

TEXAS LOTTERY COMMISSION INTERNAL AUDIT DIVISION



An Internal Audit of CHARITABLE BINGO LICENSING

IA #09-004
October 2008

James A. Cox, Jr.
Chairman

David J. Schenck
Commissioner

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Commissioner



TEXAS LOTTERY COMMISSION

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October 28, 2008

Mr. James A. Cox, Jr.
Texas Lottery Commission
P.O. Box 16630
Austin, TX 78761-6630

Dear Chairman Cox:

The accompanying report details Internal Audit's recently completed review of Charitable Bingo Licensing and the Automated Charitable Bingo System (ACBS). This audit was approved in the FY08 Internal Audit Activity Plan. The purpose of the audit was to evaluate the effectiveness and efficiency of licensing and the reliability of ACBS data. Specifically, we focused our review on the activities related to bingo conductors.

Overall, we found current licensing activities and processes require improvement to ensure licenses are processed effectively, efficiently, and in compliance with the Bingo Enabling Act. In addition, our review disclosed errors in the system which reduces the integrity and reliability of data in ACBS. Specifically, our testing revealed the information contained in the regular licensing ledger is not sufficiently reliable.

Our report makes recommendations to assist the division in strengthening its overall processes and controls related to bingo licensing and its automated system.

Responsible management has expressed agreement with Internal Audit's conclusions and recommendations detailed in the report and has included corrective actions in its responses. 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

Charitable bingo provides non-profit organizations in Texas an opportunity to raise money for charitable activities. The Charitable Bingo Operations Division (CBOD) of the Texas Lottery Commission (TLC) is responsible for licensing authorized organizations to conduct charitable bingo games in the state of Texas. CBOD relies on the Automated Charitable Bingo System (ACBS) for licensing and financial data.

The purpose of our audit was to evaluate the effectiveness and efficiency of licensing and to evaluate the reliability of ACBS data. We limited our review to the activities related to bingo conductors.

Overall, we found current licensing activities and processes require improvement to ensure licenses are processed effectively, efficiently, and in compliance with the Bingo Enabling Act. In addition, while there are controls built into ACBS to protect the accuracy and reliability of the data regarding prize fee payments, allocations and fundamental license data, opportunities exist to circumvent these controls. Our review disclosed errors in the system which reduces the integrity and reliability of data in ACBS. Specifically, our testing revealed the information contained in the regular licensing ledger is not sufficiently reliable.

The changes recommended in this report require CBOD take an organized and thoughtful approach while considering all licensing activities and processes. Overall, we recommend CBOD implement a re-engineering project to update and streamline the licensing process and concurrently commence a data clean-up project to ensure accurate accounting of license fees. The re-engineering project should take a holistic approach to ensure the following:

1. all eligibility requirements are derived from the current Bingo Enabling Act,
2. the administrative rules are aligned with the Act, and
3. administrative rules and guidelines are established to provide clarification and/or interpretation of the Act as needed.

Only after completion of a re-engineering project can CBOD effectively make changes to licensing procedures and processes.

Detailed results and recommendations of Internal Audit's review are presented in the "Detailed Review Results" section of this report. Management's detailed responses are presented in a table later in this report.

Internal Audit would like to express our appreciation to the Charitable Bingo Operations Division and other agency 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.

**MANAGEMENT'S OVERALL
RESPONSE**

Charitable Bingo Operations Division (Division) management responses to this report describe our efforts and plans to improve and strengthen the overall process and controls related to bingo licensing and the reliability and integrity of the data maintained in the Automated Charitable Bingo System (ACBS), specifically related to the licensing ledger. Division management has expressed full agreement with the identified opportunities for improvement as detailed in this report. Management has provided our responses to the specific recommendations immediately following each set of recommendations in the Detailed Results section of this report.

The Division has begun a review of all procedures relating to the licensing process to ensure eligibility requirements are derived from the current Bingo Enabling Act and will clearly define the documentation required to determine eligibility. Concurrently, the Division has commenced a data clean-up project that not only will encompass the accuracy of license fees but other areas that could possibly affect the reliability of the system or information provided. After completion of the re-engineering project, the Division will implement the changes to the licensing procedures to ensure licenses are processed effectively, efficiently, and in compliance with the Bingo Enabling Act.

The Division has also included in its Legislative Appropriation Request (LAR) for FY 2010 – 2011 an exceptional item for funding a redesign of the ACBS. An added benefit of the re-engineering project is that should funding be granted for a new system, the majority of the design phase and business analysis would be completed. This should enable an earlier completion of the system.

We will continue to work with the Legal Division, Information Resources and the Office of the Controller in our review and development of rules, system enhancements, and accurate accountability of license fees.

Finally, the Division will respond to any additional guidance it receives from our oversight committee, the House Committee on Licensing and Administrative Procedures.

DETAILED REVIEW RESULTS

The following results represent both areas of success and opportunities for the Charitable Bingo Operations Division (CBOD) to strengthen its overall processes and controls related to licensing bingo conductors. The changes recommended in this report require CBOD take an organized and thoughtful approach in taking corrective action while considering all licensing activities and processes in implementing any recommendations. Overall, we recommend CBOD implement a re-engineering project to update and streamline the licensing process and concurrently commence a data clean-up project to ensure accurate accounting of license fees. Only after completion of a re-engineering project can CBOD effectively make changes to licensing procedures and processes.

Detailed management responses are presented in a table later in this report.

1

Customer Service – *Conductor license applicants surveyed responded that the Charitable Bingo Operations Division provides positive customer service.*

Internal Audit conducted a telephone survey to determine applicants' opinions about the customer service they received during their application process for a new bingo conductor's license. Internal Audit called each of the 133 organizations that submitted an application for a new annual conductor's license during the period of January 2006 through April 2008. Forty-five percent¹ of the organizations participated in the survey and provided the following responses.

Over 90% of applicants surveyed responded:

- the overall customer service provided by CBOD met or exceeded their expectations, and
- the application was easy or average to complete.

Over 80% of those surveyed responded:

- the overall licensing experience met or exceeded their expectations,
- the application instructions were easy or average to understand, and
- it was clear or average to understand the documentation required to be submitted with the application.

Some comments we received during the survey regarding CBOD and the application process included:

- "People were outstanding."
- "Thought it would be more difficult than it was."
- "If we had questions, we called CBOD. They were very helpful."
- "We have been in existence for a long time. It is hard to find the documentation."
- "A lot to it. The process needs improvement, not the people."

¹ The Texas Lottery Commission Research team advised Internal Audit that to be considered reliable the survey needed a minimum 40% response rate.

2

Eligibility Determination – The Charitable Bingo Operations Division should ensure all eligibility requirements are derived from the current Bingo Enabling Act and should clearly define the documentation required to determine eligibility.

One of the primary responsibilities of the licensing function of a regulatory agency is to determine the eligibility of an applicant for a license. Best practices in carrying out a state regulatory program maintain that the regulatory agency “should establish standard definitions, guidelines, criteria, qualifications, etc. for each type of entity to be regulated.”² 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 and CBOD requires applicants to submit supporting documentation for eligibility requirements which are neither supported by administrative rule nor statute.

a) Eligibility Requirements

i. Outdated Eligibility Criteria

As the regulator, the Charitable Bingo Operations Division has a responsibility to license organizations based on eligibility requirements set forth in the Bingo Enabling Act. We found CBOD applies eligibility requirements based on an outdated version of the Bingo Enabling Act. The Bingo Enabling Act was recodified by the 76th legislature in September 1999. The recodification was intended to be a nonsubstantive revision of the statute therefore CBOD management believed the eligibility requirements as defined by the prior version were still in effect. For example, prior versions of the Bingo Enabling Act contained a requirement in the definition of a “nonprofit organization” to have a governing body or officers elected by vote or be affiliated with a national or state organization for at least three years.³ While this requirement is no longer in the definition of a “nonprofit organization”, CBOD continues to require this of nonprofit organizations such as veterans’ organizations.

Two separate Attorney General opinions,⁴ requested by the Texas Lottery Commission related to bingo activities, both issued January 2007, cited a Supreme Court of Texas conclusion:

[W]hen...specific provisions of a “nonsubstantive” codification and the code as a whole are *direct, unambiguous, and cannot be reconciled with prior law*, the codification rather than the prior, repealed statute must be given effect.... The codifications enacted by the Legislature are the law of this State, not the prior, repealed law. When there is no room to interpret or construe the current law as embodying the old, we must give full effect to the current law. General statements of the Legislature’s intent cannot revive repealed statutes or override the clear meaning of a new, more specific statute.⁵

² “Carrying Out a State Regulatory Program, A National State Auditors Association Best Practices Document,” Published by the National State Auditors Association, 2004

³ Title 6 Article 179d, Section 2(3)

⁴ Opinion No. GA-0499, January 12, 2007

⁵ Opinion No. GA-0505, January 25, 2007

ii. Misapplied Eligibility Criteria

During our audit, we found instances in which CBOD applies valid eligibility requirements for one type of authorized organization to other types of authorized organizations. For example, an eligibility requirement for a fraternal organization states the organization “must have had during the three-year period a bona fide membership actively and continuously engaged as an organization in furthering its authorized purposes.”⁶ CBOD applies the “actively and continuously engaged” eligibility criteria to all types of authorized organizations, not just fraternal organizations.

We recommend CBOD review and update licensing procedures to accurately reflect the eligibility requirements set forth by the current Bingo Enabling Act. We further recommend CBOD review the eligibility requirements for all other types of bingo licenses to ensure the eligibility requirements contained in the current Bingo Enabling Act are accurately applied.

iii. Unclear Eligibility Criteria

The Bingo Enabling Act prohibits the issuance of a license to conduct bingo if “an officer of the organization” has a disqualifying conviction.⁷ The Texas Non-Profit Corporation Act differentiates between a non-profit corporation’s board of directors and its officers.⁸ During our review of licensing files, we found organizations’ bylaws that also differentiated between officers and directors. CBOD, however, has not defined the term “officer” in administrative rule and in practice does not distinguish between officers and directors. CBOD submits both the officers and the directors of an organization to the Texas Department of Public Safety (DPS) for a criminal history background check. This creates an unnecessary burden for both applicants and license examiners.

Other examples of unclear eligibility criteria are the requirements “all persons who will conduct, promote, or administer the proposed bingo are active members of the applicant organization...”⁹ and “the applicant has made and can demonstrate significant progress toward the accomplishment of the purposes of the organization...”¹⁰ CBOD has not defined the critical terms “active members” and “significant progress” in administrative rule. Without clear public definition of critical terms, CBOD cannot ensure fair, consistent application of eligibility requirements. We recommend CBOD develop rules to define critical terms related to eligibility that may be contained in the Bingo Enabling Act, and modify procedures accordingly.

b) Required Documentation

Supporting documentation is a necessary component in assessing eligibility for a conductor’s license. The licensing entity must first ascertain and identify the supporting documentation needed, and then clearly communicate these requirements to the applicant. During our audit, we found that some of the documentation required to be submitted by applicants was not always necessary.

CBOD utilizes a single application for a conductor’s license for all types of authorized organizations. Because of the need to consolidate differing requirements in a single application,

⁶ Occupations Code §2001.101(b)(2)

⁷ Occupations Code §2001.105(b)

⁸ Vernon’s Texas Civil Statutes, Chapter 9

⁹ Occupations Code §2001.105(a)(5)

¹⁰ Occupations Code §2001.105(a)(4)

the documentation requests are purposely broad and vague. For example, the application for a new conductor's license states that an applicant must submit "every type of organizing instrument that may apply to your organization."¹¹ In addition to being unclear, this requirement may be overwhelming for applicants. Our review of the licensing files revealed extensive two-way communication with the applicants to clarify the documentation needed to verify eligibility. It was evident in our review that applicants were unclear as to the documentation needed. This results in additional effort and time on the part of the licensing examiner and applicant. As stated above, the Bingo Enabling Act has eligibility requirements that are unique to each type of authorized organization and thus documentation required to determine eligibility should be specified for each type of applicant and clearly communicated on the application.

Furthermore, we noted instances in which documentation requested is not supported by requirements specified in rule. For example, the application instructions state that the organization, at a regular meeting of the membership, must have voted to conduct bingo as a fund raising activity and must submit meeting minutes indicating the organization voted to conduct bingo. However, the Charitable Bingo Administrative Rules state that an organization must provide this documentation only if the organization is "applying to conduct bingo occasions at premises other than those used by it for its general activities..."¹²

CBOD should consider revising the bingo conductor application so that each type of authorized organization utilizes a separate application tailored to that type of organization. The application should provide clear instructions to the specific documentation the applicant needs to submit for CBOD to determine eligibility. To ensure successful implementation, we recommend CBOD first assess the minimum documentation needed to verify each eligibility requirement for each type of authorized organization. CBOD should ensure all requirements are supported by both statute and rule.

3

Licensing Processes – *The Charitable Bingo Operations Division should improve its licensing processes to ensure compliance with the Bingo Enabling Act and to ensure consistency in its verification procedures.*

a) Verifications Performed for New License vs. License Renewal

The Bingo Enabling Act sets forth conditions that must be met before the commission can issue or renew a license to conduct bingo. 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.

For example, an organization must submit membership lists when applying for an original license to conduct bingo. CBOD then verifies the officers and operators named in the application are members of the applicant as required by the Bingo Enabling Act.¹³ However, while the renewal application contains language that all listed as officers and operators must be members of the organization, CBOB does not verify this information. At the time of renewal, CBOD does not

¹¹ Texas Application for an Original License to Conduct Charitable Bingo

¹² TAC §402.403(a)(4)

¹³ Occupations Code §2001.105(a)

verify that all listed officers and operators, including any new officers or operators, are in fact members of the organization.

Another example of disparity is the verification performed against the Bingo Worker Registry. Before an original license is issued, CBOD verifies that all members named as an operator for the applicant are also listed in the Bingo Worker Registry as required by the Bingo Enabling Act.¹⁴ However, at the time of renewal, CBOD only verifies registry listing for the operator that actually signed the renewal application.

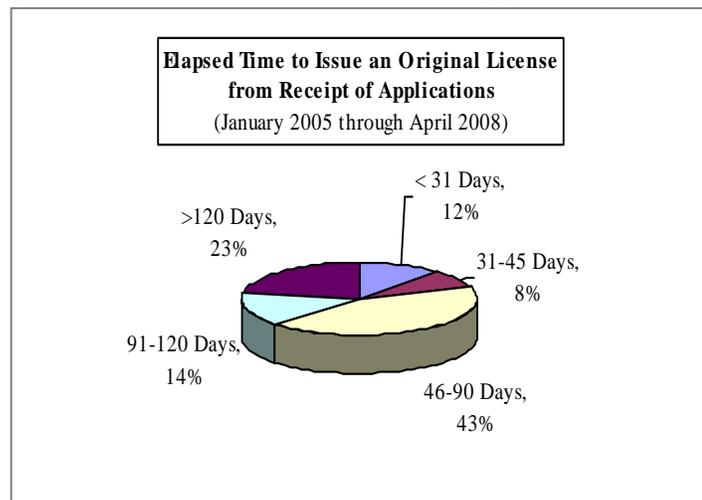
The Bingo Enabling Act does not differentiate between the requirements of issuing an original conductor's license and issuing a license renewal. Therefore, CBOD should perform verifications necessary to ensure continued eligibility at the time of renewal.

b) Temporary Authorization

The Bingo Enabling Act requires the commission to issue a "temporary authorization" if the license for a new applicant has not been issued or denied before the 31st day after the earliest date on which each of the following has occurred:

1. filing of an application,
2. payment of the required license fee,
3. verification of 501(c) status via copy of tax exemption statement issued by the IRS, if applicable, and
4. completion of criminal background investigations.¹⁵

Presently, CBOD does not issue temporary authorizations. Rather, CBOD relies upon Charitable Bingo Administrative Rule §402.400 to ensure timely issuance. Charitable Bingo Administrative Rule §402.400 requires a 14 day timeframe from receipt of an application for CBOD to (1) issue a license, (2) deny a license, or (3) require additional information from the applicant. However, in most instances, CBOD does not issue or deny the license within 14 days. As stated earlier in this report, our review of the licensing files revealed extensive two-way communication with the applicants to clarify the documentation needed to verify eligibility. This correspondence has resulted in a revolving 14 day timeframe to request and receive additional information from the applicant. By allowing for a revolving 14 day timeframe, the rule in effect circumvents the requirement in the Bingo Enabling Act to issue a temporary authorization before 31 days.



Of applications received and ultimately issued during the period January 2005 and April 2008, 88 % were issued past the 30th day of application receipt. See Figure 1.

¹⁴ Occupations Code §2001.313(d)

¹⁵ Occupations Code §2001.304(a)

We recommend CBOD review and amend the current administrative rules related to licensing timelines to ensure compliance with the Bingo Enabling Act. We further recommend the administrative rules outline the method the division will use to establish the 31 day timeline and issue temporary authorizations.

c) *Designated Member Statement of Responsibility*

The Bingo Enabling Act requires each organization to submit the name of one or more members designated as the operator responsible for conducting bingo and requires each operator sign a statement of responsibility acknowledging they are responsible and will comply with the terms of the license issued.¹⁶ 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. We recommend CBOD obtain a signed statement of responsibility from all members named as operators as required by the Bingo Enabling Act. This will help to ensure all named as operators are aware of the responsibilities they are undertaking when designated as operator on a bingo license.

d) *Application Instructions*

The application for an original license to conduct bingo states that an officer and primary operator must sign the affidavit of responsibility. The application further requires that the officer cannot sign as the primary operator. 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. In effect, CBOD is setting policy via the conductor license application instructions. This practice, as set forth in the application instructions, should be formalized in administrative rules.

e) *Administrative Hold*

CBOD allows licensees to place their license in “administrative hold” status upon the licensee’s request.¹⁷ CBOD management asserts this status was created to allow licensees that temporarily do not have a playing location to maintain their license while seeking a new location. CBOD management indicates the intention was to relieve the licensee’s burden of losing their license due to the lack of a playing location, the subsequent need to re-submit an original license application, and the administrative burden of repeating the eligibility verification process.

While in administrative hold status, the licensee maintains their license but may not engage in bingo activities. Charitable Bingo Administrative Rule §402.400 states “once the license has been placed in administrative hold, all bingo activity (i.e. leasing, conducting bingo) must cease until the licensee files an amendment and the amended license is issued...” The rule further requires the licensee to “file all reports, returns and remittances required by law” and to “file a timely and complete application for renewal of the license each time the license is ripe for renewal.” Licensees in administrative hold must also continue to pay the minimum annual license fee.

In our opinion, the status of administrative hold raises several concerns. These concerns include the following:

¹⁶ Occupations Code §2001.102(b)(10)

¹⁷ TAC §402.400(l)

- **Statutory Concerns** – The Bingo Enabling Act states an application to conduct bingo must include “an indication of the premises where and the time when bingo is to be conducted.”¹⁸ Currently, CBOD requires each initial license application and each renewal license application to indicate the intended playing location and time. However, with the creation of administrative hold status, CBOD has waived this requirement for those licensees. By renewing the license without the playing location and time indicated as required, CBOD does not appear to be in compliance with the Bingo Enabling Act.

Further, since the Bingo Enabling Act does not specifically authorize such a license status, it is unclear whether statutory authority and support exists for the creation of administrative hold status.

- **Time Limit** – There is no apparent time limit to how long a licensee may remain in administrative hold status. This is particularly concerning given the issues identified earlier in this report under Section 3 related to the extent of eligibility verification performed at renewal.
- **Performance Measures** – The status of administrative hold also has an impact on the agency’s reported performance measure data. Although a license in administrative hold status does not allow the license holder to conduct bingo activities, it is included in the number of active licenses reported under the agency’s performance measure system. Including this data may give a false impression regarding the actual number of licenses issued or in existence, and ultimately impact on efficiency measures.

Ultimately, administrative hold requires the license holder to renew timely, submit required reports, and submit an annual license fee, but does not allow the license holder to conduct the activity authorized by the license. In addition to inherent conflict with statutory provisions, Internal Audit believes this license status, as currently executed, creates risk.

We recommend CBOD revisit the appropriateness and necessity of the administrative hold status. CBOD should work with the Legal Division to ensure any administrative rules related to placing bingo licenses on administrative hold are in compliance with the Bingo Enabling Act. This review should be extended to all types of bingo licenses to ensure appropriate authority for issuing a license in administrative hold.

f) Efficiency of Effort

The Bingo Enabling Act requires that certain authorized organizations maintain tax exempt status under Section 501(c) of the Internal Revenue Code.¹⁹ An organization that submits an original application for a conductor’s license is asked to provide CBOD with supporting documentation of their 501(c) exemption. However, 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. Using the IRS data currently available to CBOD for both original and renewal verifications would streamline the application process for both the applicant and the licensing examiner, reducing the amount of time, effort, and paperwork. Additionally, CBOD should assess the availability and value of any other opportunities to independently verify eligibility without having to obtain documentation from the applicant.

¹⁸ Occupations Code §2001.102(b)

¹⁹ Occupations Code §2001.002(19)(B)

4

License Fees – *The Charitable Bingo Operations Division should improve efforts to ensure the proper, compliant, and responsible administration of license fees.*

a) Assessment of License Fees

The Bingo Enabling Act establishes minimum fee amounts for licenses to conduct bingo. The minimum amounts cited in the Act have not changed since they were initially established in 1983. The Bingo Enabling Act also states “the commission shall set the fees for a license to conduct bingo in an amount reasonable to defray administrative costs...”²⁰ CBOD assesses license fees equal to the minimum license fees established by the Bingo Enabling Act. While CBOD management asserts license fees collected have exceeded the general appropriation to administer the Act each fiscal year since 1983, 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.

CBOD should perform an analysis to determine the fees necessary to operate the division and then formalize the license fee schedule in rule.

b) Refunding License Fees

In the event an organization ceases to be licensed, withdraws an application for a license before a license is issued, or is otherwise due license fees paid, Charitable Bingo Administrative Rules state that an organization must submit a written request for a refund.²¹ Unlike payments for prize fees, we found CBOD does not have a system in place to appropriately identify organizations that are due a refund. While correspondence from CBOD states that an organization can request a review of their account, organizations may not know they are due a refund. Further, limited reliability in the data contained in the automated system (as detailed in Section 5 of this report) results in an inability to rely upon balances reflected in licensee accounts.

We recommend CBOD model the process for refunding license payments after the process for refunding prize fee payments which is prompted by the automated system instead of by request from the organization. However, CBOD must first complete a data clean-up project for license data (as detailed in Section 5 of this report) to ensure accurate balances are reflected in licensee accounts.

c) Additional Payment of License Fees

Charitable Bingo Administrative Rules state, “an organization may submit an excess license fee payment to be applied to fees in connection with future license applications.”²² The organization must designate the future license application type(s) to which the excess payment will be applied.²³ To administer these excess fee payments, CBOD creates and maintains license holder “escrow” accounts for future license fee payments for temporary licenses or license amendments.

²⁰ Occupations Code §2001.104(a)

²¹ TAC §402.404(f)

²² TAC §402.404(e)(3)

²³ TAC §402.404(e)(3)

While the Act allows for credit to be given during the recalculation process for any excess license fees paid²⁴, 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 Act²⁵ allows the practice for amendments, we found escrow accounts are also used for temporary licenses. In addition, the current accounting treatment of the escrow funds is of concern as there is no differentiation made in the agency's accounting records between the funds that are held for future license fees and those that are applied to current license fees. Furthermore, because of the control weaknesses identified in the automated system related to license data (as detailed in Section 5 of this report) maintaining escrow accounts creates further risk for the agency. We recommend CBOD seek assistance from the Office of the Controller to review the appropriateness of and the risks associated with the current practice of establishing and maintaining escrow accounts.

d) *Recalculation of License Fees*

The license fee due at renewal is the recalculated license fee from the preceding year.²⁶ The Bingo Enabling Act requires the commission recalculate the license fee based on the "amount of gross receipts actually recorded during the license period to determine if the appropriate fee amount was paid."²⁷ However, renewals for licenses must be filed with the commission before the expiration date of the current license held.²⁸ Since the commission has only three quarters of actual gross receipts reported for the license period at the time of renewal, CBOD either estimates fourth quarter receipts or uses the fourth quarter's gross receipts from a prior license period, if available, to recalculate the license fee for next period. We found, however, 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. CBOD did not identify additional fees due as appropriate.

Additionally, license fee recalculations are further complicated when changes are later made to an organization's prior period gross receipts. The division's automated system does not alert CBOD of amendments made to previously reported gross receipts that will impact the recalculated license fee.

We recommend CBOD separate the processes of estimating the license fee due at renewal and recalculating the prior license period's fees. CBOD should recalculate the license fee using actually recorded gross receipts reported by the organizations as required by the Bingo Enabling Act. CBOD should also request programming changes to its automated system to detect changes in gross receipts reported after the license fee recalculation has been computed to ensure accurate collection of fees.

²⁴ Occupations Code §2001.158(c)(2)

²⁵ Occupations Code §2001.306(e)

²⁶ TAC §402.404(c)(1)

²⁷ Occupations Code §2001.104(b)

²⁸ TAC §402.400(o)(5)

5

Automated Charitable Bingo System – *The Charitable Bingo Operations Division should undertake efforts to ensure the accuracy, integrity, and reliability of the Automated Charitable Bingo System.*

The division's automated system, Automated Charitable Bingo System (ACBS), contains financial, license and audit data for bingo license holders. The division relies on ACBS to track financial, licensing, operational, enforcement, and other activities. Internal Audit performed a control review of ACBS including data testing of the documented controls in order to determine the reliability of ACBS data. 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.

a) *Prize Fee Payments & Quarterly Report Entry*

During our audit, we found that adequate and effective controls are in place to ensure the accuracy and reliability of data entry of quarterly report data, calculation of charitable distribution requirements, data entry and calculation of prize fee payments, and ultimately, allocation of prize fees to counties and municipalities. Controls include automated reports to alert CBOD that an organization:

- has over or under paid prize fees,
- has not disbursed the required charitable distribution,
- has not filed the required quarterly report, or
- has filed a quarterly report with possible erroneous data.

Our testing revealed that when there are clear and complete payment and quarterly report submissions from the license holders, this data in ACBS is sufficiently reliable. However, license holders do not always submit accurate data. Our testing of quarterly reports revealed 30% contained erroneous and incomplete data submissions from conductor license holders and 20% included incorrect payments for prize fees. These errors were identified by the system and ultimately resulted in adjustments and/or amendments to data in ACBS.

Data accuracy can be compromised by organizations that submit late reports and/or amend previously reported information. Difficulties are also encountered in discerning some of the bingo license holders' intentions when making payments that are not accompanied with documentation or explanation. This places a burden on CBOD staff to initially guess a purpose for the payment in order to meet state requirements for timely deposits. This often results in adjustments and amendments applied later in the process, once the proper purpose is finally determined. Adjustments and amendments typically require rework and manual intervention, and each manual intervention increases the risk of errors to data in ACBS.

b) *License Data Entry*

In testing the accuracy of license application data entry, we found no errors in the general license information such as the name of the organization and playing location and times. However, we noted errors in 11% of the license records tested for individuals listed as officers and/or operators on the application. These errors consisted of individuals that the applicant requested to be removed from the license record, but remained in ACBS, and individuals to be included on the license record, but were not listed in ACBS. Therefore, the ACBS records regarding operators

and officers for an organization are not sufficiently reliable. In addition to the lack of reliability, ACBS may have prompted unnecessary background checks or may have omitted needed background checks.

c) License Fees

The Automated Charitable Bingo System generates a license ledger that reflects annual license fee history including payments received, fee recalculations, and current balances. This ledger is used by CBOD for financial related functions. These functions include determining amounts to be refunded, credits to be applied to future license fees owed, and payments that are available to apply to license fees due. During our audit, we found the information contained in the license ledger is not sufficiently reliable. We found numerous errors, inaccuracies, and unsupported transactions. Several factors contribute to inaccuracies in the license ledger. The license ledger component, while used to account for license fees, was not designed using basic accounting principles. Further, data contained in the prior system which converted to ACBS in 2003 was neither verified nor reconciled.

Internal Audit also identified control weaknesses in ACBS regarding license fees. We found adjustments are not always made to license payments with proper supporting documentation, verification, and in some instances, direct changes without supporting documentation are made to the ledger bypassing change controls built into the automated system. Due to the weaknesses identified, Internal Audit could not provide assurance that the license ledger accurately reflects organizations' balances for annual license fees.

d) The Future of ACBS

Oracle has announced that there is no commitment beyond the year 2013 to support version 10g of Oracle Forms and Oracle Reports currently utilized in ACBS. According to Information Resources, other Oracle software applications at the Texas Lottery Commission have already been upgraded. This creates a risk that ACBS will be dependent upon software that would not be supported in the event of a system failure that resulted in a disruption of service. In addition, the Charitable Bingo Operations Division may be financially responsible for maintaining a server in order to support the older technology. A request to redesign ACBS has been included in the agency's Legislative Appropriations Request for fiscal years 2010 and 2011. Internal Audit supports the agency's efforts.

We recommend CBOD embark upon efforts which would ensure a successful redesign of ACBS, resulting in improved accuracy, integrity, and reliability. As stated earlier in this report, it is vital CBOD first commit to a re-engineering project to update and streamline licensing processes. This would ensure automation of efficient, effective, and compliant processes. CBOD should concurrently perform a data clean-up project to ensure the license history and related financial data contained in ACBS are accurate, and consequently, accurate data is converted to the new system. Quality assurance is also an important part of any automated process and should be built into the data entry processes with special consideration to the input of individuals associated with a license. In addition, the redesign of ACBS should address remediation of the control weaknesses present in the system, and should address the best method to accurately account for license fees. We recommend CBOD partner with the Office of Controller to assess the most effective and efficient approach to ensure the accurate and reliable accounting of license fees.

ADDITIONAL ITEM

While this audit did not include a review of the accuracy and completeness of reported performance measure information related to charitable bingo licensing activities, we did review the appropriateness and relevance of established measures. During the audit, CBOD management submitted and received approval to make changes to their performance measures to more closely align measures with operations and better ensure information reported is both useful and meaningful. During the performance of the recommended re-engineering project and upon its completion, we recommend CBOD management work with the Office of the Controller to determine whether the re-engineering efforts warrant any further changes to the performance measurement system for the future.

<h2 style="margin: 0;">Recommendations and Management Responses</h2>
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<i>Recommendation Summary</i>	<i>Management Response</i>
<p><i>Overall Recommendation</i></p> <p>We recommend CBOD implement a re-engineering project to update and streamline the licensing process and concurrently commence a data clean-up project to ensure accurate accounting of license fees. The re-engineering project should take a holistic approach to ensure the following:</p> <ol style="list-style-type: none"> 1. all eligibility requirements are derived from the current Bingo Enabling Act, 2. the administrative rules are aligned with the Act, and 3. administrative rules and guidelines are established to provide clarification and/or interpretation of the Act as needed. <p>Only after completion of a re-engineering project can CBOD effectively make changes to licensing procedures and processes. We further recommend CBOD management work with the Office of the Controller to determine whether the re-engineering efforts warrant any further changes to the performance measurement system for the future to ensure performance measures are closely aligned with operations and that performance information reported is both useful and meaningful.</p>	<p><i>Management agrees with the overall recommendation and will initiate a re-engineering project to update and streamline the licensing process. Additionally, management has submitted a request to Information Resources for a time and effort estimate on identifying license fee data that should be reviewed for accuracy.</i></p>
<p><i>Detailed Recommendations</i></p> <p>1. <u>Customer Service</u> – Conductor license applicants surveyed responded that the Charitable Bingo Operations Division provides positive customer service.</p>	
<p>No recommendation</p>	<p>N/A</p>

<i>Recommendation Summary</i>	<i>Management Response</i>
<p>2. <u>Eligibility Determination</u> – <i>The Charitable Bingo Operations Division should ensure all eligibility requirements are derived from the current Bingo Enabling Act and should clearly define the documentation required to determine eligibility.</i></p>	
<p>a. Eligibility Requirements</p> <ul style="list-style-type: none"> ▪ Review and update current conductor licensing procedures to accurately reflect the eligibility requirements set forth by the current Bingo Enabling Act. ▪ Review the eligibility requirements for all other types of bingo licenses to ensure the eligibility requirements contained in the current Bingo Enabling Act are accurately applied. ▪ Develop rules to define critical terms related to eligibility that may be contained in the Bingo Enabling Act, and modify procedures accordingly. 	<p><i>Management agrees with the recommendations and will review procedures to ensure eligibility requirements are derived from the current Bingo Enabling Act and will clearly define the documentation required to determine eligibility. Management has already identified the eligibility requirements for the various organization types set forth by the current Bingo Enabling Act. We have begun the process of assessing the minimum documentation needed to verify each eligibility requirement and will work with the Legal Division to see that those requirements are supported by law.</i></p> <p><i>Once the minimum documentation needed to determine eligibility is resolved, we will initiate the rulemaking process with the assistance of the Legal Division to define critical terms related to eligibility. In conjunction, we will work with the Administration Division to update our current procedures and application forms.</i></p>

<i>Recommendation Summary</i>	<i>Management Response</i>
<p>b. Required Documentation</p> <ul style="list-style-type: none"> ▪ Consider revising the bingo conductor application so that each type of authorized organization utilizes a separate application tailored to that type of organization. ▪ Assess the minimum documentation needed to verify each eligibility requirement for each type of authorized organization and ensure all requirements are supported by law. ▪ Provide clear instructions to the specific documentation the applicant needs to submit to determine eligibility. 	<p><i>Management has considered the recommendation of revising the bingo conductor application so that each type of authorized organization utilizes a separate application tailored to that type of organization. After review of the current application and other jurisdictions' applications, management has ascertained an alternative variation of the recommendation. It is our intent to have one application to capture the elements contained in Section 2001.102 of the Bingo Enabling Act. Additionally separate instruction sheets would be developed reflecting the specific documentation the applicant needs to submit to determine eligibility based on the type of organization.</i></p>
<p>3. <u>Licensing Processes</u> – <i>The Charitable Bingo Operations Division should improve its licensing processes to ensure compliance with the Bingo Enabling Act and to ensure consistency in its verification procedures.</i></p>	
<p>a. Verifications Performed for New License vs. License Renewal</p> <ul style="list-style-type: none"> ▪ Perform verifications necessary to determine continued eligibility at the time of renewal. 	<p><i>Management agrees with the recommendations and has already begun to analyze the eligibility verification performed at the time of renewal application and has commenced to review an organization's charitable distributions to ensure the organization is making significant progress toward the primary purpose of the organization. The CBOD intends to develop a rule to define significant progress through the assistance of the Legal Division and implement any other identified procedural changes needed to employ this recommendation.</i></p>

<i>Recommendation Summary</i>	<i>Management Response</i>
<p>b. Temporary Authorization</p> <ul style="list-style-type: none"> ▪ Review and amend the current administrative rules related to licensing timelines to ensure compliance with the Bingo Enabling Act. ▪ Outline the method the division will use to establish the 31 day timeline and issue temporary authorizations. 	<p><i>Management agrees with the recommendations and will review and amend Charitable Bingo Administrative Rule 402.405 Temporary Authorizations to outline the method the division will use to establish the 31 day temporary authorization timeline. Concurrently, the CBOD will develop procedures to begin issuing temporary authorizations when required.</i></p>
<p>c. Designated Member Statement of Responsibility</p> <ul style="list-style-type: none"> ▪ Ensure all members named as operators sign a statement of responsibility as required by the Bingo Enabling Act. 	<p><i>Management agrees with the recommendations and has developed and implemented form Schedule B2 – Statement of Operator Responsibility to ensure all members named as operators sign a statement of responsibility as required by the Bingo Enabling Act.</i></p>
<p>d. Application Instructions</p> <ul style="list-style-type: none"> ▪ Formalize through the rule making process the practice of requiring an operator and officer of the organization sign the application. 	<p><i>Management agrees with the recommendations and has drafted a new rule ‘Signature Requirements’ to address the practice of requiring an operator and officer of the organization sign the application.</i></p>
<p>e. Administrative Hold</p> <ul style="list-style-type: none"> ▪ Revisit the appropriateness and necessity of the administrative hold status. CBOD should work with the Legal Division to ensure any administrative rules related to placing bingo licenses on administrative hold are in compliance with the Bingo Enabling Act. This review should be extended to all types of bingo licenses to ensure appropriate authority for issuing a license in administrative hold. 	<p><i>Management agrees with the recommendations and will work with the Legal Division to establish the appropriateness and necessity of the administrative hold status and to ensure any administrative rules related to placing bingo licenses on administrative hold are in compliance with the Bingo Enabling Act.</i></p>

<i>Recommendation Summary</i>	<i>Management Response</i>
<p>f. Efficiency of Effort</p> <ul style="list-style-type: none"> ▪ Utilize IRS data currently available to CBOD to verify 501(c) exempt status at both time of original licensure and at renewal. ▪ Assess the availability and value of any other opportunities to independently verify eligibility without having to obtain documentation from the applicant. 	<p><i>Management agrees with the recommendations and is now utilizing IRS data currently available to verify 501(c) exempt status at both time of original licensure and at renewal. In addition, the CBOD will research the availability and value of other opportunities to independently verify eligibility without having to obtain documentation from the applicant.</i></p>
<p>4. License Fees – The Charitable Bingo Operations Division should improve efforts to ensure the proper, compliant, and responsible administration of license fees.</p>	
<p>a. License Fees</p> <ul style="list-style-type: none"> ▪ Perform an analysis to determine the fees necessary to operate the division and then formalize the license fees schedule in rule. 	<p><i>Management agrees with the recommendation and has completed an analysis of license fees collected and operational costs; however, until the legislature provides guidance as to whether all fees collected includes prize fees, we are unable to determine whether the fees being collected are sufficient to operate the division. Once a determination is made, the CBOD, with the assistance of the Legal Division and the Office of the Controller, will amend the current Charitable Administrative Rule 402.404 – License Fees, to formalize a license fee schedule in rule that will cover all operational costs.</i></p>
<p>b. Refunding License Fees</p> <ul style="list-style-type: none"> ▪ After completion of a data clean-up project for license data as previously recommended in this report, model the process for refunding license payments after the process for refunding prize fee payments which is prompted by the system instead by request from the organization. 	<p><i>Management agrees with the recommendation and has submitted an ISR to Information Resources to develop a report to identify those organizations that may have an overpayment of license fees and are due a refund.</i></p>

<i>Recommendation Summary</i>	<i>Management Response</i>
<p>c. Additional Payment of License Fees</p> <ul style="list-style-type: none"> ▪ Seek assistance from the Office of the Controller to review the appropriateness of and the risks associated with the current practice of establishing and maintaining ‘escrow’ accounts. 	<p><i>Management agrees with the recommendation and will seek the assistance from the Office of the Controller to review the appropriateness of and the risks associated with the current practice of establishing and maintaining ‘escrow’ accounts. Based on their analysis, the CBOD will evaluate if subsequent changes to this current process should be made.</i></p>
<p>d. Recalculation of License Fees</p> <ul style="list-style-type: none"> ▪ Separate the processes of estimating the license fee due at renewal and recalculating the prior license period’s fees. ▪ Recalculate the license fee using actually recorded gross receipts reported by the organizations as required by the Bingo Enabling Act. ▪ Submit programming changes to ACBS to detect changes in gross receipts reported after the license fee recalculation has been computed to ensure accurate collection of fees. 	<p><i>Management agrees with the recommendations and has requested the IR Department initiate a cost and time analysis to make the following ACBS program changes as recommended by Internal Audit: 1) separate the processes of estimating the license fee due at renewal and recalculating the prior license period’s fees; 2) refund license payments based on internal system prompts; and 3) detect changes in reported gross receipts after the license fee recalculation has been computed to ensure accurate collection of fees.</i></p>

<i>Recommendation Summary</i>	<i>Management Response</i>
<p>5. <u>Automated Charitable Bingo System</u> – <i>The Charitable Bingo Operations Division should undertake efforts to ensure the accuracy, integrity, and reliability of the Automated Charitable Bingo System.</i></p>	
<ul style="list-style-type: none"> ▪ Continue efforts to redesign ACBS. ▪ Commit to a re-engineering project to update and streamline licensing processes. This would ensure automation of efficient, effective, and compliant processes. ▪ Concurrently perform a data clean-up project to ensure the license history and related financial data contained in ACBS are accurate, and consequently, accurate data is converted to the new system. ▪ Ensure quality assurance is built into the system’s data entry processes with special consideration to the input of individuals associated with a license. ▪ Address remediation of the control weaknesses present in the system, and address the best method to accurately account for license fees. We recommend CBOD partner with the Office of Controller to assess the most effective and efficient approach to ensure the accurate and reliable accounting of license fees. 	<p><i>Management agrees with the recommendations. A request to redesign the ACBS has been included as an exceptional item in the agency’s Legislative Appropriations Request for fiscal years 2010 and 2011. An added benefit of the re-engineering project is that should funding be granted for a new system, the majority of the design phase and business analysis would be completed. This should enable an earlier completion of the system. Additionally, the CBOD agrees a data cleanup project should be completed prior to any data being converted to the new system and has initiated a request for a time estimate from Information Resources to identify any inaccuracies in the license history and related financial data.</i></p>

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AUDIT PURPOSE, SCOPE AND METHODOLOGY

Purpose:

Internal Audit completed a review of charitable bingo licensing as specified in the approved Fiscal Year 2008 Internal Audit Activity Plan. The objectives of our audit were:

- to evaluate the effectiveness and efficiency of charitable bingo licensing, and
- to determine the reliability of ACBS data.

Scope:

Licensing

The scope of this audit was limited to examining the licensing processes for a conductor's annual license.

Reliability of ACBS Data

Internal Audit performed a control review of ACBS including data testing in order to determine the reliability of ACBS data. In our review, we documented and tested controls over data input, processing, and output.

Methodology:

Licensing

In accomplishing our objective, Internal Audit researched legislation, rules, legal guidance and prior audits of Charitable Bingo. We observed CBOD licensing examiners process conductor applications for an original annual license. We reviewed licensing files and interviewed licensing and account examiners. Internal Audit met with several applicants for a conductor's license and conducted a telephone survey of organizations who submitted an application for an annual conductor's license during the period of January 2006 through April 2008. Internal Audit interviewed responsible management and staff, examined and reviewed supporting documentation and electronic files, and performed selected test work as deemed necessary. We relied upon other independent audit work as relevant and appropriate.

Reliability of ACBS Data

Internal Audit completed a questionnaire on controls established within the automated system with contributions from bingo licensing, bingo accounting, the programmers that maintain ACBS, and the computer room coordinator. Additionally, we conducted life cycle testing that followed payments from delivery to the agency through deposit with the Office of the Controller. Internal Audit also observed the bingo accounting and licensing personnel entering data and using ACBS to perform their duties.

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 its review in accordance with the International Standards for the Professional Practice of Internal Auditing as promulgated by the Institute of Internal Auditors (IIA), and the generally accepted government auditing standards (GAGAS) as promulgated by the U.S. Government Accountability Office (GAO).

BACKGROUND

The following is a discussion of the Charitable Bingo Operations Division's prize fee allocation to cities and counties and licensing activities as presented in the Charitable Bingo Operations Division 2007 Annual Report:

Licensed Organizations

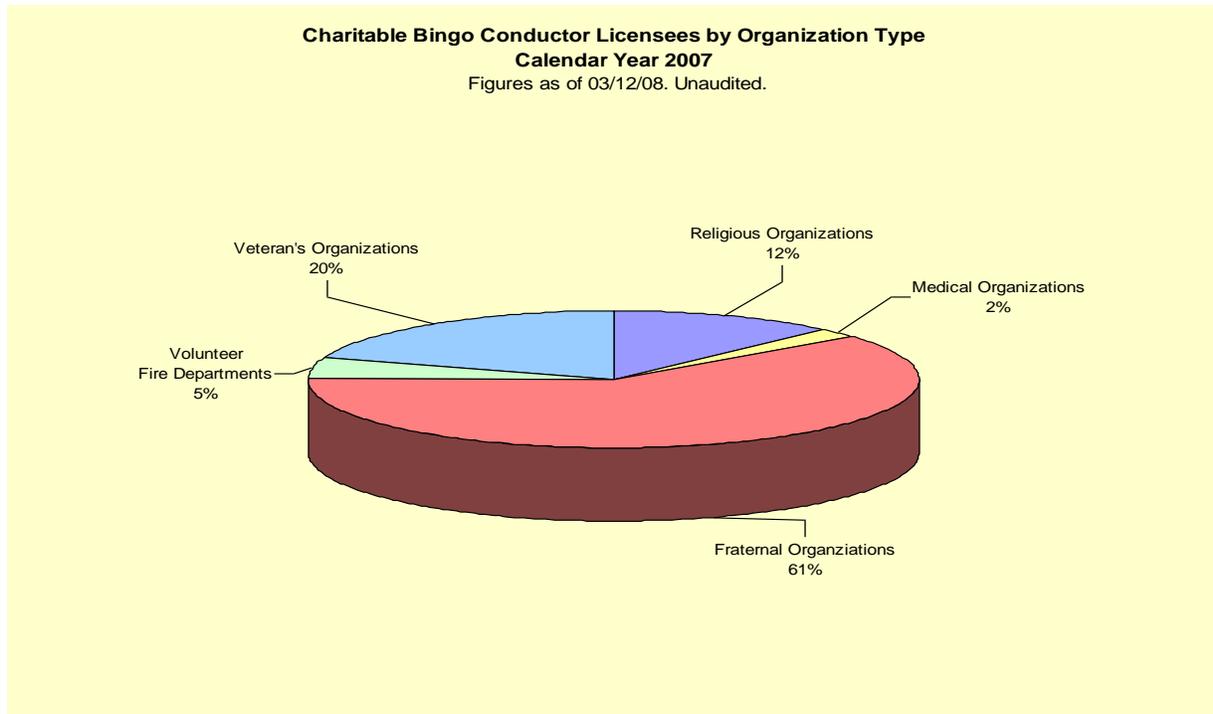
The Charitable Bingo Operations Division licenses the following types of organizations related to the regulation of charitable bingo in Texas:

- ◆ *Conductor – an authorized organization that conducts bingo. This represents the largest category of licensees in the charitable bingo industry in Texas.*
- ◆ *Conductor/Lessor – an authorized organization that conducts bingo and leases space to other authorized conductor organizations to conduct bingo.*
- ◆ *Lessor – an individual or organization that leases a location for the purpose of conducting a charitable bingo game.*
- ◆ *Distributor – an individual or organizations that sells, distributes, or supplies equipment to organizations authorized to conduct bingo.*
- ◆ *Manufacturer – an individual or organization that manufactures bingo equipment and sells to licensed distributors in Texas.*
- ◆ *System Service Provider – an individual or organization that provides integrated electronic systems for automated bingo services to be used by an authorized organization.*

Conductor Licenses

Section 2001.101 of the Act defines the types of authorized non-profit organizations eligible for a license to conduct bingo in Texas. Those organizations are:

- ◆ *A religious society that has existed in Texas for at least eight years.*
- ◆ *A nonprofit organization:*
 - *whose predominant activities are for the support of medical research or treatment programs; and*
 - *that for at least three years:*
 - ♣ *must have had a governing body or officers elected by a vote of members or by a vote of delegates elected by the members, or*
 - ♣ *must have been affiliated with a state or national organization organized to perform the same purposes as the nonprofit organization.*
- ◆ *A fraternal organization.*
- ◆ *A veteran's organization.*
- ◆ *A volunteer fire department.*



Charitable Bingo Allocations to Cities and Counties

Section 2001.502 of the Act requires a licensed authorized organization to collect from every individual who wins a bingo prize a prize fee in the amount of 5 percent of the amount or value of the prize.

Local jurisdictions in Texas benefit from charitable bingo activities in the form of allocations derived from bingo prize fees. A county that imposed a gross receipts tax on the conduct of bingo as of January 1, 1993, is entitled to 50 percent of the prize fee collected under § 2001.502 of the Act, on a prize awarded at a game conducted in the county.

A 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 § 2001.502 on a prize awarded at a game conducted in the municipality.

If a county and municipality are both entitled to a share of the fee imposed by § 2001.502 of the Act, the county is entitled to 25 percent of the fee on a prize awarded at a game conducted in the county and the municipality is entitled to 25 percent of the fee on a prize awarded at a game conducted in the municipality. All prize fees that are not allocated to local jurisdictions go to the state.

Each quarter, 2 percent of the total prize fees collected are retained in the jurisdiction's suspense account. The Commission may make refunds from the suspense account of a jurisdiction for overpayments made to those accounts and may redeem dishonored checks and drafts deposited to the credit of the jurisdiction's suspense account.

STATE OF TEXAS
TEXAS LOTTERY COMMISSION

INTERNAL AUDIT DIVISION

An Internal Audit of
CHARITABLE BINGO LICENSING

IA #09-004

October 2008

This report has been provided to the following:

Mr. James A. Cox, Jr., Chair
Mr. David J. Schenck, Commissioner

Mr. Anthony J. Sadberry, Executive Director
Mr. Philip D. Sanderson, Charitable Bingo Operations Director

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

Ms. Mary Katherine Stout, Director, Governor's Office of Budget, Planning and Policy
Mr. John O'Brien, Director, Legislative Budget Board
Mr. Joey Longley, Director, Sunset Advisory Commission
Mr. John Keel, CPA, State Auditor