

December XX, 2011

Ms. Mary Ann Williamson
Texas Lottery Commission
P.O. Box 16630
Austin, TX 78761-6630

Dear Chair Williamson:

The accompanying report details Internal Audit's completed review of the prize payment account. The purpose of the audit was to ensure that the prize payment account balances are accurate and fairly presented, assets are adequately safeguarded and appropriate controls are in place. This included evaluating the controls in place to ensure that reconciliations are performed in accordance with policies and procedures, are performed in a timely manner, and are properly reviewed and outstanding transactions are monitored and resolved. Specifically, we examined processes and controls designed to ensure reconciliations are performed in a timely manner and in accordance with established procedures, information received from outside sources is accurate, correcting or adjusting entries are made, and fraudulent activity is detected and reported to Bank of America for adjustment.

Overall, we could not determine if the prize payment account is accurate and fairly presented nor could we confirm the amount of the discrepancy noted in the reconciliations or determine the reason for the variance in the prize payment account. The absence of historical information and data prevented us from obtaining information beyond fiscal year 2007 thus limiting our ability to research the noted discrepancy. Our review noted improvements in the performance and consistency of the reconciliation process and improvements in the safeguarding of assets with the implementation of the new account; however, controls over the reconciliation process could be enhanced.

Responsible management has expressed agreement with Internal Audit's conclusions and recommendations detailed in the report and has included corrective actions in its responses. If you desire further information concerning this review, please do not hesitate to contact me at 512/344-5488.

Respectfully submitted,

Signature on File

Catherine A. Melvin, CIA, CPA
Director, Internal Audit Division

TEXAS LOTTERY COMMISSION
INTERNAL AUDIT DIVISION



An Internal Audit of the
PRIZE PAYMENT ACCOUNT

IA #12-014
December 2011

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EXECUTIVE SUMMARY

The State Auditor's Office notified the Texas Lottery Commission (TLC) of a complaint received through the State Auditor's Office fraud, waste and abuse reporting system. The complaint addressed an approximate \$600,000 difference in the bank reconciliation in which the General Ledger was higher than the reconciled balance. Internal Audit initiated this audit as a result of the complaint.

The purpose of the audit was to ensure that:

- The prize payment account balance is accurate and fairly presented,
- Assets are adequately safeguarded, and
- Appropriate controls are in place.

We also evaluated processes designed to ensure the following:

- 1) usefulness of information,
- 2) compliance with applicable requirements,
- 3) prevention and detection of fraudulent transactions,
- 4) research and correction of exceptions or deviations, and
- 5) proper presentation of the prize payment account.

Overall, we could not determine whether the prize payment account is accurate and fairly presented, nor could we confirm the amount of the discrepancy noted in the reconciliations or determine the reason for the variance in the prize payment account. The absence of historical information and data prevented us from obtaining information beyond fiscal year 2007 thus limiting our ability to research the noted discrepancy. Our review noted improvements in the performance and consistency of the reconciliation process and improvements in the safeguarding of assets with the implementation of the new account; however, controls over the reconciliation process could be enhanced.

Internal Audit would like to express our appreciation to the Office of the Controller staff for their cooperation and assistance during this engagement. Their courtesy and responsiveness extended to Internal Audit allowed us to complete our work effectively and efficiently.

DETAILED REVIEW RESULTS

The State Auditor's Office notified the Texas Lottery Commission (TLC) Internal Audit Division of a complaint received through the Special Investigations Unit reporting system. The State Auditor's Office requested Internal Audit look into the complaint which alleged that the Office of the Controller "lost" \$600,000 during the change of accounts from the legacy checking account to the new account. The complainant claimed that the accounts should have been changed on September 2009, but were not changed until September 2010. The complainant also stated that the accounts were changed due to fraud being committed by outside people and alleged that Office of the Controller management were not fiscally responsible and may be embezzling money.

Internal Audit initiated this audit as a result of the complaint. The purpose of the audit was to ensure that:

- The Prize Payment Account balance is accurate and fairly presented,
- Assets are adequately safeguarded, and
- Appropriate controls are in place.

To accomplish the audit, we sought to evaluate the processes and controls designed to ensure usefulness of information, compliance with applicable requirements, prevention and detection of fraudulent transactions, research and correction of exceptions or deviations, and proper presentation of the prize payment account. In completing our objective, Internal Audit reviewed the procedures and observed the Office of the Controller's reconciliation process. In addition we reviewed supporting documentation and electronic files, and performed selected test work as deemed necessary. The results of our review are presented below.

Issue 1:

Accuracy and Presentation of Prize Payment Account

The Prize Payment Account is a General Ledger account which captures the activity related to the payment of prize winners. The Texas Lottery Commission (TLC) pays prize winners either via a physical check from a Bank of America (BoFA) checking account or by direct deposit wired to the prize winner's bank account from the Texas Treasury Safekeeping Trust Company (TTSTC). The Prize Payment Account in the General Ledger is reconciled against checks that have cleared BoFA and wires that have been deposited in winners' bank accounts.¹

Prize winners who claim their prize at a Claim Center are issued a Bank of America (BoFA) check, creating a large volume of transactions that flows through the BoFA account each month. Bank of America pays all prize checks issued by the TLC from a zero balance account and the Texas Treasury Safekeeping Trust Company (TTSTC) reimburses BoFA on the TLC's behalf.

¹ Texas Lottery Commission Procedure OC-GL-011, *Cash in Bank*, Effective Date 6/16/09.

The Office of the Controller currently reconciles the BofA bank account used to pay prize winners monthly. There are currently two BofA checking accounts that must be reconciled. A second checking account was opened in late August 2010. This account was established, in part, to strengthen controls over the prevention of fraudulent activity. All prize payments made since September 1, 2010, are paid through the new account. The legacy account remains open to allow outstanding checks to clear the bank. Accordingly, monthly reconciliation continues for this account. However, associated with the legacy account is an unresolved balance which will be discussed further later in this report.

Internal controls are vital in ensuring that key risks are controlled or mitigated. Internal control activities, "...are the policies, procedures, techniques, and mechanisms that enforce management's directives...They help ensure that actions are taken to address risks. Control activities are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results....They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations."² Internal Audit reviewed processes and controls designed to ensure reconciliations are performed in a timely manner and in accordance with established procedures, and adjusting entries are made as appropriate.

Internal Audit was unable to determine whether the prize payment account is accurate and fairly presented, nor could we confirm the amount of the discrepancy noted in the reconciliations or determine the reason for the variance in the prize payment account. The absence of historical information and data prevented us from obtaining information beyond fiscal year 2007 thus limiting our ability to research the noted discrepancy. Further, we found neither adequate nor effective control systems in place in the past to ensure the accuracy of the prize payment account. Our review noted improvements in the performance and consistency of the reconciliation process; however, controls over the reconciliation process could be enhanced.

Variance Associated with the Legacy Account

Reconciliations are important controls that help to ensure that the information in the General Ledger is accurate, transactions have been recorded and processed appropriately, and fraudulent activity or errors are detected timely. When the reconciliation results in a variance or discrepancy, this should be researched and explained in the reconciliation file. Our audit revealed that the new bank account was being reconciled to a zero variance. During fieldwork, we determined that the legacy account, however, has not reconciled to zero since at least fiscal year 2007. While the documented discrepancy has fluctuated month-to-month, our review disclosed that the discrepancy has remained at \$622,103.40 since the two administrative check adjustments discussed later in this report were made in June 2010. Information prior to fiscal year 2007 is unavailable and the history of the discrepancy cannot be determined. Information necessary to research the variance prior to fiscal year 2007 was destroyed in accordance with the TLC's record retention schedule and is no longer available. As a result, Internal Audit was unable to either confirm the amount of the discrepancy noted in the reconciliations or determine the reason for the variance in the prize payment account.

² "Standards for Internal Control in the Federal Government" United States General Accounting Office, November 1999

Inconsistent Performance of Reconciliation

As previously mentioned, effective internal control activities help ensure that action is taken to address risk. The reconciliation is an integral part of controlling or mitigating risk of errors in the general ledger or fraudulent activity. However, throughout the history of the legacy BofA account, there have been time periods in which the bank reconciliations were not performed on a regular basis. The Office of the Controller asserted that at one point they had several vacant positions and during that time and needed to prioritize their workload, resulting in reconciliations being placed lower on the list of priorities. According to management, the position responsible for the reconciliations was filled at the beginning of fiscal year 2008 and the Office of the Controller began working on the backlog. At one time, the reconciliations were more than a year behind. The Office of the Controller stated that when they were able to address the backlog of reconciliations, they began with the most recent months and worked backwards in order to have a chance to receive credit from BofA if fraudulent transactions or errors were discovered. At the same time, a new accounting system, MIP, was implemented in September 2007 and the Office of the Controller was involved in training on and conversion to the new system. The absence of performance of the reconciliations, information that could not be accessed due to system changes, and the absence of a sound, consistent procedure for performing the reconciliations all contributed to the inability to receive credit for fraudulent transactions that were later identified during reconciliation and the growth of a difference in the bank reconciliation in which the General Ledger was higher than the reconciled bank balance.

During the course of our audit, we noted the reconciliation is performed by the same individual each month and, while other staff members are knowledgeable of the basic preparation, no others are as experienced in performing the reconciliation or as familiar with the detailed steps. This has led to a lapse in the timely preparation of the reconciliation. As discussed earlier, this position was vacant for approximately two years. As a result, the reconciliations fell behind. Once the position was filled, the individual then had to address the backlog while still responsible for performing the current period reconciliation.

Administrative Checks

The Office of the Controller reviews the general ledger Prizes Payable Clearing account daily to ensure that validations and prize payments were recorded correctly and the account balance equals zero. They also reconcile this account on a monthly basis. This reconciliation is performed by a different individual than the one who performs the bank reconciliation. The preparer records the beginning balance, debits and credits for the month, and makes any adjustments for items such as voided checks, jackpot prizes, administrative checks, and non-cash prizes. Information to perform the reconciliation is obtained from ProSys, GTECH's then-gaming system software and MIP, the TLC's accounting system. The Office of the Controller must make corrective journal entries for administrative checks in the Prizes Payable Clearing account since, due to the nature of Administrative Checks, validations do not occur automatically. Administrative checks result from previously paid tickets, expired tickets, second chance drawings, stolen tickets or the reissuance of expired, lost or damaged prize checks. With administrative checks, there is no ticket validation.

When tickets are validated through the system and the claim center generates a check to pay a winner, there is an automatic upload the following day to post the required journal entries

(debit the Prizes Payable Clearing account and credit Cash in Bank) to record the payment. According to the Office of the Controller, when a claim center issues a prize check as an administrative check, a portion of the journal entries become manual because there is no ticket validation associated with an administrative check to initiate the required entries.

During the time that the Office of the Controller was addressing the reconciliation backlog for the legacy bank account, they discovered that they had been posting the incorrect entry in the general ledger Prizes Payable Clearing account to account for the manual "validation" activity. The end result was a difference in the bank reconciliation in which the General Ledger was higher than the reconciled balance. The Office of the Controller was able to quantify the errors from fiscal year 2007 forward and made two journal entries in fiscal year 2010, one for \$53,323.55 and one for \$153,141.00, to correct these errors. According to the Office of the Controller, they were unable to go back further to research earlier errors due to records destruction requirements and accounting system conversions that have left information and data unavailable. Since the errors for fiscal year 2007 and forward were discovered and corrected, the journal entry has been made to account for administrative checks. The bank reconciliation for the legacy bank account has had a constant variance of \$622,103.40 since June 2010. Internal Audit verified that the journal entry had been made in MIP and discussed the methodology with the external financial auditor.

Contributing factors to the length of time the error went undetected may have been the absence of an adequate understanding of the impact of transactions and adequate detailed supervisory review. In addition to ensuring adequate supervisory review, periodic rotation of duties among staff can assist in a better understanding of the impact of transactions on accounts and can reduce the risk of error, waste, or wrongful acts and the risk of such problems remaining undetected.

Treatment of Outstanding Checks

When checks have been outstanding (not cashed) for three years, the TLC is required to submit the check information to the State Comptroller of Public Accounts (CPA) as unclaimed property³. The TLC reports two types of unclaimed property: prize checks in which the physical check is in our possession (e.g., check returned due to incorrect address) and prize checks for which we do not have the physical check (e.g., check was never cashed and never returned). For the period 2001 through 2010, 94 percent of checks reported as unclaimed property were not in our possession.

By November 1 of each year, the CPA requires state agencies to report all checks that have been outstanding for three years as of June 30th. In addition, the Office of the Controller must issue a check payable to the CPA for the amount of the unclaimed property. Per the CPA retention schedule, the TLC is required to retain records of unclaimed property for 10 years after the property has been reported.

The Office of the Controller forwards a copy of the items reported to the CPA as unclaimed property to the Austin Claim Center with instructions to void the reported checks in ProSys. The Austin Claim Center updates the check status in the Automated Claims Tracking System (ACTS), voids the check in ProSys, and notifies the Office of the Controller that these

³ Texas Property Code, Title 6, Chapter 74

actions have been completed. However, voiding the check in ProSys does not affect the check status with BofA. The bank considers the check to be valid unless a stop payment is placed on it.

Proper Year to Submit	Percentage Submitted Timely*	Percentage Submitted Late*	Percentage Submitted Early*
2002	4.33%	92.30%	3.37%
2003	6.81%	89.69%	3.50%
2004	90.11%	0.18%	9.71%
2005	98.78%	1.22%	-
2006	99.77%	0.23%	-
2007	100.00%	-	-
2008	99.82%	0.18%	-
2009	100.00%	-	-
2010	100.00%	-	-

* Percentage of outstanding checks submitted to the Comptroller of Public Accounts (CPA) in accordance with timelines established by the CPA, based on outstanding checks submitted as of December 2010. Does not consider whether all outstanding checks have been submitted as appropriate, thus these numbers may change in the event additional outstanding checks needing to be submitted may be discovered.

Internal Audit reviewed the unclaimed property submissions for the period 2001 through 2010. The Office of the Controller has improved controls over the unclaimed property submission by adding a formalized review process in 2009. During the period reviewed, the Office of the Controller did submit unclaimed property information to the CPA by November 1 in nine of the ten years reviewed. However, in five of the ten years reviewed, unclaimed property submissions by the TLC included outstanding checks submitted earlier and/or later than the CPA's requirements. The Outstanding Check Submission by Year chart in the Appendix breaks

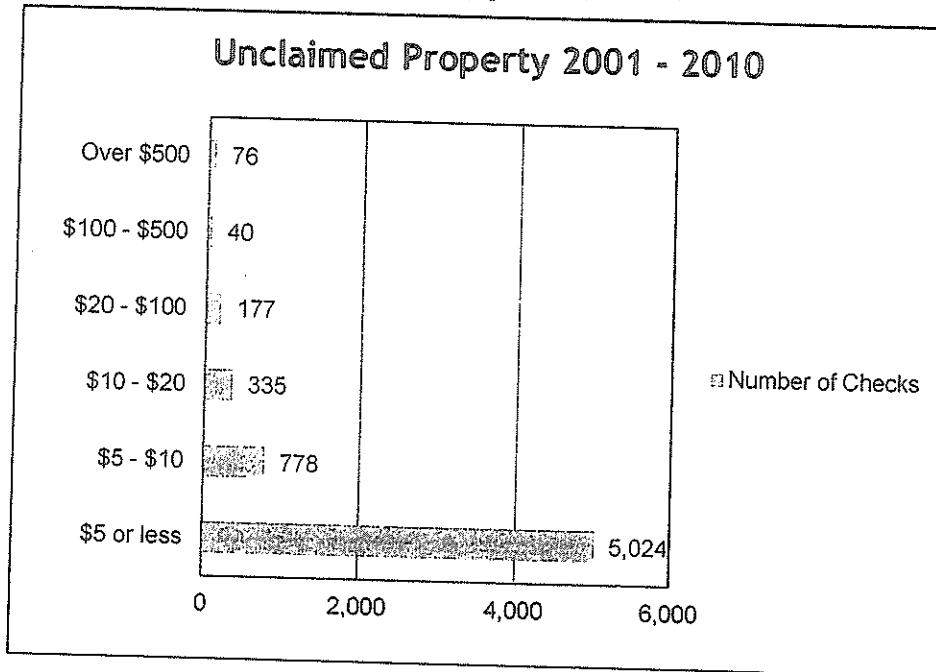
down the outstanding checks that were submitted early, late and on time by submission year. Although there are currently no financial sanctions imposed on state agencies who fail to comply with the requirements of the statute, it is important that the TLC submit all unclaimed property in the timeframe and manner required. If checks are not submitted to the CPA as unclaimed property in a timely manner, a number of issues may arise. For example, performing the bank reconciliation is more difficult due to the large number of outstanding checks that must be reviewed.

The Office of the Controller does not place a stop payment on checks that are not in the TLC's possession nor do they notify BofA of the checks that have been reported as unclaimed property and voided in ProSys. For the period of 2001 through 2010, 6,430 checks were submitted as unclaimed property. Of these, 5,024 or 78 percent were \$5.00 or less. Another 778, or 12 percent were between \$5 and \$10. At the time of our audit, BofA charged \$5.00 per check for a stop payment done online and \$10.00 per check for stop payments done through a BofA representative. Since many of the checks submitted as unclaimed property are of low dollar amounts, stopping payment on all checks would not be cost effective.

According to data provided by Information Resources and Office of the Controller records, the agency submitted 6,430 checks totaling \$144,057.56 as unclaimed property during the last 10 years. Internal Audit attempted to determine whether any checks submitted as unclaimed property were later cashed. Based on IR records, it appears since calendar 1999 at least eight checks totaling \$27 were cashed subsequent to submittal as unclaimed property. However data for instances identified prior to calendar year 1999, may not be reliable. We

also noted five checks totaling \$85 were erroneously sent to the CPA as unclaimed property after being cashed. Although the amount identified as cashed after submittal as unclaimed property is not significant, a risk exists that a claimant could be paid twice if they seek payment from the CPA as unclaimed property and subsequently cash the original check.

Office of the Controller records show that there have been 14 checks totaling \$114 in the past ten years that were cashed after being submitted to the CPA as unclaimed property. In these instances, TLC can request reimbursement from the CPA for these checks. However, a risk exists that a claimant could be paid twice if the claimant first seeks payment from the CPA and then subsequently cashes the BofA check. In such a scenario, it is unlikely TLC would be able to seek reimbursement from the CPA. While the instances of checks cashed after being submitted as unclaimed property have been few and for minimal dollars, the potential for a duplicate payment of a larger dollar value exists. The State Lottery Act expressly prohibits the payment of any specific lottery prize than once.⁴



Issue 2:

Safeguarding of Assets

Internal control helps an organization to safeguard resources against loss due to waste, abuse, mismanagement, errors, and fraud. "The three objectives of internal control are:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

⁴ Texas Government Code §466.404(a)

The safeguarding of assets is a subset of all of these objectives. Internal control should be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use or disposition of assets.⁵

During our review, we examined processes and controls designed to ensure fraudulent or otherwise unauthorized activity is timely detected and properly addressed. *Overall, based on the documentation available, we found a noted improvement in the safeguarding of assets – better ensuring the likelihood of prevention and detection of fraudulent or unauthorized activity in the bank account used to pay prizes.* Lacking adequate, timely reconciliation, the legacy bank account was vulnerable to fraudulent activity during the period before the new Positive Pay bank account was implemented. The implementation of the new account improves the prevention and detection of unauthorized checks. In addition, the regular performance of the reconciliation has improved the agency's ability to detect fraudulent activity and receive monetary credit from the bank, if needed.

Fraudulent Transactions

Monthly reconciliation assists in the timely discovery of any errors or fraudulent transactions. As discussed earlier in this report, the prize payment account historically had not been adequately reconciled. The absence of adequate reconciliation was due in part to staffing shortages. When the Office of the Controller was able to fill their vacant positions and a person with knowledge of the reconciliation process was back in that position, the reconciliations resumed and the Office of the Controller addressed the reconciliation backlog. During this time, several fraudulent transactions were discovered. During the period from October 2007 through October 2008, 12 checks totaling \$18,836.58 were fraudulently created by outside parties and paid out of the legacy BofA account. Since these transactions were not discovered until October and November 2008 and thus, the bank was not notified within the required 60 days from the date of the bank statement for all of the transactions, TLC only received credit for one check in the amount of \$2,824.69. The agency did not receive credit for the remainder of the checks totaling \$16,011.89. The Office of the Controller discovered a second fraud scheme involving ACH transactions in May 2009. This scheme was perpetrated by outside parties during the period September 2008 through May 2009. In this instance, there were 102 fraudulent electronic withdrawals totaling \$45,429.40. However, the agency was credited for 91 transactions totaling \$43,662.64. In addition, during the course of our audit, Information Resources shared four additional fraudulent or erroneous checks paid out of the legacy BofA account. Information Resources records indicated these four checks cleared the legacy BofA account, totaling \$29,194.20. The Office of the Controller indicated credit was unable to be granted for these four transactions.

In summary, of 118 fraudulent transactions discovered totaling \$93,460.18, credit was granted by BofA for 92 transactions totaling \$46,487.33. The remainder had to be treated as a loss to the state due to untimely performance of reconciliations.

⁵ Office of Management and Budget, Circular A-123, Management's Responsibility for Internal Control, Revised December 21, 2004

Positive Pay Banking

Positive Pay is an automated fraud detection tool offered by the bank. It protects against altered checks and counterfeit check fraud. It is a service that matches each check presented for payment against a list of checks authorized and issued by the TLC. All security components of the check provided to BofA must match exactly or BofA will not pay.

To take advantage of these security enhancements, the Office of the Controller opened a new bank account with BofA with Positive Pay features on August 30, 2010, and began issuing all prize payment checks out of the new account. Since reconciliation issues remained with the legacy account and uncleared checks remained, the legacy account remains open, but checks are no longer issued against it.

During the time it took to implement the new Positive Pay bank account, the potential for check fraud existed. As discussed earlier, the agency has discovered fraudulent transactions during its reconciliation efforts. Had Positive Pay been in place, fraudulent check transactions would more likely have been discovered prior to payment by Bank of America.

While timely reconciliations are an important detective control, the Positive Pay bank account features strengthen controls over fraudulent activity by *preventing* the payment of altered or counterfeit checks.

Transaction Type	Date Range	Date Discovered by GC	Fraudulent Transactions		Credit Granted	
			No. of Transactions	TTL Dollar Amount	No. of Transactions	TTL Dollar Amount
Check	Oct 2007 – Oct 2008	Oct/Nov 2008	12	\$18,836.58	1	\$2,824.69
ACH	Sep 2008 – May 2009	May 2009	102	\$45,429.40	91	\$43,662.64
Check	April 2009	May 2009	1	\$99.00	0	\$0.00
Check	Oct 2007	June 2009	3	\$29,095.20	0	\$0.00
TOTAL			118	\$93,460.18	92	\$46,487.33

Recommendations:

Overall Recommendations

Internal Audit recommends the following:

1. Develop control procedures to ensure substantive reconciliations are performed on a monthly basis and include proper supervisory review. Ensure control procedures also address the following:
 - a. Notify Bank of America within 60 days of the statement date of any errors or fraudulent transactions.
 - b. Research any variances or discrepancies and include an explanation and documentation in the reconciliation report and workpapers. If necessary and appropriate, make corrective entries to resolve the variances or discrepancies.

- c. Continue to monitor the variance in the legacy bank account each month to ensure that any changes are explained and documented.
2. Ensure the development of expertise among staff to perform reconciliations. More than one person should be trained to prepare the monthly reconciliation. We further recommend this function should be periodically rotated.
3. Develop control procedures to ensure checks that have been outstanding for three years are submitted properly to the Comptroller of Public Accounts in a timely manner. We further recommend, the Office of the Controller notify Bank of America of checks sent as unclaimed property and place a stop payment on those checks not in our possession that exceed a threshold to be determined by management.
4. Develop a plan to address the legacy account. While the account may need to remain open for some period, we recommend the Office of the Controller develop a written plan which will address how and when the account will be closed, how any outstanding transactions will be handled, and the appropriate disposition and treatment of the related unreconciled balance. We recommend the Office of the Controller seek consultation from the agency's independent financial auditor and the Comptroller of Public Accounts to ensure appropriate disposition and treatment of the related unreconciled balance.

Management Response:

Management Consideration Item:

Additional Item for Consideration

In completing our objectives, Internal Audit reviewed the procedures and observed the Office of the Controller's reconciliation process. Internal Audit offers the following for management's consideration to strengthen controls over the reconciliation process.

Manual Process

The monthly reconciliation process is primarily a manual process. The individual responsible for reconciliation manually reviews the almost 10,000 transactions every month in addition to tracking outstanding checks. The reconciliation is performed by one individual over the span of approximately two weeks. Given the volume of transactions, a manual reconciliation could result in information being overlooked or other errors. Such errors could impact the reconciliation and potentially cause a misstatement in the account. Automating the reconciliation could assist in streamlining the process and reducing errors made by manual input. Wherever possible, the Office of the Controller should utilize automated processes and request electronic information from the Texas Treasury Safekeeping Trust Company and Bank of America.

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BACKGROUND

The Texas Lottery Commission (TLC) pays prize winners either via check from Bank of America (BoFA) or by direct deposits wired to their bank accounts from the Texas Treasury Safekeeping Trust Company (TTSTC). Bank of America pays all prize checks issued by the TLC from a zero balance account and the TTSTC reimburses BoFA on the TLC's behalf. Each day, the bank provides the TLC with the amount of prize checks paid by BoFA the previous day. The TLC provides this information to the TTSTC who reimburses the bank. Prizes paid in the General Ledger are reconciled to checks that have cleared Bank of America and wires that have been deposited in winners' accounts.⁶

There are currently two bank accounts in use. A new account with positive pay features was implemented in late August 2010. All checks for prize payments have been issued from this new account since its inception. The legacy account remains open to enable claimants to cash the checks that were issued from this account prior to late August 2010. Both accounts are reconciled each month.

The Office of the Controller utilizes information from various sources to perform the monthly reconciliation. Bank of America (BoFA) sends information related to check payments such as CD-ROMs containing images of canceled checks from the previous month, a bank statement and a reconciliation report. The Texas Treasury Safekeeping Trust Company (TTSTC) provides information detailing deposits, wires, interest earned and transfers. Information Resources (IR) downloads information from the BoFA website and prepares three reports: Cleared Checks, Outstanding Checks and Exceptions.

The monthly reconciliation process is primarily manual. A large volume of transactions flows through the bank accounts each month. In the legacy bank account, there was a monthly average of 4,942 checks issued, 4,195 checks cleared, and 3,295 total checks outstanding for the period of September 2008 through December 2010. In addition, the reconciliation process also includes researching any check exceptions that appear on the monthly exception report. These exceptions had significantly decreased over time during that period. In the new account through December 2010, there has been a monthly average of 4,259 checks issued, 3,815 checks cleared, 860 total checks outstanding, and no check exceptions.

⁶ Texas Lottery Commission Procedure OC-GL-011, *Cash in Bank*, Effective Date 6/16/09.

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Appendix

Outstanding Check Submission by Year

Submittal Year	Proper Year to Submit										Total	% Submitted Timely	
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010			
1995	1											n/a	n/a
1996	36											n/a	n/a
1997	38											n/a	n/a
1998	96											n/a	n/a
1999	53											n/a	n/a
2000	69											n/a	n/a
2001	105											n/a	n/a
2002	46	59		1,255								n/a	n/a
2003		37	72	946					3			1,363	4.33%
2004			54	501					2			1,057	6.81%
2005					486				1			556	90.11%
2006						426			6			492	98.78%
2007							477		1			427	99.77%
2008								561	1			562	100.00%
2009									519			519	99.82%
2010										579		579	100.00%

Late	293			2201					14			2,508
Early	46	37	54									137
On time	105	59	72	501	486	426	477	561	519	579		3,785

* Percentage of outstanding checks submitted to the Comptroller of Public Accounts (CPA) in accordance with timelines established by the CPA, based on outstanding checks submitted to-date. Does not consider whether all outstanding checks have been submitted as appropriate, thus these numbers may change in the event additional outstanding checks needing to be submitted may be discovered.

Reconciliation Process

Office of the Controller receives 3 reports prior to reconciliation process

Bank of America

- Sends CD-ROMs containing images of canceled checks
- Bank statement
- Reconciliation report of cleared checks

Texas Treasury Safeguarding Trust Company

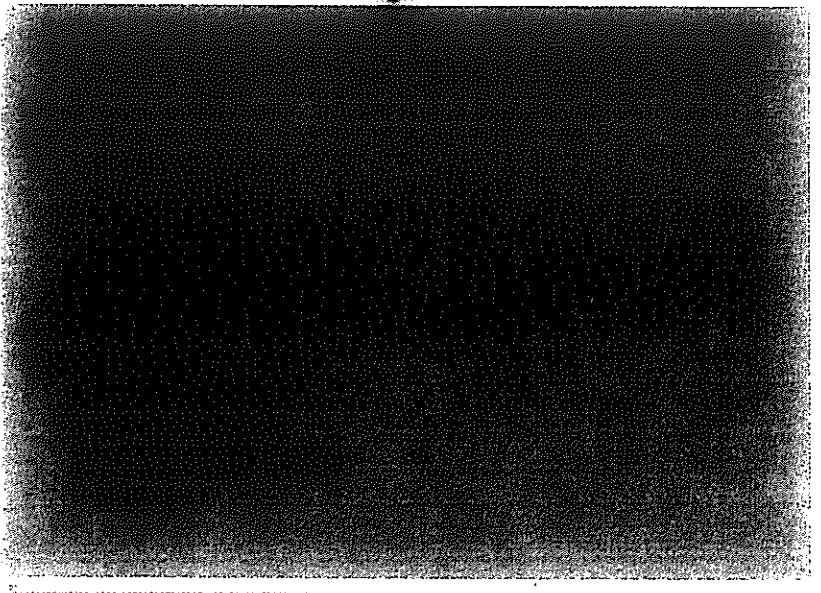
- Provides a statement detailing deposits, wins, interest earned and transfers

TLC Information Resources

- Downloads and provides 3 reports: cleared checks, outstanding checks and exceptions



Office of the Controller reconciles reports and provides report to the Controller monthly



* From September 2008 – December 2010
** August 2010 – December 2010

AUDIT PURPOSE, SCOPE AND METHODOLOGY

Purpose:

Internal Audit's review of the prize payment account was initiated as a result of a complaint to the State Auditor's Office. The purpose of the audit was to ensure that the prize payment account balance is accurate and fairly presented and that transactions are accurately, completely and timely recorded in the accounting system and monitored in accordance with policies and procedures. This included evaluating the controls in place to ensure that reconciliations were performed in accordance with policies and procedures, were performed in a timely manner, and were properly reviewed and outstanding transactions are monitored and resolved.

Scope:

Internal Audit reviewed reconciliations performed during the time period of September 1, 2006 through December 31, 2010. Due to records destruction requirements, reconciliation data and information pertaining to periods prior to fiscal year 2007 was not available. This audit did not include a review of taxes payable or warrant hold payables. In addition, this audit did not include an examination of the accuracy and completeness of transactions associated with the new bank account.

The scope of our audit including examining the system of internal control designed to ensure process objectives.

Methodology:

In accomplishing our objective, Internal Audit reviewed the procedures and observed the Office of the Controller's reconciliation process. Internal Audit interviewed responsible management and staff, examined and reviewed supporting documentation and electronic files, and performed selected testwork as deemed necessary. Internal Audit's review did not include verifying the reliability and integrity of data from ProSys, USAS, or MIP. We relied upon other independent audit work as relevant and appropriate.

Auditor's Consideration of Fraud:

In accordance with our professional standards, Internal Audit considered risks due to fraud that could significantly affect our audit objectives and the results of our audit. Accordingly, we designed our procedures to provide reasonable assurance of detecting fraud significant to the audit objectives. During the course of the audit, we were also alert to situations or transactions that could be indicative of fraud. We conducted our audit to provide reasonable assurance of detecting illegal acts or fraud that could significantly affect the audit results; however, it does not guarantee the discovery of illegal acts or fraud.

Professional Standards:

Internal Audit conducted this performance audit in accordance with the International Standards for the Professional Practice of Internal Auditing as promulgated by the Institute of Internal Auditors (IIA) in conjunction with generally accepted government auditing standards (GAGAS) as promulgated by the U.S. Government Accountability Office (GAO). 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 findings and conclusions based on our audit objectives.

Audit Team

The following members of the Internal Audit Division performed this audit:

- Dale Hernandez, CIA, CGAP, CCSA, CFE, CICA
- Kimberly Tucker

STATE OF TEXAS
TEXAS LOTTERY COMMISSION

INTERNAL AUDIT DIVISION

An Internal Audit of the
PRIZE PAYMENT ACCOUNT

IA #12-014

December 2011

This report has been provided to the following:

Ms. Mary Ann Williamson, Chair
Mr. J. Winston Krause, Commissioner
Ms. Cynthia Tauss Delgado, Commissioner

Mr. Gary Grief, Executive Director
Mr. Philip D. Sanderson, Charitable Bingo Operations Director

This report is also provided to the following for appropriate distribution in accordance with
Government Code §2102.009:

Mr. Jonathan Hurst, Director, Governor's Office of Budget, Planning and Policy
Mr. John O'Brien, Director, Legislative Budget Board
Mr. Ken Levine, Director, Sunset Advisory Commission
Mr. John Keel, CPA, State Auditor