

TEXAS LOTTERY COMMISSION INTERNAL AUDIT DIVISION



Internal Audit FOLLOW-UP REVIEW

IA #13-008
December 2012

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

December 17, 2012

Ms. Mary Ann Williamson
Texas Lottery Commission
P.O. Box 16630
Austin, TX 78761-6630

Dear Chair Williamson:

The accompanying report details Internal Audit's completed follow-up review of six previously conducted internal audits. The purpose of the review was to determine whether management has taken actions to correct conditions noted in prior internal audits or has accepted the risk of not taking corrective actions. Internal Audit performed limited work to verify management's assertions. We did not evaluate the effectiveness of actions taken by management to correct the condition. Such work, however, may be performed at the time of future audits.

Management has made considerable progress in addressing issues through the implementation of corrective actions. Of 38 prior findings reviewed, agency management has reported 35 as corrected. Management's reported progress demonstrates a commitment to efficient and effective operations and continuous improvement.

We would like to express our appreciation to agency management and staff for their cooperation and assistance during this engagement. Their courtesy and responsiveness extended to Internal Audit allowed us to complete our work effectively and efficiently.

If you desire further information concerning this review, please do not hesitate to contact me at 512/344-5488.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Catherine A. Melvin".

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

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EXECUTIVE SUMMARY

Internal Audit has completed a follow-up review of previously conducted internal audits from fiscal years 2009 through 2011. Follow up reviews are an important part of audit efforts and are required by both professional internal auditing standards and the Internal Audit Charter approved by the Texas Lottery Commission. In addition, Governor Rick Perry issued a letter in September 2011, to state agencies, including the Texas Lottery Commission, reminding agencies to be vigilant in efforts to reduce government costs by eliminating inefficiencies in operation and remedying any previous audit findings¹.

The purpose of our follow-up review was to determine whether management has taken actions to correct conditions noted in prior internal audits or has accepted the risk of not taking corrective actions. Internal Audit reviewed conditions identified in six previously conducted internal audits as follows:

- Charitable Bingo Licensing
- Background Investigations
- Instant Ticket Game Closing, Return, and Destruction
- Retailer Accounts
- Jackpot Estimations
- Claim Center Prize Validations

Agency management reported it has taken steps to correct 92% of the conditions noted in previous audit findings. Of the 38 original conditions noted, management asserts 35 have been corrected. Of the remaining conditions, Charitable Bingo has one condition considered “In Progress” and two conditions which have not been completed due to a lack of funding. While management asserts actions to correct these conditions have been delayed, it also noted there was no timeline for correction, nor was there a specified plan of implementation at the time of our review. Therefore, it is Internal Audit’s opinion the agency has accepted the risk of not taking corrective action at this time.

Management has made considerable progress in addressing issues through the implementation of corrective actions. Of 38 prior findings reviewed, agency management has reported 35 as corrected. Management’s reported progress demonstrates a commitment to efficient and effective operations and continuous improvement.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★
“I urge you to work closely with your internal auditors, fiscal officers, and other managers, to improve internal control practices and identify and remove costly inefficiencies. It is imperative that you remedy any previous audit findings.”
Governor Perry
September 6, 2011
★ ★ ★ ★ ★ ★ ★ ★ ★ ★

¹ Letter dated September 6, 2011, Texas Governor Rick Perry

A summary of the original conditions noted in each previously conducted internal audit, the current condition as reported by management, and the status of corrective action is presented in the Detailed Review Results section of this report.

The Internal Audit Division stands committed to ensuring efficient and effective processes, and will continue to work with each division to ensure significant issues and risks are identified and addressed.

SUMMARY					
Status of Corrective Actions Taken					
Internal Audit	Corrected	In Progress	Action Delayed	Management Assumes Risk	Total
Charitable Bingo Licensing	10	1	0	2	13
Background Investigations	6	0	0	0	6
Instant Ticket Game Closing, Return, and Destruction	4	0	0	0	4
Retailer Accounts	4	0	0	0	4
Jackpot Estimations	6	0	0	0	6
Claim Center Prize Validations	5	0	0	0	5
TOTALS	35	1	0	2	38

DETAILED REVIEW RESULTS

IA #09-004		Charitable Bingo Licensing		October 2008
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Eligibility Determination	The agency should clearly define the eligibility requirements to obtain a license and the requirements should be based on law. During our audit, we found CBOD applies eligibility requirements that are not based on the current Bingo Enabling Act.	Management reviewed eligibility requirements and updated as appropriate. In addition, legislative changes were occurred which affected the eligibility requirements. These changes have been incorporated into current procedures.	Corrected	
Eligibility Determination	CBOD requires applicants to submit supporting documentation for eligibility requirements which are neither supported by administrative rule nor statute.	Management reviewed minimum documentation needs to meet statutory requirements and updated process accordingly. In addition, legislative changes occurred which affected documentation requirements. These changes have been incorporated into current procedures and processes.	Corrected	
Licensing Process	During our audit, we found a disparity between the level of eligibility verification performed at the time of new license issuance and subsequent renewals. We found CBOD does not verify some eligibility requirements at the time of renewal.	Management has reviewed eligibility requirements at the time of renewal and has reviewed an organization's charitable distributions to ensure significant progress towards the organization's primary purpose. Changes have been incorporated into the renewal application.	Corrected	

IA #09-004		Charitable Bingo Licensing		October 2008
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Licensing Process	Presently, CBOD does not issue temporary authorizations. Rather, CBOD relies upon Charitable Bingo Administrative Rule §402.400 to ensure timely issuance.	Management submitted a rule for adoption by the Commission regarding temporary authorizations. Rule was approved by Commission. Changes to ACBS would enhance division's ability to process temporary authorizations, however such changes will not be able to occur until funding is available. Temporary authorizations are able to be granted without system changes	Corrected	
Licensing Process	Currently, CBOD requires a statement of responsibility only from the member designated as the primary operator and not all members named as operators for the organization.	Legislative changes occurred which no longer require statements of responsibility from all members names as operators for the organization.	Corrected	
Licensing Process	While the intent of CBOD management is to ensure that one person in an organization cannot act on their own to obtain a bingo license without the knowledge and consent of the entire leadership of the organization; this practice has not been formally adopted in administrative rule.	An Administrative Rule for appropriate signature requirements was proposed and approved by the Texas Lottery Commission	Corrected	
Licensing Process	In addition to inherent conflict with statutory provisions, Internal Audit believes the license status, Administrative Hold, as currently executed, creates risk.	Charitable Bingo Division management consulted with the Legal Division and determined the rule for placing bingo license on administrative hold should be considered in compliance with the Bingo Enabling Act.	Corrected	
Licensing Process	While CBOD has access to Internal Revenue Service (IRS) data through the IRS bulletin board, CBOD currently uses and relies upon this service only at the time of license renewal.	Charitable Bingo Division currently uses the IRS website to verify the 501c status during both the original application process and the renewal process.	Corrected	

IA #09-004		Charitable Bingo Licensing		October 2008
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
License Fees	CBOD has not performed an analysis to ensure the fees are set in an amount reasonable to defray current administrative costs. Additionally, CBOD has not formalized this fee schedule in rule.	Immediately after this condition was noted, management performed an analysis of license fees collected and operational costs. Additional correspondence has occurred between CBOD, Legal and the Office of the Controller regarding fees.	In Progress	
License Fees	We found CBOD does not have a system in place to appropriately identify organizations that are due a refund.	An amendment for Charitable Bingo Administrative Rules regarding license fees was proposed and approved by the Texas Lottery Commission to address this condition.	Corrected	
License Fees	While the Act allows for credit to be given during the recalculation process for any excess license fees paid ² , it is unclear whether the agency has authority to allow additional payments from license holders to establish escrow accounts. While CBOD management asserts the Bingo Enabling Act ³ allows the practice for amendments, we found escrow accounts are also used for temporary licenses.	Legislative changes in bingo licensing requirements have occurred which authorize the Commission to establish an escrow account for license fees for amendments to a license or a temporary license.	Corrected	
License Fees	We found CBOD does not verify that the license fee assessed was accurate upon later receipt of the fourth quarter data. Our audit work revealed instances where this practice has resulted in the assessment of inaccurate license fees.	IA recommendations require programing time and resources which are very limited at this time. While management still concurs with the recommendation, the cost of implementing such changes outweighs the risk of not implementing at this time.	Agency accepts the risk ⁴	

² Occupations Code §2001.158(c)(2)

³ Occupations Code §2001.306(e)

⁴ Charitable Bingo Operations Division management reported the status "Action Delayed" since the delay is due to funding challenges, rather than a decision not to implement. However, because there was no timeline for correction nor was there a specified plan of implementation at the time of review, it is Internal Audit's opinion the agency has accepted the risk of not taking corrective action at this time.

IA #09-004		Charitable Bingo Licensing		October 2008
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Automated Charitable Bingo System	We found that there are controls built into ACBS to protect the accuracy and reliability of the data. However, opportunities exist to circumvent controls which have resulted in errors in the system and reduce the integrity of data in the ACBS license ledger.	IA recommendations require programing time and resources which are very limited at this time. While management still concurs with the recommendation, the cost of implementing such changes outweighs the risk of not implementing at this time.	Agency accepts the risk⁵	

⁵ Ibid.

IA #09-005		Background Investigations		December 2008
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Content of Background Investigations	We found the definition of a background investigation depended upon the subject matter of the background investigation and the investigator conducting the review.	Management has modified the background check process and no longer reviews issues associated with a person's or entities' background beyond information found in a criminal history check and any court dispositions. General eligibility verification is no longer performed by Enforcement staff. Procedures have been updated.	Corrected	
Content of Background Investigations	We found investigations are performed differently among the staff, as some staff perform more extensive reviews than others.	Forms and procedures have been updated to reflect the recommended changes. Criminal history checks are no longer conducted on current commission employees being considered for other positions. Approval from the Division Director is required for any deviation from the standard background procedures.	Corrected	
Report Consistency	Some of the content in the background report sections contain varying types of information. In addition, some investigators include information in their reports which has been taken verbatim from the DPS Computerized Criminal History (CCH).	Enforcement has implemented the use of templates to standardize background investigation reports. Additional actions have been taken to further secure CCH information and prevent exposure to the public. Information in reports is limited to clearance notification or only disqualifying criminal history and case disposition information.	Corrected	

IA #09-005		Background Investigations		December 2008
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Review Process	The review process should be strengthened to ensure accuracy, completeness and appropriateness of investigations.	The background investigation report review process has been modified to ensure a thorough management review. In addition, a quality review process has also been established where reports are randomly selected each month for additional quality assurance reviews. Procedures have also been modified to ensure team coordinators do not review their own work. Logs have been created to record criminal history checks and procedures have been developed for their review.	Corrected	
Use of Investigative Tools	All investigators have access to request reports directly from Accurint without prior supervisory approval or review. In addition, while Accurint provides a place for investigators to enter a case number or other identifying information, this feature had not been previously required to be used and was inconsistently applied.	Procedures for accessing database tools have been modified or revised to document these tools are used only for defined purposes. Procedures require users to document specific reasons or case numbers for database searches. Accurint billing statements are reviewed on a monthly basis. A random sample of Accurint searches/reports are selected for review by team coordinators. On a quarterly basis, a random sample of DLIR and TDEX searches are selected for review.	Corrected	
Security of Information	Internal Audit's review revealed improvements are needed to adequately protect and secure criminal history and other sensitive information collected.	Management has implemented access controls and developed procedures to limit access to both electronic and hard copy criminal history information.	Corrected	

IA #09-013		Instant Ticket Game Closing, Return & Destruction		February 2009
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Closing of Games	Because the procedure sets the call dates on a Friday, it is possible for the call dates to be several days after the date the last top level prize is claimed. As a result, the close of game dates are sometimes as many as 52 days after the last top level prize is claimed. This practice could create confusion regarding the timeline for closing a game.	Management's current procedure is to call games in which all top prizes have been claimed on the same business day that Products Department staff is aware the last top prize has been claimed.	Corrected	
Ticket Returns and Destruction	While the Lottery Operator performs analysis of game inventory retrieval by its LSRs, at the time of our audit, TLC did not monitor the Lottery Operator's retrieval of game inventory. Nor did TLC perform an analysis of tickets returned after the close of game date. However, TLC management has recently drafted procedures to better monitor the Lottery Operator's retrieval of closing game ticket inventory.	Management currently monitors the Lottery Operator's ticket retrieval process and performs an analysis of auto-settled packs by district and by retailer over a given period of time.	Corrected	
Ticket Returns and Destruction	While our testing and observations confirm the Lottery Operator retrieved closing game inventory within the 45 day timeframe and instituted controls to assist their ongoing conformance, it is important that TLC is able to enforce this requirement should the Lottery Operator fail to meet the mandated timeframe in the future.	Management has included a requirement that tickets be returned within 45-days of game close date in the current Lottery Operator contract. This requirement will be monitored for compliance by a third-party vendor, Grant Thornton.	Corrected	

IA #09-013		Instant Ticket Game Closing, Return & Destruction		February 2009
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Process Limitations	After the game closing date, TLC is reliant upon the retailer to no longer sell tickets of closed games that remain in the retailer's possession.	An administrative rule to be placed in the Restricted Sales rule was submitted for consideration to the Texas Lottery Commission and placed on the Texas Register. The rule was approved and adopted by the Commission in the June 2012 Commission Meeting.	Corrected	

IA #09-020		Retailer Accounts		October 2009
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Retailer Accounts Sweep Process	Policies that drive how the ProSys and ICS systems calculate and apply retailer commissions to retailer accounts have not yet been documented.	Management has implemented processes and established procedures for documenting policies within the Lottery Operator system and ICS.	Corrected	
Tools for Protecting the State	The agency has not established policy or procedures regarding the use of the pooled bond fund.	The Executive Director approved a directive for the use of the pooled bond fund.	Corrected	
Tools for Protecting the State	The current practice does not facilitate an examination and analysis of the adequacy of amounts needed to protect the State from possible loss.	Management conducted an analysis of financial security requirements and made recommendations for continuance of current CD requirements. Management has committed to performing similar reviews to ensure recommendations remain valid.	Corrected	
Tools for Protecting the State	While documentation of the financial security is not a bearer instrument, consideration should be given to determine whether the Office of the Controller might more appropriately maintain custody and control of such documents.	Management has performed reviews of the CD documentation kept within Retailer Services and has established procedures for reviewing such documentation at least annually. In addition, a secure location in the document repository has been established for such documentation.	Corrected	

IA #10-003		Jackpot Estimations		May 2010
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Jackpot Estimation Process	While the amounts recorded in the Jackpot Estimation Checklist are intended to represent the agreed-upon negotiated amounts, there is no sign-off or evidence of agreement by Products to provide confirmation that both parties approved the final negotiated number recommended.	Management has implemented processes and established procedures to incorporate the Products Department staff documenting its agreement with the final negotiated number on the checklist prepared by the Controller staff.	Corrected	
Jackpot Estimation Process	We found nine (9) instances in which the Jackpot Estimation Checklist information varied from the information on the Jackpot Estimation Worksheet, without documented explanation. Two instances were noted in which the Jackpot Estimation Checklist was signed subsequent to the Jackpot Estimation Worksheet.	Management has implemented procedures to ensure deviations from the Jackpot Estimation Worksheet are documented on the Jackpot Estimation Checklist. Management has also reminded team members of the importance of reviewing the Jackpot Estimation Checklist in a timely manner.	Corrected	
Accuracy of Sales Projections	While the accuracy of the estimation is an important objective, responsible management has not yet formalized a process to assess its efforts in this area.	Management has formalized the ongoing review and assessment of estimation efforts in procedure.	Corrected	
Advertisement of Jackpot Amounts	In various Commission meetings, the Commissioners have historically directed the Executive Director to vote conservatively - directing the Executive Director to only vote for an advertised jackpot amount that is supported by the Finance Committee's total projected sales amount. <i>This direction, however, has not been formalized in either rule or procedure.</i>	Management has incorporated language regarding Commission's directions regarding the Executive Director's vote on Mega Millions Jackpot Estimation into current procedures.	Corrected	

IA #10-003		Jackpot Estimations		May 2010
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Advertisement of Jackpot Amounts	Responsible management indicated that while the interest factor is closely monitored, they did not anticipate ever basing the advertised jackpot amount on anything other than the estimated sales and the interest factor obtained on the date of estimation. However, the potential for volatility of the interest factor should continue to be monitored as an unanticipated drop in the interest factor may have a significant negative fiscal impact in certain scenarios.	Management and staff continue to closely monitor the potential for volatility of the interest factor.	Corrected	
Publication of Lotto Texas Procedures	In July 2006 and February 2008, SAO recommended proposed policies and procedures that affect Lotto Texas players be adequately communicated to the public and the public be given an opportunity to propose changes or make comments prior to approval by the Commissioners. At the time of the State Auditor's recommendations, agency management had not defined what constitutes a change that impacts the player. In addition, the desk procedures have not been separated from the procedures that do have an impact on the player. Without a distinction, the agency has adopted an overly broad and conservative approach by publishing the full content of all procedures which directly relate to Lotto Texas. This has resulted in unnecessary and unintended inefficiency and delay in responsiveness to needed administrative changes.	Management has segregated procedures that impact players from desktop procedures.	Corrected	

IA #11-004		Claim Center Prize Validations		March 2011
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Claimant Experience	While excellent customer service is a stated critical objective, we found measures of the quality of service provided are currently not formally tracked or captured. Without capturing data and comparing actual performance to expectations, management cannot effectively and objectively assess whether quality customer service is being provided.	Management has developed a formal process for tracking customer service experiences through the use of a spreadsheet. Procedures were developed to document this process and provide management review of comments received.	Corrected	
Claimant Experience	While management strives to process mail-in claims within two weeks, we found this goal has not been formalized. Accordingly, a system to formally monitor processing times has not yet been established. We found unpaid or incomplete claims were tracked manually and some claims remain open and unpaid for several months while awaiting the claimant to provide requested information.	Management has implemented a system-generated report to monitor and track pending claims, including both live tickets and pending claims. Staff will work with Information Systems to further enhance this report.	Corrected	
Management Controls	Risk that an unauthorized check could be processed unnoticed since some staff members are in a position to monitor their own work without additional oversight.	Management has implemented a process and established procedures for the monthly review of Administrative Claims Report by the Drawings and Validations Manager.	Corrected	

IA #11-004		Claim Center Prize Validations		March 2011
Risk Area	Original Finding/Condition	Management's Assertion		
		Current Condition (Summarized)	Status	
Management Controls	Without reviewing the physical voided check during the reconciliation process, the Office of the Controller is not able to verify that all checks voided in the system have either had a stop payment placed on the check or the physical check has been forwarded to the Office of the Controller. Without the verification being performed during the reconciliation, there is a risk that a check voided in the system could be presented for payment.	Management has implemented a process and established procedures for tracking and accounting for checks voided at lottery claim centers or headquarters, including placement of stop payment for all invisible check ~a check that does not print but a check number has been issued.	Corrected	
Management Controls	We found that management has not developed formal performance indicators or targets for determining if all of management's goals and objectives are being achieved.	Management continues to monitor performance through both internal management controls and newly implemented customer experience tracking. This will be an ongoing process that continues over time.	Corrected	

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AUDIT PURPOSE, SCOPE AND METHODOLOGY

Purpose:

Internal Audit completed follow-up reviews of six previously conducted internal audits. Professional internal audit standards and the Internal Audit Charter require Internal Audit to determine whether corrective action was taken on reported audit findings or that senior management has assumed the risk of not taking corrective action.

Scope:

Internal Audit's follow-up review focused on six previous internal audits conducted between fiscal years 2009 and 2011, as follows:

- Charitable Bingo Licensing
- Background Investigations
- Instant Ticket Game Closing, Return, and Destruction
- Retailer Accounts
- Jackpot Estimation
- Claim Center Prize Validations

Internal Audit's review concentrated on determining whether management has taken corrective action on reported audit findings or has assumed the risk of not taking corrective action. Internal Audit performed limited work to verify management's assertions. We did not evaluate the effectiveness of actions taken by management to correct the condition. Such work may be performed at the time of future audits.

Methodology:

In accomplishing our objective, Internal Audit reviewed previous audit findings, recommendations, management responses, and corrective action plans. Division directors were requested to provide information on the current status of corrective actions for the issues identified and to identify the corrective status of each condition as follows:

- **Corrected** - *Management has taken corrective actions so that the issue/condition noted in report no longer exists.*
- **In Progress** – *Management is in progress of taking corrective actions; however all planned actions are not yet completed.*
- **Action Delayed** – *Complete corrective action is on hold dependent on another variable such as funding, statutory authority, rule adoption, or other mechanism.*
- **Management Assumes Risk** – *Management has decided to not implement or take corrective actions and assumes any related risk.*

Internal Audit then performed a review of the information and documentation provided by management, including applicable administrative rules and agency procedures. Internal Audit also interviewed responsible management and staff, examined and reviewed supporting documentation and electronic files, and performed limited test work as deemed necessary. Finally, based on our review, Internal Audit made a final determination of the corrective action status independent of management.

Auditor’s Consideration of Fraud:

In accordance with our professional standards, Internal Audit considered risks due to fraud that could significantly affect our audit objectives and the results of our audit. Accordingly, we designed our procedures to provide reasonable assurance of detecting fraud significant to the audit objectives. During the course of the audit, we were also alert to situations or transactions that could be indicative of fraud. We conducted our audit to provide reasonable assurance of detecting illegal acts or fraud that could significantly affect the audit results; however, it does not guarantee the discovery of illegal acts or fraud.

Professional Standards:

Internal Audit conducted this follow-up audit in accordance with the International Professional Practices Framework (IPPF) as promulgated by the Institute of Internal Auditors (IIA) in conjunction with generally accepted government auditing standards (GAGAS) as promulgated by the U.S. Government Accountability Office (GAO). 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.

Audit Team

The following members of the Internal Audit Division performed this audit:

- Nancy Walden, CIA, CGAP, CICA, Project Manager
- Murray Harvel, CISA
- Nick Martinez
- Kim Tucker

STATE OF TEXAS
TEXAS LOTTERY COMMISSION

INTERNAL AUDIT DIVISION

Internal Audit
FOLLOW-UP REVIEW

IA #13-008

December 2012

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. Bruce Miner, Acting Charitable Bingo Operations Director

This report is also provided to the following for appropriate distribution in accordance with
Government Code §2102.009:

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