

TEXAS LOTTERY COMMISSION INTERNAL AUDIT DIVISION



An Internal Audit of INSTANT TICKET GAME CLOSING, RETURN & DESTRUCTION

IA #09-013
February 2009

James A. Cox, Jr.
Chairman

David J. Schenck
Commissioner

Mary Ann Williamson
Commissioner



TEXAS LOTTERY COMMISSION

Gary Grief, Deputy Executive Director

Philip D. Sanderson, Charitable Bingo Operations Director

February 4, 2009

Mr. James A. Cox, Jr.
Texas Lottery Commission
P.O. Box 16630
Austin, TX 78761-6630

Dear Chairman Cox:

The accompanying report details Internal Audit's recently completed review of Instant Ticket Game Closing, Return and Destruction. The purpose of the audit was to assess the effectiveness of controls for ensuring instant ticket games for which all top level prizes have been claimed are:

1. Closed in accordance with commission policies and procedures, and
2. Tickets are returned and destroyed in accordance with the lottery operator contract and commission policies and procedures.

Overall, based on the results of our review and testing, controls provide reasonable assurance that instant ticket games are closed, and tickets are returned and destroyed in accordance with commission policies and procedures. Additionally, we present management recommendations to strengthen the current processes.

Responsible management has expressed agreement with Internal Audit's conclusions and recommendations detailed in the report and has included corrective actions in its responses. If you desire further information concerning this review, please do not hesitate to contact me at 512/344-5488.

Respectfully submitted,

A handwritten signature in blue ink that reads "Catherine A. Melvin".

Catherine A. Melvin, CIA, CPA
Director, Internal Audit Division

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
DETAILED REVIEW RESULTS.....	2
I. CLOSING OF GAMES	2
<i>a) Identifying Games Needing Closing.....</i>	<i>2</i>
<i>b) Initiating Game Closing Procedures.....</i>	<i>2</i>
<i>c) Accuracy of Number of Top Level Prizes Available.....</i>	<i>3</i>
<i>d) Steps Taken to End Ticket Sales of an Instant Game</i>	<i>4</i>
II. TICKET RETURNS AND DESTRUCTION	4
<i>a) Instant Ticket Returns</i>	<i>4</i>
<i>b) Instant Ticket Destruction</i>	<i>6</i>
III. PROCESS LIMITATIONS.....	7
<i>a) Accounting of Instant Tickets</i>	<i>7</i>
AUDIT PURPOSE, SCOPE AND METHODOLOGY	9

This page left intentionally blank.

EXECUTIVE SUMMARY

The Texas Lottery Commission (TLC) offers over 100 instant ticket games to the licensed retailers for sale to the public each year. TLC monitors the instant ticket games for performance as well as the number of top level prizes remaining to be claimed in each game to determine when a particular game should be closed. In March 2007, the Texas Lottery Commission implemented procedures to initiate the closing of an instant ticket game once all top level prizes have been claimed. This policy was adopted and formalized under Texas Administrative Code §401.302, effective June 2007. Since the implementation of this procedure through October 2008, 41 of 163 games closed (25%) were closed as a result of all top level prizes being claimed¹.

The objective of this audit was to assess the effectiveness of controls for ensuring instant ticket games for which all top level prizes have been claimed are:

1. Closed in accordance with commission policies and procedures, and
2. Tickets are returned and destroyed in accordance with the lottery operator contract and commission policies and procedures.

Based on the results of our review and testing, controls provide reasonable assurance that instant ticket games in which all top level prizes have been claimed are closed, and tickets are returned and destroyed in accordance with commission policies and procedures. In addition, we present management recommendations to strengthen the current processes.

Internal Audit would like to express our appreciation to the Lottery Operations Division and the Information Resources Department for their cooperation and assistance during this engagement. Their courtesy and responsiveness extended to Internal Audit allowed us to complete our work effectively and efficiently.

¹ These numbers represent games in which game closing procedures were initiated during March 28, 2007 – October 31, 2008.

DETAILED REVIEW RESULTS

Internal Audit reviewed the process for closing, returning and destroying instant tickets for those games in which all top level prizes have been claimed. The results of our review are presented below.

I. CLOSING OF GAMES

In March 2007, the Texas Lottery Commission implemented procedures to initiate the closing of an instant ticket game once all top level prizes have been claimed. This policy was adopted and formalized under Texas Administrative Code §401.302, effective June 2007. Since the implementation of the procedures through October 2008, 41 of 163 games closed (25%) were closed as a result of all top level prizes being claimed².

a) Identifying Games Needing Closing

The agency must timely and accurately identify when all top prizes for an instant game have been claimed. This enables TLC to begin game closing procedures and provides players additional information to make informed choices on which games to purchase.

Internal Audit reviewed active games during the period of March 28, 2007 through October 31, 2008 to determine if instant games in which all top level prizes had been claimed were identified and closing procedures were initiated in accordance with TLC procedures.

Our testing confirmed TLC appropriately identified all games in which all top level prizes had been claimed and initiated closing procedures in accordance with approved agency procedures.

b) Initiating Game Closing Procedures

Per agency procedure³, a game's call date is "the Friday of the week in which the agency learns that all top prizes in the game have been claimed." The call date is the official initiation of game closing procedures and begins the 45 day timeline for ending ticket sales as required by TAC §401.302. The 45th day is the official close of game date and marks the end of the game. (Figure 1)

² These numbers represent games in which game closing procedures were initiated during March 28, 2007 – October 31, 2008.

³ Closing Instant Ticket Games Procedure LO-PD-004, Effective September 13, 2007

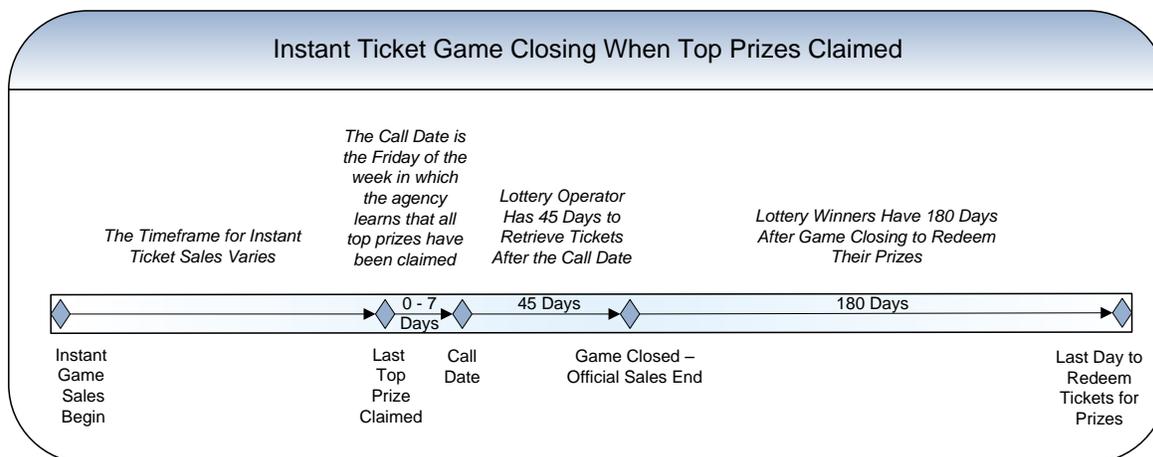


Figure 1

In order to determine if the games identified for closure were closed in accordance with TLC policies and procedures, Internal Audit recalculated the call date and the close of game date based on data provided by Information Resources. We recalculated the call date by reviewing the date the last top level prize was claimed and determining the date of the following Friday. This information was then used to determine the close of game date by adding 45 days. Internal Audit verified the calculated dates to the dates shown on documents provided by Lottery Operations. Based on these recalculations, Internal Audit determined that the call dates and the close of game dates were set in accordance with TLC policies and procedures.

Because the procedure sets the call dates on a Friday, it is possible for the call dates to be several days after the date the last top level prize is claimed. As a result, the close of game dates are sometimes as many as 52 days after the last top level prize is claimed. This practice could create confusion regarding the timeline for closing a game.

Recommendation: Internal Audit recommends TLC set the call date for games in which all top level prizes have been claimed as the same date TLC is aware the prize has been claimed or TLC should clarify the Instant Ticket Game Rules to provide transparency of when the game closing timeframe begins.

Management Response: Management agrees with the recommendation. The Lottery Operations Products Department will modify the procedure, Closing Instant Ticket Games, LO-PD-004. The procedure will detail how games in which all top prizes have been claimed will be “called” on the same business day Products Department staff is aware the top prize has been claimed.

Expected date for revision/approval of Procedure LO-PD-004 is March 2, 2009.

c) Accuracy of Number of Top Level Prizes Available

The accuracy of the number of prizes available for each instant ticket game is essential in TLC’s ability to identify games that should be closed due to all top level prizes being claimed. To ensure the accuracy of the number of top level prizes available in the 41 instant games tested, Internal Audit compared the prize amount and number of prizes in PROSYS to the End of Production Prize Structure provided by the instant ticket manufacturer. Internal

Audit confirmed that the prize amounts and the number of prizes in PROSYS matched the information from the instant ticket manufacturer for all games tested.

d) Steps Taken to End Ticket Sales of an Instant Game

In accordance with the Closing Instant Ticket Games procedure, when all top level prizes have been claimed, the Lottery Operations Products Department immediately places a graphic on the website informing the public that the instant game will be closing soon and sends a game closing announcement to the retailers and the Lottery Operator via a terminal message. The announcement states:

The following game has had all of its top prizes claimed.... Stop selling this game immediately and remove POS. Remove the inventory from the dispensers and store it properly until your sales rep can pick it up on their next visit to your store.

Upon receipt of this announcement, the Lottery Operator enters the game close date into PROSYS which stops any future shipments of the instant game to the retailers. In addition, the inventory reports available to the retailer and also utilized by the Lottery Operator's Sales Representatives (LSR) will indicate a 'C' before the instant game number to immediately inform the retailer and the LSR that the game is closing and the game inventory should be returned. Internal Audit observed the End of Game Notice sent to retailers for Game No. 1088, Triple Tripler, when game closing procedures were initiated. In addition, Internal Audit observed the LSR's process for the removal of Triple Tripler from several retail locations. Through observation, Internal Audit verified the Products Department is notifying retailers of a game closing through terminal messages and the Lottery Operator through e-mails. Internal Audit also confirmed the LSRs are removing tickets for closing games from the retailer bins during their visits in accordance with the Lottery Operator's procedure.

II. TICKET RETURNS AND DESTRUCTION

a) Instant Ticket Returns

Once games have been identified as having all top prizes claimed, it is essential tickets in the retailers' possession be retrieved from the retailers and are placed in returned in transit status. Retrieving ticket inventory ensures tickets are no longer available for sale. It is the Lottery Operator's responsibility to retrieve closing game inventory during the 45 days from the call date to the close of game date. The day after the close of game date, TLC will auto-settle any packs of tickets that remain in the retailer's inventory⁴ but have not been returned within the 45 days. The auto-settle process charges any outstanding tickets to the retailer's account. The Lottery Operations Retailer Services department will send the auto-settle information to the Lottery Operator directing them to retrieve these tickets. As stated above, Internal Audit observed the Lottery Operator's process for retrieving closing game inventory. Additionally, Internal Audit performed an analysis of the retrieval of tickets from games closed due to all top level prizes being claimed. We found, 93.8% of tickets returned are placed in returned in transit status within 30 days of the game call date. Of the remaining packs returned, 5.4%

⁴ Tickets that are in confirmed or active status.

were placed in returned in transit status within 45 days and less than 1% was placed in returned in transit status after 45 days. (Figure 2)

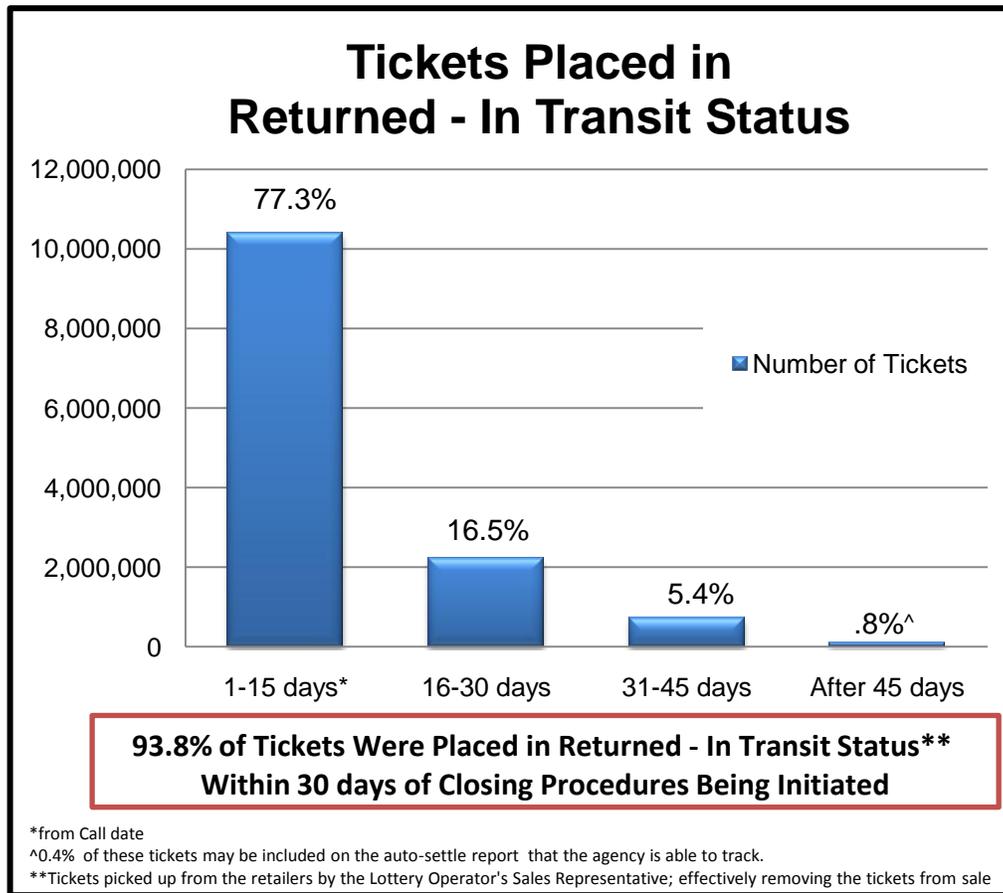


Figure 2

Internal Audit noted opportunities to strengthen the current processes regarding retrieval of closing game ticket inventory. While the Lottery Operator performs analysis of game inventory retrieval by its LSRs, at the time of our audit, TLC did not monitor the Lottery Operator's retrieval of game inventory. Nor did TLC perform an analysis of tickets returned after the close of game date. However, TLC management has recently drafted procedures to better monitor the Lottery Operator's retrieval of closing game ticket inventory.

Recommendation: We recommend TLC adopt procedures to monitor the Lottery Operator's retrieval of the tickets during the 45 day timeframe. We further recommend TLC perform analysis of the auto-settle reports as well as packs returned after the 45th day to identify any trends of retailers who repeatedly do not have all tickets returned within the 45 days and/or the Lottery Operator's districts that repeatedly do not have all tickets returned within the 45 days. This will allow TLC to take appropriate action to ensure tickets are returned within the 45 days.

Management Response: Management agrees with the recommendation. The Lottery Operations Retailer Services Department will develop procedures and reports to monitor the retrieval of tickets during the 45 day timeframe after the call of a game to ensure that ticket collection is proceeding in a manner consistent with ensuring the 45 day retrieval period. Retailer Services will also develop procedures and reports to analyze the auto-settle process and identify trends related to individual retailers and sales districts that repeatedly do not have tickets returned within 45 days from the call of a game. Retailer Services will utilize this information to work with retailers and the Lottery Operator on the timely return of tickets during the call period.

Expected date for revision/approval of LO-RS-110 is April 3, 2009. The procedure revisions will address both return monitoring and auto settle analysis. Work with retailers and the Lottery Operator related to ensuring timely return of tickets will be ongoing.

In addition, as stated earlier, TLC is reliant upon the Lottery Operator to timely retrieve closing game inventory to minimize the opportunity for closed games to be sold. This is particularly significant for games in which all top level prizes have been claimed. While our testing and observations confirm the Lottery Operator retrieved closing game inventory within the 45 day timeframe and instituted controls to assist their ongoing conformance, it is important that TLC is able to enforce this requirement should the Lottery Operator fail to meet the mandated timeframe in the future.

Recommendation: We recommend management ensure the requirement for the Lottery Operator to retrieve closing game tickets within 45 days is enforceable.

Management Response: Management agrees with the recommendation. The Lottery Operations Retailer Services Department will utilize the reports and procedures outlined in the prior management response to monitor the performance of the Lottery Operator in ensuring the 45-day timeframe is being administered properly. Additionally, management is contracting with an external vendor to monitor performance and compliance on the part of the Lottery Operator. Management will ensure that the vendor routinely evaluates the performance of the lottery operator related to these requirements.

Expected date for revision/approval of LO-RS-110 is April 3, 2009. Performance monitoring of contractual requirements will be ongoing. A contract is being initiated currently with a vendor to perform lottery operator performance and compliance monitoring. Lottery Operations and Administration will work with the new vendor to ensure that this requirement is reviewed in the early stages of work beginning under this contract.

b) Instant Ticket Destruction

To ensure instant tickets are destroyed in accordance with agency policies and procedures, Internal Audit observed the destruction process. In the destruction of instant tickets, TLC warehouse staff do not distinguish between those games closed due to all top prizes having been sold and those games closed due to other reasons. According to agency procedure⁵, tickets which have been verified as returned by TLC warehouse staff are stored according to

⁵Releasing Instant Ticket Inventory for Destruction Procedure LO-RS-075, Effective October 20, 2008

the verification date and “are eligible for destruction 90 days after sanctions are charged for non-conforming and/or omitted tickets.”

When tickets are eligible for destruction, warehouse staff receive approval from TLC management to destroy the tickets and coordinate the destruction with the Lottery Operator staff and the shredding facility. To ensure all tickets are actually destroyed at the shredding facility, the Lottery Operations Security Department provides witness and observation of the destruction process beginning at the Lottery Operator warehouse and ending at the shredding facility.

Our observation confirmed that instant tickets were destroyed in accordance with agency policies and procedures.

III. PROCESS LIMITATIONS

Instant Ticket Game Rules⁶ state “the procedure shall provide for ending ticket sales in an instant game within 45 days after game closing procedures have been initiated” and further states “no tickets in an instant game may be sold after the instant game closing date.” However, in practice TLC cannot provide complete assurance of the end of ticket sales because of limitations in the accounting of instant tickets and the potential for actions of licensees in violation of TLC’s administrative rules. The current system of accounting of instant tickets tracks packs of tickets that have been settled to a retailer’s account but does not track tickets actually sold by the retailer. Accordingly, an inherent risk exists that tickets for a closed game that have been settled to a retailer’s account *may still be available for sale after the close of a game.*

a) Accounting of Instant Tickets

Instant games are provided to licensed retailers in packs of tickets. These packs are tracked via PROSYS, the Lottery Operator’s gaming system. PROSYS tracks when the retailer:

- Confirms receipt of a pack of tickets,
- Activates a pack of tickets prior to selling the pack,
- Returns a pack of tickets , and
- Is charged for tickets as the pack is settled.

How Are Packs of Instant Tickets Settled?

Automatically

- 45 Days after a Pack has been Activated
- After 70% of the Guaranteed Prizes for that Particular Pack have been Claimed
- After an Instant Ticket Game’s Official End of Game Date

Manually

- By the Retailer Anytime After the Pack has been Activated

Figure 3

Prior to selling tickets, the retailer must confirm receipt of the pack of tickets and then activate the pack. Consistent with industry practice, PROSYS is designed to track the status

⁶ TAC §401.302 Instant Ticket Game Rules

of packs of tickets, not individual tickets; therefore, individual sales of tickets are not recorded in the system.

TLC collects the revenue from an instant ticket game when a pack is settled to the retailer's account, not as the tickets are sold by the retailer. (Figure 3) Once a pack of tickets has been settled to a retailer's account, there is no longer a mechanism in the system for tracking the pack. Aside from visual inspection by the LSR, neither TLC nor the Lottery Operator can determine if a pack of tickets that has been settled is still available for sale at a retail location. As shown in Figure 2, a small percentage of returned tickets were placed in returned in transit status (picked up from the retailer) after the 45 days or closing date. These tickets represent tickets remaining at the retail location after the game closing date and illustrate the risk that tickets for closed games could continue to be sold. After the game closing date, TLC is reliant upon the retailer to no longer sell tickets of closed games that remain in the retailer's possession.

Recommendation: We recommend the Commission continue its efforts and seek additional opportunities to ensure transparency and clarity of what TLC and the Lottery Operator can provide assurance within the 45 day game closing timeframe. While language exists elsewhere in rule, we further recommend the Commission also include language under "Restricted Sales"⁷ prohibiting retailers from selling instant tickets after the game closing date.

Management Response: *Management agrees with the recommendation. The Lottery Operations Retailer Services Department will propose language amending TAC 401.355 Restricted Sales to specifically prohibit retailers from selling instant tickets after the game closing date.*

Expected date for Commission approval and final effective date for amendment to TAC 401.355 – Restricted Sales is October 1, 2009.

⁷ TAC §401.355

**AUDIT PURPOSE, SCOPE AND
METHODOLOGY**

Purpose:

Internal Audit completed a review of instant ticket game closing, return and destruction for those games in which all top level prizes have been claimed, as specified in the approved Fiscal Year 2009 Internal Audit Activity Plan. The objective of our audit was to assess the effectiveness of controls for ensuring instant ticket games are:

1. Closed in accordance with commission policies and procedures, and
2. Tickets are returned and destroyed in accordance with the lottery operator contract and commission policies and procedures.

Scope:

Internal Audit limited the scope of this review to instant ticket games closed after all top level prizes had been claimed. The procedure initiating the closing of games when all top level prizes have been claimed was effective March 28, 2007; therefore, our population included instant ticket games that were active during the period of March 28, 2007 through October 31, 2008.

Methodology:

In accomplishing our objective, Internal Audit obtained the active instant ticket game population from Information Resources, the Lottery Operator and the Lottery Operations Products Department. Internal Audit compared the three sets of data to verify accuracy and completeness and to obtain our audit population. Internal Audit then obtained all instant ticket games from our population in which all top level prizes had been claimed and the date the last top level prize was claimed. We recalculated the call date and close of game date based on the date the last top level prize was claimed. We analyzed the number of days between the call date and the close of game date.

In addition, Internal Audit requested data from Information Resources regarding when instant tickets were placed into return in transit status after the call date. These results were analyzed to determine the number of days taken by the Lottery Operator to collect tickets from retailers. The results were then compared to the number of tickets auto-settled on the next business day after the game closed.

Internal Audit performed observations of the instant ticket return process and the destruction of instant tickets process to ensure appropriate procedures were followed. Internal Audit interviewed responsible TLC and GTECH management and staff, examined and reviewed supporting documentation and electronic files, and performed selected test work as deemed necessary. Internal Audit's review did not include verifying the reliability and integrity of data from PROSYS. We relied upon other independent audit work as relevant and appropriate⁸.

⁸ GTECH Texas, Report on Controls Placed in Operation and Tests of Operating Effectiveness, September 16, 2008.

Auditor’s Consideration of Fraud:

In accordance with our professional standards, Internal Audit considered risks due to fraud that could significantly affect our audit objectives and the results of our audit. Accordingly, we designed our procedures to provide reasonable assurance of detecting fraud significant to the audit objectives. During the course of the audit, we were also alert to situations or transactions that could be indicative of fraud. We conducted our audit to provide reasonable assurance of detecting illegal acts or fraud that could significantly affect the audit results; however, it does not guarantee the discovery of illegal acts or fraud.

Professional Standards:

Internal Audit conducted this performance audit in accordance with the International Standards for the Professional Practice of Internal Auditing as promulgated by the Institute of Internal Auditors (IIA) in conjunction with generally accepted government auditing standards (GAGAS) as promulgated by the U.S. Government Accountability Office (GAO). 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.

STATE OF TEXAS
TEXAS LOTTERY COMMISSION

INTERNAL AUDIT DIVISION

An Internal Audit of
INSTANT TICKET GAME CLOSING, RETURN & DESTRUCTION

IA #09-013

February 2009

This report has been provided to the following:

Mr. James A. Cox, Jr., Chair
Mr. David J. Schenck, Commissioner
Ms. Mary Ann Williamson, Commissioner

Mr. Gary Grief, Deputy Executive Director
Mr. Philip D. Sanderson, Charitable Bingo Operations Director

This report is also provided to the following for appropriate distribution in accordance with
Government Code §2102.009:

Ms. Mary Katherine Stout, Director, Governor's Office of Budget, Planning and Policy
Mr. John O'Brien, Director, Legislative Budget Board
Mr. Joey Longley, Director, Sunset Advisory Commission
Mr. John Keel, CPA, State Auditor