



# TEXAS LOTTERY COMMISSION

## **Internal Audit Services**

AN INTERNAL AUDIT OF

## **Procurement and Contracting Processes**

Report No. 24-003

August 23, 2024

*This report provides management with information about the condition of risks and internal controls as a specific point in time. Future changes in environmental factors and actions by personnel may 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 2024 Annual Internal Audit Plan.

### Business Objectives and Scope

To implement controls and processes that ensure Procurement and Contracting activities meet legislative requirements and are managed in accordance with TLC policies and procedures.

This audit focused on the following management controls and processes:

- Adherence to TLC Policy
- Conflict of Interest and Ethics
- Solicitation Process
- Solicitation Evaluation
- Contract Award
- Contract Monitoring
- Vendor Performance Reporting
- Contract Value True-Ups
- Needs and Risk Assessments
- Contract Close-Out

The audit scope period was September 1, 2023, through June 1, 2024.

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

*Thank you!*



### Audit Conclusions

Overall, we found the design of the Agency's management controls to be generally effective with best practice processes in the following areas:

- Formal, mature process for reviewing and updating policies and procedures to explicitly address applicable legislation.
- Procurement and contracting processes follow checklists designed to address relevant policies and procedures.

### Internal Control Rating

Generally Effective with Best Practice processes.

### What Did We Recommend?

We had no findings and therefore had no recommendations.

We noted four opportunities where the internal controls or processes were effective as designed but could be enhanced. Specifically:

TLC should consider updating the Contract Management Manual and internal policies and procedures to clarify requirements related to:

- Opportunities for HUB contractors and HUB-related procedures taken by the Executive Director.
- Documentation of modification to liquidated damages during contract extension.
- Disclosure of conflicts of interest arising at any time during the contract period.
- Posting accountability and risk analysis procedures to the agency's website.

TLC should also consider updating the procurement and contracting checklists to clarify that needs and risk assessments, cost-benefit analysis, and contract valuation reviews are performed on a biennial basis.

### Number of Findings by Residual Risk Rating

Category	High	Medium	Low	Total
Findings	0	0	0	0
Improvement Opportunities				4

## Introduction

We performed this audit as part of the approved FY 2024 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.

## Business Objective, Conclusion, and Internal Control Rating

### *Business Objective*

To design controls and processes that ensure Procurement and Contracting activities meet legislative requirements and are managed in accordance with TLC policies and procedures.

The purpose of this audit was to assess the effectiveness of management controls and processes in place. As such we focused on the following:

- Adherence to TLC Policy
- Conflict of Interest and Ethics
- Solicitation Process
- Solicitation Evaluation
- Contract Award
- Contract Monitoring
- Vendor Performance Reporting
- Contract Value True-Ups
- Needs and Risk Assessments
- Contract Close-Out

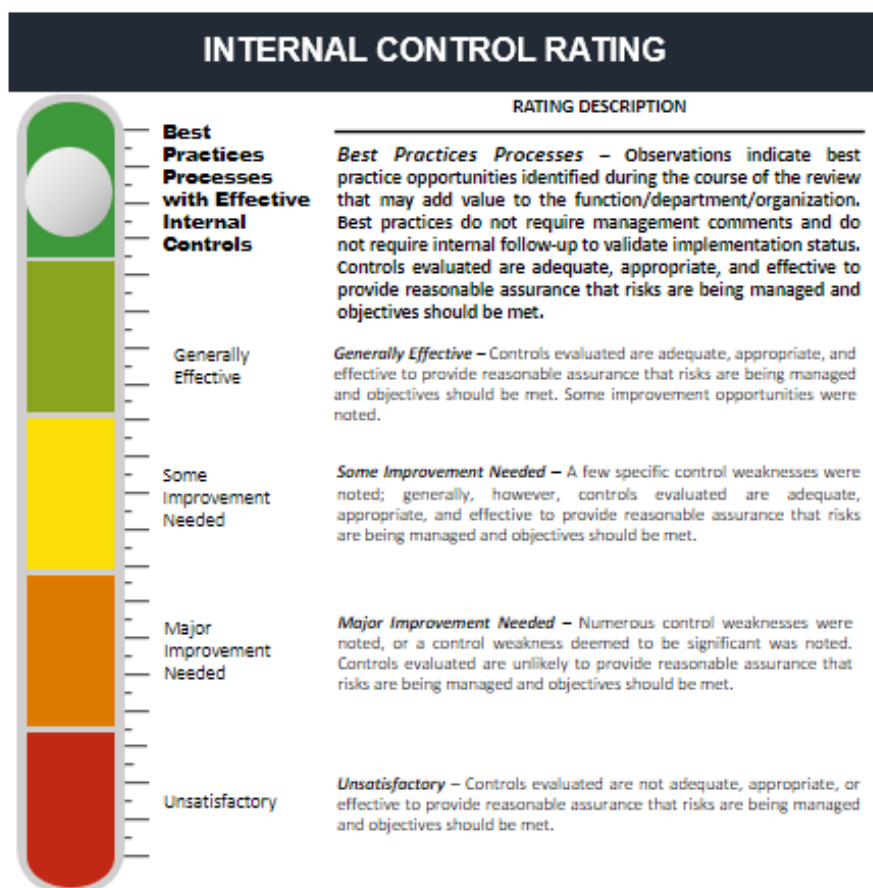
The audit scope period was September 1, 2023, through June 1, 2024.

### *Conclusion*

This audit resulted in an overall internal control rating of: **Generally Effective with Best Practice Processes** in the following areas:

- Formal, mature process for reviewing and updating policies and procedures to explicitly address applicable legislation.
- Procurement and contracting processes follow checklists designed to address relevant policies and procedures.

**Exhibit 1** describes the internal control rating.



**Exhibit 1:** Internal control rating description.

## 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.

## Findings and Risk Rating Summary

Inherent risk is the business risk associated with the respective function or process if internal controls were not in place or were not effective. Residual risk is Internal Audit's ranking of the remaining risk or likelihood of a negative event occurring with the internal controls and processes in place. **Exhibit 2** provides a summary of our audit observations. See the findings and management response section of this report for a discussion of all issues identified recommendations and management responses.

Business Objective / Focus Area	Business Risk Ranking	Control Effectiveness	Recommendations
1. To ensure that TLC's policies and procedures for Procurement and Contracting Processes are documented and	Inherent Risk: <b>High</b> Residual Risk: <b>Low</b>	Generally Effective with Best Practice Processes  <u>Findings</u> No findings noted.	  <u>Finding</u> No findings noted.

Business Objective / Focus Area	Business Risk Ranking	Control Effectiveness	Recommendations
updated. Approved written procedures serve as guidance to ensure that the business function and internal controls are performed consistently to meet organizational objectives.		<u>Opportunities for Improvement</u> No opportunities noted.	<u>Opportunity for Improvement</u> No opportunities noted.
2. To establish management controls and processes to ensure the agency is compliant with state legislation governing Procurement and Contracting.	Inherent Risk: <b>High</b> Residual Risk: <b>Low</b>	Generally Effective with Best Practice Processes  <u>Findings</u> No findings noted.  <u>Opportunity for Improvement</u> <b>OFI 1:</b> TLC has implemented AD-SS-PU-008 HUB Forum and Outreach Program, which describes general activities and responsibilities to inform minority businesses of various opportunities, but the procedures as a whole stop short of explicitly addressing the opportunities enumerated under Section 466.107(1) of the Texas Government Code and the positive steps taken by the executive director under Section 466.107(a).  <b>OFI 2:</b> AD-SS-PU-032 Preparing a Request for Proposals does not explicitly require that modifications to liquidated damages or other contractor's liability provisions during contract extension require amendment to the written explanation or justification.  <b>OFI 3:</b> The Contract Management Manual (and the Conflict-of-Interest form) requires attestation that no conflicts of interest exist, but do not specifically require disclosure of conflicts of	<u>Findings</u> No findings noted.  <u>Opportunity for Improvement</u> <b>OFI 1:</b> Consider updating the Contract Management Manual or one of its various HUB-related procedures to include HUB requirements from Texas Government Code §466.107 explicitly or by reference.  <b>OFI 2:</b> Consider adding language to explicitly address modifications to provisions for liquidated damages or other contractor's liability during contract extension require amendment to the written explanation or justification.  <b>OFI 3:</b> Consider adding language to specify that conflicts of interest arising at any time during the contract period are disclosed.

Business Objective / Focus Area	Business Risk Ranking	Control Effectiveness	Recommendations
		<p>interest that arise at any time during the contract period. These requirements are communicated to appropriate personnel during training.</p> <p><b>OFI 4:</b> AD-SS-PU-039 Accountability and Risk Analysis establishes purchasing accountability and risk analysis requirements but is not explicit with regards to the process for posting these procedures to the agency's website.</p>	<p><b>OFI 4:</b> Consider revising AD-SS-PU-039 to explicitly require submission of the accountability and risk analysis procedure to the agency's website and to validate existing links when the procedure is reviewed.</p>

**Exhibit 2:** Summary of Internal Audit Findings and Recommendations.

## Background

This section of the report provides an overview of the procurement and contracting process.

The Texas Lottery Commission's Administration Division is responsible for ensuring that the agency's procurement and contracting activities are performed in compliance with applicable laws, regulations, and internal policies and procedures. For each contract, TLC determines an overall contract value, based on the original term of the contract and any additional renewal periods, in accordance with the *State of Texas Procurement and Contract Management Guide*. This contract value is used to determine the category of contract used for administrative purposes. These categories include:

- **Major contracts:** formal procurements for goods or services that *directly* support the agency's core gaming business function and have a cumulative contract value equal to or greater than ten (10) million dollars.
- **Prime contracts:** any contract that has a cumulative contract value greater than one (1) million dollars, excluding major contracts.
- **Operational contracts:** any contract with a cumulative contract value of less than one (1) million dollars and procured through a formal procurement process.
- **Other contracts:** interagency agreements, subscriptions, Department of Information Resources (DIR) leases, Texas Facilities Commission (TFC) leases, and trademark use agreements with other lotteries with a cumulative contract value of less than one (1) million dollars.

In order to ensure effective control over procurement and contracting processes, the Administration Division has developed formal policies and procedures as well as completion checklists for key processes related to procurement and contracting.

## Detailed Findings and Management Response



*This section of the report provides a detailed discussion of opportunities we noted during the audit along with recommendations to improve internal controls or the business process.*

## Business Objective #1: Operations and Compliance with Policies/Procedures

Operations are the processes, controls, and technology in place to ensure that the respective department or function executes its responsibilities in an effective and efficient manner.

**Business Risk Rating (Inherent): High**

**Business Risk Rating (Residual): Low**

**Business Objective:** To ensure that TLC's policies and procedures for Procurement and Contracting Processes are documented and updated. Approved written procedures serve as guidance to ensure that the business function and internal controls are performed consistently to meet organizational objectives.

**Control Rating:** Generally Effective with Best Practice Processes

### Finding Narrative:

TLC has developed and implemented internal policies and procedures designed to meet the procurement and contracting objectives established in the *Texas Lottery Commission Contract Management Manual* and the *State of Texas Procurement and Contract Management Guide*. These policies and procedures are also augmented, where necessary, with additional exhibits and supplemental guidance to ensure that procurement and contracting personnel are supported in the performance of their responsibilities.

Additionally, the Administration Division has developed a robust set of checklists to be used throughout procurement and contracting management processes to ensure the completion of such tasks and that they are documented. In this way, these checklists act as both preventive and detective controls in that they act as a reminder to personnel which tasks need to be completed (preventive) and can be used to subsequently validate that those tasks were performed (detective).

Our review indicated that TLC's checklists address the **Adherence to Policy** focus area included in the scope of this audit. We also determined that, for the three contracts inspected in this audit, that all evidentiary documentation related to procurement and contracting was completed and maintained, consistent with the established policies and procedures.

Additionally, we compared the checklists to relevant procurement and contracting procedures to determine whether all significant elements of those procedures were addressed. The results of this comparison indicated that the set of checklists, taken as a whole, addressed all significant elements.

<b>Criteria</b>	<ul style="list-style-type: none"> <li>➤ COSO Internal Control Integrated Framework</li> <li>➤ <i>Texas Lottery Commission Contract Management Manual</i></li> <li>➤ <i>State of Texas Procurement and Contract Management Guide</i>.</li> <li>➤ Applicable Texas Lottery Commission Internal Procedure Documents</li> </ul>
<b>Effect/Risk/Impact</b>	<ul style="list-style-type: none"> <li>➤ TLC's Procurement and Contracting Processes may not be conducted in compliance with agency policies and procedures.</li> </ul>
<b>Control Tests</b>	<ul style="list-style-type: none"> <li>➤ Inquired of the Administration Division Director</li> <li>➤ Inspected the <i>Texas Lottery Commission Contract Management Manual</i>.</li> <li>➤ Inspected additional Texas Lottery Internal Procedure Documents, as applicable.</li> <li>➤ Inspected the Texas Lottery Commission Master Checklist for a set of three contracts related to one RFP for scratch ticket services. TLC uses this checklist to ensure all required contract administration steps are followed and supported by documentation.</li> </ul>
<b>Management Controls in Place</b>	<ul style="list-style-type: none"> <li>➤ TLC's Procurement and Contracting policies and procedures clearly establish responsibilities and requirements for procurement and contracting.</li> <li>➤ TLC's Procurement and Contracting processes are conducted in accordance with established policies and procedures.</li> </ul>



	<ul style="list-style-type: none"> <li>➤ TLC has implemented formal checklists for procurement and contracting processes to ensure that policy and procedure requirements are met.</li> <li>➤ TLC uses the procurement and contracting checklist to perform procurement and contracting processes.</li> </ul>
<b>Findings / Opportunities</b>	<p><b><u>Findings:</u></b></p> <ul style="list-style-type: none"> <li>➤ No internal control weakness findings were noted.</li> </ul> <p><b><u>Opportunities for Improvement:</u></b></p> <ul style="list-style-type: none"> <li>➤ No opportunities for improvement were noted.</li> </ul>
<b>Root Cause</b>	<ul style="list-style-type: none"> <li>➤ Not applicable – no findings were noted.</li> </ul>

**Recommended Actions:**Findings

*Not applicable – no findings were noted.*

Opportunities for Improvement

*Not applicable – no opportunities were noted.*

**Management Response:**

*Not applicable – no findings were noted.*

**Business Objective #2: Compliance with Legislation**

The Texas Lottery Commission establishes entity-level objectives that align with the agency's mission and general strategies. Compliance objectives are focused on ensuring that the agencies' operations align with laws, rules, regulations, and standards imposed by legislators, regulators, and other standard setters. The agency seeks to meet these objectives through its control environment, risk assessment activities, control activities, information management and communication, and monitoring activities. These components are established through effective governance.

Governance refers to actions that an organization's Board and executive leadership take to establish the management controls and culture. This is accomplished through setting expectations and communicating these in written policies. Governance is responsible for allocating resources to ensure appropriate organization structures are in place so that activities are carried out effectively, responsibly, and in alignment with the organization's mission and objectives. Governance also encompasses the systems and practices that guide decision-making, risk management, and overall accountability within an organization. Sound governance practices are crucial for maintaining transparency, integrity, and ethical behavior.

**Business Risk Rating (Inherent): High**

**Business Risk Rating (Residual): Low**

**Business Objective:** To establish management controls and processes that ensure the agency is compliant with state legislation governing Procurement and Contracting.

**Control Rating:** Generally Effective with Best Practice Processes

**Finding Narrative:**

The Texas Lottery Commission was established under Texas Government Code Chapter 466 State Lottery and, as a state agency, is subject to various State contracting laws, such as those listed in the criteria below.



TLC has assigned the Administration Division the responsibility of managing its procurement and contracting processes. This is documented in the *Texas Lottery Commission Administration Division Procedure – Contract Approval Authority and Responsibilities*.

The Administration Division Director is experienced and knowledgeable about the legislative requirements applicable the agency’s procurement and contracting processes and is proactive in determining those requirements and addressing them through changes to agency rules, policies, and procedures. These changes to policies and procedures follow a mature and documented process, which is documented in the *Texas Lottery Commission Administration Division Procedure - Policy, Directive and Procedure Approval Process*. As per this procedure, policies and procedures are updated biennially or when significant changes are needed.

Our review indicated that TLC has developed and implemented policies and procedures to specifically address the various areas we inspected in the scope of this audit. In general, policies and procedures were documented in a manner that directly addressed applicable legislation, which reduces the risk that these items may be misinterpreted or misapplied.

Specific policies and procedures relevant to the various focus areas of this audit are described below:

- **Conflict of Interest and Ethics.** The *Contract Management Manual* establishes requirements for individuals involved in the procurement and contracting staff to acknowledge and disclose potential conflicts of interest and establishes ethical standards for performance and conduct. The *Contract Management Manual* also includes requirements of the *State of Texas Procurement and Contract Management Guide*, which also contains ethical standards and statements on conflicts of interest disclosures.
- **Solicitation Process.** The *Contract Management Manual* provides an overview of the general solicitation process while TLC internal procedures, such as the TLC Administration Division Procedures *Preparing a Request for Proposals*, *Preparing an Invitation for Bids* and others establish specific requirements and procedural steps used to ensure the appropriate management of procurement and contracting activities.
- **Solicitation Evaluation.** The *Contract Management Manual* establishes requirements for the evaluation of solicitations, including the establishment of an evaluation committee for each formal procurement. The manual also establishes the evaluation process in accordance with 16 Texas Administrative Code §401.101, which describes specific evaluation factors to be considered.
- **Contract Award.** The *Contract Management Manual* establishes requirements for managing vendor communications prior to and after a contract is awarded. The manual also establishes requirements for negotiating and determining specific terms and conditions pertinent to awarded contracts.
- **Contract Monitoring.** The *Contract Management Manual* establishes requirements for monitoring contract compliance to verify that the contract is performing effectively and efficiently in accordance with contract terms and conditions. Additionally, *Texas Lottery Commission Administration Division Procedure - Accountability and Risk Analysis* establishes enhanced monitoring procedures applicable to contracts for which the Administration Division determines that additional transparency is needed. The procedure also establishes the requirement for additional enhanced monitoring procedures by a third-party vendor for the Lottery Operations and Services vendor due to that contract’s value and complexity.
- **Vendor Performance Reporting.** The *Contract Management Manual* establishes requirements for vendor performance reporting through the use of the State of Texas Comptroller of Public Accounts’ Vendor Performance Tracking System (VPTS). Additional details and specific procedures are documented in the *Texas Lottery Commission Administration Division Procedure – Vendor Performance Tracking System (VPTS)*.
- **Contract Value True-Ups.** The *Contract Management Manual* establishes requirements for the review and evaluation of all major procurements and contracts. This evaluation is based on a cumulative contract value over the initial term and any renewal periods based on applicable law, procedures, and regulations; State fiscal standards; and best practices. Contracts that are determined to have a value of over \$5 million are reviewed by the Contract Advisory Team (CAT), who provide state agencies in improving contract management practices by providing recommendations on solicitation and contract documentation.

- **Needs and Risk Assessments.** The *Contract Management Manual* establishes requirements for the completion of a needs and risk assessment by the Administration Division for new and current goods and services for the purposes of making sound financial decisions and providing the best value for the State of Texas. Additional details and specific procedures are documented in the *Texas Lottery Commission Administration Division Procedure – Needs and Risk Assessment*.
- **Contract Close-Out.** The *Contract Management Manual* establishes requirements for contract close-out processes. Specifically, this section requires a Contract Close-Out Memo to be initiated by the Contracts Administration within thirty (30) days after the expiration, termination, or completion of a contract. Additional details and specific procedures are documented in the *Texas Lottery Commission Administration Division Procedure – Contract Closeout Process*.

<b>Criteria</b>	<ul style="list-style-type: none"> <li>➤ COSO Internal Control Integrated Framework</li> <li>➤ 16 TAC 401A - Administration of State Lottery - Procurement</li> <li>➤ Government Code Chapter 2261 - State Contracting Standards and Oversight</li> <li>➤ Government Code Chapter 2262 - Statewide Contract Management</li> <li>➤ Government Code Chapter 466 - State Lottery</li> <li>➤ Government Code Chapter 467 - Texas Lottery Commission</li> </ul>
<b>Effect/Risk/Impact</b>	➤ TLC may not be compliant with applicable State legislation related to Procurement and Contracting.
<b>Control Tests</b>	<ul style="list-style-type: none"> <li>➤ Inquired of the Administration Division Director.</li> <li>➤ Compared TLC policies and procedures to applicable legislation to determine whether the policies and procedures were designed to ensure compliance with applicable legislation.</li> </ul>
<b>Management Controls in Place</b>	➤ TLC has implemented formal policies and procedures to ensure compliance with legislative requirements related to Procurement and Contracting.
<b>Findings / Opportunities</b>	<p><b><u>Findings:</u></b></p> <ul style="list-style-type: none"> <li>➤ Not applicable – no findings were noted.</li> </ul> <p><b><u>Opportunities for Improvement:</u></b></p> <ul style="list-style-type: none"> <li>➤ <b>OFI 1:</b> TLC has implemented AD-SS-PU-008 HUB Forum and Outreach Program, which describes general activities and responsibilities to inform minority businesses of various opportunities, but the procedures as a whole stop short of explicitly addressing the opportunities enumerated under Section 466.107(1) of the Texas Government Code and the positive steps taken by the executive director under Section 466.107(a).</li> <li>➤ <b>OFI 2:</b> AD-SS-PU-032 Preparing a Request for Proposals does not explicitly require that modifications to liquidated damages or other contractor's liability provisions during contract extension require amendment to the written explanation or justification.</li> <li>➤ <b>OFI 3:</b> The Contract Management Manual (and the Conflict-of-Interest form) requires an attestation that no conflicts of interest exist but does not specifically require disclosure of conflicts of interest that arise at any time during the contract period. These requirements are communicated to appropriate personnel during training.</li> <li>➤ <b>OFI 4:</b> AD-SS-PU-039 Accountability and Risk Analysis establishes purchasing accountability and risk analysis requirements but is not explicit with regards to the process for posting these procedures to the agency's website.</li> </ul>
<b>Root Cause</b>	➤ Not applicable – no findings were noted.

#### Recommended Actions:

#### Findings

No findings were noted.

Opportunities for Improvement

**OFI 1:** Consider updating the Contract Management Manual or one of its various HUB-related procedures to include HUB requirements from Texas Government Code §466.107 explicitly or by reference.

**OFI 2:** Consider adding language to explicitly address modifications to provisions for liquidated damages or other contractor's liability during contract extension require amendment to the written explanation or justification.

**OFI 3:** Consider adding language to specify that conflicts of interest arising at any time during the contract period are disclosed.

**OFI 4:** Consider revising AD-SS-PU-039 to explicitly require submission of the accountability and risk analysis procedure to the agency's website and to validate existing links when the procedure is reviewed.

**Management Response:**

Not applicable – no findings were noted.