

TEXAS LOTTERY COMMISSION INTERNAL AUDIT DIVISION



An Internal Audit of the PRIZE PAYMENT ACCOUNT

IA #13-007
November 2012

Mary Ann Williamson
Chairman

J. Winston Krause
Commissioner

Cynthia Tauss Delgado
Commissioner



TEXAS LOTTERY COMMISSION

Gary Grief, *Executive Director*

Philip D. Sanderson, *Charitable Bingo Operations Director*

November 6, 2012

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 determine whether 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 reconciliations are performed in accordance with policies and procedures, are performed in a timely manner, and are properly reviewed. Internal Audit also evaluated controls in place to ensure outstanding transactions are monitored and resolved.

Based on the results of our review, Internal Audit could not determine whether the Prize Payment account is accurate and fairly presented, confirm the amount of the discrepancy noted in the reconciliations, or determine the reason for the variance in the Prize Payment account. While management has made improvements in controls, adequate and effective internal controls were not in place during the period audited to ensure the Prize Payment account was adequately safeguarded against unauthorized activity.

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,

A handwritten signature in black ink, appearing to read "Catherine A. Melvin".

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

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
DETAILED REVIEW RESULTS.....	3
1. Accuracy and Management of the Prize Payment Account	3
<i>Variance Associated with the Legacy Account.....</i>	<i>4</i>
<i>Inconsistent Performance of Reconciliation</i>	<i>4</i>
<i>Administrative Checks.....</i>	<i>5</i>
<i>Treatment of Outstanding Checks</i>	<i>6</i>
2. Safeguarding of Assets	9
<i>Unauthorized Transactions</i>	<i>9</i>
<i>Subsequent Disclosure</i>	<i>10</i>
<i>Required Reporting</i>	<i>11</i>
<i>Positive Pay Banking</i>	<i>11</i>
3. Overall Recommendations	11
4. Additional Item for Consideration.....	14
<i>Manual Process.....</i>	<i>14</i>
BACKGROUND	17
APPENDIX	19
AUDIT PURPOSE, SCOPE AND METHODOLOGY	21

This page intentionally left blank.

EXECUTIVE SUMMARY

In November 2010, the State Auditor's Office notified the Texas Lottery Commission of a complaint received through the State Auditor's Office fraud, waste, and abuse reporting system. The complaint referenced an approximate \$600,000 difference in the bank reconciliation in which the General Ledger was higher than the reconciled balance. After discussions with the State Auditor's Office and agency management, Internal Audit initiated this audit in December 2010 as a result of the complaint.

The purpose of the audit was to determine whether:

- 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:

- Usefulness of information,
- Compliance with applicable requirements,
- Prevention and detection of unauthorized transactions,
- Research and correction of exceptions or deviations, and
- Proper presentation of the Prize Payment account.

Internal Audit reviewed reconciliations performed during the time period of September 1, 2006 through December 31, 2010. Per the Office of the Controller, adequate records and information prior to fiscal year 2007 are unavailable and the history of the discrepancy cannot be determined. The Office of the Controller has asserted information necessary to research the variance prior to fiscal year 2007 was destroyed in accordance with the agency's record retention schedule and is no longer available. Thus, the absence of historical information and data prior to fiscal year 2007 limited our ability to research the noted discrepancy.

Based on the results of our review, Internal Audit could not determine whether the Prize Payment account is accurate and fairly presented, confirm the amount of the discrepancy noted in the reconciliations, or determine the reason for the variance in the Prize Payment account. While management has made improvements in controls, adequate and effective internal controls were not in place during the period audited to ensure the Prize Payment account was adequately safeguarded against unauthorized activity.

In order to address the longstanding discrepancy noted in the reconciliations and improve fraud detection, agency management opened a new bank account with Positive Pay features on August 30, 2010, while allowing the legacy bank account to remain open to clear outstanding checks. As the new account had only been open a few months at the launch of our audit, we accordingly did not include an examination of the accuracy and completeness of transactions associated with the new bank account. Additionally, limited work was performed to verify reconciliation

activity associated the new bank account. However, we noted that the new bank account was reconciling to zero for the months of September, October, November, and December 2010.

Our review noted improvements in the performance and consistency of the reconciliation process and improvements in the safeguarding of assets with the implementation of a new account; however, controls over the reconciliation process could be enhanced. This report contains Internal Audit's recommendations to enhance and strengthen controls over the Prize Payment account and related processes. Agency management has concurred with all recommendations and has asserted implementation. Management's responses have been included in this report.

DETAILED REVIEW RESULTS

In November 2010, the State Auditor's Office notified the Texas Lottery Commission (TLC) Internal Audit Division of a complaint received through their fraud, waste, and abuse reporting system. The complaint referenced an approximate \$600,000 difference in the bank reconciliation in which the General Ledger was higher than the reconciled balance. After discussions with the State Auditor's Office and agency management, Internal Audit initiated this audit in December 2010 as a result of the complaint.

The purpose of the audit was to determine whether:

- 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 unauthorized 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 Management of the 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 BoFA check, creating a large volume of transactions² that flow through the BoFA account each month. 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.

The Office of the Controller is responsible for monthly reconciliation of the BoFA account used to pay prize winners. At the time of our audit, there were two BoFA checking accounts that must be reconciled. The second checking account was opened in late August 2010. This account was established, in part, to strengthen controls over the prevention of unauthorized activity. All prize

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

² See "Background" section later in this report.

payments made since September 1, 2010, are paid through the new account. At the time of our audit, the legacy account remained open to allow outstanding checks to clear the bank. Accordingly, monthly reconciliation continues for this account. However, an unresolved balance associated with the legacy account will be further discussed 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..."³ Internal Audit reviewed processes and controls designed to ensure reconciliations are performed in a timely manner and in accordance with established procedures, and that adjusting entries are made as appropriate.

Based on the results of our review, Internal Audit could not determine whether the Prize Payment account is accurate and fairly presented, confirm the amount of the discrepancy noted in the reconciliations, or determine the reason for the variance in the Prize Payment account. Adequate and effective control systems were not always in place to ensure the accuracy of the Prize Payment account. Further, the absence of historical information and data prior to fiscal year 2007 limited our ability to research the noted discrepancy. 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 the information in the General Ledger is accurate, transactions have been recorded and processed appropriately, and unauthorized 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. However, the legacy account 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. Per the Office of the Controller, adequate records and information prior to fiscal year 2007 are unavailable and the history of the discrepancy cannot be determined. The Office of the Controller has asserted information necessary to research the variance prior to fiscal year 2007 was destroyed in accordance with the agency'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.

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

³ "Standards for Internal Control in the Federal Government" United States General Accounting Office, November 1999

unauthorized activity and errors in the General Ledger. However, we found there have been time periods in which the bank reconciliations were not performed on a regular basis and were not current. Further, we found inconsistencies in the extent and substance of the reconciliations. The absence of 1) timely and adequate reconciliations, and 2) control procedures to ensure substantive reconciliations are performed on a monthly basis and include proper supervisory review have contributed both to the inability to receive credit for unauthorized transactions (discussed further in this report) and to the lack of a reconciled balance between the General Ledger and the legacy bank account.

During the course of our audit, we noted the reconciliation was primarily 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. Further, we noted the substance of the reconciliation differed during time periods when other staff members were responsible for the 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. This account must be reconciled on a monthly basis. The beginning balance, debits, and credits for the month are recorded, and any adjustments for items such as voided checks, jackpot prizes, administrative checks, and non-cash prizes are made. Information to perform the reconciliation was obtained from ProSys (GTECH's then-gaming system software), and Sage Fund Accounting (the agency'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 that posts 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. While two different staff members were responsible for preparing the General Ledger Prizes Payable Clearing account reconciliation and the Prize Payment account bank reconciliation, some entries overlapped. The end result was a difference in which the General Ledger Prizes Payable Clearing account balance was higher than the Prize Payment account 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 retention requirements and accounting system conversions that have left information and data unavailable.

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, the lack of rotation of duties, and the absence of detailed supervisory review. Ensuring proper supervisory review and periodic rotation among staff can assist in a better understanding of the impact of transactions on accounts, and the timely detection of any errors, inefficiencies, or wrongful acts.

Treatment of Outstanding Checks

When checks have been outstanding (i.e., not cashed) for three years, the TLC is required to submit the check information to the Texas Comptroller of Public Accounts (CPA) as unclaimed property⁴. 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).

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. The Austin Claim Center updates the check status in the Automated Claims Tracking System (ACTS), voids the check, and notifies the Office of the Controller that these 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 initiated.

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 Percentages chart (Chart 1) summarizes the percentage of outstanding checks submitted early, late, and on time by required submission year. Further detail and breakdown is provided in the Appendix to this report. 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.

⁴ Texas Property Code, Title 6, Chapter 74

Outstanding Check Percentages			
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.

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. For the period of 2001 through 2010, 6,430 checks were submitted as unclaimed property. Of these, 5,024 (78 percent) were \$5.00 or less. Another 778 (12 percent) were between \$5 and \$10. (See Chart 2 "Prize Checks Submitted to Unclaimed Property") 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.

Chart 1

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 (IR) 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 year 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 13 checks totaling \$112 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 more than once.⁵

⁵ Texas Government Code §466.404(a)

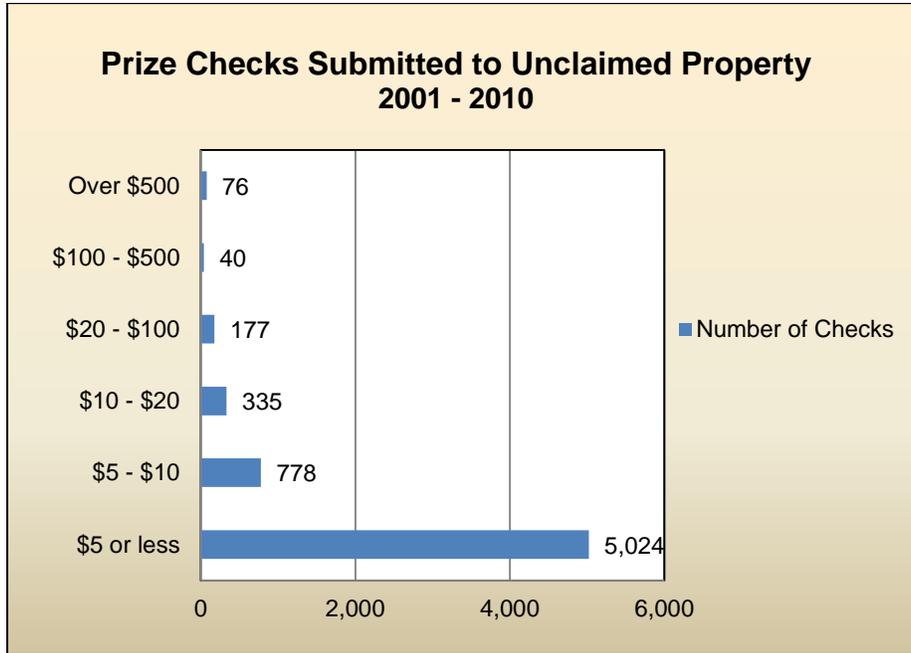


Chart 2

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.

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.”⁶

During our review, we examined processes and controls designed to ensure fraudulent or otherwise unauthorized activity is timely detected and properly addressed. *While management has made improvements in controls, adequate and effective internal controls were not in place during the period audited to ensure the Prize Payment account was adequately safeguarded against unauthorized activity.* Lacking adequate, timely reconciliation, the legacy bank account was vulnerable to unauthorized 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 transactions. In addition, the regular performance of the reconciliation has improved the agency’s ability to detect unauthorized activity and receive monetary credit from the bank, if needed.

Unauthorized Transactions

Monthly reconciliation assists in the timely discovery of any errors or unauthorized transactions. As discussed earlier in this report, the Prize Payment account historically had not been adequately reconciled. During the time the Office of the Controller was addressing the reconciliation backlog, several unauthorized and/or fraudulent transactions by outside parties were discovered. Detailed in Chart 3 are the unauthorized transactions disclosed to Internal Audit during the course of our review. During the period October 2007 through October 2008, 12 checks totaling \$18,836.58 were 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, the agency 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 scheme involving ACH transactions in May 2009. This scheme was also perpetrated by outside parties during the period September 2008 through May 2009. In this instance, there were 102 unauthorized 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, a review of Information Resources records revealed four additional unauthorized 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

⁶ Office of Management and Budget, Circular A-123, Management’s Responsibility for Internal Control, Revised December 21, 2004

Controller verified these unauthorized transactions and confirmed credit was unable to be granted for these four transactions.

Upon notification from the Office of the Controller, the agency's Enforcement Division conducted investigative work related to discovered unauthorized transactions and reported submitting the cases to local authorities.

Unauthorized Transactions Disclosed to Internal Audit							
Transaction Type	Date Range	Date Discovered	Unauthorized Transactions		Correction Granted		Notes
			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	A
Various	Nov 2007 – June 2009	Unknown	18	\$3,511.10	8	\$867.00	B
TOTAL			136	\$96,971.28	100	\$47,354.33	C
A- Verified by Internal Audit B- Subsequent revised disclosure by Office of the Controller after audit fieldwork completion (unaudited) C- Total incorporating revised disclosure (unaudited)							

Chart 3

Subsequent Disclosure

Subsequent to the completion of our fieldwork, the Office of the Controller disclosed to Internal Audit an additional 29 unauthorized transactions from the period November 2007 through June 2009, totaling \$18,569.10. Of these transactions, the Office of the Controller asserted corrections were granted by BofA for eight (8) transactions totaling \$867. These transactions were not provided to Internal Audit during our audit and consequently, we were unable to audit these transactions for accuracy, validity, or completeness. Accordingly, we make no representation regarding the transactions. The Office of the Controller later revised this disclosure to assert 11 of the 29 subsequently reported transactions were not unauthorized as reported, revising the subsequent disclosure to 18 transactions totaling \$3,511.10.

Based on the Office of the Controller's revised assertions, a total of \$49,616.95 had to be treated as a loss to the state due to untimely and/or inaccurate performance of reconciliations during 2007 through 2009.

The occurrence of this type of management disclosure six months after the conclusion of audit fieldwork (and the delivery of a draft audit report) begets the question of whether adequate and effective controls exist to ensure the tracking, reporting, and monitoring of

unauthorized transactions. Consequently, we cannot determine whether all unauthorized transactions have been identified and provided to Internal Audit, and accordingly, cannot make any representations as to the completeness of the listing of unauthorized transactions for the period under audit (September 2006 through December 2010).

Required Reporting

Government Code §321.022 requires the administrative head of an agency that “has reasonable cause to believe that money received from the state by the department or entity or by a client or contractor of the department or entity may have been lost, misappropriated, or misused, or that other fraudulent or unlawful conduct has occurred in relation to the operation of the department or entity,” to report the reason and basis for the belief to the State Auditor’s Office. Internal Audit’s review found agency management did not have an adequate process in place during the audit period to ensure reporting to the State Auditor’s Office as statutorily required.

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. The dollar amount, check number, and payee name must exactly match the information provided by TLC or BofA will not pay.

To take advantage of these security enhancements, the Office of the Comptroller 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. Due to reconciliation issues and uncleared checks, the legacy account has remained open; however, 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 unauthorized transactions during its reconciliation efforts. Had Positive Pay been in place, unauthorized check transactions would more likely have been discovered prior to payment by Bank of America.

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

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 the required reporting timeframe of any errors or unauthorized 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 be periodically rotated.
 3. Develop and enforce control procedures to ensure checks that have been outstanding for three years are submitted properly as unclaimed property 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. Institute control processes to accurately track, report, and monitor any and all unauthorized transactions found in the Prize Payment account.
 5. Ensure formal processes are in place to report all discovered instances of unauthorized transactions to the State Auditor's Office in accordance with Government Code §321.022.
 6. Develop and execute a plan to properly 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:

1. *Management concurs with the recommendations and the recommendations have been fully implemented.*

As of June 2010, monthly prize payment cash in bank reconciliations were current and included supervisory review. Prior to June 2010 there were numerous factors contributing to the inability to reconcile the prize payment cash in bank account. These factors included, but were not limited to:

- *Absence of historical prize payment cash in bank account reconciliations that reconciled to a zero variance,*
- *Absence of historical information and data,*
- *Certain inaccuracies in the Outstanding Check and Exception Reports,*

- *Numerous instances of the use of duplicate check numbers for prize payment checks between October 2005 and January 2008, which further hindered the use of the automated Outstanding Check and Exception Reports for reconciliation purposes, and*
- *Improper accounting treatment of administrative prize checks.*

Control Procedures address the following items:

- *Procedure OC-GL-011, Cash in Bank includes guidelines for performing the monthly reconciliation of the prize payment account, including Bank of America reporting of errors and unauthorized transactions.*
 - *Procedure OC-GL-011, Cash in Bank includes guidelines for performing the monthly reconciliation of the prize payment account, including research, documentation and corrective entry requirements.*
 - *The reconciliation variance of the legacy prize payment account reflected a \$622,103.40 variance beginning in August 2010 with a constant balance until May 2012. In June 2012 an entry was prepared for \$1,221.04 to address two warrant hold transactions, leaving an updated variance of \$623,324.44.*
 - *The Commission initiated closure of the legacy prize payment account with the Texas Safekeeping Trust Company on April 16, 2012.*
 - *The prize payment account with Bank of America was closed in May 2012 and the account was closed with the Texas Safekeeping Trust Company on June 4, 2012.*
2. *Management concurs with the recommendation and the recommendation has been fully implemented.*

Beginning in February 2006, two senior accounting staff were assigned to the reconciliation project with five different individuals working on various phases of the project until the reconciliation variance became constant and met the requirements of Commission procedure.

Presently there are two individuals on the General Ledger team who are proficient in the preparation of the reconciliations and the job function is rotated.

3. *Management concurs with the recommendations and the recommendations have been fully implemented.*
- *Procedure OC-GL-016, Reporting Unclaimed Property to the State Comptroller includes guidelines for submitting unclaimed property to the Comptroller of Public Accounts including the timeframe for reporting unclaimed property, including property that was not previously reported.*

In June 2009 staff identified 14 transactions during the Cash in Bank reconciliations that should have been submitted as Unclaimed Property in previous years dating back to 2002. Upon verification with the Comptroller's Office that these transactions had not been submitted, staff was instructed to submit the transactions with the 2009 Unclaimed Property submission. This is consistent with the Comptroller's Unclaimed Property Reporting Instructions which state "All property not previously reported to the state Comptroller's office that is unclaimed for the applicable period of abandonment or

longer should be included in your report.” With the exception of these 14 transactions reported upon being discovered in 2009, the remaining 3,048 unclaimed property transactions submitted from 2005 to the present have been submitted timely.

- *Procedure OC-GL-016, Reporting Unclaimed Property to the State Comptroller includes a stop payment threshold. Stop payments are currently placed on checks in the amount of \$50 and greater that have been remitted as unclaimed property.*
4. *Management concurs with the recommendation and the recommendation has been fully implemented.*
 - *Procedure OC-GL-011, Cash in Bank includes guidelines for tracking, reporting and monitoring unauthorized transactions found in the prize payment account.*
 5. *Management concurs with the recommendation and has revised Directive P-001 to clearly reflect that the responsibility for reporting such unauthorized activity resides with the Executive Director.*
 6. *Management concurs with the recommendations and the recommendations have been fully implemented.*
 - *The legacy prize payment account was monitored for changes and the prize payment bank account with Bank of America was closed in May 2012 and closed with the Texas Safekeeping Trust Company on June 4, 2012.*
 - *Communication was routed to Claims Center staff regarding closure of the legacy account on May 11, 2012 with guidelines on how to handle reissuance of any outstanding checks originally issued from the legacy account.*
 - *Office of the Controller staff discussed the accounting treatment of the prize payment account closure with the agency’s independent financial auditor on August 6, 2012.*
 - *Appropriate entries were recorded on the Commission’s books and in the Comptroller’s accounting system in August 2012 to address the unreconciled balance and proper accounting of the bad debt related to the unauthorized activity.*
 - *The Commission’s files were documented with the action taken related to closure of the account in August 2012.*
-

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.

Management Response

Management concurs with the recommendation and will incorporate additional automation to the reconciliation process as automation resources become available.

This page intentionally left blank.

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 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.⁷

At the time of our audit, there were 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. At the time of our audit, the legacy account remained open to enable claimants to cash the checks that were issued from this account prior to late August 2010. Both accounts were reconciled each month.

The Office of the Controller utilizes information from various sources to perform the monthly reconciliation. Bank of America 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 provides information detailing deposits, wires, interest earned and transfers. Information Resources 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. The reconciliation process also includes researching any check exceptions that appear on the monthly exception report. In the new account through December 2010, there has been a monthly average of 4,259 checks issued, 3,815 checks cleared, and 860 total checks outstanding.

⁷ Texas Lottery Commission Procedure OC-GL-011, *Cash in Bank*, Effective Date 6/16/09.

This page intentionally left blank.

Appendix

Outstanding Check Submission by Year

Submittal Year		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total	% Submitted Timely*	
		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010			
Proper Year to Submit	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						3		1,363	4.33%
	2003		37	72	946						2		1,057	6.81%
	2004			54	501						1		556	90.11%
	2005					486					6		492	98.78%
	2006						426				1		427	99.77%
	2007							477					477	100.00%
	2008								561		1		562	99.82%
	2009									519			519	100.00%
	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.

Legend:	Late
	Early
	On time

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 Safekeeping Trust Company

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

TLC Information Resources

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

Reconciliation

The Office of the Controller reconciles all information provided for both accounts monthly.

Reconciliation reports are created for each bank account

Legacy Account

Monthly averages^{*}:

- 4,942 checks issued
- 4,195 checks cleared
- 3,295 total checks outstanding

New Account

Monthly averages^{**}:

- 4,259 checks issued
- 3,815 checks cleared
- 860 total checks outstanding

^{*}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 determine whether 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 reconciliations are performed in accordance with policies and procedures, are performed in a timely manner, and are properly reviewed. Internal Audit also evaluated controls in place to ensure outstanding transactions are monitored and resolved.

Scope:

Internal Audit reviewed reconciliations performed during the time period of September 1, 2006 through December 31, 2010. Per agency management, adequate records and information prior to fiscal year 2007 are unavailable and the history of the discrepancy cannot be determined. Agency management has asserted information necessary to research the variance prior to fiscal year 2007 was destroyed in accordance with the agency's record retention schedule and is no longer 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 included examining the system of internal controls 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 test work as deemed necessary. Internal Audit's review did not include verifying the reliability and integrity of data from ProSys, USAS (Uniform Statewide Accounting System), or Sage Fund Accounting. We relied upon other independent audit work as relevant and appropriate.

Internal Audit began this audit in December 2010, completed our fieldwork, and provided management a draft report for response in December 2011. Due to a number of factors, agency management requested additional time to review the report. Management reported additional information, as detailed in this report, to Internal Audit in June 2012. The impact of the disclosure on this report was assessed and considered, and a final draft was provided to management for response in October 2012.

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 Professional Practices Framework (IPPF) 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 #13-007

November 2012

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. Bruce Miner, Acting 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, Governor's Advisor, Governor's Office of Budget, Planning and Policy
Mr. Ursula Parks, Acting Director, Legislative Budget Board
Mr. Ken Levine, Director, Sunset Advisory Commission
Mr. John Keel, CPA, State Auditor