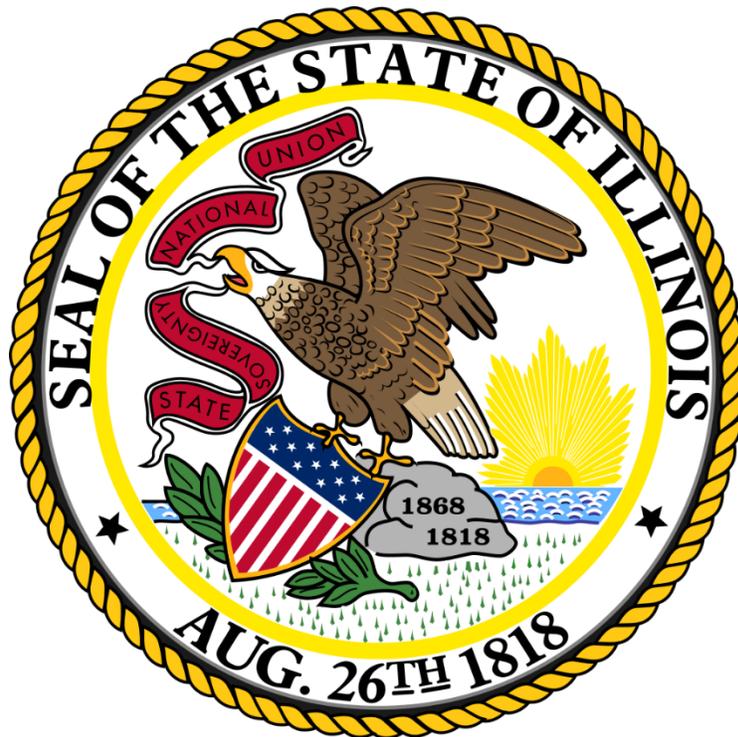


LEGISLATIVE AUDIT COMMISSION



Review of
Department of Lottery
Financial Audit For Year Ended June 30, 2020

622 Stratton Office Building
Springfield, Illinois 62706
217/782-7097

REVIEW # 4520: FY20 Financial Audit – Department of Lottery

REVIEW: #4520 ILLINOIS DEPARTMENT OF LOTTERY YEAR ENDED JUNE 30, 2020

FINDINGS/RECOMMENDATIONS – 5

IMPLEMENTED – 2

ACCEPTED AND PARTIALLY IMPLEMENTED – 3

REPEATED RECOMMENDATIONS – 2

PRIOR AUDIT FINDINGS/RECOMMENDATIONS – 4

This review summarizes the auditors' report on the Department of Lottery for the year ended June 30, 2020, filed with the Legislative Audit Commission on April 22, 2021. The auditors conducted a compliance examination in accordance with state law and Government Auditing Standards.

The Illinois Lottery began July 1, 1974 amid great excitement across the state. During its first years, it sold "passive" games via weekly drawings. First year sales topped \$129 million. Sales faltered in subsequent years, after the novelty of the Lottery wore off, prompting some to call for an end to the Lottery. In 1980 the first terminal game, Pick 3, was introduced. Pick 3 breathed new life into the Lottery, tallying sales of \$164 million during its first full year of operation.

Lottery profits initially went to the State's General Revenue Fund, until legislation was passed in 1985 earmarking profits for the Common School Fund, which is still the Lottery's major benefactor. 2006 saw the first "specialty instant games" launched; these games benefit a particular cause like Illinois Veterans, the fight against breast cancer, MS research, and assistance for people living with HIV-Aids. In 2010, the Lottery began contributing to the Capitol Projects Fund, which helps build and renovate state roads and bridges.

The Lottery (Agency #458) has been an independent, cabinet-level department for most of its history. On July 1, 2011, Northstar Lottery Group became the Lottery's first private manager. With Northstar's assistance, on March 25, 2012, the Lottery launched an internet sales pilot project for Lotto and Mega Millions and it became the first US lottery to sell tickets on the internet. On January 2, 2018, Camelot Illinois became the new private manager of the Lottery.

The Lottery operates under the direction of its Acting Director, Harold Mays, and is assisted by the Lottery Control Board. Lottery operates from its primary locations at:

- 122 South Michigan Avenue, 19th Floor
Chicago, IL 60603

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- Willard Ice Building
101 West Jefferson Street
Springfield, IL 62702

Previous Lottery Directors include: Michael Jones, Jayme Odom, BR Lane, Tim McDevitt and Greg Smith.

The current members of the Lottery Control Board include:

	Term Expires	Member Since
• Sarah Alter	07/01/2024	06/03/2019
• Diana Sheehan	07/01/2023	02/24/2020
• Alejandra Garza	07/01/2024	03/26/2021

The Illinois Lottery has spending authority from the following funds:

- GRF (only for unpaid wages);
- State Lottery (711); and
- Deferred Lottery Prize Winners (978) non-appropriated.

The daily balance of the State Lottery Fund as of 2/10/22 is \$66.5 million.

Appropriations and Expenditures

The General Assembly appropriated a total of \$2.236 billion (all Other State Funds) to the Department of the Lottery for FY22 compared to \$1.235 billion in FY 20. The difference is \$1 billion appropriated for potential lottery winnings.

According to Comptroller records, FY20 Total expenditures were \$471.1 million mostly for the following:

- Lottery awards/winnings - \$313.6 million;
- Lump sum operations - \$146.6 million; and
- Regular positions \$3.95 million.

Lottery lapses most of its appropriations. The budget authority is increased for Lottery awards/winnings just in case the jackpots reach new records.

Financial Statements

The statement of net position (deficit) for Lottery include:

- Total assets were \$481.4 million in FY20;
- While total liabilities were \$649.1 in million in FY20;
- Net position was (\$167.7 million) in FY20.

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(Source: pages 7, 8, 9 of audit report)

Capital Assets

The balance as of June 30, 2020 was \$29,000 from equipment value at \$525,000 minus accumulated depreciation of (496,000).

(Source: page 21 of audit report)

Investments

Lottery had the following investments of 297.1 million outside of the State Treasury:

- Annuities - \$108,000;
- US Treasury Bonds – \$296,762,000; and
- Money Market mutual fund - \$215,000.

(Source: page 19 of audit report)

Accountants' Findings and Recommendations

Condensed below are the 5 findings and recommendations included in the audit report. Of these, 2 are repeated from the previous audit. The following recommendations are classified on the basis of information provided by Lottery.

- 1. The auditors recommend Lottery work with the General Assembly and the Governor to resolve the \$133.966 million due from Common School Fund to State Lottery Fund and the \$89.045 million due from State Lottery Fund to Capital Projects Fund.**

FINDING: *(Noncompliance with Fund Transfer Provisions) (Repeat since 2017 and 2019)*

Lottery has not yet resolved prior period excess cash transfers from the State Lottery Fund (Fund 711) to the Common School Fund (Fund 412) or performed all transfers to the Capital Projects Fund (Fund 694) from Fund 711.

During testing, auditors noted the following:

- Lottery has been unable to resolve excess transfers to Fund 412 from Fund 711, totaling \$133.966 million. This amount consists of \$64.124 million in excess transfers which occurred in FY18 and \$69.842 million in excess transfers which occurred in periods prior to FY10.

During discussions with Lottery officials regarding the \$69.842 million, they indicated Fund 711 annually transferred more cash into Fund 412 than required on an accrual basis during periods prior to FY10. To account for the accumulation

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of excess transfers, Lottery's predecessor agency booked a due from Fund 412 (accounts receivable) for the amount of excess cash transferred from Fund 711. During the Lottery's FY12 financial audit, it was determined this due from no longer met the criteria established by the Governmental Accounting Standards Board to be reported and the Department cured the issue by reclassifying the balance as a transfer.

This remedy, however, created a cash deficit within Fund 711, as Fund 412 now had the cash that otherwise should have been deposited into Fund 694 under the waterfall calculation set forth in the Law.

Further, during discussions with Lottery officials regarding the \$64.124 million, they indicated this was due to Lottery previously interpreting the amount to transfer to Fund 412 as an absolutely mandatory monthly amount, regardless of the amount of actual proceeds remaining on an accrual basis under the waterfall calculation set forth in the Law.

- Lottery has been unable to transfer \$89.045 million from Fund 711 to Fund 694. This amount consists of \$69.842 million in excess transfers which occurred in periods prior to FY10 as discussed above and \$19.203 million in unperformed prior period transfers not performed in periods prior to FY19.

During discussions with Department officials regarding the \$19.203 million, they indicated that prior to Public Act 100-0587's enactment in June 2018, the Department was required to annually transfer cash from Fund 711 to Fund 694 on June 30. Due to both timing issues arising from the conversion of accounts receivable into cash and difficulties determining the exact amount to transfer, the Department was not able to timely transfer this balance into Fund 694.

Lottery officials indicated, due to other competing priorities and the COVID-19 pandemic, a legislative remedy has not been obtained to correct these balances.

Failure to make transfers into Fund 412 in conformity with the priority waterfall order for the distribution and use of proceeds established by the Law created a cash deficit within Fund 711. Additionally, failure to make transfers into Fund 694 in conformity with the Law has delayed Fund 694's receipt of cash.

RESPONSE:

Lottery agrees with the finding and recommendation. As noted in the finding, excess transfers to Fund 412 in the amount of \$69.842 million did occur prior to 2009 and have never been recouped. The write-off of this amount, previously categorized as a due to Fund 412, resulted in a cash shortage which affects our prior and future transfers. Additionally, Lottery transferred an excess of \$64.124 million to Fund 412 in 2018, which further increases our cash deficit in Fund 711. These over transfers lead to the Lottery's inability to transfer the remaining proceeds to Fund 694 due to the cash deficit.

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UPDATED RESPONSE:

Partially Implemented recommendation: Lottery is working with the Governor's office and General Assembly on a legislative remedy to resolve the fund transfer issues. Lottery has developed draft legislative language and has a sponsor for a bill. Lottery expects the bill to be presented during FY22 to the full General Assembly for a vote.

- 2. The auditors recommend Lottery implement controls to ensure total compensation paid to each employee is fully documented and supported within the Lottery's records.**

Further, auditors recommend that Lottery work with SERS and CMS to develop an annual reconciliation process of its active members' census data from its underlying records to a report from each plan of census data submitted to the plan's actuary. After completing an initial full reconciliation, Lottery may limit the annual reconciliations to focus on the incremental changes to the census data file from the prior actuarial valuation, provided no risks are identified that incomplete or inaccurate reporting of census data may have occurred during prior periods.

FINDING: *(Inadequate Internal Controls over Census Data)*

Lottery did not develop or retain adequate supporting documentation for its personnel transactions and did not have a reconciliation process to provide assurance census data submitted to its pension and other postemployment benefits (OPEB) plans was complete and accurate for the State Lottery Fund (Fund).

Census data is demographic data (date of birth, gender, years of service, etc.) of the active, inactive, or retired members of a pension or OPEB plan.

During testing, auditors noted the following:

- 1) Lottery had not performed an initial complete reconciliation of its census data recorded by SERS and CMS to its internal records to establish a base year of complete and accurate census data.
- 2) After establishing a base year, Lottery had not developed a process to annually obtain from SERS and CMS the incremental changes recorded by SERS and CMS in their census data records and reconcile these changes back to the Department's internal supporting records.
- 3) Two of 80 (3%) employees tested did not have documentation supporting the employee's total compensation as determined under the Illinois Pension Code (40 ILCS 5/14-133(a)), as adjustments were posted for longevity pay which Lottery could not substantiate from its own records. Auditors considered the impact of the portion of these employees' total compensation that was

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unsupported and determined these amounts did not materially impact Lottery's financial statements.

- 4) One of 80 (1%) employees tested had a discrepancy between the employee's compensation where Lottery's records reflected wages of \$3,327 per month as opposed to SRS' records of \$3,127 per month. Auditors considered the impact of this discrepancy and determined it did not materially impact Lottery's financial statements.

Lottery officials attributed these exceptions to oversight.

RESPONSE:

Lottery accepts the recommendation. Lottery will work with CMS and SERS on implementing controls to ensure census data is reconciled and documented within Lottery's records.

UPDATED RESPONSE:

Implemented recommendation: Lottery worked with SERS to develop an annual reconciliation process of its active member's census data. As part of the reconciliation process, Lottery reviewed its own internal records to ensure total compensation paid to each employee is documented and supported within Lottery's records.

- 3. The auditors recommend Lottery develop an annual financial reporting checklist which includes performing a "true up" of actual prizes paid to estimated prizes paid for all games that have closed out. Further, Lottery should complete its analysis of the impact of allocating the overhead rate as opposed to actual administrative costs and, as necessary, post adjusting entries.**

FINDING: *(Inadequate Controls over Specialty Tickets) (Repeat since 2017 and 2019)*

Lottery had not fully implemented corrective action to quantify the impact of improper prior period overhead charges and performed a "true up" of its estimated prize liabilities to prizes paid.

As of June 30, 2020, the Illinois Lottery Law (Law) required Lottery offer specialty scratch-off games to fund:

- breast cancer research grants appropriated by the General Assembly to the Department of Public Health from the Carolyn Adams Ticket For The Cure Grant Fund (Fund 208) (20 ILCS 1605/21.5);
- assistance for veterans appropriated by the General Assembly to the Department of Veterans' Affairs for grants from the Illinois Veterans Assistance Fund (Fund 236) (20 ILCS 1605/21.6);

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- multiple sclerosis research grants appropriated by the General Assembly to the Department of Public Health from the Multiple Sclerosis Research Fund (Fund 429) (20 ILCS 1605/21.7);
- HIV/AIDS prevention grants appropriated by the General Assembly to the Department of Public Health from the Quality of Life Endowment Fund (Fund 437) (20 ILCS 1605/21.8);
- Special Olympics grants appropriated by the General Assembly to the Department of Human Services from the Special Olympics Illinois and Special Children's Charities Fund (Fund 073) (20 ILCS 1605/21.9);
- Chicago Police Memorial Foundation Fund, the Police Memorial Committee Fund, and the Illinois State Police Memorial Park Fund grants appropriated by the General Assembly to the Illinois Criminal Justice Information Authority from the Criminal Justice Information Projects Fund (Fund 335) (20 ILCS 1605/21.10);
- homelessness prevention grants appropriated by the General Assembly to the Department of Human Services from the Homelessness Prevention Revenue Fund (Fund 889) (20 ILCS 1605/21.11);
- science, technology, engineering, art, and math (STEAM) programming grants appropriated by the General Assembly to the Illinois State Board of Education from the School STEAM Grant Program Fund (Fund 987) (20 ILCS 1605/21.12); and,
- Alzheimer's care, support, education, and awareness grants appropriated by the General Assembly to the Office of the Secretary of State from the Alzheimer's Awareness Fund (Fund 020) (20 ILCS 1605/21.13).

During testing, auditors noted the following problems:

- During the FY17 and FY18 annual audits, predecessor auditors had questioned whether the Lottery's practice of allocating an overhead charge to specialty tickets conformed with the Law's net revenue formula. Department officials ultimately agreed with the predecessor auditors and ceased allocating the overhead charge during FY19. However, Lottery has not yet quantified the difference between the overhead charge and its actual administrative costs solely related to each specialty scratch-off game from October 2008 through June 2018. As such, Lottery has not posted adjusting entries to correct prior period errors.
- Lottery has not performed its "true up" for its initial estimated prize liability for specialty ticket games ending during the two years prior to June 30, 2018. This true up would recalculate the amount of net revenue based upon actual known prizes paid after the game had formally ended, with adjusting entries being posted to correct for estimation differences.
- Due to the two preceding problems, the "accrual only" information sent by Lottery 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 was not complete and accurate.

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Lottery officials indicated while some work on implementing corrective action has been taken, it was hampered by other competing priorities during FY20 and the difficulties encountered in locating historical records.

RESPONSE:

Lottery accepts the recommendation. In FY19, Lottery revised our specialty ticket procedures to charge actual administrative costs incurred to each ticket. These costs do not encompass all administrative costs incurred by Lottery in administering these tickets while performing administrative duties related to all games that aren't specifically separated. Work occurs through our instant ticket processes, marketing processes, and financial processes. Lottery are able to identify direct costs incurred by our vendor for specific products or services to the development and marketing of specialty games, but the hourly efforts of Lottery's staff and the Private Manager's staff requires manual tracking and have been difficult and costly to isolate.

Lottery is still working to complete the reconciliation to "true-up" estimated prize liabilities to prizes paid, as well as, our review of the overhead rate charged to specialty tickets in years prior to 2019. Once the reconciliation is complete, Lottery will communicate directly with those agencies impacted and make any necessary transfers at this time. Finally, Lottery will continue to research and analyze a better way to allocate and account for the administrative costs associated with specialty tickets to bring forth a legislative remedy.

UPDATED RESPONSE:

Partially Implemented recommendation: Lottery is currently working on completing a "true-up" of actual prizes paid to estimated prizes paid for games that have closed out. This is expected to be completed during FY22 and Lottery will post adjusting entries as needed.

- 4. The auditors recommend Lottery comply with the current PCI DSS by conducting and documenting an annual review to determine the scope of its annual assessment and timely complete the appropriate SAQ.**

FINDING: *(Untimely Review of Credit Card Security)*

Lottery did not timely demonstrate its compliance with the Payment Card Industry Data Security Standards (PCI DSS).

Credit card payments are accepted for Lottery games at retailers, self-service terminals, and Lottery's Internet and Mobile Application (IMA) managed by a service provider. During FY20, Lottery handled approximately 3 million transactions valued at \$72 million. As a result of this activity, Lottery was required to comply with the PCI DSS as a subject entity.

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During testing, auditors noted Lottery did not complete the required annual Self-Assessment Questionnaire (SAQ) until October 5, 2020, 97 days after the end of the fiscal year.

The PCI DSS includes detailed security requirements for entities which either (1) store, process, or transmit cardholder data or (2) outsource cardholder data functions to PCI DSS validated service providers. Cardholder data includes any personally identifiable data associated with a cardholder.

In order to determine which SAQ must be completed annually, Lottery must first conduct a documented review of (1) all locations, including any backup/recovery sites and fail-over systems, (2) flows of cardholder data, and (3) all systems connected to the data environment with cardholder data or systems which could, if compromised, impact cardholder data. Based on this survey, the PCI DSS require completion of the appropriate SAQ.

Lottery officials indicated delays in receiving the Private Manager's SAQ and a transition of roles and responsibilities to a new position within Lottery led to not completing its SAQ during the examination period.

Failure to timely ensure compliance with the PCI DSS could delay the identification of security weaknesses, potentially exposing cardholder data to unauthorized use or theft, and may subject the state to unnecessary legal risks and the loss of the right to utilize certain credit card providers.

RESPONSE:

Lottery accepts the recommendation. Lottery did not receive the SAQ report from the Private Manager until September 1, 2020, which delayed Lottery's own PCI review. Lottery will work with the Private Manager to ensure the SAQ report is received timely to ensure Lottery can complete its own review on a timely basis.

UPDATED RESPONSE:

Implemented recommendation: During FY21, Lottery worked with the Private Manager to obtain the SAQ report in a timely fashion. After receipt of the report, Lottery management timely reviewed and completed the appropriate SAQ report.

- 5. The auditors recommend Lottery perform a periodic review of system access rights to ensure users are removed or access rights are deactivated for users who do not still need access. In addition, Lottery should update its Procedure to reflect its current operating environment.**

FINDING: *(System Access Weaknesses)*

Lottery failed to perform user access reviews.

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During testing, auditors noted the following:

- Lottery had not performed annual user access reviews within the engagement period for both iLottery and iSecure. The iLottery system allows Lottery players to purchase tickets online and Lottery uses iSecure to validate winning tickets.

Lottery's User Provisioning and Access Rights Review Procedure (Procedure) states an authorized coordinator regularly reviews and documents user access on Lottery's network and key systems to ensure authorized access is appropriate.

- Lottery's Procedure has not been updated to reflect Lottery's current environment. Auditors noted the Procedure:
 - 1) referred to one system which was no longer used by Lottery;
 - 2) did not address a newer system used by Lottery; and,
 - 3) had not been updated to reflect the movement of responsibilities from the CMS to DoIT.

The Procedure, which was last updated in August 2014, notes it was scheduled to have been reviewed for potential updates by Lottery's staff no later than February 2015, more than five years ago.

Lottery officials indicated the access reviews and updating the related procedure were not completed due to oversight and personnel turnover.

Failure to perform regular user access review increases the risk of unauthorized access to the Department's applications and data. In addition, failure to update the Procedure to reflect the Department's current operating environment could result in unidentified risks not being mitigated or employees not performing their duties in accordance with management's intent.

RESPONSE:

Lottery accepts the recommendation. While the Private Manager who operates the iLottery system has been performing periodic user reviews on iLottery, Lottery will implement procedures to conduct its own user access reviews on iLottery and iSecure. In addition, Lottery is currently updating its policies and procedures to reflect the current operating environment.

UPDATED RESPONSE:

Partially Implemented recommendation: Lottery has performed user access reviews for the majority of the systems in place and will be conducting reviews on the remaining systems within the upcoming quarter. In addition, Lottery is in the process of finalizing an updated policy to reflect the current operating environment.

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Emergency Purchases

The Illinois Procurement Code (30 ILCS 500/) states, “It is declared to be the policy of the state that the principles of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts....”

Lottery did not have any Emergency Purchases in 2020 or 2021.

Headquarters Designations

The State Finance Act requires all state agencies to make semiannual headquarters reports to the Legislative Audit Commission. Each state agency is required to file reports of all its officers and employees for whom official headquarters have been designated at any location other than that at which official duties require them to spend the largest part of their working time.

For both 2020 and 2021, Lottery had 0 employees assigned to locations others than official headquarters.