consider recovering payment of unallowable lodging and per diem in accordance with GC section 19838.

RESPONSE:

The Lottery agrees in general that during the audit period, the Sales Division misapplied the 50-mile rule for lodging and per diem. In addition, the Lottery agrees that its Sales Division travel invoice review and approval processes need to be strengthened. In accordance with the SCO's recommendations, the Lottery already has taken the following corrective actions:

Insufficient 50-mile rule exception justification:

The Lottery agrees that Sales Division travel requests during the audit period lacked sufficient justification to substantiate exceptions to the 50-mile lodging rule for certain employees attending annual retailer trade shows, annual sales training seminars, and other Sales Division meetings. As noted by the SCO, before April 2018 the Sales Division on occasion allowed sales staff to stay at hotels located within 50 miles of their residence or headquarters to attend annual retailer trade shows and annual sales training seminars to enable team-building and to promote the sharing of experiences and best practices.

As noted, in March 2018, the Lottery recognized that the justification previously used in allowing exceptions to the 50-mile lodging rule for employees attending sales training conferences and retailer trade shows was not consistent with the spirit of the rule. As such, the Lottery eliminated this practice before its April 2018 Modesto mid-year sales conference and retailer trade show.

Cancelled rooms:

A significant number (19 of 25) of rooms were cancelled based on a reevaluation by executive management of the justification and ultimate cost, in resources and travel expenses, of planned travel by certain Sales Division staff to an April 2018 mid-year sales training and retailer trade show in Modesto. This decision to cancel travel for several employees was made after analysis showed that the resulting attrition charges by the hotel were less than the cost of lodging, per diem and lost productivity that otherwise would have been incurred had all the proposed Sales Division employees attended and stayed for the nights booked. Many of the remaining room cancellations resulted from the unavailability of the employees scheduled to attend due to illness or other last-minute unavoidable schedule conflicts.

Double booked rooms:

The Lottery agrees that six hotel room nights appear to have been "double booked" (meaning reservations were made for a single employee at two different hotels). The majority of these double-bookings appear to be a result of errors made by the hotels in question. The Lottery is seeking reimbursement from the hotels for such charges.

Room and parking charges:

The Lottery agrees that one room and certain parking charges were charged at a higher rate than the contracted rate. The hotel room charge appears to be the result of a number transposition by the hotel. Similarly, the vast majority of inappropriate parking charges identified by the SCO appear to be the result of hotel billing errors. The Lottery is seeking reimbursement from the hotels for these overages.

Sales Division staff meetings:

The Lottery agrees that some hotel lodgings for certain Lottery Sales Managers who attended team meetings within 50 miles of either their residence or headquarters did not have valid exceptions to the 50-mile rule, and the related per diem reimbursements were also unallowable. As previously mentioned, all Sales Division meetings now require a comprehensive pre-approval.

Measures taken by the Lottery to address these issues as a whole:

The Lottery will conduct mandatory training to refresh supervisors and managers on state travel rules. Although Lottery management has largely curtailed Sales Division practices that required hotel contracts, to the extent that the Lottery books hotels for blocks of employees in the future, the Lottery will ensure that no inaccurate charges are incurred.

FINDING 3 – Inadequate controls over the processing of travel expense claims (TEC)

RECOMMENDATION:

The SCO recommends that to prevent improper TEC payments from recurring, the Lottery should:

- Establish adequate internal controls to ensure that payments for TECs are accurate and comply with collective bargaining agreements and CalHR rules;
- Provide training to the Travel Unit staff who process TECs to ensure that they understand the requirements under collective bargaining agreements and CalHR rules; and
- Maintain supporting documentation for mileage claims on TECs for future audits.

RESPONSE:

The Lottery agrees that it did not properly apply the rule to limit reimbursement for certain Sales Division staff to only the miles driven in excess of the normal commute for employees claiming privately-owned vehicle mileage and also misapplied the rule allowing mileage to be claimed from/to home when using a privately-owned vehicle to travel to/from a common carrier. The Lottery has since provided instruction to all Lottery employees clarifying both of these rules.

With respect to the lack of sufficient documentation associated with claimed mileage, the Lottery has provided clear direction to all Lottery Sales Managers regarding the documentation required to be included with privately-owned vehicle mileage claims to substantiate the reimbursement amount. Specifically, Lottery Sales Managers who drive privately-owned vehicles to visit retailers within their districts are now required to submit a

report generated at the Lottery terminal located in the store for each retail location they visit along with a Google Maps printout (or similar mapping application) showing the route they drove to each location, as well as a printout showing the route driven for their normal commute to their Lottery office.

Regarding the Lottery recruiters' privately-owned vehicle mileage, the Lottery agrees that the associated claims for reimbursement were not well-documented but were provided in good faith after following Sales Division management's direction.

A significant portion of the unallowable privately-owned vehicle mileage noted in this finding is associated with mileage claimed by Lottery recruiters whose primary duties are to canvas certain assigned areas of the state to bring on new retailers to sell Lottery products. Although the SCO notes that the Lottery did not comply with the CalHR mileage policy requiring employees to deduct normal commute miles when claiming privately-owned vehicle mileage, their work requires daily travel to alternate locations instead of working from their "headquarters" (e.g., assigned district office). Therefore, recruiters do not have a "normal commute."

Instead, the Lottery's past practice required recruiters, when driving privately-owned vehicles for work, to exclude from mileage reimbursement claims the distance traveled from their residence to their first retail location visited for the day as well as the distance traveled from the final retail location visited for the day back to their residence. Mileage claims were only allowed for miles driven from the first retailer visited through the last retailer visited when recruiting prospective retailers.

As of July 2017, the recruiters have been assigned Lottery-owned vehicles because their mileage reimbursements and business practices supported the need for an assigned vehicle. This finding has therefore not applied to these employees since that time.

FINDING 4 – Improper food and beverage purchases for IGT-hosted events

RECOMMENDATION:

The SCO recommends that the Lottery:

- Establish adequate internal controls to ensure that payments for corporate card charges comply with state law to prevent improper corporate card charges or payments; and
- Provide adequate oversight to ensure that accounts payable staff processes only valid and authorized payments that comply with state law.

RESPONSE:

The Lottery agrees with the finding and recommendations. The Lottery has received full reimbursement from IGT for this expense.

FINDING 5 – Improperly authorized short-term rates for a long-term out-of-class assignment

RECOMMENDATION:

The SCO recommends that for future long-term assignments, that the Lottery comply with the long-term travel provisions set forth in collective bargaining agreements and the CalHR Human Resources Manual.

RESPONSE:

The Lottery agrees with the finding and recommendation but was unable to find suitable long-term lodging for the subject employee in San Francisco within the allowable rate of \$1,130 per month. Additionally, the Lottery had approved the short-term per diem rate reimbursement based on a misunderstanding of the facilities available at the selected hotel.

In 2016, the Lottery authorized a Sales Division employee from another Lottery district office to act in the capacity as the Lottery Sales Manager on a temporary, long-term assignment for the San Francisco District Office due to recruitment issues. The Lottery was not able to locate appropriate lodging near the district office that did not exceed the allowable long-term rate of \$1,130 per month. The Lottery therefore authorized short-term lodging in San Francisco for this employee.

The Lottery approved an exception to the short-term per diem rates based on the understanding that the hotel where the employee was staying did not offer certain long-term amenities such as a kitchen. The Lottery has since learned that the hotel in which the employee resided while on temporary, long-term assignment did in fact include adequate long-term amenities.

FINDING 6 – Inadequate controls over Sales Division vendor purchases

RECOMMENDATION:

The SCO recommends that the Lottery strengthen its internal controls over the PO process and ensure that procurement procedures are followed by each division as well as by CDS.

RESPONSE:

The Lottery agrees that documentation for the questioned purchases does not adequately reflect whether appropriate approvals were obtained prior to the orders being placed with the vendors and agrees with the recommendation to strengthen and ensure compliance with procurement process internal controls and procedures.

FINDING 7 – Unallowable items purchased for Lottery staff at sales conferences

RECOMMENDATION:

The SCO recommends that the Lottery adhere to GC section 8880.64 to ensure that Sales Division purchases are necessary and appropriate.

RESPONSE:

The Lottery agrees with the finding and recommendation.

FINDING 8 -- Misclassification of transportation costs related to sales conferences and retailer trade shows

RECOMMENDATION:

The SCO recommends that the Lottery:

- Provide training to staff and implement adequate oversight over the allocation of transportation expenses; and
- Monitor expenses on a regular basis to identify any irregularities.

RESPONSE:

The Lottery agrees with the finding that certain travel expenditures associated with sales training seminars and retailer trade shows were mistakenly charged to incorrect expense accounts. The Lottery also agrees with the SCO's recommendations with respect to this finding. The Lottery has provided additional training to staff to ensure that expenditures are charged to the correct accounts in the future.

FINDING 9 -- Improperly signed and authorized hotel agreements and costs

RECOMMENDATION:

The SCO recommends that the Lottery implement:

- Procedures to ensure that the appropriate individual signs contracts, including hotel agreements; and
- A review and approval procedure for when actual costs exceed the delegated signatory's authority.

RESPONSE:

The Lottery agrees that, in some cases, Lottery staff executed hotel contracts exceeding the signers' delegated authority. All of the contracts noted in this finding, however, had been reviewed and approved through proper channels and their terms and conditions were reviewed and negotiated by the Lottery Legal Office. None of the contracts contained terms that were materially adverse to the Lottery.

We agree with the recommendations of this finding. Although the Lottery does not anticipate the scope and scale of hotel contracts as in the past, it will require any hotel costs to be clearly identified prior to contract execution to ensure approval at the appropriate level.

FINDING 10 – Lack of review over IGT retailer trade show expenses

RECOMMENDATION:

The SCO recommends that the Lottery adequately review IGT invoices and supporting documentation for any expenses claimed by IGT.

RESPONSE:

The Lottery agrees with the finding and, as discussed above, has already curtailed purchases of branded promotional items and the use of IGT contract funds for such purposes. We agree with the recommendations regarding vendor purchase oversight. The Lottery recognizes that a more robust review and pre-approval process is needed for these expenditures.

FINDING 11 – Excess Lodging Rate Request forms were not properly completed and submitted

RECOMMENDATION:

The SCO recommends that the Lottery:

- Ensure that STD 255C forms are adequately supported and submitted in a timely manner; and
- Excess lodging requests should be approved before execution of agreement.

RESPONSE:

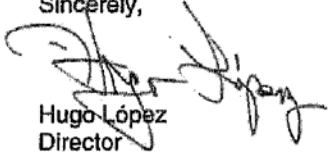
We agree with the finding and the recommendations. In addition, as noted, the Lottery is seeking more efficient and effective ways to conduct sales staff and retailer training in the future and intends to significantly reduce the number of Sales Division staff who will be authorized to travel to meetings and trainings throughout the state. Also, the upcoming mandatory travel training refresher for all Lottery supervisors and managers will cover, among

Mr. Finlayson
March 29, 2019
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other topics, excess lodging, including the timing for submittal of the STD 255C forms and the required accompanying documentation.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Hugo López", is written over the typed name and title.

Hugo López
Director

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

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