



# TEXAS LOTTERY COMMISSION

## Internal Audit Services

AN INTERNAL AUDIT OF

## Retailer Incentive & Bonus Programs

Report No. 24-005

August 30, 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 establish management controls and processes that ensure the Retailer Cash Incentive Program (RCIP) and Bonus Payment Program are administered:

- In compliance with applicable legislation
- In compliance with internal policies and procedures, and
- To ensure accuracy of payments to eligible participants.

The audit scope period was September 1, 2023, through August 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.
- RCIP and Bonus Payment Program processes are shared effectively across multiple Divisions and external parties to ensure accurate calculations and approvals for all retailer cash incentive and bonus payments.

### Internal Control Rating

Generally Effective with Best Practice Processes.

### What Did We Recommend?

We had no findings and therefore had no recommendations.

We noted two opportunities where the internal controls or processes were effective as designed but could be enhanced. Specifically, for the Bonus Payment Program:

- The email sent automatically by the Winning Ticket System (WTS) to internal recipients and SCA Promotions, Inc. (SCA) did not indicate that the notification is required under Section 3.c of the Contract but that other approvals are required before SCA is authorized to pay the retailer bonus, as indicated by *TLC Lottery Operations Division Procedure - Powerball® and Mega Millions® Retailer Bonus Payments*. We noted that this notice was provided in a prior communication.
- The retailer bonus record generated in WTS did not contain the Taxable Entity Address as indicated in *TLC Lottery Operations Division Procedure - Powerball and Mega Millions Retailer Bonus Payments*. We noted that this did not prevent effective payment of the retailer bonus.

### Number of Findings by Residual Risk Rating

Category	High	Medium	Low	Total
Findings	0	0	0	0
Improvement Opportunities				2

## 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 establish management controls and processes that ensure the Retailer Cash Incentive Program (RCIP) and Bonus Program are administered in compliance with applicable legislation, in compliance with internal policies and procedures, and to ensure accuracy of payments to eligible participants.

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

1. Compliance with internal policies and procedures (See **Business Objective 1**),
2. Accuracy of retailer cash incentive and bonus payments (See **Business Objective 1**), and
3. Compliance with applicable legislation (See **Business Objective 2**).

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

### *Conclusion*

Overall, we found the design of the Texas Lottery Commission's (TLC / Agency) 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.
- RCIP and Bonus Payment Program processes are shared effectively across multiple Divisions and external parties to ensure accurate calculations and approvals for all retailer cash incentive and bonus payments.

### *Internal Control Rating*

This audit identified findings that resulted in an overall internal control rating of: **Generally Effective with Best Practice Processes**.

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

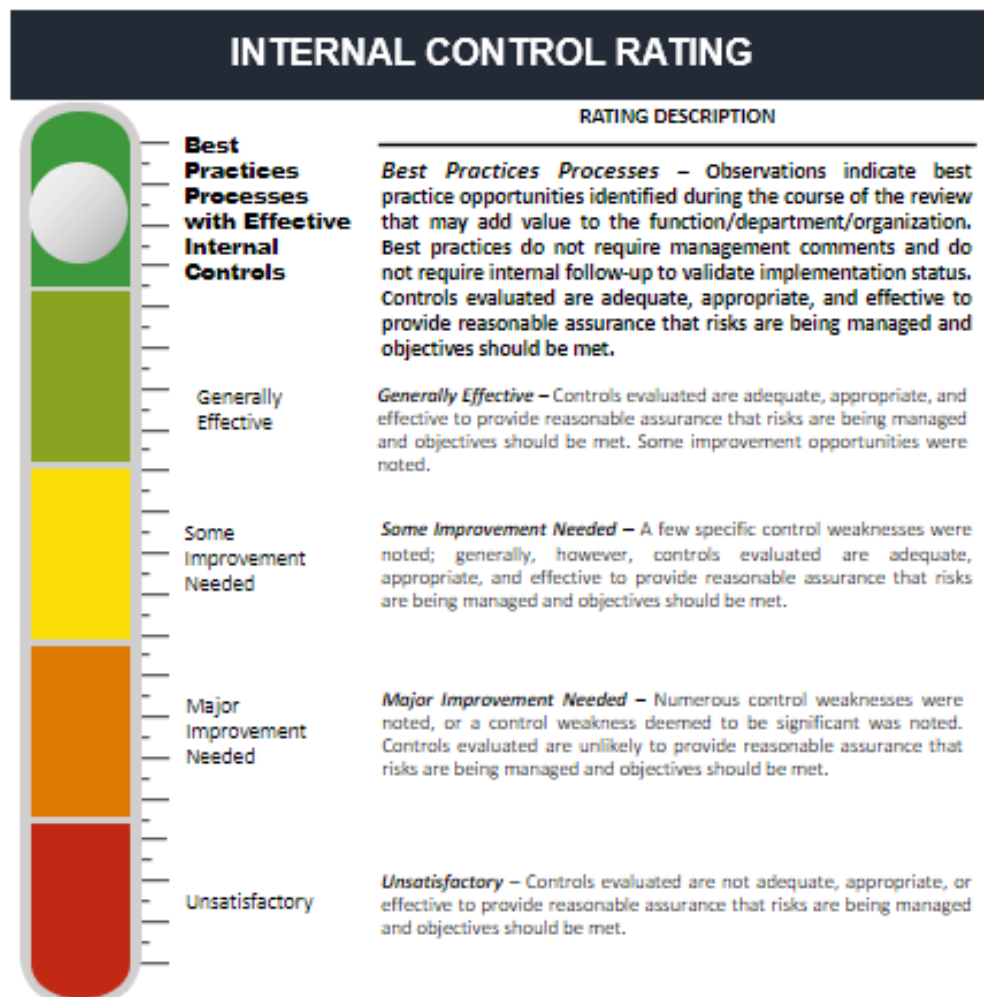


Exhibit 1. Internal Control Rating Diagram

## 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 the Retailer Commission and Incentive Program and Bonus Payment Program are administered consistently with policies and procedures and organizational objectives, including accuracy of payments.	Inherent Risk: <b>High</b> Residual Risk: <b>Low</b>	<p>Generally Effective with Best Practice Processes (See <b>Business Objective #1</b> for details)</p> <p><u>Finding</u> No findings noted.</p> <p><u>Opportunity for Improvement</u> <b>OFI 1:</b> The email sent automatically by WTS to internal recipients and SCA did not indicate that the notification is required under Section 3.c of the Contract but that other approvals are required before SCA is authorized to pay the retailer bonus, as indicated by TLC Lottery Operations Division Procedure - Powerball and Mega Millions Retailer Bonus Payments. We noted that this notice was provided in a prior communication.</p> <p><b>OFI 2:</b> The retailer bonus record generated in WTS did not contain the Taxable Entity Address as indicated in TLC Lottery Operations Division Procedure - Powerball and Mega Millions Retailer Bonus Payments. We noted that this did not prevent effective payment of the retailer bonus.</p>	<p><u>Finding</u> No findings noted.</p> <p><u>Opportunity for Improvement</u> <b>OFI 1:</b> Update the WTS automated bonus notification email parameters to include the required statement or revise TLC Lottery Operations Division Procedure - Powerball and Mega Millions Retailer Bonus Payments to specify which email notification includes the language in compliance with Section 3.c. of the SCA Contract.</p> <p><b>OFI 2:</b> Perform reviews to ensure that the Draw Game Specialist enters the correct taxable entity contact information as noted in the procedure.</p>
2. To ensure that the agency is compliant with state legislation governing the Texas Lottery Commission's authority for retailer commissions	Inherent Risk: <b>High</b> Residual Risk: <b>Low</b>	<p>Generally Effective with Best Practice Processes (See <b>Business Objective #2</b> for details)</p> <p><u>Finding</u> No findings noted.</p> <p><u>Opportunity for Improvement</u> No opportunities noted.</p>	<p><u>Finding</u> No findings noted.</p> <p><u>Opportunity for Improvement</u> No opportunities noted.</p>

Exhibit 2. Summary of Internal Audit Findings and Recommendations

## Background

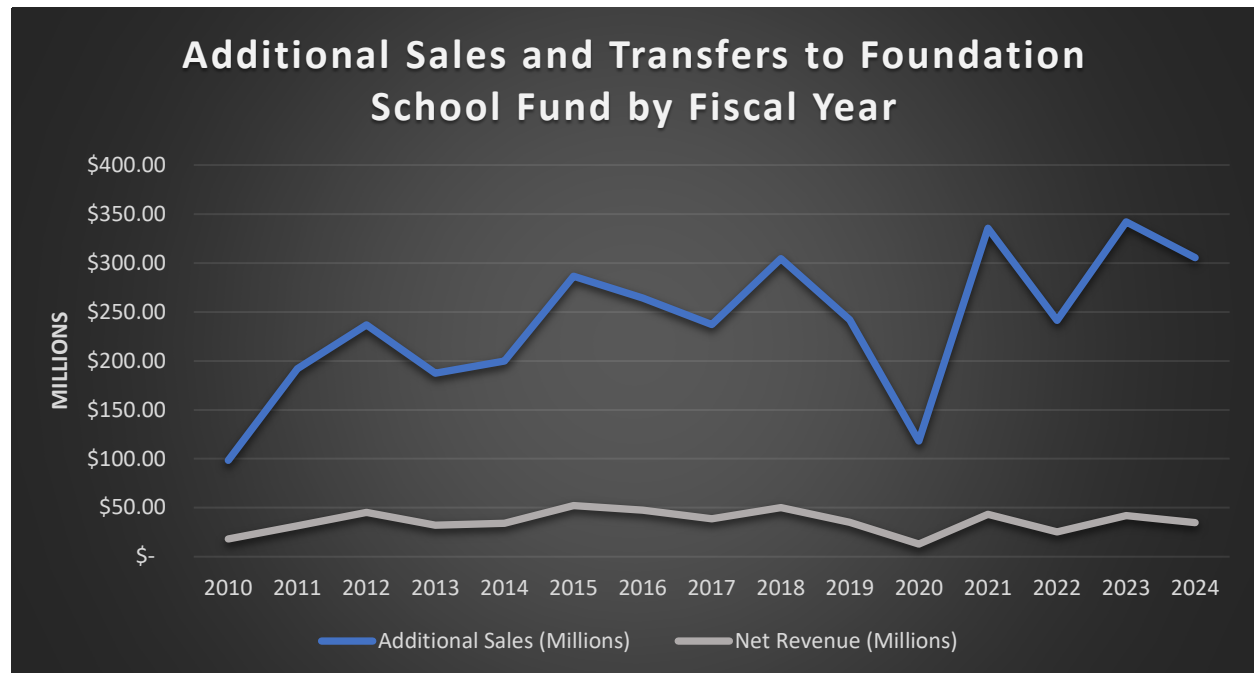
The Retailer Cash Incentive Program was established as a method to increase sales of targeted lottery games. Each RCIP is developed based on authorized funding limitations set forth in the General Appropriations Act and the agency's sales increase strategies. **Exhibit 3** provides the section of the General Appropriations Act for the 2024-25 Biennium (House Bill No. 1, 88th Legislature) related to the RCIP.

### 8. Retailer Commissions.

- a. Pursuant to Government Code, Chapter 466, an amount equal to 5 percent of gross sales shall be made available for the purpose of paying retailer commissions.
- b. The amounts included above in Strategy A.1.11, Retailer Commissions, include an estimated amount equal to one-half of one percent of gross sales each fiscal year that is in addition to the 5 percent retailer commission amount in subsection (a) above and may only be used for the purpose of paying sales performance retailer commissions. Any unobligated and unexpended balances of appropriations for the fiscal year ending August 31, 2024, are appropriated to the agency for the same purposes for the fiscal year beginning September 1, 2024. Prior to providing an additional retail commission above 5 percent of gross sales, the Texas Lottery Commission shall provide a report to the Governor and the Legislative Budget Board outlining the Texas Lottery Commission's plans to implement a retailer sales performance commission or similar sales performance incentive program and the projected benefits of the program to lottery ticket sales and state revenues.

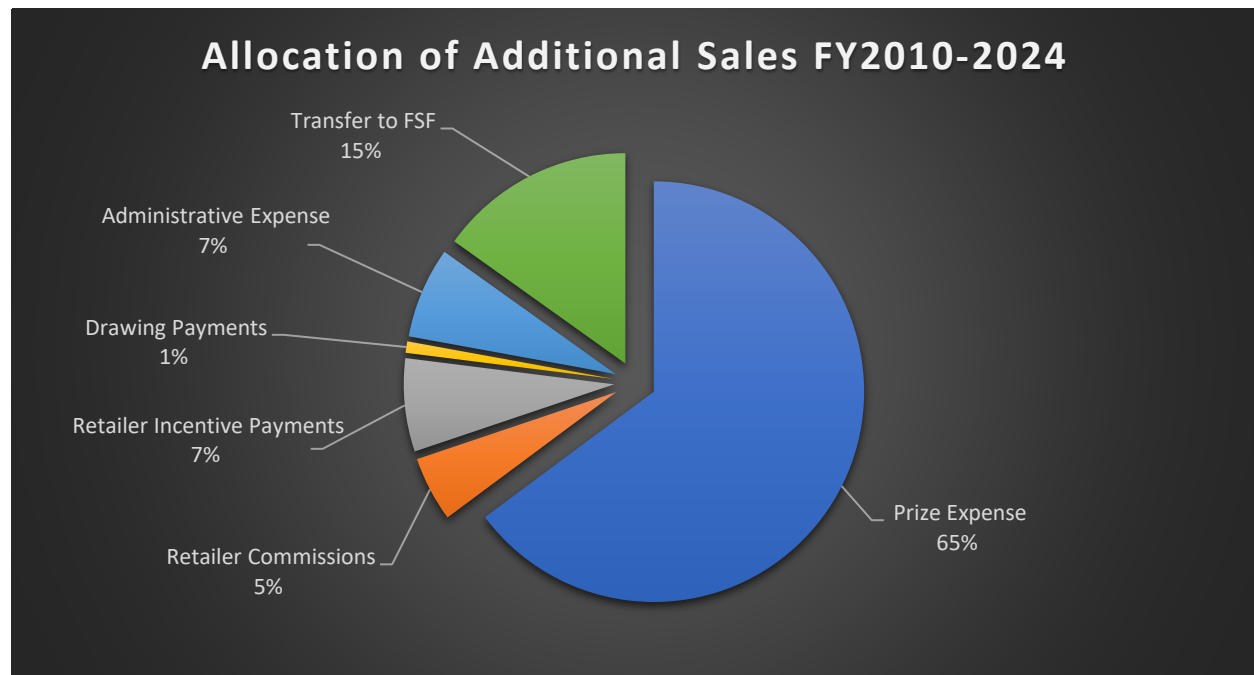
**Exhibit 3.** *General Appropriations Act for the 2024-2025 Biennium - VII-11 Retailer Commissions.*

The authority to provide retailers additional sales performance commissions provides the agency an opportunity to develop programs to incentivize lottery retailers to sell more tickets and create revenue for the state of Texas. Generally, the agency aims to conduct as many RCIPs as possible during the fiscal year to incentivize and promote retailer participation. Typically, each secondary program is focused on selected scratch ticket games and runs six weeks. Most primary programs run over the course of a thirteen (13) week period. However, during FY 2024 and FY 2025, TLC extended the eligibility period to seventeen (17) weeks due to the implementation timeline of a new system of record. Forty-three (43) RCIPs have been completed since the program's inception in FY2010. Sales for these 43 RCIPs have totaled more than \$3.59 billion which generated more than an additional \$543 million of revenue transferred to the Foundation School Fund (FSF). **Exhibit 4** provides a summary of the additional sales and transfers to the FSF by RCIP.



**Exhibit 4.** Additional Lottery Sales and Transfer to Foundation School Fund by RCIP FY2010-2024.

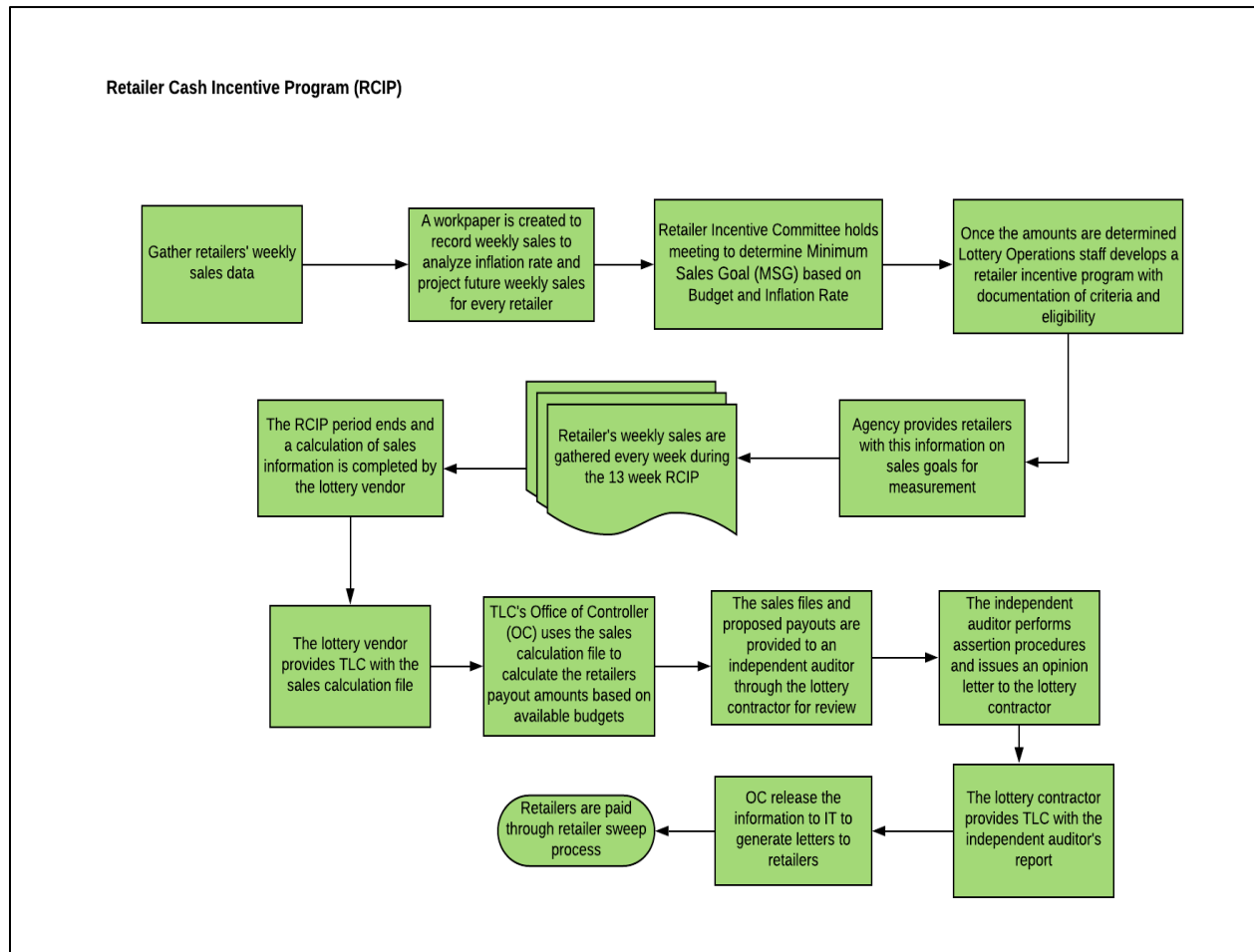
The \$3.59 billion of increased sales resulted in \$2.33 billion in prizes paid to players, \$179.5 million paid to retailers for regular commissions and \$257.2 million in incentive payments to retailers. **Exhibit 5** provides a summary of the additional sales revenue allocation.



**Exhibit 5.** Allocation of RCIP Additional Sales Revenues FY2010-FY2024.



The RCIP process involves several divisions, departments and activities. The agency has a structured process in place, including an internal RCIP Committee and the use of independent auditors to ensure only eligible retailers that met defined sales goals receive the incentive payments and drawing entries. These processes ensure that information used to administer the RCIP meets the agency's standards of ensuring the highest standard of security, integrity and responsible gaming principles. **Exhibit 6** provides an overview of the RCIP.



**Exhibit 6.** *Retailer Cash Incentive Program Process Overview.*



## 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 the Retailer Cash Incentive Program and Bonus Payment Program are administered consistently with policies and procedures and organizational objectives, including accuracy of payments.

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

#### Finding Narrative:

##### *Compliance with Policies and Procedures*

TLC has developed and implemented internal policies and procedures designed to meet the objectives and budgeting requirements established in the *General Appropriations Act*. These policies and procedures were developed and are reviewed biennially to ensure that retailer cash incentive and bonus payments are processed in a manner consistent with TLC's requirements and expectations.

Internal collaboration between the Lottery Operations Division and the Office of the Controller Division to process RCIP and bonus payments is effective and well-defined in the existing set of policies and procedures. This is also true for external communications with vendors, which include the Lottery Operator (IGT) and their independent auditor (Deloitte) (for RCIP) and SCA Promotions (for bonus payments).

##### *Accuracy of Payments*

TLC's processes for making RCIP payments and bonus payments each involve communications between multiple internal and external parties to ensure that all payments are made accurately and that all retailers are eligible for payment.

<b>Criteria</b>	<ul style="list-style-type: none"> <li>➤ TLC Lottery Operations Division Procedure – Retailer Cash Incentive Program Payments</li> <li>➤ TLC Lottery Office of the Controller - Retailer Cash Incentive Program Payment by Sweep</li> <li>➤ Texas Lottery Commission Retailer Cash Incentive Program Process</li> <li>➤ Texas Lottery Operations Division Procedure - Powerball and Mega Millions Retailer Bonus Payments</li> </ul>
<b>Effect/Risk/Impact</b>	<ul style="list-style-type: none"> <li>➤ Written procedures may not reflect expectations, responsibilities, current or complete processes.</li> <li>➤ TLC's RCIP may not be conducted in compliance with agency policies and expectations.</li> </ul>

	<ul style="list-style-type: none"> <li>➤ TLC's Bonus Payment Program may not be conducted in compliance with agency policies and expectations.</li> </ul>
<b>Control Tests</b>	<ul style="list-style-type: none"> <li>➤ Reviewed applicable written procedures.</li> <li>➤ Verified that the documentation of roles, responsibilities, and authority exist.</li> <li>➤ Reviewed documents provided to ensure they reflected documented policy and procedures.</li> <li>➤ Inspected supporting documentation for the processing of 13 primary RCIP payments and 5 secondary RCIP payments.</li> <li>➤ Inspected supporting documentation for the processing of the one jackpot bonus payment that occurred in FY 2024.</li> </ul>
<b>Management Controls in Place</b>	<ul style="list-style-type: none"> <li>➤ RCIP processes are documented in policy and procedures.</li> <li>➤ Business functions and internal controls for the RCIP and Bonus Payment Program reflect documented policies and procedures.</li> <li>➤ Effective communications between Divisions ensure RCIP and Bonus Payments are processed according to policies and procedures.</li> <li>➤ Use of well-designed and functional tools, such as calculation worksheets, ensure that RCIP and Bonus Payments are accurate and consistent with policies and procedures.</li> <li>➤ Validation and approval of calculations and eligibility requirements by multiple parties reduce the risk of inaccurate payments or payments to ineligible retailers.</li> </ul>
<b>Findings / Opportunities</b>	<p><b><u>Findings</u></b></p> <ul style="list-style-type: none"> <li>➤ N/A – No findings noted.</li> </ul> <p><b><u>Opportunities for Improvement</u></b></p> <ul style="list-style-type: none"> <li>➤ <b>OFI 1:</b> The email sent automatically by WTS to internal recipients and SCA did not indicate that the notification is required under Section 3.c of the Contract but that other approvals are required before SCA is authorized to pay the retailer bonus, as indicated by TLC Lottery Operations Division Procedure - Powerball and Mega Millions Retailer Bonus Payments. We noted that this notice was provided in a prior communication.</li> <li>➤ <b>OFI 2:</b> The retailer bonus record generated in WTS did not contain the Taxable Entity Address as indicated in TLC Lottery Operations Division Procedure - Powerball and Mega Millions Retailer Bonus Payments. We noted that this did not prevent effective payment of the retailer bonus.</li> </ul>
<b>Root Cause</b>	<ul style="list-style-type: none"> <li>➤ N/A – No findings noted.</li> </ul>

### Recommended Actions:

#### Findings

No findings were noted.

#### Opportunities for Improvement

**OFI 1:** Update the WTS automated bonus notification email parameters to include the required statement or revise TLC Lottery Operations Division Procedure - Powerball and Mega Millions Retailer Bonus Payments to specify which email notification includes the language in compliance with Section 3.c. of the SCA Contract.

**OFI 2:** Perform reviews to ensure that the Draw Game Specialist enters the correct taxable entity contact information as noted in the procedure.

**Management Response:**

Not applicable – no findings were noted.

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

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

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

**Business Objective:** To ensure that the agency is compliant with state legislation governing the Texas Lottery Commission's authority for retailer commissions.

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

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.

**Finding Narrative:**

The TLC establishes entity-level objectives that align with the agency's mission and general strategies. Compliance objectives are focused on ensuring that the agency's 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.

The RCIP and Bonus Payment Program are allocated funds as Strategic Objectives of the TLC in the General Appropriations Act. For FY 2024, the total budget was \$39.165 million for retailer sales performance commissions and \$2.01 million for the bonus payment program.

Budgeting, planning, and performing RCIPs follow clear and mature processes to ensure that these programs are compliant with applicable legislation.

<b>Criteria</b>	➤ General Appropriations Act (House Bill No. 1, 88th Legislature)
<b>Effect/Risk/Impact</b>	➤ Agency may not be compliant with legislation developed by the state of Texas.
<b>Control Tests</b>	➤ Reviewed applicable written procedures. ➤ Conducted interviews with process owners performing key functions within the RCIP process. ➤ Reviewed RCIP Committee meeting notes. ➤ Performed audit testing on the documentation used to determine budgets, eligibility, results and cash bonus payout.

<b>Management Controls in Place</b>	<ul style="list-style-type: none"> <li>➤ Tenured staff ensure compliance and understanding of the General Appropriations Act relating to retailer commissions.</li> <li>➤ TLC has developed and documented policies and procedures to establish requirements to ensure compliance with applicable legislation.</li> <li>➤ Calculations determining budgets, eligibility, results and cash bonus payouts are reflective of the calculation percentages in the General Appropriations Act and the agency's policies.</li> </ul>
<b>Findings / Opportunities</b>	<p><b><u>Findings</u></b></p> <ul style="list-style-type: none"> <li>➤ N/A – No findings noted.</li> </ul> <p><b><u>Opportunities for Improvement</u></b></p> <ul style="list-style-type: none"> <li>➤ N/A – No findings noted.</li> </ul>
<b>Root Cause</b>	<ul style="list-style-type: none"> <li>➤ N/A – No findings noted.</li> </ul>

**Recommended Actions:**

No findings were noted.

**Management Response:**

Not applicable – no findings were noted.