



**TEXAS LOTTERY
COMMISSION**



**An Internal Audit of
Jackpot Estimations**

June 2016

Report #16-003



McCONNELL & JONES LLP
CERTIFIED PUBLIC ACCOUNTANTS



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 jackpot estimation 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 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

We have completed the audit of the Lotto Texas and Texas Two Step jackpot estimation processes due to the high potential impact on TLC's ability to meet the following business objectives:

- Generate revenue for the State of Texas through sales of lottery games.
- Maintain public trust and integrity of lottery games.

TLC is responsible for preparing jackpot estimations for Lotto Texas and Texas Two Step. Jackpot estimations for Mega Millions and Powerball are prepared by the Multi-State Lottery Association (MUSL) and therefore were excluded from this audit. Based on our audit results, we determined that management controls are operating effectively to achieve the business objectives. We did not identify any significant issues.

Internal controls over the jackpot estimation process are effective and working as intended

**Audit Period:**

The audit period included September 1, 2014 through December 31, 2015. 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.

Jackpot Estimations:

We reviewed business processes for jackpot estimations and jackpot advertisements related to the two draw games that TLC prepares estimates; Lotto Texas and Texas Two Step. Texas Administrative Codes (TAC) provides guidance on game jackpots. The “Lotto Texas” game is governed by TAC Title 16, Part 9, Chapter 401, Subchapter D, Rule 401.305. This rule states “The jackpot prize for a drawing is the greater of 40.47 percent of the proceeds from *Lotto Texas* ticket sales for all drawings in the roll cycle and any earnings on an investment of all or part of the sales proceeds, paid in 30 annual installments; or the amount advertised in accordance with subsection (e) of the Lotto Texas On-Line Game Rule as the estimated jackpot for the drawing, paid in 30 annual installments.” The “Texas Two Step” game rule is found in TAC Title 16, Part 9, Chapter 401, Subchapter D, Rule 401.312. The rule states, “The jackpot prize for a *Texas Two Step* drawing is the amount the commission establishes and authorizes vendors to publicize for the drawing”.

The Office of the Controller and the Lottery Operations Division Products Department independently prepare jackpot estimations based on their projections of anticipated sales, and then consult with each other to agree on a negotiated sales projection. The agreed-upon estimated sales projection results in a recommended advertised jackpot amount to be used in the event of a roll. The Office of Controller uses a Jackpot Estimation Checklist to document the jackpot estimation process for each draw. The Jackpot Estimation Checklists includes the estimated sales for the current draw; estimated total sales for the current roll cycle; projected total sales for the next drawing; and the estimated support for the jackpot prize for the next drawing. These are all supported with detailed sales data.

TLC pays winning Lotto Texas ticket holders the higher of actual sales or the advertised jackpot. Texas Two Step jackpot winners are paid the advertised jackpot, regardless of actual sales. We compared actual sales for each draw to the estimated sales in order to determine the accuracy rate. We also compared the accuracy percentages to those noted in the prior internal audit period to determine trends. The overall average sales estimations to actual sales variance for both games were 1.4 percent. **Figure 1** provides a summary of the sales estimate to actual sales comparison for each instance where the jackpot rolled from one drawing to another during the audit periods. The jackpot estimation accuracy for both games improved from the prior audit period.



Game	Number of Estimations in Which the Jackpot Rolled	Sales Estimate * < Actual Sales		Sales Estimate * > Actual Sales		Overall Average Variance From Estimate *
		Percentage of Occurrences	Average Variance	Percentage of Occurrences	Average Variance	
Lotto Texas						
9/1/14 – 12/31/15 (this audit period)	132 (95% of all drawings)	64.29% of rolls 61.15% of all drawings	3.20%	35.61% of rolls 33.81% of all drawings	-1.71%	1.43%
9/1/08 – 8/31/10 (prior audit period)	194	61.86%	-3.30%	38.14%	1.98%	-1.29%
Texas Two Step						
9/1/14 – 12/31/15 (this audit period)	105 (75% of Drawings)	64.76% of rolls 61.15% of all drawings	3.71%	35.24% of rolls 26.43% of all drawings	-3.00%	1.48%
9/1/08 – 8/31/10 (prior audit period)	158	83.54%	-5.48%	16.46%	3.21%	-4.05%

Figure 1: Texas Lotto and Texas Two Step Sales Estimate to Actual Sales Comparison Sept. 1, 2014 – Dec. 31, 2015 The goal is for jackpot estimations to be as close to actual sales as possible. Approximately 95 percent of all Lotto Texas drawings resulted in no winners and a jackpot roll while approximately 75 percent of Texas Two Step drawings resulted in jackpot rolls. Sales estimations for approximately 65 percent of all jackpot estimation calculations that were rolled from previous drawings resulted with actual sales being greater than estimated. Conversely,



approximately 35 percent of sales estimations were higher than actual sales. With an overall average variance between estimated and actual sales of one percent the process is deemed to be accurate.

** Low end sales estimate. While sales is estimated as a range, the recommended advertised jackpot is based on the low end of the estimate. Per agency management jackpot advertising practices, we used the low end estimate in our review above.*

Results and Conclusions:

Based on the audit results, we determined that controls over the jackpot estimation processes are effective and working as intended to achieve the business objectives. **This audit resulted in findings that jackpot estimations were accurate and that internal controls over the jackpot estimation processes are effective.** A rating of effective means that controls evaluated are adequate, appropriate, and 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 business processes. The timely completion of this audit was due to their efforts, responsiveness to our requests and maintenance of documentation in electronic format.



Internal Audit of Jackpot Estimations – Business Risks and Audit Results

Objective #	1	2	3	4	5
Business Objective	To accurately estimate anticipated jackpots based on sales projections.	To ensure all jackpot estimates are reviewed and authorized by the Executive Director (or designee) prior to being published.	To ensure that the advertised jackpots represent accurate estimates of potential winnings.	To monitor jackpot estimation accuracy and take corrective actions when necessary.	Ensure that jackpot estimation calculations, review, authorization and advertising follow Commission policies and procedures.
Business Risk	Overestimated sales revenues do not meet sales projections which then results in inaccurate advertised jackpots and financial loss to the State of Texas. Underestimated sales projections could result in inaccurate advertised jackpots and loss of consumer confidence and willingness to play the games.	Incorrect or unauthorized jackpots could be advertised.	Loss of consumer confidence and willingness to play the games.	Inaccurate sales estimations can result in financial loss to the State of Texas when sales revenues are consistently estimated at higher levels than actual ticket sales.	Jackpot estimates are not prepared in accordance with policies and procedures. This could result in noncompliance with TAC rules.
Management Controls	Jackpot estimations are prepared by more than one individual for the	Written procedures and the Jackpot Estimation Checklist	Jackpot estimation worksheets include sales calculation	Review of the spreadsheet that tracks sales	Detailed written procedures exist and are reviewed on a



Objective #	1	2	3	4	5
	<p>same period and then compared.</p> <p>Jackpot estimation process includes looking at historical data and trends, including drawing dates, anticipated weather, holidays and current advertised jackpot.</p>	<p>require TLC’s Executive Director review and signature.</p>	<p>support data.</p>	<p>estimated to actual sales and the variances is conducted each week.</p> <p>Discussions are held between the Office of Controller and Lottery Operations to determine any changes that may impact sales.</p>	<p>regular basis.</p> <p>A Jackpot Estimation Checklist is used during the estimation process to verify that all prior information is correct and that all of the required steps have been completed.</p>
Control Tests	<p>Reviewed jackpot estimation tracking sheet and sampled individual jackpot estimation worksheets and supporting documentation to ensure that information agreed.</p>	<p>Tested jackpot estimation checklists for completeness and authorization.</p>	<p>Reviewed jackpot estimation worksheets and supporting documentation for agreement to the advertised amounts.</p>	<p>Reviewed jackpot estimation tracking spreadsheet and conducted interviews with staff.</p>	<p>Reviewed Texas Administrative Code and TLC written procedures.</p> <p>Tested jackpot estimation checklists for compliance with written procedures.</p>
Results	<p>Overall, jackpots were accurately estimated.</p>	<p>All jackpot estimations are appropriately documented, reviewed and authorized prior to jackpot advertisement.</p>	<p>All jackpot estimations agreed with advertised jackpots.</p>	<p>Regular review of jackpot estimations to actual sales is conducted.</p>	<p>Written procedures include TAC requirements for jackpot estimations and also provide detailed step-by-step instructions for the jackpot estimation process. Jackpots</p>



Objective #	1	2	3	4	5
					estimations complied with written procedures.
Recommended Actions	None	None	None	None	None
Management Action Plans	None Required				