



**TEXAS LOTTERY
COMMISSION
CHARITABLE
BINGO
OPERATIONS
DIVISION**



**An Internal Audit of:
Prize Tax Fee Allocation Processes**

December 8, 2014

Report #14-002



Introduction

McConnell & Jones LLP (MJ) serving as the outsourced internal audit function (Internal Audit) for the Texas Lottery Commission (TLC) performed an internal audit of the Charitable Bingo Operations Division (CBOD) prize fee tax allocation processes. We conducted this 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 observations and conclusions based on our audit objectives.

Pertinent information has not been omitted because it was not deemed privileged or confidential by law. This report summarizes the audit scope, our assessment based on our audit objectives and the audit approach.

Results and Conclusions

Based on the audit results, we determined that controls over the prize fee allocation business processes which are under the CBOD control are well managed. However, taxing jurisdictions must fulfill their obligations to report boundary changes in order for CBOD records to be accurate and information system improvements are needed in order to achieve the business objectives associated with prize fee allocations. The new Bingo Operating Service System (BOSS) is being programmed to address the deficiencies of the current system limitations. The noted weaknesses in controls are summarized below and in the executive summary.

- ★ The current information system (ACBS) does not capture prize fees collected and accurately allocate to counties and municipalities for isolated instances where non-regular temporary license prize fees are collected and distributed prior to issuing a temporary license.
- ★ CBOD’s current information system (ACBS) does allow staff to record at the jurisdictional level prize fee receivables, liabilities, distributions, and reconcile prize fees reported to amounts collected.
- ★ Political jurisdictions that opted to receive a portion of bingo prize fees collected have not reported their boundary changes to CBOD and therefore CBOD records have not been updated to identify potential impacts to prize fee tax allocations.

Overall Control Rating:

Deficiency

Due to current information system limitations that are being remedied in the new BOSS system

Internal Audit categorizes audit findings as Deficiency, Significant Deficiency, Material Weakness, and Comment. This audit resulted in findings that led to an overall internal control rating of Deficiency for prize fee tax allocation business processes. A deficiency in internal



control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.

Objectives and Scope

The purpose of this audit is to review business processes and internal controls related the CBOD prize tax fee allocation process to determine if management controls are in place to achieve business objectives and comply with policy and procedures, Statutes and Administrative Rules, including:

- ★ Are there adequate control systems over the collection, calculation, and reporting of prize fee taxes?
- ★ Are prize fee taxes accurately recorded and reported?
- ★ Are prize fee taxes being captured and reported in the most efficient manner?
- ★ Are reconciliations being performed in a timely manner?
- ★ Are applicable regulations being followed?
- ★ Have any prior audit findings related to charitable bingo allocations been addressed?
- ★ Is information technology being used effectively & efficiently to capture and report prize fee taxes?

The audit period included January 1, 2013 through May 31, 2014. However, some test procedures were performed as of fieldwork date. This work product was a point-in-time evaluation that cannot address the inherent dynamic nature of subsequent changes to the process/procedures reviewed.

Acknowledgement:

We wish to thank all staff involved in this audit for their professionalism and positive outlook towards the assessment of their operations. The timely completion of this audit was due to their efforts and responsiveness to our requests.



Executive Summary

Business Objective	To ensure prize fee tax collected by CBOD is accurately allocated to the taxing jurisdictions in accordance with Section 2001.503 of the Texas Occupations Code.	To accurately account for prize fee tax receivables and liabilities.	To ensure taxing jurisdiction records are accurate.
Business Risk	Prize fee taxes submitted to CBOD are distributed to the incorrect taxing jurisdiction.	Prize fee taxes paid by Bingo players are not collected by CBOD and accurately submitted to the taxing jurisdiction.	Outdated records cause prize fee taxes collected to go to the incorrect taxing jurisdiction.
Management Controls	Reconciliations between prize fee revenues received and deposited are conducted prior to distribution to taxing jurisdictions.	CBOD delinquent taxpayer report is at the license level and does not include taxing jurisdiction.	Management controls are based upon original information system setup and has not been updated due to no notification provided by local jurisdictions.
Control Tests	Reviewed and recalculated prize fee tax allocation reconciliations.	Management inquiry, reconciliation review, and recalculation of allocation.	Management inquiry; reviewed allocation distributions.
Results	For isolated instances where non-regular temporary license prize fees are collected and distributed prior to issuing a temporary license, CBOD's current information system does not capture prize fees collected and accurately allocate to counties and municipalities.	CBOD current system limitations does not allow staff to record at the jurisdictional level prize fee receivables, liabilities, distributions, and reconcile prize fees reported to amounts collected.	Records have not been updated due to CBOD not being provided annexation information since the Statute was adopted in 1993.
Recommended Actions	Incorporate functionality into BOSS to enable prize fees resulting from non-regular temporary licenses to be tied to the county and municipality in which the game was played.	Incorporate within BOSS a prize fee tax receivable and payable at the jurisdiction level and establish a reconciliation process at the ledger account level.	Disseminate an annual notice to all jurisdictions that are eligible to receive apportion of the prize fee tax informing them of their responsibility to notify CBOD of any boundary changes that have occurred.
Management Action Plans	BOSS will be programmed such that non-regular temporary licensees are tied to a playing location to ensure proper allocation to the correct jurisdiction.	Boss will be programmed with jurisdictional level prize fee information and statements of prize fees reported and remitted will be provided with quarterly remittances.	BOSS will be programmed to issue a notice with the 4 th quarter's remittance informing jurisdictions of their responsibility to notify CBOD of any changes.



Detailed Observations

Observation 1:

Until the CBOD can successfully implement the new BOSS system, they are constrained by the current system’s (ACBS) limitations. The ACBS system does not adequately capture prize fees collected and accurately allocate to counties and municipalities for isolated instances where non-regular temporary license prize fees are collected and distributed prior to issuing a temporary license.

In two instances identified, prize fee taxes were misallocated between counties and municipalities because the location of the municipality was not accurately recorded before the allocations were distributed. In these two instances the counties and municipalities had imposed the tax and were entitled to 25 percent of the tax collected, however the counties received 50 percent and municipalities received zero. Allocation reports subsequently generated in connection with this audit indicated that the two instances were related to prize fees collected from non-regular temporary licenses that were not scheduled in the Automated Charitable Bingo System (ACBS), CBOD’s original book of entry, to play until a date after the prize fee tax allocations were distributed.

Section 2001.502 of the Texas Occupation code (TOC) provides that a licensed authorized organization shall collect from a person who wins a bingo prize a fee in the amount of five percent of the amount or value of the prize. Section 2001.503 of the TOC states that a county or municipality that imposed a gross receipts tax on the conduct of bingo as of January 1, 1993 is entitled to 50 percent of the fee collected under Section 2001.502 on a prize awarded at a game in that county or municipality. If both the county and municipality imposed the gross receipts tax, then they are both entitled to 25 percent of the prize fee collected.

Prize fee payments are recorded in ACBS by manually linking them to a license and location number. The ACBS payment entry screen does not provide users with enough information to select and link the payment to a more accurate license and location number. A license remains in the “pending” location table until the day it becomes active (played), then it is placed in an “active” location table.

ACBS determines the allocation split between the county and municipality by searching the “active location table” to ascertain if the conductor plays inside or outside the city limits. If the license number is not listed in the “active location table”, ACBS defaults a value of “outside” the city limits. When the actual date and location is not specified in ACBS at the time funds are recorded and because of the limitations to the ACBS



entry screen, the system characterizes the funds received as “outside” the city limits. As a result of the mischaracterization of funds, the municipality is excluded from their 25 percent portion of the prize fee tax allocation.

ACBS automatically recalculates the allocation to correctly split the imposed tax between the counties and municipalities once the non-regular temporary license is “active.” However, the system does not automatically create an edit file to alert the user that a previously allocated amount has changed to prompt further action. BOSS is being programmed to correct this limitation.

Implication:

Not having a systematic method to capture prize fees related to non-regular temporary licenses collected and distributed before the pending license is active and not reconciling at the allocation level prior to distribution could result in the following risks:

- Inaccurate allocation splits between counties and municipalities leading to one of the entities not receiving funds due to them.
- Charitable Bingo could suffer reputational risk due to miscalculated prize fee tax allocations.

Recommendation:

	Recommendation	Responsibility
	Management Action Plan	Due Date
A)	Incorporate functionality into BOSS to enable prize fees resulting from non-regular temporary licenses to be tied to the county and municipality in which the game was played at the time that the temporary license is issued.	Licensing and Accounting Manager
	Management agrees with the recommendation and will work toward BOSS programming such that non-regular temporary licensees are tied to a playing location to ensure proper allocation to the correct jurisdiction. NOTE: At this time all conductors regardless if they are an annual license holder or a non-regular license holder are required to file one report for the quarter. If a non-regular conductor should play two or more occasions in different locations they are only required to file one quarterly report and the last location determines the allocation payment.	March 2015



Observation 2:

Until the CBOD can successfully implement the new BOSS system, they are constrained by the current system’s (ACBS) limitations. ACBS does not allow staff to record at the jurisdictional level prize fee receivables, liabilities, distributions, and reconcile prize fees reported to amounts collected.

All current prize fee tax reconciliations performed by CBOD are based strictly on payments received from organization and funds disbursed to taxing jurisdictions. The current Automated Charitable Bingo System (ACBS), CBOD’s original book of entry, is not designed as a general ledger system whereby an accounts receivable from the organization for prize fee taxes is established and accounts payable to the municipality and county is established upon receipt of the organization’s quarterly reports. Additionally, reconciliations are not performed at the prize fee tax allocation level to identify discrepancies between amounts scheduled to be collected from organization for distribution to the county and municipality to revenues received for prize fee taxes.

Currently, the total daily prize fee amounts collected by CBOD during the quarter are reconciled multiple times before distributing allocations to ensure agreement between the cash positions reflected in the Uniform State Accounting System (USAS), Texas Comptroller’s accounting system; the conductor prize fees recorded in ACBS; and the prize fee amounts reflected in MIP, the Texas Lottery Commission’s general ledger. The ACBS report used for the reconciliation does not detail the amounts allocated. CBOD relies exclusively on ACBS to calculate the allocation amounts between the counties and municipalities. BOSS is being programmed as a general ledger system and will provide the ability to determine amounts owed by organizations and due to the respective jurisdictions.

Implication:

Not having a general ledger system to establish a liability from the organization and a payable to a municipality and county creates a risk for CBOD to potentially not allocate prize fee taxes to the correct entity in instances whereby an organization may change playing locations and submit prize fee taxes for a quarter in which their playing location was in a different taxing jurisdiction. It also creates a situation of not knowing how much each municipality and county is owed but not yet collected.

Not having business processes in place to perform monthly reconciliation of the prize fee taxes received to amounts reported on the quarterly reports places CBOD at risk of not identifying all underpayments and pursuing the tax obligations in a timely manner. Additionally, not reconciling prize fee tax activity creates a risk that irregularities may not be identified in a timely manner.



Recommendations:

	Recommendation	Responsibility
	Management Action Plan	Due Date
A)	Incorporate functionality into BOSS to capture prize fee tax receivables and the related allocation payables to county and municipalities upon receipt of the quarterly reports.	Licensing and Accounting Manager
	BOSS is being programmed as a general ledger system and therefore will have the ability to capture prize fee tax receivables and the related allocation payables to county and municipalities upon receipt of the quarterly reports.	March 2015
B)	Establish an automated monthly reconciliation process within BOSS to identify discrepancies at the organization allocation level prior to distribution. CBOD Accounting Staff would then research and resolve the noted discrepancies.	Licensing and Accounting Manager
	Management agrees with the recommendation and will work toward BOSS programming such that discrepancies are identified at the organizational level prior to allocation distribution. This process will be coupled with accounting staff reconciling the allocation activity.	March 2015
C)	Establish business process for CBOD Accounting Staff to perform monthly reconciliation of the prize fee allocation account activity.	Licensing and Accounting Manager
	Management agrees with the recommendation and will work toward BOSS programming such that discrepancies are identified at the organizational level prior to allocation distribution. This process will be coupled with accounting staff reconciling the allocation activity.	March 2015
D)	Establish business process for BOSS to include a statement of prize fee taxes receivable from organizations and amounts payable in each jurisdictions quarterly prize fee allocation payment notice.	Licensing and Accounting Manager
	Management agrees with the recommendation and will work toward BOSS programming such that a statement of prize fees reported and remitted is provided to each jurisdiction quarterly.	March 2015



Observation 3:

Jurisdictions have not provided the Charitable Bingo Operations Division with information regarding annexation activity in their area in order to update the CBOD records.

When areas are annexed or have a change in boundaries, the Texas Government Code (Government Code) requires the annexing city to provide notice to interested parties. However, CBOD has never been notified of any boundary changes and therefore records have not been updated since the 1993 Statute adoption that allows certain jurisdictions to receive a portion of the prize fee taxes collected. As a result, some prize fee taxes could potentially be going to counties that are no longer eligible to receive that portion of the tax because a city annexed the area where the bingo hall resides. Conversely, some eligible cities are not receiving prize fee taxes for bingo halls that reside in areas that they have annexed.

Section 2001.503 of the Texas Occupations Code (TOC) entitles the county or municipality to receive 50 percent of the prize fees collected if that county or municipality imposed a gross receipts tax on the conduct of bingo as of January 1, 1993. If both the county and municipality imposed the gross receipts tax, then they are both entitled to 25 percent of the prize fee collected.

The Government Code allows boundaries of municipalities to change through various methods of annexation or transfers. A change in jurisdictional boundaries could impact how prize fee taxes are split between counties and municipalities. For example, if bingo was originally conducted in a jurisdictional area that had not imposed the 1993 gross receipts tax and was subsequently annexed by a neighboring city that had imposed the gross receipts tax, then 25 percent of the prize fee tax would now be allocated to the acquiring city.

Charitable Bingo Operations Division does not have easily accessible and cost effective means to monitor changes in political jurisdictions to identify related impacts to prize fee tax allocations. Research indicated that there is not a comprehensive source of zip codes that has been impacted by boundary changes. Therefore, extensive resources would be required for CBOD staff to monitor and update boundary changes that impact prize fee allocations. Staff would need to dedicate a significant amount of time each year researching web sites for electronic records of boundary changes and then determine which bingo halls reside within those changes.



Implication:

Jurisdictions not providing annexation information to CBOD so that records can be updated accordingly could result in the following risks:

- Inaccurate allocation of prize fee splits between counties and municipalities.
- Charitable bingo could suffer reputational risk due to miscalculated prize fee tax allocations.

Recommendations:

	Recommendation	Responsibility
	Management Action Plan	Due Date
A)	Disseminate an annual notice to all jurisdictions that are eligible to receive a portion of the prize fee tax informing them of their responsibility to notify CBOD of any boundary changes that have occurred. Update BOSS records based upon responses.	Licensing and Accounting Manager
	Management agrees with the recommendation and will work toward BOSS programming such that all affected jurisdictions would be notified annually of their responsibility to notify CBOD of any boundary changes at the street address level using the fourth quarter’s remittance notice of allocations paid so that playing location records could be updated.	March 2015



Appendix

Below is the audit rating scale used by the audit industry to rate audit results and audit observations.

Ratings	Description of Ratings
Deficiency	A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.
Significant Deficiency	A control deficiency or combination of control deficiencies that adversely affects the TLC's ability to initiate, authorize, record, process, or report financial data reliability in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.
Material Weakness	A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's reporting will not be prevented, or detected and corrected on a timely basis.
Comment	A comment is provided when an opportunity to improve controls or business processes is noted. Management comments do not become part of the final report.