



Ohio Lottery Commission Merchandise Inventory Audit

Audit Period: July through December 2015

Results Summary:

Objective	Conclusion
Merchandise Inventory Ordering, Receiving and Paying	Improvement Needed
Merchandise Inventory Distribution	Improvement Needed



Executive Summary

Background

The Ohio Lottery Commission (OLC) was created in May 1973 and is operated as a business enterprise within the framework of the State's laws and regulations. Part of the OLC's mission is to maximize revenues to provide funds for the educational system of the State by offering games of chance to the public at large. Since 1974 when tickets first went on sale, OLC has provided more than \$22 billion to public education. The OLC is self-sustaining and funded through the State Lottery Fund. Appropriations support the computerized gaming systems, the purchase and distribution of Instant tickets, the payment of prizes to winners, funding for programs supporting gambling and related addiction services, and regulation of the video lottery terminal program.

The OLC purchases and distributes marketing merchandise and point of sale promotional items such as pens, water bottles, shirts, banners, and signs. Average annual purchases for such items are approximately \$3.1 million. OLC receives all merchandise and point of sale items at the Central Perkins warehouse and distributes to the nine regional warehouses throughout the State on a monthly basis. The regional warehouses provide items to lottery retailers as needed. OLC uses merchandise items for various promotional events held at retail locations.

During the audit, OIA identified opportunities for OLC to strengthen internal controls and improve business operations. This audit conforms with the International *Standards for the Professional Practice of Internal Auditing*. OIA would like to thank OLC staff and management for their cooperation and time in support of this audit.

This report is solely intended for the information and use of agency management and the State Audit Committee. It is not intended for anyone other than these specified parties.

Scope and Objectives

OIA staff was engaged to perform an assurance audit related to the controls over the OLC's merchandise inventory process. This work was completed March through June 2016. The scope of this audit included the key merchandise inventory processes such as: (1) ordering, receiving and payment, and (2) distribution (tracking and reconciling). The following summarizes the objectives of the review:

- Evaluate the design and effectiveness of controls over the merchandise inventory ordering, receiving, and paying process.
- Evaluate the design and effectiveness of controls over the merchandise inventory distribution process.



Detailed Observations and Recommendations

The Observations and Recommendations include only those risks which were deemed high or moderate. Low risk observations were discussed with individual agency management and are not part of this report. However, the low risk observations were considered as part of the audit objective conclusions.



Observation 1 – System Utilization

OLC implemented the Intralot Back Office System's (BOS) Supply and Merchandise Inventory (SMI) module to administer the merchandise and point-of-sale inventory distribution and tracking process. SMI is a collection of applications used to manage inventory items separate from tickets and supplies. The system is aimed at promoting efficient ordering, receiving, payment, and distribution of the merchandise and point-of-sale items. The SMI module provides several applications to help place orders (Create Order, Vendor Management, and Purchase Order), schedule events (Event Management), and track inventory (Product Management, Mini Warehouses, Load Products, Product Inventory Level, Unit Management, Process Manifest, and Barcode). Capabilities of applications include, but are not limited to:

- Product Management – listing of all products with an associated ID automatically assigned by the system along with the product type (Asset, Point-of-Sale, Promotional, etc.);
- Vendor Management – listing of approved vendors. Utilized when creating purchase orders;
- Event Management – tracks event names, dates, total sales, attendance, region etc.;
- Purchase Order (PO) – creates PO with vendor, order date, requested delivery date, product(s) ordering (must be in the product management application). Also allows user to indicate the date and amount received;
- Product Inventory Levels – listing of inventory counts by item ID by mini warehouse;
- Create Order – allows order placement by mini warehouses or for events;
- Mini Warehouses – details and contact information for each warehouse.

However, OLC management did not fully configure the SMI module within the Intralot system upon implementation, and use of the SMI module is not mandated throughout the agency. According to the nine regional warehouses' management, this is due to OLC management implementing SMI without adequate user training and without formal procedures and centralized oversight. Instead, Central Warehouse (Perkins) and the nine regional warehouses order, receive, distribute, and track merchandise and point-of-sale items via manual forms and informal processes. Additionally, there is variation in the warehouses' processes for conducting periodic physical inventory counts and updating records. Four of the nine (44%) regional warehouses do not conduct periodic inventory counts. Finally, there is no centralized process owner or governance to ensure standardization, compliance, and minimize risks throughout ordering, receiving, and distributing processes.

Failure to fully utilize the SMI module reduces the efficiency and effectiveness of ordering, receiving, and distributing merchandise and point-of-sale items. Lack of a statewide centralized



record of merchandise and point-of-sale inventory items increases the likelihood for unnecessary purchases, incorrect order distributions to regional warehouses, and lost or stolen inventory items without timely detection.

Recommendation

For a long-term solution, implement a statewide system for ordering, receiving, and distributing merchandise and point-of-sale inventory items. For instance:

- Determine a process owner and governance structure for the merchandise and point-of-sale inventory process. Include central and regional warehouse managers, the OLC Internal Auditor (for advisory purposes), Program Administrator, IT and representatives from the Marketing, Promotions, and Sales departments in the governance team.
- Determine business requirements of a comprehensive merchandise and point-of-sale inventory system to include requirements, roles and responsibilities for ordering, receiving, tracking, and distributing functions. Document business requirements in policies and in workflows to outline processes and timeframes.
- Determine if the SMI module fits the documented business requirements. Document results to outline business requirements that the SMI module cannot fulfill. Review those business requirements to determine modifications to the requirements to fit SMI module capabilities. Document results and update policies and workflows. Research alternative supply and inventory systems/programs, if needed, to identify the best fit for the agency's operations.
- Once a system is selected, conduct a comprehensive evaluation of the system's modules/applications to determine those to implement and utilize. Develop policies and procedures over ordering, receiving, distributing, tracking, and verifying merchandise and point-of-sale items within the system.
- Provide detailed training over the merchandise and point-of-sale inventory business requirements, policies, procedures, process workflows, the system and its applications to end users.
- The process owner and members of the governance team should provide overall oversight of merchandise and point-of-sale inventory processes, provide ongoing guidance and support, and monitor processes to ensure requirements are met and standardization is achieved.

In the short term, determine a standard process to reduce variation in ordering, receiving, distributing, and tracking of inventory item processes across the agency. Require and implement periodic (monthly/quarterly) physical inventory counts at each warehouse. Document and centrally maintain, such as on a SharePoint site, results of periodic inventory counts and adjustments to inventory records in order to display items on-hand at each warehouse and to



increase transparency of the inventory process. Develop policies and procedures to document requirements.

Management Response

Due to the wide range of intra-departmental tasks and responsibilities, external third party interactions, unique regional characteristics, and other business attributes inherent in the Lottery business, management has identified the SMI process as a Kaizen opportunity to address, both short term and long term concerns.

This will be a collaboration of various divisions; addressing items ranging from warehouse logistics to IT support to Sales responsibilities, keeping in mind that a large percentage of the point-of-sale and merchandising items procured are done so with the intention of distributing them to the general public or Lottery retailers in support of Lottery sales revenues.

A phased approach will be utilized with the Kaizen analysis target completion date of 12/16.

Risk*	Remediation Owner	Estimated Completion Date
Moderate	Inventory Control Manager	December 2016

Due to the limited nature of our audit, we have not fully assessed the cost-benefit relationship of implementing the observations and recommendations suggested above. However, these observations reflect our continuing desire to assist your department in achieving improvements in internal controls, compliance, and operational efficiencies.

* Refer to Appendix A for classification of audit observations.



Appendix A – Classification of Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Well-Controlled	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.
Well-Controlled with Improvement Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Improvement Needed	Weaknesses are present that compromise achievement of one or more control objectives but do not prevent the process from achieving its overall purpose. While important weaknesses exist, their impact is not widespread.
Major Improvement Needed	Weaknesses are present that could potentially compromise achievement of its overall purpose. The impact of weaknesses on management of risks is widespread due to the number or nature of the weaknesses.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Agency Management; State Audit Committee (Not reported)
Moderate	Observation has moderate impact to the agency. Exposure may be significant to unit within an agency, but not to the agency as a whole. Compensating controls may exist but are not operating as designed. Requires near-term agency attention.	Agency Management and State Audit Committee
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	Agency Management and State Audit Committee