



STATE OF ILLINOIS
**OFFICE OF THE
 AUDITOR GENERAL**

Frank J. Mautino, Auditor General

SUMMARY REPORT DIGEST

DEPARTMENT OF THE LOTTERY

Financial Audit For The Year Ended June 30, 2016

Release Date: February 2, 2017

FINDINGS THIS AUDIT: 1	AGING SCHEDULE OF REPEATED FINDINGS						
	New	Repeat	Total	Repeated Since	Category 1	Category 2	Category 3
Category 1:	1	0	1				
Category 2:	0	0	0				
Category 3:	0	0	0				
TOTAL	<u>1</u>	<u>0</u>	<u>1</u>				
FINDINGS LAST AUDIT: 1*							

*- Prior report was the financial audit report for the year ended June 30, 2015.

SYNOPSIS

(16-001) The Department of the Lottery (Department or Lottery) did not comply with the Illinois Lottery Law by depositing \$75 million with the Commonwealth of Virginia, which is the Multi-state control office, for paying prize awards attributable to Illinois sales of multi-state lottery game tickets that had not yet occurred. In addition, the Lottery inappropriately established a non-appropriated spending authority to advance the \$75 million to the Commonwealth of Virginia for future multi-state lottery prize awards (Powerball and Mega Millions).

- Category 1:** Findings that are **material weaknesses** in internal control and/or a **qualification** on compliance with State laws and regulations (material noncompliance).
- Category 2:** Findings that are **significant deficiencies** in internal control and **noncompliance** with State laws and regulations.
- Category 3:** Findings that have **no internal control issues but are in noncompliance** with State laws and regulations.

{Financial information is summarized on next page.}

**DEPARTMENT OF THE LOTTERY
FINANCIAL AUDIT
For the Year Ended June 30, 2016**

STATEMENT OF NET POSITION (amounts in thousands)	June 30, 2016	June 30, 2015
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
Cash equity in State Treasury.....	\$ 199,963	\$ 245,963
Cash and cash equivalents	27,464	16,205
Accounts receivable, net of allowance of \$17,594 and \$15,798, respectively.....	21,762	35,861
Investments (current and noncurrent).....	325,714	301,659
Private management contract receivable.....	58,240	32,618
Prepaid Assets.....	-	20,000
Capital assets being depreciated, net.....	58	93
Deferred outflows of resources - pension.....	10,475	11,718
Total assets and deferred outflows of resources.....	<u>643,676</u>	<u>664,117</u>
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES:		
Prizes payable.....	83,299	235,017
Accounts payable and accrued liabilities.....	142,937	82,259
Due to other Government- Federal.....	69	72
Due to other State funds.....	105,841	60,803
Unearned revenue.....	3,415	2,789
Other liabilities.....	1,170	1,222
Long-term annuity prizes payable (current and noncurrent).....	281,052	272,727
Other noncurrent liabilities.....	780	828
Net pension liability.....	65,511	65,780
Deferred inflows of resources - pension.....	3,597	2,345
Total liabilities and deferred inflows of resources.....	<u>687,671</u>	<u>723,842</u>
Net Position (Deficit).....	<u>\$ (43,995)</u>	<u>\$ (59,725)</u>
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION (amounts in thousands)		
	FY 2016	FY 2015
OPERATING REVENUE:		
Charges for sales and services.....	\$ 2,855,535	\$ 2,837,805
Private management contract fee.....	-	10,000
Other.....	6,521	6,487
Total Operating Revenues.....	<u>2,862,056</u>	<u>2,854,292</u>
OPERATING EXPENSES:		
Cost of sales and services.....	160,942	161,607
Prizes and claims.....	1,837,402	1,823,572
General and administrative.....	139,735	147,078
Allowance for (recovery of) private management contract fee.....	-	(21,776)
Depreciation.....	35	55
Total Operating Expenses.....	<u>2,138,114</u>	<u>2,110,536</u>
Operating Income.....	<u>723,942</u>	<u>743,756</u>
NONOPERATING REVENUES (EXPENSES):		
Investment income (expense).....	27,948	11,533
Interest expense.....	(11,996)	(12,298)
Other.....	-	(8)
Total Nonoperating Revenues (Expenses), net.....	<u>15,952</u>	<u>(773)</u>
Changes in Net Position Before Transfers.....	739,894	742,983
Transfers to Common School Fund.....	(691,550)	(678,550)
Transfers to Capital Projects Fund.....	(29,216)	(61,563)
Transfers to other State funds.....	(3,398)	(3,792)
Change in Net Position.....	<u>15,730</u>	<u>(922)</u>
Net Position at beginning of year.....	(59,725)	(58,803)
Net Position at end of year.....	<u>\$ (43,995)</u>	<u>\$ (59,725)</u>
DIRECTOR		
During Engagement Period: B.R. Lane (Acting) to June 10, 2016, Tim McDevitt (Acting) June 11, 2016 to October 23, 2016, Greg Smith (Acting) effective October 24, 2016		
Currently: Greg Smith, Acting		

FINDING, CONCLUSION, AND RECOMMENDATION

NONCOMPLIANCE WITH THE ILLINOIS LOTTERY LAW

Auditors in performing their testing of \$75 million in payments to the Commonwealth of Virginia determined the Lottery did not comply with various provisions of the Illinois Lottery Law and failed to comply with the criteria for the establishment of a non-appropriated spending authority.

\$10 million was still on deposit with the Commonwealth of Virginia for future multi-state prize payments

As set forth in the Illinois Lottery Law (Law), “The Department is authorized to transfer prize award funds attributable to Illinois sales of multi-state lottery game tickets to the multi-state control office, or its designated depository, for deposit to such game pool account or accounts as may be established by the multi-state game directors...” At the time the \$75 million was sent to the Commonwealth of Virginia the Illinois Lottery still had approximately \$10 million on deposit with the Commonwealth of Virginia for future multi-state prize payments from prepayments made in fiscal year 2015 (see Illinois Lottery State Compliance Report, finding 2015-002 *Inappropriate Prepayments to Fund Out-of-State Prize Payment Obligations*).

\$75 million was prepayments for future multi-state game prize liabilities

The \$75 million in payments did not constitute “prize award funds attributable to Illinois sales of multi-state lottery games tickets,” but instead were prepayments for future prize liabilities. In fact, prize awards for multi-state games are not computed until after a grand/jackpot winning prize ticket has occurred. The \$75 million was deposited into a separate account at the Commonwealth of Virginia and was used to pay prize liabilities upon Lottery approval.

In October 2015, the Lottery submitted a Chart of Accounts Maintenance and Inquiry form (C-45) to the Illinois Office of the Comptroller (Comptroller) to establish a non-appropriated spending authority within the State Lottery Fund (Lottery Fund). Prior to establishing the non-appropriated spending authority, the Lottery conducted an analysis in which they determined the requirements were met with respect to the payments to Commonwealth of Virginia as well as being in conformance with applicable law. The Comptroller subsequently approved the C-45 form indicating it was for a “CONTINUING APPROP - PAY PRIZE”, thus establishing the non-appropriated spending authority from the Lottery Fund.

General Assembly must expressly authorize expenditures associated with the multi-state games

One of the criteria for the establishment of a non-appropriated spending authority is the spending is not required to be appropriated by a specific statute. Auditors noted the Law sets forth the Department shall not expend State funds on a contractual basis unless those functions and expenditures are expressly authorized by the General Assembly. In addition, the Law specifically notes for multi-state games the Lottery shall not expend State funds on a contractual basis in connection with any such game unless such expenditures are expressly authorized by the General Assembly.

\$75 million deposits were not authorized by the General Assembly

The October 2015 deposits were not authorized by the General Assembly. House Bill 4160 of the 99th General Assembly contained fiscal year 2016 appropriations for the Lottery, including \$1 billion for prize payments. The bill passed the General Assembly on June 24, 2015, but was vetoed in total by the Governor on June 25, 2015. No further positive action was taken by the General Assembly, therefore, the veto stood. In the absence of the Governor's approval of the bill or an override of the veto by the General Assembly there was no express authorization for fiscal year 2016 Lottery expenditures until the enactment of Public Act 99-491, effective December 7, 2015. Of the \$75 million deposited with the Commonwealth of Virginia \$71,261,600 was not used to pay prize liabilities and was returned to the Lottery on December 16, 2015, following the passage of P.A. 99-491.

Establishment of a non-appropriated spending authority as well as making deposits for multi-state lottery prize liabilities that have not occurred violates the Illinois Lottery Law and diminishes the oversight and authority of the budgeting and appropriation process by the General Assembly and the Governor. (Finding 1, pages 32-35)

Recommended the Lottery adhere to the requirements of the Illinois law

We recommended the Lottery adhere to the requirements of the Illinois law concerning payment of multi-state lottery prizes and, specifically, not make deposits for such prizes without authority. If the Lottery continues to believe its actions complied with applicable statutes we recommend the Lottery seek a formal written opinion from the Illinois Office of the Attorney General as to the legality of the actions it undertook to submit deposits to the Commonwealth of Virginia for future multi-state lottery prize awards.

Lottery disagreed with finding

In summarizing the Lottery's response to the finding the Lottery indicated they determined that it could utilize a C-45 to establish non-appropriated spending authority, which it subsequently used to make \$75 million in deposits (the "Deposits") from the State Lottery Fund to the multi-state control office, after performing a thorough review and analysis of the Illinois Lottery Law, SAMS, the multi-state contracts allowing the Lottery to sell multi-state game tickets and other relevant statutes and regulations. The Lottery disagreed with the conclusion that its actions violated, or were in non-compliance, with the Illinois Lottery Law.

The Comptroller accepted the Lottery's C-45 and allowed it to make use of the established non-appropriated spending authority in order to make the Deposits. Additionally, following establishment of the non-appropriated spending authority, the Lottery's outside counsel reviewed the Lottery's analysis and concluded that the Lottery's interpretation of applicable law and requirements was reasonable.

In addition to finding it was proper to establish the non-appropriated spending authority, the Lottery determined that making the Deposits was also appropriate and in compliance with all applicable Law, rules, and contractual obligations. The Deposits were only applied to pay Illinois' share of jackpot and high tier prizes after confirmation of the occurrence of these wins. Draw down of these funds occurred in accordance with the procedures set forth in Mega Millions' Finance and Operation Procedures for Mega Millions and Powerball games. The exact balance of funds was returned on December 16, 2015, upon request of the Lottery.

Based on the foregoing, the Lottery disagreed with the auditors' determination that it failed to comply with the Illinois Lottery Law and inappropriately established a non-appropriated spending authority. The Lottery will consider the auditors' recommendation that it seek a formal written opinion from the Illinois Office of the Attorney General regarding the legality of its actions.

Auditor's comment on Lottery response

Auditors in commenting to the Lottery's response noted that per the Illinois Office of the Comptroller's (Comptroller) Statewide Accounting Management System (SAMS) Manual, the "deposit" of \$75 million with the Commonwealth of Virginia constituted an "expenditure" when the invoice voucher was submitted by the Lottery to the Comptroller. The vouchers for the \$75 million were approved and recorded per Comptroller records on October 5, 2015, thus becoming an expenditure by the Lottery on that date.

The Law requires that the General Assembly must authorize expenditures associated with the Lottery, including multi-state games. In addition, the Law sets forth the Department shall not expend State funds on a contractual basis unless those functions and **expenditures** are expressly authorized by the General Assembly. For purposes of the circumstances presented in the finding, the auditors' interpretation is that expenditures are expressly authorized when an appropriation bill is passed by the General Assembly and signed by the Governor.

Further, although the Law authorizes the Department to transfer **prize award funds** attributable to Illinois sales of multi-state lottery game tickets to the multi-state control office, or its designated depository, for deposit to such game pool account or accounts as may be established by the multi-state game directors, the \$75 million in payments did not constitute "prize award funds attributable to Illinois sales of multi-state lottery games tickets," but instead were prepayments for future prize liabilities.

Upon consideration of the Lottery's response to the finding, the auditors continue to believe the establishment of a non-appropriated spending authority as well as making deposits for multi-state lottery prize liabilities that have not occurred violates the Illinois Lottery Law and diminishes the oversight and authority of the budgeting and appropriation process by the General Assembly and the Governor.

AUDITOR'S OPINION

The auditors stated the Department of the Lottery financial statements as of June 30, 2016 and for the year then ended were presented fairly in all material respects.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

FJM:RPU

SPECIAL ASSISTANT AUDITORS

Our Special Assistant Auditors for this financial audit and compliance examination were KPMG LLP.