



**TEXAS LOTTERY
COMMISSION**



An Internal Audit of Second-Chance Drawing Processes

August 31, 2017

Report #17-008



McCONNELL & JONES LLP
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 agency’s processes for second-chance drawings. We conducted this audit in accordance with generally accepted government auditing standards (GAGAS). 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 observations and conclusions based on our audit objectives.

Pertinent information has not been omitted from this report. This report summarizes the audit objective and scope, our assessment based on our audit objectives and the audit approach.

Objectives and Scope

The purpose of this audit is to review the business processes and internal controls related to the Texas Lottery Commission’s second-chance drawing processes to determine if management controls are in place to achieve the business objectives and comply with TLC’s policy and procedures,

legislative statutes and Administrative Rules. Internal Audit examined the following business processes during the audit process:

1. Second-chance eligibility determination.
2. Second-chance winner certification.
3. Second-chance award notification.
4. Second-chance winner fulfillment.
5. Second-chance random number generator equipment is verified by the independent auditor.

The audit scope was September 1, 2015 – March 31, 2017. Observations of drawings and results to obtain an understanding of the process were conducted in the current period

Results and Conclusions

The internal controls governing Second-chance Drawing are effective and working as intended to achieve the business objectives and compliance with regulatory requirements. Our audit work identified no reportable findings. TLC’s processes for second-chance drawings are best practices that could be replicated by other state lotteries.

Rating	Description of Ratings
Best Practices	Observations indicate best practice opportunities identified during the course of the review that may add value to the function/department/organization. Best practices do not require management comments and do not require internal follow-up to validate implementation status.



Rating	Description of Ratings
Effective	Controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.
Some Improvement Needed	A few specific control weaknesses were noted; generally however, controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.
Major Improvement Needed	Numerous specific control weaknesses were noted. Controls evaluated are unlikely to provide reasonable assurance that risks are being managed and objectives should be met.
Unsatisfactory	Controls evaluated are not adequate, appropriate, or effective to provide reasonable assurance that risks are being managed and objectives should be met.

Acknowledgement:

We wish to thank all staff involved in this audit for their professionalism and positive outlook towards the assessment of their operations.

The timely completion of this audit was due to their efforts and responsiveness to our requests.



Executive Summary

A second-chance drawing is a process that enables scratch ticket players to enter their non-winning scratch ticket (ticket) for the specific scratch ticket game for which a second-chance drawing will be conducted. Only certain scratch ticket games have the second-chance drawing feature. Entries for the second-chance drawing are only allowed through TLC's Website/Luck Zone or the Texas Lottery® app. The scratch ticket player (entrant) is required to enter the game number, pack number, ticket number and validation number on the TLC Luck Zone. This information is included on each scratch ticket. **Figure 1** provides a snapshot of TLC's Second Chance Luck Zone web page. From this page, players can learn about the games that offer second-chance drawings, register for a user account and login to their account. **Figure 2** provides a snapshot of the player's login registration showing the general terms and that they certify they are registering from a Texas location.



Figure 1: Texas Lottery Commission Second Chance Luck Zone

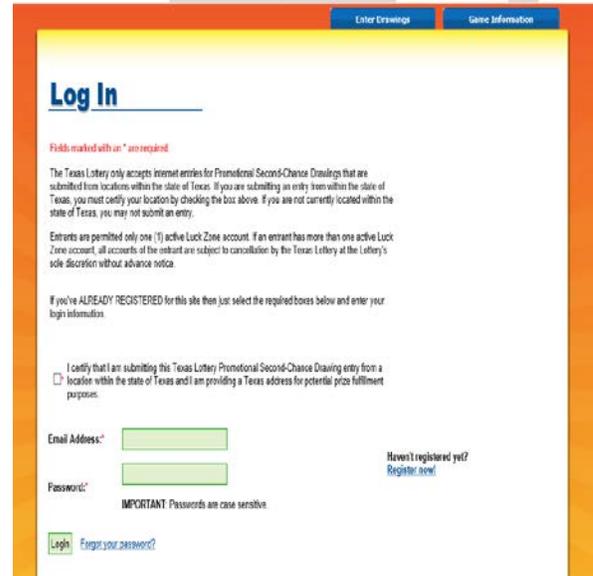


Figure 2: Texas Lottery Commission Luck Zone Login Screen

The TLC Luck Zone also provides detailed information on each game offering second-chance drawings. This includes the prizes, drawing information, a list of winners, FAQs and the second-chance entry tab. The respective game's web page also provides an option to view the winners list for each second-chance drawing. All information provided to the public and players is transparent and easy to understand. The web pages are also easy to navigate. **Figure 3** provides a screen shot of the Willy Wonka™ Golden Ticket second-chance ticket information page. **Figure 4** provides screen shots of instructions provided to players, the second-chance entry deadlines and the drawing date.



Figure 3: Example of Second-Chance Game Information Page

TrustedDraw secure electronic drawing system. Although the lottery operator vendor is responsible for performing the second-chance drawings, TLC staff are heavily involved in the process.

Each second-chance drawing is audio and video recorded and follows the same process as traditional lottery draw games. This process includes equipment inspection, testing and independent auditor certification of the process and results. TLC's Security Department staff verify that the second-chance entrants on the list are valid and that selected winners are not ineligible.



Figure 4: Second-Chance Game Entry Information Page

The second-chance drawing process requires multiple TLC teams including the Office of Controller and several Lottery Operations Division Departments including Drawings, Security, Validations and Products. Each team has defined processes, authority, roles and responsibilities documented in the agency's policy and procedures to support the business objectives. The agency supports these policies with checklists, defined approvals and an internal application called the Fulfillment Tracking System (FTS) used by the Products team to ensure the fulfillment of prizes and the proper invoicing of prize fulfillment vendors for the associated prizes. Figure 5 represents a high-level view of the second-chance drawing process and teams.

The Texas Lottery Commission's lottery operator vendor is responsible for conducting the second-chance drawings using their

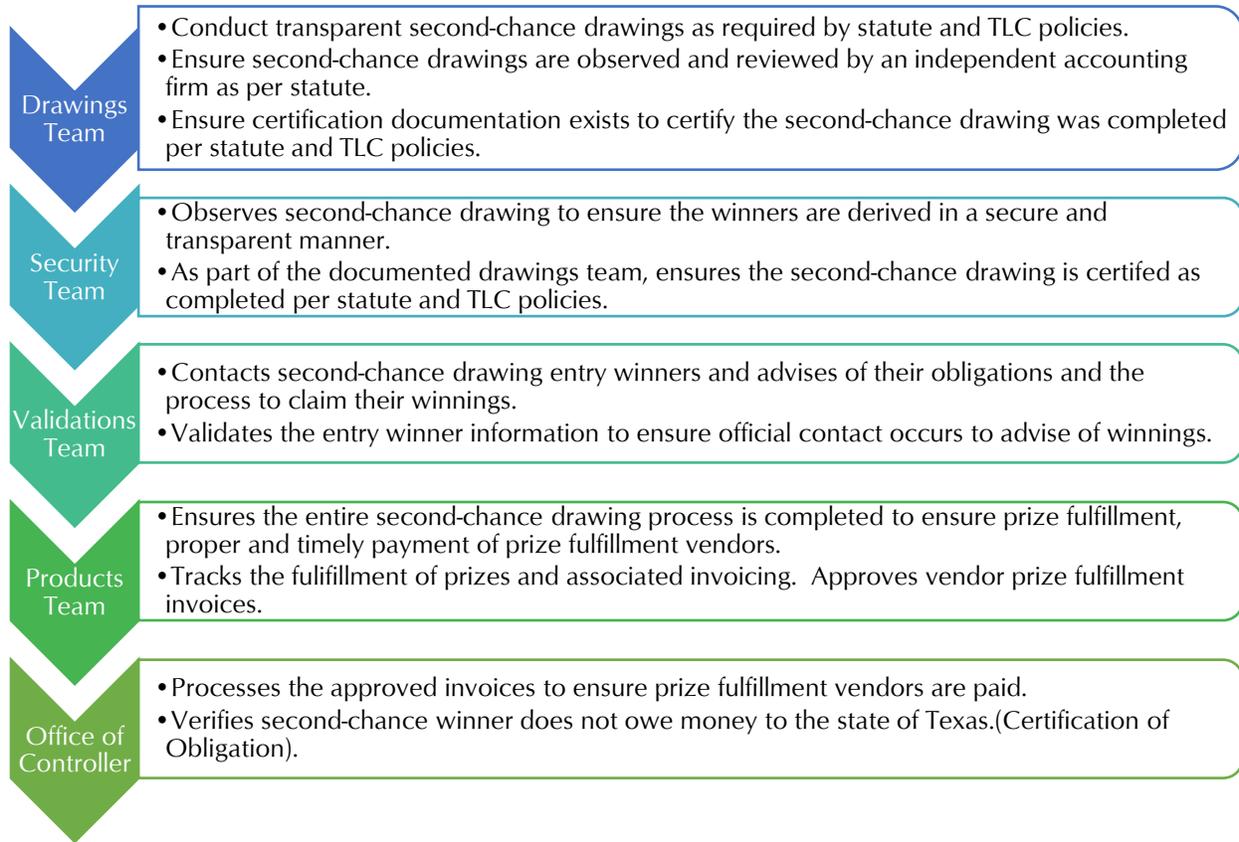


Figure 5: Texas Lottery Commission Second-Chance Drawing Process

Our assessment of the second-chance drawing business processes indicates that each business function is currently residing in the correct TLC division/department based on the expertise required to complete the function. TLC ensures the completion of the multiple functions of the second-chance drawing processes using a licensed property checklist. The licensed property checklist documents the following information:

- ✓ Second-chance drawing date.
- ✓ Date the Security Department staff approved list is provided to the Products Department staff.
- ✓ Date the second-chance drawing winners list is uploaded to the Fulfillment Tracking System.

- ✓ Date the second-chance drawing winner list is sent to the contracted vendor for prize fulfillment.
- ✓ Date that the fulfillment prize vendor invoice is reconciled in Fulfillment Tracking System.
- ✓ Date the list of second-chance drawing winners was sent to the Austin Claim Center (Validations) for fulfillment compliance tracking purposes.

The licensed property checklist was developed on a recommendation received from the State Auditor’s Office to document the completion of processes associated with the second-chance drawings. Interviews and walkthrough also indicate a mature understanding of the second-chance drawing process.



The following tables describe the Texas Lottery Commission second-chance drawing business objectives, risks, management

controls and assessment of the internal controls based on our audit procedures applied.

BUSINESS OBJECTIVE 1: Policy and Procedures	
Business Objective	Policy and procedures ensure the second-chance drawing objectives and processes are clearly described in addition to clear documentation of authority, roles and responsibilities of key stakeholders.
Business Risk	<ul style="list-style-type: none"> ➤ Second-chance process not completed in a consistent manner, which can lead to a weak internal control environment. ➤ Process owners do not understand their authority, role and responsibility. ➤ Processes completed by the divisions are not documented. ➤ Segregation of duties does not exist within the process.
Management Controls	<ul style="list-style-type: none"> ➤ Policy and procedures include detailed processes. ➤ Policy and procedures are easily accessible and updated per the agency's policy management standards. ➤ TLC has coordinated the process to ensure segregation of duties and consistent monitoring. ➤ Policy and procedures have defined the authority, responsibility and roles of key stakeholders in the second-chance drawing process.
Control Tests	<ul style="list-style-type: none"> ➤ Conducted interviews and walkthroughs. ➤ Reviewed policy and procedures. ➤ Reviewed state statutes governing the Texas Lottery Commission. ➤ Assessed policy and procedures accessibility to employees.
Control Environment	Effective
Recommended Actions	None
Management Action Plan	None Required

BUSINESS OBJECTIVE 2: Transparent and Certified Second-Chance Drawings	
Business Objective	To ensure that the agency's second-chance drawing processes are transparent, comply with state regulations and are completed in a consistent and accurate manner.
Business Risk	<ul style="list-style-type: none"> ➤ Second-chance drawing process not observed or approved using segregation of duties. ➤ Second-chance drawing process not conducted per state regulations, which include a security presence and independent certification. ➤ Second-chance drawing winners and alternates are not independently certified.



BUSINESS OBJECTIVE 2: Transparent and Certified Second-Chance Drawings

Management Controls	<ul style="list-style-type: none"> ⇒ Second-chance drawing checklist is completed by the lottery drawings coordinator. This checklist documents drawing activities were witnessed and performed in accordance with the current lottery operator vendor and TLC’s second-chance drawing procedures. ⇒ Checklist represents the drawing process details included in the current lottery operator vendor and TLC’s second-chance drawing procedures. ⇒ Second-chance drawings are certified and documented by an independent accounting firm. ⇒ Second-chance drawing schedule communicated to the divisions/departments involved in the processes. ⇒ Second-chance drawing documentation (checklists) are maintained as per the state’s records retention guidelines.
Control Tests	<ul style="list-style-type: none"> ⇒ Reviewed policy, procedures and checklists. ⇒ Conducted interviews of TLC staff involved in the second-chance drawing processes. ⇒ Observed a second-chance drawing. ⇒ Documented control activities. ⇒ Tested the control activities.
Control Environment	Effective
Recommended Actions	None
Management Action Plan	None Required

BUSINESS OBJECTIVE 3: Second-Chance Drawing Security and Winner Certification

Business Objective	To ensure processes are in place to ensure the second-chance drawing’s security and integrity and ensure the winners are eligible.
Business Risk	<ul style="list-style-type: none"> ⇒ The second-chance drawing process is not secure and does not ensure the process integrity. ⇒ TLC’s Security staff does not fulfill requirements outlined in the agency’s policy and procedures. ⇒ Winner certification to ensure eligibility is not performed. ⇒ TLC Products Department staff are not advised by the agency’s Security Department staff of the certified winners.
Management Controls	<ul style="list-style-type: none"> ⇒ TLC’s Security Department and Draw team staff independently monitor the drawings to ensure the security of information, process and assets. ⇒ TLC’s Security Department staff maintains a copy of initial winners and alternates on a USB drive, which is stored in a secured safe.



BUSINESS OBJECTIVE 3: Second-Chance Drawing Security and Winner Certification

	<ul style="list-style-type: none"> ➤ The agency assigns TLC’s Security Department staff defined authority, roles and responsibility. ➤ TLC’s Security Department staff receives the completed list of second-chance drawing winning, duplicate and alternate entries. ➤ TLC’s Security Department staff ensure second-chance ticket entries entered into the second-chance drawing were not stolen or in an invalid status. ➤ TLC’s Security Department staff review the second-chance drawing entrant list for duplicate phone numbers and restricted players. ➤ Communicate to drawing vendor if an alternate winner is needed.
Control Tests	<ul style="list-style-type: none"> ➤ Observed the second-chance drawing process. ➤ Reviewed policy and procedures. ➤ Conducted interviews with TLC staff involved with the second-chance drawing processes. ➤ Tested certification of the drawing process and second-chance drawings winner list. .
Control Environment	Effective
Recommended Actions	None
Management Action Plan	None Required

BUSINESS OBJECTIVE 4: Winner Notification and Validation

Business Objective	To ensure that second-chance drawing winners are correctly advised of their winnings/prizes in a timely manner and are processed in an efficient and effective manner.
Business Risk	<ul style="list-style-type: none"> ➤ Second-chance drawing winner notification and validation is not documented or completed in an efficient and effective manner. ➤ Second-chance drawing winner information is not reviewed to ensure winners receive the documentation needed to redeem their prize. ➤ Prize package announcements are not received by the second-chance drawing winners due to incorrect addresses. Returns are not reprocessed to ensure correct research or alternate winners are chosen. ➤ Documentation to support the second-chance drawing winner’s claims, contact and validation is not maintained.
Management Controls	<ul style="list-style-type: none"> ➤ TLC’s Validations policy and procedures define the authority, role and responsibility as it pertains to the second-chance drawing process. ➤ TLC approves the second-chance drawing notification letters with specific terms and conditions communicated to the winner.



BUSINESS OBJECTIVE 4: Winner Notification and Validation	
	<ul style="list-style-type: none"> ⇒ Second-chance drawing winners are reviewed for debts owed to state. ⇒ The second-chance drawing taxable prize process defined. ⇒ The second-chance drawing claimant must present identification to validate their claim. ⇒ Second-chance drawing returned prizes are investigated and resent as needed.
Control Tests	<ul style="list-style-type: none"> ⇒ Conducted interviews and walkthroughs with staff involved in the second-chance drawing processes. ⇒ Testing the validation of the winners to determine eligibility. ⇒ Reviewed policy and procedures.
Control Environment	Effective
Recommended Actions	None
Management Action Plan	None Required

BUSINESS OBJECTIVE 5: Vendors and Second-Chance Drawing Winners	
Business Objective	To ensure prize fulfillment vendors paid in an accurate and timely manner while ensuring winners owe no debt to the state prior to receiving their prizes.
Business Risk	<ul style="list-style-type: none"> ⇒ Invoices of prizes awarded are not paid in a timely manner. ⇒ Invoices of prizes awarded are not reviewed and approved prior to payment. ⇒ Process to validate prize fulfillment vendor payments and support documentation is not conducted in a consistent manner. ⇒ Winners receive prizes despite owing money to the state of Texas.
Management Controls	<ul style="list-style-type: none"> ⇒ Invoices of prizes awarded are reconciled and approved by the Products Department management team. ⇒ Approval of invoices by Products Department and payment support documentation maintained. ⇒ Office of the Controller reviews all winners for debt obligations to the state of Texas.
Control Tests	<ul style="list-style-type: none"> ⇒ Conducted interviews with staff involved in the processes. ⇒ Tested prize fulfillment vendor payments. ⇒ Reviewed policy and procedures.
Control Environment	Effective
Recommended Actions	None



BUSINESS OBJECTIVE 5: Vendors and Second-Chance Drawing Winners

Management Action Plan	None Required
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BUSINESS OBJECTIVE 6: Prize Fulfillment and Vendor Invoice Tracking

Business Objective	Track the certified winners and ensure vendors are invoiced properly using the Fulfillment Tracking System (FTS).
Business Risk	<ul style="list-style-type: none"> ➤ Second-chance drawing winners are not entered or tracked in FTS to ensure tracking of prize fulfillment and invoicing. ➤ Reconciliation of second-chance drawing winners and claim prizes is not completed to ensure that the winners or alternates are accurately and timely processed. ➤ Prize fulfillment vendors not invoiced when prizes are claimed. ➤ Effective reporting does not exist to manage the second-chance drawing process.
Management Controls	<ul style="list-style-type: none"> ➤ TLC’s Products Department staff developed policy and procedures that are easy to understand with defined authority roles and responsibility. ➤ The verified second-chance drawing winner file is received from TLC’s Security staff and is uploaded into the FTS for tracking. ➤ Fulfillment Tracking System has built-in controls to assist with the verification of uploaded file. ➤ Fulfillment tracking system reporting is generated to assist the Validation Department, reconciliations and prize fulfillment vendor payments. ➤ TLC’s licensed game property checklist is used to support the post-drawing activities. ➤ TLC has clearly defined processes for games with a prize value over \$599. ➤ TLC has clearly defined processes for games with a value below \$599.
Control Tests	<ul style="list-style-type: none"> ➤ Conducted interviews and walkthroughs with staff involved in the second-chance drawing processes. ➤ Reviewed policy and procedures. ➤ Tested information in the Fulfillment Tracking System.
Control Environment	Effective
Recommended Actions	None
Management Action Plan	None Required



Second-Chance Drawing Processes Internal Control Environment

The Texas Lottery Commission developed and instituted an effective control environment ensuring that risks associated with the second-chance drawing processes are managed to

ensure the agency meets its business objectives. The chart below reflects the key controls and the respective control rating based on the audit procedure applied.

Internal Controls Practices	Rating
Risk-based policy, procedures and second-chance drawing documentation exists and is easily accessible.	
Texas Lottery Commission’s management of second-chance drawings is compliant with state statute.	
Effective reporting exists to support the second-chance drawing processes.	
Management reviews the second-chance drawing process to ensure it remains efficient and effective.	
The second-chance drawing process is transparent and certified by the contracted vendor conducting the drawing, the lottery drawings coordinator and an independent auditor.	
TLC developed and regularly maintains the Fulfillment Tracking System to reduce the manual processes involved in the second-chance drawing process.	
Second-chance drawing winners are certified to ensure they are eligible to play and receive prizes.	
Second-chance drawing winners are researched, advised and processed in a timely manner.	
Prize fulfillment vendors are invoiced on a timely basis to ensure proper payments.	
Prize fulfillment vendor invoices are reviewed and approved prior to payment.	
Second-chance drawing winner tax obligations are addressed with processes to ensure compliance with state statute.	
TLC’s licensed property checklist and other supporting documentation is maintained according to the agency’s records retention policy.	