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McCONNELL & JONES LLP
CERTIFIED PUBLIC ACCOUNTANTS

INTERNAL AUDIT SERVICES

Texas Lottery

STATUS REPORT TO THE COMMISSIONERS

APRIL 6, 2017

INFORMATION ITEM – NO ACTION REQUIRED

Internal Audit Activities This Period

Internal Audit Services' activities during this period (February 1, 2017 through March 15, 2017) include:

- Drafted CBOD audit process report
- Completed the retailer management audit
- Completed planning for the following audits:
  - Time and Attendance
  - Active Directory
  - Second Chance Drawings

Fiscal Year 2017 Internal Audit Plan Status

Activity #	Audit	Planning	Fieldwork	Draft Report	Mgmt. Comments	Final Report	Issued
1	Scratch Ticket Warehouse Receiving Controls	Completed	Completed	Completed	Completed	Completed	
2	Scratch Ticket Pack Reconstruction	Completed	Completed	Completed	Completed	Completed	
3	Bingo Audit Processes	Completed	Completed	Completed	Completed	Completed	
4	Enforcement - Background Check and Investigation Processes	Completed	Completed	Completed	In-Progress		
5	Retailer Management	Completed	Completed	Completed	In-Progress		
6	Fraud Awareness Training	Completed	Completed	N/A	N/A	N/A	N/A
7	Time and Attendance	Completed					
8	Second Chance Drawing Process	In-Progress					
9	Crisis Management Plan	In-Progress					
10	Active Directory Audit	In-Progress					
11	Jackpot Estimation System	Not Started					

Legend: Not Started In-Progress Completed Continuous

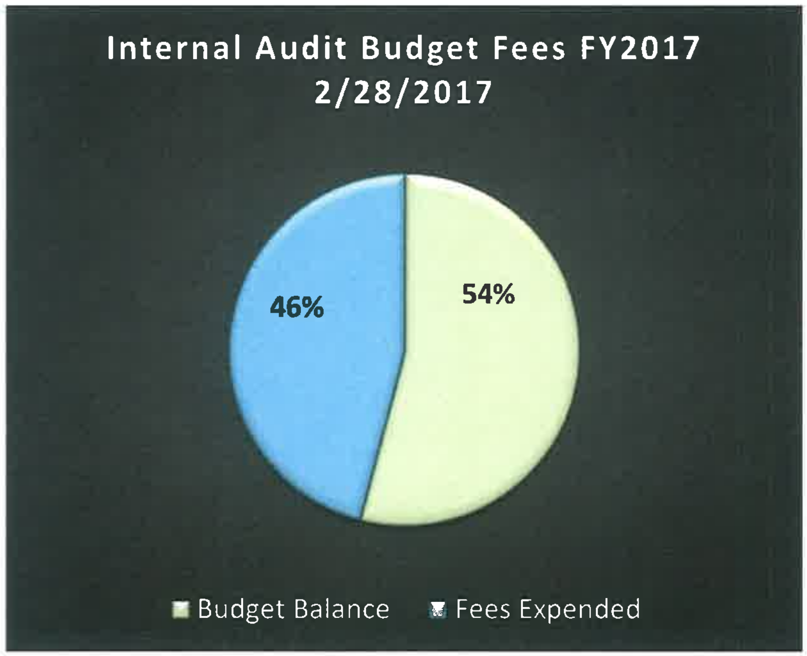
Fiscal Year 2017 Internal Audit Plan Status Cont'd

Activity #	Audit	Planning	Fieldwork	Draft Report	Mgmt. Comments	Final Report	Issued
12	Scratch Ticket Working Paper Workflow System	Not Started					
13	Follow-Up On Prior Audit Findings	Continuous	Continuous	Continuous	Continuous	Continuous	Continuous
14	Monitor of Fraud/Complaint Hotlines Lines	Continuous	Continuous	Continuous	Continuous	Continuous	Continuous
15	External Audit / Review Assistance	Continuous	Continuous	Continuous	Continuous	Continuous	Continuous
16	Update Risk Assessment & Develop 2018 Audit Plan	Not Started					
17	Annual Audit Report	Not Started					

Legend: Not Started In-Progress Completed Continuous

FY2016 Internal Audit Budget as of February 28, 2017

MJ is cognizant of the importance of managing the approved hours and budget. As such we are diligent about staying within the estimated hours per audit and activity. There may be instances where audits/activities are over or under estimated hours and we will adjust the audit plan budget accordingly to stay within the total approved budget.



Anticipated Activities Next Period

- **Begin:**
  - Crisis management audit
  - Time and attendance audit
  - Active Directory Audit

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INTERNAL AUDIT SERVICES

TEXAS LOTTERY

AUDIT REPORT SUMMARY

APRIL 6, 2017

ACTION ITEM

-TEXAS- LOTTERY

Scratch Ticket Warehouse Receiving Controls Audit

Audit	Audit Rating	Number of Observations
17-001 Scratch Ticket Warehouse Receiving Controls	Effective	0

Internal controls over the agency's scratch ticket warehouse receiving function and process are effective and working as intended.

Processes Reviewed:

- Shipping Notifications
- Transportation Security
- Receiving
- Inspection

Key Agency Risks:

- Compromised security of scratch tickets during transportation between scratch ticket manufacturer and the Texas Lottery Commission's warehouse.
- Undetected tampering of scratch ticket shipping container.
- Introduction of contraband into scratch ticket transportation containers.

Conclusion:

We believe that both the scratch ticket manufacturing vendors and the Texas Lottery Commission have adequate controls in place to ensure that scratch tickets are transported in a secure manner and that controls are in place to ensure that contraband of any nature is not able to be introduced into the transportation vehicle without the vehicle's security breach being identified by TLC upon delivery.

Additionally, suppliers printing scratch tickets in facilities outside of the United States borders hold high level transportation certifications issued by the United States Department of Homeland Security. The certifications add an additional layer of security for transporting scratch tickets across borders.

Scratch Ticket Warehouse Receiving Controls Audit

Audit	Audit Rating	Number of Observations
17-002 Scratch Ticket reconstruction Controls	Effective	0

Internal controls over the agency's scratch ticket reconstruction function and process are effective and working as intended.

Processes Reviewed:

- Scratch ticket reconstruction requests
- Scratch ticket reconstruction security
- Scratch ticket reconstruction usage
- Scratch ticket reconstruction reconciliation

Key Agency Risks:

- Unauthorized reconstruction requests submitted to scratch ticket manufacturers.
- Employees obtaining scratch ticket reconstruction information for malicious intent to achieve personal gain.
- Missing or stolen reconstruction data or tickets and financial loss.

Conclusion:

We believe that the Texas Lottery Commission has adequate controls in place to ensure that scratch tickets reconstruction requests are stringently controlled, authorized, monitored and accounted for to prevent malfeasance or loss.

CBOD Audit Services Review

Purpose:

CBOD's Director requested internal audit to assess Charitable Bingo Operations Division (CBOD) Audit Services' audit processes for improvement opportunities.

Six Questions:

1. What are the root causes leading to lengthy audit completion times?
2. How can we change the customer and license holders' perception of the Audit Services Department and processes?
3. How can we improve audit transparency?
4. What audit processes can be enhanced or eliminated?
5. How can the audit procedures be organized to be more efficient?
6. Is the Audit Services Department appropriately staffed?

Assessment Procedures:

- Gained an understanding of Bingo Audit Services processes from risk assessment and audit planning to audit steps and reporting.
- Mapped the Bingo Enabling Act and Administrative Rule requirements to Bingo Audit Services audit procedures.
- Observed audit entrance and exit conferences.
- Observed a game inspection.
- Observed bingo operations at a bingo hall.
- Reviewed Bingo Audit Services forms and workpaper templates.

CBOD Audit Services Review Cont'd

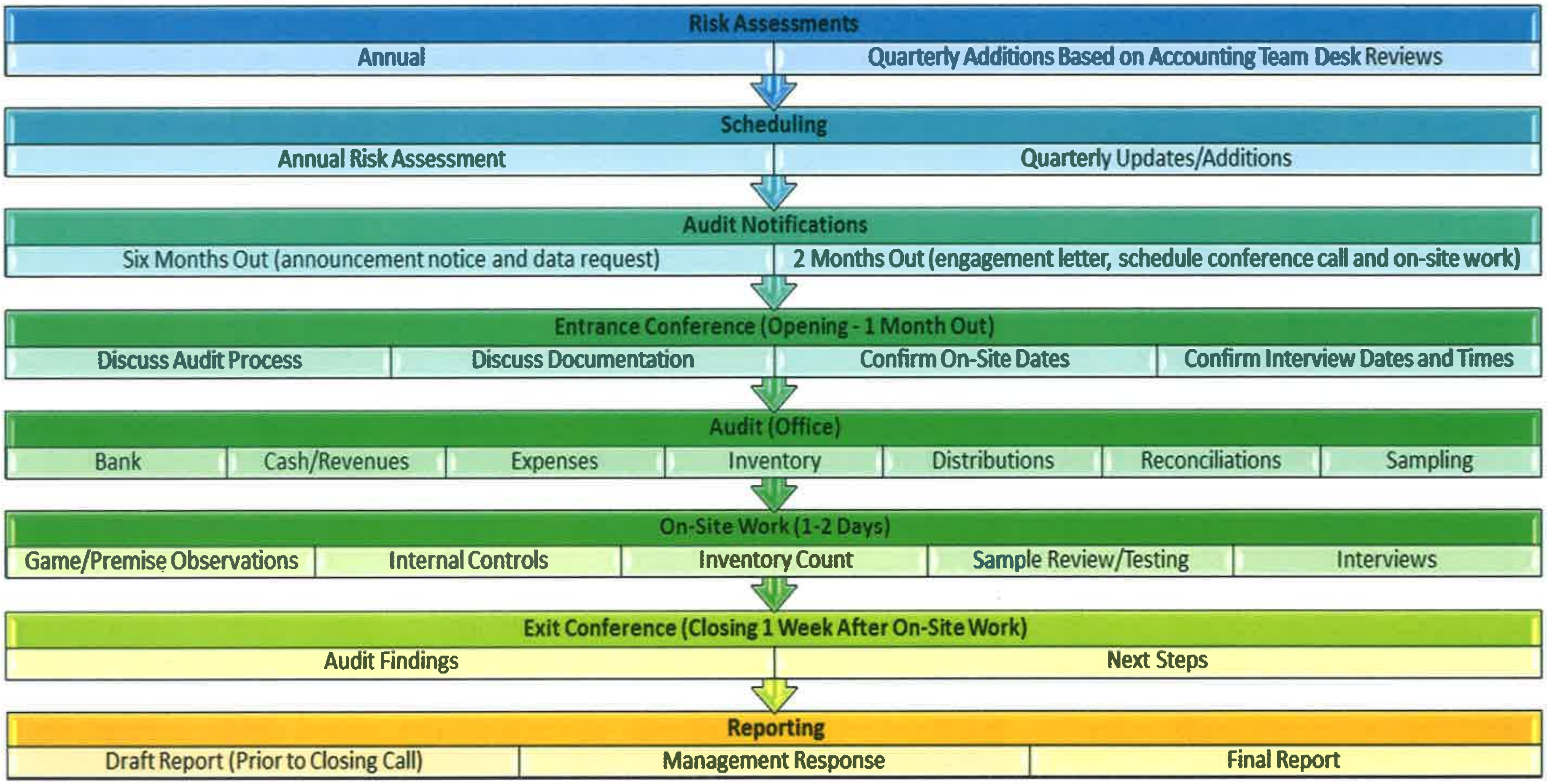
Conclusion:

Bingo Audit Services audit steps are effective to ensure license holder compliance with the BEA and Administrative Rules. However, there are opportunities to improve license holder and charitable organization's perceptions of the audit function, expand the number of audits performed, increase efficiencies and shorten the audit completion times. Incorporating organizational change management concepts and principals into implementing these recommendations is crucial to the acceptance of changes and long-term success.

Recommendations:

1. Restructure audit process from the risk assessment to planning, audit and reporting.
2. Establish processes to improve perceptions, provide guidance or examples to organizations and obtain feedback from auditees.
3. Revise audit processes to issue an audit notification letter at least six months in advance of the scheduled audit.
4. Obtain data analytics software to facilitate the data analysis and identify potential anomalies. Require license holders to submit documentation and records electronically in advance of the audit's on-site activities.
5. Organize the working paper audit steps into the following self-contained components to minimize overlap.
6. Refine the CBOD Audit Services staffing model to reflect revised audit processes, redefine staff roles and responsibilities and add a Sr. Lead/scheduler and Sr. auditor positions.

Proposed CBOD Audit Process



MJ McConnell & Jones LLP

Action

Internal Audit requests your approval of the following audit reports:

1. Scratch Ticket Warehouse Receiving Controls
2. Scratch Ticket Reconstruction Controls
3. CBOD Bingo Audit Services Review