



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

Frank J. Mautino, Auditor General

**SUMMARY REPORT DIGEST**

**DEPARTMENT OF THE LOTTERY**  
**STATE LOTTERY FUND**

**Financial Audit**  
**For the Year Ended June 30, 2019**

**Release Date: March 3, 2020**

FINDINGS THIS AUDIT: 4				AGING SCHEDULE OF REPEATED FINDINGS			
	New	Repeat	Total	Repeated Since	Category 1	Category 2	Category 3
<b>Category 1:</b>	<b>1</b>	<b>2</b>	<b>3</b>	2018	<b>19-02</b>		
<b>Category 2:</b>	<b>0</b>	<b>1</b>	<b>1</b>	2017	<b>19-03</b>	<b>19-04</b>	
<b>Category 3:</b>	<b>0</b>	<b>0</b>	<b>0</b>				
<b>TOTAL</b>	<b>1</b>	<b>3</b>	<b>4</b>				
<b>FINDINGS LAST AUDIT: 5</b>							

**INTRODUCTION**

This digest covers the State Lottery Fund’s financial audit as of and for the year ended June 30, 2019. A separate digest covers the Department’s compliance examination for the two years ended June 30, 2019.

**SYNOPSIS**

- **(19-01)** The Department did not ensure timely compliance by its Private Manager with obtaining a timely System Organization and Control examination of the Central Gaming System by an Independent Service Auditor, a critical piece of audit evidence for both the Department’s and State’s financial statements.
- **(19-02)** The Department has not resolved the prior period excess cash transfers from the State Lottery Fund to the Common School Fund, totaling \$64.124 million.
- **(19-03)** The Department has not performed all the transfers to the Capital Projects Fund from the State Lottery Fund required by the Illinois Lottery Law, totaling \$89.045 million at June 30, 2019.

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

**DEPARTMENT OF THE LOTTERY  
STATE LOTTERY FUND  
FINANCIAL AUDIT  
For The Year Ended June 30, 2019**

<b>STATEMENT OF NET POSITION (DEFICIT) (in thousands)</b>	<b>2019</b>	<b>2018</b>
<b>Assets and Deferred Outflows of Resources</b>		
Cash and cash equivalents.....	\$ 48,929	\$ 100,427
Investments.....	289,140	267,395
Receivables (net).....	57,897	29,358
Capital assets (net).....	56	83
Other.....	309	368
Deferred Outflows of Resources - pensions and OPEB.....	13,930	19,205
Total.....	410,261	416,836
<b>Liabilities and Deferred Inflows of Resources</b>		
Prizes payable.....	50,942	74,002
Accounts payable and accrued liabilities.....	23,571	42,376
Long-term annuity prizes payable.....	264,251	253,709
Unearned revenue.....	1,261	1,803
Due to other State funds.....	109,309	89,877
Net pension liability.....	80,724	83,979
Net OPEB liability.....	48,112	58,928
Other.....	1,445	1,823
Deferred Inflows of Resources - pensions and OPEB.....	23,331	14,227
Total.....	602,946	620,724
<b>Net Position</b>		
Net investment in capital assets.....	19	26
Unrestricted.....	(192,704)	(203,914)
Total.....	\$ (192,685)	\$ (203,888)
<b>REVENUES, EXPENSES, AND CHANGES IN NET POSITION (DEFICIT) (in thousands)</b>		
<b>Operating Revenues</b>		
Charges for sales and services.....	\$ 2,974,539	\$ 2,926,375
Other.....	6,585	6,517
Total.....	2,981,124	2,932,892
<b>Operating Expenses</b>		
Costs of sales and services.....	165,329	165,045
Prizes and claims.....	1,907,153	1,910,896
General and administrative.....	154,343	163,855
Other.....	27	34,392
Total.....	2,226,852	2,274,188
Operating income.....	754,272	658,704
<b>Nonoperating revenues (expenses)</b>		
Investment income (expense).....	22,384	(3,088)
Interest expense.....	(11,181)	(6,354)
Other.....	(107)	11
Total.....	11,096	(9,431)
Transfers to other State Funds.....	(754,165)	(722,525)
Change in net position.....	\$ 11,203	\$ (73,252)
<b>DEPARTMENT DIRECTOR</b>		
During Audit Period: Mr. Greg Smith (Acting) (through 7/13/18)		
Mr. Harold Mays (Acting) (effective 7/14/18)		
Currently: Mr. Harold Mays (Acting)		

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

**FAILURE TO ENSURE TIMELY COMPLIANCE WITH  
THE PRIVATE MANAGER AGREEMENT**

The Department of the Lottery (Department) did not ensure timely compliance by its Private Manager with obtaining a timely System Organization and Control (SOC) examination of the Central Gaming System (CGS) by an Independent Service Auditor, a critical piece of audit evidence for both the Department's and State's financial statements.

**Department transitioned private managers during the year**

During the Department's transition process from the predecessor Private Manager to the current Private Manager from the beginning of Fiscal Year 2019, the Office of the Auditor General (OAG) communicated the need for the Department to ensure it received a SOC 1, Type 2 report from both entities covering the period each entity ran the CGS during Fiscal Year 2019. Department officials acknowledged the importance of these SOC reports to both the Department's and State's financial statements, indicating the predecessor Private Manager was aware of the need for a final SOC report through the date when its CGS transitioned to the new Private Manager. Additionally, Department officials indicated the new Private Manager would be contractually required to obtain a SOC report covering its CGS each fiscal year over the duration of the contract.

**Department officials acknowledged the importance of a timely SOC report to the financial statements**

**Private manager contractually obligated to provide the SOC report no later than September 28, 2019**

Ultimately, § 11.7.2 of the *Private Management Agreement* between the Department and the new Private Manager required delivery of the SOC report to the State covering the portion of Fiscal Year 2019 when it operated the CGS no later than September 28, 2019. When the CGS transitioned to the new Private Manager on February 18, 2019, the new Private Manager assigned the functions to operate and maintain the CGS to a subcontractor.

**Subcontractor announced it was not going to obtain the appropriate SOC report**

During this audit, we communicated the importance of obtaining a timely SOC 1, Type 2 report to Department officials. After we became aware the subcontractor was not going to obtain the appropriate SOC report from an Independent Service Auditor, we jointly worked with Department officials to develop a workable scope for the SOC examination and set a mutually-agreeable deadline to receive the SOC 1, Type 2 report of October 15, 2019, which would still have enabled us to express our opinion on the Department's financial statements to meet the deadline within the State Comptroller Act to compile and publish the State's audited Comprehensive Annual Financial Report (CAFR) no later than December 31, 2019. In a letter to the Private Manager on August 6, 2019, Department officials communicated (1) the need for a SOC 1, Type 2 report with the change in scope to get a workable report and (2) their

**Auditors and Department officials worked together to agree on an acceptable SOC report with a new deadline of October 15, 2019**

expectation the subcontractor should have been aware of this need.

**Auditors grew concerned about missing the new deadline**

As the audit progressed, we became concerned the SOC 1, Type 2 report was not going to be received timely. On October 16, 2019, Department officials informed the OAG they had interacted with the Private Manager and determined the delays were due to the Private Manager's subcontractor contracting with a firm to perform the examination that **did not have sufficient available resources** to timely complete both this SOC 1, Type 2 engagement and the SOC 2, Type 2 engagement (see the separately released compliance report).

**Department officials attributed delays to contracting with a firm that lacked sufficient resources**

**Auditors obtained the terms of the engagement between the Private Manager and the Service Auditor**

In response, we requested the Department provide us the engagement letter and/or terms of the engagement between the Private Manager and the Independent Service Auditor. We noted the engagement letter between the Independent Service Auditor and the Private Manager's subcontractor operating the CGS was not written until October 7, 2019, and not executed in writing by all parties until October 8, 2019. Under this agreement, **the Independent Service Auditor was not going to start performing its sole week of testing until November 18, 2019. Further, the Independent Service Auditor was not going to deliver the final report until January 2, 2020.** Along with this letter, Department officials provided an undated and unsigned "delivery schedule" showing the **testing was to be conducted from October 21 through November 1, 2019, with the final report delivered on November 30, 2019.**

**Deadlines agreed to by the Private Manager's subcontractor did not reflect the State's need for a timely SOC report**

**SOC report ultimately delivered over two months late from the revised deadline**

The Private Manager's subcontractor ultimately delivered the SOC 1, Type 2 report signed by the Independent Service Auditor on December 20, 2019, which significantly delayed our completion of this audit. (Finding 1, pages 46-49)

We recommended the Department take immediate action to ensure the Private Manager and its subcontractor obtain a SOC 1, Type 2 report for the CGS system covering the State's fiscal year no later than 45 days after the close of the State's fiscal year. In addition, we recommended the Department monitor changes to its environment to ensure it receives SOC 1, Type 2 reports for all systems comprising the State's Lottery operated by service providers.

**Department officials agree**

Department officials agreed with our recommendation.

#### **EXCESS TRANSFERS TO THE COMMON SCHOOL FUND**

The Department has not resolved the prior period excess cash transfers from the State Lottery Fund (Fund 711) to the Common School Fund (Fund 412), totaling \$64.124 million.

During testing, we noted the following:

**Current process allows for transfers when profits do not exist to support the transfer amount**

- Due to the overall profitability of the Illinois Lottery during Fiscal Year 2019, the Department was able to fully meet its Fiscal Year 2019 obligations to Fund 412. As such, while the net overpayment to Fund 412 from Fund 711 did not increase this year, the Department's process still calls for, in years where the Illinois Lottery does not have sufficient profitability to fully satisfy its obligations to Fund 412, the Department to perform excess transfers into Fund 412 from Fund 711 based upon the prescribed amount.

**Unresolved excess prior period transfers, totaling \$64.124 million**

- The Department was unable to resolve excess transfers that occurred during prior fiscal years, totaling \$64.124 million. (Finding 2, pages 50-51)

**Department officials identified several problems with the statute**

Department officials indicated the Illinois Lottery Law's current language lacks clarity and specificity on how to address the conflict between the Department's monthly obligation to transfer the statutorily pre-determined amount to Fund 412 with the transfer of actual final sales proceeds that are both not fully realized nor audited until, at least, three months after the end of the fiscal year. Therefore, the Department's current process is to make the monthly transfers based on the availability of cumulative cash proceeds from the ticket sales, as the Illinois Lottery Law does not have a provision for adjusting the deposits and transfers made during the fiscal year after the actual final sales proceeds in a given fiscal year have been realized and audited in accordance with the priority order established by the Illinois Lottery Law. Further, the Department has been unable to recoup the prior period overpayments as the Illinois Lottery Law does not have a mechanism for Fund 412 to reimburse overpayments from Fund 711. Finally, Department officials indicated they have not had ample time to reach a legislative remedy.

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 Illinois Lottery Law or seek a legislative remedy. Further, the Department should take action to correct the overpayment of \$64.124 million.

**Department officials agree**

Department officials agreed with our recommendation.

### **NONCOMPLIANCE WITH THE CAPITAL PROJECTS FUND TRANSFER PROVISIONS WITHIN THE ILLINOIS LOTTERY LAW**

**\$89.045 million due to the Capital Projects Fund at June 30, 2019**

The Department has not performed all the transfers to the Capital Projects Fund (Fund 694) from the State Lottery Fund (Fund 711) required by the Illinois Lottery Law (Law), totaling \$89.045 million at June 30, 2019.

**Balance has accumulated**

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

**Transfers to the Common School Fund exceeded resources available on the accrual basis of accounting**

- 1) Fund 711 annually transferred more cash into the Common School Fund (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.

**Transfers related to periods before Public Act 100-0587 delayed without a clear mechanism to move the cash**

- 2) Prior to Public Act 100-0587, 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 3, pages 52-53)

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 which occurred before June 30, 2009. Further, we recommended the Department transfer the other \$19.203 million due to Fund 694 from Fund 711.

**Department officials agree**

Department officials agreed with our recommendation.

**OTHER FINDING**

The remaining findings pertain to the Department's controls over specialty tickets. 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 State Lottery Fund of the Department as of and for the year ended June 30, 2019, are fairly stated in all material respects.

This financial audit was conducted by Sikich, LLP.

**SIGNED ORIGINAL ON FILE**

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JANE CLARK  
Division Director

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

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FRANK J. MAUTINO  
Auditor General

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