



TEXAS LOTTERY COMMISSION

Internal Audit Services

AN INTERNAL AUDIT OF

Ticket and Game Management

Report No. 22-003

Sept 28, 2022



McConnell Jones
Diverse Thinking | Unique Perspectives

This report provides management with information about the condition of risks and internal controls at a specific point in time. Future changes in environmental factors and actions by personnel will impact these risks and internal controls in ways that this report cannot anticipate.

Report Highlights

Why Was This Review Conducted?

McConnell & Jones LLP (MJ) serving as the outsourced internal audit function (Internal Audit) for the Texas Lottery Commission (TLC) performed this internal audit as part of the approved FY 2022 Annual Internal Audit Plan.

Audit Objectives and Scope

MJ assessed Texas Lottery Commission's (TLC) processes and management controls in place to ensure scratch ticket game management and third-party scratch ticket supply-chain risks are effective to meet the Agency's objectives of ensuring entertaining products for customers.

The audit scope period was FY2020-2021 and FY2021-2022 YTD.

Audit Focus

To evaluate the internal controls and processes in place related to scratch tickets and game management. Specifically:

- Scratch ticket game planning,
- Scratch ticket vendor security controls and scratch ticket supply chain management (third-party vendor management)
- In-lane lottery product sales retailer security, and
- Scratch ticket game closing.



We wish to thank all employees for their openness and cooperation. Without this, we would not have been able to complete our review.

Audit Conclusions

TLC has numerous effective controls to provide reasonable assurance of the continuous availability of scratch ticket games. The controls start with the use of an annual game plan to schedule due dates for scratch ticket game planning documents and deliveries of the scratch tickets well in advance of each game's scheduled start date.

TLC has contracted with the three industry-leading vendors of scratch ticket games to provide competitive pricing, provide supply chain redundancy to mitigate potential supply chain interruptions and ensure the continuous availability of scratch ticket games.

TLC has also implemented scratch ticket game closure procedures that we consider to be best practice processes which have been replicated by other state lotteries.

We did identify one opportunity for improvement, to enhance current policies and procedures by formalizing requirements to review third-party security assessments (e.g., SOC reports or ISO certifications) of scratch ticket vendors.

Internal Control Rating

Best practices for scratch ticket game planning and closing procedures. Internal controls are generally effective overall.

What Did We Recommend?

We made no recommendations related to internal controls.

Number of Findings/ Opportunities by Risk Rating

Category	High	Medium	Low	Total
Findings	0	0	0	0
Improvement Opportunities	0	0	1	1

Introduction



McConnell & Jones LLP (MJ) performed an internal audit of Scratch Ticket Game Management.

We performed this audit as part of the approved FY 2022 Annual Internal Audit Plan. This audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained accomplishes that requirement.

Pertinent information has not been omitted from this report. This report summarizes the audit objective and scope, our assessment based on our audit objectives and the audit approach.

Objective, Conclusion, and Internal Control Rating



*This audit identified processes and controls that resulted in an overall internal control rating of **Best Practices for scratch ticket game planning and closing. Internal controls are Generally Effective overall. Exhibit 1** describes the internal control rating.*

The purpose of this audit was to assess Texas Lottery Commission's (TLC) management's controls and business processes in place related to Scratch Ticket Game Management.

As such we focused on the following processes:

1. Scratch ticket game planning
2. Scratch ticket vendor security and scratch ticket supply chain management (third-party vendor management),
3. In-lane lottery product sales retailer security.
4. Scratch ticket game closing procedures.

Finding vs Improvement Opportunity

We define a finding as an internal control weakness or non-compliance with required policy, law, or regulation. We define an improvement opportunity as an area where the internal control or process is effective as designed but can be enhanced.

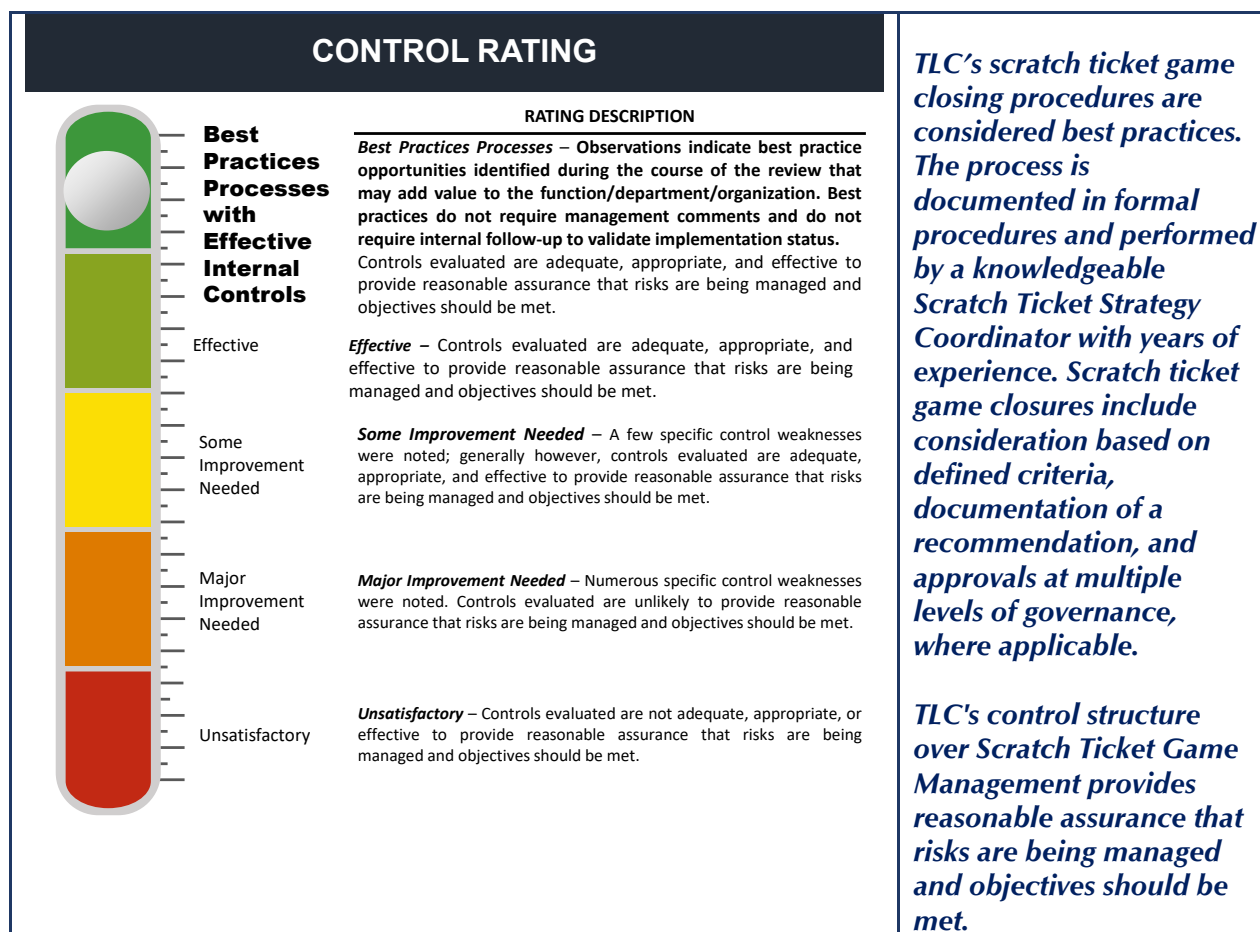


Exhibit 1: Internal control rating description.

Observation and Risk Rating Summary



Exhibit 2 provides a summary of our audit observations. See the business risk section of this report for a discussion of all issues identified, recommendations, and management responses.

Business Objective	Internal Control Rating	Control Assessment / Findings	Recommendations
TLC's scratch ticket supply chain management processes ensure the continuous availability of scratch tickets for sale.	Generally Effective	<p>No findings noted.</p> <p><i>Opportunities for Improvement:</i></p> <ul style="list-style-type: none"> • There is no current process in place to periodically review the results of independent 	<p>No recommendations are made.</p> <p><i>Opportunities for Improvement:</i></p> <ul style="list-style-type: none"> • Consider implementing a formal process to review the results of independent third-party security

Business Objective	Internal Control Rating	Control Assessment / Findings	Recommendations
		third-party security assessments of scratch ticket vendors to assure their continued compliance with control standards over data security.	assessments, such as SOC reports or ISO certificates, to assure the respective scratch ticket vendor's continued compliance with control standards over data security. This review should include: <ul style="list-style-type: none"> ♦ verifying that the vendor's internal controls were operating effectively. ♦ reviewing user-entity controls and TLC's strategy(ies) for addressing them. <i>Note: TLC is in the process of finalizing vendor contracts for 2024, which includes requirements for scratch ticket vendors to provide SOC 2 reports to TLC for review.</i>
TLC's scratch ticket supply chain management processes ensure the continuous availability of scratch tickets for sale and minimize potential supply chain interruptions.	Generally Effective	No findings noted.	No recommendations are made.
TLC's retailer management processes ensure the integrity of in-lane lottery ticket products.	Generally Effective	No findings noted.	No recommendations are made.
TLC's scratch ticket game closure processes ensure that scratch ticket games are closed according to established policies and supporting documentation is	Best Practice Processes	No findings noted.	No recommendations are made.

Business Objective	Internal Control Rating	Control Assessment / Findings	Recommendations
maintained for historical purposes.			

Detailed Findings and Management Response



This section of our report provides a discussion on the reportable findings we noted during the audit, our recommendations, and managements response.

Business Objective #1: TLC's scratch ticket supply chain management processes ensure the continuous availability of scratch tickets for sale.

Risk Ranking: **Generally Effective**

Observations

- TLC has a standardized Request for Proposal (RFP) process to ensure all TLC scratch ticket vendors meet TLC's supply chain needs.
- TLC schedules scratch ticket games several months in advance to ensure scratch ticket game launches are not delayed if print runs or shipments are delayed.
- TLC contracts with multiple scratch ticket game vendors to ensure continuous availability of scheduled scratch ticket games.
- TLC scratch ticket vendors operate multiple printing facilities to ensure that print runs and shipments can be performed in the event of a supply chain interruption.
- TLC distributes scratch ticket game orders evenly across all contracted scratch ticket vendors to minimize the risk that a disruption event affecting one vendor will impact the availability of scratch ticket games delivered to TLC.
- Through data analysis, we also noted an upward trend on TLC's lead time between when a scratch ticket game is to planned start and the time vendors are required to submit their working papers to TLC. This helps to ensure that scratch ticket games are ready to print and ship well in advance of the scheduled game start date.

Opportunity for Improvement:

1. Although TLC's processes include close monitoring of their scratch ticket vendor relationships and scratch ticket shipments, there is no current process in place to periodically review the results of independent third-party security assessments to assure the respective vendor's continued compliance with control standards over data security.

Recommendations #1

No recommendations are made.

Opportunity for Improvement Recommendation:

1. Consider implementing a formal process to review the results of independent third-party security assessments, such as SOC reports or ISO certificates, to assure the respective scratch ticket

vendor's continued compliance with control standards over data security. This review should include:

- verifying that the vendor's internal controls were operating effectively.
- reviewing user-entity controls and TLC's strategy(ies) for addressing them.

Note: TLC is in the process of finalizing vendor contracts for 2024, which includes requirements for scratch ticket vendors to provide SOC 2 reports to TLC for review.

Managements Response #1

Management response is not required for improvement opportunities not related to internal controls or process efficiencies.

Business Objective #2: To ensure the continuous availability of scratch tickets for sale without supply chain interruptions.

Risk Ranking: **Generally Effective**

Observations

- Staff escalate any potential scratch ticket supply chain incidents to the Agency's Contracts & Facilities Manager, which subsequently could be escalated to TLC's Executive Director.
- Staff review scratch ticket incidents against vendor contracts to determine the appropriate recourse and remedy for supply chain issues, based on contract terms.

Recommendations #2

No recommendations are made.

Managements Response #2

None required.

Business Objective #3: TLC's third-party vendor management processes ensure the integrity of in-lane lottery product sales.

Risk Ranking: **Generally Effective**

Observations

- TLC has implemented a standardized RFP process that requires all in-lane lottery product sales retailers to provide a data security plan that is reviewed and approved by the TLC Data Security Manager to ensure they meet TLC's data security requirements.

Recommendations #3

No recommendations are made.

Managements Response #3

None required.

Business Objective #4: TLC's scratch ticket game closure processes ensure that the games are closed and supporting documentation is maintained for historical purposes.

Risk Ranking: **Best Practices**

Observations

1. TLC has a formalized procedure that clearly establishes criteria for closing scratch ticket games and includes specific instructions for the performance and documentation of scratch ticket game closure analysis.
2. TLC has established requirements for approval signatures for scratch ticket game closures at various levels of authority within the organization.

Recommendations #4

No recommendations are made.

Managements Response #4

None required.

APPENDIX A - BACKGROUND



This section of the report provides an overview of the scratch ticket procurement and scratch ticket game closure procedures.

Sales of all lottery games contributed over \$1.9 Billion in FY21 to the Foundation School Fund, Texas Veterans Commission, and the state's General Revenue Fund. The Texas Lottery Commission scratch ticket games make up around 80 percent of TLC's annual sales. TLC's goal is to ensure that new scratch ticket games with available prizes are always accessible to retailers for players to purchase.

To ensure continued availability of scratch ticket games, TLC has entered into agreements with three scratch ticket vendors to provide TLC with millions of tickets across dozens of games annually, according to an established delivery schedule. The utilization of an annual scratch ticket game plan allows TLC to schedule game releases months in advance. As a result of their advanced planning and supplier redundancy, TLC has been able to effectively manage the continuous availability of scratch tickets throughout the contract period to date, including the global supply chain issues resulting from shutdowns related to the COVID-19 pandemic.

Procurement of scratch ticket production services follows a standard Request for Proposal process, which establishes requirements for the quality and scheduled delivery of games as well as sanctions for not meeting TLC's quality standards or delivery timelines. Each scratch ticket vendor must provide TLC with a data security plan which details the controls in place to ensure the confidentiality, integrity, and availability of scratch tickets and scratch ticket data.

In addition to their efforts to assure the continuous production and delivery of scratch tickets, TLC strives to ensure that older scratch ticket games with low sales or desired sell-through rates are reviewed and closed according to established criteria and procedures.

The scratch ticket game closing processes developed by the Texas Lottery Commission has become a model that is adopted by other state lotteries. **Figure 1** provides an overview of the scratch ticket game life cycle.



Figure 1 *Scratch ticket game life cycle.*

Scratch ticket games are closely monitored and evaluated against established criteria to determine when a game should be closed. Scratch ticket game performance is evaluated based on the number of weeks the game has been available for sale, the rate of sales, and ticket inventory in the warehouse and at retailer locations.

TLC's Scratch Ticket Strategy Coordinator reviews scratch ticket sales information and determines if a scratch ticket game meets the stated criteria for closing and replacement. Once this review process determines that a game should be closed, the Scratch Ticket Strategy Coordinator completes the required documents and obtains authorization.

Once the scratch ticket game is approved for closing, there are four key dates that are followed. Figure 2 provides an overview of these dates. It is important to note that if a game needs to be closed immediately to maintain the security and integrity of lottery games the game would be "called" immediately with no pre-call notice.

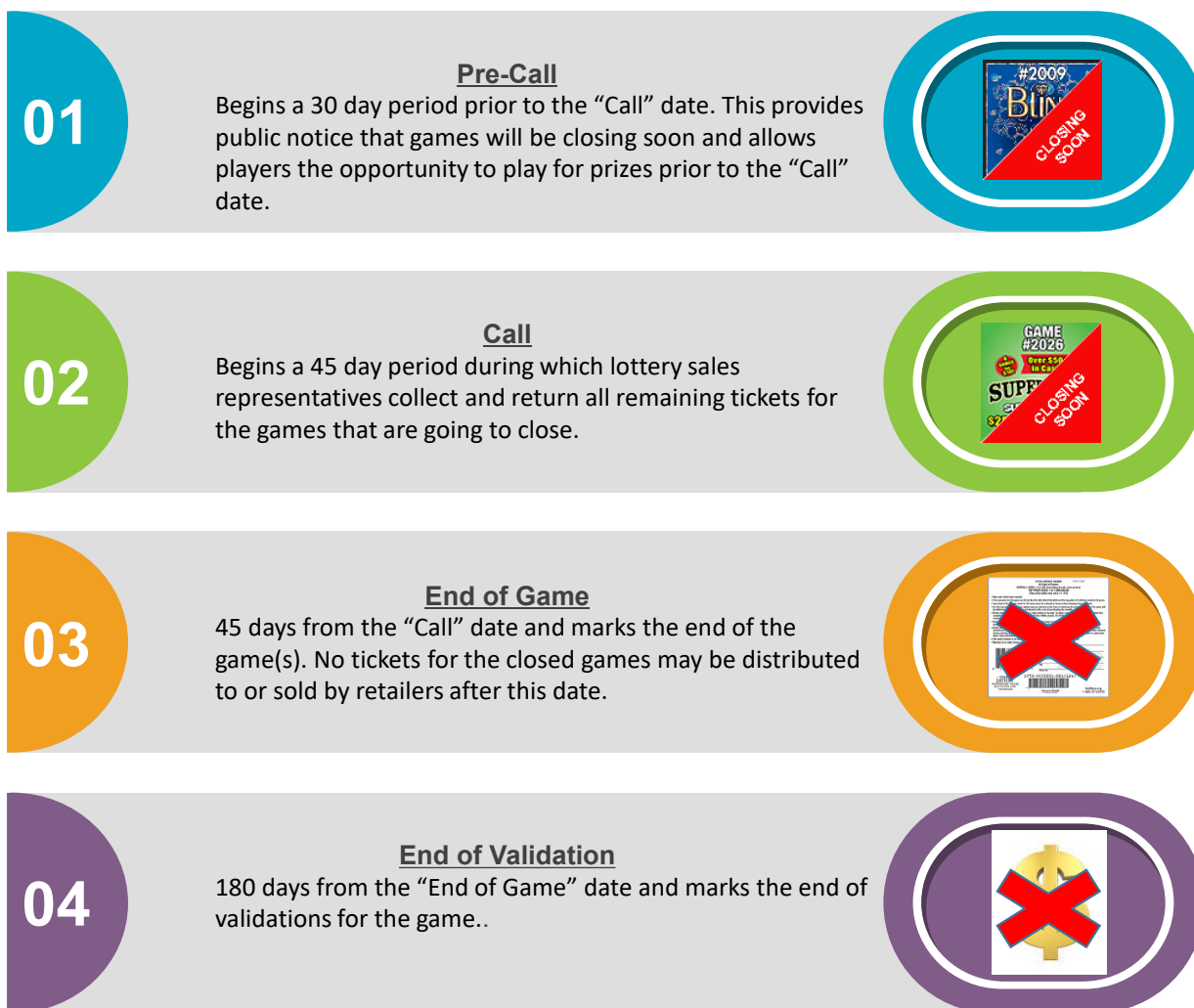


Figure 2 Scratch ticket game closing dates.

APPENDIX B – BUSINESS OBJECTIVES, RISKS, FINDINGS AND MANAGEMENT RESPONSE



This section of the report provides a summary of the function's key business objectives, primary business risks, management's controls in place and the respective internal control assessment. Each table also includes our recommendations to address deficiencies noted, or opportunities to enhance current controls.

1 BUSINESS OBJECTIVE: SCRATCH TICKET SUPPLY CHAIN

Business Objective	To ensure continuous availability of scratch tickets for sale.
Business Risk	<ul style="list-style-type: none"> Availability of scratch ticket games may be negatively affected due to supply chain issues (e.g., COVID19 and other environmental factors).
Management Controls in Place	<ul style="list-style-type: none"> TLC has a standardized RFP process to ensure all TLC scratch ticket vendors meet TLC's supply chain needs. TLC schedules scratch ticket games months in advance to ensure scratch ticket game launches are not delayed even when print runs or shipments are delayed. TLC contracts with multiple scratch ticket vendors to ensure continuous availability of scratch tickets. TLC scratch ticket vendors operate multiple printing facilities to ensure that print runs and shipments can be performed in the event of a supply chain interruption. TLC scratch ticket vendors are subject to multiple security audits, including SOC 2 type 2, ISO 27001, and World Lottery Association (WLA) to ensure the secure handling and continued availability of scratch ticket games.
Control Tests	<ul style="list-style-type: none"> Interviewed key process owners. Inspected TLC scratch ticket vendor contracts to determine the contractual requirements established to address supply chain issues and the continuous availability of scratch ticket games. Inspected scratch ticket vendor security reports (e.g., Soc 2 Type II reports, ISO certifications)
Control Assessment / Findings	<p>Generally Effective</p> <ul style="list-style-type: none"> Controls are working effectively. No control findings noted. <p><u>Opportunity for Improvement</u></p> <ul style="list-style-type: none"> Although TLC's processes include close monitoring of their vendor relationships and scratch ticket shipments, there is no current process in place to periodically review the results of independent third-party security assessments to ensure the scratch ticket vendor's continued compliance with control standards over data security.
Recommended Actions	<u>Opportunities for Improvement</u>

1 BUSINESS OBJECTIVE: SCRATCH TICKET SUPPLY CHAIN

- Consider implementing a formal process to review the results of independent third-party security assessments, such as SOC reports or ISO certificates, to assure the scratch ticket vendor's continued compliance with control standards over data security. This review should include:
 - verifying that the vendor's internal controls were operating effectively.
 - reviewing user-entity controls and TLC's strategy(ies) for addressing them.

Note: TLC is in the process of finalizing vendor contracts for 2024, which includes requirements for scratch ticket vendors to provide SOC 2 reports to TLC for review.

2 BUSINESS OBJECTIVE: SCRATCH TICKET SUPPLY CHAIN INCIDENT RESPONSE

Business Objective	To implement supply chain management processes that ensure the continuous availability of scratch tickets for sale without supply chain interruptions.
Business Risk	<ul style="list-style-type: none"> ▪ TLC may not be able to meet customer demand when scratch ticket supply chain issues arise.
Management Controls in Place	<ul style="list-style-type: none"> ▪ TLC contracts with multiple scratch ticket vendors to ensure continuous availability of scheduled scratch ticket games. ▪ Staff escalate any potential scratch ticket supply chain incidents to the Agency's Contracts & Facilities Manager, which subsequently could be escalated to TLC's Executive Director. ▪ TLC staff review scratch ticket incidents against vendor contracts to determine the appropriate recourse and remedy for scratch ticket supply chain issues, based on contract terms.
Control Tests	<ul style="list-style-type: none"> ▪ Interviewed key process owners. ▪ Inspected TLC's Agenda for 2021 Contract Compliance Meetings and the Roles and Responsibilities documents to determine whether and to whom TLC has assigned responsibility for managing and reporting issues related to scratch ticket contract management and scratch ticket supply chain incidents. ▪ Inspected TLC scratch ticket vendor contracts to determine the contractual requirements established to address scratch ticket supply chain issues. ▪ Inspected scratch ticket supply chain incidents and TLC response documentation to determine whether the actions taken by TLC and its vendors to manage the issue were in alignment with contract terms.
Control Assessment / Findings	<p>Generally Effective</p> <ul style="list-style-type: none"> ▪ Controls are working effectively. No control findings noted.

2 BUSINESS OBJECTIVE: SCRATCH TICKET SUPPLY CHAIN INCIDENT RESPONSE

Recommended Actions	None made.
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3 BUSINESS OBJECTIVE: IN-LANE LOTTERY PRODUCTS SALES Security

Business Objective	To ensure that lottery products sold through retailers that offer in-lane sales protect the integrity of lottery products.
Business Risk	<ul style="list-style-type: none"> ▪ The integrity of in-lane lottery products may be compromised.
Management Controls in Place	<ul style="list-style-type: none"> ▪ TLC has implemented a standardized RFP process that requires all TLC retailers that sell lottery product in-lane to provide a data security plan. This plan is reviewed and approved by the TLC Data Security Manager to ensure the respective TLC retailer meets TLC's data security requirements.
Control Tests	<ul style="list-style-type: none"> ▪ Interviewed key process owners to determine the process in place to ensure that in-lane lottery products are secured per TLC's data security needs. ▪ Inspected TLC's RFP documentation to determine the process for ensuring that TLC in-lane sales retailers meet TLC's data security requirements.
Control Assessment / Findings	<p>Generally Effective</p> <ul style="list-style-type: none"> ▪ Controls are working effectively. No control findings noted.
Recommended Actions	None made.

4 BUSINESS OBJECTIVE: SCRATCH TICKET GAME CLOSURE PROCEDURES

Business Objective	To ensure that scratch ticket games are closed according to established policies and procedures and supporting documentation is maintained for historical purposes.
Business Risk	<ul style="list-style-type: none"> ▪ Scratch ticket games may not be closed according to established criteria.
Management Controls in Place	<ul style="list-style-type: none"> ▪ TLC has a formalized procedure that clearly establishes criteria for closing scratch ticket games and includes specific instruction for the respective scratch ticket game performance and documentation of game closure analysis. ▪ TLC has established requirements for approval signatures for scratch ticket game closures at various levels of authority within the organization.
Control Tests	<ul style="list-style-type: none"> ▪ Interviewed key process owners. ▪ Inspected the Texas Lottery Commission Lottery Operations Division Procedure LO-PD-004 Closing Scratch Ticket Games to determine the procedural requirements for closing scratch ticket games.

4 BUSINESS OBJECTIVE: SCRATCH TICKET GAME CLOSURE PROCEDURES

- Inspected an example management reports used to determine the information provided to Lottery Operations personnel in the determination of which scratch ticket games should be closed.
- Inspected example of scratch ticket game analysis worksheets 'Avg Weekly Sales' and 'Avg # of Weeks' to determine how average weekly sales and average number of weeks on market are tracked for each scratch ticket game.
- Inspected an example Scratch Ticket Game Closing Analysis to determine how scratch ticket game closing analysis is documented to support requirements established in Texas Lottery Commission Lottery Operations Division Procedure LO-PD-004 Closing Scratch Ticket Games.
- Inspected the list of closed scratch ticket games as published on the Texas Lottery website to determine the population of games closed during the audit period (SFY 2021 - Q3 SFY 2022).
- Inspected scratch ticket game closure packages for a sample of 15 games closed during the audit period (SFY 2021 - Q3 SFY 2022) to determine whether scratch ticket game closures were performed according to TLC policies and procedures.

**Control
Assessment
Rating**

Best Practices

- Controls are working effectively. No control findings noted.

**Recommended
Actions**

None made.