

CALIFORNIA LOTTERY

Audit Report

SAM 20000 AUDIT: PURCHASING CYCLE

January 1, 2006, through December 31, 2007



JOHN CHIANG
California State Controller

January 2007



JOHN CHIANG
California State Controller

January 25, 2007

Joan M. Borucki
Acting Director
California Lottery
600 North Tenth Street
Sacramento, CA 95814

Dear Ms. Borucki:

The State Controller's Office audited the Purchasing Cycle as part of our process of studying and evaluating the accounting and administrative controls of the California Lottery for the biennial period ending December 31, 2007. The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Purchasing Cycle.

Our audit did not disclose any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Purchasing Cycle.

If you have any questions, please call Andrew Finlayson, Chief, Operations Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/ams:vb

cc: John Mass, Chairman
California Lottery Commission
Rachel Montes, Commissioner
California Lottery Commission
Manuel Ortega, Commissioner
California Lottery Commission
Patt Eberhart, Director
Finance and Administration
California Lottery
Stacy Matsunami, Director
Special Projects
California Lottery
Cathleen Dinubilo, Chief
Internal Audits Office
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Audit Report

Summary

The State Controller's Office (SCO) is in the process of studying and evaluating the internal accounting and administrative controls of the California State Lottery (Lottery) in accordance with *State Administrative Manual* Section 20060 (Internal Control Reporting) for the biennial period ending December 31, 2007. The SCO has concluded the audit for the Purchasing Cycle. The last day of fieldwork was December 5, 2006.

The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Purchasing Cycle.

Our audit did not disclose any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Purchasing Cycle.

Background

Proposition 37, the California State Lottery Act of 1984 (Lottery Act), amended the California Constitution to authorize the establishment of a statewide lottery, to create the California Lottery Commission, and to give the commission broad powers to oversee the operation of a statewide lottery.

The Lottery Act created a special fund, known as the State Lottery Fund, within the State Treasury. The State Lottery Fund operates as an enterprise fund and is required to be entirely self-funded from Lottery sales. The Lottery Act further stipulates that 50% of lottery sales proceeds are to be allocated to prizes, and that no more than 16% are to be used for administrative costs. The remaining proceeds from lottery sales, a minimum of 34%, are to be directed to the benefit of public education.

In accordance with the California *Public Contract Code*, Sections 10308 and 10331-10333, the Department of General Services has delegated purchase authority to the Lottery.

Given that authority, the Lottery utilizes a number of procurement methods for purchasing and procuring goods and services. These include master service agreements, purchase orders, and the Visa CAL-Card. The Lottery has designated one staff person within each unit to obtain needed goods and services. The Contract/Procurement Services (CPS) section within the Executive Division of the Lottery is responsible for monitoring all procurements. CPS ensures that all purchases comply with purchasing standards before payment is authorized.

Authority

State Administrative Manual Section 20060 (Internal Control Reporting) states:

Pursuant to the FISMA [*Financial Integrity and State Manager's Accountability Act of 1983*], the head of each state entity shall prepare and submit a report on the adequacy of their entity's internal control on December 31 of each odd numbered fiscal year. . . . The report shall consist of a certification letter, the most recent audit report on internal accounting and administrative controls, and management's response to the audit report.

The Lottery delegated the duty of performing the biennial audit of internal controls to the SCO in a letter dated September 6, 2002.

Objectives, Scope, and Methodology

We studied and evaluated the accounting and administrative controls of the Lottery's Purchasing Cycle in effect as of December 5, 2006. We conducted our study and evaluation in accordance with the *Standards for the Professional Practice of Internal Auditing*, issued by the Institute of Internal Auditors, and included testing that we considered necessary to determine whether accounting and administrative controls are in place and operative.

Lottery management is responsible for establishing and maintaining adequate internal controls. This responsibility, in accordance with *Government Code* Sections 13402 et seq., includes documenting internal control, communicating requirements to employees, and ensuring that internal control is functioning as prescribed. To fulfill its responsibility, Lottery management must assess the expected benefits and related costs of control procedures.

The objectives of accounting and administrative controls are to provide management with reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition;
- Transactions are executed in accordance with management's authorization and recorded properly, so as to permit the preparation of reliable financial statements; and
- Financial operations are conducted in accordance with policies and procedures established in the *State Administrative Manual* (SAM).

The specific objectives were to determine whether:

- Established purchasing policies and procedures exist;
- Adequate separation of duties associated with the purchasing function exists;
- The purchase of goods and services is adequately controlled;
- Purchases are approved by responsible persons and the approvals are documented;

- Expenditures do not exceed appropriation category or program;
- Purchases are promptly and accurately recorded;
- Goods and services ordered are received, and that only requested goods and services are accepted;
- Payments for purchases are accurate and are processed and recorded promptly; and
- Purchase adjustments are properly authorized and promptly and accurately recorded.

The audit procedures performed included:

- Analyzing and evaluating the internal controls for the Purchasing Cycle by identifying their strengths and weaknesses;
- Performing tests to determine if control objectives are being properly achieved; and
- Documenting a description of the internal controls over the Purchasing Cycle that encompasses the Lottery's policies and procedures.

Conclusion

Our study and evaluation did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Purchasing Cycle.

In our opinion, the Lottery's accounting and administrative controls over the Purchasing Cycle in effect as of December 5, 2006, taken as a whole, were sufficient to meet the objectives stated above.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all of these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

Views of Responsible Official

We discussed the audit results with Kathie Johnson, Audit Specialist, Internal Audits, on December 5, 2006. Ms. Johnson agreed with the audit results. No findings were disclosed during the audit; therefore, a draft report is not necessary and the report will be issued as final.

Restricted Use

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

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

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