

August 29, 1997

Members of the Legislative Audit Committee  
and  
Mr. Lawrence Littwin, Executive Director  
Texas Lottery Commission

Dear Members of the Legislative Audit Committee and Mr. Littwin:

During the management control audit of the Texas Lottery Commission (Commission) issues in addition to those reported in *An Audit Report on Management Controls at the Texas Lottery Commission* (SAO Report No. 97-092), came to our attention. These issues include:

- Monitoring and data management problems, relating to investigative case files, that create a risk the Commission will lose its ability to effectively prosecute certain criminal cases.
- Internal control weaknesses over the Commission's cash and expenditures
- The Commission is correctly collecting monies owed to the State from lottery winnings

### **Management of Investigative Files Should Be Improved**

The case monitoring and data management processes for investigative case files need improvement in the Security and Legal Divisions. Weaknesses in the monitoring process create a risk that timely legal action may not be taken and the ability to effectively prosecute these cases will be lost. Weaknesses in the data management process resulted in certain case files not being tracked effectively. Cases were inconsistently named, numbered, and classified in the Security Division. Examples of the case monitoring control weaknesses include:

- Lack of Legal Division feedback to the Security Division on the status or disposition of cases
- Lack of timely legal reviews of cases with no monitoring or follow-up process
- Lack of coordination between the Security Division and Legal Division tracking systems

Weaknesses in the data management process within the Security Division complicate the coordination and communication problems with the Legal Division and increase the risk that cases fail to receive timely submission for legal review and prosecution. Additionally, inconsistent case names have prevented the Security Division's tracking systems from being reconciled with the Legal Division's and the District Attorneys' tracking systems. Other examples of these weaknesses in the data management process include:

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- Inconsistent case numbers between old and new numbering systems
- Forwarding of certain original case files to the Legal Division and District Attorneys' offices rather than copies

Recommendations:

All cases submitted to the Legal Division by the Security Division should be reviewed and acted upon in a timely manner. A formal communications process should be established to regularly provide case status information to the Security Division on cases it has submitted to the Legal Division. The Legal Division should regularly submit a formal letter or memo to the Security Division upon completion of cases with courses of action taken responding to the expected course of action recommended by the Security Division.

The Legal and Security Divisions should consider using the same type of tracking systems with linkages to assist with monitoring these cases and to ensure that they are completed within time frames needed for prosecution. Comparisons and monitoring of cases listed in the Security Division's tracking system and case status of those cases in the Legal Division's tracking system should be conducted regularly to ensure that all cases are promptly acted upon.

The process for assigning case names and numbers to cases in the tracking system should be documented. The case names should be the name of the potential defendant or suspect rather than the name of the complainant. The case numbering system should be consistent for all cases, including Bingo-related cases, and a conversion chart should be developed to reconcile the new system to the old system. The process should be consistent with the Legal Division's and the District Attorneys' methods for assigning case names to allow for reconciliation of case files submitted to the Legal Division and District Attorneys. The tracking system should allow for a query of complainants or potential defendants.

All case files should be copied prior to submitting them to any prosecutor's office with the original case file kept at the Lottery Commission. To ensure that this occurs, this task should be added to a checklist kept in each case file. The Director of the Security Division should review and sign the checklist prior to closing a case or submitting it for prosecution.

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## **The Financial Administration Division Should Continue Improving Controls and Procedures**

Weaknesses exist in the Financial Administration Division's controls over cash and expenditures. These control weaknesses include:

- The Director of Financial Administration had access to the safe containing the preprinted "manual" checks used for the Prize Payment Account. Only one signature is required on these manual checks. The Director of Financial Administration is also an authorized check signer. Persons with signature authority should not have access to blank check stock.
- There is no dollar threshold that requires two signatures on the manual checks. Not requiring a second signer on checks over a certain dollar amount increases the risk of significant loss due to illegal acts.
- During fiscal year 1996, bank reconciliations for the Commission's local funds were not performed in a timely manner. Timely bank reconciliations, within one month after the end of the monthly accounting cycle, are an important control in detecting errors and illegal acts.
- The Commission erroneously classified some payments to vendors in its accounting records. The Commission also made some payments to parties other than the vendor to whom the payment was owed. Consistent, accurate accounting treatment of vendor transactions is necessary to ensure expenditure data is accurate and provides useful information about agency disbursements.

Management corrected a significant long-term weakness in its internal controls over cash in early fiscal year 1997. Prior to that time, Financial Administration Division staff had to override its accounting controls to replace voided checks to avoid double counting expenditures due to inadequacies in the Lottery Operator's automated system.

### Recommendations:

The Commission should continue to strengthen internal controls over cash. Blank check stock should not be accessible to persons authorized to sign checks. The Commission should ensure that bank reconciliations are completed within 30 days after the end of the monthly accounting cycle. The Commission should print a dollar threshold for two signatures on its checks.

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Financial Administration Division staff should receive increased training on identifying the proper coding for transactions. Standard coding of transactions should be emphasized. The Financial Administration Division should improve verification of voucher data to identify and correct errors before they are entered into the accounting system.

### **The Commission Is Properly Collecting Debts Owed to the State**

The Commission correctly deducted debts owed to the State from lottery winnings as required by law. As a result, the State is collecting monies owed more quickly than it might have without the Lottery.

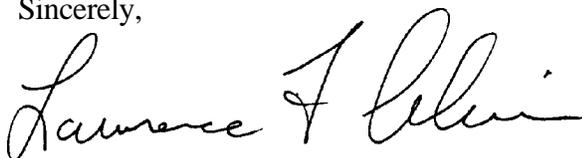
A sample of 44 lottery winners revealed that, in each case, management correctly collected monies owed for back taxes, delinquent child support payments, and student loans on which the winner had defaulted.

Our initial sample identified 15 other winners who had initially been flagged by the Lottery's system as owing money to the State. However, subsequent, routine investigation of these winners by Commission staff correctly revealed that they did not currently owe monies to the State. Although the Commission loads debtor information onto its automated system daily, it appears that some of the information may not be updated timely by the appropriate agencies.

The State Auditor's Office will continue to monitor the Commission's implementation of corrective action on these controls through follow-up audits and in working with your Internal Audit Department.

If you have any questions, please feel free to contact Gregory S. Adams, CPA, the project manager, or Frank Vito, CPA, the audit manager at 479-4700.

Sincerely,

A handwritten signature in cursive script that reads "Lawrence F. Alwin".

Lawrence F. Alwin, CPA  
State Auditor

pab/rmn

attachment

## **Attachment - Commission's Responses**

*Management implemented a procedure in which all of SAO's recommendations between Legal and Security have been addressed including reconciling case lists monthly to ensure better monitoring of cases. Legal has a PC-based database to track cases. We are now in the process of implementing a new legal case management computer system that will allow other division users to independently access the status update on these cases.*

*An independent CPA firm is retained annually by the Texas Lottery Commission to perform an audit of all accounts and transactions of the lottery. These audits have not indicated a control weakness as reflected in the Management Letter.*

### *Bullet One:*

*The Director of Financial Administration at no time opened the safe. The safe combination was changed in June 1997 and is now restricted. None of the current individuals with check signing authority know the combination, nor do they have access to the safe and blank check stock, nor do they prepare or review bank reconciliations.*

### *Bullet Two:*

*Further, check signing authority is restricted to the highest level of management -- General Counsel, Deputy Executive Director, and Financial Administration Director. We believe mitigating controls are in place that minimize the risk to a low level. We believe safeguards are in place to ensure the safety and custody of State funds to prevent loss that could result from potential illegal acts. We will continue to review our financial procedures to ensure that we have implemented sound financial controls.*

### *Bullet Three:*

*We concur and are always working to achieve timely bank reconciliations given fiscal and full time employee constraints.*

### *Bullet Four:*

*The classification issues are being reviewed and the necessary training is taking place. However, it should be noted that in no way did the matter raised have a material impact on the Texas Lottery Commission's financial statements per the Texas Lottery Commission's annual independent financial audits.*

*Due to inflexibility in the Lottery Operator's computer system, manual controls prevented duplicating reimbursements to the prize payment account. The Lottery Operator's (Stratus) computer system was designed to prevent duplicate payments on a single claim. However, when a check is voided and re-issued again, the computer system automatically created a second reimbursement to the prize payment account. A tape of transactions from the Lottery Operator's computer is sent to the Comptroller's Office for uploading into USAS. To correct the prize payment account balance, Financial Administration staff created journal entries to adjust this account in USAS. Effective September 1, 1996, the Lottery Operator's system was reprogrammed to handle this type of accounting problem automatically.*