CALIFORNIA LOTTERY

Audit Report

ACCOUNTS PAYABLE PROCESS

June 1, 2012, through April 30, 2016

BETTY T. YEE
California State Controller

June 2017
June 30, 2017

California Lottery Commission  
700 North Tenth Street  
Sacramento, CA 95811  
ATTN: Gregory Ahern, Chair

Dear Commissioners:

We audited the California Lottery’s (Lottery) accounts payable process for the period of June 1, 2012, through April 30, 2016. The purpose of the audit was to determine if the Lottery maintained adequate systems of internal control over the accounts payable process.

Based on our audit, we noted that:

- Invoices were not properly reviewed and approved by the program manager; and
- Expenditures for Alcone Marketing Group, Contract No. 13285, were not properly monitored.

If you have any questions, please contact Andrew Finlayson, Bureau Chief, Division of Audits, by telephone at (916) 324-6310 or by email at afinlayson@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/ls
cc: Connie M. Perez-Andreeson, Vice Chair
    California Lottery Commission
Nathaniel Kirtman III, Commissioner
    California Lottery Commission
Rowena Libang-Bobila, Commissioner
    California Lottery Commission
Hugo López, Director
    California Lottery
Nicole Soluri, Chief Deputy Director and Acting Chief Counsel
    California Lottery
Nicholas Buchen, Deputy Director, Finance Division
    California Lottery
Terry Murphy, Deputy Director, Operations Division
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    California Lottery
Roberto Zavala, Deputy Director, Internal Audits
    California Lottery
James Shannon, Audit Manager, Internal Audits
    California Lottery
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Attachment—California Lottery’s Response to Draft Report
Audit Report

Summary
We audited the California Lottery’s (Lottery) accounts payable process for the period of June 1, 2012, through April 30, 2016. The purpose of the audit was to determine if the Lottery is maintaining an effective system of internal controls over the accounts payable process.

Based on our audit, we noted that:

- Invoices were not properly reviewed and approved by program managers; and

- Expenditures for Alcone Marketing Group (Alcone), Contract No. 13285, were not properly monitored.

Background
In 1984, Proposition 37 amended the California Constitution to authorize the establishment of a statewide lottery. As an initiative statute, the California State Lottery Act of 1984 created the California State Lottery Commission and gave it broad powers to oversee the operations of a statewide lottery. The purpose of the Lottery Act was to provide supplemental monies to benefit public education without the imposition of additional or increased taxes. The Lottery is administered by a five-person Commission appointed by the Governor and confirmed by the State Senate.

As of November 1, 2016, the Lottery’s Finance Division has 79 budgeted positions. The division consists of five units: Accounting Operations and Prize Payments, Financial Analysis and Risk Management, Financial Reporting, Budgets, and Revenue Collections. The division provides services in the areas of taxes, prize payments, accounts payable, cash receipts and disbursement, financial statements and game accounting, and investments.

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

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

The objectives of the audit were to determine whether:

- The Lottery complied with applicable laws, rules, regulations, policies, and procedures related to the accounts payable process;
- The Lottery maintained adequate internal controls over the accounts payable process;
- Accounts payable transactions were accurate, approved by authorized personnel, and properly recorded; and
- Accounts payable systems, records, and files were adequately safeguarded.

The audit period was June 1, 2012, through April 30, 2016. To meet the audit objectives, we performed the following procedures:

- Reviewed the Lottery Act, State Administrative Manual, Lottery policies and procedures, and any other applicable laws, rules, and regulations as they relate to the accounts payable process;
- Reviewed prior reviews and audits performed by the SCO;
- Interviewed and observed individuals involved in processes related to accounts payable transactions;
- Analyzed and evaluated processes and procedures related to accounts payable;
- Gained an understanding of and evaluated internal controls as they related to the objectives and scope of the audit; and
- Performed tests of procedural compliance:
  - Tested 113 purchase order payments
  - Tested 20 of 87 retailer refunds
  - Tested 20 of 186 security deposit refunds
  - Tested 20 of 1268 IRS tax payments
  - Tested 10 of 979 mid-tier payments
  - Tested one of 24 sets of monthly reconciliations

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 accounts payable. We did not audit the Lottery’s financial statements.
Conclusion

Based on our audit of the Lottery’s accounts payable process for the period of June 1, 2012, through April 30, 2016, we noted that invoices were not properly reviewed and approved by program managers. In addition, we noted that expenditures for Alcone Contract No. 13285 were not properly monitored. These findings are discussed in the Findings and Recommendations section of this report.

Views of Responsible Officials

Hugo López, Director, responded to the draft report on behalf of the Lottery on June 28, 2017. Overall, the Lottery agreed with the findings and recommendations. Its response is, in part, incorporated in the Findings and Recommendations section and is included in its entirety as an attachment to this report.

Restricted Use

This report is intended for the information and use of the Lottery, the California Lottery Commission, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of the final report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

June 30, 2017
Findings and Recommendations

FINDING 1—
Invoices were not properly reviewed and approved by program managers

Forty of 113 invoices tested were not properly approved by program managers using the Invoice Review and Approval Form (IRAF), as specified in the Lottery’s procedures for matching purchase orders.

A completed IRAF indicates that billed goods or services were reviewed for accuracy and approved for payment by the program manager. When invoices are received at the Lottery, Accounting Operations will forward the invoices and IRAFs to the program managers responsible for approving them. After reviewing invoices for accuracy and completing the IRAF, program managers will then use the eProcurement system to release purchase orders for the next level of processing and review.

It appears that the Lottery has been bypassing the IRAFs and has been using only eProcurement as a form of invoice payment approval. In addition, payments were processed by Accounting Operations despite incomplete or absent forms.

The Lottery’s procedures state:

The program manager will review the invoice and ensure that the billing is correct for the goods or services that were received.

• The program manager will either initiate a purchase order to pay the invoice or they will approve the invoice for payment by accepting the amount in eProcurement.

• The program manager will sign and return the IRAF to Accounting Operations by the due date listed on the IRAF within 7 days of receiving the form.

Government Code section 13401 states that each agency must maintain effective systems of internal accounting and administrative control as an integral part of its management practices. Controls shall be evaluated on an ongoing basis and, when detected, weaknesses must be promptly corrected. All levels of management must be involved in assessing and strengthening the systems of internal accounting and administrative control.

As a result of not abiding with invoice processing procedures, the Lottery paid invoices for goods and services that were not properly reviewed. The Lottery should exercise effective internal controls by ensuring that program managers and other staff involved in processing and approving billings understand and consistently adhere to invoice review and approval procedures.

Recommendation

We recommend that the Lottery enforce the use of IRAFs or other internal control methods to ensure that physical invoices for goods and services are reviewed prior to payment.
Lottery’s Response

The Lottery agrees with the finding and recommendation. It should be noted that all invoices in question represented goods or services that were satisfactorily delivered to the Lottery.

The Lottery has reinforced its procedures to ensure contract managers complete the IRAF form during the payment approval process. This includes strengthening current controls for issuing payments by requiring Contract Managers to manually complete the IRAF form while electronically approving payments using the existing eProcurement system. This reinforcement to our current process ensures that involves for goods and services are both physically and electronically reviewed before payment is approved.

SCO’s Comment

The Lottery indicated that it has already taken corrective actions in regard to this issue. We will follow up at the next accounts payable process audit to ensure that the actions noted are adequate and appropriate to remedy the finding.

FINDING 2—Expenditures for Alcone Contract No. 13285 were not properly monitored

Of the 113 invoice payments tested, 48 invoices, totaling $918,195, were paid to Alcone under a one-time purchase order (PO) and not under an active contract.

On August 31, 2014, the contract between the Lottery and Alcone (Contract No. 13285) expired, and the expenditure authority was depleted. Although contract expenditures are monitored by program managers, Contract Administration Services, and Accounting Operations, a contract amendment was not established to increase the expenditure authority as required by Lottery procedures. Instead, on October 9, 2014, one-time PO No. 17208 was approved by the Lottery Director and Commission, authorizing payments to Alcone for services rendered under the expired contract.

The Lottery’s Contract Manager’s Handbook indicates that it is the contract manager’s responsibility to monitor the contract budget and expenditure authority, and to ensure that the contract does not exceed the total amount authorized. Additionally, it states that contract amendments must be executed prior to the original contract expiration date, and the contract manager should plan for amendments at least six months in advance of the needed change.

According to the Lottery’s Matching Purchase Order Procedures, POs are for the procurement of goods and/or one-time services purchased or rented by the Lottery, including goods and services procured from a contract. If the nature of services to be procured is a recurring service type, a service agreement or contract should be used rather than a purchase order.
The Lottery did not properly monitor the contract expenditures for Alcone Contract No. 13285 as required by the Lottery’s procedures. The Lottery did not establish a contract amendment to increase the expenditure authority, and payments totaling $918,195 were made to the contractor under a one-time PO and not under an active contract.

Recommendation

We recommend that the Lottery:

- Adequately monitor all contract expenditures to ensure that expenditures do not exceed authorized amounts; and
- Comply with PO procedures by ensuring that one-time POs are not used to pay for recurring services associated with contracts.

Lottery’s Response

The Lottery agrees with the finding and recommendation. We would like to note that although there were budgeting issues, all expenditures made in relation to services provided by Alcone were valid, reviewed, and approved by Lottery management and the Lottery Commission.

In 2014, the Lottery recognized an opportunity to improve its contract management monitoring process and established the Contract Administration Services (CAS) office. CAS assists Contract Managers in the administration of large and complex contracts. Members of CAS meet with Contract Managers on a weekly basis to review expenditures, project future costs, and review budgets based on available contract funds. After it became evident that a PO would be required to address services provided by Alcone under the original contract, the Lottery assigned future Alcone contracts to CAS for contract administration services. This additional scrutiny ensures that all expenditures for Alcone contracts receive the appropriate oversight, review and approvals.

The Lottery also used the lessons learned to meet with departmental stakeholders to develop a proactive approach to avert similar occurrences. Consequently, the Lottery developed and now utilizes an Invoice Audit Checklists, Balance Verification Reports, Closeout Reports, and developed contract management related training to assist contract staff with the use of these new tools and keep updated on related best practices.

The Lottery is confident that these contract management enhancements will ensure expenditures are adequately monitored and do not exceed authorized amounts, thereby eliminating the need to use other payment vehicles for recurring services.

SCO’s Comment

The Lottery indicated that it has already taken corrective actions in regard to this issue. We will follow up at the next accounts payable process audit to ensure that the actions noted are adequate and appropriate to remedy the finding.
Attachment—
California Lottery’s
Response to Draft Report
June 28, 2017

Jeffrey V. Brownfield, Chief
Division of Audits
State Controller's Office
Post Office Box 942850
Sacramento, California 94250-5874

Re: Accounts Payable Process Audit

Dear Mr. Brownfield,

The California State Lottery (Lottery) offers the following general comments and specific points regarding the recently concluded audit conducted by the State Controller's Office (SCO). The audit scope was limited to an audit of the Lottery's accounts payable process.

The Lottery takes its mission as a public agency very seriously. We also understand that an important part of this mission is to perform our duties in a cost-effective and transparent manner to ensure public trust. As stated above, the focus of the audit was on the Lottery's accounts payable process. We are pleased to note that, after a comprehensive review by the SCO, there are no findings that hinder the Lottery's ability to meet its mission.

The draft report provides some recommendations for the Lottery to consider. Most of the recommendations call for the Lottery to enhance its internal control structure by enforcing the use of Invoice Review and Approval Forms (IRAF), adequately monitoring contract expenses, and complying with purchase order (PO) procedures. The Lottery finds these recommendations useful as the Lottery continuously evaluates and implements methods to improve its business practices and internal controls structure.

Below are the Lottery's responses to the specific recommendations provided in the draft audit report. The Lottery will develop a work plan as part of the SCO follow-up process.

FINDING 1: Invoices were not properly reviewed and approved by program managers.

RECOMMENDATION: The Lottery should enforce the use of IRADF or other internal control methods to ensure that physical invoices for goods and services are reviewed prior to payment.
RESPONSE: - The Lottery agrees with the finding and recommendation. It should be noted that all invoices in question represented goods or services that were satisfactorily delivered to the Lottery.

The Lottery has reinforced its procedures to ensure contract managers complete the IRAF form during the payment approval process. This includes strengthening current controls for issuing payments by requiring Contract Managers to manually complete the IRAF form while electronically approving payments using the existing eProcurement system. This reinforcement to our current process ensures that invoices for goods and services are both physically and electronically reviewed before payment is approved.

FINDING 2: - Expenditures for Alcone Contract No. 13285 were not properly monitored.

RECOMMENDATION: - We recommend that the Lottery:
- Adequately monitor all contract expenditures to ensure that expenditures do not exceed authorized amounts; and
- Comply with PO procedures by ensuring that one-time POs are not used to pay for recurring services associated with contracts.

RESPONSE: - The Lottery agrees with the finding and recommendation. We would like to note that although there were budgeting issues, all expenditures made in relation to services provided by Alcone were valid, reviewed, and approved by Lottery management and the Lottery Commission.

In 2014 the Lottery recognized an opportunity to improve its contract management monitoring process and established the Contract Administration Services (CAS) office. CAS assists Contract Managers in the administration of large and complex contracts. Members of CAS meet with Contract Managers on a weekly basis to review expenditures, project future costs, and review budgets based on available contract funds. After it became evident that a PO would be required to address services provided by Alcone under the original contract, the Lottery assigned future Alcone contracts to CAS for contract administration services. This additional scrutiny ensures that all expenditures for Alcone contracts receive the appropriate oversight, review and approvals.

The Lottery also used the lessons learned to meet with departmental stakeholders to develop a proactive approach to avert similar occurrences. Consequently, the Lottery developed and now utilizes an Invoice Audit Checklists, Balance Verification Reports, Closeout Reports, and developed contract management related training to assist contract staff with the use of these new tools and keep updated on related best practices.

The Lottery is confident that these contract management enhancements will ensure expenditures are adequately monitored and do not exceed authorized amounts, thereby eliminating the need to use other payment vehicles for recurring services.
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June 28, 2017
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If you have any additional questions, please contact Roberto Zavala, Deputy Director, Internal Audits at (318) 822-8358.

Sincerely,

[Signature]

Hugo López
Director

cc: Gregory Ahern, Lottery Chair
    Connie M. Perez, Lottery Vice Chair
    Rowena Libang-Bobila, Commissioner
    Nathaniel Kirtman III, Commissioner
    Nicole Soluri, Chief Deputy Director
    Nicholas Buchen, Deputy Director, Finance
    Sharon Allen, Deputy Director, Sales and Marketing
    Roberto Zavala, Deputy Director, Internal Audits
    James Shannon, Audit Manager, Internal Audits