



# Ohio Lottery Commission Supply Inventory Audit

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**Audit Period: January through December 2016**

## Results Summary:

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

\* Please refer to Appendix A for classification of audit objective conclusions.



## **Executive Summary**

### **Background**

The Ohio Lottery Commission (OLC) purchases and distributes gaming supplies such as bet cards and Ohio lottery thermal paper to authorized lottery retailers. There are currently two sizes of thermal paper utilized along with approximately nine different bet cards for which OLC has a printing contract. This contract averages approximately \$6 million in expenditures annually. OLC receives most supplies at the Strongsville warehouse which is then distributed directly to retailers. Additionally, limited supplies are shipped directly to the Central Warehouse (Perkins) to deliver to regional warehouses to distribute to Lottery Sales Representatives (LSR).

During the audit, OIA identified opportunities for OLC to strengthen internal controls and improve business operations. OIA 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 agency's supply inventory process. This work was completed December 2016 through March 2017. The scope of the audit was limited to the key supply inventory processes to include: (1) ordering, receiving and payment and (2) distribution (tracking and reconciling) during the period of January through December 2016. The following summarizes the objectives of the review:

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

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

\* Refer to Appendix A for classification of audit observations.



## Observation 1 – Inventory Management

Inventory tracking systems help to streamline inventory processes, simplify documentation, and maintain accuracy beyond what is achievable through manual inventory control processes. Periodic inventory counts help ensure accuracy and completeness of inventory records. OLC utilizes the Intralot Back Office System (BOS) to manage Supply Inventory processes. OLC utilizes the BOS system to track receipt and usage of supply inventory and to consign and transfer supply inventory to and from regional warehouses as well as to Lottery Sales Representatives (LSRs) and Lottery Retailers. OLC may utilize BOS to categorize inventory as returned, shipped, issued, or damaged. Use of additional classification categories is available.

However, BOS lacks functionality to track and report supply inventory balance information in total or by location. To reduce this shortfall, OLC has implemented manual processes at the Strongsville warehouse as well as at the regional warehouses. For instance, on a daily basis, the Inventory Control Manager updates inventory levels on a spreadsheet based on BOS Consumables reports and new items received to provide a reasonable estimation of supply inventory balances on hand at the Strongsville warehouse. However, the Inventory Control Manager records inventory adjustments based on actual physical inventory counts only semi-annually despite warehouse managers conducting monthly physical counts for other inventory items, such as tickets. However, no evidence of the semi-annual physical counts is maintained nor is there documentation maintained of significant variances and adjustments.

Central Warehouse (Perkins) and the nine regional warehouses order, receive, distribute, and track supply inventory items via manual forms and informal processes. Additionally, there is variation in the warehouses' processes for conducting periodic physical inventory counts and updating records with inventory balances. Overall, the regional warehouses lack a centralized governance structure and process owner to ensure standardization and compliance to help minimize risks throughout the ordering, receiving, and distributing processes.

Management Analysts (MAs) at the regional warehouses are to change the status of inventory items in BOS from "shipped" to "issued" when supply inventory is received. This allows the system to properly reflect the items located at specific warehouses. MAs should consign paper supply to the LSRs and subsequently to the Retailers. However, status changes and consignments are not completed consistently. For instance, supply inventory products as far back as 2014 are still reported in BOS in shipped status rather than received and then consigned and used by the retailers.

The inability of the system to maintain and report current inventory balances requires manual tracking outside the system which increases the likelihood for errors to occur in inventory levels. Lack of an automated record of inventory items increases the likelihood for supply inventory items to be lost or stolen without timely detection. Failure to timely and consistently update inventory statuses reduces the reliance that OLC management may place on the system



and increases the likelihood of excess or inventory shortages and improper inventory distribution.

**Recommendation**

Implement a statewide system for tracking supply inventory items. The system should be capable of receiving, distributing and consigning inventory items to any warehouse, LSR, or Retailer, as well as provide current inventory levels by warehouse and statewide.

In the short term, determine a standard process for receiving, distributing/consigning, and tracking inventory items across the agency. Consider implementing periodic (quarterly or semi-annual) physical inventory counts at each regional 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. The level of detail maintained for consigning paper should be determined by management and communicated to each regional warehouse to ensure the proper chain of custody is maintained over supply inventory.

Overall, reconciliations between the system or manual balances and the physical inventory count at all warehouses should be performed periodically to ensure large variances do not go without correction for long periods of time. When large adjustments occur, it is an indication that record keeping is inaccurate or theft of supply is occurring, which should result in an unexpected physical inventory count to be conducted. Properly tracking supply balances across the agency will help ensure the appropriate amounts are ordered at appropriate times.

**Management Response**

The physical inventory will be conducted by a team member of General Services, i.e. Inventory Control Specialist II or Inventory Control Supervisor, when directed by the Inventory Control Manager. A worksheet, containing all gaming consumable products, without quantities, will be provided by the ICM.

After completing the physical count, the employee will sign and date the worksheet and return it to the ICM. The ICM will then review and compare the quantities shown on the Intralot Consumables Spreadsheet, and if necessary, enter adjustments. The worksheet will be scanned and saved for audit purposes. Major discrepancies in quantities will be investigated and documented.

To address the supply and distribution risks identified in the OBM Merchandise Audit conducted last year, the Lottery has tested and procured InFlow, a powerful inventory management software program that will track orders, control stock, and manage supply at Perkins Warehouse and the Lottery regional offices.

InFlow has been deployed to all end users who have already conducted physical inventories and have updated their quantities on hand.



We are now in the process of adding gaming consumables to the POS Inventory list. Once done, inventory levels, at all locations, can be instantly viewed. End users will have the ability to deplete their stock as gaming consumables are distributed.

Risk*	Remediation Owner	Estimated Completion Date
Moderate	Inventory Control Manager	May 2017



## Appendix A – Classification of Conclusions and Observations

### Classification of Audit Objective Conclusions

Conclusion	Description of Factors
<b>Well-Controlled</b>	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.
<b>Well-Controlled with Improvement Needed</b>	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
<b>Improvement Needed</b>	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.
<b>Major Improvement Needed</b>	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
<b>Low</b>	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Agency Management; State Audit Committee (Not reported)
<b>Moderate</b>	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
<b>High</b>	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