



# TEXAS LOTTERY COMMISSION INTERNAL AUDIT

## ANNUAL INTERNAL AUDIT REPORT FY2016



**McCONNELL & JONES LLP**  
CERTIFIED PUBLIC ACCOUNTANTS



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McCONNELL & JONES LLP  
CERTIFIED PUBLIC ACCOUNTANTS

October 13, 2016

The Honorable Greg Abbott, Governor  
Members of the Legislative Budget Board  
Members of the Sunset Advisory Commission  
Internal Audit Coordinator, State Auditor's Office

Dear Ladies and Gentlemen:

Attached is the fiscal year 2016 Internal Audit Report for the Texas Lottery Commission (TLC). This annual internal audit report is submitted in accordance with the Texas Internal Auditing Act requirement for state agency internal auditors to prepare and distribute an annual report (Government Code, Chapter 2102). TLC engaged McConnell & Jones LLP (MJ) on January 1, 2014 to provide internal audit services to the TLC in accordance with The Texas Internal Auditing Act, pursuant to the Request for Proposals (RFP) issued October 22, 2013. MJ submits this FY2016 Annual Internal Audit Report on behalf of the TLC Commissioners.

The Texas Internal Auditing Act requires agencies to file an annual report on their internal audit activities and the internal audit reports prepared for their governing board. The purpose of the annual internal audit report is to provide information on the assurance services, consulting services, and other activities of the internal audit function. In addition, the annual internal audit report assists oversight agencies in their planning and coordination efforts. According to Texas Government Code, Sections 2102.009 and 2102.0091, the FY2016 Annual Internal Audit Report is due November 1, 2016.

Please contact Darlene Brown at 713.968.1617 or Commissioner J. Winston Krause at 512.477.6707 if you should have any questions about this audit report.

Sincerely,

Darlene Brown, CIA, CFE  
Director, Enterprise Risk Services

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## I. COMPLIANCE WITH TEXAS GOVERNMENT CODE, SECTION 2102.015: POSTING THE AUDIT PLAN AND ANNUAL REPORT ON THE INTERNET

Texas Government Code, Section 2102.015, requires state agencies and institutions of higher education to post agency internal audit plans and internal audit annual reports to the agency's internet website within 30 days of approval. Texas Government Code, Section 2102.015, also requires agencies to update the posting on the website to include a detailed summary of any weaknesses, deficiencies, wrongdoings, or other concerns raised by the audit plan or annual report and include a summary of the actions taken by the agency to address the issues raised.

In accordance with requirements of Texas Government Code, Section 2102.015, McConnell & Jones LLP (MJ) will ensure the required internal audit plan, internal audit annual report and any other required internal audit information is provided to the Texas Lottery Commission (TLC) for posting to their website.

## II. FISCAL YEAR 2016 INTERNAL AUDIT PLAN STATUS

McConnell & Jones LLP prepared the Fiscal Year 2016 Annual Internal Audit plan based on a comprehensive risk assessment which was approved by the TLC commissioners on May 28, 2015. The chart below reflects the status of the revised Internal Audit Plan that was approved by the TLC Commissioners to accommodate the Charitable Bingo Operations Division (CBOD) ledger reconciliation project.

**FY2016 Internal Audit Plan Status as of August 31, 2016**

Task #	Description	Report Number	Report Date	Report Title	Audit Status
1	Procure-to-Pay Cycle	16-001	February 24, 2016	Procure-to-Pay Cycle	Completed
4	Entity-Wide Performance Measures	16-002	April 28, 2016	Entity-Wide Performance Measures	Completed
2	Jackpot Estimations	16-003	June 2016	Jackpot Estimations	Completed
3	Drawing Process	16-004	June 2016	Lottery Drawings	Completed
5	Retailer Management	N/A	N/A	N/A	Postponed to FY2017
6	Bingo Restructure and BOSS Implementation Follow-Up	16-005	TBD	CBOD Restructure and BOSS Implementation Follow-Up	In-Progress - Report Will be Issued In December 2017.
7	Human Resources Life Cycle	16-006	TBD	Human Resources	Completed – Report Will be Issued in December 2017.





Task #	Description	Report Number	Report Date	Report Title	Audit Status
8	Follow-Up On Prior Audit Findings	N/A	N/A	N/A	On-Going
9	Management of Fraud/Complaint Hotlines Lines	N/A	N/A	N/A	On-Going
10	External Audit / Review Assistance	N/A	N/A	N/A	No Assistance Requested
11	Update Risk Assessment & Develop 2017 Audit Plan	N/A	N/A	N/A	Completed
12	Annual Audit Report	N/A	N/A	N/A	Completed
13	Audit Communications, Committee Meetings, Project Management	N/A	N/A	N/A	On-Going
14	CBOD Ledger Reconciliation Project	N/A	N/A	N/A	Completed

#### Deviation from Fiscal Year 2015 Internal Audit Plan

Internal audit postponed the retailer management audit until FY2017 to place priority on completing the Charitable Bingo Operations Division (CBOD) ledger reconciliation project.

### III. CONSULTING SERVICES AND NON-AUDIT SERVICES COMPLETED

Internal Audit provided on-going consultative assistance to Charitable Bingo Operations Division (CBOD) management in conjunction with their project to perform a reconciliation of approximately 1,400 charitable organization bingo ledger accounts. Internal Audit's participation and services were limited to reviewing the charitable bingo organization ledger account reconciliation work completed by CBOD audit staff; ensuring both auditor independence and objectivity were not compromised. Such activity did not result in reports or management letters during fiscal year 2016.

### IV. EXTERNAL QUALITY ASSURANCE REVIEW (PEER REVIEW)

MJ has been a member of the AICPA since 1987, and is subject to the AICPA's peer review process every three years. Our commitment to quality is underscored by the fact that we have consistently received an unqualified opinion in our external peer review of our accounting and auditing practice by the AICPA in the most recent four peer reviews. After a thorough review of our procedures and work practices, which include reviews of our nonprofit, governmental, and commercial engagements, the reviewers concluded that MJ complies with the stringent quality control standards established by the American Institute of Certified Public Accountants. We provide a copy of our most recent peer review letter below.



*Join Us on the Road*



### System Review Report

February 20, 2016

To the Partners of  
**McConnell & Jones, LLP**  
and the National Peer Review Committee

We have reviewed the system of quality control for the accounting and auditing practice of **McConnell & Jones, LLP** (the firm) applicable to engagements not subject to PCAOB permanent inspection in effect for the year ended **June 30, 2014**. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included audits of employee benefit plans and audits performed under *Government Auditing Standards*.

In our opinion, the system of quality control for the accounting and auditing practice of **McConnell & Jones, LLP** (the firm) applicable to engagements not subject to PCAOB permanent inspection in effect for the year ended **June 30, 2014**, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. **McConnell & Jones, LLP** has received a peer review rating of *pass*.

*Turner, Stone & Company, LLP*

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## V. FISCAL YEAR 2017 INTERNAL AUDIT PLAN

MJ developed the Fiscal Year 2017 Internal Audit Plan based on results of the annual risk assessment. The risk assessment included reviewing the agency's strategic plan, the Legislative Appropriations Request and the Survey of Employee Engagement results; reviewing prior audit reports and findings; and conducting discussions with management. Our assessment evaluated risk exposures relating to the TLC's governance, operations, and information systems regarding the reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations, and contracts. We also included consideration of contract management and information technology risks.

The State Auditor's Office (SAO) annual report guidelines included the requirement to indicate which projects in the audit plan address certain items described below.

State Auditor's Office Requirement	FY2017 Internal Audit Plan Activity
Benefits proportionality, expenditure transfers, capital budget controls, or any other limitation or restriction in the General Appropriations Act.	Not included. Will be included in the FY2018 audit plan.
Contract management and other requirements of Senate Bill 20 (84th Legislature)	Not included. Audit was conducted in FY2015.

Risks rated as high that are not included in the fiscal year 2017 audit plan include the following:

- Investments – these assets are managed by the state's Treasury and are outside of the agency's control.

MJ will perform eleven scheduled audits, conduct fraud awareness training, update the risk assessment, conduct follow-up activities related to prior audit findings, prepare the fiscal year 2018 Annual Internal Audit Plan and prepare the Fiscal Year 2017 Annual Audit Report in accordance with the Texas Internal Auditing Act. These activities are estimated to require **2,274 hours**. The planned audits, timing and estimated hours are summarized in the table below.

### Fiscal Year 2017 Annual Audit Plan Activities

Audit Activity #	Description	Risk Rating	Estimated Timing	Estimated Hours
1	Scratch Ticket Warehouse Receiving Controls	Request	September 2016 - November 2016	119
2	Scratch Ticket Pack Reconstruction	Medium	September 2016 - November 2016	180
3	CBOD Audit Processes	Request	October 2016 – December 2016	300
4	Enforcement - Background Check and Investigation Processes	High	October 2016 - December 2016	282
5	Retailer Management	High	January 2017 – March 2017	300



Audit Activity #	Description	Risk Rating	Estimated Timing	Estimated Hours
6	Fraud Awareness Training	Low	January 2017	36
7	Time and Attendance	Medium	February 2017 - March 2017	118
8	Second Chance Drawing Process	Medium	February 2017 - April 2017	200
9	Crisis Management Plan	Low	March 2017 - April 2017	84
10	Active Directory Audit	Medium	March 2017 - May 2017	226
11	Jackpot Estimation System	Low	June 2017	140
12	Scratch Ticket Working Paper Workflow System	Low	June 2017	92
13	Follow-Up On Prior Audit Findings	Compliance	On-Going	37
14	Monitor Fraud/Complaint Hotlines Lines	Compliance	On-Going	8
15	External Audit / Review Assistance	Compliance	On-Going	10
16	Update Risk Assessment & Develop 2018 Audit Plan	Compliance	July - August 2017	73
17	Annual Audit Report	Compliance	August 2017	9
18	Audit Communications, Committee Meetings, Project Management	N/A	On-Going	60
	<b>Total</b>			<b>2,274</b>

*Proposed audits will focus on internal controls and business processes*





## VI. EXTERNAL AUDIT SERVICES PROCURED IN FISCAL YEAR 2016

The following represent external audit services that were procured by the Texas Lottery Commission or were ongoing in fiscal year 2016.

<i>Audit / Review</i>	<i>Auditor</i>
<i>Drawings Audit</i>	<i>DK Partners, P.C.</i>
<i>FY16 Financial Audit Services</i>	<i>Weaver and Tidwell, LLP</i>
<i>Biennial Security Study</i>	<i>BerryDunn</i>

## VII. REPORTING SUSPECTED FRAUD AND ABUSE

Texas Lottery Commission has implemented measures to comply with Article IX, Section 7.10, the General Appropriations Act (81st Legislature) and Texas Government Code, Section 321.022. These measures include, but are not limited to, the following:

The Texas Lottery Commission included a link to the State Auditor's Office (SAO) website for fraud reporting at the footer of the Texas Lottery Commission website. In addition, information on reporting suspected fraud to the State Auditor's Office is included in the agency's policies and procedures.

The Texas Lottery Commission utilizes EthicsPoint Reporting. EthicsPoint is a third-party vendor that provides an Internet and telephone based reporting system that can be accessed by Commission employees. This system is intended to supplement the existing avenues within the Commission for employees to report concerns. All EthicsPoint complaints are reviewed by the agency's General Counsel and reported to SAO as applicable.

## VIII. SIGNIFICANT INTERIM CHANGES

Interim changes to the annual audit plan may occur from time to time due to changes in management direction, objectives, business risks, timing of initiatives, and staff availability. In accordance with IIA Performance Standard 2020, MJ will communicate any significant changes of the audit plan to TLC's executive management and present these changes to the TLC Commissioners for review and approval. Notification of significant changes to the Internal Audit Plan approved by the Audit Committee will be submitted to the State Auditor's Office (SAO).

This annual internal audit report was presented to the Commissioners and approved on October 13, 2016.



J. Winston Krause, Chairman