

CALIFORNIA STATE LOTTERY

Audit Report

PRIZE PAYMENT PROCESS AUDIT

July 1, 2017, through October 31, 2020



BETTY T. YEE
California State Controller

August 2022



BETTY T. YEE
California State Controller

August 12, 2022

Alva Vernon Johnson, Director
California State Lottery
700 North Tenth Street
Sacramento, CA 95811

Dear Mr. Johnson:

The State Controller's Office audited the California State Lottery's (Lottery) prize payment process for the period of July 1, 2017, through October 31, 2020. The purpose of the audit was to determine whether the prize payment process was adequately controlled and prize payments made by the Lottery were legal and proper. Based on our audit, we determined that the Lottery's prize payment process is adequately controlled and prize payments processed by the Lottery appear to be legal and proper. However, we noted that the Sacramento District Office made various errors when processing claims for immediate payment.

If you have any questions, please contact Roochel Espilla, Chief, State Agency Audits Bureau, by telephone at (916) 323-5744 or by email at respilla@sco.ca.gov.

Sincerely,

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/lis

cc: Harjinder Shergill-Chima, Chief Deputy Director
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Audit Report

Summary

The State Controller's Office (SCO) audited the California State Lottery's (Lottery) prize payment process for the period of July 1, 2017, through October 31, 2020. The purpose of the audit was to determine whether the prize payment process was adequately controlled and prize payments made by the Lottery were legal and proper. Based on our audit, we determined that the Lottery's prize payment process is adequately controlled and prize payments processed by the Lottery appear to be legal and proper. However, we noted that the Sacramento District Office (DO) made various errors when processing claims for immediate payments.

Background

On November 6, 1984, California voters passed Proposition 37, the California State Lottery Act of 1984 (Lottery Act), which authorized the creation of a state-operated lottery. The Lottery Act is found in Chapter 12.5, section 8880 et seq., of Government Code. The Lottery Act created the California State Lottery Commission (Commission) and gave it broad powers to oversee the Lottery's operations. The purpose of the Lottery Act is to provide supplemental money to benefit public education without the imposition of additional or increased taxes.

The Lottery has eight divisions: Executive, Finance, Human Resources, Operations, Public Affairs and Communications, Security and Law Enforcement, Information Technology Services, and Sales and Marketing. As of August 1, 2021, the Lottery has 934 budgeted positions; staff are located at Lottery Headquarters, two distribution centers, and nine district offices.

The Lottery processes prize claims received from players, and multiple Lottery divisions are involved with the prize payment process. The Operations Division's Mail and Reproduction Services Unit and the Sales and Marketing Division's district offices are responsible for collecting incoming prize claims and, in some cases, facilitating transfers to the next destination for processing. The Finance Division's Prize Payment Unit receives, records, and approves prize claims, processes certain retailer account adjustments, and responds to prize-related inquiries received by the Lottery's Customer Contact Center. The Security and Law Enforcement Division conducts claim investigations, and reviews and authenticates questionable claims and high-value prize claims.

In processing prize payments, the Lottery provides assurance that:

- Only winning tickets eligible for payment are paid;
- No winning ticket is paid more than once;
- All statutory restrictions are observed; and
- Prize payment data is accurately recorded.

On November 13, 2018, the Lottery began a program to process immediate payments up to \$1,000 for error-free claims. The program started as a pilot project at the Sacramento DO, and expanded to the Fresno and San Diego DOs. The Lottery plans to implement the program statewide. The program is intended to improve the customer service experience and reduce the standard processing time for payment of error-free claims.

Audit Authority

We conducted this audit under the authority of Government Code (GC) section 8880.46.6, which requires the SCO to conduct quarterly and annual audits of the Lottery, as the Controller deems necessary. In addition, GC section 12410 provides the SCO with general authority to audit the disbursement of state money for correctness, legality, and sufficient provisions of law. GC section 12411 provides further authority for the Controller to suggest plans for the improvement and management of public revenues.

Objectives, Scope, and Methodology

The objectives of our audit were to determine whether the Lottery:

- Has adequate controls over the Lottery's prize payment process to safeguard against theft, abuse, or loss to the State;
- Complies with state and federal laws, rules, and regulations and policies applicable to prize payments;
- Ensures that prize payments made by the Lottery are legal and proper; and
- Maintains economical and efficient prize payment practices that maximize funding to public education.

The audit period was July 1, 2017, through October 31, 2020.

To achieve our objectives, we performed the following procedures:

- We reviewed the State Administrative Manual, the Lottery's policies and procedures, and applicable laws, rules, and regulations as they relate to the prize payment process.
- We reviewed prior reviews and audits performed by the SCO, external agencies, and the Lottery's Internal Audits Office or any other Lottery unit, and followed up on prior audit findings.
- We performed walkthroughs and interviews, and observed staff members engaged in the Lottery's processes and procedures related to prize payments.
- We gained an understanding of the prize payment process and evaluated internal controls that were significant to our audit objectives.
- We performed tests of procedural compliance on mail processes using non-statistical sampling methods to select six of 40 months of Daily Mail Statistic Logs and Firm Delivery Receipts.

- We performed tests of procedural compliance on prize payment claims using non-statistical sampling methods to select transactions. We tested the following prize payment claims:
 - Draw Games – 90 of 40,363 (\$792,018,712 of \$1,671,616,163);
 - Scratchers – 81 of 295,392 (\$67,056,000 of \$1,317,596,586);
 - Non-ticket Winner – 60 of 8,728 (\$858,500 of \$36,981,000);
 - Annuity – 66 of 11,479 (\$38,511,564 of \$260,562,134); and
 - Error-free Immediate – 202 of 10,941 (\$365,918 of \$11,213,619).
- We determined whether prize payments processed through the Office Revolving Fund were legal and proper.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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. We limited our review of internal controls to gaining an understanding of the Lottery's prize payment process.

We did not audit the Lottery's financial statements.

Conclusion

Our audit found that the Lottery's prize payment process is adequately controlled and prize payments processed by the Lottery appear to be legal and proper. However, we noted that the Sacramento DO made the following errors:

- Three prize payments, totaling \$6,000, were processed although the social security numbers (SSNs) entered into the International Game Technology (IGT) gaming system did not match the SSNs entered into the Franchise Tax Board (FTB) website;
- One prize payment, totaling \$11,000, was processed although an incorrect SSN had been entered into the IGT gaming system;
- One prize payment, totaling \$999, was processed although an incorrect SSN had been used on the FTB website to check the claimant's eligibility for immediate payment;
- Two prize payments, totaling \$9,000, were processed although they were missing documentation to verify that the claimant's SSN did not belong to a person who owed money to government agencies;
- Three payments, totaling \$2,703, were processed although the claim forms lacked appropriate "hold" codes related to questions about the claimant's relationship with Lottery retailers on the claim form;
- Three payments, totaling \$3,000, were processed without proper "hold" codes to prevent payment at the district office; and
- A non-taxed prize payment, totaling \$1,000, was issued although the claimant was not a U.S. citizen or a resident alien, according to the statement on the Lottery claim form.

**Follow-up on Prior
Audit Findings**

We last performed an audit of the Lottery's prize validation process on July 29, 2015. Based on work performed in the current audit, we noted that the Lottery has taken appropriate corrective actions on prior audit findings.

**Views of
Responsible
Officials**

We issued a draft audit report on March 22, 2022. Lottery representatives responded by letter dated April 1, 2022, agreeing with the audit results. This final audit report includes the Lottery's response as an attachment.

Restricted Use

This report is intended for the information and use of the Lottery, the Commission, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record, and is available on the SCO website at www.sco.ca.gov.

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

August 12, 2022

Finding and Recommendation

**FINDING—
Payment
processing errors
identified at
Sacramento
District Office**

Our audit found that the Lottery’s Sacramento DO made errors when processing prize payments. The errors occurred due to staff oversight, and resulted in inaccurate records and questionable payments. The Sacramento DO processed a total of 10,941 transactions totaling \$11,213,619 during the audit period. We reviewed 202 transactions, totaling \$365,918. We noted that of the 202 transactions tested, there were a total of 14 transaction processing errors, resulting in an error rate of 6.9%.

We noted the following errors in claims processed by the Sacramento DO:

- Three prize payments, totaling \$6,000, were processed although the SSNs entered into the IGT gaming system did not match the SSNs that were entered into the FTB website. The discrepancies were the result of keying errors and of illegible SSNs written on the Lottery claim form. Discrepancies in SSNs could result in the Lottery maintaining and reporting inaccurate claimant data. In addition, if inaccurate SSNs are entered into the FTB website, the Lottery could pay claimants who are ineligible to receive immediate payments.
- A prize payment, totaling \$11,000, was processed although an incorrect SSN had been entered into the IGT gaming system. The discrepancy was the result of an illegible SSN written on the claimant’s Lottery claim form. Discrepancies in SSNs could result in the Lottery maintaining and reporting inaccurate claimant data.
- A prize payment, totaling \$999, was processed although an incorrect SSN had been used to check claimant eligibility for immediate payment through the FTB website. The SSN written on the Lottery claim form was corrected, and Sacramento DO staff did not verify the updated SSN on the FTB website. If inaccurate SSNs are entered into the FTB website, the Lottery could pay claimants who are ineligible to receive immediate payments.
- Two prize payments, totaling \$9,000, were processed although they were missing documentation to verify that the claimants’ SSNs did not belong to people who owed money to government agencies. We could not confirm that those payments should have been paid immediately; therefore, the payments were questionable.
- Three payments, totaling \$2,703, were processed although the claims were missing proper “hold” codes related to questions about the claimant’s relationship with Lottery retailers on the claim form. District office staff are required to accurately reflect retailer status when processing claims, to ensure that the Lottery can accurately record and monitor retailer-related claims.
- Three payments, totaling \$3,000, were processed although the claim forms were missing proper “hold” codes to prevent payment at the Sacramento DO. Those claims were processed with unmatched ticket and Lottery claim form names, and resulted in questionable payments.

- A non-taxed prize payment, totaling \$1,000, was issued although the claimant was not a U.S. citizen or a resident alien, according to the statement on the Lottery claim form. The Sacramento DO staff did not check the appropriate box in the IGT gaming system to automatically apply the appropriate tax rate for claimants based on citizenship. If Lottery claim form data is not accurately entered into the IGT gaming system, the Lottery is at risk of paying prizes not in accordance with Federal Tax Rules.

If processing errors are not mitigated, the Lottery is at risk of maintaining and reporting inaccurate claimant data and issuing immediate payments to ineligible claimants.

The Lottery's *District Office Paying Claims Procedures* include processes to make immediate payments to claimants with error free claims for prizes \$1,000 and under. The individual processes outline specific steps to ensure claims are processed in compliance with state and federal laws, rules, and regulations. The relevant sections of the procedures are as follows:

- **PR-DO-001.2 – Preparing a Claim Form** requires district office staff to ensure that the Lottery claim form contains no errors.
- **PR-DO-001.4 – Data Entry of Draw Games and Scratchers Claims** requires district office staff to enter into the IGT gaming system information regarding the claimant's citizenship status and whether the claimant is a Lottery retailer, employed by a Lottery retailer, or related to a Lottery retailer. Staff must enter any "hold" codes that apply to the claim in the IGT gaming system.
- **PR-DO-001.5 – Reasons for HQ Processing** lists reasons the Scratchers ticket requires additional review at Lottery headquarters, including unmatched ticket and Lottery claim form names, and outstanding governmental debts.
- **PR-DO-001.5 – Supervisor Quick Reference** requires supervisors to print from the FTB website the page that indicates whether or not an offset exists for the claimant and attach it to the Lottery claim form.
- **PR-DO-001.5 – Supervisory Approval** for issuing a check requires that supervisors verify that all the claimant information from the Lottery claim form matches the claimant information entered into the IGT gaming system.
- **PR-DO-001.6 – Retention Procedures** states that claims must be kept for three years after the current year.
- **Federal Tax Rules on Prize Winnings** states that non-resident aliens are subject to a 30% tax on gross gambling proceeds.

Recommendation

To prevent inaccurate records and processing questionable claims, we recommend that:

- Sacramento DO staff consult with supervisory staff to ensure that they are in agreement with the SSN presented on the Lottery claim form. If the SSN is illegible, obtain clarification and documentation from the claimant or send the claim to headquarters for processing;
- All FTB offset documentation be retained in accordance with retention procedures;
- Supervisory staff ensure that “hold” codes are appropriately applied to claims, and that such claims are sent to Headquarters for processing; and
- Claimant citizenship data is accurately entered into the IGT gaming system to ensure that appropriate tax rates are applied to prize payments.

**Attachment—
California State Lottery's
Response to Draft Audit Report**



April 1, 2022

Andrew Finlayson, Chief
State Agency Audits Bureau
State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, California 94250

Subject: Audit of the California State Lottery Prize Payment Process

Dear Mr. Finlayson:

Thank you for providing the California State Lottery (Lottery) the opportunity to review and respond to the State Controller's Office (SCO) Draft Prize Payment Process Report. We find the report finding and recommendations helpful and constructive.

We are pleased to hear that your audit found that the Lottery's prize payment process is adequately controlled and prize payments processed by the Lottery appear to be legal and proper.

Below is the Lottery's response to the finding and recommendations provided in the draft audit report:

FINDING – Payment processing errors identified at Sacramento District Office

SCO RECOMMENDATION:

To prevent inaccurate records and processing questionable claims, we recommend that:

- Sacramento DO staff consult with supervisory staff to ensure that they are in agreement with the SSN presented on the Lottery claim form. If the SSN is illegible, obtain clarification and documentation from the claimant or send the claim to headquarters for processing;
- All FTB offset documentation be retained in accordance with retention procedures;
- Supervisory staff ensure that "hold" codes are appropriately applied to claims, and that such claims are sent to Headquarters for processing; and
- Claimant citizenship data is accurately entered into the IGT gaming system to ensure that appropriate tax rates are applied to prize payments.

LOTTERY RESPONSE:

The Lottery agrees with the finding as detailed below. Mitigating processing errors will ensure the Lottery maintains and reports accurate claimant data and correctly issues immediate payments to eligible claimants.

The Lottery agrees that staff should consult with supervisors to ensure there is agreement with the SSN data presented on the Lottery claim form and the claim is processed according to the agreed-upon data. If the data is illegible, clarification will be obtained from the claimant and documented on the claim form, or the claim will be sent to Headquarters for processing. Desk procedures have been updated to further clarify the details and steps needed to validate and agree on legibility of data reflected on claims. In addition, training will be conducted on the updated procedures.

The Lottery agrees that all claims including the associated Franchise Tax Board (FTB) offset documentation should be retained in accordance with retention procedures to substantiate that the claims were eligible for immediate payments. Desk procedures on claim assembly and filing in accordance with retention procedures have been reviewed with the team.

The Lottery agrees supervisors should ensure all data from the claim form, including retailer question responses provided by the claimant, are entered into the gaming system. This will ensure gaming system codes are appropriately applied to claims. In the case of the retailer question responses, if the data is keyed correctly, the gaming system automatically applies a code indicating the claimant has responded 'yes' to one or more of the questions. Claims are either approved for immediate payment if they meet the criteria of paying claims at the District Office or are sent to Headquarters for processing. Although not all codes automatically applied to a claim by the system would disqualify a claim from being paid immediately, desk procedures will be updated to reflect all information recorded by the claimant on the claim form is keyed into the gaming system.

The Lottery agrees that claims where the name on the ticket appears to be unmatched to the Lottery claim form should be further reviewed and substantiated. If the names cannot be validated as matching using identification, then the claim will be sent to Headquarters for processing. Desk procedures will be updated to reflect additional steps in validating a claimant's name if the name written on the back of the ticket does not match the name written on the claim form. The procedure will include the type of supporting documentation necessary (e.g., copy of government-issued identification) and/or comments to be added in the gaming system to confirm same-day payment. If there is no support for the name difference, the claim will be forwarded to Headquarters for processing.

The Lottery agrees that supervisors should ensure that all data from the claim form, including tax information provided by the claimant, are entered into the gaming system. This will ensure that the appropriate tax rates are applied. Desk procedures on keying claims including correctly keying the tax information from the claim form have been reviewed with the team.

The Lottery will continue to conduct periodic, ongoing monitoring and training for all procedures, including for these items noted above, to ensure corrective action is effective in minimizing errors.

Mr. Andrew Finlayson
April 1, 2022
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The Lottery appreciates SCO's time and assessment of the Prize Payment process. The Lottery takes its mission seriously and understands the importance of performing duties in a cost-effective and transparent manner to ensure public resources are safeguarded.

Thank you again for the opportunity to review and respond to the report. If you have any additional questions, please contact Deputy Director of Internal Audits, Sara Sheikholislam at (916) 639-2877.

Sincerely,

DocuSigned by:

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Alva V. Johnson
Director

**State Controller's Office
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