

TEXAS LOTTERY COMMISSION

INTERNAL AUDIT



INTERNAL AUDIT

ANNUAL REPORT

For the Fiscal Year Ended August 31, 2009

IA #10-001

October 2009

Mary Ann Williamson
Chairman

David J. Schenck
Commissioner

J. Winston Krause
Commissioner



TEXAS LOTTERY COMMISSION

Gary Grief, *Deputy Executive Director*

Philip D. Sanderson, *Charitable Bingo Operations Director*

October 31, 2009

Honorable Rick Perry, Governor
Members of the Legislative Budget Board
Members of the Sunset Advisory Commission
Mr. John Keel, CPA, State Auditor
Commissioners of the Texas Lottery Commission
Mr. Gary Grief, Deputy Executive Director
Mr. Phil Sanderson, Charitable Bingo Operations Division Director

Attached is the annual report of the Internal Audit Division of the Texas Lottery Commission. This report fulfills the requirements set forth in the Texas Internal Auditing Act (the Act). As mandated in the Act, the State Auditor's Office prescribes the content. This report has been prepared in accordance with the State Auditor's content requirements.

The work performed by Internal Audit is a key element in assuring accountability, economy, efficiency, and effectiveness within the Texas Lottery Commission operations. The Internal Audit Division is committed to being a trusted, independent and objective resource and providing quality internal auditing services. We will aggressively pursue projects in fiscal year 2010 to continue our assistance to the Texas Lottery Commission in improving controls, reducing risk, and enhancing agency operations.

Please contact me at (512) 344-5488 if you desire further information about the contents of this report or would like to request additional copies.

Sincerely,

A handwritten signature in blue ink, appearing to read "Catherine A. Melvin".

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

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I. Fiscal Year 2009 Internal Audit Activity Plan

For the Period September 2008 – August 2009

	Initial Allocated Hours
<u>Internal Audit Assurance and Consulting/Advisory Activities</u>	
1. Retailer Accounts	800
2. Instant Ticket Game Closing, Returns and Destruction.....	900
3. Lottery Sales Representatives (Oversight of Lottery Operator)	700
4. Administrative Hearing Process.....	250
5. Automated Procurement Process	350
6. Tracking and Applying Contract Sanctions	200
7. Jackpot Estimation Procedures	160
8. Commission Orders Tracking	80
9. Closeout of Fiscal Year 2008 Projects	40
10. Reserved for Special Requests	1,245
<i>SUBTOTAL</i>	<i>4,725</i>
<u>Special Initiatives</u>	
11. Agency Education/Awareness	470
12. Charitable Bingo Audit Services	350
<i>SUBTOTAL</i>	<i>820</i>
<u>Statutorily Required Internal Audit Activities</u>	
13. Auditing Standards and Statutory Requirements	450
14. Coordination of External Audits of the Agency.....	140
<i>SUBTOTAL</i>	<i>590</i>
<u>Administrative Internal Audit Activities</u>	
15. Administration of the Internal Audit Function	300
<i>SUBTOTAL</i>	<i>300</i>
Fiscal Year 2009 TOTAL BUDGETED HOURS	<u>6,435</u>

Fiscal Year 2009 Internal Audit Activity Plan

The Fiscal Year 2009 Internal Audit Activity Plan was approved by the Commissioners in the September 17, 2008 Commission meeting.

Please refer to Sections III, IV and VI which further details the Internal Audit Division's efforts during fiscal year 2009.

Variations from the Activity Plan were as follows:

Administrative Hearing Process - *Postponed to FY2010*

Automated Procurement Process - *Other higher-risk projects took precedence.*

Tracking and Applying Contract Sanctions - *Initial scoping efforts indicated this audit should be considered at a later date based on risk.*

Jackpot Estimation Procedures - *Initiated in late FY2009 - report will be issued in FY2010*

II. External Quality Assurance Review

The Internal Audit Division underwent a comprehensive external quality assurance review in accordance with the Institute of Internal Auditors (IIA) *International Standards for the Professional Practice of Internal Auditing*, the U.S. Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Auditing Act (Texas Gov't. Code Chapter 2102). The review was performed by an independent, qualified reviewer – Mr. Dennis D. O'Neal. The resulting report was issued October 2009.

October 25, 2009

Ms. Catherine Melvin, CIA, CPA
Director of Internal Audit
Texas Lottery Commission
Austin, Texas 78701

Dear Ms. Melvin:

Based on the information received and evaluated during this external quality assurance review, it is my opinion that the Texas Lottery Commission Internal Audit Department fully complies with the Institute of Internal Auditors *International Standards for the Professional Practice of Internal Auditing*, the United States General Accountability Office *Governmental Auditing Standards*, and the Texas Internal Auditing Act (Texas Government Code, Chapter 2102).

This opinion, which is the highest of the three possible ratings, means that the Internal Audit Department has in place structures, policies, procedures and processes that comply with the requirements of the professional standards. The Department is independent and objective and the staff is qualified, proficient, and knowledgeable in the areas they are required to audit. Audits are planned using risk assessment techniques; audit conclusions are supported in the working papers; and findings and recommendations are communicated properly. The Department is also well managed internally.

The Department has effective relationships with the Board and is well respected and supported by management. Interviews conducted during the review indicate that management considers Internal Audit a useful part of overall agency operations and finds that the audit process and report recommendations add value and help improve the agency's operations.

The objective, scope, and methodology of the review, along with recommendations to further improve the Internal Audit Department are attached. I would like to thank you and your staff for your cooperation during this review.

Sincerely,



Dennis D. O'Neal

Attachment

III. List of Audits Completed

Internal Audit conducted the following assurance activities in fiscal year 2009.

Report No.	Report Date	Title	High-Level Objective	Overall Conclusion
09-004	10/28/08	Charitable Bingo Licensing	The purpose of our audit was to evaluate the effectiveness and efficiency of licensing and to evaluate the reliability of ACBS data. We limited our review to the activities related to bingo conductors.	<i>Overall, we found current licensing activities and processes require improvement to ensure licenses are processed effectively, efficiently, and in compliance with the Bingo Enabling Act. In addition, while there are controls built into ACBS to protect the accuracy and reliability of the data regarding prize fee payments, allocations and fundamental license data, opportunities exist to circumvent these controls. Our review disclosed errors in the system which reduces the integrity and reliability of data in ACBS. Specifically, our testing revealed the information contained in the regular licensing ledger is not sufficiently reliable.</i>
09-005	12/11/2008	Background Investigations	The purpose of our audit was to evaluate the effectiveness of controls in place for ensuring policies, procedures and practices are in compliance with statutory requirements; background investigations are conducted in a consistent, efficient, effective, and fair manner; and records are adequately protected from inappropriate disclosure and unauthorized access. Our audit focused on background investigations of Charitable Bingo licensees and workers, lottery sales agents, and prospective and current employees.	<i>Based on the results of our review and testing, Internal Audit found that current procedures and processes do not ensure background investigations are conducted consistently, efficiently, or fairly, nor do they ensure records are adequately protected. In addition, current background investigation efforts sometimes go beyond that which is supported by agency policy or statutory or administrative rule requirements. Internal Audit recommends agency management strengthen policies, procedures and practices to improve controls over background investigations.</i>

Texas Lottery Commission
Internal Audit Annual Report for Fiscal Year 2009

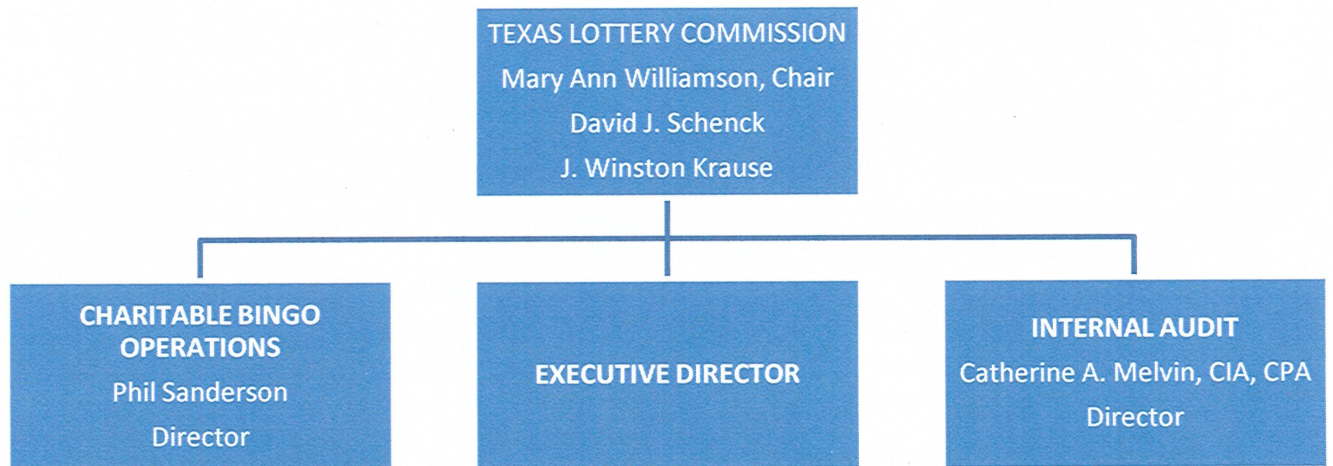
Report No.	Report Date	Title	High-Level Objective	Overall Conclusion
09-013	02/04/2009	Instant Ticket Game Closing, Return and Destruction	<p>The objective of this audit was to assess the effectiveness of controls for ensuring instant ticket games for which all top level prizes have been claimed are:</p> <ul style="list-style-type: none"> • Closed in accordance with commission policies and procedures, and • Tickets are returned and destroyed in accordance with the lottery operator contract and commission policies and procedures. 	<p>Based on the results of our review and testing, controls provide reasonable assurance that instant ticket games in which all top level prizes have been claimed are closed, and tickets are returned and destroyed in accordance with commission policies and procedures. In addition, we present management recommendations to strengthen the current processes.</p>
09-020	10/01/2009	Retailer Accounts	<p>The objective of this audit was to evaluate the adequacy and effectiveness of internal controls for ensuring accurate and efficient retailer collections and adjustments. A secondary objective was to evaluate the tools in place to protect the State from monetary loss in the event of retailer non-payment.</p>	<p>Overall, based on the results of our review and testing, controls provide reasonable assurance that the retailer sweep is performed accurately, retailer adjustments are made accurately and in accordance with agency policies and procedures, and the collection of non-sufficient funds (NSFs) is performed in a timely manner. We present management recommendations to strengthen controls and improve current processes. Additionally, opportunities may exist to further manage and minimize the State's risk of loss.</p>
09-021	10/01/2009	Lottery Sales Representatives Program	<p>The objective of our engagement was to gather information about GTECH Texas LSR activities and oversight, and present this information for TLC management's consideration. As part of our review, we reviewed the administration and management of the LSR program.</p>	<p>Overall, we found Lottery Sales Representatives play an important role in the success of the Texas Lottery Commission. The LSRs have a wide range of responsibilities serving over 16,000 retailers across the state of Texas. Accordingly, they face several challenges in the performance of these responsibilities, including balancing customer service with proper controls.</p> <p>We have provided agency management with further details regarding the information provided here in this report. In order to protect confidential and/or proprietary information, those details are accordingly not included in this report.</p>

IV. List of Consulting Engagements and Non-audit Services Completed

Internal Audit participated in various agency committees or workgroups during fiscal year 2008, and provided ongoing consultative assistance to management. Our participation and services were limited to an advisory basis only; ensuring both auditor independence and objectivity were not compromised.

Project #	Engagement	Work Performed
09-008	RFP - Lottery Operator Contract Compliance	Participated on RFP committee to evaluate submitted proposals to provide contract compliance review services.
09-011	TLC Data Security Breach	Provided assistance to the Comptroller of Public Accounts in their review of a data security breach.
09-014	Agency Education/Awareness Initiative	Proactively focused efforts on educating and assisting agency management and employees regarding control activities. Internal Audit participated in key agency initiatives to assist in the consideration of risks and associated controls during process discussions.
09-003	Charitable Bingo Audit Services Consultative Assistance	Provided ongoing consultative and advisory assistance to the Charitable Bingo Operations Division Audit Services function.
09-027	Bingo Audit Manager	Provided consultative assistance to the Charitable Bingo Operations Division Director in the posting and selection process for the Bingo Audit Manager position.
09-028	Internet Submission of Second Chance Drawings	Assisted management in the consideration of appropriate controls over the proposed Internet-submission of second chance drawings.
Misc	Other Management Workgroups and Assistance	Provided miscellaneous consultative and advisory assistance to TLC management and staff. Participated in other management workgroups focused on various initiatives and concerns of the agency.

V. Organizational Chart



VI. Report on Other Internal Audit Activities

Activity	Work Performed
Coordination of External Audits and Reviews of TLC <ul style="list-style-type: none"> • Annual Financial Audit (Maxwell Locke & Ritter, LLP) • Agreed Upon Procedures for Mega Millions (Maxwell Locke & Ritter, LLP) • Request for Status of Prior Audit Recommendations (State Auditor's Office) • Biennial Security Study (Mir-Fox & Rodriguez, P.C.) • Comptroller Post-Payment Audit 	<p>Provided coordination, liaison assistance, and represented TLC's interests.</p> <p>Requested delegation of authority to procure audit or audit-related services for services specified under Section VIII of this report.</p>
Coordination of Audits and Reviews of Vendors <ul style="list-style-type: none"> • GTECH - GTECH SAS 70 (Deloitte) • GTECH - Contract Compliance (Grant Thornton) 	<p>Provided coordination, liaison assistance, and represented TLC's interests.</p>
Legislative Session	<p>Performed bill analysis and provided additional information, research, and assistance during the 81st Legislative Session.</p>
Ethics Point	<p>EthicsPoint is a phone and Internet-based reporting system that provides employees an additional avenue to report concerns about possible misconduct, fraud or other issues in the workplace. Internal Audit serves as administrator for the system and intakes all complaints which come through EthicsPoint.</p>
Other Complaints	<p>Internal Audit received and assisted or forwarded complaints for appropriate disposition.</p>
Continuing Professional Education	<p>Each professional member of the Internal Audit Division is required by professional standards to earn a minimum of 80 hours of continuing professional education every two years with at least 24 of the 80 hours in subjects directly related to government auditing or the industry the agency operates. Division members exceeded those minimum requirements.</p> <p>Internal Audit staff achieved certification as Certified Internal Controls Auditors (CICA).</p>
Internal Audit Community	<p>Participated as an active member in State Agency Internal Audit Forum (SAIAF).</p> <p>Served as chair of the SAIAF Legislative Subcommittee.</p> <p>Participated as active members in the Austin Chapter of the Institute of Internal Auditors.</p> <p>Mentored and sponsored a group of University of Texas students in their IT Audit class project.</p>

Activity	Work Performed
Gaming Audit Community	<p>Participated as active members in the North American Association of State and Provincial Lotteries (NASPL) Internal Audit Subcommittee.</p> <p>Kept abreast of current lottery industry issues.</p>
Open Records Requests	<p>Responded to various requests for information in conformance with the Texas Public Information Act.</p>
Administration of the Internal Audit Function	<p>Various activities were performed related to the general administration of the Internal Audit Function. These included the following:</p> <ul style="list-style-type: none"> • Provided reports to the TLC Commission and agency management. • Prepared the Internal Audit Annual Report. • Developed the Annual Internal Audit and Activity Plan based on an agency risk assessment. • Prepared updated charter signed July 2009 • Underwent mandatory external quality assurance review. • Managed contracts administered by the Internal Audit Division: <ul style="list-style-type: none"> • <u>TeamMate</u> – automated working paper application • <u>EthicsPoint</u> – phone and Internet-based reporting system • <u>Biennial Security Study</u> • <u>Annual Financial Audit and MegaMillions Agreed-Upon Procedures Engagement</u>

VII. Internal Audit Activity Plan for Fiscal Year 2010

For the Period September 2009 – August 2010
This plan was approved in the October 2, 2009 Commission meeting.

	Initial Allocated Hours
<u>Internal Audit Assurance and Consulting/Advisory Activities</u>	
1. Claim Center Prize Validation Process	2100
2. Lottery Retailer Licensing Process	1200
3. Administrative Hearings Process	1050
4. Closeout of Fiscal Year 2009 Projects	105
5. Reserved for Special Requests	1,100
SUBTOTAL	<u>5,555</u>
<u>Statutorily Required Internal Audit Activities</u>	
6. Auditing Standards and Statutory Requirements	450
7. Coordination of External Audits of the Agency	160
SUBTOTAL	<u>610</u>
<u>Administrative Internal Audit Activities</u>	
8. Administration of the Internal Audit Function	300
SUBTOTAL	<u>300</u>
Fiscal Year 2010 TOTAL BUDGETED HOURS	<u>6,465</u>

VIII. External Audit Services

The following represent external audit services that were procured by the Texas Lottery Commission or were ongoing in fiscal year 2009.

Audit/Review	Auditor
Drawings Audit	Davila Buschhorn & Associates
FY08 Annual Financial Audit	Maxwell Locke and Ritter LLP
FY08 Mega Millions Agreed Upon Procedures	Maxwell Locke and Ritter LLP
FY09 Annual Financial Audit	Maxwell Locke and Ritter LLP
FY09 Mega Millions Agreed Upon Procedures	Maxwell Locke and Ritter LLP
Biennial Security Study	Mir-Fox & Rodriguez, P.C.

IX. Reporting Suspected Fraud and Abuse

Actions taken to implement the requirements of:

- 1) **Fraud Reporting.** Article IX, Section 17.05, the General Appropriations Act (81st Legislature).

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

- 2) **Reporting Requirements.** Article XII, Section 5(c), the General Appropriations Act (81st Legislature).

This provision is not applicable to the Texas Lottery Commission as the agency does not receive funds as a result of the American Recovery and Reinvestment Act.

- 3) **Texas Government Code, Section 321.022.**

The Texas Lottery Commission reports incidents as required under Texas Government Code, Section 321.022.

STATE OF TEXAS
TEXAS LOTTERY COMMISSION

INTERNAL AUDIT

INTERNAL AUDIT ANNUAL REPORT
For the Fiscal Year Ended August 31, 2009

IA #10-001

OCTOBER 2009

This report has been provided to the following:

Ms. Mary Ann Williamson, Chair
Mr. David J. Schenck, Commissioner
Mr. J. Winston Krause, Commissioner

Mr. Gary Grief, Deputy Executive Director
Mr. Phil Sanderson, Charitable Bingo Operations Division Director

**This report is also provided to the following for appropriate distribution in accordance
with Government Code 2102.009:**

Ms. Mary Katherine Stout, Director, Governor's Office of Budget, Planning and Policy
Mr. John O'Brien, Director, Legislative Budget Board
Mr. Ken Levine, Interim Director, Sunset Advisory Commission
Mr. John Keel, CPA, State Auditor