



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, 2018**

**Release Date: January 29, 2019**

FINDINGS THIS AUDIT: 5	AGING SCHEDULE OF REPEATED FINDINGS						
	New	Repeat	Total	Repeated Since	Category 1	Category 2	Category 3
Category 1:	2	1	3	2017	18-02		
Category 2:	2	0	2				
Category 3:	0	0	0				
<b>TOTAL</b>	<b>4</b>	<b>1</b>	<b>5</b>				
<b>FINDINGS LAST AUDIT: 2</b>							

**INTRODUCTION**

This digest covers the Department’s financial audit as of and for the year ended June 30, 2018. The Department’s next compliance examination will be performed next year for the two years ending June 30, 2019.

**SYNOPSIS**

- **(18-01)** The Department transferred \$73.054 million more in cash from the State Lottery Fund than was available under the priority order for distributing proceeds under the Illinois Lottery Law.
- **(18-02)** The Department has not performed all of the transfers to the Capital Projects Fund required by the Illinois Lottery Law.
- **(18-04)** The Department used an unallowable allocation of overhead costs as opposed to direct costs incurred to specialty scratch-off tickets and had not performed a “true up” of estimated prize liabilities to prizes paid.

**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 Data is summarized on next page.}

**DEPARTMENT OF THE LOTTERY**  
**FINANCIAL AUDIT**  
**For the Year Ended June 30, 2018**

STATEMENT OF NET POSITION (DEFICIT) (amounts in thousands)	June 30, 2018	June 30, 2017
<b>ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b>		
Cash equity in State Treasury.....	\$ 67,863	\$ 80,094
Cash and cash equivalents .....	32,564	37,539
Accounts receivable, net of allowance of \$21,157 and \$19,197, respectively.....	29,357	50,324
Investments (current and noncurrent).....	267,395	287,563
Capital assets being depreciated, net.....	83	37
Other assets.....	369	2
Deferred outflows of resources.....	19,205	21,525
Total assets and deferred outflows of resources.....	<u>416,836</u>	<u>477,084</u>
<b>LIABILITIES AND DEFERRED INFLOWS OF RESOURCES:</b>		
Prizes payable.....	74,002	76,517
Accounts payable and accrued liabilities.....	42,376	12,980
Due to other State funds (current and noncurrent).....	89,877	99,090
Unearned revenue.....	1,803	1,545
Other liabilities (current and noncurrent).....	1,823	2,069
Long-term annuity prizes payable (current and noncurrent).....	253,709	264,749
Net pension liability.....	83,979	82,700
Net OPEB liability.....	58,928	-
Deferred inflows of resources.....	14,227	3,288
Total liabilities and deferred inflows of resources.....	<u>620,724</u>	<u>542,938</u>
<b>Net Position (Deficit).....</b>	<u>\$ (203,888)</u>	<u>\$ (65,854)</u>

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION (amounts in thousands)	Fiscal Year 2018	Fiscal Year 2017
<b>OPERATING REVENUE:</b>		
Charges for sales and services.....	\$ 2,926,375	\$ 2,843,956
Other.....	6,517	6,152
Total Operating Revenues.....	<u>2,932,892</u>	<u>2,850,108</u>
<b>OPERATING EXPENSES:</b>		
Cost of sales and services.....	165,045	160,045
Prizes and claims.....	1,910,896	1,820,110
General and administrative.....	198,230	137,821
Depreciation.....	17	21
Total Operating Expenses.....	<u>2,274,188</u>	<u>2,117,997</u>
Operating Income.....	<u>658,704</u>	<u>732,111</u>
<b>NONOPERATING REVENUES (EXPENSES):</b>		
Investment income (expense).....	(3,088)	(10,183)
Interest income (expense).....	(6,354)	(11,181)
Other.....	11	60
Total Nonoperating Revenues (Expenses), net.....	<u>(9,431)</u>	<u>(21,304)</u>
Changes in Net Position Before Transfers.....	<u>649,273</u>	<u>710,807</u>
Transfers to Common School Fund.....	(718,750)	(705,625)
Transfers to Capital Projects Fund.....	-	(24,336)
Transfers to other State funds.....	(3,775)	(2,705)
Total Transfers.....	<u>(722,525)</u>	<u>(732,666)</u>
Change in Net Position (deficit).....	<u>(73,252)</u>	<u>(21,859)</u>
Restatement - Implementation of GASB Statement No. 75 (OPEB).....	(64,782)	-
Net Position (deficit) at beginning of year.....	(130,636)	(43,995)
Net Position (deficit) at end of year.....	<u>\$ (203,888)</u>	<u>\$ (65,854)</u>

<b>DIRECTOR</b>
During Engagement Period: Greg Smith (Acting) (through 7/13/18), Harold Mays (Acting) (effective 7/14/18)
Currently: Harold Mays (Acting)

**FINDINGS, CONCLUSIONS, AND**  
**RECOMMENDATIONS**

**EXCESS TRANSFERS TO THE COMMON SCHOOL FUND**

The Department of the Lottery (Department) transferred \$73.054 million more in cash from the State Lottery Fund (Fund 711) than was available under the priority order for distributing proceeds under the Illinois Lottery Law (Law).

The Law (20 ILCS 1605/9.1(o)) requires the Department distribute the proceeds of lottery tickets and shares sold in the following priority order and manner:

- 1) to pay prizes and retailer bonuses;
- 2) to pay costs related to administering the Lottery (including all amounts due to the Private Manager);
- 3) to distribute the net revenue from specialty tickets into specific State funds;
- 4) to transfer into the Common School Fund (Fund 412) an amount equal to the proceeds transferred into Fund 412 from Fund 711 in Fiscal Year 2009, adjusted for inflation, on the last day of each month or as soon thereafter as possible; and,
- 5) to annually deposit, on or before September 30, any estimated remaining proceeds from the prior fiscal year into the Capital Projects Fund (Fund 694), with an adjustment in the subsequent annual transfer for any difference between the estimated amount and actual audited amount reported in the Department's annual financial report.

**Priority order for distributing proceeds**

**\$645.696 million in net proceeds available for transfer into the Common School Fund**

**\$718.750 million actual transfer**

During testing, we noted the Department's draft financial statement provided to us in October 2018 reflected \$649.273 million was available after satisfying its obligations to (1) prizewinners and retailers for bonuses and (2) administering the Lottery. From this amount, \$3.577 million was transferred as net revenue from specialty tickets, which left \$645.696 million for transfer into Fund 412. Instead of transferring the \$645.696 million into Fund 412 related to Fiscal Year 2018 proceeds, we noted the Department actually transferred \$718.750 million in cash into Fund 412. As such, Fund 412 was transferred \$73.054 million more in cash from Fund 711 during Fiscal Year 2018 than was available under the priority order for distributing proceeds within the Law. (Finding 1, pages 38-39)

We recommended the Department implement controls to provide assurance it has the resources available on an accrual basis to properly allocate proceeds in accordance with the Law, or seek a legislative remedy. Further, we recommended the Department take action to correct the overpayment of \$73.054 million.

## **Department officials agree**

Department officials stated the Department is researching possible solutions to resolve this issue, will seek an opinion from the Attorney General on interpreting the Law, and will propose an amendment that allows the Department to address this concern.

## **NONCOMPLIANCE WITH THE ILLINOIS LOTTERY LAW**

The Department has not performed all of the transfers to the Capital Projects Fund (Fund 694) required by the Illinois Lottery Law (Law). All of the unperformed transfers relate to periods prior to Fiscal Year 2018.

During our testing of transfers to other funds, we noted the State Lottery Fund (Fund 711) owed \$89.045 million to Fund 694 at June 30, 2018. This balance has accumulated since 2009 because the actual amount of cash transferred by the Department into Fund 694 has been less than required by the Law.

During our discussions with Department officials concerning this balance, they indicated this balance has accumulated due to the following reasons:

- 1) Fund 711 annually transferred more cash into Fund 412 than required on an accrual basis during fiscal years prior to June 30, 2009. In order to account for this excess transfer, the Department's predecessor agency booked a due from Fund 412 (accounts receivable) for the amount of excess cash transferred in Fund 711 of \$69.842 million at June 30, 2009. During the Department's Fiscal Year 2012 financial audit, it was determined this due from did not meet criteria established by the Governmental Accounting Standards Board to be reported and Department management posted an adjustment to reclassify the \$69.842 million as a transfer out to Fund 412. This created a cash deficit of \$69.842 million within Fund 711, as Fund 412 now had the cash that otherwise should have been deposited into Fund 694 in accordance with the Law.
- 2) Prior to Public Act 100-0023, the Department was required to annually transfer cash from Fund 711 into Fund 694 on June 30. Due to difficulties determining the exact amount to transfer and timing issues arising from the conversion of accounts receivable into cash, the Department was not able to timely transfer the remaining \$19.203 million from Fund 711 into Fund 694. (Finding 2, pages 40-41)

**\$89.045 million owned to the Capital Projects Fund**

**\$69.842 million due to excess cash transfers prior to June 30, 2009**

**\$19.203 million due to the timing of the transfer in prior fiscal years**

We recommended the Department work with the General Assembly to address the permanent cash deficit of \$69.842 million within Fund 711 arising from the excess transfers before June 30, 2009 and transfer the other \$19.203 million due to Fund 694 from Fund 711.

**Department officials agree**

Department officials accepted our recommendation.

**INADEQUATE CONTROLS OVER SPECIALTY TICKETS**

The Department used an unallowable allocation of overhead costs as opposed to direct costs incurred to specialty scratch-off tickets and had not performed a “true up” of estimated prize liabilities to prizes paid.

**Improper allocation of overhead costs as opposed to direct costs**

- The Department’s calculation of net proceeds for its specialty scratch-off games incorrectly included certain overhead charges as opposed to actual and identifiable direct administrative costs. The allocated overhead charge has varied over time, beginning at 3% through October 2008, falling to 2.7% from November 2008 through December 2012, increasing to 2.77% from January 2012 through June 2014, and increasing to the current rate of 3.05% in July 2015. In addition, in certain years, actual direct administrative costs exceeded amounts allocated in the calculation of net proceeds. The following chart, which has been adjusted to reflect known and quantifiable direct costs, shows the amount of overhead allocated since inception for each game as of June 30, 2018:

**Allocated costs in excess of known and quantifiable direct costs**

Inception	Fund	Amount
	Veterans' Assistance	
2006	Fund (236)	\$ 1,532,045
2006	Breast Cancer (208)	1,052,755
	HIV/AIDS Prevention	
2008	(437)	724,517
	Multiple Sclerosis	
2009	(429)	703,399
	Special Olympics	
2015	(073)	250,784
	<b>Total</b>	<b>\$ 4,263,500</b>

As actual overhead charges were unable to be identified by the Department, we were unable to quantify the impact of this error.

**Estimated prize liabilities not timely adjusted to known actual prizes paid**

- The Department’s estimate for its prize liabilities associated with its specialty scratch-off games had not been adjusted to reflect actual amounts paid for games ending on or before June 30, 2017, as of June 30, 2018. We were unable to quantify the impact of this error.

**Inaccurate financial reporting to other State agencies**

- The Department did not report accurate “accrual only” information to the Department of Public Health, the Department of Veterans’ Affairs, and the Department of Human Services during the State’s annual financial reporting process as it had not properly calculated “net revenues” or performed a “true up” for its prize liabilities associated with its specialty scratch-off games. (Finding 4, pages 44-46)

We recommended the Department implement controls to calculate “net revenues” in accordance with the Law and correct its prior errors, or seek a legislative remedy. Further, we recommended the Department implement controls to perform a “true up” process in a timely manner for its prior period prize liability estimates to reflect actual prizes paid and communicate with each “administering agency” receiving its “accrual only” information to correct any prior period errors.

**Department officials agree**

Department officials accepted our recommendation.

**OTHER FINDINGS**

The remaining findings pertain to the improper classification of a residual value compensation expense and certain errors within the Department’s annuity prizes payable calculation. 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, 2018, 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**

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FRANK J. MAUTINO  
Auditor General

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