

# **TEXAS LOTTERY COMMISSION**

## **INTERNAL AUDIT**



## **INTERNAL AUDIT**

## **ANNUAL REPORT**

For the Fiscal Year Ended August 31, 2010

IA #11-001

October 2010



Mary Ann Williamson  
Chairman

J. Winston Krause  
Commissioner



# TEXAS LOTTERY COMMISSION

Gary Grief, *Executive Director*

Philip D. Sanderson, *Charitable Bingo Operations Director*

October 31, 2010

Honorable Rick Perry, Governor  
Members of the Legislative Budget Board  
Members of the Sunset Advisory Commission  
Mr. John Keel, CPA, State Auditor  
Commissioners of the Texas Lottery Commission  
Mr. Gary Grief, Executive Director  
Mr. Phil Sanderson, Charitable Bingo Operations Division Director

Attached is the annual report of the Internal Audit Division of the Texas Lottery Commission. This report fulfills the requirements set forth in the Texas Internal Auditing Act (the Act). As mandated in the Act, the State Auditor's Office prescribes the content. This report has been prepared in accordance with the State Auditor's content requirements.

The work performed by Internal Audit is a key element in assuring accountability, economy, efficiency, and effectiveness within the Texas Lottery Commission operations. The Internal Audit Division is committed to being a trusted, independent and objective resource and providing quality internal auditing services. We will aggressively pursue projects in fiscal year 2011 to continue our assistance to the Texas Lottery Commission in improving controls, reducing risk, and enhancing agency operations.

Please contact me at (512) 344-5488 if you desire further information about the contents of this report or would like to request additional copies.

Sincerely,

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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## I. Fiscal Year 2010 Internal Audit Activity Plan

For the Period September 2009 – August 2010

	<u>Initial Allocated Hours</u>
<b><u>Internal Audit Assurance and Consulting/Advisory Activities</u></b>	
1. Claim Center Prize Validation Process .....	2100
2. Lottery Retailer Licensing Process.....	1200
3. Administrative Hearings Process .....	1050
4. Closeout of Fiscal Year 2009 Projects .....	105
5. Reserved for Special Requests .....	1,100
<b><i>SUBTOTAL</i></b>	<b><i>5,555</i></b>
<b><u>Statutorily Required Internal Audit Activities</u></b>	
6. Auditing Standards and Statutory Requirements .....	450
7. Coordination of External Audits of the Agency .....	160
<b><i>SUBTOTAL</i></b>	<b><i>610</i></b>
<b><u>Administrative Internal Audit Activities</u></b>	
8. Administration of the Internal Audit Function .....	300
<b><i>SUBTOTAL</i></b>	<b><i>300</i></b>
<b>Fiscal Year 2010 TOTAL BUDGETED HOURS</b>	<b><u>6,465</u></b>

**Fiscal Year 2010 Internal Audit Activity Plan**

The Fiscal Year 2010 Internal Audit Activity Plan was approved by the Commissioners in the October 2, 2009 Commission meeting.

Please refer to Sections III, IV and VI which further details the Internal Audit Division's efforts during fiscal year 2010.

Variations from the Activity Plan were as follows:

*Administrative Hearing Process – Audit no longer indicated as division performed an extensive self-evaluation, thus lowering the need for an independent review.*

## II. External Quality Assurance Review

The Internal Audit Division underwent a comprehensive external quality assurance review in accordance with the Institute of Internal Auditors (IIA) *International Standards for the Professional Practice of Internal Auditing*, the U.S. Government Accountability Office (GAO) *Government Auditing Standards*, and the Texas Internal Auditing Act (Texas Gov't. Code Chapter 2102). The review was performed by an independent, qualified reviewer – Mr. Dennis D. O'Neal. The resulting report was issued October 2009.

October 25, 2009

Ms. Catherine Melvin, CIA, CPA  
Director of Internal Audit  
Texas Lottery Commission  
Austin, Texas 78701

Dear Ms. Melvin:

Based on the information received and evaluated during this external quality assurance review, it is my opinion that the Texas Lottery Commission Internal Audit Department fully complies with the Institute of Internal Auditors *International Standards for the Professional Practice of Internal Auditing*, the United States General Accountability Office *Governmental Auditing Standards*, and the Texas Internal Auditing Act (Texas Government Code, Chapter 2102).

This opinion, which is the highest of the three possible ratings, means that the Internal Audit Department has in place structures, policies, procedures and processes that comply with the requirements of the professional standards. The Department is independent and objective and the staff is qualified, proficient, and knowledgeable in the areas they are required to audit. Audits are planned using risk assessment techniques; audit conclusions are supported in the working papers; and findings and recommendations are communicated properly. The Department is also well managed internally.

The Department has effective relationships with the Board and is well respected and supported by management. Interviews conducted during the review indicate that management considers Internal Audit a useful part of overall agency operations and finds that the audit process and report recommendations add value and help improve the agency's operations.

The objective, scope, and methodology of the review, along with recommendations to further improve the Internal Audit Department are attached. I would like to thank you and your staff for your cooperation during this review.

Sincerely,



Dennis D. O'Neal

Attachment



### III. List of Audits Completed

Internal Audit conducted the following assurance activities in fiscal year 2010.

Report No.	Report Date	Title	High-Level Objective	Overall Conclusion
10-003	05/11/2010	Jackpot Estimation	<p>The purpose of the audit was to verify that jackpot estimations, and the resulting advertised amounts, are derived in accordance with commission policies and procedures. In addition, we sought to assess relevant controls to ensure key objectives are met. At the time of our audit and for the period under review, Texas did not participate in the Powerball game. Accordingly, our review was limited to Texas Two Step, Lotto Texas and Mega Millions jackpot estimations.</p>	<p><i>Overall, based on the results of our review and testing, jackpot estimations and the resulting advertised jackpot amounts are derived in accordance with agency policies and procedures. However, management should strengthen controls and improve current processes to ensure key objectives continue to be met.</i></p>

Texas Lottery Commission  
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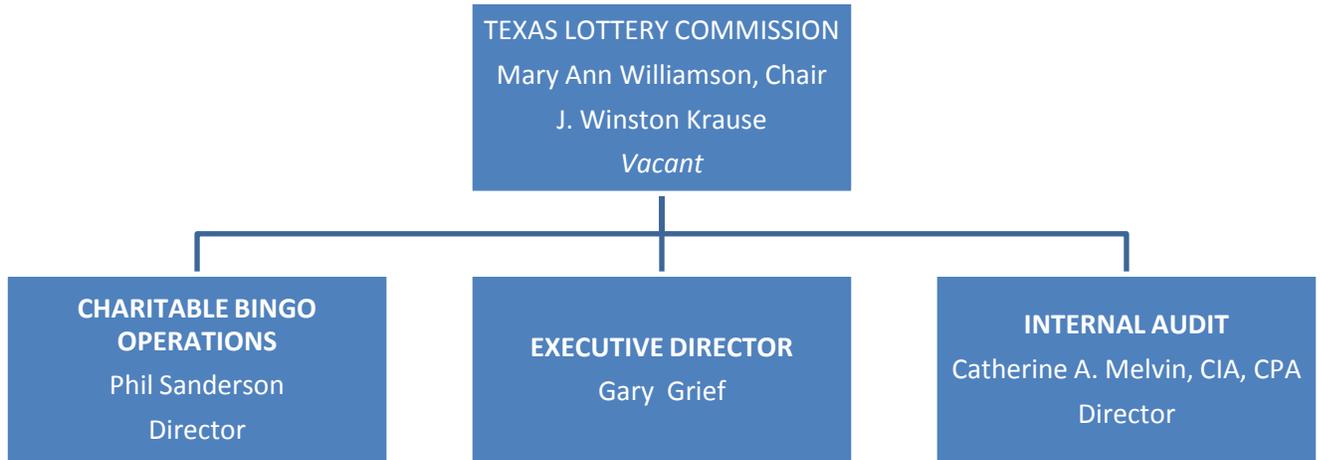
Report No.	Report Date	Title	High-Level Objective	Overall Conclusion
11-004	TBD	Claim Center Prize Validations	<p>The purpose of the audit was to evaluate the adequacy and effectiveness of the system of internal control and the quality of performance in carrying out assigned responsibilities related to the payment of prizes by Texas Lottery Commission Field Office Claim Centers (Claim Centers). Accordingly, our audit focused on prizes paid up to \$1 million. We evaluated processes designed to ensure the following: 1) reliability and integrity of information, 2) compliance with applicable requirements, 3) safeguarding of assets, 4) economical and efficient use of resources, and 5) accomplishment of goals and objectives. Specifically, we examined processes and controls designed to ensure accurate validation of tickets, proper verification of winners, accurate, appropriate, and timely payment of prizes, and excellent customer service.</p>	<p><i>This audit was completed in FY10. A report will be forthcoming.</i></p>

#### IV. List of Consulting Engagements and Non-audit Services Completed

Internal Audit participated in various agency committees or workgroups during fiscal year 2010, and provided ongoing consultative assistance to management. Our participation and services were limited to an advisory basis only; ensuring both auditor independence and objectivity were not compromised.

Project #	Engagement	Work Performed
10-004	PAF Process Review	Assisted management with an assessment of the Personnel Action Form (PAF) process to assess the adequacy of internal controls and the efficiency of the process.
10-012	GTECH Validation Issue	Ongoing in FY11. Coordinated efforts and represented the agency's interests regarding assessment of instant ticket validation issues.
10-022	Promotional Ticket Assistance	Provided assistance and guidance regarding controls over promotional tickets.
10-015	Enforcement – Test Tickets	Assisted management in its consideration of the use of test tickets.
10-013	MegaMillions – Powerball Cross Sell	Provided assistance as requested during implementation of MegaMillions/Powerball cross-sell initiative.
10-009	Retailer Incentive Drawing	Assisted management in the consideration of appropriate controls over the newly implemented retailer incentive drawings
Misc	Other Management Workgroups and Assistance	Provided miscellaneous consultative and advisory assistance to TLC management and staff. Participated in other management workgroups focused on various initiatives and concerns of the agency.

## V. Organizational Chart



## VI. Report on Other Internal Audit Activities

Activity	Work Performed
<p><b>Procurement of Audit Services</b></p> <ul style="list-style-type: none"> <li>• Biennial Security Study</li>   <li>• Annual Financial Audit &amp; MegaMillions Agreed Upon Procedures</li> </ul>	<p>Chaired committee to draft Request for Proposals (RFP) for the statutorily-mandated biennial security study. Chaired committee to review proposals in response to RFP and recommend apparent successful proposer.</p> <p>Chaired committee to draft Request for Proposals (RFP) for the statutorily-mandated annual financial audit. Included in RFP was an agreed-upon procedures engagement as required by the MegaMillions agreement documents. Chaired committee to review proposals in response to RFP and recommend apparent successful proposer.</p>
<p><b>Coordination of External Audits and Reviews of TLC</b></p> <ul style="list-style-type: none"> <li>• Annual Financial Audit (Maxwell Locke &amp; Ritter, LLP)</li> <li>• Agreed Upon Procedures for Mega Millions (Maxwell Locke &amp; Ritter, LLP)</li> <li>• Request for Status of Prior Audit Recommendations (State Auditor’s Office )</li> <li>• Audit of the Charitable Bingo Operations Division (State Auditor’s Office)</li> <li>• Compliance with Historically Underutilized Business Requirements (State Auditor’s Office)</li> <li>• Biennial Security Study (Grant Thornton)</li> </ul>	<p>Provided coordination, liaison assistance, and represented TLC’s interests.</p> <p>Requested delegation of authority to procure audit or audit-related services for services specified under Section VIII of this report.</p>
<p><b>Coordination of Audits and Reviews of Vendors</b></p> <ul style="list-style-type: none"> <li>• GTECH - GTECH SAS 70 (Deloitte)</li> <li>• GTECH - Contract Compliance (Grant Thornton)</li> </ul>	<p>Provided coordination, liaison assistance, and represented TLC’s interests.</p>
<p><b>Ethics Point</b></p>	<p>EthicsPoint is a phone and Internet-based reporting system that provides employees an additional avenue to report concerns about possible misconduct, fraud or other issues in the workplace. Internal Audit serves as administrator for the system and intakes all complaints which come through EthicsPoint.</p>
<p><b>Other Complaints</b></p>	<p>Internal Audit received and assisted or forwarded complaints for appropriate disposition.</p>

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<b>Activity</b>	<b>Work Performed</b>
<b>Continuing Professional Education</b>	<p>Each professional member of the Internal Audit Division is required by professional standards to earn a minimum of 80 hours of continuing professional education every two years with at least 24 of the 80 hours in subjects directly related to government auditing or the industry the agency operates. Division members exceeded those minimum requirements.</p>
<b>Internal Audit Community</b>	<p>Participated as an active member in State Agency Internal Audit Forum (SAIAF).  Served as chair of the SAIAF Legislative Subcommittee.  Participated as active members in the Austin Chapter of the Institute of Internal Auditors.</p>
<b>Gaming Audit Community</b>	<p>Participated as active members in the North American Association of State and Provincial Lotteries (NASPL) Internal Audit Subcommittee.  Assisted in providing information and feedback to other lotteries upon request.  Kept abreast of current lottery industry issues.</p>
<b>Open Records Requests</b>	<p>Responded to various requests for information in conformance with the Texas Public Information Act.</p>

Activity	Work Performed
<p><b>Administration of the Internal Audit Function</b></p>	<p>Various activities were performed related to the general administration of the Internal Audit Function. These included the following:</p> <ul style="list-style-type: none"> <li>• Provided reports to the TLC Commission and agency management.</li> <li>• Prepared the Internal Audit Annual Report.</li> <li>• Developed the Annual Internal Audit and Activity Plan based on an agency risk assessment.</li> <li>• Managed contracts administered by the Internal Audit Division:               <ul style="list-style-type: none"> <li>• <u>TeamMate</u> – automated working paper application</li> <li>• <u>EthicsPoint</u> – phone and Internet-based reporting system</li> <li>• <u>Biennial Security Study</u></li> <li>• <u>Annual Financial Audit and MegaMillions Agreed-Upon Procedures Engagement</u></li> </ul> </li> <li>• Filled vacant Internal Audit staff position – posted vacant position, screened applicants, interviewed candidates, and hired an individual.</li> </ul>

## VII. Internal Audit Activity Plan for Fiscal Year 2011

For the Period September 2010 – August 2011  
*This plan was approved in the September 10, 2010 Commission meeting.*

	<u>Initial Allocated Hours</u>
<b><u>Internal Audit Assurance and Consulting/Advisory Activities</u></b>	
1. Lottery Retailer Licensing Process.....	1,200
2. Transfers to the State .....	1,000
3. Sales Performance Incentive Program .....	600
4. Financial Review .....	400
5. Closeout of Fiscal Year 2010 Projects .....	100
6. Reserved for Special Requests .....	2,200
<b>SUBTOTAL</b>	<b><u>5,500</u></b>
<b><u>Statutorily Required Internal Audit Activities</u></b>	
7. Auditing Standards and Statutory Requirements .....	450
8. Coordination of External Audits of the Agency .....	163
<b>SUBTOTAL</b>	<b><u>610</u></b>
<b><u>Administrative Internal Audit Activities</u></b>	
9. Administration of the Internal Audit Function .....	300
<b>SUBTOTAL</b>	<b><u>300</u></b>
<b>Fiscal Year 2011 TOTAL BUDGETED HOURS</b>	<b><u>6,413</u></b>

### **VIII. External Audit Services**

The following represent external audit services that were procured by the Texas Lottery Commission or were ongoing in fiscal year 2010.

<b>Audit/Review</b>	<b>Auditor</b>
Drawings Audit	Davila Buschhorn & Associates
FY09 Annual Financial Audit	Maxwell Locke and Ritter LLP
FY09 Mega Millions Agreed Upon Procedures	Maxwell Locke and Ritter LLP
FY10 Annual Financial Audit	Maxwell Locke and Ritter LLP
FY10 Mega Millions Agreed Upon Procedures	Maxwell Locke and Ritter LLP
Biennial Security Study	Grant Thornton LLP

## **IX. Reporting Suspected Fraud and Abuse**

Actions taken to implement the requirements of:

- 1) **Fraud Reporting.** Article IX, Section 17.05, the General Appropriations Act (81st Legislature).

*The Texas Lottery Commission included a link to the State Auditor's website for fraud reporting at the footer of the Texas Lottery Commission website. In addition, information on reporting suspected fraud to the State Auditor is included in the agency's policies and procedures.*

- 2) **Reporting Requirements.** Article XII, Section 5(c), the General Appropriations Act (81st Legislature).

*This provision is not applicable to the Texas Lottery Commission as the agency does not receive funds as a result of the American Recovery and Reinvestment Act.*

- 3) **Texas Government Code, Section 321.022.**

*The Texas Lottery Commission reports incidents as required under Texas Government Code, Section 321.022.*

STATE OF TEXAS  
TEXAS LOTTERY COMMISSION

INTERNAL AUDIT

**INTERNAL AUDIT ANNUAL REPORT**  
For the Fiscal Year Ended August 31, 2010

**IA #11-001**

OCTOBER 2010

**This report has been provided to the following:**

Ms. Mary Ann Williamson, Chair  
Mr. J. Winston Krause, Commissioner

Mr. Gary Grief, Executive Director  
Mr. Phil Sanderson, Charitable Bingo Operations Division 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. Ken Levine, Interim Director, Sunset Advisory Commission  
Mr. John Keel, CPA, State Auditor