



Texas Lottery Commission

Internal Audit Services

AN INTERNAL AUDIT OF:

TLC Warehouse Operations

Report No. 20-008

November 13, 2020

This report provides management with information about the condition of risks and internal controls at a specific point in time. Future changes in environmental factors and actions by personnel will impact these risks and internal controls in ways that this report cannot anticipate.



McCONNELL & JONES LLP
CERTIFIED PUBLIC ACCOUNTANTS



Audit Report Highlights TLC Warehouse Operations

Why Was This Review Conducted?

This audit was performed as part of the approved FY 2020 Annual Internal Audit Plan.

Audit Objectives and Scope

We performed this audit to assess management's internal control structure in place to ensure the warehouse security procedures are effective, safety guidelines are properly followed and the receiving and distribution processes are according to agency policies. The scope period was FY 2020 and current security measures.

Audit Focus

This audit focused on the following areas:

- ✓ Physical security
- ✓ Safety measures
- ✓ Receiving and distribution of goods/merchandise
- ✓ Inventory management

Roles and Responsibilities

The agency's administration division is responsible for the warehouse operations. The agency's facilities manager oversees daily operations, and the warehouse is supported by two full-time employees.



We wish to thank all employees for their openness and cooperation. Without this, we would not have been able to complete our review.

Audit Conclusions

The agency has sound processes and strong internal controls in place to ensure that warehouse operations protect the agency's assets, secure the facility, and provide a safe work environment for employees and visitors.

Internal Control Rating

Effective.

Notable Practices

The agency has the following practices we wish to recognize as strong internal controls and practices:

- The agency ensures that the warehouse has 24-hour security surveillance.
- Agency staff operating the warehouse fully understand their roles and responsibilities and do not take safety and security lightly.
- The warehouse is maintained and ready to serve as the operations back-up facility at any given moment.
- Sensitive areas within the warehouse have additional access controls and monitoring.

What Did We recommend?

We had no reportable findings and therefore made no recommendations.

Number of Findings by Risk Rating

High	Medium	Low	Total
0	0	0	0



INTRODUCTION



McConnell & Jones LLP (MJ) serving as the outsourced internal audit function (Internal Audit) for the Texas Lottery Commission (TLC) performed an internal audit of the agency's central warehouse operations. Note: The central warehouse is not the scratch ticket operations warehouse.

We performed this audit as part of the approved FY 2020 Annual Internal Audit Plan. This audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). 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 meets that requirement.

Pertinent information has not been omitted from this report. This report summarizes the audit objective and scope, our assessment based on our audit objectives and the audit approach.

OBJECTIVE



The purpose of this audit was to assess management's internal control structure in place to ensure the warehouse security measures are effective, safety guidelines are properly followed and staff receiving processes are according to agency policies.

We designed audit procedures to evaluate internal controls and processes over:

- ✓ Physical security
- ✓ Safety measures
- ✓ Receiving and distribution of goods/merchandise
- ✓ Inventory management

SCOPE



This audit period was September 1, 2019 through XX, 2020. Some test procedures were performed as of the fieldwork date. This work product was at a point in time evaluation that cannot address the inherent dynamic nature of subsequent changes to the process and procedures reviewed.

PROCEDURES PERFORMED



We conducted interviews, performed on-site physical and safety review, business process walkthroughs, reviews of written policies and procedures, and assessed building access controls.

CONCLUSION AND INTERNAL CONTROL RATING



This audit identified findings that resulted in an overall internal control rating of **Effective**. **Exhibit 1** describes the internal control rating.

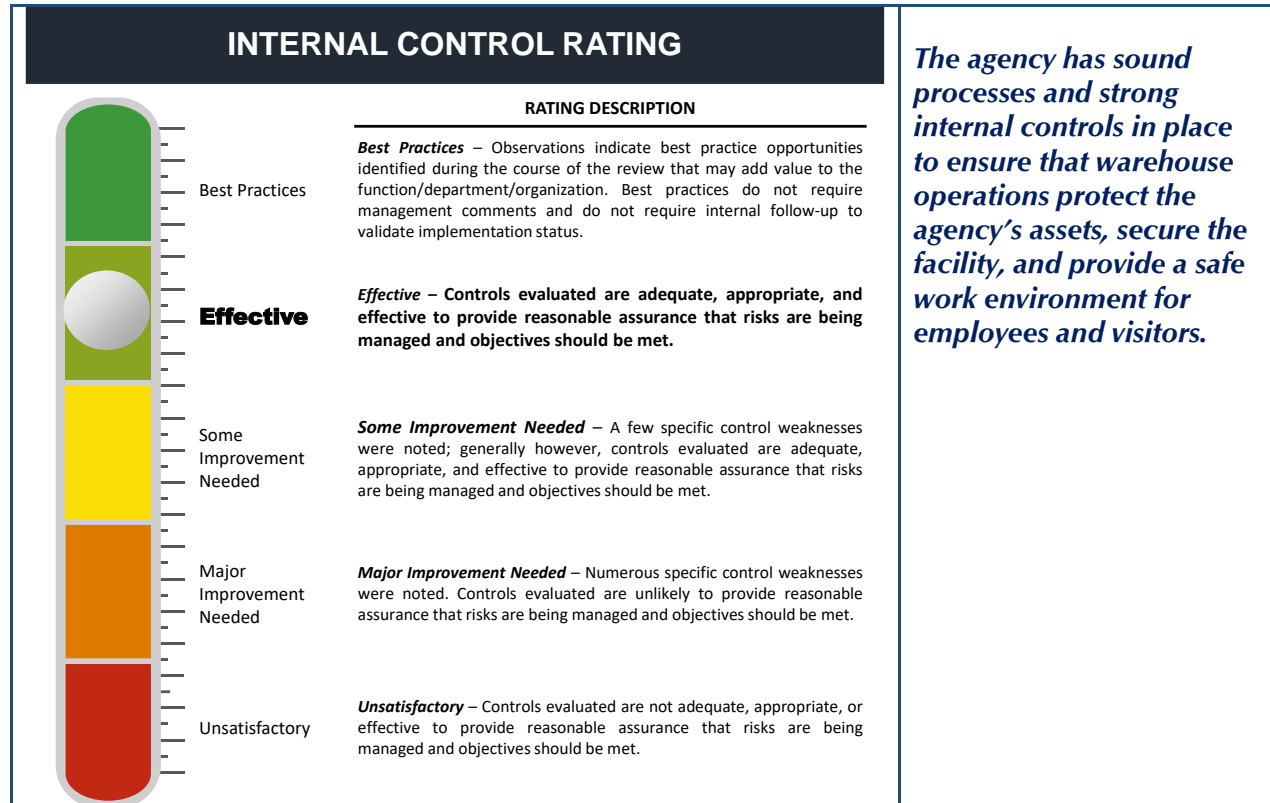


Exhibit 1: Internal control rating description.

BACKGROUND



This section of the report provides an overview of TLC's warehouse operations.

The Texas Lottery Commission leases a warehouse facility in the Austin area. This facility serves as the back-up operations site in addition to receiving and distributing merchandise, storing unused furniture and equipment, records storage, and some inventory.

The agency's administration division is responsible for the warehouse operations. The agency's facilities manager oversees daily operations, and the warehouse is supported by two full-time employees. Access to the warehouse facility is restricted and controlled through employee badges. Visitors must sign-in and be escorted. The facilities are secured and monitored with exterior and interior security cameras.



TLC WAREHOUSE OPERATIONS BUSINESS OBJECTIVES, RISKS, FINDINGS AND MANAGEMENT RESPONSE



This section of the report provides a summary of applicable business objectives, risks, and controls in place to ensure that TLC's Warehouse Operations protect assets and employees. Each table also includes our assessment of internal controls for the respective business risk, our recommendations to address deficiencies noted or opportunities to enhance current controls and management's response.

1 BUSINESS OBJECTIVE: WAREHOUSE OPERATIONS

Business Objective	To ensure warehouse operations are governed by formalized written procedures that include physical security, safety measures, and inventory handling.
Business Risk	<ul style="list-style-type: none"> ➔ The agency may not have comprehensive guidance for staff to follow on how to operate the warehouse safely and securely. ➔ The policy, procedure and expected processes may not be known to employees. ➔ Employees may not understand how to protect the facility, inventory and themselves in warehouse operations.
Management Controls in Place	<ul style="list-style-type: none"> ➔ TLC has documented policies and procedures for warehouse operations. ➔ Employees are knowledgeable of policies, procedures and processes.
Control Tests	<ul style="list-style-type: none"> ➔ Interviewed key process owners. ➔ Review the policy and procedures provided for completeness and formalization.
Control Assessment / Findings	Internal Controls are Effective.
Recommended Actions	None.
Management Response and Action Plan	None required.



2 BUSINESS OBJECTIVE: BUILDING PHYSICAL SECURITY

Business Objective	To ensure effective controls are in place to protect the warehouse facility, contents, and employees.
Business Risk	<ul style="list-style-type: none"> ➤ Unauthorized access to the warehouse may occur. ➤ Security methods in place may not protect the facility, inventory, and employees.
Management Controls in Place	<ul style="list-style-type: none"> ➤ Detailed security policy is in place. ➤ Badge access is required in the warehouse and sensitive areas. ➤ Security cameras are installed on the exterior and interior. ➤ Security cameras are monitored and recorded 24/7.
Control Tests	<ul style="list-style-type: none"> ➤ Interviewed key process owners. ➤ Visited the warehouse and observed the implemented internal security controls.
Control Assessment / Findings	<p>Internal Controls are Effective.</p> <p>We provided management with a list of our security walkthrough notes which contained minor maintenance suggestions.</p>
Recommended Actions	None.
Management Response and Action Plan	None Required.

3 BUSINESS OBJECTIVE: INCIDENT MANAGEMENT

Business Objective	To ensure that process and controls are in place to prevent and manage unforeseen disruptive events.
Business Risk	<ul style="list-style-type: none"> ➤ Security system may be compromised due to power outage, software hack or unauthorized use of employee badges. ➤ Facilities and contents may be compromised due to power outage, software hack or unauthorized use of employee badges.
Management Controls in Place	<ul style="list-style-type: none"> ➤ Detailed policy is in place to instruct employees for disaster recovery, threat response and alarm management. ➤ Security cameras, security guards and generators are in place to mitigate the risk of incidents and disasters.
Control Tests	<ul style="list-style-type: none"> ➤ Interviewed key process owners. ➤ Reviewed the policy and procedures.
Control Assessment / Findings	<p>Internal Controls are Effective.</p>
Recommended Actions	None.



3 BUSINESS OBJECTIVE: INCIDENT MANAGEMENT

Management Response and Action Plan	None required.
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4 BUSINESS OBJECTIVE: UNAUTHORIZED ACCESS

Business Objective	To ensure that processes and controls limit warehouse access to authorized individual(s) based on their job roles or business purpose and visitors are always escorted.
Business Risk	<ul style="list-style-type: none"> ➤ Unauthorized person(s) gain access to the warehouse and sensitive areas. ➤ Employee badges may include warehouse access although there is not a need based on their job function. ➤ Employee badges may include warehouse sensitive area access although there is not a need based on their job function. ➤ Separated employees with warehouse access may not have their badges deactivated in a timely manner.
Management Controls in Place	<ul style="list-style-type: none"> ➤ Badge access is required to enter the warehouse. ➤ Additional layers of badge authorization is required to access sensitive areas. ➤ Visitors are required to sign-in and are escorted at all times. ➤ Badge access is disabled upon employee separation. ➤ Periodic review of assigned badge access privileges is performed.
Control Tests	<ul style="list-style-type: none"> ➤ Visited warehouse and observed the facility, including access controls. ➤ Obtained building and location entrance logs and determined there was unauthorized entrance. ➤ Compared the terminated employee list to the entrance logs and determined no separated employees accessed the warehouse after separation.
Control Assessment / Findings	Internal Controls are Effective.
Recommended Actions	None.
Management Response and Action Plan	None required.



5 BUSINESS OBJECTIVE: OSHA Guidelines Compliance

Business Objective	To ensure warehouse employees follow Occupational Safety and Health Administration (OSHA) safety guidelines.
Business Risk	<ul style="list-style-type: none"> ➤ Warehouse employees and visitors may not be aware of OSHA guidelines followed by the agency. ➤ OSHA safety guidelines may not be followed by warehouse employees and visitors. ➤ The agency may not provide necessary training for employees to operate powered industrial trucks. ➤ The agency may not perform regular safety inspections of the warehouse. ➤ Employees and visitors may be injured as a result of unsafe conditions.
Management Controls in Place	<ul style="list-style-type: none"> ➤ The agency developed detailed and comprehensive policy and procedure for warehouse storage safety, powered industrial truck training and safety, use and storage of hazardous materials, etc. ➤ Signage of safe operations are posted in the warehouse. ➤ The agency contracts with the State Office of Risk Management to perform regular safety inspections. ➤ OSHA recommended safety stations are in place. ➤ Warehouse staff are required to receive powered industrial truck training.
Control Tests	<ul style="list-style-type: none"> ➤ Interviewed key process owners. ➤ Visited warehouse and observed the facility. ➤ Reviewed the policy and procedures regarding warehouse operation safety.
Control Assessment / Findings	Internal Controls are Effective.
Recommended Actions	None.
Management Response and Action Plan	None Required.

6 BUSINESS OBJECTIVE: RECEIVING AND DISTRIBUTION

Business Objective	To ensure that process and internal controls for receiving and distribution protect the agency's assets.
Business Risk	<ul style="list-style-type: none"> ➤ Receiving and distribution policies and procedures may not be documented for employees to follow. ➤ Receiving and distribution procedures may not be performed according to policies and could result in loss of assets. ➤ Merchandise receipt and distribution may not be recorded timely or accurately.



6 BUSINESS OBJECTIVE: RECEIVING AND DISTRIBUTION	
	➔ The agency may pay for merchandise not received.
Management Controls in Place	<ul style="list-style-type: none">➔ Documented and formalized policy and procedure for receiving and distribution are in place.➔ The agency tracks inventory receiving and distribution in a database and performs physical count for promotional inventory.➔ Receiving documents are required for invoices to be paid.
Control Tests	<ul style="list-style-type: none">➔ Interviewed key process owners.➔ Reviewed the policy and procedures regarding inventory receiving and distribution process.➔ Visited warehouse and observed inventory receiving and storage. <i>Note: No deliveries were in process during visit. However, controls associated with receiving and distribution were observed during the visit.</i>
Control Assessment / Findings	Internal Controls are Effective.
Recommended Actions	None.
Management Response and Action Plan	None Required.