TEXAS LOTTERY COMMISSION

INTERNAL AUDIT

INTERNAL AUDIT ANNUAL REPORT

For the Fiscal Year Ended August 31, 2011

IA #12-001

October 2011

Mary Ann Williamson
Chairman

J. Winston Krause
Commissioner

Cynthia Tauss Delgado
Commissioner

TEXAS LOTTERY COMMISSION

Gary Grief, *Executive Director*

Philip D. Sanderson, *Charitable Bingo Operations Director*

October 31, 2011

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, 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 and is current through October 31, 2011.

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 2012 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,

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

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I. Fiscal Year 2011 Internal Audit Activity Plan

For the Period September 2010 – August 2011

	Initial Allocated Hours
Internal Audit Assurance and Consulting/Advisory Activities	
1. Lottery Retailer Licensing Process	1,200
2. Transfers to the State	1,000
3. Sales Performance Incentive Program	600
4. Financial Review	400
5. Closeout of Fiscal Year 2010 Projects	100
6. Reserved for Special Requests	2,200
SUBTOTAL	***5,500***
Statutorily Required Internal Audit Activities	
7. Auditing Standards and Statutory Requirements	450
8. Coordination of External Audits of the Agency	163
SUBTOTAL	***610***
Administrative Internal Audit Activities	
9. Administration of the Internal Audit Function	300
SUBTOTAL	***300***
Fiscal Year 2011 TOTAL BUDGETED HOURS	**6,413**[1]

[1] See supporting calculations in Appendix 1.

Fiscal Year 2011 Internal Audit Activity Plan

The Fiscal Year 2011 Internal Audit Activity Plan was approved by the Commissioners in the September 10, 2010 Commission meeting.

Please refer to Sections II, III and V which further details the Internal Audit Division's efforts during fiscal year 2011.

Variations from the Activity Plan were as follows:

Transfers to the State – *Review has been postponed until FY 2012.*

II. List of Audits Completed

Internal Audit conducted the following assurance activities in fiscal year 2011.

Report No.	Report Date	Title	High-Level Objective	Overall Conclusion
11-004		Claim Center Prize Validations	The purpose of the audit was to evaluate the adequacy and effectiveness of the system of internal control and the quality of performance in carrying out assigned responsibilities related to the payment of prizes by Texas Lottery Commission Field Office Claim Centers (Claim Centers). Accordingly, our audit focused on prizes paid up to $1 million. We evaluated processes designed to ensure the following: 1) reliability and integrity of information, 2) compliance with applicable requirements, 3) safeguarding of assets, 4) economical and efficient use of resources, and 5) accomplishment of goals and objectives. Specifically, we examined processes and controls designed to ensure accurate validation of tickets, proper verification of winners, accurate, appropriate, and timely payment of prizes, and excellent customer service.	*Overall, based on the results of our review, controls provide reasonable assurance that claims paid by TLC Claim Center staff are paid accurately, timely, and appropriately. In addition, Claim Center staff efforts are consistent with management's goals and objectives to provide excellent customer service.*

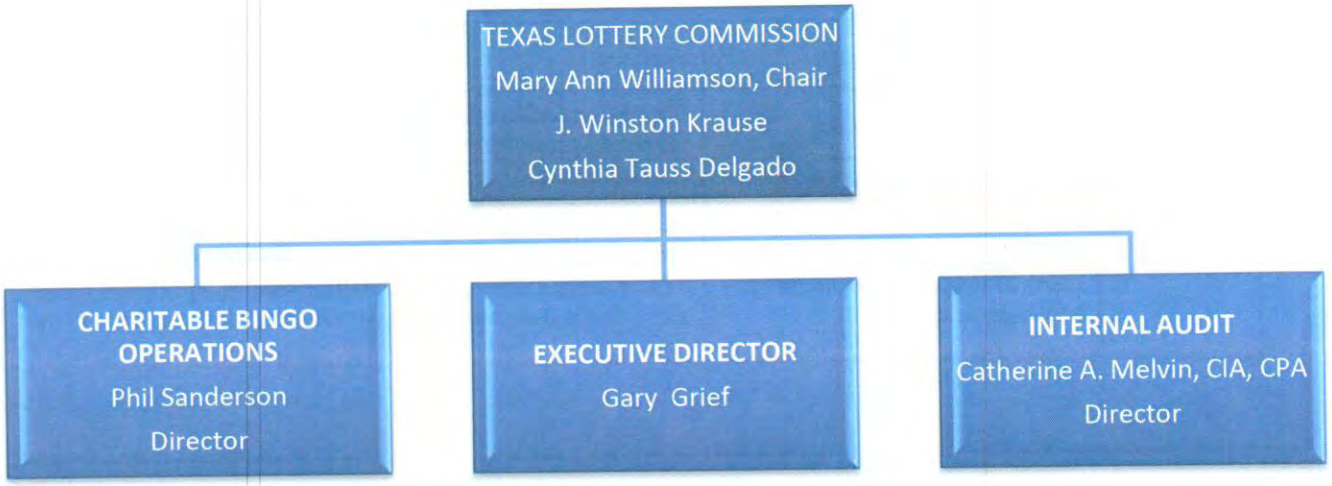
Report No.	Report Date	Title	High-Level Objective	Overall Conclusion
11-012	8/31/2011	Retailer Licensing	The purpose of the audit was to evaluate the adequacy and effectiveness of the system of internal control and the quality of performance in carrying out assigned responsibilities related to retailer licensing. Specifically, we examined processes and controls (1) to determine if the licensing process ensures only eligible applicants are granted a license and the process affords fairness and consistency to all applicants, (2) to determine if the licensing process is streamlined for both the applicant and the agency, and (3) to evaluate the controls over the receipt and recording of application fees.	1. *To determine if the licensing process ensures only eligible applicants are granted a new license and the process affords fairness and consistency to all applicants.* ***Overall, we found the current system of internal control over retailer licensing requires improvements to better ensure only eligible applicants are granted a new license and the process affords fairness and consistency to all applicants.*** 2. *To determine if the licensing process is streamlined for both the applicant and the agency.* ***Overall, we found the licensing process is streamlined for the applicant. However, we identified opportunities to improve agency licensing processes.*** 3. *To evaluate the controls over the receipt and recording of application fees.* ***Overall, we found adequate and effective controls over the receipt and recording of application fees. However, additional analysis is needed to ensure application fees cover the processing costs incurred as required by the State Lottery Act. In addition, the agency is not refunding the bond fee for all denied applicants in accordance with the State Lottery Act.***

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

Internal Audit participated in various agency committees or workgroups during fiscal year 2010, 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
11-005	GTECH Validation Issue	Coordinated efforts and represented the agency's interests regarding assessment of instant ticket validation issues.
11-018	Human Resources Assistance – Records Management	
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.

IV. Organizational Chart



V. Report on Other Internal Audit Activities

Activity	Work Performed
Managed Contracts for Audit/Review Services • Biennial Security Study	Managed and administered contract for the statutorily required biennial security study.
• Annual Financial Audit & Mega Millions Agreed Upon Procedures	Managed and administered contract for required annual financial audit and agreed upon procedures engagements.
Coordination of External Audits and Reviews of TLC • Annual Financial Audit (Maxwell Locke & Ritter, LLP) • Agreed Upon Procedures for Mega Millions (Maxwell Locke & Ritter, LLP) • Agreed Upon Procedures for Powerball (Maxwell Locke & Ritter, LLP) • Agreed Upon Procedures for Power Play (Maxwell Locke & Ritter, LLP) • Request for Status of Prior Audit Recommendations (State Auditor's Office) • Compliance with Historically Underutilized Business Requirements (State Auditor's Office) • Biennial Security Study (Grant Thornton)	Provided coordination, liaison assistance, and represented TLC's interests. Requested delegation of authority to procure audit or audit-related services for services specified under Section VIII of this report.
Coordination of Audits and Reviews of Vendors • GTECH - SAS 70 (Deloitte) • GTECH – SSAE 16 (Deloitte) • GTECH - Contract Compliance (Grant Thornton) • Scientific Games – Second Chance Drawings (Ernst & Young)	Provided coordination, liaison assistance, and represented TLC's interests.
Ethics Point	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.
Other Complaints	Internal Audit received and assisted or forwarded complaints for appropriate disposition.

Activity	Work Performed
Continuing Professional Education	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.
Internal Audit Community	Participated as an active member in State Agency Internal Audit Forum (SAIAF). Served as chair of the SAIAF Legislative Subcommittee. Participated as active members in the Austin Chapter of the Institute of Internal Auditors, Association of Government Accountants, Association of Certified Fraud Examiners, Information Systems And Control Auditors, among other professional groups.
Gaming Audit Community	Participated as active members in the North American Association of State and Provincial Lotteries (NASPL) Internal Audit Subcommittee. Assisted in providing information and feedback to other lotteries upon request. Kept abreast of current lottery industry issues.
Open Records Requests	Responded to various requests for information in conformance with the Texas Public Information Act.

Activity	Work Performed

Administration of the Internal Audit Function	Various activities were performed related to the general administration of the Internal Audit Function. These included the following:
	• 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.
	• Managed contracts administered by the Internal Audit Division:
	  • TeamMate – automated working paper application
	  • EthicsPoint – phone and Internet-based reporting system
	  • Biennial Security Study
	  • Annual Financial Audit and Mega Millions Agreed-Upon Procedures Engagement
	• Filled vacant Internal Audit staff position – posted vacant position, screened applicants, interviewed candidates, and hired an individual.

VI. Internal Audit Activity Plan for Fiscal Year 2012

For the Period September 2011 – August 2012

This plan was approved in the October 19, 2011 Commission meeting.

	Initial Allocated Hours
Internal Audit Assurance and Consulting/Advisory Activities	
1. Transfers to the State	900
2. Financial Review	500
3. Follow Up Audits of Previously Conducted Audit Work	900
4. Agency Awareness	330
5. Closeout of Fiscal Year 2011 Projects	380
6. Reserved for Special Requests	2,335
SUBTOTAL	***5,015***
Statutorily Required Internal Audit Activities	
7. Auditing Standards and Statutory Requirements	680
8. Coordination of External Audits of the Agency	330
SUBTOTAL	***1010***
Administrative Internal Audit Activities	
9. Administration of the Internal Audit Function	300
SUBTOTAL	***300***
Fiscal Year 2012 TOTAL BUDGETED HOURS	**6,325**[2]

[2] See supporting calculations in Appendix 1.

VII. External Audit Services

The following represent external audit services that were procured by the Texas Lottery Commission or were ongoing in fiscal year 2011.

Audit/Review	Auditor
Drawings Audit	Davila Buschhorn & Associates
FY10 Annual Financial Audit	Maxwell Locke and Ritter LLP
FY10 Mega Millions Agreed Upon Procedures	Maxwell Locke and Ritter LLP
FY11 Annual Financial Audit	Maxwell Locke and Ritter LLP
FY11 Mega Millions Agreed Upon Procedures	Maxwell Locke and Ritter LLP
FY11 Powerball Agreed Upon Procedures	Maxwell Locke and Ritter LLP
FY11 Power Play Agreed Upon Procedures	Maxwell Locke and Ritter LLP
Biennial Security Study	Grant Thornton LLP

VIII. 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 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
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This report has been provided to the following:

Ms. Mary Ann Williamson, Chair
Mr. J. Winston Krause, Commissioner
Ms. Cynthia Tauss Delgado, Commissioner

Mr. Gary Grief, 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:

Mr. Jonathan Hurst, Director, Governor's Office of Budget, Planning and Policy
Mr. John O'Brien, Director, Legislative Budget Board
Mr. Ken Levine, Director, Sunset Advisory Commission
Mr. John Keel, CPA, State Auditor