



**TEXAS LOTTERY
COMMISSION**

Internal Audit Services

Audit Report of:

Scratch Ticket Reconstruction Controls

Audit Report #17-002

January 19, 2016

Prepared By:



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CERTIFIED PUBLIC ACCOUNTANTS

This report provides management with information about the condition of risks and internal controls at a specific point in time. Future changes in environmental factors and actions by personnel will impact these risks and internal controls in ways that this report cannot anticipate.



Introduction

McConnell & Jones LLP (MJ), serving as the outsourced internal audit function (Internal Audit) for the Texas Lottery Commission (TLC), performed an internal audit of the scratch ticket reconstruction processes and internal controls. This audit was part of the FY17 approved audit plan at the Texas Lottery Commission. We conducted this audit in accordance with generally accepted government audit standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient appropriate evidence to provide a reasonable basis for the audit findings and conclusions based on the audit objectives. We believe the evidence obtained meet these requirements.

Pertinent information has not been omitted because it was not deemed privileged or confidential by law. This report summarizes the audit scope, our assessment based on the audit objectives and the analysis of Texas Lottery Commission's scratch ticket reconstruction process.

Objectives and Scope:

The audit of scratch ticket reconstruction was conducted to ensure the control environment addresses the associated risks with the business processes related to requesting and receiving scratch ticket reconstructions from ticket manufacturers (vendors). We have completed the audit of the scratch ticket reconstruction processes due to the impact that the process has on TLC's ability to meet the following business objectives:

- Maintain public trust and integrity of lottery scratch ticket games.
- Ensure that sensitive information received from customers and manufacturers is safeguarded.

Audit Period:

The audit period included September 1, 2014 – August 31, 2016. However, some test procedures were performed as of fieldwork date.

Results and Conclusions:

Based on the audit results, we determined that **controls over the scratch ticket reconstruction processes are effective and working as intended to achieve the business objectives**. Our audit testing concluded that overall, the Texas Lottery Commission has adequate controls in place to ensure that scratch tickets reconstruction requests are stringently controlled, authorized, monitored and accounted for to prevent malfeasance or loss. We also observed scratch ticket production and reconstruction internal controls at one of TLC's scratch ticket manufacturers. These controls add an additional layer of security to ensure that winning ticket information is tightly controlled and limited to only authorized individuals.



The Texas Lottery Commission and scratch ticket manufacturer internal controls over scratch ticket production and reconstruction data ensure the integrity and fairness of scratch ticket games.

The TLC internal control environment is accomplished through:

- Well documented policies and procedures that are understood and followed by employees.
- Defined roles and responsibilities for the scratch ticket reconstruction processes.
- Limited number of staff with authority to authorize and request scratch ticket reconstructions from scratch ticket manufacturers.
- Limited number of staff with access to scratch ticket reconstruction information.
- Monthly reconciliations of scratch ticket reconstruction request and usage.

Background:

Scratch ticket reconstruction is a process whereby the data that was originally printed on a scratch ticket is provided to TLC upon authorized requests. Ticket manufacturers can reconstruct information about specific scratch tickets when specific information is unknown, missing or may have been tampered with. Scratch ticket information is sensitive and authorization to request ticket reconstructions is strictly controlled. Only designated TLC Security Department personnel have authority to request reconstructions from ticket manufacturers and requests must be on a designated TLC form. A unique reference number is assigned to each request and request information is entered into a reconstruction request log maintained by TLC's Security Department. Ticket manufacturers provide a monthly report to TLC's Security Department documenting all requests submitted by the TLC. The monthly report is then reconciled with TLC's Security Department's request log.

The purpose for requesting scratch ticket reconstructions are limited to:

- Compliance and investigations conducted by TLC's Enforcement Division;
- Validating scratch ticket information for certain retailer adjustments; and
- Validating scratch tickets submitted by customers that were not able to be validated at retailers or claims centers due to missing, damaged or altered ticket information.

Currently, the Texas Lottery Commission receives scratch ticket games from three contracted manufacturers. These manufacturers and the Texas Lottery Commission follow documented processes to ensure scratch ticket reconstruction requests are electronically transmitted in a secure manner (encrypted software). It is the responsibility of the Texas Lottery Commission, specifically the Security Department, to ensure that each scratch ticket manufacturer has signature examples on file for all authorized TLC personnel involved in the scratch ticket reconstruction request process. These authorized signature examples are used by the manufacturers for the purposes of confirming the reconstruction requestor and approver. Signature examples are reconciled between TLC Security Department staff and the three scratch ticket manufacturers annually and as staff changes occur. Additionally, TLC's Security Department is responsible for ensuring adequate approval is documented prior to requesting reconstruction data from the ticket manufacturers. A limited number of Security Department staff are responsible for requesting scratch ticket reconstructions based on reasons specified in Procedure Number LO-SE-001: Ticket Reconstruction. No other TLC divisions or staff can submit scratch ticket reconstruction requests to the ticket manufacturers.



Upon receiving the actual encrypted reconstruction file from the respective scratch ticket manufacturer, the Security Department Staff decrypt the sensitive information and then perform one of the following activities:

- Forwards reconstruction data to designated staff in TLC’s Enforcement Division for compliance and investigation purposes;
- Forwards reconstruction data to designated staff in TLC’s Retailer Services Division for determination of retailer adjustments;
- Forwards reconstruction data to the Austin Claims Center (ACC) for claim payment determination or opens an investigate case as a result of the information obtained from the reconstruction.

On a monthly basis, the Enforcement Division conducts a reconciliation of scratch tickets used in investigations that have been reconstructed. The Enforcement Division submits their monthly scratch ticket reconciliations and supporting information to the Office of Controller for review. The review process consists of verifying the number of requested scratch tickets, if the scratch tickets were redeemed at retailers or returned to inventory, and when cash is submitted by the investigator and submitted to the Austin Claim Center for deposit.

TLC’s Security Department requested a total of 3,122 scratch ticket reconstructions from the three scratch ticket manufacturers from September 1, 2014 to August 31, 2016. **Figure A** provides a summary of scratch ticket reconstruction requests by manufacturer.

Scratch Ticket Reconstructions Requests	FY2015	FY2016
Vendor #1	426	519
Vendor #2	363	400
Vendor #3	451	963
Total Scratch Ticket Reconstructions Requested	1,240	1,882

Figure A: Summary of TLC Scratch Ticket Reconstruction Requests by Manufacturer *TLC requested 1,240 scratch ticket reconstruction requests in FY2015 and 1,882 in FY2016. The increase in reconciliations performed were for documented business reasons and no issues with these requests were identified in the audit.*

Acknowledgement:

We wish to thank all the staff involved in the audit for their professionalism and positive outlook towards the audit process performed on the business processes. The timely completion of this audit was due to their efforts and responsiveness to our requests.



Scratch Ticket Reconstruction Business Objectives, Risks and Results

Objective #	1 – Scratch Ticket Reconstruction Requests
Business Objective	To ensure that scratch ticket reconstructions are requested for valid purposes.
Business Risk	<ul style="list-style-type: none"> ➤ Unauthorized reconstruction requests are submitted to scratch ticket manufacturers. ➤ Reputational risks due to TLC employees obtaining scratch ticket reconstruction information for malicious intent to achieve personal gain.
Management Controls	<ul style="list-style-type: none"> ➤ TLC maintains updated procedures with specific purposes for requesting reconstructions. ➤ An established approval hierarchy is in place based on reconstruction request levels; all requests require dual signature, requestor and approver. ➤ TLC’s Security Department ensures that each scratch ticket manufacturer has updated signature examples on file for validating requestors and approvers for the process. ➤ Evidence of physical scratch ticket possession is required prior to submitting scratch ticket reconstruction requests to scratch ticket manufacturers.
Control Effectiveness Rating	Effective
Audit Testing Results	No exceptions noted.
Recommended Actions	None.
Observation Risk Rating	N/A – No Observations Noted.
Management Action Plans	None Required.



Objective #	2 – Scratch Ticket Reconstruction Request Tracking
Business Objective	To ensure that scratch ticket reconstruction requests and reconstruction data received and distributed is tracked.
Business Risk	<ul style="list-style-type: none"> ➤ Unauthorized reconstruction requests submitted to scratch ticket manufacturers go undetected. ➤ Scratch ticket reconstruction data could be accessed by unauthorized individuals.
Management Controls	<ul style="list-style-type: none"> ➤ Scratch ticket reconstruction requests are logged by TLC’s Security Department and the respective scratch ticket manufacturer. ➤ Each scratch ticket manufacturer provides the TLC Security Department with their request log of all reconstruction requests received from and processed for the TLC during the prior month. The Security Department reconciles the TLC Reconstruction Request Log with the Ticket Manufacturer vendors’ reconstruction logs. This reconciliation is reviewed and approved by the TLC Security Manager. ➤ Designated Security Department staff perform a monthly reconciliation to ensure that all scratch ticket reconstructions requested from scratch ticket manufacturers were received and distributed to authorized employees involved in the reconstruction process. This reconciliation is reviewed and approved by TLC’s Security Manager.
Control Effectiveness Rating	Effective.
Audit Testing Results	No exceptions noted.
Recommended Actions	None.
Observation Risk Rating	N/A – No Observations Noted.
Management Action Plans	None Required.



Objective #	3 –Scratch Ticket Reconstruction Data and Ticket Physical Security
Business Objective	To safeguard scratch ticket reconstruction data and associated scratch tickets.
Business Risk	<ul style="list-style-type: none"> ➤ Lack of physical safeguards could result in missing or stolen reconstruction data or tickets and financial loss. ➤ Reputational risks due to TLC employees obtaining scratch ticket reconstruction information or tickets for malicious intent.
Management Controls	<ul style="list-style-type: none"> ➤ Scratch ticket reconstruction data is electronically secured through system access controls. ➤ Physical scratch tickets used for investigation purposes are coded as such in the Instant Ticket Management (ITM) System. ➤ Physical scratch tickets used for investigation purposes are secured in a locked and secured area. This area requires an access code to enter. Access to this area is limited to only three Enforcement Division staff. ➤ Physical scratch tickets are released to authorized staff on an as needed basis and tracked by the Enforcement Division’s ticket coordinator. ➤ Enforcement Division investigators assigned scratch tickets are required to complete a form acknowledging their receipt of the scratch tickets and the purpose. This form is maintained by the Enforcement Division’s executive assistant. ➤ The Enforcement Division’s executive assistant tracks investigation tickets on a detailed log that indicates the ticket’s status and is then used to reconcile scratch tickets issued and returned.
Control Effectiveness Rating	Effective.
Audit Testing Results	No exceptions noted.
Recommended Actions	None.
Observation Risk Rating	N/A – No Observations Noted.
Management Action Plans	None Required.



Objective #	4 – Physical Investigative Scratch Ticket Reconciliations
Business Objective	To ensure that all investigation scratch tickets are fully accounted for.
Business Risk	<ul style="list-style-type: none"> ➤ Lack of physical safeguarding of investigation scratch tickets could result in unaccounted for, missing or stolen tickets.
Management Controls	<ul style="list-style-type: none"> ➤ Two designated Enforcement Division staff jointly perform a monthly scratch ticket inventory reconciliation through a tracking sheet generated from the Instant Ticket Management (ITM) System which lists all tickets in the Enforcement Division’s possession. The tracking sheet is used as a checklist to verify the status of each winning scratch ticket number and to perform a physical count of all winning instant tickets in the investigation inventory. ➤ The Enforcement Division’s executive assistant also performs a monthly winning scratch ticket reconciliation. This reconciliation reconciles beginning investigation ticket inventory to ending investigation ticket inventory (including ticket destructions, returns, additions and validations/redemptions as a result of retailer investigations) for the associated reconciliation period. This reconciliation ensures that the Enforcement Division’s ticket coordinator verifies and deposits the total amount collected for investigation scratch tickets (per the Lottery Operator Gaming System Portal) through the Austin Claim Center. ➤ The Enforcement Division director reviews and approves all scratch ticket reconciliations. ➤ Each winning scratch ticket reconciliation and all associated supporting documentation is submitted to TLC’s Office of the Controller ➤ The Office of Controller reconciles the submitted winning scratch ticket reconciliation to actual cash collected and deposited at the Austin Claim Center. The Office of Controller’s financial accounting and reporting director reviews and approves this reconciliation.
Control Effectiveness Rating	Effective.
Audit Testing Results	No exceptions noted.
Recommended Actions	None.
Observation Risk Rating	N/A – No Observations Noted.
Management Action Plans	None Required.