



Texas Lottery Commission

Internal Audit

An Internal Audit of

Unclaimed Prize Processes

May 30, 2018

Report #18-007

Prepared by:



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 unclaimed prize funds' processes and internal controls. 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. This report summarizes the audit scope, objectives and our assessment of TLC's internal controls for unclaimed prize funds.

Objectives and Scope

TLC is responsible for identifying, monitoring, reconciling and transferring unclaimed prize funds to required beneficiaries in accordance with Texas Government Code 466.408. The required beneficiaries, subject to legislative appropriation, are the Department of State Health Services, the Health and Human Services Commission, the Texas Veterans Commission and the Foundation School Fund.

We completed the audit of the unclaimed prizes' processes to ensure that the appropriate internal controls were in place to identify and account for the funds that are not claimed by players from scratch ticket and draw games.

We reviewed business processes for unclaimed prizes which include TLC's actions taken to inform the public of winning tickets that are approaching their deadlines for claiming prizes.

In some cases, the funds transferred from unclaimed prizes to the designated beneficiaries represent a substantial portion of their funding streams. Therefore, it is important that TLC's internal controls for unclaimed prizes are sound and working as intended. Accordingly, we focused this audit on the following business objectives:

- ✓ Identify, calculate and transfer accurate unclaimed prize funds to required beneficiaries.
- ✓ Ensure that unclaimed prize funds are reconciled, reviewed and approved prior to disbursing funds to the state and beneficiaries in accordance with statute.
- ✓ Ensure that the public is informed of unclaimed prizes that are approaching the claim deadline.

We evaluated internal controls and business processes related to the unclaimed prize management for the period of September 1, 2017 through March 31, 2018. Some test procedures were performed as of fieldwork date. This work product was a point-in-time evaluation that cannot address the inherent dynamic nature of subsequent changes to the process/procedures reviewed.

Results and Conclusions

Internal Audit categorizes audit findings as Effective, Some Improvement Needed, Major Improvement Needed, Unsatisfactory and Best Practices. **Based on the audit results, we**



determined that TLC’s processes and controls over the unclaimed prizes processes are best practices that could be replicated by other state lotteries. This audit did not result

in any reportable findings. We did identify improvements that can enhance existing controls over the workbook used to calculate unclaimed prize transfers.

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 the status of implementation initiatives.
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 would be met.

Acknowledgement

We wish to thank all staff involved in this audit for their professionalism and positive outlook towards the assessment of their business processes. The timely completion of this audit

was due to their efforts, responsiveness to our requests and maintenance of documentation in electronic format.

BACKGROUND

Texas Government Code Requirements

Texas Government Code provides requirements on the handling and distribution of unclaimed prizes related to both scratch ticket and draw games. Texas Government Code 466.408 states “The division shall retain an unclaimed prize on a

winning ticket for payment or delivery to the person entitled to the prize for 180 days after the date on which the winner was selected.” The code goes on to list the priority, amounts and uses for unclaimed prizes. The unclaimed prize distribution, subject to legislative appropriation, and usage priority are as follows:



1. Up to \$20 million to the Department of State Health Services state-owned multicategorical teaching hospital account to provide indigent health care services as specified in Chapter 61, Health and Safety Code;
2. up to \$5 million to the Health and Human Services Commission to support the provision of inpatient hospital services in hospitals located in 15 counties that comprise the Texas-Mexico border area;
3. up to \$5 million to the fund for veterans’ assistance for unclaimed prizes attributable to games designated for veterans’ assistance; and
4. the remaining unclaimed prizes go to the foundation school fund.

The code also lists the exceptions in which the 180 day claim period is waived for active duty military persons. TLC has a process in place to accommodate these individuals and instances where the winning ticket was part of a claim under review by the claim center or under a security investigation.

Texas Lottery Commission Process

The liability for scratch ticket prizes payable is recorded as a function of ticket sales based on a predetermined prize structure for each scratch ticket game. As new scratch ticket games are introduced, the games are added to the internal financial system (MIP) during the game load process. On a monthly basis, the Office of the Controller (OC) identifies scratch ticket games that are closed for 180 days. From the games identified, the last day of redemption is obtained from the “Scratch

Tickets – Closed Games” tab on TLC’s website. This date is defined as 180 days from the date that the scratch ticket game closed.

The liability for draw games prizes payable is recorded following each draw as the number of tickets that are winners and the amount of prizes is immediately known. Prizes that are paid out are tracked through the Enterprise Series (ES) gaming system and updated to the MIP general ledger nightly through ICS. Prizes that are not awarded after the 180th day of any drawing become unclaimed prizes.

Prize funds accrued as prizes payable and that are unclaimed at the end of the claim period are recorded to the Unclaimed Prizes Payable account within the MIP general ledger.

The Unclaimed Prizes Payable account is reconciled each month. A journal entry is then prepared for review and approval to transfer unclaimed prizes to the required beneficiaries in accordance with statute. The transfer of unclaimed prizes to the required beneficiaries occurs on a quarterly basis. A total of \$391,611,068 has been transferred to the required beneficiaries between September 1, 2012 and March 31, 2018. **Figure 1** provides a summary of unclaimed prize funds transferred to the state’s beneficiaries between FY 2013 and March 31, 2018.

Figure 2 provides the amount of unclaimed prizes transferred to the required state beneficiaries between FY 2013 and March 31, 2018. Beginning with 2014, unclaimed prizes previously transferred to the General Revenue Fund were designated to the Foundation School Fund following a legislative change. It is important to note that TLC also developed a scratch ticket that is dedicated to the Texas Veterans and TVC receives the net proceeds for these ticket sales instead of the Foundation School Fund.

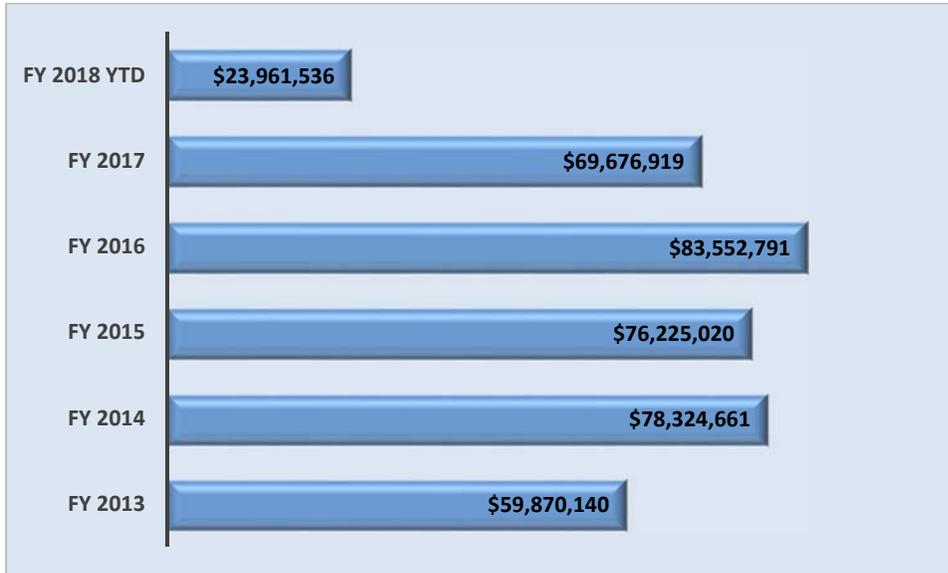


Figure 1: Texas Lottery Commission Unclaimed Prize Transfers FY 2013 – FY 2018 YTD (March 31, 2018)



Figure 2: Texas Lottery Commission Unclaimed Prize Transfers FY 2013 – FY 2018 YTD (March 31, 2018)



TLC does inform the public of prizes that are approaching the claim deadline. The Office of the Controller communicates with TLC’s Media Relations Division regarding any large unclaimed prize amounts on a continuous basis. As part of our audit testing we noted that TLC’s Media Relations Division notified the public that a \$1 million winning Powerball

ticket purchased on August 26, 2017 had not been claimed and the claim deadline was approaching. TLC’s Media Relations Division notifies the public by various forms of communication which include social media, news broadcasts and local outlets throughout the state, including additional focus on the location the ticket was purchased.

BUSINESS OBJECTIVES AND RISKS

This section of the report provides a summary of the unclaimed prizes’ business objectives, primary business risks, TLC’s internal controls in place and the respective internal control assessment. TLC

established internal controls in the form of policies, procedures, management review and monitoring processes. These internal controls are effective and working as intended.

BUSINESS OBJECTIVE 1: Unclaimed Prizes Policies and Procedures	
Business Objective	To provide governance of the unclaimed prize processes through well written policies and procedures that encompass Texas Government Code 466.408 requirements.
Business Risk	➤ Unclaimed prize funds are not monitored to accurately identify, reconcile and transfer to required beneficiaries in accordance with policies and procedures. This could result in noncompliance with the Texas Government Code.
Management Controls	➤ Detailed written procedures exist and are reviewed on a regular basis.
Control Tests	<ul style="list-style-type: none"> ➤ Conducted interviews and process walk throughs. ➤ Performed audit testing. ➤ Analyzed applicable written procedures.
Control Assessment	<p>Internal controls are effective.</p> <ul style="list-style-type: none"> ➤ Written procedures include Texas Government Code requirements for the timeframe required to hold unclaimed prizes and also provide detailed step-by-step instructions for the unclaimed prize processes. ➤ Unclaimed prize processes complied with written procedures.
Recommended Actions	None
Management Action Plan	None Required



BUSINESS OBJECTIVE 2: Tracking Unclaimed Prizes

Business Objective	To identify unclaimed prizes and monitor scratch and draw games that have been closed for 180 days.
Business Risk	<ul style="list-style-type: none"> ➤ Unclaimed prizes are not identified and tracked. ➤ Games that have been closed for 180 days are not identified. ➤ Scratch games that support Texas Veterans Commission are not monitored separately.
Management Controls	<ul style="list-style-type: none"> ➤ Closed games are identified by TLC and posted to the Commission’s website’s Closed Games webpage. ➤ The last day to redeem prizes is tracked. ➤ Office of the Controller maintains a photo listing of scratch ticket games that support Texas Veterans Commission.
Control Tests	<ul style="list-style-type: none"> ➤ Conducted interviews and process walk throughs. ➤ Reviewed policy and procedures. ➤ Performed audit testing.
Control Assessment	<p>Internal controls are effective.</p> <ul style="list-style-type: none"> ➤ Documentation to support the tracking of unclaimed prizes and closed games exists and is followed in accordance with established procedures.
Recommended Actions	None
Management Action Plan	None Required

BUSINESS OBJECTIVE 3: Preparing Unclaimed Prizes Reconciliations

Business Objective	To ensure processes are in place to identify, record and reconcile unclaimed prize funds to be transferred to required beneficiaries.
Business Risk	<ul style="list-style-type: none"> ➤ Unclaimed prizes are improperly stated in TLC’s financial records. ➤ Unclaimed prize funds are not reviewed. ➤ Unclaimed prize funds are over/understated and result in beneficiaries receiving incorrect amounts.
Management Controls	<ul style="list-style-type: none"> ➤ Monthly reconciliations are performed to ensure that unclaimed prize funds are accurately accounted for and recorded. ➤ Review of the unclaimed prize fund reconciliation is performed.
Control Tests	<ul style="list-style-type: none"> ➤ Conducted interviews and process walk throughs. ➤ Reviewed policy and procedures. ➤ Performed audit testing.
Control Assessment	<p>Internal controls are effective.</p> <ul style="list-style-type: none"> ➤ The reconciliations for unclaimed prizes are well documented and include comments when unclaimed prizes are high or low. Communications of large unclaimed prizes are included in reconciliation packet.



BUSINESS OBJECTIVE 3: Preparing Unclaimed Prizes Reconciliations

	<ul style="list-style-type: none"> Documentation supports segregation of duties exists to prepare, review, and approve key data prior to transferring funds to required beneficiaries.
Recommended Actions	None
Management Action Plan	None Required

BUSINESS OBJECTIVE 4: Public is Informed of Expiring Unclaimed Prizes

Business Objective	To ensure that TLC alerts the public of expiring unclaimed prizes.
Business Risk	<ul style="list-style-type: none"> Public is not informed of expiring unclaimed winning tickets. Public trust in the lottery is lost.
Management Controls	<ul style="list-style-type: none"> TLC’s Media Relations Division is provided information of large unclaimed prizes prior to the 180 days after the game closes. TLC’s Media Relations Division utilizes social media and news outlets to inform the public of occurrences where large unclaimed prizes are expiring.
Control Tests	<ul style="list-style-type: none"> Conducted interviews. Performed audit testing. Analyzed applicable documentation.
Control Assessment	<p>Internal controls are effective.</p> <ul style="list-style-type: none"> TLC’s Media Relations Division notifies the public of large prizes that are unclaimed and expiring. Media Relations drafts the media release with vital information such as selling date, location and instructions for redemption.
Recommended Actions	None
Management Action Plan	None Required

BUSINESS OBJECTIVE 5: Unclaimed Prize Fund Data Integrity

Business Objective	To ensure that unclaimed prize fund data is appropriately secured and that tools used for reconciling these funds is protected.
Business Risks	<ul style="list-style-type: none"> Data is inadvertently or intentionally changed or deleted by individuals working with the data.
Management Controls	<ul style="list-style-type: none"> The spreadsheet used to track and reconcile unclaimed prize funds is maintained on Office of the Controller’s shared network folder.
Control Tests	<ul style="list-style-type: none"> Conducted interviews and process walk throughs. Performed audit testing. Analyzed applicable documentation.



BUSINESS OBJECTIVE 5: Unclaimed Prize Fund Data Integrity

Control Assessment	⇒ The spreadsheet used for reconciling unclaimed prizes is an appropriate tool to meet TLC’s needs. However, the spreadsheet itself is unprotected and therefore the data and formulas are at risk of being altered.
Recommended Actions	⇒ Incorporate password protection on the spreadsheet cells that contain formulas and lock the entire spreadsheet once the reconciliation process is completed.
Management Action Plan	None Required

BUSINESS OBJECTIVE 6: Transfer of Unclaimed Prizes to Beneficiaries

Business Objective	To ensure that accurate funds are transferred to required beneficiaries in accordance with Texas Government Code 466.408.
Business Risks	<ul style="list-style-type: none"> ⇒ Unclaimed prize funds are maintained to subsidize TLC operations instead of being transferred to the required beneficiaries. ⇒ State agencies that benefit from the unclaimed prize funds cannot support their operations due to loss of funds. ⇒ Public trust is lost.
Management Controls	⇒ The unclaimed prize fund reconciliation includes journal entry of transfer.
Control Tests	<ul style="list-style-type: none"> ⇒ Conducted interviews and process walk throughs. ⇒ Performed audit testing. ⇒ Analyzed applicable documentation.
Control Assessment	<p>Internal controls are effective.</p> <ul style="list-style-type: none"> ⇒ TLC’s Office of the Controller reconciles unclaimed prize funds on a monthly basis and performs quarterly transfers on or before the 15th day of the month after the quarter end.
Recommended Actions	None
Management Action Plan	None Required

DETAILED OPPORTUNITY AND RECOMMENDATION

This section of the report provides a discussion of the Texas Lottery Commission’s opportunity noted that can enhance the unclaimed prizes calculation spreadsheet’s data integrity to ensure the accuracy of funds

transferred to beneficiaries stated in the Texas Government Code and in accordance with agency procedures. This opportunity is an enhancement to current internal controls and



not a reportable finding. Therefore, management response is not required.

Opportunity 1: Protecting Unclaimed Prize Data

TLC’s unclaimed prizes spreadsheet could be enhanced to protect the data that is used to maintain the reconciled unclaimed prize fund totals. This reconciliation serves as the basis for the amount of funds transferred to required beneficiaries in accordance with Texas Government Code 466.408.

The spreadsheet is maintained in TLC’s Office of the Controller’s shared network folder which is restricted to OC staff. However, this spreadsheet is not password protected. The spreadsheet contains formulas that sum the reconciled totals that are to be transferred quarterly. These totals include the Texas Veterans’ Commission’s (TVC) specialty

scratch tickets which TVC receives 100 percent of the unclaimed prizes for these tickets. The TVC games are manually tracked and monitored.

The TLC accountant responsible for maintaining the spreadsheet enters the reconciled totals for each closed game’s unclaimed prizes on a monthly and quarterly basis. When the quarterly reconciliation is completed the funds are transferred to the required beneficiaries.

Figure 3 provides a snapshot of the unclaimed prize reconciliation workbook.

UNCLAIMED AVAILABLE FY 2018				
2018		September-17	October-17	November-17
Lotto	90100	87,824.00	87,249.00	76,482.00
Lotto Extra!	90110	90,520.00	70,604.00	75,524.00
Pick 3	90200	104,780.00	107,200.00	129,670.00
Pick 3 Sum It Up	90210	3,519.00	8,078.00	8,121.00
Cash Five	90300	49,501.00	68,163.00	49,226.50
Texas Two Step	90500	51,364.00	349,134.00	44,414.50
Mega Millions	90600	169,550.00	111,526.00	114,507.00
Megaplier	90610	73,989.00	53,586.00	52,104.00
Daily 4	90700	67,000.00	92,150.00	53,750.00
Daily 4 Sum It Up	90710	5,866.00	7,108.00	5,378.00
Powerball	90800	186,942.00	181,002.00	369,192.00
Power Play	90810	62,838.00	55,468.00	122,302.00
All or Nothing	90900	22,368.00	24,908.00	24,024.00
Texas Triple Chance	91100	16,759.00	18,946.00	18,055.00
Total Online		998,820.00	1,235,122.00	1,142,750.00
Scratch Tickets (Less TVC games)		1,782,221.55	4,460,955.37	1,713,335.73
TVC Scratch Tickets		221,719.54	1,435,192.26	0.00
		3,002,761.09	7,131,269.63	2,856,085.73
				12,990,116.45
Amount Transferred:				
Health and Human Services Commission				\$ 439,444.00
Texas Veterans Commission				\$ 1,656,911.80
Foundation School Fund				\$ 10,893,760.65
Total				\$ 12,990,116.45

Figure 3: TLC Unclaimed Prize Fund Reconciliation Snapshot



Without password protection of the unclaimed prize fund reconciliation spreadsheet the data could be changed and the TVC totals can be inadvertently redistributed, deleted or rolled into the allocation for another beneficiary.

A strong mitigating control in place is that the reconciliation supporting documents are printed and also electronically stored. This enables staff to look at previous reconciliations to compare the previous information to the current data.

We sampled February 2018 and March 2018 unclaimed prize reconciliations which included the quarterly reconciliation and transfer to TVC, Foundation School Fund and HHSC. We noted that the calculations and transfers were accurate.

Recommendation 1: Spreadsheet Protection

Create a password for the unclaimed prizes spreadsheet columns that contain formulas. Lock the spreadsheet once the reconciliation process is completed.

