

STATE OF FLORIDA AUDITOR GENERAL

Operational Audit

Report No. 2017-019
September 2016

DEPARTMENT OF THE LOTTERY

Selected Administrative Activities and Prior Audit Follow-Up



Sherrill F. Norman, CPA
Auditor General

Secretary of the Department of the Lottery

The Department of the Lottery is established by Section 20.317, Florida Statutes. The head of the Department is the Secretary who is appointed by the Governor and subject to confirmation by the Senate. During the period of our audit, the following individuals served as Department Secretary:

Tom Delacenserie	From November 23, 2015 Interim October 2, 2015, through November 22, 2015
Cynthia F. O'Connell	Through October 1, 2015

The 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.

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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 also included a follow-up on the findings noted in our report No. 2014-198. Our audit disclosed the following:

Finding 1: Department records did not always evidence that the Department reviewed the State's listing of convicted vendors prior to contracting with vendors.

Finding 2: Department records did not always evidence that all individuals involved in the contract award process were independent of, and had no conflicts of interest related to, responding vendors.

Finding 3: As similarly noted in our report No. 2014-198, the Department did not always ensure that tangible personal property records were accurate.

Finding 4: Department controls continue to need improvement to ensure that all property items of a sensitive and attractive nature are properly recorded and accounted for in Department property and financial records.

Finding 5: As similarly noted in prior audit reports, most recently in our report No. 2014-198, the Department should continue efforts to ensure the full implementation of the Business Lottery Accounting System 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 2014-15 fiscal year, the Department was authorized 420 positions, received appropriations totaling approximately \$163.5 million, and transferred over \$1.49 billion to the EETF.

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

² Section 24.121, Florida Statutes.

FINDINGS AND RECOMMENDATIONS

Finding 1: Review of Convicted Vendor List

State law³ specifies that a public entity⁴ may not accept any bid, proposal, or reply from, award any contract to, or transact any business in excess of \$35,000 with any person or affiliate on the State's convicted vendor list for a period of 36 months following the date the person or affiliate was placed on the convicted vendor list. The Department of Management Services (DMS) is responsible for maintaining the State's convicted vendor list and, pursuant to DMS rules,⁵ the DMS is to quarterly publish on its Web site an updated list.

Department management indicated in response to our audit inquiry that, for all contracts, staff were to verify, prior to awarding a contract, that the vendor was not on the convicted vendor list and document the verification in the contract procurement file. However, the Department had not established written policies and procedures for the contract procurement process, including review of the State's convicted vendor list. In addition, our examination of Department records for six contracts, totaling \$54,059,135, initiated during the period July 2013 through June 2015, disclosed that for two contracts for leases (leases), totaling \$3,071,175, Department records did not evidence that staff had reviewed the State's convicted vendor list prior to executing the leases with the lessors. In response to our audit inquiry, Department management indicated that the Department was in the process of developing written policies and procedures for the contract procurement process, as well as a checklist to evaluate Department compliance with the requirements of all applicable procurement laws and rules, including the required review of the State's convicted vendor list.

Our review of the State's convicted vendor list in March 2016 found that neither lessor was included on the list. However, absent documentation of the Department's timely review of the State's convicted vendor list, the Department cannot demonstrate that it has only accepted bids, proposals, or replies from, awarded contracts to, and transacted business with appropriate vendors.

Recommendation: We recommend that Department management continue efforts to establish written policies and procedures and a checklist for the contract procurement process and ensure that Department records evidence that the State's convicted vendor list has been timely reviewed during the procurement process.

Finding 2: Conflicts of Interest

State law⁶ specifies that no officer or employee of the Department with decisionmaking authority is to participate in any decision involving any vendor or retailer with whom the officer or employee has a financial interest. State law⁷ also establishes that fair and open competition is a basic tenet of public

³ Section 287.133(2)(b), Florida Statutes.

⁴ Section 287.133(1)(f), Florida Statutes, defines public entity to mean the State, any of its departments or agencies, or any political subdivision.

⁵ DMS Rule 60A-1.006(5), Florida Administrative Code.

⁶ Section 24.105(19)(b), Florida Statutes.

⁷ Section 287.001, Florida Statutes.

procurement and that such competition reduces the appearance and opportunity for favoritism and inspires public confidence that contracts are awarded equitably and economically. State law specifies that documentation of the acts taken is an important mean of curbing any improprieties and establishing public confidence in the process by which commodities and contractual services are procured.

For procurements of goods or contractual services in excess of \$65,000, the Department was to utilize an *Attestation of No Conflict of Interest* form to document that individuals involved in the contract evaluation or award process had no conflicts of interest related to the responding vendors. As part of our audit, we examined Department records for 13 contracts, totaling \$52,690,807, procured or awarded during the period July 2013 through June 2015, to determine whether the Department documented that all individuals involved in the contract evaluation or award process had no conflicts of interest related to the responding vendors. Our examination disclosed that, for two competitively procured contracts totaling \$49,986,800, Department records did not include documentation demonstrating that five of the eight individuals responsible for negotiating these two contracts had no conflicts of interest related to the responding vendors. In response to our audit inquiry, Department management indicated that staff turnover and the Department's former practice of scanning all procurement files at the conclusion of a contract procurement contributed to the absence of conflict of interest documentation.

Documentation demonstrating that all individuals involved in the contract evaluation or award process are independent of, and have no conflicts of interest related to, responding vendors would reduce the appearance and opportunity for favoritism and provide greater assurance that Department contracts are impartially awarded.

Recommendation: We recommend that Department management ensure that documentation is maintained to demonstrate that all individuals involved in the contract evaluation or award process are independent of, and have no conflicts of interest related to, responding vendors.

Finding 3: Tangible Personal Property Controls

Effective controls for the management of tangible personal property⁸ require that property items be adequately controlled, safeguarded, and accounted for by Department management. Department of Financial Services (DFS) rules⁹ specify that State agencies are to record all tangible personal property with a value or cost of \$1,000 or more and a projected useful life of 1 year or more in the Florida Accounting Information Resource Subsystem (FLAIR) Property Subsystem. To promote the proper accountability for and safeguarding of tangible personal property, DFS rules¹⁰ 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 date the item was last physically inventoried.

In our report No. 2014-198 (finding No. 1), we noted that Department tangible personal property records did not include for all property items the information required by DFS rules and that the information in

⁸ 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 1 year or more.

⁹ DFS Rule 69I-72.002, Florida Administrative Code.

¹⁰ DFS Rules 69I-72.003 and 69I-72.006, Florida Administrative Code.

Department property records was not always accurate. According to Department property records as of November 30, 2015, the Department had 764 items of tangible personal property with acquisition costs totaling approximately \$12 million. As part of our audit follow-up procedures, we analyzed Department property records as of November 30, 2015, and found that, although the Department had taken corrective actions, further improvements were needed to ensure that the information recorded in Department property records was accurate. Specifically, our analysis found that 59 of the 764 items of tangible personal property, with acquisition costs totaling approximately \$1.1 million, had a March 30, 2015, inventory date, which was prior to the items' recorded acquisition date.

In response to our audit inquiry, Department staff indicated that the property record discrepancies were due to errors in updating the property records for the results of the physical inventory. 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.

Recommendation: We again recommend that Department management enhance tangible personal property controls to ensure that Department property records are accurately maintained.

Finding 4: Sensitive and Attractive Property Items

Department policies and procedures¹¹ specified that, in addition to tangible personal property items, sensitive or attractive property items purchased with expense¹² funds were to be recorded in Department property records and annually inventoried. In accordance with a Department management directive, sensitive and attractive property items were to be recorded in Department property records at actual acquisition cost. As of November 30, 2015, Department property records included 1,129 sensitive and attractive property items such as personal computers, laptop computers, iPads, printers, and firearms.

In our report No. 2014-198 (finding No. 2), we noted that the Department did not always record sensitive and attractive items in Department property records and that Department policies and procedures did not specify the types of electronic and technology equipment considered to be sensitive or attractive. In September 2014, Department management provided to staff guidance that defined attractive property items.

As part of our audit follow-up procedures, we evaluated the Department's September 2014 guidance and analyzed the Department's sensitive and attractive property records as of November 30, 2015. Our audit procedures disclosed that the Department's guidance defined attractive property items as items: (1) determined by the Department to be susceptible to theft, loss, or being misplaced due to their size or nature; (2) with an acquisition cost from \$500 to less than \$1,000 and with a useful life of more than 1 year, and (3) that were not software. As a result, computers and other electronic equipment that may contain sensitive or confidential Department data, but cost less than \$500, were not required to be recorded in Department property records. In addition, we found that:

¹¹ Department Policy and Procedure No. 430.010, *Property Management*.

¹² Expense is defined as the appropriation category used to fund the usual, ordinary, and incidental expenditures, including commodities, supplies of a consumable nature, current obligations, and fixed charges and excludes operating capital outlay expenditures.

- The Department recorded 656 sensitive and attractive property items, including, but not limited to, laptop computers, printers, and firearms, to Department property records at actual acquisition costs totaling \$291,171. However, the Department recorded expenses totaling \$72,062 for 100 of the 656 items when purchased, while also recognizing depreciation expense totaling \$25,250 for these same items as of November 30, 2015.
- 10 of the 1,129 sensitive and attractive property items had a March 30, 2015, inventory date, which was prior to the items' recorded acquisition date.

In addition, as part of our audit follow-up procedures, we examined documentation related to expenses, totaling \$4,130, for eight sensitive or attractive items purchased during the period November 2014 through October 2015. Our examination identified five items (four tents and one television), totaling \$2,900, that had not been included in Department property records as of November 30, 2015.

In response to our audit inquiry, Department management indicated that the sensitive and attractive items had not been correctly recorded or accounted for correctly due to employee oversight. By nature of their portability, adaptability for personal use, or data storage capabilities, sensitive and attractive items, such as computers and electronic equipment, are more susceptible to loss and theft. Therefore, controls designed to 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 policies and procedures to ensure that all sensitive and attractive property items are appropriately recorded and accounted for in Department property and financial records.

Finding 5: Implementation of the Business Lottery Accounting System

The Department sells terminal and scratch-off game tickets to generate revenue for the Educational Enhancement Trust Fund. 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 81 new scratch-off games and 1 new terminal game during the period July 2013 through June 2015. During the same period, the Department closed 69 scratch-off games and 1 terminal game. As of July 27, 2016, the Department made 83 scratch-off and 7 terminal games available to customers.

For each game, Department procedures required that ticket sales and the 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, including research, license, advertising, and promotional item costs. To allow financial data for each game to be recorded in one accounting system, produce profit and loss data on games, and strengthen the Department's game and cost analysis capabilities, in 2010 the Department purchased an off-the-shelf financial software package and began modifying the system, the Business Lottery Accounting System (BLAST), to meet the Department's needs. On March 28, 2012, the Department reported that BLAST was expected to go live on July 1, 2012.

In our report No. 2014-198 (finding No. 3), we noted 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 part of our audit follow-up procedures, we inquired of Department

management regarding the status of BLAST implementation and examined relevant Department records. In response to our audit inquiry, Department management indicated that, as of June 2015, the Department had implemented some BLAST functionalities, with related costs totaling \$1,916,909. As of December 2015, the Department estimated that the Department would incur additional costs totaling \$989,506 to fully implement BLAST.¹³ Department management further indicated that, as of July 2016, BLAST had been placed into parallel testing and that Department management anticipated full implementation in the near future.

A fully implemented system that captures all 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. The functionality of BLAST and whether BLAST is meeting its accounting, game analysis, and other objectives may be subject to future audits.

Recommendation: We recommend that Department management continue efforts to ensure the full implementation of BLAST to facilitate the tracking and summarization of game cost data 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. 2014-198.

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 September 2015 through March 2016 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 Department of the Lottery (Department) 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, 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

¹³ The Department's Office of Inspector General reported in its April 2015 BLAST System audit report that the Department had not established a total budget for the BLAST project nor set an implementation date.

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. 2014-198.

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 agency 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:

- Reviewed applicable laws, rules, Department policies and procedures, contract documents, and other guidelines, and interviewed Department personnel to gain an understanding of Department contract procurement processes.
- Examined Department records for 20 contracts, totaling \$57,981,122, from the population of 49 contracts, totaling \$59,463,077, procured or awarded during the period April 2013 through June 2015, to determine whether the Department had procured and awarded the contracts in accordance with applicable laws and rules.
- Examined Department records for 2 contract extensions and 4 contract renewals, totaling \$257,056,809, from the population of 13 contract extensions or renewals, totaling \$259,820,533, executed during the period July 2013 through June 2015, to determine whether the Department had executed the contract renewals and extensions in accordance with the original contract terms and applicable laws and rules. Additionally, we examined the 13 contract extensions or renewals

and Florida Accountability Contract Tracking System (FACTS) records to determine whether the executed documents and related information were timely input into FACTS.

- Evaluated Department actions taken to correct the findings noted in our report No. 2014-198. Specifically, we:
 - Examined Department records for 13 expenses, totaling \$237,935, coded in Department accounting records as acquisitions of tangible personal property, and 11 expenses, totaling \$20,080, potentially related to the acquisition of sensitive or attractive property items, from the population of 16,451 non-prize, non-personnel, non-transfer expenses, totaling \$117,589,529, incurred during the period November 2014 through October 2015, to determine whether the Department had appropriately recorded the acquisitions in Department property records.
 - Examined Department records for 47 property items, with acquisition costs totaling \$308,219, from the population of 462 property items, with acquisition costs totaling \$1,503,972, denoted in Department records as lost, stolen, suffered casualty loss, traded or deleted during the period November 2014 through November 2015, to determine whether the Department had properly recorded the status of the property items in Department property records.
 - Analyzed Department property records as of November 30, 2015, which included 1,893 active property items with recorded acquisition costs totaling \$12,262,642, to determine:
 - Whether the property records included a 2014-15 fiscal year inventory date for all active property items acquired prior to July 2014.
 - Whether all active property records related to motor vehicles included a 17-digit vehicle identification number.
 - Observed, documented, and evaluated the status of the implementation of the Business Lottery Accounting System.
- Observed, documented, and evaluated the effectiveness of selected Department processes and procedures for:
 - Budgetary activities.
 - The administration of Department travel in accordance with State law and other applicable guidelines. From the population of the 4,400 records of travel expenses, totaling \$387,613, incurred during the period July 2013 through August 2015, examined Department records for 60 travel expenses, totaling \$68,986, to determine whether Department travel expenses were paid in correct amounts, supported by adequate documentation, made in accordance with applicable laws, rules, and other guidelines, and properly authorized and approved.
- 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. Management's response is included in this report under the heading **MANAGEMENT'S RESPONSE**.

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.



Sherrill F. Norman, CPA
Auditor General

MANAGEMENT'S RESPONSE

RICK SCOTT
Governor



TOM DELACENSERIE
Secretary

September 15, 2016

Sherrill F. Norman, CPA
Auditor General
Claude Denson Pepper Building, Suite G74
111 West Madison Street
Tallahassee, Florida 32399-1450

Dear Ms. Norman:

The Lottery has received the list of preliminary and tentative audit findings and recommendations resulting from your operational audit of the Department of the Lottery, Selected Administrative Activities and Prior Audit Follow-Up. Below is our response to each finding and recommendation:

Finding 1: Review of Convicted Vendor List

Recommendation: We recommend that Department management continue efforts to establish written policies and procedures and a checklist for the contract procurement process and ensure that Department records evidence that the State's convicted vendor list has been timely reviewed during the procurement process.

Lottery's Response: The Lottery will continue to verify, during the procurement process, vendors submitting responses are not on the convicted vendor list. Additionally, the Lottery will continue to verify, prior to executing a contract or lease, that the selected vendor/Lessor is not on the convicted vendor list. Documentation evidencing the Lottery's review will be included in the procurement or contract administration file, as applicable. The Lottery will continue efforts to establish written policies, procedures, and/or checklists for the Contract Administration and Contract Management processes.

Finding 2: Conflicts of Interest

Recommendation: We recommend that Department management ensure that documentation is maintained to demonstrate that all individuals involved in the contract evaluation or award process are independent of, and have no conflicts of interest related to, responding vendors.

Lottery's Response: The Lottery will continue to ensure and document that individuals involved in the development or selection of criteria for evaluation, the evaluation process, and/or the award process are independent of and have no conflict of interest in any of the entities evaluated or selected.

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Finding 3: Tangible Personal Property Records

Recommendation: We again recommend that Department management enhance tangible personal property controls to ensure that Department property records are accurately maintained.

Lottery's Response: We concur with the recommendation. Affected property records have been corrected and measures have been taken to ensure records are accurately maintained going forward.

Finding 4: Sensitive and Attractive Property Items

Recommendation: We recommend that Department management enhance policies and procedures to ensure that all sensitive and attractive property items are appropriately recorded and accounted for in Department property and financial records.

Lottery's Response: The Lottery will continue to assess its policies and procedures regarding sensitive and attractive items to ensure it supports the intent and risk of recording such items, as guided by DFS, so that items are appropriately recorded and accounted for.

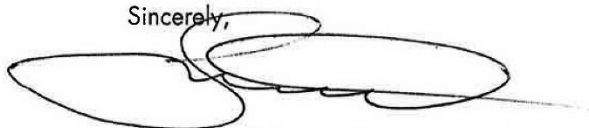
Finding 5: Implementation of the Business Lottery Accounting System

Recommendation: We recommend that Department management continue efforts to ensure the full implementation of BLAST to facilitate the tracking and summarization of game cost data for use in post-game analyses and planning future games.

Lottery's Response: We concur with the recommendation. As of July 2016, BLAST had been placed into parallel process testing. We will continue efforts to ensure the full implementation of BLAST to facilitate the tracking and summarization of game cost data for use in post-game analyses and planning future games.

Thank you for your audit efforts and recommendations. I look forward to receiving your final report.

Sincerely,



Thomas R. Delacenserie
Secretary

TD/JS/js

cc: Dan Olson, Chief of Staff
Joan Schoubert, Deputy Secretary of Administration
Andy Mompeller, Inspector General