

REPORT DIGEST

DEPARTMENT OF THE LOTTERY

FINANCIAL AND COMPLIANCE AUDIT

For the Year Ended:
June 30, 1996

Summary of Findings:

Total this audit	9
Total last audit	6
Repeated from last audit	2

Release Date:



State of Illinois
Office of the Auditor General

WILLIAM G. HOLLAND
AUDITOR GENERAL

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SYNOPSIS

- ◆ The Department made electronic fund transfers to pay for various operating expenses without statutory authority and without adequate internal control.
- ◆ The Department had inadequate internal controls over collections of revenues from agents after failed electronic fund transfers.
- ◆ The Department had inadequate internal controls over unsold “instant tickets” held by delinquent agents.

{Expenditures and Activity Measures are summarized on the reverse page.}

DEPARTMENT OF THE LOTTERY
COMPLIANCE AUDIT
For The Year Ended June 30, 1996

EXPENDITURE STATISTICS	1996	1995	1994
! Total Expenditures (All Funds).....	\$1,005,550,281	\$1,024,941,711	\$946,748,743
<u>OPERATIONS TOTAL</u>	\$57,626,436	\$59,393,365	\$52,963,132
% of Total Expenditures	5.7%	5.8%	5.6%
Personal Services.....	\$8,277,012	\$7,834,993	\$7,471,636
% of Operations Expenditures.....	14.3%	13.1%	14.1%
Average No. of Employees.....	290	294	292
Other Payroll Costs (FICA, Retirement).....	\$2,349,577	\$2,330,254	\$2,168,987
% of Operations Expenditures.....	4.1%	3.9%	4.1%
Contractual Services.....	\$25,412,288	\$25,367,434	\$22,050,350
% of Operations Expenditures.....	44.1%	42.7%	41.6%
Game Promotion.....	\$10,028,740	\$12,363,618	\$9,125,893
% of Operations Expenditures.....	17.4%	20.8%	17.2%
Electronic Data Processing.....	\$2,458,276	\$2,081,328	\$2,034,544
% of Operations Expenditures.....	4.3%	3.5%	3.8%
Telecommunications.....	\$7,762,406	\$8,111,698	\$8,705,140
% of Operations Expenditures.....	13.5%	13.7%	16.5%
All Other Operations Items.....	\$1,338,137	\$1,304,040	\$1,406,582
% of Operations Expenditures.....	2.3%	2.3%	2.7%
<u>COMMISSIONS AND FEES</u>	\$108,955,999	\$106,529,874	\$99,069,583
% of Total Expenditures	10.9%	10.4%	10.5%
<u>PRIZES</u>	\$838,967,846	\$859,018,472	\$794,716,028
% of Total Expenditures	83.4%	83.8%	83.9%
! Cost of Property and Equipment.....	\$4,923,876	\$4,756,687	\$4,331,184

SELECTED ACTIVITY MEASURES	YEAR ENDED JUNE 30,		
	1996	1995	1994
! Ticket Sales.....	\$1,582,769,640	\$1,574,384,917	\$1,472,626,392
! Operating Transfers To Common School Fund.....	\$602,870,334	\$584,907,500	\$557,068,720
AGENCY DIRECTOR(S)			
During Audit Period: Desiree Glapion Rogers, Director			
Currently: Lori Montana, Director			

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

LACK OF APPROPRIATION AND VOUCHERING CONTROLS

Payments made without statutory authority

The Department made electronic funds transfers to pay various operating expenses without statutory authority. The operating expenses consisted of contractual payments to the Department's ticket distribution contractor, to its on-line computer service contractor, and also fixed monthly rental payments to the lessor of its instant ticket vending machines. In the current audit period, a total of \$26,775,453 was paid to these three contractors. These payments were not subject to appropriation control nor made through the voucherizing process.

Department personnel believed the Illinois Lottery Law at 20 ILCS 1605/20 authorized these payments. This paragraph provides for the creation in the State Treasury of a State Lottery Fund and states in part: "Such fund shall consist of all revenues received from the sale of lottery tickets or shares, net of commissions, fees and prizes of less than \$600 *which have been validly paid at the agent level...* (emphasis added)."

The Department is in compliance with the law in allowing agents to retain from lottery sales revenue any amounts due to the agents for commissions and lottery prizes under \$600 paid directly by the agents. However, the questioned payments totaling \$26,775,453 were paid to Department contractors not to lottery agents.

Absent specific statutory authority to the contrary, the Department should comply with the provisions of the law requiring the deposit of State funds in the State Treasury and expenditure of those funds through the appropriation process.

Department officials strongly disagreed with this finding and have requested an opinion from the Attorney General. Their complete response is included in the Audit Report. As previously pointed out, the Department believed the authority for these transfers (payments) is found at 20 ILCS 1605/20. Furthermore, they said, "the General Assembly recognized when drafting the Lottery Act that a

Attorney General's Opinion requested

lottery is unlike any other governmental operation, and drafted the Act in such a way as to provide for a business-like operation which competes in the commercial marketplace." (Finding 1, pages 10-13)

Auditors Comment

We continue to stand by this finding and repeat our recommendation. We believe that *clear, express* authority from the General Assembly is required before an agency may depart from certain key principles of public accountability: 1) that all moneys received by or on behalf of the State should be deposited into the State Treasury or other authorized account without deduction of any kind; and 2) that expenditures of State moneys should be made from funds which have been reviewed and appropriated by the legislature. The Department's authority to pay out \$26.8 million *off the top* from lottery proceeds is neither clear nor express. Further, under the Department's reading of the applicable statutes, there is apparently no limit to the amount or type of operational expenses which the Department, in its own discretion, could choose to pay from undeposited and unappropriated lottery proceeds.

In paying its vendors from undeposited and unappropriated lottery proceeds, the Department uses an electronic funds transfer process. In both last year's and this year's audits, we noted deficiencies in the Department's internal controls over electronic funds transfers (see Finding 2, page 14).

At last year's Legislative Audit Commission, members suggested that efforts be made to clarify State law on this matter. As noted in this year's finding, the Department drafted language to change Section 1605/20 of the Illinois Lottery Law, but that amendment did not get introduced. While the Department promoted that amendment as a *clarification* of its authority, the auditors' reading of that proposed amendment was that it would greatly *increase* the Department's license to pay operational expenses without legislative oversight and greatly *decrease* legislative control.

We look forward to working with the Department and the Attorney General to resolve this significant matter of public accountability.

INADEQUATE CONTROL OVER ELECTRONIC FUNDS TRANSFERS

The Department did not have adequate internal control over electronic funds transfers. As discussed in the previous finding the Department makes electronic funds transfers to pay for various operating expenses. During the current audit period, a total of \$26,775,453 was paid to three contractors. The transfers are made to accounts which are designated by the contractors. Notifications of accounts to be used are accepted by telephone and are authorized by a form prepared and signed by the deputy director, finance division. While the cash control section normally makes the transfers, the supervisor of the financial accounting section is authorized to make the transfers and does sometimes make them.

Without a separation of duties, funds could be diverted and records altered to prevent detection

Good internal control includes a separation of duties among personnel having access to cash and those responsible for the accounting records. Without the separation of these duties, a person having access to the electronic transfer procedures and documents to authorize accounts to which funds may be transferred could divert State funds and possibly also alter accounting records to prevent detection on a timely basis.

The Department concurred with our finding and said transfer duties have been changed, and authorization for approving accounts has been delegated to the Deputy Director of Operations. (Finding 2, page 14)

INADEQUATE CONTROL OVER NSF TRANSACTIONS

The Department's internal control was inadequate over transactions regarding collections of revenue from agents after failed electronic fund transfers.

Current Department procedures provide that after two failed attempts to electronically transfer revenue from agent bank accounts or after a returned agency check for non-sufficient funds (NSF), an agent is placed on a guaranteed remittance basis which requires payment by a guaranteed check. These payments are required to be made to the District offices. Department procedures require that all cash

Accounting records were apparently fraudulently altered and \$26,764 in cash diverted to an employee's account

collections at the Springfield office be made by the cash control unit of the office. However, during the current fiscal year an employee of the fiscal office obtained custody of a collection of \$26,764. Accounting records of the Department were apparently fraudulently altered, and the cash collection was not deposited to the account of the Department.

Adequate internal control requires a separation of duties so that the same persons responsible for the accounting and reporting functions do not have access to the cash collections of the Department.

The Department has engaged a firm of certified public accountants who are certified fraud auditors to perform procedures to determine the extent of the apparent fraudulent activity and to prepare recommendations regarding the Department's system of internal control. The firm has reported to the Agency that no other similar instances have been found.

\$18,000 of State funds were diverted to the same employee by obtaining close-out disbursements from Lottery bank accounts

The firm did report, however, that approximately \$18,000 of Department funds were obtained by the same employee in 1994 and other prior years by obtaining the close-out disbursements of bank accounts which had been used under previous revenue collection methods of the Department. Because that system is no longer in use and because all such bank accounts have been closed, we make no recommendations regarding this matter.

The Department believes that complete restitution of the amounts will be received. (Finding No. 3, page 15)

The Department agreed to modify its current methods to insure that a separation of duties of employees will result in no access to cash by any persons whose duties include access to the financial accounting and reporting functions of the Department.

INADEQUATE CONTROL OVER UNSOLD INSTANT TICKETS OF DELINQUENT AGENTS

The procedures for collection of unsold tickets held by agents who are delinquent in remitting money from instant and on-line ticket sales are not adequate.

Delinquent agents continued to sell instant tickets after the agent's on-line terminals were shut off

The Department has procedures to suppress the on-line terminals of agents for whom the weekly sweep of bank accounts results in rejected transfers due to non-sufficient funds (NSF). Those procedures provide for notification and collection actions which generally will result in suppressing the agent's on-line terminals so that no more than two weeks of sales are uncollected. However, our review of agent statements of account revealed two instances in which the agents continued to sell instant tickets during parts of two additional weeks. The sales amounted to \$1,765 and \$1,145 and resulted in additional uncollected amounts.

Instant tickets are not picked up from delinquent agents at the same time that terminals are suppressed because in most cases the agents then make up the delinquent payments and the terminals are reactivated. Also, many of the agents have sales of relatively small amounts which would not economically justify earlier pickup of instant tickets.

Bad debt expense of the Department for the five years ended June 30, 1996, averaged \$563,367. In order to minimize losses from uncollectible agent accounts, the procedures of the Department should be formulated in such a way as to minimize the bad debts in circumstances where additional procedures are economically practical. (Finding 6, page 18)

The Lottery agreed to modify its agreements with agents to require the agents to discontinue sales of instant tickets at the time their on-line terminals are suppressed and agreed to notify agents that they are to discontinue sales of instant tickets.

The Lottery also noted that changes in policies regarding the licensing of agents with questionable credit records have resulted in a material reduction in the number of insolvent agents and that this will be reflected in the amounts written off in future years.

OTHER FINDINGS

The remaining findings have been accepted by the

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

Ms. Desiree Glapion Rogers, former Director of the Department of the Lottery and Ms. Lori Montana, the new Director, provided the responses.

AUDITORS' OPINION

The auditors report that the financial statements of the Department of the Lottery at June 30, 1996 are fairly stated.

WILLIAM G. HOLLAND, Auditor General

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SPECIAL ASSISTANT AUDITORS

Sleeper, Disbrow, Morrison, Tarro & Lively were our special assistant auditors for this audit.

