TEXAS LOTTERY COMMISSION
2016 INTERNAL AUDIT PLAN

As Prepared by

McConnell & Jones LLP

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MJ McCONNELL & JONES LLP
CERTIFIED PUBLIC ACCOUNTANTS

May 28, 2015

The Honorable Greg Abbott, Governor
Members of the Legislative Budget Board
Members of the Sunset Advisory Commission
Mr. John Keel, CPA, State Auditor

Dear Ladies and Gentlemen:

Attached is the 2016 Internal Audit Plan for the Texas Lottery Commission (TLC). This annual audit plan was discussed with the TLC's Commissioners and received approval on May 28, 2015. The annual audit plan will enable the TLC to comply with the Texas Internal Auditing Act, Texas Government Code Chapter 2102 as amended by House Bill 2485 during the 78th Legislature and House Bill 16 during the 83rd Legislature. This annual audit plan will be executed by McConnell & Jones LLP (MJ) in accordance with The Texas Internal Auditing Act, The Institute of Internal Auditors' (IIA) International Standards for the Professional Practice of Internal Auditing, the IIA's Code of Ethics, and Generally Accepted Government Auditing Standards (GAGAS).

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 plan.

Sincerely,

Ira Wayne McConnell

Ira Wayne McConnell, CPA
Partner

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1.0 COMPLIANCE WITH HOUSE BILL 16: PUBLICATION OF AUDIT PLAN AND ANNUAL REPORT ON THE INTERNET

House Bill 16 amended the Texas Internal Auditing Act to require state agencies and institutions of higher education, as defined in the bill, to post agency internal audit plans and internal audit annual reports to the agency's Internet website within 30 days of approval. House Bill 16 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 House Bill 16, MJ will provide the required internal audit plan, internal audit annual report and any other required internal audit information to the Texas Lottery Commission's (TLC) Executive Director who will ensure the information is posted to the TLC's website.

2.0 PURPOSE

The purpose of this report is to communicate the annual risk-based audit plan as approved by the Texas Lottery Commission (TLC) Commissioners on May 28, 2015, the methodology used to develop the annual audit plan, the timing and resource requirements necessary to complete the audit plan, and the communication of audit results and any significant interim changes to the annual audit plan.

The annual audit plan was developed based on changes to the FY2015 internal audit plan, the 3-year audit plan presented for the FY2014 and a prioritization of the audit universe updating the prior years' risk assessment based upon input from the TLC leadership team. Using our risk assessment framework, we identified the organizational sources for potential engagements and auditable activities; examined organizational risk factors; evaluated the proposed engagements; and prioritized the audits based on the risk score and TLC leadership input.

3.0 RISK ASSESSMENT

Risk is defined as the possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood. An organization's risk exposure is determined through the identification of risks and evaluating the impact on operations and likelihood of occurrence.

Risk assessments identify an organization's exposure to business disruptions and barriers to achieving the organization's strategic goals. They serve as a tool to focus limited resources to perform evaluations of controls that are in place to limit the exposure.

In accordance with Texas Internal Auditing Act and The Institute of Internal Auditors (IIA) Standard 2010.A1, this internal audit plan is based on a documented risk assessment and input of the TLC leadership team. 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, policies and procedures, and contracts.

The types of risk exposure relevant to the TLC are:

- *Financial Exposure*: Financial exposure exists whenever an audit area is susceptible to errors or defalcations that affect the general ledger and financial statements or the integrity and safekeeping of agency assets, regardless of the financial statement impact.

- *Compliance Exposure*: Compliance exposure exists whenever an event in an audit area could cause the agency to fail to comply with regulations mandated by state or federal authorities, irrespective of whether financial exposure exists.
- *Information Exposure*: An information exposure exists whenever there is information of a sensitive or confidential nature, which could be altered, destroyed, or misused.
- *Efficiency Exposure*: An efficiency exposure exists whenever agency resources are not being utilized in an effective or efficient manner.
- *Human Resource Exposure*: A human resource exposure exists whenever an area is managing human resources in a way, which is contrary to agency policy.
- *Environmental Exposure*: An environmental exposure exists whenever internal or external factors pose a threat to the stability and efficiency of an audit area. Examples of factors that affect environmental exposure are:
    - Recent changes in key personnel
    - Changing economic conditions
    - Time elapsed since last audit
    - Pressures on management to meet objectives
    - Past audit findings and quality of internal control
- *Public Service Exposure*: A public service exposure exists whenever an event in an audit area could jeopardize existing public services or new public services.
- *Reputational Exposure:* A reputational exposures exists whenever an event in the audit area could jeopardize the reputation of the agency and stakeholder trust.

MJ discussed the risk exposures with the TLC Commissioners and leadership team. We then updated the annual and 3-year audit plan based upon current risks facing TLC operations.

4.0 2016 ANNUAL AUDIT PLAN

MJ will conduct seven audits, follow-up on prior audit findings, update the risk assessment, manage complaints received through the State Auditor's Office (SAO) and the Ethics Line, assist TLC with coordinating external audits and reviews, prepare the 2017 annual audit plan and prepare the 2016 annual audit report in accordance with the Texas Internal Auditing Act. These activities are estimated to require **2,265 hours** for a total annual budget not to exceed $299,829. The planned audits, timing and estimated hours are summarized in the chart below.

2016 Annual Audit Plan Activities

Audit Activity #	Description	Risk Rating	Estimated Timing	Estimated Hours
1	Procure – To – Pay Cycle	Compliance	September 2015 – November 2015	360
2	Entity-Wide Performance Measures	Compliance	December 2015 – January 2016	240
3	Drawing Process	High	January 2016 – March 2016	180
4	Jackpot Estimations	Compliance	January 2016 – March 2016	180
5	Human Resources Life Cycle	Medium	April 2016 – June 2016	320
6	Retailer Management Life Cycle	High	May 2016 – July 2016	425
7	Bingo Restructure and BOSS Implementation Follow-Up	Compliance	July 2016 – August 2016 **	160

Audit Activity #	Description	Risk Rating	Estimated Timing	Estimated Hours
8	Follow-Up on Prior Audit Findings	Compliance	May 2015 – August 2015	100
9	Management of Complaint Lines	Compliance	All Year	40
10	External Audit / Review Assistance	Compliance	All Year	40
11	Update Risk Assessment & Develop 2017 Audit Plan	Compliance	July – August 2014	44
12	2016 Annual Audit Report	Compliance	July – August 2014	16
13	Audit Communications, Committee Meetings, Project Management	N/A	All Year	160
	Total			**2,265**

***Assumes pending legislation to transfer the Charitable Bingo Operations Division (CBOD) to the Texas Department of Licensing & Regulation does not pass. If CBOD is transferred, we will devote the audit hours to performing an additional audit of TLC business processes.*

The following chart is the three-year audit plan which is a result of the risk assessment.

Texas Lottery Commission
Proposed Three Year Audit Plan

Audit Area	Risk Category	Year 1 2016	Year 2 2017	Year 3 2018
Procure – To – Pay Cycle	Medium	✓		
Entity-Wide Performance Measures	Complaince	✓		
Drawing Process	High	✓		
Jackpot Estimations	High	✓		
Human Resources Life Cycle	Medium	✓		
Retailer Management Life Cycle	High	✓		
Bingo Restructure and BOSS Implementation Follow-Up **	Compliance	✓		
Contract Management Life Cycle	Medium		✓	
Instant & Draw Game Life Cycle	High		✓	
Financial Reporting Life Cycle	Medium		✓	
Customer Complaint Process	Medium		✓	

Audit Area	Risk Category	Year 1 2016	Year 2 2017	Year 3 2018
Instant Game Life Cycle	Medium		✓	
Business Continuity / Disaster Recovery	High			✓
Revenue to Receivables Life Cycle	Medium			✓
Charitable Bingo Life Cycle	Compliance			✓
Follow-Up on Prior Audit Findings	Compliance	✓	✓	✓
Ethics Line Management	Compliance	✓	✓	✓
Update Risk Assessment & Develop Annual Audit Plan	Compliance	✓	✓	✓
Annual Audit Report	Complaince	✓	✓	✓
Audit Communications	Complaince	✓	✓	✓

***Assumes pending legislation to transfer the Charitable Bingo Operations Division (CBOD) to the Texas Department of Licensing & Regulation does not pass. If CBOD is transferred, we will devote the audit hours to performing an additional audit of TLC business processes.*

5.0 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 executive management and present these changes to the TLC's Commissioners for review and approval. Notification of significant changes to the Internal Audit Plan approved by the Commissioners will be submitted to the State Auditor's Office.

This annual audit plan was presented to the Commissioners and approved on May 28, 2015.

J. Winston Krause, Chairman