

DEPARTMENT OF THE LOTTERY

**SELECTED ADMINISTRATIVE ACTIVITIES AND
PRIOR AUDIT FOLLOW-UP**

Operational Audit



SECRETARY OF THE DEPARTMENT OF THE LOTTERY

The State of Florida, Department of the Lottery (Lottery) was established as a State agency in 1987 with the enactment of the Florida Public Education Lottery Act, Chapter 24, Florida Statutes. Pursuant to Section 20.317, Florida Statutes, the head of the Lottery is the Secretary, who is appointed by the Governor subject to the confirmation of the Senate. Cynthia F. O'Connell served as Secretary during the period of our audit.

The audit team leader was Jon M. Bardin, CPA, and the audit was supervised by Allen G. Weiner, CPA. Please address inquiries regarding this report to Kathryn D. Walker, CPA, Audit Manager, by e-mail at kathrynwalker@aud.state.fl.us or by telephone at (850) 412-2781.

This report and other reports prepared by the Auditor General can be obtained on our Web site at www.myflorida.com/audgen; by telephone at (850) 412-2722; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

DEPARTMENT OF THE LOTTERY

Selected Administrative Activities and Prior Audit Follow-Up

SUMMARY

This operational audit of the Department of the Lottery (Department) focused on selected administrative activities and included a follow-up on the findings noted in our report No. 2012-007. Our audit disclosed the following:

Finding No. 1: Department tangible personal property records did not include for all property items the information required by Department of Financial Services rules. Additionally, the information in Department tangible personal property records was not always accurate.

Finding No. 2: Although Department procedures specified that sensitive or attractive items (i.e., electronic equipment, handguns, and technology equipment) were to be included in Department property records, the procedures did not specify the types of electronic and technology equipment considered to be sensitive or attractive. This may have contributed to sensitive and attractive items not always being identified and included in Department property records.

Finding No. 3: The Department should continue efforts to implement the Business Lottery Accounting System (BLAST) so that all applicable cost data can be tracked for each game and summarized for use in post-game analyses and planning future games.

BACKGROUND

State law¹ authorizes the Department of the Lottery (Department) to operate lottery games so as to maximize revenues in a manner consonant with the dignity of the State and the welfare of its citizens. The net proceeds of lottery games are to benefit public education. Specifically, revenues from the sale of lottery tickets, less prizes paid to winning ticket holders, retailer commissions and fees, gaming vendor fees, and administrative costs, are to be transferred to the Educational Enhancement Trust Fund (EETF) managed by the Department of Education.² The amount transferred to the EETF is calculated net of all Department administrative and game expenses. For the 2012-13 fiscal year, the Department was authorized 423 positions, received appropriations totaling approximately \$149 million, and transferred over \$1.4 billion to the EETF.

FINDINGS AND RECOMMENDATIONS

Finding No. 1: Tangible Personal Property Controls

Effective controls for the management of tangible personal property³ require that property items be adequately controlled, safeguarded, and accounted for by Department management. Department of Financial Services (DFS) rules⁴ provide guidelines for identifying and recording the tangible personal property items acquired by State agencies. Those rules⁵ require that all tangible personal property with a value or cost of \$1,000 or more and a projected useful life of one year or more be recorded in the Florida Accounting Information Resource Subsystem (FLAIR) Property

¹ Article X, Section 15 of the State Constitution, and Sections 24.102 and 24.104, Florida Statutes.

² Section 24.121, Florida Statutes.

³ Property is defined in applicable laws and rules as State-owned equipment, fixtures, and other tangible personal property of a nonconsumable or nonexpendable nature, the value or cost of which is \$1,000 or more and the projected useful life of which is one year or more.

⁴ DFS Rules, Chapter 69I-72, Florida Administrative Code.

⁵ DFS Rule 69I-72.002, Florida Administrative Code.

Subsystem. The acquisition cost recorded for each tangible personal property item is to include the invoice price plus all the costs necessary to get the property in place and ready for use, less any discounts. For example, any applicable taxes or surcharges, transportation or delivery fees, and installment costs are to be added to the invoice price of the related tangible personal property item when the item is recorded in the FLAIR Property Subsystem. In determining the acquisition cost, DFS rules also require that the value of any property exchanged in satisfaction of a portion of the purchase price for a new property item not be deducted from the full purchase price regardless of any property “traded in” on the new property item.

The FLAIR Property Subsystem facilitates the creation and maintenance of a property file that contains detailed information for each property item. To promote the proper accountability for and safeguarding of tangible personal property, DFS rules⁶ require State agencies to complete a physical inventory of all tangible personal property at least once each fiscal year and specify that, for each item, agency property records include, among other things, the inventory date, the acquisition cost, a description of the item, the assigned property number, and the manufacturer’s serial number, if any. If the item is a motor vehicle, the vehicle identification number (VIN)⁷ and title certificate number, if applicable, is required.

According to Department property records as of July 31, 2013, the Department had 722 items of tangible personal property with acquisition costs totaling approximately \$12.7 million. As part of our audit, we reviewed the Department’s property records as of July 31, 2013, and documentation for 75 selected expenses incurred during the period July 2011 through June 2013 that had either been coded in Department accounting records as purchases of tangible personal property or appeared to potentially relate to the acquisition of property items. Our audit procedures disclosed that Department property records did not contain all the information necessary to ensure the accurate reporting and safeguarding of Department property and to demonstrate compliance with DFS rules. Specifically, we noted that:

- Department property records included 676 active tangible property items with acquisition dates prior to June 30, 2012; however, the records for 553 of the 676 items did not include an inventory date and the records for another 114 items reflected inventory dates in 2001 or 2002. The recorded acquisition costs for the 667 items with blank or noncurrent inventory dates totaled approximately \$11.9 million. Although the Department was able to provide documentation of annual physical inventories conducted subsequent to 2002, absent property records that accurately indicate the date each property item was last inventoried, Department management has reduced assurance that all property items were located during an annual inventory and that the inventory was conducted in accordance with DFS rules.
- Department property records for 178 motor vehicles, with recorded acquisition costs totaling \$2,859,542, did not include the VIN as required by DFS rules. Without the VIN, the Department’s property records may not contain sufficient detail to appropriately identify and account for Department motor vehicles.
- Department property records listed the status of 204 tangible personal property items, with acquisition costs totaling \$919,110, as lost or stolen. In response to our audit inquiries, Department personnel indicated that most of the items were incorrectly classified as lost or stolen in the property records and had been surplus and disposed of by the Department. We reviewed Department documentation for 4 of these items to determine whether the documentation demonstrated the proper surplus and disposal of the items. We found that the documentation supported the surplus and disposal of 3 of the 4 items; however, documentation for the other item (a computer) showed that the item had been reported as missing during the 2007-08 fiscal year inventory. Improper classification of the status of items in the property records inhibits the Department’s ability to demonstrate that property items were appropriately controlled and, as applicable, disposed of in accordance with DFS rules.

⁶ DFS Rules 69I-72.003 and 69I-72.006, Florida Administrative Code.

⁷ The VIN is a unique 17-digit number that provides various information about a motor vehicle, including the manufacturer, make, type, model year, and manufacturing plant.

- The acquisition costs included in Department property records for 21 items were incorrect. For example, the costs recorded for a security system did not include all equipment costs and installation costs totaling \$156,689.
- The Department purchased a camera filter wheel upgrade for \$1,205 in October 2012. However, the camera filter wheel upgrade was not recorded as a separate property item, nor was it added to the value of any camera in the property records.

In response to our audit inquiries, Department staff indicated that they were not always aware of the FLAIR Property Subsystem capabilities and that a lack of communication between the property staff and accounting staff contributed to the issues we identified. Absent effective tangible personal property controls, Department management has reduced assurances regarding the accuracy of the information needed to accurately report and maintain proper accountability over Department property, as well as to demonstrate compliance with applicable DFS rules.

Recommendation: We recommend that Department management enhance tangible personal property controls to ensure that Department property records are accurately maintained in accordance with DFS rules. Among other things, the enhanced controls should promote Department staff knowledge of the FLAIR Property Subsystem and effective communication between Department staff responsible for the property and accounting functions.

Finding No. 2: Sensitive and Attractive Property Items

Department procedures⁸ specified that, in addition to tangible personal property items, all sensitive or attractive property items costing less than \$1,000 were to be recorded in Department property records and annually inventoried. To distinguish sensitive or attractive property items from Department tangible personal property items, the records for sensitive or attractive property items were to reflect an acquisition cost of \$0.01 each. Department procedures defined sensitive or attractive property items as electronic equipment, handguns, and technology equipment. However, Department procedures did not specify the types of electronic and technology equipment that were to be considered sensitive or attractive. As of July 31, 2013, Department property records contained 787 sensitive or attractive items, including desktop and laptop computers, printers, projectors, digital cameras, and handguns.

As part of our audit, we identified various expenses incurred during the period July 1, 2011, through June 30, 2013, that could potentially relate to the purchase of sensitive or attractive items, and selected and examined documentation for 39 of these expenses. Our examination identified 20 items (10 two-way portable radios, 2 scanners, 2 projectors, 2 DVD players, a television, a computer monitor, an iPad Mini, and a conference telephone) that, pursuant to Department procedures, could be considered sensitive or attractive but were not included in Department property records.

We also reviewed Department property records as of July 31, 2013, and noted that the records for 706 sensitive or attractive items acquired prior to June 30, 2012, did not include an inventory date. In addition, the property records for another 213 sensitive or attractive items (196 computers, 13 printers, 2 portable GPS navigators, 1 camera, and 1 projector) indicated a status of lost or stolen. As discussed in finding No. 1, Department personnel indicated that most of the items recorded as lost or stolen had actually been surplus and disposed of by the Department.

By nature of their portability, adaptability for personal use, or data storage capabilities, sensitive and attractive items, such as computer and electronic equipment, are more susceptible to loss and theft. Therefore, controls designed to

⁸ Department Procedure No. 430.010, *Property Management*.

ensure proper accountability for and adequate safeguarding of these items, and any sensitive or confidential Department data they may contain, are especially important.

Recommendation: We recommend that Department management enhance procedures to clarify the definition of sensitive or attractive property items. We also recommend that Department management take appropriate actions to ensure that all sensitive and attractive items are included in Department property records and that the records contain the information necessary to provide proper accountability for the items.

Finding No. 3: Business Lottery Accounting System (BLAST)

The Department sells terminal game and scratch-off game tickets to generate revenue for the EETF. Scratch-off games are considered instant games because customers can immediately determine if they are a winner by scratching off the latex covering of the ticket. Terminal games are generally games in which winning numbers are selected or drawn at a designated time.

The Department introduced 89 new scratch-off games and one new terminal game during the period July 1, 2011, through June 30, 2013. The Department typically makes available approximately 40 scratch-off games and 7 terminal games at any one time. For each game, Department procedures require that the sales of tickets and number of prizes claimed be monitored on a regular basis. Within the Department, various groups and systems accumulate the specific costs associated with each game, which include research, license, advertising, and promotional item costs.

In our report No. 2012-007, finding No. 4, we noted that the costs associated with the Department's various games were not identified, allocated, and recorded in Department accounting records in a manner which would allow for a summarization of the costs applicable to each game. We recommended that the Department consider tracking in one system all applicable costs related to each game, and that the cost information be used in post-game analyses.

In their August 30, 2011, response to the finding, Department management indicated that the implementation of a new financial accounting system, the Business Lottery Accounting System (BLAST), had been initiated that, when implemented, would strengthen the Department's game and cost analysis capabilities. The Department later reported, on March 28, 2012, that the first phase of BLAST was in parallel processing and that BLAST was expected to go live on July 1, 2012. However, in response to our follow-up audit inquiries, Department management indicated that, as of February 2014, BLAST was still in the application development stage and that high staff turnover rates and increased workloads had contributed to the implementation delay. As of June 30, 2013, the Department had incurred external consulting services costs totaling approximately \$1.5 million related to the development of BLAST.

A fully implemented system that captures all the costs associated with each game would facilitate the Department's performance of post-game analyses and would also assist the Department in planning future games.

Recommendation: We recommend that Department management continue efforts to implement BLAST so that all applicable cost data can be tracked for each game and summarized for use in post-game analyses and planning future games.

PRIOR AUDIT FOLLOW-UP

Except as discussed in the preceding paragraphs, the Department had taken corrective actions for the findings included in our report No. 2012-007.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Auditor General conducts operational audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

We conducted this operational audit from August 2013 through April 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This operational audit focused on selected administrative activities. The overall objectives of the audit were:

- To evaluate management's performance in establishing and maintaining internal controls, including controls designed to prevent and detect fraud, waste, and abuse, and in administering assigned responsibilities in accordance with applicable laws, administrative rules, contracts, grant agreements, and guidelines.
- To examine internal controls designed and placed in operation to promote and encourage the achievement of management's control objectives in the categories of compliance, economic and efficient operations, the reliability of records and reports, and the safeguarding of assets, and identify weaknesses in those internal controls.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

Our audit also included steps to determine whether management had corrected, or was in the process of correcting, all deficiencies noted in our report No. 2012-007.

This audit was designed to identify, for those programs, activities, or functions included within the scope of the audit, deficiencies in management's internal controls, instances of noncompliance with applicable governing laws, rules, or contracts, and instances of inefficient or ineffective operational policies, procedures, or practices. The focus of this audit was to identify problems so that they may be corrected in such a way as to improve government accountability and efficiency and the stewardship of management. Professional judgment has been used in determining significance and audit risk and in selecting the particular transactions, legal compliance matters, records, and controls considered.

As described in more detail below, for those programs, activities, and functions included within the scope of our audit, our audit work included, but was not limited to, communicating to management and those charged with governance the scope, objectives, timing, overall methodology, and reporting of our audit; obtaining an understanding of the program, activity, or function; exercising professional judgment in considering significance and audit risk in the design and execution of the research, interviews, tests, analyses, and other procedures included in the audit methodology; obtaining reasonable assurance of the overall sufficiency and appropriateness of the evidence gathered in support of our audit's findings and conclusions; and reporting on the results of the audit as required by governing laws and auditing standards.

Our audit included the selection and examination of transactions and records. Unless otherwise indicated in this report, these transactions and records were not selected with the intent of statistically projecting the results, although we have presented for perspective, where practicable, information concerning relevant population value or size and quantifications relative to the items selected for examination.

An audit by its nature, does not include a review of all records and actions of Department management, staff, and vendors, and as a consequence, cannot be relied upon to identify all instances of noncompliance, fraud, abuse, or inefficiency.

In conducting our audit we:

- Examined Department records for 36 expenses, totaling \$621,328, selected from the population of 1,412 expenses, totaling \$1,955,187, coded in Department accounting records as acquisitions of tangible personal property during the period July 2011 through June 2013, to determine whether the Department had appropriately recorded the acquisitions in Department property records.
- Identified various expenses incurred during the period July 1, 2011, through June 30, 2013, that, although not coded in Department accounting records as property acquisitions, could potentially relate to the purchase of tangible personal property items or sensitive or attractive property items, and selected and examined Department records for 39 of these expenses, totaling \$687,385, to determine whether the Department had properly recorded any applicable items in Department property records.
- Examined Department documentation for 11 property items, with acquisition costs totaling \$118,607, which Department records indicated were disposed of during the period July 2011 through June 2013 to determine whether the Department had disposed of the items in accordance with Department policies and procedures and DFS rules.
- Examined Department documentation of physical inventories conducted for the 2011-12 and 2012-13 fiscal years at Department headquarters and two district offices to determine whether Department property was properly inventoried, the inventory results were timely reconciled to the property records, and appropriate actions were taken to follow up on any items that could not be located.
- Analyzed, for the fiscal years ended June 30, 2012, and June 30, 2013, the reasonableness of the insurance coverage for Department property, including Department tangible personal property.
- Analyzed the reasonableness of Department travel expenses of \$506,316 incurred during the period July 2010 through June 2013 by comparing the expenses to those incurred in prior periods.
- Examined Department records for 100 travel expenses, totaling \$172,571, incurred during the period July 2010 through April 2013 to determine whether the Department's travel expenses were paid in correct amounts and adequately documented; made in accordance with applicable laws, rules, and contract terms; and properly authorized and approved.
- Evaluated Department actions taken to correct the deficiencies noted in our report No. 2012-007. Specifically:
 - Performed inquiries, observations, and inspections of documents and records to determine whether the Department had adequately designed and implemented controls over game development and management.
 - Examined Department records for 15 of the 90 games launched during the period July 2011 through June 2013 to determine whether the games had been developed in accordance with Department policies and procedures and properly monitored.
 - Observed, documented, and evaluated the status of BLAST implementation.
- Reviewed applicable laws, rules, and other State guidelines to obtain an understanding of the legal framework governing Department operations.
- Observed, documented, and evaluated the effectiveness of selected processes and procedures related to the Department's management of motor vehicle assignment and use, wireless telephones and other devices, and State Purchasing Card Program activities.
- Communicated on an interim basis with applicable officials to ensure the timely resolution of issues involving controls and noncompliance.

- Performed various other auditing procedures, including analytical procedures, as necessary, to accomplish the objectives of the audit.
- Prepared and submitted for management response the findings and recommendations that are included in this report and which describe the matters requiring corrective actions.

AUTHORITY

Section 11.45, Florida Statutes, requires that the Auditor General conduct an operational audit of each State agency on a periodic basis. Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.



David W. Martin, CPA
Auditor General

MANAGEMENT'S RESPONSE

In a response letter dated June 5, 2014, the Secretary of the Department of Lottery provided responses to our audit findings and recommendations. The Secretary's response is included as **EXHIBIT A**.

**EXHIBIT A
MANAGEMENT'S RESPONSE**

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

June 5, 2014

David W. Martin, CPA
Florida Auditor General
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Mr. Martin:

The Lottery has received your May 22, 2014 list of preliminary and tentative audit findings and recommendations resulting from your audit of the Lottery's Selected Administrative Activities and Prior Audit Follow-Up. The staff has discussed your recommendations and responds as follows:

Audit Finding #1: "Department tangible personal property records did not include for all property items the information required by Department of Financial Services rules. Additionally, the information in Department personal property records was not always accurate."

Recommendation: "We recommend that Department management enhance tangible personal property controls to ensure that Department property records are accurately maintained in accordance with DFS rules. Among other things, the enhanced controls should promote Department staff knowledge of the FLAIR Property Subsystem and effective communication between Department staff responsible for the property and accounting functions."

Response: We concur with the finding and recommendation. The following additional controls relating to tangible personal property have been or will be implemented:

- 1) Property records for each item have been accurately updated to reflect the most recently completed annual inventory date.
- 2) Motor vehicle property records, previously containing tag numbers, have been corrected to reflect the VIN number in the serial number field.
- 3) Previously, surplus or items otherwise disposed of were incorrectly coded as "4: lost/stolen". Support Services staff are in the process of correcting these miscodings. Moving forward, staff will ensure that the appropriate code is utilized.
- 4) We will conduct a review of current procedures utilized in determining the acquisition cost entered in FLAIR to ensure the total cost is appropriately captured.
- 5) Support Services staff will be attending refresher training classes in an effort to enhance their knowledge of the system.

EXHIBIT A (CONTINUED)
MANAGEMENT'S RESPONSE

David W. Martin, CPA
June 5, 2014
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Audit Finding #2: "Although Department procedures specified that sensitive or attractive items (i.e., electronic equipment, handguns, and technology equipment) were to be included in Department property records, the procedures did not specify the types of electronic and technology equipment considered to be sensitive or attractive. This may have contributed to sensitive and attractive items not always being identified and included in Department property records."

Recommendation: "We recommend that Department management enhance procedures to clarify the definition of sensitive or attractive property items. We also recommend that Department management take appropriate actions to ensure that all sensitive and attractive items are included in Department property records and that the records contain the information necessary to provide proper accountability for the items."

Response: We concur with the finding and recommendation. The Lottery will take action to ensure all applicable policies and procedures are updated to reflect a clarified definition of sensitive or attractive property items. Training will be provided to the Lottery Custodian's Delegates on what constitutes sensitive or attractive property. In addition, spot inventories will be implemented.

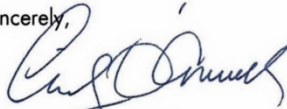
Audit Finding #3: "The Department should continue efforts to implement the Business Lottery Accounting System (BLAST) so that all applicable cost data can be tracked for each game and summarized for use in post-game analyses and planning future games."

Recommendation: "We recommend that Department management continue efforts to implement BLAST so that all applicable cost data can be tracked for each game and summarized for use in post-game analyses and planning future games."

Response: We concur with this recommendation and the Lottery is continuing its implementation of BLAST. Upon complete implementation, it is anticipated that financial records will be recorded with associated game numbers for return on investment reporting. Currently, the department is focused on stabilizing the environment given the significant amount of data associated with the retailer sweep process (Accounts Receivable). Once the retailer sweep process is stabilized, the department will turn its attention to the Accounts Payable and Encumbrance processes. It is anticipated the department will have the core system operational in January 2015.

I would like to thank your staff for their efforts on behalf of the Lottery and look forward to receiving your final report.

Sincerely,



Cynthia F. O'Connell
Secretary

cc: J. Bruce Hoffmann, Chief of Staff
Ellyn Hutson, Chief Financial Officer
Andy Mompeller, Inspector General