



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, 2017**

Release Date: January 31, 2018

FINDINGS THIS AUDIT: 2	AGING SCHEDULE OF REPEATED FINDINGS						
	New	Repeat	Total	Repeated Since	Category 1	Category 2	Category 3
Category 1:	1	0	1	No Repeat Findings			
Category 2:	1	0	1				
Category 3:	<u>0</u>	<u>0</u>	<u>0</u>				
TOTAL	2	0	2				
FINDINGS LAST AUDIT: 1*							

* The Department's prior report was the financial audit report as of and for the year ended June 30, 2016.

INTRODUCTION

This digest covers the Department's financial audit as of and for the year ended June 30, 2017. The Department's compliance examination for the two years ended June 30, 2017, will be released later.

SYNOPSIS

- **(17-01)** The Department did not transfer the required amount to the Capital Projects Fund and did not properly disclose the noncurrent portion of the liabilities associated with not making the transfer in its financial statements.
- **(17-02)** The Department did not exercise adequate internal control over reporting its online games prize liabilities at June 30, 2017.

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.

{Expenditures and Activity Measures are summarized on next page.}

**DEPARTMENT OF THE LOTTERY
FINANCIAL AUDIT
For the Year Ended June 30, 2017**

STATEMENT OF NET POSITION (amounts in thousands)	June 30, 2017	June 30, 2016
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
Cash equity in State Treasury.....	\$ 80,094	\$ 199,963
Cash and cash equivalents	37,539	27,464
Accounts receivable, net of allowance of \$19,197 and \$17,594, respectively.....	50,324	21,762
Investments (current and noncurrent).....	287,563	325,714
Private management contract receivable.....	-	58,240
Capital assets being depreciated, net.....	37	58
Other assets.....	2	-
Deferred outflows of resources - pension.....	21,525	10,475
Total assets and deferred outflows of resources.....	<u>477,084</u>	<u>643,676</u>
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES:		
Prizes payable.....	76,517	83,299
Accounts payable and accrued liabilities.....	12,980	142,937
Due to other Government- Federal.....	61	69
Due to other State funds (current and noncurrent).....	99,090	105,841
Unearned revenue.....	1,545	3,415
Other liabilities (current and noncurrent).....	2,008	1,950
Long-term annuity prizes payable (current and noncurrent).....	264,749	281,052
Net pension liability.....	82,700	65,511
Deferred inflows of resources - pension.....	3,288	3,597
Total liabilities and deferred inflows of resources.....	<u>542,938</u>	<u>687,671</u>
Net Position (Deficit).....	<u>\$ (65,854)</u>	<u>\$ (43,995)</u>

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION (amounts in thousands)	Fiscal Year 2017	Fiscal Year 2016
OPERATING REVENUE:		
Charges for sales and services.....	\$ 2,843,956	\$ 2,855,535
Other.....	6,152	6,521
Total Operating Revenues.....	<u>2,850,108</u>	<u>2,862,056</u>
OPERATING EXPENSES:		
Cost of sales and services.....	160,045	160,942
Prizes and claims.....	1,820,110	1,837,402
General and administrative.....	137,821	139,735
Depreciation.....	21	35
Total Operating Expenses.....	<u>2,117,997</u>	<u>2,138,114</u>
Operating Income.....	<u>732,111</u>	<u>723,942</u>
NONOPERATING REVENUES (EXPENSES):		
Investment income (expense).....	(10,183)	27,948
Interest expense.....	(11,181)	(11,996)
Other.....	60	-
Total Nonoperating Revenues (Expenses), net.....	<u>(21,304)</u>	<u>15,952</u>
Changes in Net Position Before Transfers.....	<u>710,807</u>	<u>739,894</u>
Transfers to Common School Fund.....	(705,625)	(691,550)
Transfers to Capital Projects Fund.....	(24,336)	(29,216)
Transfers to other State funds.....	(2,705)	(3,398)
Total Transfers.....	<u>(732,666)</u>	<u>(724,164)</u>
Change in Net Position.....	<u>(21,859)</u>	<u>15,730</u>
Net Position at beginning of year.....	(43,995)	(59,725)
Net Position at end of year.....	<u>\$ (65,854)</u>	<u>\$ (43,995)</u>

DIRECTOR
During Engagement Period: Tim McDevitt (Acting) (through October 23, 2016); Greg Smith (Acting) (effective October 24, 2016) Currently: Greg Smith (Acting)

**FINDINGS, CONCLUSIONS, AND
RECOMMENDATIONS**

**FAILURE TO TRANSFER REQUIRED AMOUNTS TO
THE CAPITAL PROJECTS FUND**

The Department of the Lottery (Department) did not transfer the required amount to the Capital Projects Fund (Fund 694), as required by the Illinois Lottery Law (Law), and did not properly disclose the noncurrent portion of the liabilities associated with not making the transfer in its financial statements.

**Amount due to the Capital Projects
Fund has grown to \$98.382 million**

**Cash transfers were less than
required under the Law**

During testing, the auditors noted the amount owed to Fund 694 from the State Lottery Fund (Fund 711) has grown to \$98.382 million. This amount has been steadily increasing since June 30, 2015, because the actual annual amount of cash transferred to Fund 694 from Fund 711 has been less than required by the Law. The following is an analysis of the actual transfers and cash deposits into Fund 694 and amounts due to Fund 694 (in thousands) over the past three fiscal years:

	Fiscal Year Ended June 30,		
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Amount to Transfer into Fund 694	\$ 61,563	\$ 29,216	\$ 24,336
Actual Cash Deposits into Fund 694	8,000	-	15,000
Difference	<u>\$ 53,563</u>	<u>\$ 29,216</u>	<u>\$ 9,336</u>

	As of June 30,		
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Due to Fund 694	<u>\$ 59,830</u>	<u>\$ 89,046</u>	<u>\$ 98,382</u>

In analyzing Fund 711's current assets for the last three years, there were sufficient funds available from current assets to pay current liabilities (less amounts due to Fund 694) with current assets left over. The following summary analysis shows Fund 711's current assets, current liabilities (excluding the amount due to Fund 694), and cash balances (in thousands) over the past three fiscal years:

	As of June 30,		
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Current Assets	\$ 349,580	\$ 306,434	\$ 166,856
Current Liabilities*	<u>321,265</u>	<u>246,690</u>	<u>91,998</u>
Excess Current Assets	<u>\$ 28,315</u>	<u>\$ 59,744</u>	<u>\$ 74,858</u>

*less amounts due to Fund 694

	As of June 30,		
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Cash Equity in State Treasury	\$ 244,501	\$ 198,266	\$ 77,879
Cash and Cash Equivalents	<u>15,284</u>	<u>26,542</u>	<u>36,729</u>
Total Cash	<u>\$ 259,785</u>	<u>\$ 224,808</u>	<u>\$ 114,608</u>

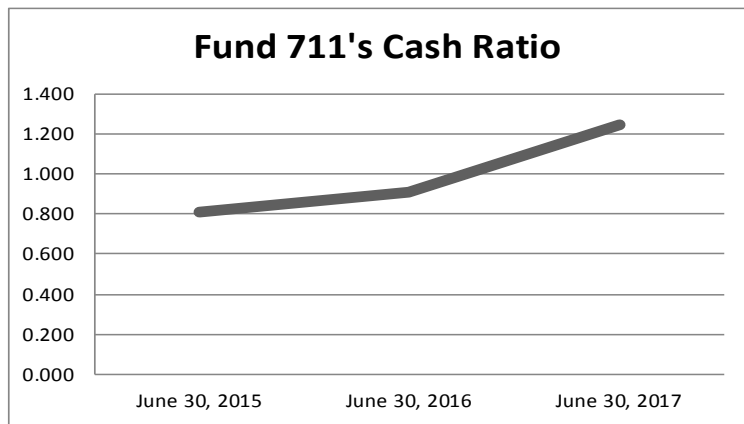
Finally, the cash ratio, a comparison of total cash to current liabilities, is one metric to analyze liquidity, or ability to satisfy an entity's short-term obligations with cash. The higher the cash ratio, the more capable an entity is to pay its current liabilities. The cash ratio is generally a more conservative look at an

entity's ability to cover its liabilities than many other liquidity ratios because other current assets, including accounts receivable, are left out of the equation and some current liabilities have not yet been invoiced by vendors. A cash ratio of 1.0 or greater is an indicator an entity is better positioned to cover its current liabilities. The following is a summary analysis and chart of Fund 711's increasing cash ratio (in thousands) over the past three fiscal years:

	As of June 30,		
	<u>2015</u>	<u>2016</u>	<u>2017</u>
Total Cash	\$ 259,785	\$ 224,808	\$ 114,608
Current Liabilities*	<u>321,265</u>	<u>246,690</u>	<u>91,998</u>
Cash Ratio**	<u>0.809</u>	<u>0.911</u>	<u>1.246</u>

*less amounts due to Fund 694

**Cash Ratio = (Total Cash / Current Liabilities)



Incorrect classification between current and noncurrent liabilities

In addition, the auditors noted the Department had not properly disclosed its current and noncurrent liabilities associated with the interfund balances due to Fund 694 from Fund 711. Department management corrected this error in the Department's final financial statements. (Finding 1, pages 33-36)

Department officials indicated insufficient transfers due to statutory problems

Department officials stated the insufficient transfers were due to:

- 1) excess transfers from Fund 711 to the Fund 412 which occurred up to June 30, 2009; and,
- 2) the Law's annual deadline for transferring cash from Fund 711 to Fund 694 occurring on the last day of the State's fiscal year, which does not allow the Department to perform a close of its accounting records to determine the actual amount of net proceeds to transfer into Fund 694.

Department officials indicate they are unable to develop a reasonable estimate

Further, Department officials indicated the development of a reasonable estimate is complicated by an unknown liability for prizes won (particularly, if a jackpot was to be won) on June 30 but after the transfer would have to be completed and the fact the Lottery has to maintain sufficient cash reserves to continue normal operations until non-cash assets at June 30 are converted to cash, such as accounts receivable.

Cash shortage due to excess cash transfers to the Common School Fund before June 30, 2009

In regards to the excess transfers referenced by the Department’s management, until June 30, 2009, the Department’s predecessor agencies had historically made cash transfers into Fund 412 in excess of Fund 711’s accrual basis net income. These excess transfers were recorded as a due from Fund 412 on Fund 711’s financial statements (effectively, an account receivable). As of June 30, 2009, this amount of excess transfers was \$69.9 million. At June 30, 2012, the Department determined – due to the statutory changes within Public Act 096-0034 (effective on July 13, 2009) – the excess contributions would not be collected. As such, the Department recorded an adjustment of \$69.842 million to reclassify the due from Fund 412 as a transfer. Through the end of fieldwork, the Department has not been able to recoup the \$69.9 million in excess transfers, which has caused a shortage of cash available to perform current period transfers.

Excess transfers were \$69.9 million before June 30, 2009

We recommended the Department study its estimation process for the amount due to Fund 694 so the annual transfer can better approximate the amount required to transfer in accordance with the Law, absent a statutory change in the transfer date. Further, the Department should continue to seek a legislative remedy to allow the Department to “true-up” its annual required transfer after finalizing its accounting records. In addition, the Department should properly report the current and noncurrent portions of the amount due to Fund 694 from Fund 711 during its financial reporting process.

Department officials agree

Department officials accepted the recommendation.

NEED TO IMPROVE THE ACCOUNTING OF ONLINE GAMES’ PRIZE LIABILITIES

The Department did not exercise adequate internal control over reporting its online games prize liabilities at June 30, 2017.

During testing, we noted the following:

Either players did not receive the opportunity to participate in a special prize pool or a transfer to the Common School Fund did not occur, totaling \$4.647 million

- The Department had not eliminated online prize liabilities, totaling \$4.647 million, related to the Pick 3 plus FIREBALL and Pick 4 plus FIREBALL which had expired between September 2015 through June 2017 for games between September 2014 and June 2016. Due to this error, the Department had either not offered a special prize pool or transferred these proceeds into the Common School Fund (Fund 412).

Unreconciled difference within the Department’s online games

Estimates not adjusted to reflect actual events timely

- The Department had an unreconciled difference of \$2.032 million within its accounts for prize liabilities from online games. Further, the Department’s estimate for its prize liabilities from online games for Fiscal Year 2015 and Fiscal Year 2016 were not adjusted to reflect actual amounts paid as of June 30, 2017. As a result of these errors, the Department’s prizes payable and prizes

**Transfers out to the Capital Projects
Fund understated by \$2.602 million**

and claims expense accounts were overstated by \$2.602 million and the due to the Capital Projects Fund (Fund 694) and transfers out to Fund 694 accounts were understated by \$2.602 million. (Finding 2, pages 37-38)

These amounts were deemed immaterial by Department management and were not corrected in the Department's final financial statements; however, we determined these exceptions represent a significant deficiency in the Department's internal control over financial reporting. Further, these conditions represent a significant deficiency in the Department's internal control over compliance for not preventing, or detecting and correcting, these conditions.

We recommended the Department decide how to handle its unclaimed prizes in excess of one year since the prize's drawing date in accordance with the Law and ensure its accounting records correctly reflect this position. Further, the Department should ensure its online games prize liabilities reconcile to supporting documentation and a "true-up" process occurs within a timely manner for its prior period estimates to reflect actual conditions.

Department officials agree

Department officials agreed with the recommendation.

We will review the Department's progress towards the implementation of our recommendations in our next financial audit.

AUDITOR'S OPINION

The auditors stated the financial statements of the Department as of and for the year ended June 30, 2017, are fairly stated in all material respects.

This financial audit was conducted by KPMG, LLP.

SIGNED ORIGINAL ON FILE

JANE CLARK
Division Director

This report is transmitted in accordance with Section 3-14 of the Illinois State Auditing Act.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

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