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An Audit Report on Management Controls at the Lottery Commission's Charitable Bingo Division

October 1998

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Key Points of Report

An Audit Report on Management Controls at the Lottery Commission's Charitable Bingo Division

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Overall Conclusion

The Lottery Commission's Charitable Bingo Division (Bingo Division) does not receive or fully use all the financial, security, and performance data necessary to ensure it manages its resources efficiently. This has an adverse impact on its ability to effectively achieve its mission of maximizing the revenues distributed to licensed charities by ensuring that the bingo games are conducted fairly.

To ensure the fairness and integrity of the industry, the Bingo Division relies on its own Licensing and Audit Services sections and on the Commission's Security Division to enforce bingo regulations. Improvements are needed in the Licensing Section to reduce the potential risk of licensing ineligible charities. The Audit Services Section ensures fairness and integrity in the bingo industry by effectively identifying and auditing potential violators of the Bingo Enabling Act. Enhancing the process used to select organizations for audit and adding procedures to increase audit efficiency would improve these processes.

Key Facts and Findings

- The Bingo Division does not obtain or use all the information it needs to efficiently manage resources and effectively regulate bingo licensing. Executive management does not always ensure information reaches the managers who need it.
 - The Bingo Division spent 28 percent of its operating budget for support services provided by other Lottery Commission divisions. The costs do not reflect the actual cost of the services. Due to the lack of cost information, unbudgeted fiscal year end expenses have averaged approximately \$200,000 or 7.5 percent of total budget over the last two fiscal years.
 - Greater control by the Bingo Division over certain areas of the enforcement of regulations would add vital information to improve licensing and audit functions and provide possible cost savings of approximately \$27,000 per year.
- The automated Charitable Bingo System contains many access problems and inefficiencies. A formal needs assessment and cost/benefit analysis are needed to determine if the system should be replaced.
- Management controls over the Licensing Section should be improved to further limit the risk of licensing ineligible charities.
- The Audit Services Section has processes and audit coverage that ensure charities and lessors of bingo facilities comply with bingo statutes and regulations. An improved audit selection process and more efficient audits should enable Audit Services to increase this regulatory effectiveness.

Contact: Frank Vito, CPA, Audit Manager, (512) 479-4700



Office of the State Auditor

Lawrence F. Alwin, CPA

This audit was conducted in accordance with Government Code, Section 321.0133.

Executive Summary

The Lottery Commission's Charitable Bingo Division (Bingo Division) does not receive or fully utilize all the key management information needed to ensure it manages its resources efficiently. The type of management information that is not received or utilized includes financial, performance, and bingo enforcement data prepared by other divisions within the Lottery Commission. This has an adverse impact on the Bingo Division effectively achieving its mission of ensuring that the bingo games are conducted fairly in order to maximize the revenues distributed to licensed charities.

The Bingo Division relies on its own Licensing and Audit Services sections to ensure the fairness and integrity of the industry. The Licensing Section needs to improve its policies and procedures to reduce the risk of issuing a bingo license to an ineligible recipient. The Audit Services Section effectively ensures audited organizations comply with bingo statutes and regulations. It can enhance this effectiveness by improving the process used to select organizations for audit and adding procedures to increase audit efficiency.

Financial and Performance Data Is Not Received or Fully Utilized

Bingo Division management does not have access to timely and accurate budget and cost information needed to monitor the availability of funds, verify the authorization of expenditures, or plan major purchases. Bingo Division management also did not distribute the limited budget information that was available to program managers.

As a result of not having and using this essential data, the Bingo Division spent \$789,321 (28 percent of its fiscal year 1997 operating budget) for support services provided by other Lottery Commission divisions that do not reflect the actual cost of the services. Examples were identified that indicate the Bingo Division is paying a disproportionate share of these costs. Also, in fiscal years 1996 and 1997, an average of over \$200,000 (or 7.5 percent of the Bingo Division's operating budgets) was spent on fiscal year end expenditures, which were almost entirely unbudgeted. Accurate and useful information, if received in a timely manner, would assist Bingo Division management in efficiently managing its resources and in effectively achieving the Division's mission and goal.

Additionally, important performance data was not utilized to implement and monitor prior audit recommendations.

Greater Control of Enforcement Functions Will Increase the Flow of Data Enhancing Licensing and Audit Efforts

Coordination of sharing bingo enforcement data between the Bingo and Security divisions needs to be improved. Necessary bingo-related enforcement data was not obtained from the Lottery Commission's Security Division, which adversely affected the Bingo Division's ability to regulate the industry. Benefits can be derived by having the Bingo Division perform some of these functions, including increased effectiveness in the Bingo Division's Licensing and Audit Services sections as well as possible cost savings of approximately \$27,000 per year.

Executive Summary

The Charitable Bingo System Contains Access Problems and Inefficiencies

The Bingo Division's automated computer system can not produce new or customized reports or print reports from user queries. Additionally, it has system screens that are difficult to read and not user-friendly. Recent adjustments have corrected some significant system problems. However, a formal needs assessment and cost/benefit analysis are necessary to determine if replacement of the system should be considered as a more efficient way to fix the remaining problems.

In spite of the access problems and inefficiencies of this central computer system, the Bingo Division was able to significantly increase its efficiency in returning prize fees to cities and counties by processing information more efficiently.

The Licensing Section Needs Improvement While the Audit Section Is Generally Effective

The key components of the Bingo Division's mission and goal are to ensure the fairness and integrity of the industry. To achieve its mission and goal, the Bingo Division relies on its own Licensing and Audit Services sections and on the Lottery Commission's Security Division to enforce bingo regulations.

Improvements are needed in the Licensing Section to reduce the potential risk of licensing charities that do not qualify under bingo statutes and policies. Implementing and applying comprehensive policies and procedures would help ensure that unqualified organizations are not licensed. These procedures should

require that licensing examiners obtain sufficient evidence from applicants to make quality licensing decisions. Additionally, using enforcement information, improving file maintenance, and ensuring that all license forms meet statutory requirements will enhance the quality and consistency of the licensing decision process.

The Audit Services Section effectively ensures that those organizations audited are in compliance with bingo statutes and regulations. It accomplishes this by identifying and auditing high-risk areas. The Audit Services Section can further increase its effectiveness by enhancing the process used to select organizations for audit, adding procedures to increase audit efficiency, and improving training.

Summary of Management's Responses

Bingo Division and Lottery Commission management generally agree with this report's findings and recommendations. In some cases, corrective action has already begun. Specific responses are included at the end of each section of this report.

Objective and Scope

The objective of this audit was to evaluate the effectiveness of management processes and control systems within the Bingo Division of the Lottery Commission. The scope of the audit included consideration of the Bingo Division's:

- Organizational structure
- Management information systems
- Performance measures
- Licensing Section
- Audit Services Section

Section 1:

Bingo Management Should Obtain the Information It Needs to Effectively Regulate Bingo

The Bingo Division does not receive all the accurate and useful financial, security, and performance information needed from other sources to ensure it achieves its mission and goal. When this information was obtained, Bingo Division management

Charitable Bingo Division's Mission

To maximize revenues to licensed bingo charities by ensuring the fairness and integrity of the bingo industry.

did not always pass it on to program managers. The program managers could have used it to determine whether the Bingo Division met its goal within a reasonable expenditure of resources or to make adjustments as needed throughout the

year. Therefore, accurate information did not always reach the managers who needed it. The Security Division did not formally share information it obtained from its investigations with the Bingo Division's Licensing and Audit Services sections that could also use it in their processes that regulate bingo. The Bingo Division's central computer system used to administer and regulate the major bingo activities contains access problems and inefficiencies.

Lottery Commission Goal B - Enforce Bingo Laws

Enforce regulations to ensure the fair conducting of bingo games to maximize the distributions to authorized charities.

Without obtaining necessary, accurate information and distributing it to the proper users, the Bingo Division increases its risk of not meeting its goal of enforcing regulations to ensure the fair conducting of bingo games to maximize the distributions to authorized charities.

In spite of the access problems and inefficiencies of the Bingo Division's central computer system, the Bingo Division was able to significantly increase its efficiency in returning prize fees to cities and counties by processing information more efficiently.

Section 1-A:

Bingo Division Management Should Gain Full Access to Budget Information

Bingo Division management does not have access to timely and accurate budget and cost information to monitor the availability of funds, verify that expenditures are authorized, and plan major purchases.

Bingo Division management does not have inquiry access to the Uniform Statewide Accounting System (USAS), the Automated Budget and Evaluation System of Texas (ABEST), or to the Lottery Commission's internal accounting system. The Bingo Division's source of budget information is a monthly report with details of expenditures that the Lottery Commission's Financial Administration Division

provides to Bingo Division management. Management did not pass it on to Bingo Division program managers.

Total indirect and support costs charged to the Bingo Division by other Lottery Commission divisions do not reflect the actual cost of service. Instead, the cost allocation methodology was based on the divisions using "best guess" estimates to determine the costs of providing support services to the Bingo Division. In fiscal year 1997, the Bingo Division spent \$789,321 (28 percent of its operating budget) on indirect costs. No time studies were performed to justify these charges.

Under the current cost allocation methodology, the Bingo Division reimbursed \$404,306 to the Lottery Commission for indirect and support costs of the Security Division for fiscal year 1997. However, the Security Division only began tracking its time in October 1997. There is evidence that some of the timesheets since October 1997 are not based on an equitable allocation of time between Bingo Division and Lottery Commission services performed.

For example, the Security Division bills the Bingo Division for half the salary expense of employees working at the front desk of the Lottery Headquarters. However, the Bingo Division does not employ half the personnel working in the Headquarters Building, nor does the Bingo Division use half the floor space. As a result, the cost allocation methodology appears to pass a disproportionate share of Lottery Commission costs to the Bingo Division.

The indirect costs discussed above are processed and billed to the Bingo Division only at the end of the year. Since management does not know the total amount of indirect costs until the end of the year, it keeps a conservative reserve to pay them. The Bingo Division had excess funds averaging over \$200,000 at the end of fiscal years 1996 and 1997.

Former Bingo Division management spent \$167,539 (6.1 percent) of total fiscal year 1996 appropriations and \$241,652 (8.9 percent) of total fiscal year 1997 appropriations on state-of-the-art computers, office furniture, and advertising for the bingo industry. These expenditures, which were almost entirely unbudgeted, occurred at the end of the fiscal year.

Analysis of available funds is a vital planning tool that provides management with critical financial information and equips it to make decisions concerning the future. Without a reasonable, consistent, and timely basis for knowing how much indirect costs it has incurred, the Bingo Division has no assurance that it can effectively manage its budget. Maintaining large reserves hinders management's ability to make timely and effective expenditure decisions.

Recommendation:

Bingo Division management should gain timely access to financial information:

- The Lottery Commission should immediately begin to provide inquiry access to program managers from all divisions for appropriate computerized systems that track expenditures and monitor budget. This access would enable them to monitor availability of funds on a timely basis. With adequate information, managers can perform this analysis before a division director approves an expenditure requisition. This access equips management with the information to make informed decisions concerning the future of its programs.
- We recommend that the Lottery Commission fairly allocate indirect costs. Senior management of the Bingo Division and executive management of the Lottery Commission should determine equitable ways to allocate these costs. While a percentage of employees' time is often a fair way to divide costs, the percentage should be based on historical data. Also, other means such as cost per job, total full-time equivalent employees, square footage, total appropriations, or some other mutually agreeable base can be more effective.
- The Lottery Commission's Financial Administration Division should implement its plan to begin processing and collecting indirect costs billed quarterly to the Bingo Division and should consider eventually changing to monthly billing. Bingo Division management should use this data to manage Bingo Division finances.

Management's Response:

Management concurs with the recommendation. Steps have already been taken to gain access to USAS and ABEST for Division management and Division program managers. The Acting Bingo Director and Executive Director have begun a process to ensure future indirect costs are allocated on a more equitable basis and that these indirect costs are accounted for in a more timely fashion.

Section 1-B:

The Bingo Division Director Should Give Managers Access to Information They Need to Control Their Programs

Bingo Division management did not give program managers access to budget information they could have used to do their jobs effectively and efficiently. Bingo Division program managers did not receive copies of monthly budget reports supplied by the Lottery Commission's Financial Administration Division to the Bingo Division Director.

As noted in Section 1-A, the monthly reports supplied by the Financial Administration Division to division directors have been the primary source of budget information because the program managers do not have access to key automated accounting and

budget systems. The monthly reports contain details of expenditures and budget preparation information for the managers' programs. The Bingo Division managers must rely on the Bingo Division Director to forward this information to them.

The Legislature funds strategies, expecting that certain objectives will be accomplished. Agencies place managers over programs to ensure that the objectives are met. Without supplying adequate tools to program managers to monitor their appropriated funds, accomplishment of these objectives may be at risk. Additionally, managers should know other key information about their areas. During the audit, we observed managers who were unaware of important information affecting their areas:

- Bingo Division management was unaware of the results of audit work that had occurred in the Licensing Section. In 1996, we audited two of the Bingo Division's performance measures (SAO Report No. 96-071, *An Audit Report on Performance Measures at 20 State Agencies and 1 Educational Institution*). We were unable to certify either performance measure: "Percentage of Bingo Licensees Making Use of Regulatory Instructions" and "Average Bingo License Processing Time (Days)."
- Both the affected area's manager and the current Acting Bingo Division Director, who was Bingo Division Assistant Director at the time of the audit, stated that they were unaware of the audit results. Since the former Division Director did not share the audit recommendation, the Bingo Division had two official ways to calculate the same measure that yielded different results. Improvements have since been made that indicate these measures probably will be certifiable in the future.

Organizations need to ensure that key institutional information is maintained and readily accessible. This information should reside within the organization, not with a few individuals. For example, it took management over a month to locate data for years prior to fiscal year 1998. Also, the Licensing Manager did not know how to access information needed to calculate one of the Bingo Division's performance measures. With the departure of the former Bingo Division Director, the Licensing Manager started keeping fiscal year 1998 information.

Recommendation:

We recommend that the Bingo Division management give program managers access to information they need to control their programs.

- Bingo Division management should distribute any detailed information affecting Bingo Division strategies to the program managers responsible for implementing those strategies. Program managers' input should be solicited when drafting the budgets for their programs.
- Management should take steps to make sure that key information resides within the organization. Those who need the information should have access

to it. Bingo Division management should continue expanding upon an inclusive management style to develop subordinates and spread institutional knowledge.

Management's Response:

Management concurs with the recommendation. The Acting Director was appointed in December 1997. After a period of review and evaluation, the Acting Director is making changes to internal Division policies regarding the dissemination of information. One of the changes started in June 1998 involved the distribution of budgetary information to program managers.

The Acting Director holds regular meetings with Division managers in order to share information as well as plan for and coordinate the completion of goals set for the Division. The Acting Director has also traveled to the majority of the Regional Offices to meet with staff to keep them better informed. Additionally, regular meetings are held with the headquarters staff. Recently, a Division-wide staff meeting was held bringing together Headquarters and Regional staff.

Section 1-C:

The Bingo Division Should Ensure It Receives All Essential Information by Controlling All Phases of Bingo Regulation, Including Enforcement

The Bingo Division may not obtain necessary bingo enforcement information because the Lottery Commission's Security Division controls bingo enforcement.

Coordination for sharing enforcement information between these divisions should be improved. The lack of complete enforcement information adversely affects the Bingo Division's ability to regulate the bingo industry. Without this information the Bingo Division's Audit Services Section cannot select the best places to concentrate its audit efforts, and the Licensing Section increases the risk of making an incorrect decision to approve or deny a license to an entity.

The Security Division currently performs these enforcement duties for the Bingo Division:

- Initial processing of complaints and referral to regional security staff
- Surprise observations of bingo occasions (games)
- Performing required investigations of new manufacturer and distributor applicants in conjunction with the Audit Services Section
- Conducting background investigations on license applicants and Bingo Division employees
- Witnessing and verifying destruction of bingo paper

Processing and resolving complaints and witnessing bingo occasions yield useful information about the risk presented by the involved entities. The Audit Services Section should consider this information in its audit risk assessment. Additionally, the Licensing Section should consider complaints, observations of occasions, and the results of investigations performed by the Security Division when processing license applications. Currently, complaint information may be shared informally in the regional offices. However, it is not communicated between divisions at the Austin headquarters. This information does not flow to the Bingo Division from the Security Division for several reasons:

- Although the Acting Bingo Division Director is responsible for the day-to-day regulation of bingo, the Director does not currently control all activities relating to bingo. Prior to October 1997, both the Bingo Division and the Security Division reported to the Lottery Commission's Executive Director. Recent legislation changed the Lottery Commission's organizational structure by having the Bingo Division Director report directly to the Commissioners rather than the Lottery Commission Executive Director. No adjustment was made to account for the fact that the Security Division, which is responsible for bingo enforcement, is outside the span of control of the Bingo Division Director who is responsible for bingo operations.
- The Security Division does not proactively provide enforcement data to the Bingo Division. There are no documented procedures in the Security Division for sharing appropriate information with the Bingo Division. Additionally, the Bingo Division does not have access to the Security Division's automated Case Tracking Systems.
- The Security Division stopped providing the Licensing Section copies of complaint forms when the Security Division found that these forms were not used. The documented enforcement information provided by the Security Division in the past was not comprehensive enough to allow follow-up by the Bingo Division.

While more extensive sharing of information could address this issue, there are benefits to the Bingo Division performing some of these functions in cooperation with the Security Division. First, as long as the Bingo Division employees conduct this work properly, the Bingo Division will obtain enforcement information in a timely manner, thereby increasing efficiency. Second, having Bingo Division employees do these activities will increase their firsthand knowledge of the bingo industry and the entities the Bingo Division regulates. Finally, Bingo Division employees can perform these functions less expensively than the Security Division staff. Transferring the bingo-related duties of one investigator at each of the four Bingo Division regional offices to an auditor could save the Bingo Division approximately \$27,000 per year in allocated costs.

Recommendation:

The Bingo Division should assume more responsibility for enforcement functions that generate information. These functions would include processing, investigating, and resolving the majority of complaints and conducting surprise observations of bingo occasions. Additionally, the Bingo Division should assume shared responsibility for witnessing and verifying destruction of bingo paper. The Bingo Division should use the enforcement information to regulate bingo.

The Bingo Division should continue to obtain the following services from the Security Division:

- Complaints that may require specific investigative skills – Investigations of certain complaints should be conducted by investigators with a law-enforcement background.
- Investigations of manufacturers and distributors – The Bingo Division should continue to share responsibility of required inspections with Security Division personnel.
- Background investigations for licensing purposes – Evidence indicates that the Security Division conducts background investigations in a cost-effective manner. As long as these services are cost-effective to the Bingo Division, it should continue to purchase them from the Security Division.
- Other services Bingo Division management believes can be more cost-effectively or more safely provided by the Security Division – Examples of these services include situations where observations of the destruction of bingo paper or of bingo occasions may be included with other planned travel.

Bingo Division and Lottery Commission management should jointly perform a needs assessment to determine the most efficient allocations of resources to effectively accomplish these functions.

Additionally, the Bingo Division should be given inquiry access to the Security Division's Case Tracking System to track the status of investigations being handled by the Security Division.

Management's Response:

Management concurs with the recommendation. The Acting Director has already started a process whereby information relating to enforcement issues is shared among all affected Divisions. Prior to the issuance of the draft audit report, the agency's General Counsel, Security Director and Acting Bingo Director began to hold regularly scheduled weekly meetings to discuss and coordinate action on pending matters, complaints, and cases. As of August 26, 1998, bingo management obtained read-only access to the Security case tracking system in an effort to receive key information. A study is currently underway to determine the number of bingo

employees who should have read-only access to the Security Division's Case Tracking System. Also, the Bingo and Security Divisions have started a process to ensure better coordination and communication insofar as the shared enforcement responsibilities are concerned.

In cooperation with the Security Division, the Bingo Division will continue to review additional enforcement responsibilities it can assume. For example, the Security Division has started to redesign its complaint form to more easily identify complaints that need to be referred directly to the Bingo Division. Additionally, the complaint intake unit in the Security Division may be restructured to include an auditor from the Bingo Division to review incoming complaints.

Section 1-D:

Management Should Finish Updating Procedures

The lack of current, written procedures documenting key processes hinders the Bingo Division's regulatory effectiveness. Bingo Division management recognized this problem prior to our audit and is drafting or revising 97 key processes.

The lack of documented procedures contributes to the possible licensing exceptions we noted during our examination of license applications (Section 2-A). The Bingo Division's Licensing Section has never had a Lottery Commission procedure manual for its activities. The Licensing Section operates under an outdated Comptroller of Public Accounts procedures manual.

Since there were no finalized, documented procedures, Licensing Section staff members depended upon word of mouth and some draft procedures for guidance. Licensing Section staff members currently rely on a checklist that may result in inconsistent processing of applications. This could lead to differing interpretations of the Bingo Enabling Act. For example, we observed that license examiners used two different checklists to perform the same licensing process for original operator licenses.

The Bingo Division's Audit Services Section provides documented policies and procedures for its staff, but they need to be updated. For example, the *Audit Reference and Procedures Manual* used by Audit Services does not address auditing electronic bingo and lacks procedures for using statistical information to limit the number of electronic bingo games played.

Formalized policies and procedures document management's expectations of controls and processes used in daily operations. Documented policies and procedures are important because they:

- Reduce the likelihood of confusion and inconsistencies that could occur if employees are not fully aware of the procedures.
- Communicate expectations of controls and processes to employees.

- Guide employees performing duties in the absence of others.
- Reduce the risk that errors or irregularities could occur and not be detected.
- Facilitate the efficiency of operations.
- Form a basis for evaluations

Recommendation:

Management should complete a comprehensive set of policies and procedures that documents important functions of the Bingo Division.

Management's Response:

Current Bingo Division management has made the identification and completion of procedures a priority since October 31, 1997. On January 2, 1998, the Acting Director acquired a technical writer to assist with this process. As of September 1, 1998, 59 of the 90 identified procedures, or 65%, have been completed.

Section 1-E:

Management Should Determine the Feasibility of Continued Use of the Charitable Bingo System

The Bingo Division's automated system, the Charitable Bingo System (System), contains many access problems and inefficiencies. As a result, the Bingo Division's ability to regulate bingo and provide necessary information to decision-makers is adversely impacted.

Specific problems with the System include:

- The inability to produce custom reports to meet user needs
- The inability to print reports from queries
- Inefficient system design that is inflexible in producing information to meet new user needs
- System screens that are difficult to read and not user-friendly

The System has been used by the State's bingo regulatory function within the three agencies where the function has operated (the Comptroller of Public Accounts, the Alcoholic Beverage Commission, and the Lottery Commission). Each time the bingo regulatory function shifted to a different agency, the System underwent major changes to allow the new host agency to use it. These "patchwork" changes are the main reason for the System's inefficient design.

Recommendation:

The Bingo Division should conduct or contract out for a formal needs assessment and a cost/benefit analysis to determine whether continued use of the System is feasible. The Bingo Division has recently corrected some significant System problems. As a result, the System now better meets the needs of its users. Some of the remaining problems can be improved in the current System. Still, many of the problems might be fixed more efficiently through the development of a new system. A formal needs assessment and a cost/benefit analysis are necessary to determine which option is best.

Management's Response:

The Bingo Division has identified the problems and inefficiencies with the current Charitable Bingo System (CBS) since at least 1996. An exceptional item request was submitted with the agency's Legislative Appropriation Request (LAR) to the 75th Legislature. The request was not granted. Subsequently, the Bingo Division has submitted another exceptional item request with the agency's LAR to the 76th Legislature. Current Bingo Division management, working with the Information Technologies Division of the agency, began formalizing the needs assessment and designing user requirements in May 1998.

Section 1-F:

The Bingo Division Significantly Increased Its Efficiency in Returning Prize Fees to Cities and Counties by Processing Information More Efficiently

As mentioned in Section 1-E, the Bingo Division's Charitable Bingo System has undergone several changes. An example of a positive patchwork change to the System involves the return of prize fees to local governments. The Bingo Division had the Lottery Commission's Information Systems Division rewrite the allocation program. This resulted in improved efficiency in bingo regulation. The Bingo Division decreased by half the time it takes to return prize fees to cities and counties.

The Bingo Division collects prize taxes from bingo operators and remits half these receipts to the cities and counties in which the operators are located. We compared fee allocations to the six largest cities in Texas for the calendar years 1994 and 1997. Tax remittances were over \$400,000 for the quarters we tested in both years. Our analysis revealed that the Bingo Division remitted money 2.3 times faster in 1997 than in 1994. As a result, the Bingo Division is now able to have the funds returned to the cities and counties in significantly less time.

Section 2:

Management Should Improve Its Licensing Processes to Ensure the Eligibility of Bingo Applicants

The management controls over the Bingo Division Licensing Section should be improved to further limit the risk of licensing charities that may not qualify under

state bingo statutes and regulations. The implementation and application of comprehensive policies and procedures would help ensure that nonqualified organizations are not licensed. Additionally, using enforcement information, improving file maintenance, and ensuring that all license forms meet statutory requirements will enhance the quality and consistency of the licensing process.

Lottery Commission Strategy B.2.1 - Bingo Licensing

Process bingo applications in a timely manner and ensure eligibility of Bingo applicants.

Section 2-A:

Management Should Ensure Correct, Consistent Licensing

The Bingo Division's Licensing Section (Licensing) may not obtain sufficient

information from some applicants to accurately determine applicant eligibility. In other instances, Licensing has sufficient information to minimize the risk of applicant ineligibility but fails to obtain all the information required by Bingo Division policy.

Upon subsequent review resulting from questions raised by our audit, there was no evidence that a license was issued to an organization that was ineligible. However, since in a few cases sufficient information was not obtained at the time of the licensing decision, the possibility of issuing a license to an ineligible organization exists.

An examination of 31 applications for original licenses revealed that licenses were issued to seven entities where questions remained or documentation was not provided that could adversely affect the organization's licensing qualifications. Of these seven entities, two organizations did not provide sufficient information for the license examiner to determine if the organization met bingo requirements. The examiner should have asked additional questions of the applicants to verify that their primary activities met statutory requirements. In these two instances, additional proof of charitable and educational activities should have been obtained at the time of the licensing decision.

Licensing uses checklists to aid in the examination of documentation submitted with applications. These checklists did not alert the examiner to the omissions for the two applicants mentioned above. There is inconsistency between the statutory requirements and the checklists created by the Licensing Section. The checklists are more stringent in their requirements. This resulted in some licenses being granted to applicants who met the statutory requirements but not Bingo Division policy.

The remaining five organizations were granted licenses even through they did not provide all the information required by Licensing's checklist. Licensing uses this checklist as a tool to aid its reviewers in processing license applications. The checklist contains reminders of license qualification requirements, some of which are based on the Bingo Division's reasonable interpretation of the Charitable Bingo statutes. In the five instances noted, licenses were issued because it was determined that the organization still qualified under a strict interpretation of the Charitable Bingo statutes even though it did not provide all the information required under the checklist.

For example, the statute requires an organization to substantiate three years of qualified activity to be eligible for a license. The checklist requires the applicant to support qualified activity during the “past three year” period. In our examination, we noted that licenses were issued to organizations that could support three years of qualified activity even though it was not three consecutive years of qualified activity. Other similar inconsistent applications of the checklist were noted regarding documentation of an organization’s purpose in its charter and documentation required to support an applicant’s good standing with its national organization.

This inconsistent application of the checklist increases the risk that incorrect licensing decisions could be made. In addition, other problems were noted regarding the checklist, its application, and the licensing process. These include:

- The checklists do not mirror the statutes. Further, as stated in Section 1-D, the checklists themselves, as used by the license examiners, are not consistent.
- There are no formal, written policies and procedures. Current and new Licensing staff members depend upon word of mouth and some draft procedures for guidance. This informal guidance can lead to inconsistent interpretation and application of the bingo licensing laws and regulations.
- Quality control is ineffective because there is no set standard against which to measure applicants. An effective quality control function would have detected deficiencies in the applications of at least five of the organizations.
- Examiners’ level of skepticism is insufficient. An examiner should have required more information from some of the organizations applying for licenses to determine whether they were eligible.

Licensing should have a consistent procedure in which all similar applicants are treated equally under the Bingo Enabling Act. Adequate controls should be in place to prevent and detect licensing errors.

Recommendation:

Management should ensure correct, consistent licensing by creating a single way to license. Comprehensive, written licensing procedures should be completed and implemented. These procedures should require that licensing examiners obtain sufficient evidence from applicants to make quality licensing decisions. Checklists should be standardized and revised to reflect consistent Bingo Division policy. Management should also implement an effective quality control function to examine each application. The quality control function should make sure that licensing procedures are followed.

Management's Response:

As stated above, current management has already started the process, and made it a priority, of having all procedures completed. Additionally, all new staff of the Charitable Bingo Division now undergo a detailed orientation process that provides for a thorough understanding of issues relating to licensing and the entire Division. The specific licenses reviewed by the SAO were all original applications. These applications are reviewed by the most experienced, senior examiners in the Division. These examiners thoroughly review the applications and make best judgment decisions in areas that are not always clearly defined by the Bingo Enabling Act. For instance, these examiners do their best to ensure that each applicant submits "sufficient facts relating to its incorporation and organization to enable the commission to determine whether it is an authorized organization." (Section 12(a)(1), Bingo Enabling Act). All checklists have been reviewed and revised by the Bingo Division, including the checklist for an original conductor. The checklists will be submitted to Legal to ensure they are consistent with statutory requirements. When the new checklists are completed, all staff will receive training on the use of the lists.

Section 2-B:

All Sections of the Bingo Division Should Enforce the Bingo Enabling Act Consistently

The Bingo Division should enforce the Bingo Enabling Act as consistently as possible, including treating Bingo Enabling Act offenses equally. During our examination of license applicants, we discovered an instance in which prior Bingo Division management did not report to the Security Division an organization that was conducting bingo occasions without a license. Conducting an unlawful bingo game is a third-degree felony. The organization, which previously held a bingo operator's license, allowed the license to lapse. However, it continued to conduct bingo operations. The organization did stop playing bingo after it was informed by Bingo Division staff that it was in violation of the statute. The organization subsequently applied for a bingo license, which it received.

If Security Division employees encountered this violation while performing bingo enforcement duties, as peace officers they would have been required by statute to refer this case for prosecution. This type of violation would constitute grounds for denial of a license application. The State's regulation of bingo should treat all regulated entities consistently.

Reasons were not documented as to why former management did not report this situation to the Security Division in August 1997. Current management has indicated that there are difficulties in enforcing the Bingo Enabling Act, especially the criminal provisions. Reasons for this difficulty include:

- The Bingo Division does not have statewide venue for criminal cases.
- The Bingo Division Director must satisfy a very high standard of proof to recommend temporary suspension of a bingo license.

- The Bingo Division lacks the subpoena power it needs to access certain evidence.

Recommendation:

We recommend that the Bingo Division report all possible criminal violations to the Security Division to ensure enforcement of the Bingo Enabling Act. We also recommend that such information be considered during the licensing process.

Management's Response:

Management concurs with the recommendation. The Bingo Division will work with other appropriate divisions within the agency to ensure better communication and coordination regarding enforcement matters. The Bingo Division will refer all possible criminal violations to Security.

Section 2-C:

The Licensing Section Should Use Enforcement Information During the Licensing Process

As stated in Section 1-C, Licensing does not obtain or use enforcement information in its licensing decisions. Licensing may not request the data it needs from the applicant to make a quality decision if it does not consider enforcement information. Requesting the appropriate information is especially important since the law now limits Licensing to two-page applications for most license renewals.

Recommendation:

Licensing should use enforcement information during the licensing process. Bingo Division management should determine efficient ways to make enforcement information accessible during its needs assessment of the Charitable Bingo System.

Management's Response:

Management concurs with the recommendation. As stated above, the Acting Bingo Director has already started the process of obtaining access to pending cases within the Security Division that affect applicants and licensees of the Bingo Division. The information contained in the Security Division Case Tracking System is currently being reviewed by the Acting Director, Licensing Manager and Senior Audit Supervisor to determine the most efficient way to use this information. In addition, the previously mentioned checklist will be revised to include a step that requires the examiner to determine whether a matter may be pending in Security. Currently, if Security refers a matter to Legal, Bingo will receive notice and a copy of the referral package.

Section 2-D:

Licensing Should Improve Its File Maintenance

Licensing has not maintained its files in a manner that ensures documents will be properly filed. During our testing of original applications, we encountered several misfiled documents. Licensing employees could not find 2 of approximately 50 files that we requested and had difficulty finding 2 others. Poor file maintenance increases the risk that key documents will be lost.

Filing problems have been created in part by turnover in the file clerk position. The file clerk position has been filled by temporary workers over the past two years, and there has been significant turnover.

Recommendation:

We recommend that Licensing improve its file maintenance. Documents should be filed so that they can be readily located. Management should take steps to reduce file clerk turnover and improve training for new employees in that position. Bingo Division management should consider the possibility of scanning documents into the Charitable Bingo System as part of its a formal needs assessment and cost/benefit analysis.

Management's Response:

Management concurs with the recommendation. We are exploring other methods, such as scanning, for improving file maintenance. In the last fourteen months the Bingo Division has utilized nine temporary file clerks. Additionally, the Bingo Division underwent a complete move in May 1997. The Retention Schedule has been reviewed and updated. Files have been archived, correctly identified for destruction or warehoused. There have been 1.5 FTE positions transferred from the Bingo Division to other divisions of the agency. On April 24, 1998, the Acting Director of the Bingo Division submitted a request to the Executive Director of the agency requesting an FTE position to be used as a file control clerk. The Executive Director has indicated that there are no available FTEs which can be transferred because of higher priority needs identified elsewhere within the agency. The agency is in the process of requesting approval from the Legislative Budget Board and Governor's Office in conjunction with a rider in the Appropriations Act to bring certain functions currently out-sourced in house. This activity, which is out-sourced, will be included in this request. Finally, the two files that could not be located in the file room were retrieved via microfilm and the complete files have subsequently been located.

Section 2-E:

Management Should Ensure That All License Forms Meet Statutory Requirements

The Bingo Division's current license form does not contain certain information that is required by statute. This missing information documents the specific use for the net proceeds and the prizes and amounts being awarded. Management does not put this information on the license form due to space constraints and limitations of the Charitable Bingo System.

Recommendation:

We recommend that the Bingo Division redesign the license form to contain all statutorily required information.

Management's Response:

In an effort to become compliant, we are exploring ways to address this recommendation. This is a function performed by the Charitable Bingo System that was mentioned earlier. This automated system was inherited from the Texas Alcoholic Beverage Commission and did not contain the specified language when bingo transferred to the Texas Lottery Commission. Current management will request that the upcoming legislature remove this language from the Bingo Enabling Act.

Section 3:

Management Should Improve Audit Methodology to Continue Providing Quality Audit Services

Lottery Commission Strategy B.1.1 - Bingo Enforcement

Conduct inspections and compliance audits of bingo licensees, initiate sanctions, and increase employee and licensee understanding of Bingo Laws through training and public education.

The Audit Services Section of the Bingo Division (Audit Services) has processes and audit coverage that enhance compliance with the Bingo Enabling Act by charities and lessors of bingo facilities. Audit Services accomplishes this enforcement

function by identifying and auditing high-risk areas. An improved audit selection process would enable Audit Services to increase this regulatory effectiveness. Additionally, improving audit methodology and training would further enhance the effectiveness of Audit Services

Section 3-A:

The Audit Services Section Should Improve Its Risk Assessment Methodology

Audit Services currently does not use a risk assessment to choose the entities it will audit. This increases the chance that Audit Services will not audit entities that are violating the Bingo Enabling Act.

Currently, Audit Services selects entities to audit based on requests by Bingo Division or Security Division management, the results of book and records inspections, and audit requests by entities to be audited. Audit Services recently cleared the backlog of audits generated by these means and began using random selection as a means to select entities.

Now that the backlog has been cleared, the use of random selection alone will not ensure that the highest-risk entities are selected for audit. As a result, Audit Services is not maximizing its likelihood of detecting the most significant violations of the Bingo Enabling Act.

Recommendation:

Audit Services should create a sophisticated risk assessment process to help it identify and audit the most risky entities using its limited amount of audit resources. In addition to the factors currently considered for audit selection, a risk assessment should also consider factors such as:

- The results of financial analyses to compare entities with each other – Such financial analyses would enable Audit Services to identify entities where there is a high risk of errors or irregularities, such as skimming cash from the receipts and underreporting revenue.
- Indicators of business volume such as bingo attendance, number of occasions, and gross receipts – These indicators could help identify such compliance exceptions as excessive numbers of electronic cardminders and applications for inappropriate licenses.
- Other risk indicators, such as the time lapsed since last audit and the number and resolution of complaints – These types of indicators would help give Audit Services a more complete picture of how much risk each entity presents.
- Enforcement information – As noted in Section 1-C, the Bingo Division is not obtaining sufficient enforcement information from the Security Division due to several factors. Enforcement information provides useful information about the risk presented by regulated entities. Not considering the most significant, relevant information in preparing its risk assessment reduces the likelihood of detecting potential violations of the Bingo Enabling Act.

Management's Response:

Management concurs with the recommendation. Audit Services will work to develop a risk assessment program to select appropriate organizations for audit. Because of the work the auditors have done handling the audits generated through complaints, the number of complaint driven audits has decreased.

Section 3-B:

The Audit Services Section Should Improve Its Current, Effective Audit Methodology

Audit Services currently uses an effective audit methodology. Audit Services can increase its efficiency and effectiveness by making some enhancements in the way it audits. These improvements include:

- Adding new audit procedures to enhance Audit Services' ability to detect Bingo Enabling Act violations
- Strengthening the quality control function by having some quality control reviews done in the field
- Completing a comprehensive set of formal, written procedures that reflect current practice
- Identifying and reducing working paper inefficiencies

Recommendation:

We recommend that Audit Services improve its audit methodology. To do this it should:

- Consider the suggested audit steps provided by the State Auditor's Office. Management should adopt those audit steps that will improve audit effectiveness, keeping cost/benefit in mind.
- Duplicate only working papers requiring court or administrative action for quality control review at Audit Headquarters. All other quality control review should be done in the field with original working papers.
- Complete a comprehensive set of policies and procedures that documents key policies, processes, and steps needed for important functions of Audit Services.
- Work with the State Auditor's Office to improve working paper efficiency.

Management's Response:

Management concurs with the recommendation. The Audit Services Section will continue to improve its audit processes by offering further training to the staff and updating all audit procedures. Management is reviewing software used by the SAO and the SAO has already had the opportunity to provide training to audit staff at a recent division conference. Management foresees a continued working relationship with the SAO.

Section 3-C:

The Audit Services Section Should Continue Offering Training That Will Increase Compliance With the Bingo Enabling Act

Audit Services works to train regulated entities in a number of ways including:

- Prelicensing site visits
- Book and records inspections
- Other educational efforts

This training appears to be increasing compliance with the Bingo Enabling Act. The number of bingo operators failing to file Bingo Quarterly Status Report dropped to a total of 75 non-filers for the first quarter of calendar year 1998 compared to 148 non-filers for the first quarter of 1994.

Recent legislation has required the Bingo Division to approve a program of eight hours of training to certain individuals operating bingo games. Although this training has not started, management has designed a curriculum and is in the process of putting the class together.

Recommendation:

We recommend that management complete design and implementation of the new mandated training program as required by law.

Management's Response:

Management concurs with the recommendation. The Audit Services Section will continue to work with the Bingo Advisory Committee to finalize the training program authorized by the Bingo Enabling Act. Additionally, staff has been reviewing training programs offered by other states.

Objective, Scope, and Methodology

The objective of this audit was to evaluate the effectiveness of management processes and control systems within the Bingo Division of the Lottery Commission. The scope of the audit included consideration of the Bingo Division's:

- Organizational structure
- Management information systems
- Performance measures
- Licensing Section
- Audit Services Section

Agency financial data was analyzed, and relevant reports and documentation were reviewed. Conventional audit procedures were applied to collect information, including interviews with management and staff of the Bingo Division. Audit testing and analysis included:

- Control review
- Review of other states' audit approaches
- Trend analysis of expenditures and performance statistics
- Review of project and personnel files
- Review of performance measures
- Review of licensing procedures

Fieldwork was conducted from February 1998 to July 1998. The audit was conducted in accordance with Generally Accepted Government Auditing Standards.

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

- Gregory S. Adams, CPA, CGFM (Project Manager)
- Beverly Schulke, CPA
- Frances Moore
- Linda Buford, CPA
- Dorvin Handrick, CISA, CDP
- Worth Ferguson, CPA (Quality Control Reviewer)
- Frank Vito, CPA (Audit Manager)
- Craig Kinton, CPA (Audit Director)