TEXAS DEPARTMENT OF LICENSING AND REGULATION

Internal Audit Services

AN INTERNAL AUDIT OF

Retailer Bonus and Incentive Programs

Report No. 26-006

June 3, 2026

FINAL

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.

Internal Audit Report Summary

Audit Report Number and Name:	26-006 Retailer Bonus and Incentive Programs
Audit Report Date:	May 28, 2026
Internal Control Assessment Rating	Generally Effective.
Business Objective:	To establish management controls and processes that ensure the Retailer Incentive and Bonus Programs (RCIP) are administered: • In compliance with applicable legislation • In compliance with internal policies and procedures, and • To ensure accuracy of payments to eligible participants.
Scope:	The audit scope period was September 1, 2024 – March 1, 2026.
Conclusion:	Overall, we found the design of the Agency's management controls to be generally effective. We had no findings and therefore had no recommendations. We noted opportunities where the internal controls or processes were effective as designed but could be enhanced. Specifically: 1. Establish a consistent schedule for documenting and updating program notes for incentive programs. 2. Update the Winning Ticket System (WTS) automated bonus notification email parameters to include the email notification to external recipients, or revise Lottery Operations Procedure - Bonus Payments to not include this part of the process. 3. Update Lottery Operations Procedure - Bonus Payments to reflect current practices relating to Draw Game Specialist email notifications to Lottery Operator for corporate retailer contact information.

Total Number of Findings by Risk:	**High**	**Medium**	**Low**	**Total**
	0	0	0	0
Opportunity For Improvement Recommendations by Root Cause:	**Governance / Policies**	**People / Staffing**	**Processes**	**Technology**
	2	0	1	0

Why This Review Was Conducted:

McConnell & Jones LLP (MJ), serving as the outsourced internal audit function (Internal Audit) for the Texas Lottery performed this internal audit as part of the approved FY 2026 Annual Internal Audit Plan.

Business Objective / Focus Area	Business Risk Rating	Control Effectiveness	Opportunities for Improvement (OFI)	Root Cause: Governance	Root Cause: People / Staffing	Root Cause: Processes	Root Cause: Technology
Business Objective 1: Retailer Cash Incentive Program - To increase lottery sales by motivating retailers to exceed baseline or projected sales performance through performance-based cash incentives and drawing entries.	Residual Risk: Low Inherent Risk: High	Generally Effective. (See Business Objective #1)	1. **OFI**: The meeting notes for programs are only periodically updated. Management should establish a consistent schedule for documenting and updating meeting notes.			X	
Business Objective 2: Bonus Program - To increase retailer engagement and participation in Lottery games by recognizing and financially rewarding retailers that sell jackpot-winning or otherwise designated high-value tickets.	Residual Risk: Low Inherent Risk: High	Generally Effective. (See Business Objective #2)	1. **OFI**: The procedures refer to an email that is sent automatically by WTS to external recipients; however, no documentation was available to support this practice. Management should update the WTS automated bonus notification email parameters to include the email notification, or revise Lottery Operations Division Procedure - Bonus Payments to not include this part of the process. 2. **OFI**: The procedures refer to an email notification that is sent by Draw Specialist regarding corporate retailer's contact information; however, no documentation was available to support this practice. Management should update the Lottery Operations Division Procedure - Bonus Payments to current practices	X X			

Business Objective / Focus Area	Business Risk Rating	Control Effectiveness	Opportunities for Improvement (OFI)	Root Cause: Governance	Root Cause: People / Staffing	Root Cause: Processes	Root Cause: Technology
			relating to Draw Game Specialist email notifications to Lottery Operator for corporate retailer contact information.				

Introduction

We performed this audit as part of the approved FY 2026 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.

Functional Area Responsibilities and Activity Summary

Background

The Retailer Cash Incentive Program (RCIP) 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 1** provides the section of the General Appropriations Act for the 2026-27 Biennium (Senate Bill No. 1, 89th Legislature) related to the RCIP.

21. 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 D.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, 2026, are appropriated to the agency for the same purposes for the fiscal year beginning September 1, 2026. Prior to providing an additional retail commission above 5 percent of gross sales, the Department of Licensing and Regulation shall provide a report to the Governor and the Legislative Budget Board outlining the Department of Licensing and Regulation'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 1. *General Appropriations Act for the 2026-2027 Biennium - VIII-33 Retailer Commissions.*

The authority to provide retailers additional 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 program spans the course of a thirteen (13) week period. Forty-seven (47) RCIPs have been completed since the program's inception in FY2010.

The RCIP process involves several divisions, departments, the Lottery Operator, and activities. The agency has a structured process in place, including an internal Retailer Incentive Committee and the use of independent auditors to ensure only eligible retailers that met defined sales goals receive the incentive payments. These processes ensure that information used to administer the Retailer Cash Incentive Program meets the agency's standards of ensuring the highest standard of security, integrity and responsible gaming principles. **Exhibit 2** provides an overview of the Retailer Cash Incentive Program:

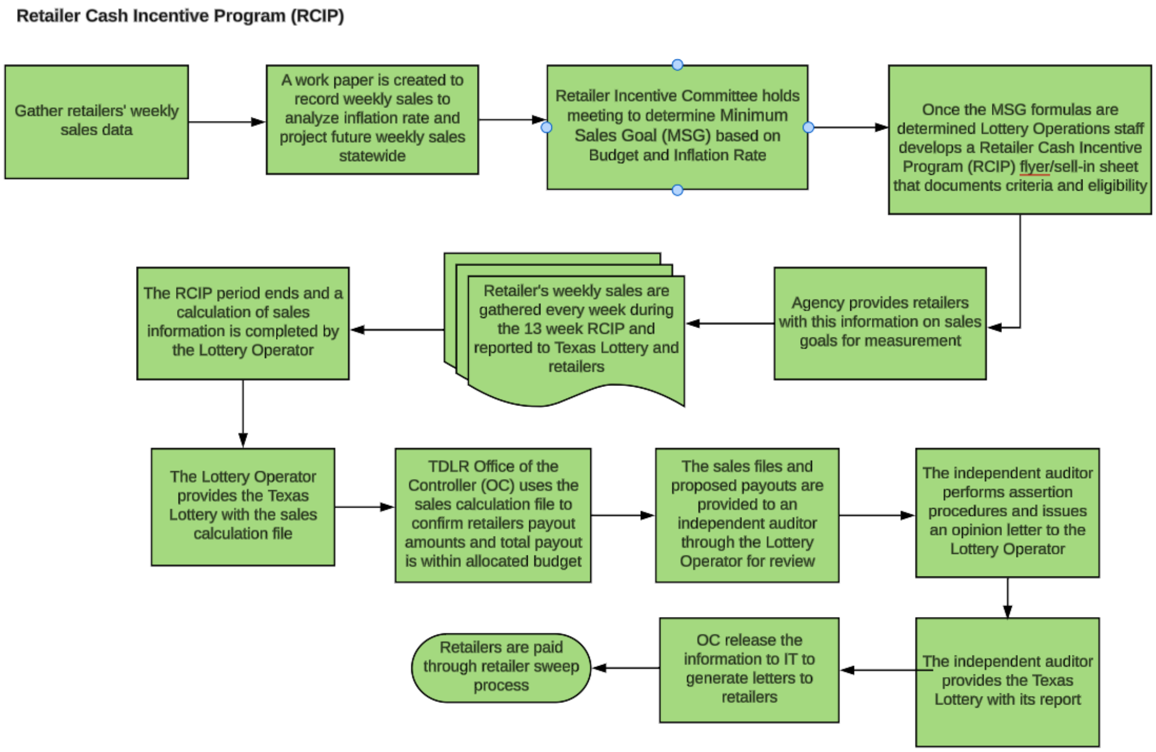

Exhibit 2. *Retailer Incentive Program Process Overview.*

Finding vs. Opportunity for Improvement

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 internal controls or processes are effective as designed but can be enhanced. A control weakness is a failure in the implementation or performance of internal controls. A control gap occurs when controls do not exist, do not effectively mitigate a risk, or are not operating effectively.

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 (what could go wrong). 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.

Detailed Business Objectives, Focus Areas, and Internal Controls Discussion

This section of the report provides discussion on the audit's focus areas, grouped by business objective, and provides a summary of our testing, findings, and recommendations. Each business objective includes the definition, inherent risk to the organization if controls were not in place or were working, and the residual risk to the organization's ability to achieve the respective business objective based upon our assessment of the effectiveness of controls and processes in place.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) was formed in 1985 to improve financial reporting quality through ethics, internal controls, and risk-management. The frameworks developed provide organizations with a tool to detect fraud and manage risks. COSO is known for its Internal Control – Integrated Framework and Enterprise Risk Management Framework. COSO's Internal Control – Integrated Framework is closely aligned with the Institute of Internal Auditor's (IIA) Professional Practices

Framework (IPPF) and the IIA promotes COSO as the premier framework for internal control. COSO's framework is organized around five integrated components of internal control:

1. Control environment
2. Risk assessment
3. Control activities
4. Information and communication
5. Monitoring activities

McConnell Jones incorporates the COSO framework into all internal audits we execute.

Business Objective 1: Increase sales through Retailer Cash Incentive Program and Bonus Program

Texas Lottery's retailer incentives and bonus programs are administered by Lottery Operations in accordance with the Legislative Appropriations Rider and internal policies. Both programs are in place to increase sales of lottery scratch tickets and draw games. These programs are coordinated between Lottery Operations, and Office of Controller.

Policies and Procedures

TDLR – Lottery Operations 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 incentive and bonus payments are processed in a manner consistent with TDLR's requirements and expectations.

Internal collaboration between the Lottery Operations Division and the Office of the Controller Division to process retailer incentive 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 (BrightStar) and their independent auditor (Deloitte) (for retailer incentives).

Accuracy of Payments

TDLR's processes for making retailer incentive 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.

Audit Focus Areas of This Discussion:

We focused on the compliance with internal policies and procedures and accuracy of retailer commission incentive and bonus payments.

Business Risk Ranking

Risk	Low	Medium	High
Inherent			X
Residual	X		

Control Rating

Generally Effective	Some Improvement Needed	Major Improvement Needed	Unsatisfactory
X			

Opportunity for Improvement Root Cause	Governance	People / Staffing	Processes	Technology
			X	

Audit Activities Performed and Management Controls	
Criteria Used	➲ Texas Lottery Operations Division Procedure – Retailer Cash Incentive Program Payments. ➲ Texas Lottery Office of the Controller - Retailer Cash Incentive Program Payment by Sweep. ➲ Texas Lottery Retailer Cash Incentive Program Process. ➲ Texas Lottery Operations Division Procedure - Retailer Bonus Payments.
Control Tests Applied	➲ Inspected policies and procedures. ➲ Inspected supporting documentation for the processing of 11 primary retailer incentive program payments and five (5) secondary retailer incentive program payments. ➲ Inspected supporting documentation for the processing of five (5) bonus payments and one (1) jackpot bonus payment that occurred in FY2026.
Management Controls in Place	➲ RCIP processes are documented in policy and procedures. ➲ Business functions and internal controls for the RCIP and Bonus Payment Program align with documented policies and procedures. ➲ Effective communications between Divisions ensure RCIP and Bonus Payments are processed according to policies and procedures. ➲ 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. ➲ Validation and approval of calculations and eligibility requirements by multiple parties reduce the risk of inaccurate payments or payments to ineligible retailers.

Findings:

No Findings were noted.

Opportunity for Improvement # 1

The meeting notes for programs are only periodically updated. Management should establish a consistent schedule for documenting and updating program notes.

Management Response:

We had no findings and therefore management response is not required. Management response is not required for improvement opportunity recommendations.

Business Objective 2: Compliance with Legislation

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.

The Texas Department of Licensing and Regulation - Lottery Operations 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.

Audit Focus Areas of This Discussion:

The RCIP and Bonus Payment Programs are allocated funds as Strategic Objectives of the TDLR – Lottery Operations in the General Appropriations Act. For FY2026, the total budget was $39.409 million for Retailer Commissions and $2.01 million for the budget payment program.

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

Business Risk Ranking

Risk	Low	Medium	High
Inherent			X
Residual	X		

Control Rating

Generally Effective	Some Improvement Needed	Major Improvement Needed	Unsatisfactory
X			

Opportunity for Improvement Root Cause

Governance / Policies	People / Staffing	Processes	Technology
X			

Audit Activities Performed and Management Controls	
Criteria Used	➲ General Appropriations Act (Senate Bill No. 1, 89th Legislature) ➲ COSO Internal Control–Integrated Framework Principle 12 - The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.
Control Tests Applied	➲ Reviewed applicable written procedures. ➲ Conducted interviews with process owners performing key functions within the RCIP process. ➲ Performed testing to determine budgets, eligibility, results and cash bonus payout.
Management Controls in Place	➲ Tenured staff ensure compliance and understanding of the General Appropriations Act relating to retailer commissions. ➲ TDLR has developed and documented policies and procedures to establish requirements to ensure compliance with applicable legislation. ➲ 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.

Findings:

No findings were noted.

Opportunity for Improvement # 2

The Retailer Bonus Payments procedures refer to an email that is sent automatically by WTS to external recipients; however, no documentation was available to support this practice. Management should update the WTS automated bonus notification email parameters to include the email notification, or revise Lottery Operations Division Procedure - Bonus Payments to not include this part of the process.

Opportunity for Improvement # 3

The Retailer Bonus Payments procedures refer to an email notification that is sent by Draw Game Specialist regarding corporate retailer's contact information; however, no documentation was available to support this practice. Management should update the Lottery Operations Division Procedure - Bonus Payments to current practices relating to Draw Game Specialist email notifications to Lottery Operator for corporate retailer contact information.

Management Response:

We had no findings and therefore management response is not required. Management response is not required for improvement opportunity recommendations.