



TEXAS LOTTERY COMMISSION



An Internal Audit of Instant Ticket Sales to Transfer-to-State January 24, 2015 Report #15-001



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 instant ticket sales to transfer of funds to state treasury business cycle. 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 because it was not deemed privileged or confidential by law. This report summarizes the audit scope, our assessment based on our audit objectives and the audit approach.

Objectives and Scope

The purpose of this audit is to review business processes and internal controls related to the Texas Lottery instant ticket sales to determine if management controls are in place to achieve business objectives and comply with TLC policy and procedures, Statutes and Administrative Rules. Internal Audit examined the following business processes during our audit:

1. Ticket Sales
2. Sales Reporting
3. Ticket Validation at Claims Centers
4. Retailer Incentives
5. Promotional Tickets
6. Retailer Adjustments
7. EFT's / Sweeps (automated payment via retailer dedicated lottery bank account)
8. Transfer of Funds to State Treasury

Audit scope for ticket validation was limited to observing only claim center validation processes and testing transactions; Retail Centers were excluded and the processes performed by the mailroom and security office were not included in this review. We also reviewed prior audit findings and performed audit procedures to determine the recommendation implementation status. The audit period included instant ticket sales for the period of September 1, 2013 through August 31, 2014. However, 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:

Based on the audit results, we determined that controls over the instant ticket sales-to-transfer of funds to state business process are effective and working as intended to achieve the business objectives and comply with regulatory requirements. We noted that three of the seven prior audit recommendations have not been fully implemented.

Internal controls over the instant ticket sales reporting and transfer of funds are effective and working as intended

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.



Internal Audit of Instant Ticket Sales to Transfer to State Executive Summary

Business Objective	To ensure all instant tickets are accurately and completely tracked and reported while in inventory, issued to retailers and sold to consumers	To ensure compliance with Texas Administrative Code (TAC) Instant Game closing procedures	To ensure accurate and timely instant ticket sales monitoring and reporting
Business Risk	TLC may not be in compliance with the TAC procedures and legislative intent as mandated by Texas Administrative Code RULE §401.302, Instant Game Rules.	TLC may not be in compliance with the Game closing procedures as defined in RULE §401.302 (j).	TLC may not monitor instant ticket sales and provide timely and accurate financial reports to aid agency management decision-making.
Management Controls	Monthly Instant Ticket Inventory (MIA) reports; weekly reconciliations and sales reports prepared by Controller's Office.	Instant Ticket Closing Analysis reports prepared by the Controller's Office.	Weekly sales reports prepared by Controller's Office.
Control Tests	Interviews, observation, inventory report analysis and report testing.	Interviews, observation, closing analysis report analysis and report testing.	Interviews, observation, sales report analysis and report testing.
Results	Management controls are effective to accurately account for instant ticket inventory	Management controls over instant ticket closing analyses are functioning as intended.	Management controls are effective to monitor instant ticket sales and produce accurate and timely reports.
Recommended Actions	None	None	None
Management Action Plans	None Required	None Required	None Required



Internal Audit of Instant Ticket Sales to Transfer to State Executive Summary (Cont'd)

Business Objective	To ensure that only valid lottery tickets are processed for payment.	To ensure that the correct winner is paid for winning tickets.	To ensure that revenues from instant ticket lottery sales are collected and deposited into the State Treasury on a timely basis.
Business Risk	Invalid instant tickets could be presented for claims and paid.	Winning tickets are paid to the incorrect winner.	Revenues from instant ticket lottery sales may not be collected and deposited into the State Treasury.
Management Controls	Ticket validation is automated through the GTECH system. Unvalidated tickets and logs are provided to management in the Austin Claim Center for further review. Administrative checks are verified.	Winner signatures and ID are required for claiming winnings at a claim center. Tickets are validated by the GTECH ticket system.	Automated electronic funds transfer (EFT)/sweeps of retailer lottery bank accounts are performed on a weekly basis. Reconciliation of sales to revenues deposited is performed.
Control Tests	Observation of the ticket validation process at claim centers, review of validation controls in the test lab, review of third party validation audit report, review of sample of validated and administrative claim payments.	Observation of the ticket validation process at claim centers.	Review and analysis of the EFT/sweeps and testing of reconciliations.
Results	Management controls over ticket validation are working as intended.	Management controls over winning claims are working as intended.	Management controls are in place to ensure instant ticket revenues are deposited into the State Treasury in a timely manner and corrective actions are taken when retailers have not deposited all the sales revenue.
Recommended Actions	None	None	None
Management Action Plans	None Required	None Required	None Required



Internal Audit of Instant Ticket Sales to Transfer to State Executive Summary (Cont'd)

Business Objective	To record timely, accurate, and authorized adjustments to retailer accounts in ES, the lottery operating system.	To increase lottery ticket sales through Retailer Cash Incentive Programs (RCIP).	To increase consumer awareness of instant ticket lottery games through providing free tickets to consumers during targeted promotional events.
Business Risk	Adjustments to retailer accounts may not be appropriate, authorized, or accurate.	Incentives paid may be based on inaccurate sales data and payments made could be greater than authorized by Statute.	Promotional tickets may not be adequately controlled and accurately accounted for, causing financial loss to the Agency.
Management Controls	Retailer Services Department does not utilize a management report to periodically review and monitor adjustments to retailer accounts. In-process controls consist of secondary review of posted adjustments.	Monthly management team meetings, RCIP reports, external audit of sales goals and sales attainment.	Promotional event and ticket planning calendar, promotional event and ticket close out reports.
Control Tests	Management inquiry and analyzed a sample of retailer adjustments.	Management inquiry, reviewed meeting minutes, analyzed RCIP reports.	Reviewed promotional event planning worksheet and tested a sample of promotional events.
Results	Adjustments are not verified by a second party prior to posting in ES, resulting in data entry errors that require corrections.	Management controls are in place to ensure accurate payments and compliance with Statute.	Management controls to ensure accountability of promotional tickets are working as intended. The process is being automated and Internal Audit will review the controls before implementation.
Recommended Actions	Modify workflow within the Retailer Services Department to post transactions after they are verified by an approving party. Establish management reports designed to capture all retailer adjustments posted and the adjustment reasons.	None	None
Management Action Plans	All transactions will continue to be posted directly to the ES, but they will be batched and queued. Management reports are being pursued.	None Required	None Required



Internal Audit of Instant Ticket Sales to Transfer to State Executive Summary (Cont'd)

Business Objective	To ensure that transfers of lottery ticket sales proceeds and unclaimed prizes are determined and distributed to state agencies in accordance with applicable state laws.	To ensure that transferred amounts are calculated accurately and supported by accounting, management, and financial records and reports of lottery ticket sales proceeds and unclaimed prizes.	To examine evidence that transferred amounts were provided to the authorized state agencies within the timeframes required by state law.
Business Risk	Transfers of lottery ticket sales proceeds and unclaimed prizes may not be determined and distributed to state agencies in accordance with applicable state laws.	Transferred amount calculations may be inaccurate and may not be supported by accounting, management, and financial records and reports of lottery ticket sales proceeds and unclaimed prizes.	Transfers may not be made on a timely basis as prescribed in and required by state law.
Management Controls	The elements of each transfer calculation are prepared by a staff person and reviewed by two levels of Controller's Office management.	The worksheets used to calculate transfers are standardized and well established with years of usage. Therefore, staff is intimately familiar with the worksheets.	Work is scheduled to meet deadlines. Calculation worksheets are detailed and indexed to system reports of sales, prize expenses, commissions, and administrative expenses.
Control Tests	Reviewed reconciliation of MIP and CSR reports and recalculated transfer amounts.	Traced each component of transfers to reports generated from MIP system.	Verified that transfers were made to authorized agencies within the timeframes established by statute.
Results	Transfers of lottery ticket sales proceeds and unclaimed prizes were determined and distributed to state agencies in accordance with applicable state laws.	Transferred amounts are calculated accurately and supported by accounting, management, and financial records and reports of lottery ticket sales proceeds and unclaimed prizes.	Transferred amounts are being provided to the authorized state agencies within the timeframes required by state law.
Recommended Actions	None	None	None
Management Action Plans	None Required	None Required	None Required



Opportunities and Recommendations

Opportunity 1: Retailer Adjustments

The current business process of verifying retailer adjustment entries after they are posted to ES does not prevent errors from being recorded in ES. Additionally, ES is not configured with automated controls that include limited drop-down fields of specific adjustment characteristics.

Retailer adjustments are not verified by a second party prior to posting in the lottery operator information system (ES), resulting in data entry keying errors that have required corrections. Three of the 27 (9%) retailer adjustments selected for test work were to correct previously posted retailer adjustments due to data entry keying errors. The data entry keying errors consisted of dollar amounts entered incorrectly and selecting the wrong product (associated game) from the drop-down menu. One of the three items contained more than one correcting entry to rectify the adjustment.

TLC procedures LO-RS-079 and LO-RS-009 require designated Retailer Services Department staff to post adjustment requests in ES and sign off on the applicable hard-copy adjustment form from which the request was initiated. Additionally, the entries are required to be subsequently verified by a different designated individual and signed by the verifying party's signature on the adjustment form. All transactions reviewed appeared to be consistent with these procedures.

Implication:

The current process of reviewing entries after they have posted could result in the following:

- ★ Errors could continue to be posted to ES and go undetected.
- ★ Errors posted to retailer accounts could cause reputational harm to the Lottery as retailers have view-only access to the ES system.

Recommendations:

TLC management should consider the following changes in order to reduce the level of staff effort required for posting retailer adjustments, thereby providing for these resources to be redirected to other activities. The recommended management report would allow for more effective monitoring of retailer adjustments and provide the ability to identify trends.



- ★ Modify the workflow within Retailer Services Department to post transactions after they are verified by an approving party.
- ★ Explore an electronic workflow solution to initiate, post, and retain retailer adjustment requests and entries and eliminate the current paper process.
- ★ Configure ES drop-down fields to display selection choices that are relevant to the specific adjustment characteristics.
- ★ Establish management reports designed to capture all retailer adjustments posted and adjustment reasons for management to review on a periodic basis.

Management Response:

All transactions will continue to be posted directly to the ES, but they will be batched and queued. The batch will then be reviewed by someone other than the person who created the batch and once approved, the adjustments will be posted to the retailer's individual accounts. The batch process should do away with most, if not all, of the paperwork associated with the batches and will create a record of the actions taken for review and approval. Management is pursuing configuring ES drop-down fields to display selection choices that are relevant to the specific adjustment characteristics and establishing management reports designed to capture all retailer adjustments posted and adjustment reasons for management to review on a periodic basis. This recommendation will be fully implemented no later than 04/30/15.



Prior Audit Findings and Recommendation Implementation Status

We reviewed prior audit reports related to activities included in the instant ticket sales business cycle to identify audit findings and recommendations. We performed audit procedures to determine implementation status. Of the 7 findings associated with the instant ticket sales business cycle, five have been fully implement and two have been partially implemented.

Audit #	Report Date	Report Title	Summary of Findings	Management's Corrective Action Plan	13-008 December 2012 Follow-Up Status	2014 Internal Audit Follow-Up Status
11-004	29-Mar-11	Claim Center Prize Validations	<p>Ensure administrative checks are reviewed by an individual outside of the Claims and Payments process.</p> <p>Strengthen the reconciliation process to:</p> <ul style="list-style-type: none"> a. Account for all voided checks, and b. Ensure that a stop payment has been placed on all voided checks for which the Office of the Controller is not in possession of the physical check. 	<p>Management concurs with these recommendations. The Claims and Payment Section modified Procedure LO-CC-021, Prize Payment Void and Void/Reissue, on January 3, 2011 to address these recommendations. The Office of the Controller will also develop a procedure that addresses the tracking and accounting of all voided checks as related to the reconciliation process. The new procedure will require General Ledger Accountants to match all Voided Check Memos (with defaced checks) received for that day to the Daily Voided Check Report. The updated procedure will also require a General Ledger Accountant to place a stop payment for all checks for which a Voided Check Memo (with defaced check) is not received.</p>	<p>Corrected</p> <p>Management has implemented a process and established procedures for tracking and accounting for checks voided at lottery claim centers or headquarters, including placement of stop payment for all invisible check (a check that does not print but a check number has been issued).</p>	<p>Open Partially Implemented</p> <p>Claim center staff does not consistently document the void reason.</p> <p>Claim Center staff should consistently select the reason for the void check from the drop down menu or manually document the reason for the void check (if there is a system problem for example) on the void check memo.</p>



Audit #	Report Date	Report Title	Summary of Findings	Management's Corrective Action Plan	13-008 December 2012 Follow-Up Status	2014 Internal Audit Follow-Up Status
<p>January 2015 Management Response: Management agrees with the recommendation. Functionality issues with the void check memo form existed and have been identified and corrected. Additionally, management has ensured that claim center staff is aware of the importance of capturing the void reason recorded in the claims processing system on all void check memos. This was completed 1/21/2015</p>						
11-004	29-Mar-11	Claim Center Prize Validations	Ensure administrative checks are reviewed by an individual outside of the Claims and Payments process.	Management concurs with the recommendation. The Drawings and Validations Manager routinely reviews the Administrative Claims Report and selects a random sample of claims for review. Going forward, this review will occur, at a minimum, on a monthly basis. Documentation of this review will be kept on file.		<p>Open Partially Implemented</p> <p>Monthly review is not consistently performed. However, we recommend that this review be changed to quarterly if the volume remains low.</p>
<p>January 2015 Management Response: Management agrees with the recommendation to change the administrative check review to quarterly and has begun quarterly reviews. Management will continue to monitor check volume and if the volume increases significantly, more frequent reviews will be evaluated. Procedure LO-CC -014 has been updated to reflect the change to Quarterly review. This was completed 01/08/15</p>						
11-004	29-Mar-11	Claim Center Prize Validations	We recommend management set formal processing goals for mail-in claims and periodically measure actual performance against those goals, including reviewing reports from ACTS tracking unpaid claims. Management should consider the need to document and track follow-up efforts to request additional forms or documentation from claimants that have unpaid claims.	Management concurs with the recommendation.	Management has implemented a system-generated report to monitor and track pending claims, including both live tickets and pending claims. Staff will work with Information Systems to further enhance this report.	<p>Open Partially Implemented</p> <p>Report enhancements are still needed. For example, the aging report should include a field for number of days unprocessed for mail-in claims and unvalidated</p>



Audit #	Report Date	Report Title	Summary of Findings	Management's Corrective Action Plan	13-008 December 2012 Follow-Up Status	2014 Internal Audit Follow-Up Status
						<p>claims.</p> <p>Additionally, staff should include notes as to why claims are pending.</p>
<p>January 2015 Management Response: Management agrees with recommendation to add a field to the report for the number of days of unprocessed mail-in claims and unvalidated claims and will modify procedure to reflect the new process. Management also agrees with the recommendation to include notes as to why claims are pending. Management has submitted a software enhancement request to Information Resources and will work with them to implement the system modifications. Anticipated Completion 03/01/15.</p>						
11-004	29-Mar-11	Claim Center Prize Validations	Internal Audit recommends agency management establish and track performance measurements for customer service.	Management concurs with the recommendation. The Claims and Payment Section within the Drawings and Validations Department will develop a procedure and process to track relevant feedback received from the public regarding customer service.	Management has developed a formal process for tracking customer service experiences through the use of a spreadsheet. Procedures were developed to document this process and provide management review of comments received.	<p>Closed</p> <p>Management's response has been implemented with only two customer services comments for the year. There is no process to request and automate the customer feedback process.</p>



Audit #	Report Date	Report Title	Summary of Findings	Management's Corrective Action Plan	13-008 December 2012 Follow-Up Status	2014 Internal Audit Follow-Up Status
11-004	29-Mar-11	Claim Center Prize Validations	Develop formal performance indicators or targets that will provide a measurement of whether or not the established goals and objectives are being met. These could be performance targets or trend analysis that would alert management of any changes to the desired performance. In addition to those recommended previously in this report, we recommend management consider whether other performance measures may be beneficial.	Management concurs in principle with the recommendation. However, management has not noted any significant changes in performance over time regarding claims processing that would yield value from the implementation of additional performance measures. That said, management will continue to monitor performance through both internal management controls and newly implemented external customer reporting, as noted in management response 1.a. of section 4 of this report. Should trends or patterns emerge as business processes evolve, management will evaluate the value of implementing further performance measures in this area.	Management continues to monitor performance through both internal management controls and newly implemented customer experience tracking. This will be an ongoing process that continues over time.	Closed Recommendation has been fully implemented
12-009	May-12	Retailer Sales Incentive Program	Agency management should ensure control mechanisms are in place in future program runs to ensure it stays within its appropriation authority granted in Rider 10(b).	Management concurs with the recommendation that control mechanisms should be in place for the Retailer Incentive Sales program, but does not concur that controls were not in place to ensure full compliance with Rider 10(b). Various options were considered during April 2011 to address the funding of payments for Program 5 to ensure that the Rider 10(b) appropriation amount would not be exceeded.		Closed Recommendation has been fully implemented



Audit #	Report Date	Report Title	Summary of Findings	Management's Corrective Action Plan	13-008 December 2012 Follow-Up Status	2014 Internal Audit Follow-Up Status
13-004	13-Apr-13	Transfers to the State of Texas	Internal Audit recommends the Office of Controller ensure employees are adequately cross-trained to perform this important core duty (calculation of transfer calculation).	Management agrees with the recommendation and the recommendation has been fully implemented. More than one staff member within the Office of the Controller is trained in the preparation and review of the monthly transfer calculation and associated calculation of unclaimed prizes. This job function will continue to be rotated in the future to ensure uninterrupted performance of this job responsibility.		Closed Recommendation has been fully implemented