



McCONNELL & JONES LLP
CERTIFIED PUBLIC ACCOUNTANTS



**TEXAS LOTTERY COMMISSION
INTERNAL AUDIT
FY2013 ANNUAL REPORT
AMENDED**





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February 2, 2014

The Honorable Rick Perry, 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 amended 2013 Internal Audit Report for the Texas Lottery Commission (TLC). This annual audit report is submitted in accordance with the Texas Internal Auditing Act requirement for state agency internal auditors to prepare and distribute an annual report (Government Code, Chapter 2102). The annual audit plan related to this 2013 Internal Audit Report was conducted by the former internal audit division of the TLC. McConnell & Jones LLP (MJ) was engaged on January 1, 2014 to provide internal audit services to the TLC in accordance with The Texas Internal Auditing Act. Pursuant to the Request for Proposals (RFP) issued October 22, 2013, MJ submits this amended internal audit annual report for fiscal year 2013 based on work performed by the Texas Lottery's former internal auditor.

Please contact Odysseus Lanier at 713.968.1603 or Gary Grief at 512.344.5160 if you should have any questions about this audit report.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Odysseus Lanier'.

Odysseus Lanier, CPA
Partner



I. 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, McConnell & Jones LLP (MJ) will ensure the required internal audit plan, internal audit annual report and any other required internal audit information is provided to the Texas Lottery Commission (TLC) for posting to their website.



II. INTERNAL AUDIT PLAN FOR FISCAL YEAR 2013

The following annual audit plan was prepared by the Texas Lottery Commission’s (TLC) former Internal Audit Division and approved by the TLC commissioners on November 8, 2012.

Texas Lottery Commission Internal Audit Division Fiscal Year 2013 Internal Audit Activity Plan	
Fiscal Year 2013 Internal Audit Activity Plan	
For the Period September 2012 – August 2013	
	Initial Allocated Hours
Internal Audit Assurance and Consulting/Advisory Activities	
1. Development and Approval of Instant Games	1,000
2. Internet Entry Promotional Second Chance Drawings	800
3. Promotional Instant Ticket Reconciliation	780
4. Administrative Hearings Process	300
5. Lottery Gaming System	300
6. Closeout of FY 2012 Projects	500
7. Reserved for Special Requests	1,450
<i>SUBTOTAL</i>	<u>5,130</u>
Mandatory Internal Audit Activities	
8. Coordinate External Audits/Reviews	300
9. Quality Assurance Review	200
10. Continuing Professional Education	160
11. Development of the Fiscal Year 2014 Internal Audit Activity Plan	250
<i>SUBTOTAL</i>	<u>910</u>
Administrative Internal Audit Activities	
12. Service to the Profession	40
13. Administration of the Internal Audit Function	660
<i>SUBTOTAL</i>	<u>700</u>
Fiscal Year 2013 TOTAL BUDGETED HOURS	<u>6,740</u>



Texas Lottery Commission
Internal Audit Division
Fiscal Year 2013 Internal Audit Activity Plan

Discussion of Proposed Engagements, Initiatives, and Activities

NOTE: The below represents an initial discussion and some preliminary scoping of proposed Internal Audit projects for Fiscal Year 2013. However, the actual scope will be determined at the time the planned project is commenced, and may differ from the below discussion based on an assessment of risk at that time.

Internal Audit Assurance and Consulting/Advisory Activities

- 1. Development and Approval of Instant Games:** Almost seventy-five percent of TLC's revenues are generated by instant ticket sales. Approximately one hundred new instant ticket games are introduced by the Lottery Operations division each fiscal year. Internal Audit will evaluate processes and controls on the front end of the instant games process – reviewing the development and approval of instant ticket games prior to the release of a game for sale to the public.
- 2. Internet Entry Promotional Second-Chance Drawings:** The agency recently moved to internet entry for promotional second-chance drawings. Internal Audit intends to evaluate the adequacy and effectiveness of internal controls over these drawings. Internal Audit will consider any work performed during the agency's biennial security study so as not to duplicate audit efforts.
- 3. Promotional Instant Ticket Reconciliation:** Promotional instant game tickets are active tickets utilized in functions or events at which the Texas Lottery is being promoted. Agency staff must maintain and reconcile records related to the request, delivery, use, and any return of such tickets. Internal Audit will examine processes to ensure the accounting and safekeeping of the promotional tickets.
- 4. Administrative Hearings Process:** This is a key control process which has significant impact for our agency in regulatory matters. Internal Audit will examine the Administrative Hearings process to ensure its effectiveness and efficiency, while reviewing existing statutes and rules for compliance. Given the extensive nature of this process, Internal Audit will begin audit work in FY13, with the bulk of the work being completed in FY14.
- 5. Lottery Gaming System:** The implementation of the new lottery gaming system, ES, was a significant change for the agency. Rather than traditional audit/assurance work, Internal Audit intends to focus on more of a consultative/advisory role in FY2013 since the system is still early in implementation. Further, review of certain elements of the new system is currently being performed as components of both the biennial security study and the financial audit.
- 6. Closeout of Fiscal Year 2012 Projects:** Hours are allocated to complete outstanding fiscal year 2012 Internal Audit projects.
- 7. Reserved for Special Projects and Requests:** Hours are allocated for unanticipated and special project requests for Internal Audit assistance that arise throughout the year so that the division can be responsive to the immediate needs of the Commissioners and management. Allocated hours represent approximately 20% of total budgeted hours. Hours included here are also allocated for Internal Audit to proactively focus efforts on assisting agency management and employees regarding control activities. Internal Audit can assist in the consideration of risks and associated controls during process discussions.

Mandatory Internal Audit Activities

- 8. Coordinate External Audits/Reviews:** The Internal Audit Division serves as a liaison for all external audits/reviews of the agency. Internal Audit also monitors external audits/reviews of certain prime vendors of the agency.
- 9. Quality Assurance Review:** In accordance with the Texas Internal Auditing Act (Gov't Code Chapter 2102) and our professional standards, the internal audit function is required to undergo a periodic quality assurance review. The objective of this review is to determine whether the function is in compliance with applicable standards and the Texas Internal Auditing Act.



Texas Lottery Commission
Internal Audit Division
Fiscal Year 2013 Internal Audit Activity Plan

10. Continuing Professional Education: Professional standards require internal auditors to obtain 40 hours of continuing professional education yearly.

11. Development of the Fiscal Year 2014 Internal Audit Activity Plan: The Internal Audit Director is required to establish plans to carry out the responsibilities of the internal auditing department. An effective plan allocates internal audit resources to the most critical areas of the agency needing independent review. Integral to this process is the performance of an agency-wide risk assessment. Risk assessment is a systematic process for assessing and integrating professional judgments about probable adverse conditions and/or events. The risk assessment process leads the Internal Audit Director to establish audit work schedule priorities which become the Internal Audit Activity Plan.

Administrative Internal Audit Activities

12. Service to the Profession: As part of Internal Audit's commitment to stay abreast of developments in its profession and its commitment to develop staff, we will continue to devote a small number of hours to the state internal audit community. Potential activities include mentoring, speaking, training, participating in professional organizations, and participating in peer reviews of other internal audit shops, including other lottery audit shops. In addition to developing staff, these efforts will help enhance the agency's stature in the professional internal audit community and help to attract and retain quality staff.

13. Administration of the Internal Audit Function: Allocated hours represent less than 10% of total budgeted hours.



Deviation from 2013 Plan:

The Internal Audit Division Director resigned in July 2013, and the existing Division staff was reassigned pending further decision on filling the Internal Audit function. The development and approval of instant games audit was in process that time. This audit is now included in the 2014 audit plan as part of the Sales-to-Transfer audit. The remaining audits planned for 2013 were not completed and will not be included in the 2014 audit plan based on the risk measurement scores received from the 2014 risk assessment.



III. CONSULTING SERVICES AND NON-AUDIT SERVICES COMPLETED

The Internal Audit Division (Internal Audit) participated in various agency committees or workgroups during fiscal year 2013, and provided ongoing consultative assistance to management. Internal Audit's participation and services were limited to an advisory basis only; ensuring both auditor independence and objectivity were not compromised. Such activity did not result in reports or management letters during fiscal year 2013.



IV. EXTERNAL QUALITY ASSURANCE REVIEW (PEER 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 Government 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



V. INTERNAL AUDIT PLAN FISCAL YEAR 2014

MJ will conduct three audits, review internal controls and business processes for the implementation of two major information systems being implemented, update the risk assessment, manage fraud and ethic complaints received, prepare the 2015 annual audit plan and prepare the 2014 annual audit report in accordance with the Texas Internal Auditing Act. These activities are estimated to require **1,917 hours**. The planned audits, timing and estimated hours are summarized in the chart below.

2014 Annual Audit Plan Activities

<i>Audit Activity #</i>	<i>Description</i>	<i>Risk Rating</i>	<i>Estimated Timing</i>	<i>Estimated Hours</i>
1	<i>Lottery Service Portal (LSP) Internal Controls</i>	<i>Internal Controls</i>	<i>February 2014 – August 2014</i>	146
2	<i>Bingo Operating Service System (BOSS) Internal Controls</i>	<i>Internal Controls</i>	<i>All Year</i>	352
3	<i>Charitable Bingo Allocation</i>	<i>High</i>	<i>March 2014 – April 2014</i>	225
4	<i>Sales to State Transfer</i>	<i>High</i>	<i>May 2014 – August 2014</i>	500
5	<i>IT Security & General Controls (Active Directory)</i>	<i>High</i>	<i>February 2014 – March 2014</i>	250
6	<i>Management of Complaint Lines</i>	<i>Compliance</i>	<i>All Year</i>	120
7	<i>External Audit / Review Assistance</i>	<i>Compliance</i>	<i>All Year</i>	88
8	<i>Update Risk Assessment & Develop 2015 Audit Plan</i>	<i>Compliance</i>	<i>July – August 2014</i>	88
9	<i>2014 Annual Audit Report</i>	<i>Compliance</i>	<i>July – August 2014</i>	44
10	<i>Audit Communications, Committee Meetings, Project Management</i>	<i>N/A</i>	<i>All Year</i>	104
	Total			1,917



VI. EXTERNAL AUDIT SERVICES PROCURED IN FISCAL YEAR 2013

The following represent external audit services that were procured by the Texas Lottery Commission or were ongoing in fiscal year 2013.

<i>Audit / Review</i>	<i>Auditor</i>
<i>Drawings Audit</i>	<i>Davila Buschhorn & Associates, P.C.</i>
<i>FY13 Audit Services (Financial Audit, Mega Millions Agreed-Upon Engagement Procedures and Powerball Agreed-Upon Engagement Procedures)</i>	<i>Weaver and Tidwell, LLP</i>
<i>Biennial Security Study</i>	<i>Delehanty Consulting</i>
<i>FY12 Audit Services (Financial Audit)</i>	<i>Maxwell Locke and Ritter LLP</i>



VII. REPORTING SUSPECTED FRAUD AND ABUSE

Texas Lottery Commission has implemented measures to comply with Article IX, Section 7.10, the General Appropriations Act (81st Legislature) and Texas Government Code, Section 321.022. These measures include, but are not limited to, the following:

The Texas Lottery Commission included a link to the State Auditor's Office (SAO) 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.

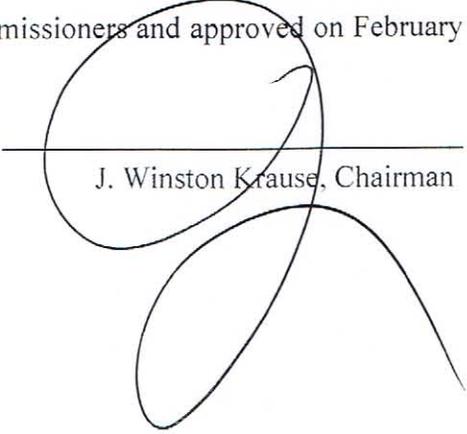
The Texas Lottery Commission utilizes EthicsPoint Reporting. EthicsPoint is a third-party vendor that provides an Internet and telephone based reporting system that can be accessed by Commission employees. This system is intended to supplement the existing avenues within the Commission for employees to report concerns. All EthicsPoint complaints were reviewed by the agency's General Counsel and reported to SAO as applicable. McConnell & Jones LLP has taken over monitoring and reporting of complaints received from this system.



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

This annual internal audit report was presented to the Commissioners and approved on February 13, 2014.



J. Winston Krause, Chairman