

# CALIFORNIA LOTTERY

Audit Report

## **SAM 20000 AUDIT: FIXED ASSETS CYCLE**

*January 1, 2006, through December 31, 2007*



**JOHN CHIANG**  
California State Controller

November 2007



**JOHN CHIANG**  
**California State Controller**

November 9, 2007

Joan M. Borucki, Director  
California Lottery  
600 North Tenth Street  
Sacramento, CA 95814

Dear Ms. Borucki:

The State Controller's Office audited the Fixed Assets Cycle as part of our process of studying and evaluating the accounting and administrative controls of the California Lottery for the biennial period ending December 31, 2007. The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Fixed Assets Cycle.

Our audit did not disclose any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Fixed Assets Cycle. However, our audit disclosed the following issues:

- The Lottery has recently improved controls to ensure that asset acquisitions are properly accounted for, yet some assets acquired in prior periods remain unaccounted for; and
- The Lottery has no process in place to periodically reconcile asset acquisitions and dispositions to the Computerized Asset Tracking (CAT) system.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

*Original signed by*

**JEFFREY V. BROWNFIELD**  
Chief, Division of Audits

JVB/sk

Attachment

cc: John Mass, Chairman  
California Lottery Commission  
Rachel Montes, Commissioner  
California Lottery Commission  
Manuel Ortega, Commissioner  
California Lottery Commission  
Patt Eberhart, Director  
Finance and Administration  
California Lottery

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## **Audit Report**

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# Audit Report

## Summary

The State Controller's Office (SCO) is in the process of studying and evaluating the internal accounting and administrative controls of the California State Lottery (Lottery) in accordance with State Administrative Manual section 20060 (Internal Control Reporting) for the biennial period ending December 31, 2007. The SCO has concluded the audit for the Fixed Assets Cycle. The last day of fieldwork was February 7, 2007.

The purpose of our audit was to determine and identify any accounting and administrative control strengths and weaknesses over the Fixed Assets Cycle.

Our audit did not disclose any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Fixed Assets Cycle. However, our audit disclosed the following issues:

- The Lottery has recently improved controls to ensure that asset acquisitions are properly accounted for, yet some assets acquired in prior periods remain unaccounted for; and
- The Lottery has no process in place to periodically reconcile asset acquisitions and dispositions to the Computerized Asset Tracking (CAT) system.

## Background

Proposition 37, the California State Lottery Act of 1984 (Lottery Act), amended the California Constitution to authorize the establishment of a statewide lottery, to create the California Lottery Commission, and to give the commission broad powers to oversee the operation of a statewide lottery.

The Lottery Act created a special fund, known as the State Lottery Fund, within the State Treasury. The State Lottery Fund operates as an enterprise fund and is required to be entirely self-funded from Lottery sales. The Lottery Act further stipulates that 50% of lottery sales proceeds are to be allocated to prizes, and that no more than 16% are to be used for administrative costs. The remaining proceeds from lottery sales, a minimum of 34%, are to be directed to the benefit of public education.

Fixed assets are defined in governmental operations as property, plant, and equipment. A fixed asset is capitalized (recorded in the accounting records) as property to maintain accountability for the acquisition, maintenance, control, and disposition of the asset. SAM section 8602 (Capitalized Property) states that property will be capitalized if it has a normal useful life of at least one year; has a unit acquisition cost of at least \$5,000; and will be used to conduct state business.

## Authority

State Administrative Manual section 20060 (Internal Control Reporting) states:

Pursuant to the FISMA [*Financial Integrity and State Manager's Accountability Act of 1983*], the head of each state entity shall prepare and submit a report on the adequacy of their entity's internal control on December 31 of each odd numbered fiscal year. . . . The report shall consist of a certification letter, the most recent audit report on internal accounting and administrative controls, and management's response to the audit report.

The Lottery delegated the duty of performing the biennial audit of internal controls to the SCO in a letter dated September 6, 2002.

## Objectives, Scope, and Methodology

We studied and evaluated the accounting and administrative controls of the Lottery's Fixed Assets Cycle in effect as of February 7, 2007. We conducted our study and evaluation in accordance with the *Standards for the Professional Practice of Internal Auditing*, issued by the Institute of Internal Auditors, and included testing that we considered necessary to determine whether accounting and administrative controls are in place and operative.

Lottery management is responsible for establishing and maintaining adequate internal controls. This responsibility, in accordance with Government Code sections 13402 et seq., includes documenting internal control, communicating requirements to employees, and ensuring that internal control is functioning as prescribed. To fulfill its responsibility, Lottery management must assess the expected benefits and related costs of control procedures.

The objectives of accounting and administrative controls are to provide management with reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition;
- Transactions are executed in accordance with management's authorization and recorded properly, so as to permit the preparation of reliable financial statements; and
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual (SAM).

The specific objectives were to determine whether:

- Established policies and procedures exist for acquiring, disposing, and recording fixed assets;
- Adequate separation of duties exist over the Fixed Assets Cycle;
- Acquisitions and dispositions are properly authorized and recorded in the accounting records;

- Recorded fixed assets are in existence and can readily be identified; and
- Subsidiary records are posted accurately and on time, and are periodically reconciled to the control accounts.

The audit procedures performed included:

- Analyzing and evaluating the internal controls for the Fixed Assets Cycle by identifying strengths and weaknesses that impact the accounting system;
- Performing tests to determine if control objectives are being properly achieved; and
- Documenting internal controls over the Fixed Assets Cycle encompassing the Lottery's policies and procedures.

## **Conclusion**

Our study and evaluation did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls over the Fixed Assets Cycle. However, our audit disclosed that the Lottery has recently improved controls to ensure that asset acquisitions are properly accounted for, yet some assets acquired in prior periods remain unaccounted for. Also, the Lottery has no process in place to periodically reconcile asset acquisitions and dispositions to the Computerized Asset Tracking (CAT) system. The Findings and Recommendations section of this report provides a detailed explanation of the audit findings.

In our opinion, the Lottery's accounting and administrative controls over the Fixed Assets Cycle in effect as of February 7, 2007, taken as a whole, were sufficient to meet the objectives stated above.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all of these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

## **Views of Responsible Officials**

We issued a draft report dated August 22, 2007. Joan M. Borucki, Director, responded by letter agreeing with the results of the audit. The letter, dated September 19, 2007, is included in this report as an Attachment.

**Restricted Use**

This report is intended for the information and use of the California Lottery, the California Lottery Commission, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits

# Findings and Recommendations

## **FINDING 1— Asset records are incomplete and inaccurate**

The Lottery has been improving its accounting for fixed assets by implementing new procedures and strengthening controls. Our testing of recently acquired assets indicates that these procedures are working properly and that recently acquired assets are properly accounted for. However, despite these improvements, the Lottery still needs to locate and correct errors originating before the improvements were implemented.

A sample of 62 assets located at the Lottery Headquarters was selected for testing. The results of testing were as follows:

- Four (6.5%) of the 62 assets were not tagged;
- Another four (6.5%) assets were tagged but could not be located in the CAT system; and
- An additional asset was located in the CAT system, but was improperly listed as disposed.

The net result is 9 of the 62 (14.5%) assets were not properly accounted for.

Most of the nine unrecorded assets were either acquired in prior years before the implementation of the improved fixed asset procedures or were acquired with a credit card. Since most of the assets were acquired in prior years, it can be inferred that the prior physical inventory count failed to identify these assets. Also, the Lottery does not review credit card documentation to ensure that all assets purchased on credit cards are properly accounted for.

SAM section 8650 (Accounting and Control of Property) states:

Departments will record the following information when property is acquired: Date acquired, property description, property identification number. . . . Departments will keep track of state property, whether capitalized or not, in an automated property accounting system. . . .

Without a complete fixed asset database, the Lottery may have trouble locating assets for utilization/reutilization purposes. It may also be difficult for the Lottery to detect and investigate missing assets if the assets are not tagged or are not accounted for.

### Recommendation

The Lottery should take greater care in performing the physical inventory. In particular, the Lottery should perform another inventory count in the audio-visual room downstairs because four of the nine unaccounted assets were located in the audio-visual room. Also, the Lottery should conduct a periodic search for assets purchased with credit cards by reviewing the supporting documentation for credit card purchases kept by AOTB.

### Lottery's Response

The Lottery agrees with this finding.

**FINDING 2—  
Asset acquisitions and  
dispositions are not  
reconciled to the Asset  
Tracking System**

The Lottery lacks procedures for periodically reconciling asset acquisitions and dispositions to the CAT system. Such procedures would enable Lottery management to ensure that all asset acquisitions have been entered into the CAT system. Also, the CAT system cannot produce a standardized report that details assets that have been removed from the CAT system. In the absence of such a report, Lottery management cannot monitor the removal of records from the CAT system to determine if the removals were properly authorized and accurately recorded.

SAM section 8650 (Accounting and Control of Property) states:

Departments will record the following information when property is acquired: Date acquired, property description, property identification number. . . . Departments will keep track of state property, whether capitalized or not, in an automated property accounting system. . . .

Recommendation

The Lottery should create a general ledger report that details all acquisitions containing assets that have been designated as “required to be tagged.” The report should be used to periodically reconcile asset acquisitions to the CAT system. Also, the Lottery should either disable a user’s ability to delete records from the CAT system or create a report that can identify all assets removed from the CAT system to reconcile the removed assets to the approved asset dispositions of the Property Survey Reports.

Lottery’s Response

The Lottery agrees with this finding.

**Attachment—  
California Lottery’s  
Response to Draft Report**

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**California State Lottery**

*Headquarters*

*600 North Tenth Street*

*Sacramento, CA 95814*

September 19, 2007

Mr. Andy Finlayson, Chief  
Operations Audit Bureau  
State Controller's Office  
P.O. Box 942850  
Sacramento, CA 94250-5874

Dear Mr. Finlayson:

Attached is the California State Lottery's (Lottery) response to the State Controller's Office (SCO) draft audit of the Lottery's SAM 20000 Fixed Assets audit, dated August 22, 2007.

Our response to your findings and recommendations follows:

**1. SCO Finding – The Lottery has been improving its accounting for fixed assets by implementing new procedures and strengthening controls. Our testing of recently acquired assets indicates that these procedures are working properly and that recently acquired assets are properly accounted for. However, despite these improvements the Lottery still needs to locate and correct errors originating before the improvements were implemented.**

**SCO Recommendation – The Lottery should take greater care in performing the physical inventory. In particular, the Lottery should perform another inventory count in the audio-visual room downstairs because four of the nine unaccounted assets were located in the audio-visual room. Also, the Lottery should conduct a periodic search for assets purchased with credit cards by reviewing the supporting documentation for credit card purchases kept by the Accounting Operations & Tax Bureau.**

**Lottery Response to SCO Finding:**

1. The Lottery will perform an audit of the audio-visual room and reconcile the inventory against fixed asset lists. This audit will be performed by October 31, 2007.
2. The Lottery will conduct a periodic search to identify assets bought with credit cards and reconcile the items against the records kept by the Finance unit. This project will be performed by November 30, 2007.

Mr. Andy Finlayson, Chief  
September 19, 2007  
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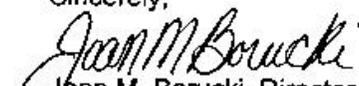
**2. SCO Finding** – The Lottery lacks procedures for periodically reconciling asset acquisitions and dispositions to the Computerized Asset Tracking System (CAT). Such procedures would enable Lottery management to ensure that all asset acquisitions have been entered into the CAT. Also, the CAT cannot produce a standardized report that details assets that have been removed from CAT. In the absence of such a report, Lottery management cannot monitor the removal of records from CAT to determine if the removals were properly authorized and accurately recorded.

**SCO Recommendation** – The Lottery should create a general ledger report that details all acquisitions containing assets that have been designated as “required to be tagged”. The report should be used to periodically reconcile asset acquisitions to CAT. Also, the Lottery should either disable a users ability to delete records from CAT or create a report that can identify all assets removed from CAT to reconcile the removed assets to the approved asset dispositions of the Property Survey Reports.

Lottery Response to SCO Finding:

The Lottery agrees with the recommendation that the acquisitions recorded in the general ledger as assets be reconciled to the CAT system. The Financial Reporting Bureau can provide an Asset Account Activity-detailed Report to Facilities on a periodic basis (i.e. monthly, quarterly, annually), or as needed so that the additions from the Epicor system can be reconciled to the CAT system.

Sincerely,

  
Joan M. Borucki, Director  
California State Lottery

**State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, CA 94250-5874**

**<http://www.sco.ca.gov>**