TEXAS LOTTERY COMMISSION

INTERNAL AUDIT DIVISION

An Internal Audit of

RETAILER SALES INCENTIVE PROGRAM

IA #12-009

May 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*

May 10, 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 Retailer Sales Incentive Program (RSIP). The purpose of the audit was to verify all requirements outlined in Rider 10(b) of the General Appropriations Act (Senate Bill No. 1, 81st Legislature) were met and to review controls surrounding the implementation of the RSIP to determine whether it met management's overall stated goals and objectives. In addition, Internal Audit sought to determine whether incentive goals were accurately calculated and program payments were accurately processed to eligible retailers. Regarding each of the stated audit objectives, Internal Audit's conclusions are as follows:

1. To determine whether the agency was in compliance with Rider 10(b) of the General Appropriations Act (Senate Bill No. 1, 81st Legislature).

   Due to the absence of a payment cap or other similar control in place to ensure full compliance, the agency exceeded its appropriation authority granted in Rider 10(b) for the second fiscal year of the 2010 – 2011 biennium.

2. To determine whether the RSIP met stated overall goals and objectives which were to generate additional revenue for the Foundation School Fund (FSF), to increase the sale of lottery products, and to reward retailers who incrementally increased their sales over a given period.

   Internal Audit found retailers achieved incremental sales increases from Program 1 to Program 5 and were rewarded accordingly. However, because sales are only one factor of many that contribute to the overall transfers to the Foundation School Fund (FSF), Internal Audit is unable to conclude the program has generated additional revenue to the FSF.

3. To determine whether incentive goals were accurately calculated and program payments were accurately processed to only eligible retailers.

   Overall, we found the agency had controls in place to ensure incentive goals, eligible retailers, and program payments were accurately calculated. In addition, our testing of Programs 4 and 5 disclosed accurate processing of program payments.

Our report makes recommendations to assist the agency in strengthening its overall processes and controls related to the Retailer Sales Incentive Program. If you desire further information concerning this review, please do not hesitate to contact me at 512/344-5488.

Respectfully submitted,

Catherine A. Melvin

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

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EXECUTIVE SUMMARY

During the 81st Legislative session, Texas Lottery Commission (TLC) sought authority for "an additional one-half percent of gross sales to be used to incentivize growth in retailer sales performance"[1]. While other state lotteries provide incentive programs to their retailers, these programs are usually based on cashing bonuses or other non-sales incentives. TLC management felt it was important to tie the incentive program directly to increasing sales at retailer locations, in an effort to increase revenue to the state. Authority was granted in Rider 10(b) of the General Appropriations Act.

The purpose of Internal Audit's review was to verify all requirements outlined in Rider 10(b) of the General Appropriations Act (Senate Bill No. 1, 81st Legislature) were met and to review controls surrounding the implementation of the RSIP to determine whether it met management's overall stated goals and objectives. In addition, Internal Audit sought to determine whether incentive goals were accurately calculated and program payments were accurately processed to eligible retailers. Internal Audit's conclusions are as follows:

1. To determine whether the agency was in compliance with Rider 10(b) of the General Appropriations Act (Senate Bill No. 1, 81st Legislature**).**

   Due to the absence of a payment cap or other similar control in place to ensure full compliance, the agency exceeded its appropriation authority granted in Rider 10(b) for the second fiscal year of the 2010 – 2011 biennium.

2. To determine whether the RSIP met stated overall goals and objectives which were to generate additional revenue for the Foundation School Fund (FSF), to increase the sale of lottery products, and to reward retailers who incrementally increased their sales over a given period.

   Internal Audit found retailers achieved incremental sales increases from Program 1 to Program 5 and were rewarded accordingly. However, because sales are only one factor of many that contribute to the overall transfers to the Foundation School Fund (FSF), Internal Audit is unable to conclude the program has generated additional revenue to the FSF.

3. To determine whether incentive goals were accurately calculated and program payments were accurately processed to only eligible retailers.

   Overall, we found the agency had controls in place to ensure incentive goals, eligible retailers, and program payments were accurately calculated. In addition, our testing of Programs 4 and 5 disclosed accurate processing of program payments.

Internal Audit would like to express our appreciation to the Lottery Operations Division staff and Office of 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.

[1] Senate Finance Hearing, Monday, February 10, 2009, Testimony of Gary Grief, Executive Director

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DETAILED RESULTS

During the 81st Legislative session, Texas Lottery Commission sought authority to provide, "an additional one-half percent of gross sales to be used to incentivize growth in retailer sales performance". While other state lotteries provide incentive programs to their retailers, these programs are usually based on cashing bonuses or other non-sales incentives. Texas Lottery Commission management felt it was important to tie the incentive program directly to increasing sales at retailer locations. Authority was granted in Rider 10(b) of the General Appropriations Act.

Internal Audit's review process was designed to verify all requirements outlined in Rider 10(b) of the General Appropriations Act (Senate Bill No. 1, 81st Legislature) were met and to review controls surrounding the implementation of the RSIP to determine whether it met management's overall stated goals and objectives. In addition, Internal Audit sought to determine whether incentive goals were accurately calculated and program payments were accurately processed to eligible retailers.

Accordingly, our audit examined program runs conducted in fiscal years 2010 and 2011. During the biennium, TLC had conducted five program runs of the RSIP. Each program run lasted 13 weeks. Based on the achievement of a minimum sales goal, a retailer received an incentive payment and an entry into a drawing for a possible second cash incentive. Further incentive payments and drawing entries were earned through additional incremental sales.

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1 Compliance

Internal Audit's first objective was to determine if the agency was in compliance with Rider 10(b) of the General Appropriations Act (Senate Bill No. 1, 81st Legislature) regarding the retailer sales incentive program.

> ***Due to the absence of a payment cap or other similar control in place to ensure full compliance, the agency exceeded its appropriation authority granted in Rider 10(b) for the second fiscal year of the 2010 – 2011 biennium.***

Senate Bill No. 1,
81st Legislature
(General Appropriations Act)
Article VII, 10(b)

In addition to the 5 percent retailer commission amount in subsection (a) above, an amount not to exceed an additional one-half of one percent of gross sales each fiscal year may be made available for the purpose of paying sales performance retailer commissions. Prior to providing an additional retail commission above 5 percent of gross sales, the Texas Lottery Commission shall provide a report to the Governor and the Legislative Budget Board outlining the Texas Lottery Commission's plans to implement a retailer sales performance commission or similar sales performance incentive program and the projected benefits of the program to lottery ticket sales and state revenues.

Exhibit 1

Rider 10(b) outlines requirements for the agency's Retailer Sales Incentive Program (see Exhibit 1). In compliance with the rider, the Texas Lottery Commission submitted a report, "Retailer Sales Performance Incentive Program Plan for FY 10 – FY 11", to the Governor and the Legislative Budget Board (LBB) on July 27, 2009, prior to beginning the first program run. The report outlined the agency's plan to implement the RSIP and the projected benefits to lottery ticket sales and state revenues, as required. Additionally, agency management committed to keeping the Governor and the LBB informed of "major modifications to the structure of the plan".

The agency complied with the appropriation limitation established in Rider 10(b) in fiscal year 2010 as all funds were not expended. Excess funds in the amount of $12,318,725 were transferred to the Foundation School Fund (FSF) at the end of the fiscal year. As fiscal year 2011 progressed, management forecasted the RSIP would exceed the established appropriation limit in Rider 10(b). In April 2011, the agency's Controller sought clarification from the Texas Comptroller of Public Accounts (Comptroller's Office). Based on the Controller's interpretation of a transfer mechanism found in Article IX, Section 14.01 of the Appropriations Act, the agency transferred funds to cover the over expenditure.

During the course of our audit, Comptroller's Office management confirmed that Rider 10(b) expenditures cannot exceed the additional one-half of a percent of gross ticket sales for each fiscal year. Further, other transfer mechanisms found in the agency's bill pattern or in Article IX of the Appropriations Act do not provide the authority to exceed the limitation established in Rider 10(b). Thus, the agency exceeded its appropriation authority granted in Rider 10(b) in the second fiscal year of the biennium by $281,850. Based on sales, the amount not to exceed was $19,056,350.

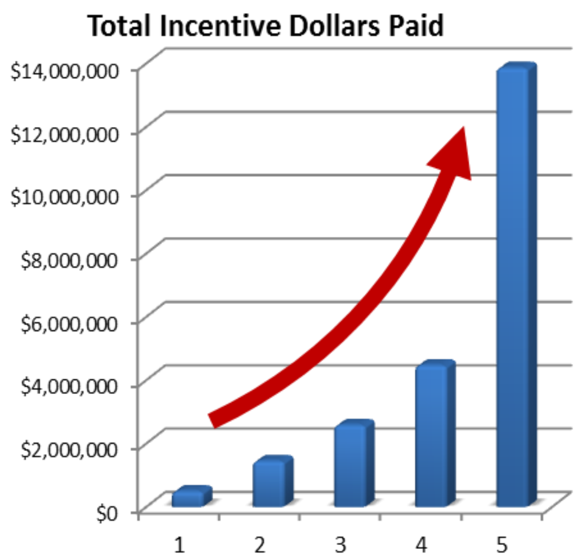

Exhibit 2

Although a limitation existed in the rider, the RSIP as implemented in the 2010 – 2011 biennium did not include a cap to ensure actual payments would not exceed the appropriation limitation. Agency management did not have a payment cap or other similar control in place to ensure compliance with this requirement of the rider. The agency experienced higher than anticipated participation levels resulting in unprecedented incentive payments made in the last program run launched in fiscal year 2011. With no changes in the implementation from Program 4 to Program 5, the agency paid over three times the amount of retailer sales incentive dollars. Program 5 paid total sales incentives of $13,864,300, while Program 4 paid $4,473,900 (see Exhibit 2). These unexpected participation levels, combined with the lack of a program cap, resulted in the over expenditure.

Finally, while the RSIP underwent changes[2] since its initial implementation, whether such changes are considered "major modifications" as intended in the submitted report is unclear as management had not defined the term. Agency management has stated the only formal communication to the Governor and the LBB during fiscal years 2010 and 2011 was the initial report.

[2] The Retailer Sales Incentive Program underwent a change from Program 2 to Program 3. See "Background Information" section later in this report.

Recommendation:

Agency management should ensure control mechanisms are in place in future program runs to ensure it stays within its appropriation authority granted in Rider 10(b). Further, if the agency anticipates continued high levels of participation and success in the RSIP, we recommend management explore options to seek further funding authority. We recommend agency management consider the need to appropriately inform oversight entities of the over expenditure in fiscal year 2011 and the need to explore any possible remedies, if available.

Further, Internal Audit recommends agency management define "major modifications" and determine when and how such modifications will be communicated to oversight entities.

Management Response:

Management concurs with the recommendation that control mechanisms should be in place for the Retailer Incentive Sales program, but does not concur that controls were not in place to ensure full compliance with Rider 10(b).

Various options were considered during April 2011 to address the funding of payments for Program 5 to ensure that the Rider 10(b) appropriation amount would not be exceeded (see Exhibit A). These options included:

1) *Continue Program 5 through the planned thirteenth week and utilize FY 2010 unexpended authority for the budget shortfall, if any;*
2) *Continue Program 5 through the planned thirteenth week, but defer the drawing payment to FY 2012, if required; and*
3) *Continue Program 5, but modify the end date by one week with an end date of April 30, 2011.*

The Office of the Controller sought clarification from the Comptroller of Public Accounts regarding the Rider 10(b) Retailer Incentive funding mechanism. Guidance was provided by the Comptroller of Public Accounts in April 2011 that FY 2010 unexpended authority for the budget shortfall up to $2.47 million or the use of Article IX, Section 14.01 transfer authority could be used for the FY 2011 Retailer Incentive obligations. After discussing these funding mechanisms with the Commission's assigned Comptroller of Public Accounts Appropriation Control Officer, the decision was made by management to utilize transfer authority outlined in Article IX, Section 14.01. The decision to use Article IX, Section 14.01 transfer authority was documented by the Controller in an email on April 19, 2011 to the Commission's assigned Comptroller of Public Accounts Appropriation Control Officer (see Exhibit B). The verbal guidance provided by the Comptroller of Public Accounts Appropriation Control Officer in April 2011 has now been confirmed in writing (see Exhibit C). The appropriate budget transfer documents were processed on the Uniform Statewide Accounting System in June 2011 upon finalization of the program liability.

Following an inquiry by the Internal Audit Department in March 2012 regarding whether the Commission complied with Rider 10(b) appropriation authority, a second written request was made to the Commission's assigned Comptroller of Public Accounts Appropriation Control Officer. In response to this inquiry, the Comptroller of Public Accounts provided modified guidance in April 2012 stating that neither Article IX, Section 14.01 transfer authority or Rider 12 unexpended balance authority could be utilized for the Retailer

Incentive Sales program. Had this interpretation been made by the Comptroller of Public Accounts when guidance was requested in April 2011, the alternative funding options previously mentioned such as deferring the drawing payment or modification of the program end date that were considered by management at that time could have been implemented to ensure that the FY 2011 Rider 10(b) appropriation authority was not exceeded by $281,850.

The Commission provided a final accounting of FY 2011 expenditures, including the Rider 10(b) Retailer Incentive expenditures, in the FY 2012 Itemized Operating Budget filed with the Governor's Office and the Legislative Budget Board on December 1, 2011. Total expenditures for FY 2011 did not exceed the Commission's total authorized appropriation in FY 2011 and the Commission returned $13,351,610 of unspent administrative funding to the Foundation School Fund.

In May 2011 the agency began work to revise the funding structure for future Retailer Incentive programs. The FY 2012-13 Program implemented in December 2011 reflects a revised funding structure including a payment cap for the retailer incentive payments. If total incentive payments for the program exceed the funding cap, each retailer's incentive payment is reduced by the same percentage required to reach the cap. While the original plans for the FY 2012-13 biennium reflected seven individual retailer incentive programs, management will be revising these plans to incorporate the updated guidance received from the Comptroller's Office in April 2012.

The agency will continue to work with the Comptroller of Public Accounts and the Legislative Budget Board regarding proposed revisions to Rider 10(b) related to Retailer Incentive appropriation transfer authority and unexpended balance authority for submission in the FY 2014-15 Legislative Appropriations Request.

Management will inform oversight entities of the over expenditure and will consult with the Comptroller of Public Accounts regarding any possible remedies.

Management will formally define "major modifications" to the program, as well as when and how such modifications will be communicated to the Governor's Office and Legislative Budget Board in the future.

Auditor's Comment:

Internal Audit agrees several options were considered by management upon discovery of the impending over expenditure in the 10th week of the 13 week program run. However, the consideration of options at the point of imminent over expenditure is itself not a "control". By definition, an internal control in this situation is a mechanism that <u>prevents</u> an undesirable outcome. The quality of an internal control is gauged on several elements, including both adequacy and effectiveness of preventing undesirable outcomes. Instituting a control in the initial design of the program to prevent any over expenditures would have precluded the need to consider unfavorable options such as halting the program mid-run. Each of management's stated options carried risk to the agency and was considered less than optimum. Further, none of the stated options would have prevented future over expenditures. While agency management did not provide Internal Audit with the documentation in management's Exhibit A during the course of our audit, Internal Audit notes, ultimately, agency management selected an action to address the imminent over expenditure that was neither in its documented recommendations nor included in its documented listing of options for consideration as presented in management's Exhibit A. While the action may have appeared to management to avert the over expenditure at the time, the absence of an adequate control placed the agency in the preventable position of having to consider less than optimum actions that carried inherent risk to the agency.

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2 Meeting Overall Stated Goals and Objectives for the Retailer Sales Incentive Program

Internal Audit also sought to determine whether management met their stated goals and objectives for the overall Retailer Sales Incentive Program (RSIP). According to the "Retailer Sales Performance Incentive Program Plan for FY 10 – FY 11" report submitted to the Governor and the LBB prior to the implementation of the first program run, TLC management stated, "The purpose of this retailer incentive plan is to generate additional revenue for the Foundation School Fund." In interviews, RSIP committee team members and senior management stated their overall goals of the RSIP were to increase sales of lottery products and generate additional revenue for the Foundation School Fund by rewarding retailers who incrementally increase their sales over a given period.[3]

Internal Audit found retailers achieved incremental sales increases from Program 1 to Program 5 and were rewarded accordingly. However, because sales are only one factor of many that contribute to the overall transfers to the Foundation School Fund (FSF), Internal Audit is unable to conclude the program has generated additional revenue to the FSF.

At the conclusion of each program run, the Office of the Controller conducts a financial analysis of the results. The analysis compares projected sales of retailers who exceeded their established sales goal and actual sales of those retailers for the program period. Costs of the program are removed including administrative expenses, retailer commissions, incentive payments, and estimated prize payout expense. The resulting figure represents the agency's estimated return to the state. The internal report is only used as a reference and is not a direct correlation to what is actually transferred to the FSF. In addition to this financial analysis, RSIP committee members discuss qualitative elements of each program run, including successes and challenges, as well as,

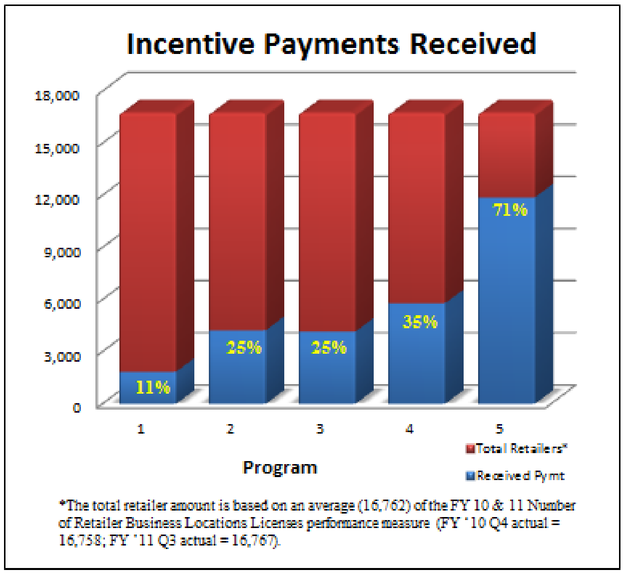

Exhibit 3

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[3] For more information on the calculation of individual retailer sales goals, see "Background Information" section later in this report.

possible changes to current and future program runs. This qualitative analysis is not formally documented.

Internal Audit conducted an independent analysis of sales achieved, retailers who received an incentive payment, and incentive payments awarded. In four of the five program runs conducted, total sales increased over the previous year's total sales for the same time frame (see Exhibit 3). Additionally, total annual sales for fiscal years 2010 and 2011 increased over the previous year (see Exhibit 4). Generally, the number of retailers who received an incentive payment increased from Program 1 to Program 5, as did the percentage of retailers receiving an incentive payment to the total number of lottery retailers (see Exhibit 5). The total amount of incentive payments awarded also increased (see Exhibit 2).

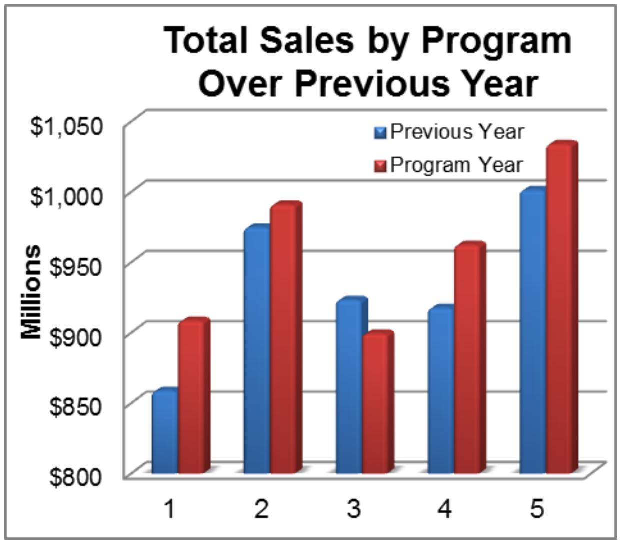

Exhibit 4

Intuitively, an increase in ticket sales should translate to an increase in the overall transfers to the state. However, many factors influence the transfers to the FSF, only one of which is sales. It is difficult to determine if transfers to the FSF have been directly increased by the RSIP since the RSIP is only one factor contributing to total lottery sales. Other factors affecting lottery sales and the transfers to the FSF include: prize payout percentage, concurrent promotions, introduction of new games, lottery product mix, effectiveness of advertising, use of administrative funds, use of funds to pay for the RSIP, retailer commissions paid and combinations of these factors. Appendix A contains a Summary of Financial Information for TLC which details annual sales and transfers to the FSF.

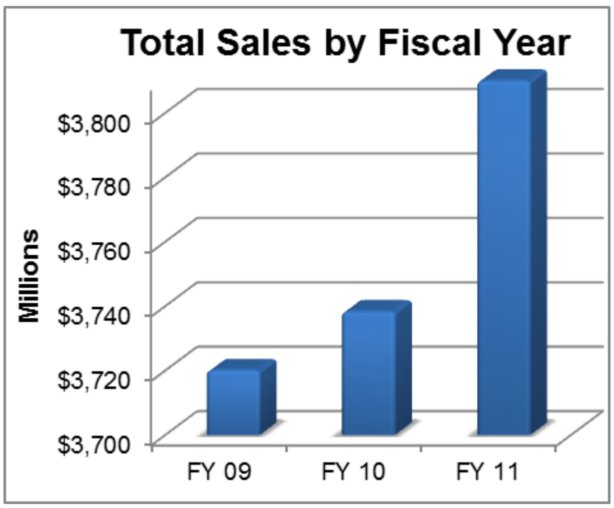

Exhibit 5

Recommendation:

Management should revisit the intended goals of the RSIP to ensure the overall goals are measurable. Furthermore, management should document the qualitative program analysis it already performs to ensure important decisions are adequately captured and carried forward and to ensure the continuity of RSIP knowledge when team members change. Internal Audit acknowledges team members have not changed since the first program run.

Management Response:

Management has established measurable retailer same-store sales incentive goal criteria consistent with direction in Rider 10(b) of the Commission's general appropriation that the rider monies "may be made available for the purpose of paying sales performance retailer incentives." While management agrees that retailer sales performance incentives are not the only driver of overall sales, they are the optimal measure of individual retailer sales performance. Since inception, management has routinely revisited the goals of the program and made modifications based on retailer sales results and individual incentive program performance. Management has taken steps to further document these reviews and any resulting incentive program modifications.

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3 Accurate Retailer Incentive Goals and Payments

Finally, Internal Audit sought to determine whether incentive goals were accurately calculated and program payments were accurately processed to all and only eligible retailers.

Overall, we found the agency had controls in place to ensure incentive goals, eligible retailers, and program payments were accurately calculated. In addition, our testing of Programs 4 and 5 disclosed accurate processing of program payments.

Prior to beginning a program run, the Lottery Operator provides a minimum sales goal for each retailer based on criteria established by the agency. These goals are reviewed by an independent external auditor on whom the agency relies to ensure incentive goals are accurately calculated. Retailers are able to monitor their progress and sales achievements throughout each program run through the use of terminal reports and the Retailer Services Center located on the agency's website. At the completion of each program run, the agency relies on the attestations of the external auditor that all and only eligible retailers are receiving incentive payments and that the payments and drawing entries were accurately calculated.

Internal Audit performed work to determine whether the agency can confidently rely upon the attestations of the external auditor. This included recalculating sales goals and comparing them to the actual sales during each program run, recalculating incentive payments and drawing entries awarded, and reviewing retailer eligibility status. As Programs 4 and 5 were the largest and most recent program runs within our audit scope period, Internal Audit focused its efforts on these two program runs, and found no exceptions. However, during our review, we found a significant amount of manual manipulation of the data is required to identify eligible retailers due to paper change of ownerships and retailers with multiple terminals. The volume of retailer licenses further complicates manual manipulation. In fiscal years 2010 and 2011, the average number of retailers licensed by the agency was 16,762[4], but some retailers hold multiple licenses. Although no errors were revealed in the resulting data, manual manipulation increases the risk of possible errors.

[4] Number of Retailer Business Locations Licenses Performance Measure (FY '10 Q4 actual = 16,758; FY '11 Q3 actual = 16,767).

In addition, Internal Audit performed work to determine whether retailers received warrants for the amounts verified by the external auditor. Again, Internal Audit focused its efforts on Programs 4 and 5. We relied upon statistical sampling techniques to perform our testing to determine whether retailers received accurate payments. Our testing disclosed payments were accurately processed.

In reviewing controls over incentive payments, we found a payment procedure had been developed; however, this procedure does not reflect current practices. We did find the Office of Controller has internal controls in place to ensure payments are accurately processed. These controls include:

- Independent Verification – After the external auditor sends the payment file to the agency, the Financial Operations Manager performs an independent verification to ensure payments have been accurately calculated.
- Checklists – A checklist is used for creating the Retailer File Payment Upload. The checklist ensures warrants are issued in the correct mailing order and payment information is transferred from Excel format into a CSV file for importing into USAS.
- Separation of Duties – The external auditor sends information directly to Information Resources staff who prints out letters for each retailer receiving an incentive payment. Office of Controller receives the warrants from the Comptroller's Office, and using multiple staff, combines the letters with the warrants. This ensures any discrepancies are discovered and researched.
- Supporting Documentation – The Financial Operations Manager maintains workpapers relating to the payment process with detailed steps necessary to complete the payment processing.
- Supervisory Review – Final workpapers are reviewed by a separate manager and by the Controller.

Although the Office of Controller has implemented controls to limit the risk of incorrectly paying a retailer and our testing revealed payments were accurately processed, there is an inherent risk that errors could be made. The mailing of paper warrants is an area of concern due to the numerous Texas Identification Number System numbers that were required to be manually entered into the Comptroller's Statewide Teleprocessing System and the physical merging of letters with warrants by agency staff. While this process was completed manually in the first five programs runs, management asserts changes have been made to allow future payments to be made directly to retailers electronically.

Recommendation:

Management should take steps to limit the inherent risk associated with manual processing. In addition, management should update the agency's payment procedures to align with current practices.

Management Response:

Management agrees that automation of manual processes is beneficial and has recently implemented automated incentive payment distribution to retailers for the most recent *retailer incentive program. Management will continue to seek opportunities for further automation of program processes.*

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APPENDIX A

Texas Lottery Commission
Summary Financial Information
(Audited unless otherwise noted)

	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00
SALES:									
Total Sales	$591,570,852	$1,856,090,753	$2,760,217,110	$3,036,517,308	$3,432,309,408	$3,745,469,123	$3,090,031,624	$2,571,599,617	$2,657,290,483
EXPENSE:									
Total Prize Expense	$268,869,533	$981,698,407	$1,528,691,259	$1,689,345,205	$1,951,060,296	$2,151,737,003	$1,648,106,270	$1,329,014,108	$1,508,849,680
Prize Payout Percentage	45.5%	52.9%	55.4%	55.6%	56.8%	57.4%	53.3%	51.7%	56.8%
Commissions	$29,578,543	$92,815,046	$138,011,596	$151,845,090	$171,719,838	$187,394,765	$154,581,140	$128,827,796	$133,000,980
1 % Retailer Bonus	$0	$4,282,752	$6,107,225	$6,942,860	$5,429,790	$6,019,956	$5,596,251	$4,482,957	$4,390,016
Administrative Expenses	$45,140,800	$124,873,791	$166,644,017	$188,383,295	$217,499,395	$236,216,504	$198,286,932	$169,246,199	$172,117,471
UNCLAIMED PRIZES									
Unclaimed Prizes Transferred to State	-	-	-	$2,647,094	$7,284,316	$2,982,148	-	$9,688,000	$35,517,170
CASH TRANSFERS:									
To General Revenue Fund	$203,015,076	$609,236,760	$869,073,948	$927,335,075	$1,158,346,166	$1,189,403,706	-	-	-
To Foundation School Fund	-	-	-	-	-	-	$1,156,694,680	$969,332,257	$889,998,478
To Texas Veterans Commission	-	-	-	-	-	-	-	-	-
Total Cash Basis Transfers to State	**$203,015,076**	**$609,236,760**	**$869,073,948**	**$927,335,075**	**$1,158,346,166**	**$1,189,403,706**	**$1,156,694,680**	**$969,332,257**	**$918,109,074**

	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09
SALES:									
Total Sales	$2,825,298,062	$2,966,262,259	$3,130,692,602	$3,487,924,569	$3,662,462,838	$3,774,685,562	$3,774,178,802	$3,671,477,953	$3,720,113,711
EXPENSE:									
Total Prize Expense	$1,643,183,197	$1,715,355,957	$1,845,198,257	$2,068,643,667	$2,228,000,419	$2,310,561,488	$2,315,304,967	$2,281,125,261	$2,299,752,566
Prize Payout Percentage	58.2%	57.8%	58.9%	59.3%	60.8%	61.2%	61.3%	62.1%	63.3%
Commissions	$141,299,672	$148,359,044	$156,554,911	$174,413,287	$183,176,006	$188,818,621	$188,751,041	$183,771,055	$186,145,362
1 % Retailer Bonus	$5,048,075	$4,172,484	$3,606,784	$2,143,103	$4,286,558	$2,804,521	$4,423,161	$1,953,223	$1,926,785
Administrative Expenses	$172,803,846	$166,748,437	$158,310,106	$180,818,463	$178,776,958	$184,900,665	$182,715,675	$167,497,621	$192,447,669
UNCLAIMED PRIZES									
Unclaimed Prizes Transferred to State	$38,939,061	$69,618,383	$66,993,269	$41,581,437	$60,764,140	$54,222,589	$58,947,388	$54,134,747	$43,088,652
CASH TRANSFERS:									
To General Revenue Fund	-	-	-	$19,465,000	$21,947,637	$45,155,529	$48,895,469	$43,538,325	$33,088,652
To Foundation School Fund	$835,874,850	$869,700,799	$888,192,471	$1,003,336,284	$1,016,209,580	$1,029,612,987	$1,031,866,772	$983,143,879	$1,000,405,304
To Texas Veterans Commission	-	-	-	-	-	-	-	-	-
Total Cash Basis Transfers to State	**$864,952,279**	**$956,587,389**	**$955,185,740**	**$1,044,135,379**	**$1,076,823,122**	**$1,084,768,516**	**$1,090,762,241**	**$1,036,682,204**	**$1,043,493,956**

	FY10	FY 11	FY 12*	Cumulative
			Unaudited	Unaudited
SALES:				
Total Sales	$ 3,738,369,487	$3,811,270,135	$1,282,657,291	**$63,596,489,547**
EXPENSE:				
Total Prize Expense	$ 2,300,182,561	$2,387,243,785	$818,761,940	**$37,270,685,825**
Prize Payout Percentage	61.5%	62.6%	63.8%	59%
Commissions	$ 187,302,974	$190,808,232	$64,174,815	**$3,181,349,814**
1 % Retailer Bonus	$ 8,857,990	$21,323,656	$727,438	**$104,525,593**
Administrative Expenses	$ 185,283,677	$174,332,929	$37,060,286	**$3,500,104,737**
UNCLAIMED PRIZES				
Unclaimed Prizes Transferred to State	$ 86,859,465	$53,789,921	$11,361,958	**$698,419,737**
CASH TRANSFERS:				
To General Revenue Fund	$ 76,859,465	$43,263,654	$5,310,253	**$5,293,934,714**
To Foundation School Fund	$ 1,000,434,318	$963,172,500	$310,182,600	**$13,948,157,758**
To Texas Veterans Commission	$ 7,328,844	$8,658,018 (1)	$1,727,492	**$17,714,354**
Total Cash Basis Transfers to State	**$ 1,094,622,627**	**$1,025,094,172**	**$322,970,345**	**$19,596,624,711**

(1) Includes transfers from sales and unclaimed prizes
* Through December 31, 2011

* Totals may not sum due to rounding.
Prepared by: Office of the Controller

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AUDIT PURPOSE, SCOPE AND METHODOLOGY

Purpose:

Internal Audit completed a review of the Retailer Sales Incentive Program, as specified in the approved Fiscal Year 2011 Internal Audit Activity Plan. The purpose of the audit was to verify all requirements outlined in Rider 10(b) of the General Appropriations Act (Senate Bill No. 1, 81st Legislature) were met and to review controls surrounding the implementation of the RSIP to determine whether it met management's overall stated goals and objectives. In addition, Internal Audit sought to determine whether incentive goals were accurately calculated and program payments were accurately processed to eligible retailers.

Scope:

Internal Audit's review focused on program runs during fiscal years 2010 and 2011. The review covered the activity of program runs one through five. Internal Audit focused our testing on the Programs 4 and 5. Internal Audit's review concentrated on determining whether the program procedures in place were being followed as stated in the plan to the Legislative Budget Board and Governor's Office. Internal Audit's review did not include evaluating the success of the program, the complexity of the program, or the retailer's understanding of the program. In addition, our review did not include examining any program runs implemented after fiscal year 2011.

Methodology:

In accomplishing our objective, Internal Audit reviewed the General Appropriations Act[5], the State Lottery Act[6], applicable administrative rules, and agency procedures. 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 performed testing to ensure sales goals and drawing entries were calculated correctly, all and only eligible retailers were receiving payments, and payments were successfully sent to retailers. As Programs 4 and 5 were the largest and most recent program runs within our audit scope period, Internal Audit accordingly focused its testing on these two program runs.

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

[5] Article VII, 10(b)
[6] Sec. 466.355. STATE LOTTERY ACCOUNT; Sec. 466.358. COMPENSATION OF SALES AGENT

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:

- Nancy Walden, CIA, CGAP, CICA, Project Manager
- Kim Tucker

BACKGROUND INFORMATION

During fiscal years 2010 and 2011, the agency conducted five program runs of the Retailer Sales Incentive Program. Features in Programs 1 and 2 were modified before the implementation of Program 3 after agency management felt changes were necessary. Details of each program run are provided below:

Programs 1 & 2:

- Program 1 operated September 6, 2009 through December 5, 2009.
- Program 2 operated January 17, 2010 through April 17, 2010.
- Each program had two phases. Retailers were eligible for Phase 2 if they had earned an incentive in Phase 1.

Phase 1:

- Retailers were measured on instant and online sales separately. Online sales excluded Lotto Texas, Mega Millions and Megaplier. Retailers were able to earn incentives for instants, online or both.
- Not all retailers were eligible to participate in the program.
- Retailers were provided a specific sales increase based on their sales category; each sales category was established based on a statewide average and had a set incentive payment (see charts below):
- Retailers who were active at least 8 consecutive weeks during a given 26-week base period were eligible to participate in the 13-week program.

	Instant Average Weekly Sales	Weekly Increase	Total 13-Week Incentive Payment
Retailer Categories	<$3,000	Not eligible	
	>=$3,000, <$4,000	$350	$260
	>=$4,000, <$6,000	$500	$390
	>=$6,000, <$8,000	$600	$520
	>=$8,000, <$10,000	$700	$650
	>=$10,000, <$12,000	$750	$975
	>=$12,000, <$15,000	$850	$1,300
	>=$15,000	$1,000	$1,950

	On-line Average Weekly Sales	Weekly Increase	Total 13-Week Incentive Payment
Retailer Categories	<$500	Not eligible	
	>=$500, <$700	$60	$40
	>=$700, <$900	$70	$55
	>=$900, <$1,200	$80	$70
	>=$1,200, <$1,500	$95	$90
	>=$1,500, <$2,500	$115	$150
	>=$2,500, <$5,000	$165	$260
	>=$5,000	$275	$540

Phase 2:

- Retailers qualified for the drawing in Phase 2 by meeting their instant goal, online goal or both.
- Retailers received one entry for Phase 2 drawing for every $1,500 increase in online sales, excluding Lotto Texas, Mega Millions and Megaplier; Retailers received one entry for Phase 2 drawing for every $5,000 increase in instant sales.

- In Phase 2, retailers could only win once in the drawing.
- Prizes awarded in drawings remained the same for all five program runs. See chart below.

Incentive Drawing Prizes		
# Prizes	**$ Prize**	**Total**
2	$50,000	$100,000
5	$10,000	$50,000
20	$5,000	$100,000
30	$2,500	$75,000
100	$1,000	$100,000
150	$500	$75,000
307		**$500,000**

Programs 3, 4 and 5:

- Program 3 operated May 9, 2010 through August 7, 2010.
- Program 4 operated October 10, 2010 through January 8, 2011.
- Program 5 operated February 6, 2011 through May 7, 2011.
- Each program had two phases. Retailers were eligible for Phase 2 if they had earned an incentive in Phase 1.

Phase 1:

- Retailers were measured on a combination of instant and online sales excluding Mega Millions, Megaplier, Powerball, and Power Play. Online sales included Lotto Texas sales beginning with Program 3.
- Retailers who were active at least 8 consecutive weeks during a given 26-week base period were eligible to participate in the 13-week program. The base period was used to calculate the retailer’s weekly sales average.
- Retailers were provided a minimum sales goal, calculated on the weekly sales average multiplied by 13 weeks + $1000.
- Retailers earned $100 for reaching their minimum sales goal plus an additional $100 for each additional $1,000 in sales.

Phase 2:

- Retailers can win only one drawing prize per location. A chain with multiple locations may win at more than one location.
- Retailers would earn an entry into the drawing for reaching their minimum sales goal. An additional entry is earned for each additional $1,000 in sales.
- Prizes awarded in drawings remained the same for all five program runs. See chart above.

MANAGEMENT RESPONSE WITH EXHIBITS

Management's response, including its provided exhibits, is presented in its entirety as follows.

INTEROFFICE MEMO

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

To: **Catherine Melvin**

From: **Gary Grief** GG

Date: **May 3, 2012**

Re: **Management Response – IA #12-009 "An Internal Audit of Retailer Sales Incentive Program"**

Please find below the management response for the above referenced audit.

Thanks.

Section #1—Compliance

Internal Audit Recommendation—Agency management should ensure control mechanisms are in place in future program runs to ensure it stays within its appropriation authority granted in rider 10(b). Further, if the agency anticipates continued high levels of participation and success in the RSIP, we recommend the agency explore options to seek further funding authority. We recommend the agency consider the need to appropriately inform oversight entities of the over expenditure in fiscal year 2011 and the need to explore any possible remedies, if available.

Further, Internal Audit recommends agency management define "major modifications" and determine when and how such modifications will be communicated to oversight entities.

Management Response— Management concurs with the recommendation that control mechanisms should be in place for the Retailer Incentive Sales program, but does not concur that controls were not in place to ensure full compliance with Rider 10(b).

Various options were considered during April 2011 to address the funding of payments for Program 5 to ensure that the Rider 10(b) appropriation amount would not be exceeded (see Exhibit A). These options included:

1) Continue Program 5 through the planned thirteenth week and utilize FY 2010 unexpended authority for the budget shortfall, if any;
2) Continue Program 5 through the planned thirteenth week, but defer the drawing payment to FY 2012, if required; and
3) Continue Program 5, but modify the end date by one week with an end date of April 30, 2011.

The Office of the Controller sought clarification from the Comptroller of Public Accounts regarding the Rider 10(b) Retailer Incentive funding mechanism. Guidance was provided by the Comptroller of Public Accounts in April 2011 that FY 2010 unexpended authority for the budget shortfall up to $2.47 million or the use of Article IX, Section 14.01 transfer authority could be used for the FY 2011 Retailer Incentive obligations. After discussing these funding mechanisms with the Commission's assigned Comptroller of Public Accounts Appropriation Control Officer, the decision was made by management to utilize transfer authority outlined in Article IX, Section 14.01. The decision to use Article IX, Section 14.01 transfer authority was documented by the Controller in an email on April 19, 2011 to the Commission's assigned Comptroller of Public Accounts Appropriation Control Officer (see Exhibit B). The verbal guidance provided by the Comptroller of Public Accounts Appropriation Control Officer in April 2011 has now been confirmed in writing (see Exhibit C). The appropriate budget transfer documents were processed on the Uniform Statewide Accounting System in June 2011 upon finalization of the program liability.

Following an inquiry by the Internal Audit Department in March 2012 regarding whether the Commission complied with Rider 10(b) appropriation authority, a second written request was made to the Commission's assigned Comptroller of Public Accounts Appropriation Control Officer. In response to this inquiry, the Comptroller of Public Accounts provided modified guidance in April 2012 stating that neither Article IX, Section 14.01 transfer authority or Rider 12 unexpended balance authority could be utilized for the Retailer Incentive Sales program. Had this interpretation been made by the Comptroller of Public Accounts when guidance was requested in April 2011, the alternative funding options previously mentioned such as deferring the drawing payment or modification of the program end date that were considered by management at that time could have been implemented to ensure that the FY 2011 Rider 10(b) appropriation authority was not exceeded by $281,850.

The Commission provided a final accounting of FY 2011 expenditures, including the Rider 10(b) Retailer Incentive expenditures, in the FY 2012 Itemized Operating Budget filed with the Governor's Office and the Legislative Budget Board on December 1, 2011. Total expenditures for FY 2011 did not exceed the Commission's total authorized appropriation in FY 2011 and the Commission returned $13,351,610 of unspent administrative funding to the Foundation School Fund.

In May 2011 the agency began work to revise the funding structure for future Retailer Incentive programs. The FY 2012-13 Program implemented in December 2011 reflects a revised funding structure including a payment cap for the retailer incentive payments. If total incentive payments for the program exceed the funding cap, each retailer's incentive payment is reduced by the same percentage required to reach the cap. While the original plans for the FY 2012-13 biennium reflected seven individual retailer incentive programs, management will be revising these plans to incorporate the updated guidance received from the Comptroller's Office in April 2012.

The agency will continue to work with the Comptroller of Public Accounts and the Legislative Budget Board regarding proposed revisions to Rider 10(b) related to Retailer Incentive appropriation transfer authority and unexpended balance authority for submission in the FY 2014-15 Legislative Appropriations Request.

Management will inform oversight entities of the over expenditure and will consult with the Comptroller of Public Accounts regarding any possible remedies.

Management will formally define "major modifications" to the program, as well as when and how such modifications will be communicated to the Governor's Office and Legislative Budget Board in the future.

Section #2—Meeting Overall Stated Goals and Objectives for the Retailer Sales Incentive Program

Internal Audit Recommendations—Management should revisit the intended goals of the RSIP to ensure the overall goals are measureable. Furthermore, management should document the qualitative program analysis in already performs to ensure important decisions are adequately captured and carried forward to ensure the continuity of the RSIP knowledge when team members change. Internal Audit acknowledges team members have not changed since the first program run.

Management Response—Management has established measurable retailer same-store sales incentive goal criteria consistent with direction in Rider 10(b) of the Commission's general appropriation that the rider monies "may be made available for the purpose of paying sales performance retailer incentives." While management agrees that retailer sales performance incentives are not the only driver of overall sales, they are the optimal measure of individual retailer sales performance. Since inception, management has routinely revisited the goals of the program and made modifications based on retailer sales results and individual incentive program performance. Management has taken steps to further document these reviews and any resulting incentive program modifications.

Section #3—Accurate Retailer Incentive Goals and Payments

Internal Audit Recommendations—Management should take steps to limit the inherent risk associated with manual processing. In addition, management should update the agency's payment procedures to align with current practices.

Management Response—Management agrees that automation of manual processes is beneficial and has recently implemented automated incentive payment distribution to retailers for the most recent retailer incentive program. Management will continue to seek opportunities for further automation of program processes.

cc: Kathy Pyka
Michael Anger

Pyka, Kathy

From:	Pyka, Kathy
Sent:	Tuesday, April 19, 2011 9:44 AM
To:	Grief, Gary
Cc:	Anger, Michael
Subject:	Retailer Incentive program
Attachments:	FY 2011 projection for discussion.xlsx

Gary,

Michael, Robert, Kelly and myself met this morning to discuss the funding issue related to the current Retailer Incentive program. Attached is a spreadsheet that provides a summary of the projected liability of the program as of 4/16 and an updated projected liability for each of the remaining weeks of the program.

- The analysis reflects two projections, one based on a straight line average of sales using actual data from weeks 1 – 10 of the program and the second projection based on a projection of sales for weeks 11 – 13 using week 10 sales as a straight line projection.
- Included on the spreadsheet are options considered regarding payment funding along with a recommendation for the payment.
- We will continue to update the payment projections on a weekly basis.
- I am still awaiting a response from the Comptroller's Office regarding whether we can utilize any of the FY 2010 unobligated Retailer Incentive funds.

Michael and I are available to discuss further or respond to any questions. Thanks, Kathy

Exhibit A

1

FY 2011 Retailer Incentive Program (updated 4/19/2011)

FY 2011 Retailer Incentive Budget	$18,750,000
Budget Based on Sales of:	$3,750,000,000
Program 4 Incentive Payment	$4,473,900
Program 4 Drawing Payment	$500,000
Program 4 Total	$4,973,900
FY 2011 Unobligated Budget after Program 4	$13,776,100

	Payments Projected as of: 04/16/11 Week 10	04/23/11 Week 11	04/30/11 Week 12	05/07/11 Week 13
Straight-line Projection based on Weeks 1- 10				
Program 5 Incentive Payment	$1,653,000	$3,976,200	$8,100,700	$13,611,200
Program 5 Drawing Payment	$500,000	$500,000	$500,000	$500,000
Program 5 Total	$2,153,000	$4,476,200	$8,600,700	$14,111,200
Remaining Budget Authority using Straight-line Projection	$11,623,100	$9,299,900	$5,175,400	-$335,100
Projection using Week 10 as Projected Sales for Weeks 11-13				
Program 5 Incentive Payment	$1,653,000	$3,950,600	$7,983,600	$13,293,000
Program 5 Drawing Payment	$500,000	$500,000	$500,000	$500,000
Program 5 Total	$2,153,000	$4,450,600	$8,483,600	$13,793,000
Remaining Budget Authority using Week 10 Sales Projection Method	$11,623,100	$9,325,500	$5,292,500	-$16,900

I. Variables:

a) Sales for the final three weeks of the program (April 17th - May 7th)

b) Program budget is based on Sales of $3.75B, any variance (higher or lower sales) would adjust the budget of $18.75M.

II. Methodology:

a) Assumed $13,776,100 available budget authority remains for the FY 2011 Retailer Incentive Program.

b) The payment liability for the Retailer Incentive payment through week 10 is $1,653,000 and $500,000 for the drawing payment.

c) A projection of the payment liability was developed through each of the weeks remaining in the program as follows:

i. Payment based on a Straight Line average of sales using Weeks 1 - 10.

ii. Payment based on Sales through Week 10 and using Week 10 Sales a Straight Line average for the remaining 3 weeks.

III. Options to consider:

a) If the Comptroller certifies that Unexpended Balance (UB)[1] Authority can be used, continue Program 5 and use FY 2010 UB Authority for budget shortfall, if any.

b) If Option a is not available, continue Program 5 but defer Drawing Payment to FY 2012 if not sufficient funding in FY 2011.

c) Continue Program 5, but modify end date by one week with an end date of April 30, 2011.

d) Modify Frenzy Promotion by 1 week from May 1 to May 8. (Already Implemented)

e) In all options considered, Program 5 will be the final Program offered for FY 2011.

IV. Recommendation:

a) If the Comptroller certifies that Unexpended Balance (UB)[1] Authority can be used, continue Program 5 and use FY 2010 UB Authority for budget shortfall, if any.

b) If Option a is not available, continue Program 5 but defer Drawing Payment to FY 2012 if not sufficient funding in FY 2011.

d) Modify Frenzy Promotion by 1 week from May 1 to May 8. (Already Implemented)

e) In all options considered, Program 5 will be the final Program offered for FY 2011.

[1] There is $12.3M of Unobligated FY 2010 Retailer Incentive budget authority. Currently there is approximately $500K of unspent FY 2010 cash authority available for use that has not been transferred to the Foundation School Fund. The 9/17/2010 Sales accrual transfer of $2.8M could also be modified if required.

[1] FY 2010 Retailer Incentive Budget	$18,350,000
Budget Based on Sales of:	$3,670,000,000
Program 1-3 Incentive Payment	$4,531,275
Program 1-3 Drawing Payment	$1,500,000
Program 1-3 Total	$6,031,275
FY 2010 Unobligated Budget	$12,318,725

Exhibit A

Pyka, Kathy

From:	Pyka, Kathy
Sent:	Tuesday, April 19, 2011 10:59 AM
To:	'Kristalle Erwin'
Cc:	Stuckey, Kelly
Subject:	RE: Rider 10 Retailer Commission

Kristalle,
Thanks again for your help this morning. As we discussed, we will proceed with using the 12.5% transfer provision outlined in Article IX, Section 14.01 to address the funding transfer (if any) into the Retailer Incentive appropriation funded by Rider 10. Thanks so much, Kathy

---

From: Pyka, Kathy
Sent: Tuesday, April 19, 2011 9:29 AM
To: 'Kristalle Erwin'
Cc: Stuckey, Kelly
Subject: Rider 10 Retailer Commission

Good morning Kristalle,
I wanted to follow up with you to determine if you have any updated information regarding Rider 10 and whether there is sufficient authority granted in Rider 12 to carry forward a small portion of the unspent Retailer Incentive appropriation authority from FY 2010 and FY 2011. Currently there is $12,318,725 of unspent authority in FY 2010 and the inquiry relates to the potential to carry forward less than $500,000 of this unspent authority to FY 2011. Thanks so much! Kathy

Kathy Pyka, CPA
Controller
Texas Lottery Commission
Phone: 512-344-5410
Fax: 512-344-5066

Exhibit B

1

Pyka, Kathy

From:	Kristalle Erwin <Kristalle.Erwin@cpa.state.tx.us>
Sent:	Thursday, May 03, 2012 7:36 AM
To:	Pyka, Kathy
Cc:	Rob Coleman; Daniel Benjamin; James Hight
Subject:	RE: Rider 10 Retailer Commission

Kathy,

I placed a call to you on April 19th between 9:29am and 10:59 am in which I advised you that the Commission could utilize the 12.5% transfer authority outlined in Art IV, Sec. 14.01 of the GAA to address a perceived short fall for the Retailer Incentive Bonus Program.

Kristalle Erwin
Appropriation Control Officer
(512) 463-3301

From: Pyka, Kathy [mailto:Kathy.Pyka@lottery.state.tx.us]
Sent: Wednesday, May 02, 2012 2:31 PM
To: Kristalle Erwin
Subject: RE: Rider 10 Retailer Commission

Kristalle,

I wanted to follow up with you on our initial phone conversations and email communications below that occurred in April 2011 regarding the Retailer Incentive funding options.

As you know the funding of our retailer incentive program has been a complex and somewhat unique challenge. I greatly appreciate the assistance your office has provided over the last several weeks.

The first email below routed on April 19th pertains to the agency's initial April 18th phone inquiry about one potential option, the use of Rider 12 unexpended balance authority. This email was followed up with a second email from me on April 19th reflecting the final decision to utilize a different option, the Article IX, Section 14.01 transfer provision, rather than utilizing the Rider 12 unexpended balance authority.

While there are a number of emails that I routed within our agency regarding the discussions you and I had via telephone, what is missing from our file is written dialogue between us on the guidance your office provided to our agency between my April 18th inquiry on the use of Rider 12 appropriation and the April 19th decision documented in the email below to ultimately address the funding issue with Article IX, Section 14.01 transfer authority. Please know that this inquiry pertains only to the original April 2011 inquiry to your office and the guidance we received at that time. The Commission fully respects the modified guidance received in April of this year noting that neither Rider 12 authority or Article IX, Section 14.01 transfer authority can be utilized for the Rider 10 Retailer Incentive program.

Thanks in advance for your assistance. Kathy

From: Pyka, Kathy
Sent: Tuesday, April 19, 2011 10:59 AM
To: 'Kristalle Erwin'

Exhibit C

1

Cc: Stuckey, Kelly
Subject: RE: Rider 10 Retailer Commission

Kristalle,
Thanks again for your help this morning. As we discussed, we will proceed with using the 12.5% transfer provision outlined in Article IX, Section 14.01 to address the funding transfer (if any) into the Retailer Incentive appropriation funded by Rider 10. Thanks so much, Kathy

---

From: Pyka, Kathy
Sent: Tuesday, April 19, 2011 9:29 AM
To: 'Kristalle Erwin'
Cc: Stuckey, Kelly
Subject: Rider 10 Retailer Commission

Good morning Kristalle,
I wanted to follow up with you to determine if you have any updated information regarding Rider 10 and whether there is sufficient authority granted in Rider 12 to carry forward a small portion of the unspent Retailer Incentive appropriation authority from FY 2010 and FY 2011. Currently there is $12,318,725 of unspent authority in FY 2010 and the inquiry relates to the potential to carry forward less than $500,000 of this unspent authority to FY 2011. Thanks so much! Kathy

Kathy Pyka, CPA
Controller
Texas Lottery Commission
Phone: 512-344-5410
Fax: 512-344-5066

Exhibit C

2

STATE OF TEXAS
TEXAS LOTTERY COMMISSION

INTERNAL AUDIT DIVISION

An Internal Audit of
Retailer Sales Incentive Program

IA #12-009

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