



## INTEROFFICE MEMO

*Gary Grief, Executive Director*

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**To:** J. Winston Krause, Chairman  
Carmen Arrieta-Candelaria, Commissioner  
Peggy A. Heeg, Commissioner  
Doug Lowe, Commissioner  
Robert Rivera, Commissioner

**From:** Kathy Pyka, Controller *KP*

**Date:** June 27, 2016

**Re:** State Auditor's Office Audit Report: Administration of Selected Instant Ticket Contracts

The State Auditor's Office will provide an overview of the following audit report issued in May 2016:

Report No. 16-028: An Audit Report on The Texas Lottery Commission's Administration of Selected Instant Ticket Contracts

Please feel free to contact me at 512-344-5410 if you need additional information or have any questions.



An Audit Report on

**The Texas Lottery Commission's  
Administration of  
Selected Instant Ticket Contracts**

May 2016  
Report No. 16-028



An Audit Report on

# The Texas Lottery **Commission's** Administration of Selected Instant Ticket Contracts

SAO Report No. 16-028  
May 2016

## Overall Conclusion

The Texas Lottery Commission (Commission) generally planned, procured, and formed the two instant ticket contracts audited in accordance with applicable statutes, rules, Office of the Comptroller of Public Accounts requirements, and Commission policies and procedures to help ensure that the State's interests were protected. The two contracts audited were the Commission's contract with Pollard Banknote Limited (Pollard) for instant ticket printing and the Commission's contract with IGT Solutions Corporation (IGT) for operations related to instant tickets (see text box for additional details).

While the Commission generally monitored those contracts to ensure compliance with contract terms, it should improve its monitoring of the Pollard contract to ensure that it records correct delivery truck seal numbers, consistently performs required background checks on key contractor personnel, and verifies that Pollard provides all required reports.

### Background Information

The Texas Lottery Commission (Commission) offers approximately 90 instant ticket games annually. Instant ticket (scratch-off) games consist of preprinted tickets with symbols hidden under a latex covering that allows a player to determine "instantly" whether a prize may be claimed when the latex is removed.

The Commission's 6-year contract with Pollard Banknote Limited to print instant tickets began in September 2012 and has a total value of \$25.4 million.

The Commission's 10-year contract with IGT Solutions Corporation was for providing instant ticket warehouse operations, inventory, and delivery of instant ticket games to participating retailers. That contract also provided lottery drawing services, but auditors did not audit that portion of the contract. That contract began in December 2010, and the instant ticket portion of that contract totaled approximately \$601 million.

The Commission reported instant ticket revenue of \$3.481 billion for fiscal year 2015; that amount represented 77 percent of total lottery sales for fiscal year 2015.

Source: The Commission.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters and Related Issue Ratings		
Chapter	Title	Issue Rating <sup>a</sup>
1	The Commission Generally Planned, Procured, and Formed the Pollard and IGT Contracts According to Applicable Statutes, Rules, Office of the Comptroller of Public Accounts Requirements, and Commission Policies and Procedures	Low
2	The Commission Generally Monitored the Pollard Contract; However, It Should Improve Certain Aspects of Its Monitoring	Medium
3	The Commission Adequately Monitored the IGT Contract	Low
4	Pollard and IGT Contract Invoices Were Valid, Properly Supported, and Approved	Low

<sup>a</sup> A chapter is rated **Priority** if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A chapter is rated **High** if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A chapter is rated **Medium** if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A chapter is rated **Low** if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Auditors communicated other, less significant issues in writing to Commission management.

## Summary of Management's Response

At the end of certain chapters in this report, auditors made recommendations to address the issues identified during this audit. The Commission agreed with the recommendations in this report.

## Audit Objective and Scope

The objective of this audit was to determine whether the Commission administered selected provisions of instant ticket contracts in accordance with applicable requirements.

The scope of this audit covered:

- An instant ticket printing contract with Pollard. Specifically, auditors reviewed contract planning, procurement, and formation activities the Commission performed in 2011 and 2012. Auditors also reviewed the

Commission's monitoring of that contract's deliverables from September 2014 through August 2015.

- A lottery operations contract with IGT. Specifically, auditors reviewed contract planning, procurement, and formation activities the Commission performed in 2009 and 2010. Auditors also reviewed the Commission's monitoring of that contract's deliverables from September 2014 through August 2015.

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# Detailed Results

## Chapter 1

### *The Commission Generally Planned, Procured, and Formed the Pollard and IGT Contracts According to Applicable Statutes, Rules, Office of the Comptroller of Public Accounts Requirements, and Commission Policies and Procedures*

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Chapter 1  
Rating:  
Low <sup>1</sup>

While Texas Government Code, Section 466.105, exempts the Texas Lottery Commission (Commission) from many statutory contracting requirements, the Commission has voluntarily adopted rules and policies to follow certain statewide requirements for contract planning and procurement.

For the Pollard Banknote Limited (Pollard) contract audited and IGT Solutions Corporation (IGT) contract audited, the Commission generally complied with applicable statutes, rules, Office of the Comptroller of Public Accounts requirements, *State of Texas Contract Management Guide* requirements, and Commission policies and procedures to ensure that it performed the activities discussed below.

#### **Contract Planning, Procurement, and Formation**

**Planning** - Identify contracting objectives and contracting strategy.

**Procurement** - Fairly and objectively select the most qualified contractors.

**Contract Formation/Rate/Price Establishment** - Ensure that the contract contains provisions that hold the contractor accountable for producing desired results, including all relevant terms and conditions, and establish processes that are cost-effective and aligned with the cost of providing goods and services.

Source: *State of Texas Contract Management Guide*, version 1.8.

#### **Contract Planning Phase Activities**

For both contracts audited, the Commission:

- Submitted solicitations to the State's Contract Advisory Team for review and comments.
- Completed contracting needs assessments and risk assessments prior to the solicitations.
- Appropriately selected the request for proposals method it used to solicit the contracts.
- Obtained management approval prior to the solicitations.

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<sup>1</sup> Chapter 1 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

### **Contract Procurement Phase Activities**

For both contracts audited, the Commission:

- Followed historically underutilized business (HUB) rules to require the contractor proposals to include HUB subcontracting plans.
- Ensured that all evaluation team members signed non-disclosure statements. Non-disclosure forms documented the evaluation team members' affirmations that they would not divulge any information concerning the proposals and evaluations to anyone who was not a part of the evaluation team.
- Ensured that all proposals it evaluated met the minimum requirements and were received by the due dates.
- Appropriately awarded the contracts to the proposers with the highest scores. The Commission received instant ticket printing bids from three proposers and awarded a contract to each proposer (including Pollard). The three proposals each received at least 85 percent of the maximum score. The Commission received lottery operations bids from three proposers and awarded the contract to the proposer with the highest score (IGT).

### **Contract Formation Phase Activities**

For both contracts audited, the Commission:

- Included essential clauses from the *State of Texas Contract Management Guide*.
- Ensured that management approved contract amendments and notified key divisions about those amendments.

Additionally, the Commission's procurement staff and contract managers held the required certifications (certified Texas contract manager, certified Texas procurement manager, and certified Texas purchaser).

However, the Commission (1) did not require contracting personnel and evaluation team members to sign conflict of interest forms and (2) did not require contracting personnel to sign non-disclosure forms for the contracts audited, as required by Texas Government Code, Sections 2261.252 and 2262.004 (the Commission is not exempt from those requirements). The Commission has developed procedures that require contracting personnel to complete those forms for future contracts.



## **Management's Response**

*The Commission appreciates the SAO's thorough review of the Commission's contract planning and procurement processes.*

*Responsible management: Administration Division Director*

*Target Date: Not Applicable*

*The Commission Generally Monitored the Pollard Contract; However, It Should Improve Certain Aspects of Its Monitoring*

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**Chapter 2  
Rating:  
Medium <sup>2</sup>**

The Commission performed monitoring activities to ensure that Pollard complied with the contract requirements. For each individual instant ticket game that auditors tested, the Commission's monitoring activities ensured that (1) the Commission received the correct quantities and quality of instant tickets and (2) the instant tickets were tamper-resistant and compatible with the Commission's instant ticket information systems. For example, the Commission:

**Contract Monitoring**

Contract monitoring focuses on enforcing the terms of the contract.

Source: *State of Texas Contract Management Guide*, version 1.8.

- Ensured that instant ticket games met all requirements prior to releasing those games to retailers for sale to the public.
- Factored monetary sanctions into its payments of the invoices that Pollard submitted.
- Voluntarily complied with Texas Government Code, Section 2161.253, and monitored Pollard's HUB subcontracting plan on an ongoing basis.

However, the Commission should improve certain aspects of its monitoring to ensure that Pollard meets other contract requirements. Specifically, the Commission should improve its monitoring to ensure that it records correct delivery truck seal numbers, consistently performs required background checks on key contractor personnel, verifies that Pollard provides all required reports, and verifies that Pollard complies with test game submission requirements.

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<sup>2</sup> Chapter 2 is rated Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concerns and reduce risks to a more desirable level.

The Commission did not consistently follow its procedures to verify seal numbers on delivery trucks prior to opening and accepting delivery of instant tickets from Pollard.

To provide evidence that its delivery trucks' contents were not accessed by

#### Delivery Truck Seals

The Pollard contract requires Pollard to provide delivery truck seal numbers to the Commission prior to the delivery of instant tickets. Upon delivery, Commission staff verify that the seal numbers on the delivery truck doors match the seal numbers that Pollard previously provided.

Sources: The Commission and the Pollard contract.

unauthorized personnel, Pollard places seals containing unique numbers on the doors of the trucks that deliver instant tickets to the Commission (see text box for information on delivery truck seals). Two of the nine shipments that auditors tested did not contain adequate support for the correct seal numbers. Specifically, in one case, the Commission could not provide supporting documentation for a discrepancy in the seal numbers; in the other case, Commission staff signed shipment documents that noted both correct and incorrect seal numbers. Auditors determined that none of the instant tickets for those two shipments was missing. However, not following procedures to verify seal numbers increases the risk that the Commission may not receive all instant tickets from Pollard.

The Commission did not consistently comply with its policy to perform background checks on all key Pollard personnel. The Commission received an updated list of those personnel dated June 2012, but it was unaware that two of the listed personnel needed background checks until auditors brought that to its attention in February 2016. The Commission has begun to perform those background checks. Not performing required background checks increases the risk that the Commission could conduct business with individuals who may have criminal histories, which increases the risk of inappropriate use of information.

The Commission did not adequately monitor Pollard's reporting of the delivery of second chance drawing prizes (see text box for information on second chance drawings). The

#### Second Chance Drawing

The Commission offers several instant ticket games with prizes that an individual can win by entering a non-winning instant ticket into what the Commission refers to as a "second chance drawing." There is no additional cost to enter a second chance drawing.

Source: The Commission.

Commission did not adequately monitor the receipt of the final report from Pollard for one game's second chance drawing. The contract requires Pollard to submit that report within 30 days of the end of a game. That report must include an accounting of all merchandise prizes, unsuccessful attempts to deliver the merchandise, all complaints of missing or damaged merchandise, and identification of the resolution of complaints. Pollard did not provide the final report for the second chance drawing tested until after auditors made inquiries (105 calendar days after the game ended). Not ensuring that it receives those reports increases the risk that the Commission could pay for prizes that were damaged or not delivered.

The Commission did not have formal procedures to verify that final instant ticket artwork agreed with the contracted and approved artwork. The Commission asserted that it reviewed final production proofs of instant tickets that Pollard submits at the start of print production for each instant ticket game; however, it did not document those reviews. Auditors did not identify any differences between the contracted and approved artwork and the

production proofs of the instant tickets. However, not documenting its reviews increases the risk that the Commission could accept printed instant ticket games that do not conform to the approved artwork, which could result in instant tickets that do not reflect the intended artwork.

The Commission did not perform a risk assessment to focus its monitoring on contract requirements with a high risk of noncompliance. The *State of Texas Contract Management Guide* states that risk assessment is an ongoing process and should be reviewed and re-evaluated by agencies on a continual basis until a contract is fully performed and final payment is made. Not performing a risk assessment increases the risk that the Commission may not identify noncompliance with contract requirements. Performing a risk assessment could have helped the Commission identify the monitoring weaknesses that auditors identified.

The Commission did not have processes to adequately monitor whether Pollard complied with a requirement in the request for proposals to submit a test game. Although Pollard submitted test game files and test game instant tickets, those items were not for the same test game. The purpose of a test game is to ensure that a proposer's operations are compatible with the Commission's systems. Not monitoring test game submissions increases the risk that the Commission could receive incompatible games and files, which could result in additional costs to resolve incompatibility issues.

## Recommendations

The Commission should:

- Develop, document, and implement procedures to maintain documentation supporting correct delivery truck seal numbers, and consistently verify and affirm that correct seal numbers are present when it receives deliveries of instant tickets.
- Consistently comply with its policy to perform background checks on all key contractor personnel.
- Develop, document, and implement procedures to ensure that it receives all required second chance drawing reports.
- Develop, document, and implement formal procedures to verify and document that final instant ticket artwork agrees with the contracted and approved artwork.
- Develop, document, and implement a risk assessment to identify contract requirements with a high risk of noncompliance, and incorporate the results of that risk assessment into its monitoring.

- Develop, document, and implement procedures to verify that it receives required test game files and test game instant tickets.

### **Management's Response**

*The Commission should:*

- *Develop, document and implement procedures to maintain documentation supporting correct delivery truck seal numbers, and consistently verify and affirm that correct seal numbers are present when it receives deliveries of instant tickets.*

*Management Response: The Commission concurs with the recommendation.*

*To ensure that all documentation related to delivery truck seals is maintained and to consistently verify and affirm that correct seal numbers are present at the time of scratch game delivery, procedure LO-RS-032 Receiving New Scratch Game Tickets will be revised to include additional information on these processes. Staff will be trained on the additional details as part of the implementation.*

*Responsible management: Lottery Operations Division Director*

*Target Date: July 15, 2016*

- *Consistently comply with its policy to perform background checks on all key contractor personnel.*

*Management Response: The Commission concurs with the recommendation.*

*Management has completed the background checks identified by the auditors and will ensure consistent application of Commission policy in the future.*

*Responsible management: Enforcement Division Director*

*Target Date: Completed, April 21, 2016*

- *Develop, document, and implement procedures to ensure that it receives all required second chance drawing reports.*

*Management Response: The Commission concurs with the recommendation.*

*To ensure the proper receipt of all required second chance drawing reports, a new checklist has been created for games which include second-chance drawings. This checklist will be documented in procedure LO-PD 021, Non-Cash Prize Fulfillment.*

*Responsible management: Lottery Operations Division Director*

*Target Date: July 15, 2016*

- *Develop, document, and implement formal procedures to verify and document that final instant ticket artwork agrees with the contracted and approved artwork.*

*Management Response: The Commission concurs with the recommendation.*

*To ensure all final instant ticket artwork agrees with the approved artwork, the Commission will modify its Game Release Checklist to include the process of comparing the vendor's press sheet to the approved color proof. This modification will be documented in procedure LO-PD-003, Game Release Checklist.*

*Responsible management: Lottery Operations Division Director*

*Target Date: July 15, 2016*

- *Develop, document, and implement a risk assessment to identify contract requirements with a high risk of noncompliance, and incorporate the results of that risk assessment into its monitoring.*

*Management Response: The Commission concurs with the recommendation.*

*A Risk Assessment Analysis procedure has been developed and will be implemented no later than May 31, 2016.*

*Responsible management: Administration Division Director*

*Target Date: May 31, 2016*

- *Develop, document, and implement procedures to verify that it receives required test game files and instant tickets.*

*Management Response: The Commission concurs with the recommendation.*

*To ensure the proper receipt of all required test game files and instant tickets, a new checklist will be created. This checklist will be documented in procedure LO-PD-003, Game Release Checklist.*

*Responsible management: Lottery Operations Division Director*

*Target Date: July 15, 2016*

Chapter 3  
Rating:  
Low <sup>3</sup>

The Commission adequately monitored the IGT contract through monitoring activities it contracted to Grant Thornton LLP (Grant Thornton) and direct monitoring activities.

The Commission contracted out significant portions of the monitoring of the IGT contract to Grant Thornton. Based on the fiscal year 2015 monitoring reports that Grant Thornton submitted, auditors concluded that the Commission:

- Adequately monitored all 62 activities that auditors tested. Examples of those activities include monitoring to ensure that (1) IGT's information system maintains and reports all gaming data, (2) IGT conducts a physical inventory of instant tickets, and (3) IGT prevents defective instant tickets from being shipped to retailers.
- Followed up on all 19 instances of noncompliance that Grant Thornton reported.
- Appropriately applied sanctions for 4 of the 19 instances of noncompliance that Grant Thornton reported.

Additionally, the Commission adequately performed direct monitoring activities for the IGT contract. Those activities included:

- Working with Grant Thornton to develop a risk assessment and a schedule to review the IGT contract deliverables.
- Calculating and deducting annual rebates and credits authorized by the IGT contract.
- Maintaining documentation of the Commission's receipt of Grant Thornton's monitoring reports and the Commission's reviews of those reports.
- Voluntarily complying with Texas Government Code, Section 2161.253, regarding HUB subcontracting and monitoring IGT's HUB subcontracting plan on an ongoing basis.

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<sup>3</sup> Chapter 3 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.



- Requesting background checks on key IGT personnel, as required by the Commission's policies and procedures.

### **Management's Response**

*The Commission appreciates the SAO's thorough review of the Commission's monitoring of the IGT contract.*

*Responsible management: Administration Division Director*

*Target Date: Not Applicable*

## ***Pollard and IGT Contract Invoices Were Valid, Properly Supported, and Approved***

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Chapter 4  
Rating:  
Low <sup>4</sup>

For both contracts audited, the Commission complied with requirements in the *State of Texas Contract Management Guide*, its policies and procedures, and specific terms in the contracts to verify that contractor invoices were valid, properly supported, and approved. Auditors tested 9 Pollard contract invoices totaling \$2,762,975 and 9 IGT contract invoices totaling \$17,269,661 and determined they were properly supported, authorized, allowable, and calculated and paid in a timely manner. Additionally, the Commission appropriately supported, authorized, and reduced payments to the contractors based on sanctions that the contracts allowed.

Although invoices were valid, properly supported, and approved, one Commission employee had access rights to the Uniform Statewide Accounting System (USAS) that would allow the employee to both enter and release USAS transactions. That represented a weakness in segregation of duties. The Commission removed that access after auditors brought it to the Commission's attention. Auditors verified that the employee did not both enter and release USAS transactions in fiscal year 2015. The Office of the Comptroller of Public Accounts' USAS policies and procedures state that agencies should have controls over expenditure processing that segregate each accounting task to the greatest extent possible.

### **Recommendation**

The Commission should periodically review USAS user access to ensure that access rights are appropriate and to maintain proper segregation of duties.

### **Management's Response**

*The Commission concurs with the recommendation.*

*Management has evaluated its process for reviewing USAS user access to ensure proper segregation of duties is maintained.*

*Responsible management: Office of the Controller Division Director*

*Target Date: Completed, February 12, 2016*

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<sup>4</sup> Chapter 4 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

# Appendices

## Appendix 1

### Objective, Scope, and Methodology

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#### Objective

The objective of this audit was to determine whether the Texas Lottery Commission (Commission) administered selected provisions of instant ticket contracts in accordance with applicable requirements.

#### Scope

The scope of this audit covered:

- An instant ticket printing contract with Pollard Banknote Limited (Pollard). Specifically, auditors reviewed contract planning, procurement, and formation activities the Commission performed in 2011 and 2012. Auditors also reviewed the Commission's monitoring of that contract's deliverables from September 2014 through August 2015.
- A lottery operations contract with IGT Solutions Corporation (IGT). Specifically, auditors reviewed contract planning, procurement, and formation activities the Commission performed in 2009 and 2010. Auditors also reviewed the Commission's monitoring of that contract's deliverables from September 2014 through August 2015.

#### Methodology

The audit methodology included collecting and reviewing procurement documentation and contracts; conducting interviews with Commission staff; reviewing statutes, rules, Office of the Comptroller of Public Accounts requirements, the *State of Texas Contract Management Guide*, and Commission policies and procedures; and performing selected tests and other procedures.

The selection methodology for the contracts was based on contract dollar amount, recent audit coverage, and length of contract.

#### Data Reliability and Completeness

Auditors used expenditure information in the Uniform Statewide Accounting System (USAS) and the Commission's internal accounting system (MIP Fund Accounting, or MIP) and performed analysis to determine completeness of the data in those systems. Auditors also reviewed user access to and segregation of duties for MIP and the Commission's USAS access rights.

Auditors performed analysis of USAS data and relied on previous State Auditor's Office audit work performed on USAS for data completeness and accuracy of USAS. Auditors determined that the data in those systems was sufficiently reliable for purposes of this audit.

Auditors assessed the reliability of IGT's Texas Lottery Operations Enterprise Series (ES) system, which records all transactions related to instant tickets. The assessment included reviewing the Commission's most current Statement on Standards for Attestation Engagements (SSAE) No. 16 Type 2 report for the ES system. Auditors determined that the data in that system was sufficiently reliable for purposes of this audit.

Auditors assessed the reliability of the balancing process for the Commission's Internal Control System (ICS), which the Commission uses to verify the transactions captured in IGT's ES system. The assessment included (1) observing the controls over the balancing process, (2) reviewing user access and segregation of duties, and (3) observing physical controls in the server room. Auditors determined that the data in that system was sufficiently reliable for purposes of this audit.

Auditors assessed the reliability of sanction data in the Commission's Instant Ticket Management (ITM) system, which the Commission uses to track instant ticket sanctions, record the results of instant ticket validation testing, and record the receipt of instant ticket shipments. The assessment included (1) verifying edit checks through observation and application control testing and (2) reviewing user access and segregation of duties. Auditors determined that the data in that system was sufficiently reliable for purposes of this audit. However, auditors could not determine the completeness of the manual sanctions in ITM.

For the Centralized Master Bidders List solicitations associated with both contracts audited, auditors tested Commission files that contained the responses it received to the solicitations. However, auditors could not determine the completeness of those files.

### **Sampling Methodology**

Auditors selected nonstatistical samples through systematic selection designed to be representative of the population for the following areas: Pollard instant ticket games, Pollard instant ticket game invoices, IGT operations invoices, Pollard instant ticket second chance draw invoices, and IGT automated sanctions. In those cases, results may be projected to the population, but the accuracy of the projection cannot be measured.

Auditors selected nonstatistical samples through systematic selection designed to be representative of the population for IGT manual sanctions,

but the results cannot be projected to the population and accuracy cannot be measured because completeness of the population could not be verified.

For IGT Centralized Master Bidders List advertising and Pollard production schedule reports, auditors used professional judgment to select sample items for testing. Those sample items generally were not representative of the population and, therefore, it would not be appropriate to project those results to the populations.

For Pollard instant ticket manual sanctions, Pollard instant ticket licensing, and Pollard Centralized Master Bidders List advertising, auditors tested the entire population.

For Grant Thornton monitoring reports on IGT contract deliverables, auditors selected all items related to instant tickets in the fiscal year 2015 reports.

Information collected and reviewed included the following:

- Contract between the Commission and Pollard.
- Contract between the Commission and IGT.
- Commission policies and procedures.
- Commission non-disclosure statements.
- Certification records of the Texas Procurement and Support Services division of the Office of the Comptroller of Public Accounts.
- Commission planning and procurement files, approvals, invoices, working papers, and other supporting documentation.
- Commission contract expenditure data from MIP.
- Commission internal accounting system user access list and roles.
- Commission USAS user access list and roles.
- USAS vendor payment data.
- ITM user access list and roles.
- ICS user access list and roles.
- Commission solicitation documentation, bid documentation, and supporting emails.

- Office of the Comptroller of Public Accounts requirements in the *State of Texas Procurement Manual*, which auditors used as best practices.

Procedures and tests conducted included the following:

- Interviewed employees at the Commission regarding the management of contract compliance.
- Reviewed the Commission's contracting policies and procedures to determine whether they aligned with the *State of Texas Contract Management Guide*.
- Tested whether Commission purchasing staff and contract managers met the training and certification requirements in Texas Government Code, Sections 2261.252 and 2262.004.
- Reviewed planning documentation for each contract audited.
- Reviewed both contracts audited to determine whether they contained required approvals, a payment methodology, essential and recommended terms in the *State of Texas Contract Management Guide*, and other requirements.
- Tested contract expenditures for both contracts audited for compliance with contract terms, the *State of Texas Contract Management Guide*, and Commission policies and procedures.
- Reviewed and/or tested the Commission's monitoring activities for both contracts audited.
- Tested segregation of duty controls related to purchasing in MIP and USAS.
- Tested segregation of duty controls in ICS and ITM.

Criteria used included the following:

- Texas Government Code, Chapters 322, 466, 572, 2251, 2261, and 2262.
- Texas Government Code, Chapters 2155, 2156, and 2161 (although the Commission is exempt from those statutes, it chose to comply with them as a best practice, where applicable).
- Title 16, Texas Administrative Code, Chapters 401 and 403.
- Title 34, Texas Administrative Code, Chapter 20.

- *State of Texas Contract Management Guide*, version 1.8 for the Pollard contract and version 1.7 for the IGT contract.
- The Commission's contracting policies and procedures.
- General Appropriations Acts (81st and 82nd Legislatures).

### **Project Information**

Audit fieldwork was conducted from November 2015 through April 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Robert G. Kiker, CGAP (Project Manager)
- Jerod Heine, MBA (Assistant Project Manager)
- Ahmed T. Bah
- Brady Bennett, MBA, CFE
- Adam K. Ryan, MACT
- Armando S. Sanchez, MBA
- Mary Ann Wise, CPA, CFE (Quality Control Reviewer)
- Cesar Saldivar, CGAP (Audit Manager)

## Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; violation of state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.



Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair  
The Honorable Joe Straus III, Speaker of the House, Joint Chair  
The Honorable Jane Nelson, Senate Finance Committee  
The Honorable Robert Nichols, Member, Texas Senate  
The Honorable John Otto, House Appropriations Committee  
The Honorable Dennis Bonnen, House Ways and Means Committee

### **Office of the Governor**

The Honorable Greg Abbott, Governor

### **Texas Lottery Commission**

Members of the Texas Lottery Commission

Mr. J. Winston Krause, Chair  
Ms. Carmen Arrieta-Candelaria  
Ms. Peggy A. Heeg  
Mr. Doug Lowe  
Mr. Robert Rivera  
Mr. Gary Grief, Executive Director



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