



M E M O R A N D U M

Date: December 3, 2008

To: California State Lottery Commission

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Director

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Subject: Item 9(d) – Establishment of an Audit Committee

ISSUE

Should the California State Lottery Commission (Commission) approve the establishment of an Audit Committee?

RECOMMENDATION

California State Lottery (Lottery) staff recommends that the Commission approve the establishment of an Audit Committee.

BACKGROUND

Senate Bill 1452 (chaptered September 2006) requires any governing body that oversees a state agency that performs or reviews internal audits to establish an Audit Committee. Senate Bill 1452 is designed to raise the importance of the Internal Audit function in California. The bill requires the Audit Committee to generally meet the frameworks recommended by the American Institute of Certified Public Accountants (AICPA) referenced in the publication, "AICPA Audit Committee Toolkit: Government Organizations" (Guidelines).

According to best practices, management, the Commission, and the Audit Committee all play critical roles in an organization's ethical environment and its compliance with laws and regulations. In addition, best practices and the framework of AICPA Guidelines

recommend the use of the Audit Committees to monitor an organization's ethical environment and its compliance with laws and regulations.

DISCUSSION

The California State Lottery Act defines the Commission as the five members appointed by the Governor to oversee the Lottery. The Lottery is overseen by a governing body and has a function that performs internal audits. Therefore, the Lottery is subject to the Audit Committee requirements of Senate Bill 1452.

Moreover, a survey of other United States Lotteries disclosed that most lotteries have an Audit Committee made up of a sub-set of its Commission or board of directors and that the Internal Audit group maintains a direct reporting relationship to the Audit Committee. Audit Committees are considered a best practice in both private and public industries.

In addition, an Audit Committee can assist the Commission in fulfilling its oversight responsibilities for (1) the integrity of the Commission's financial statements, (2) the company's compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence, and (4) the performance of the company's internal audit function and independent auditors.

Therefore, in order to be compliant with Senate Bill 1452 and follow best practices, the Commission should approve the establishment of an Audit Committee.

Once established, Lottery staff will assist the Commission in nominating and appointing committee members and a chairperson. Progress will be reported by staff at the next Commission meeting. Subsequent steps to consider include drafting the Audit Committee Charter and planning a tentative calendar for the coming year.