

# 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:**

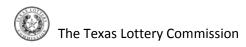
Based on the audit results, we determined that controls over the instant ticket sales—to-transfer of funds to state business process are effective and working as intended to achieve the business objectives and comply with regulatory requirements. We noted that three of the seven prior audit recommendations 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.

None Required

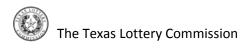


# **Internal Audit of Instant Ticket Sales to Transfer to State Executive Summary**

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

None Required

**Action Plans** 



**Action Plans** 

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

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

MJ NONNELL & JONES LLP

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	Ensure administrative checks are reviewed by an individual outside of the Claims and Payments process.  Strengthen the reconciliation process to:  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.	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.	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).	Open Partially Implemented  Claim center staff does not consistently document the void reason.  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.

2014 Internal

13-008 December 2012

Report Title

Audit

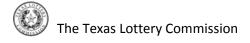
Report

Summary of Findings

#	Date				Follow-Up Status	Audit Follow-Up Status
Manag manag	ement agre ement has o			ne void check memo form existed and have be of capturing the void reason recorded in the		
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.		Open Partially Implemented  Monthly review is not consistently performed. However, we recommend that this review be changed to quarterly if the volume remains low.
Manag monito	ement agre r check vol		e increases significantly, more freque	e check review to quarterly and has begun quent reviews will be evaluated. Procedure LO	,	
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.	Open Partially Implemented 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

Management's Corrective Action Plan

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
						claims.
						Additionally, staff
						should include
						notes as to why
						claims are
						pending.
Manage to reflec	ement agre	process. Managemer	nt also agrees with the recommenda	he number of days of unprocessed mail-in classion to include notes as to why claims are pair implement the system modifications. Antici	ending. Management has submitte	
11-	29-	Claim Center Prize	Internal Audit recommends	Management concurs with the	Management has developed a	Closed
004	Mar-11	Validations	agency management establish	recommendation. The Claims and	formal process for tracking	Management's
			and track performance	Payment Section within the Drawings	customer service experiences	response has been
			measurements for customer	and Validations Department will develop	through the use of a	implemented with
			service.	a procedure and process to track	spreadsheet. Procedures were	only two customer
				relevant feedback received from the	developed to document this	services comments
				public regarding customer service.	process and provide	for the year. There
					management review of comments received.	is no process to request and
					comments received.	automate the
						customer feedback
						process.



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