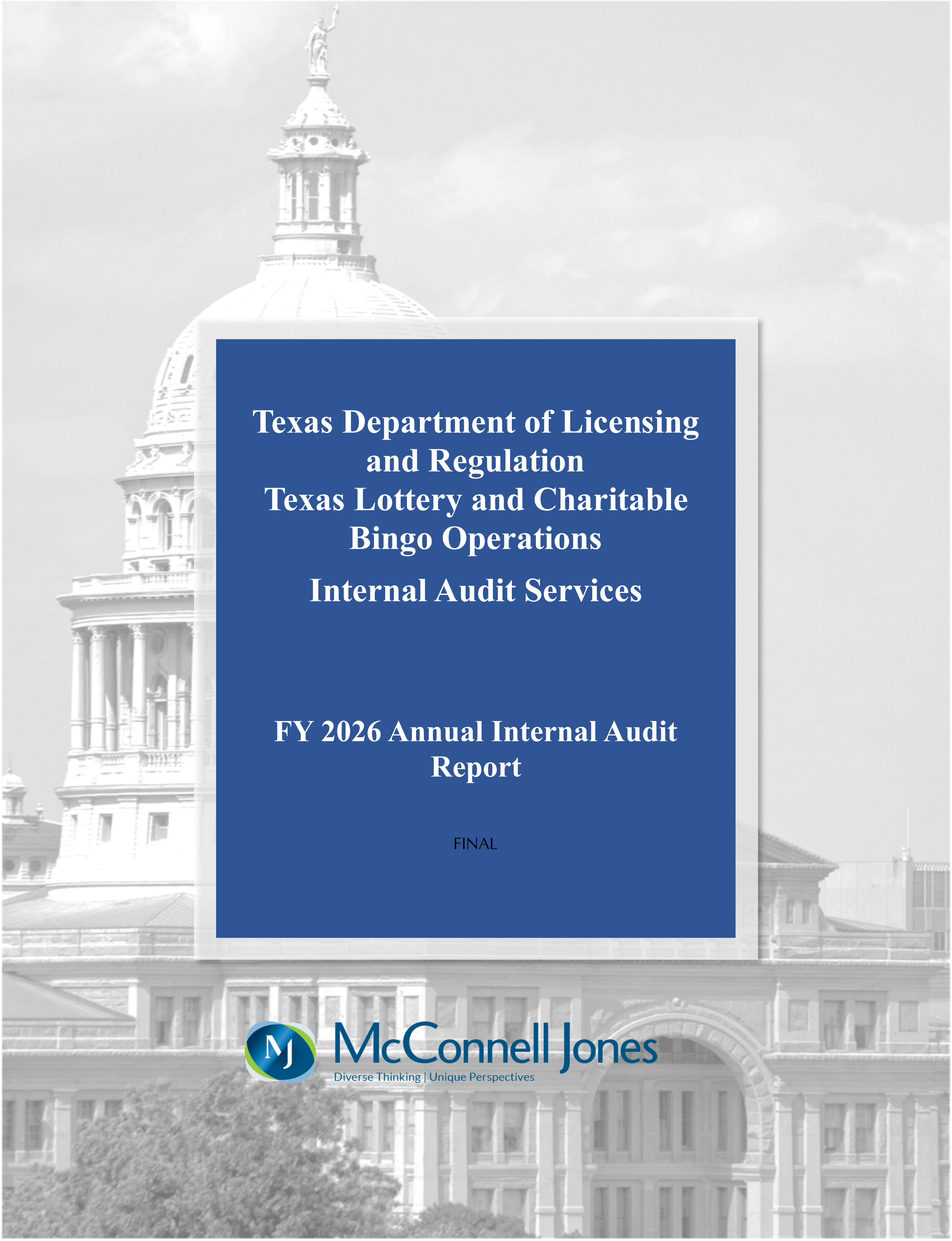

Texas Department of Licensing and Regulation
Texas Lottery and Charitable Bingo Operations

Internal Audit Services

FY 2026 Annual Internal Audit Report

FINAL

McConnell Jones
Diverse Thinking | Unique Perspectives

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McConnell
Jones

July 28, 2026

The Honorable Greg Abbott, Governor
Members of the Legislative Budget Board
Internal Audit Coordinator, State Auditor's Office

Dear Ladies and Gentlemen:

Attached is the fiscal year (FY) 2026 Annual Internal Audit Report for the Texas Department of Licensing and Regulation Texas Lottery and Charitable Bingo Operations (TDLR LOBO). This annual internal audit report is submitted in accordance with the Texas Internal Auditing Act requirement for state agency internal auditors to prepare and distribute an annual report (Government Code, Chapter 2102).

TDLR engaged McConnell & Jones LLP (MJ) to provide internal audit services for their Texas Lottery and Charitable Bino operations in accordance with The Texas Internal Auditing Act. MJ submits this fiscal year 2026 Annual Internal Audit Report on behalf of the TDLR Commissioners.

The Texas Internal Auditing Act requires agencies to file an annual report on their internal audit activities and the internal audit reports prepared for their governing board. The purpose of the Annual Internal Audit Report is to provide information on the assurance services, consulting services, and other activities of the internal audit function. In addition, the Annual Internal Audit Report assists oversight agencies in their planning and coordination efforts. According to Texas Government Code, Sections 2102.009 and 2102.0091, the FY 2026 Annual Internal Audit Report is due November 1, 2026. This is being submitted prior to the issuance of the State Auditor's Office issuing instructions for this annual report due to the timing of our internal audit services contract ending. Should any changes be required, we will provide an updated version to TDLR.

Please contact Darlene Brown at 713.968.1600 or Ms. Courtney Arbour if you should have any questions about this audit report.

Sincerely,

Darlene Brown

Darlene Brown, CIA, CFE
Partner

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I. COMPLIANCE WITH TEXAS GOVERNMENT CODE, SECTION 2102.015: POSTING THE AUDIT PLAN AND ANNUAL REPORT ON THE INTERNET

Texas Government Code, Section 2102.015, requires state agencies and institutions of higher education to post agency Annual Internal Audit Plans and Annual Internal Audit Reports to the agency's internet website within 30 days of approval. Texas Government Code, Section 2102.015, also requires agencies to update the posting on the website to include a detailed summary of any weaknesses, deficiencies, wrongdoings, or other concerns raised by the audit plan or annual report and include a summary of the actions taken by the agency to address the issues raised.

In accordance with requirements of Texas Government Code, Section 2102.015, McConnell & Jones LLP (MJ) will ensure the required Annual Internal Audit Plan, Annual Internal Audit Report and any other required internal audit information is provided to the Texas Department of Licensing and Regulation for posting to their website.

II. FISCAL YEAR 2026 INTERNAL AUDIT PLAN STATUS

McConnell & Jones LLP prepared the Fiscal Year 2026 Annual Internal Audit plan based on a comprehensive risk assessment which was approved by the TDLR commissioners. The table below reflects the status of the approved FY 2026 Internal Audit Plan as of July 28, 2026.

FY 2026 Annual Internal Audit Plan Status

Task #	Description	Report Number	Report Date	Report Title	Audit Status
1	Sales Tracking and Reporting	26-001	June 2, 2026	Sales Tracking and Reporting	Completed
2	TDLR Governance over Texas Lottery and Charitable Bingo Operations	26-002	May 14, 2026	Governance Structure, Staffing, and Responsibilities for the Texas Lottery and Bingo Operations	Completed
3	Legislative Mandates & Sunset Commission Recommendations Implementation	26-003	June 5, 2026	Legislative Mandates & Sunset Commission Recommendations Implementation	Completed
4	Rulemaking Process	26-004	June 2, 2026	Rulemaking Process	Completed
5	Retailer Compliance and Monitoring	26-005	June 3, 2025	Retailer Compliance and Monitoring	Completed
6	Retailer Bonus and Incentive Programs	26-006	June 3, 2026	Retailer Bonus and Incentive Programs	Completed
7	Information System User Access	Completed. Confidential reports were issued for each review. No exceptions have been noted during quarterly testing.			

Deviation from Fiscal Year 2026 Internal Audit Plan

The FY2026 Annual Internal Audit Plan was executed and completed without deviation.

III. FY2026 Internal Audit Summaries

Audits conducted in FY2026 are summarized below. 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.

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.

Audit: 26-001 Sales Tracking and Reporting
Inherent Risk: High
Residual Risk: Low
Conclusion: Management activities related to Sales Tracking and Reporting are designed to support complete, accurate, timely, and transparent capture and reporting of lottery sales information and are operating effectively. TDLR has established processes, procedures, and supporting systems for sales tracking, financial reporting, and related activities, including defined roles and responsibilities, reconciliation processes, and routine reporting practices that support fiscal accountability and reliable financial reporting for the State of Texas.

Based on the procedures performed, no significant deficiencies or opportunities for improvement were identified.

Audit Focus Areas	Internal Control Rating	Findings	Opportunities for Improvement
✓ Data Integrity ✓ System Interfaces ✓ Key Activities and Deadlines ✓ Responsibilities	Generally Effective	None	None

Audit: 26-002 Governance Structure, Staffing, and Responsibilities for the Texas Lottery and Bingo Operations
Inherent Risk: High
Residual Risk: Medium
Conclusion: At the time of audit fieldwork (Jan. 2026 – March 2026), governance practices were in transition, and certain policies, procedures, and back-office activities related to the integration had not yet been fully formalized or consistently applied. This is not concerning from an audit perspective given that the Agency was only five months into transition. The model that TDLR has been building is scalable to accommodate any additional transitions of similar nature.

TDLR has established core governance structures to support the integration of Licensing and Regulation (L&R) and Lottery and Charitable Bingo operations (LOBO) under SB 3070, including documented delegations of authority, defined reporting lines, and executive-level oversight. These mechanisms provide a foundation for accountability and continuity of operations. Staffing and responsibility structures support operational stability by clearly assigning roles, maintaining segregation of duties, and providing management oversight across operational and administrative functions. TDLR made a conscious decision not to change Lottery and Bingo operations but did make necessary changes to the organization structure to provide the necessary oversight and monitoring. TDLR also centralized all administrative functions such as information technology management, accounting, procurement, legal, and human resources.

The primary concern from an audit perspective is that Administrative Rules to address the 89th Texas Legislature, Regular Session mandates have been drafted but not approved and adopted, including addressing couriers, internet sales, sales to minors, and the 100-ticket sales limit. However, from a controls perspective software changes were put in place to limit the value of sales to $100 per transaction. Communications through various activities were also made to the public and retailers about the requirements.

Audit Focus Areas	Internal Control Rating	Findings	Opportunities for Improvement
✓ Governance Structure ✓ Administrative Rule Updates ✓ Governance and Oversight Integration Status ✓ Roles and Responsibilities ✓ Cost Allocation Methodology and Process	Some Improvement Needed	At the time of the audit, the Lottery had drafted but not finalized and adopted Administrative Rules codifying the 89th Texas Legislature, Regular Session mandates that include: • Knowingly selling tickets to courier services. • Knowingly sells tickets to individuals attempting to purchase all possible winning tickets. • Selling more than 100 tickets per transaction. • Selling tickets to minors. • Facilitating ticket sales through telephone, internet, and mobile internet. • Selling tickets to a person not physically present at the retailer's location or outside of the retailer's normal business hours. Management agreed with the recommendation to take measures to ensure the 89th Texas Legislature, Regular Session mandates are codified in Administrative Rules as quickly as the public comment period allows.	None

Audit: 26-003 Legislative Mandates and Sunset Recommendations Implementation
Inherent Risk: High
Residual Risk: Low

Conclusion: TDLR has established processes to support the integration of Licensing and Regulation (L&R) and Lottery and Charitable Bingo operations (LOBO) under S.B. 3070 and Sunset Commission recommendations including defined reporting lines, statutory change identification, an established implementation plan, and timely communication to management and staff. These processes ensure TDLR is carrying out its statutory duties for LOBO.

Based on the procedures performed, no significant deficiencies or opportunities for improvement were identified.

Audit Focus Areas	Internal Control Rating	Findings	Opportunities for Improvement
✓ Implementation Status of Applicable Legislative Changes ✓ Implementation Status of Enacted Sunset Recommendations	Generally Effective	None	None

Audit: 26-004 Rulemaking Process
Inherent Risk: High
Residual Risk: Low
Conclusion: TDLR has effective management oversight of the rulemaking process through established reporting lines and responsibility identification.

Audit Focus Areas	Internal Control Rating	Findings	Opportunities for Improvement
✓ Rule Identification ✓ Rule Review ✓ Rule Update Process, Including Posting for Public Comments	Generally Effective	None	None

Audit: 26-005 Retailer Compliance and Monitoring
Inherent Risk: High
Residual Risk: Low
Conclusion: Overall, we found the design of the Agency's management of monitoring and enforcement controls to be generally effective. Compliance Activity Monitoring Process (CAMP) information system processes are shared effectively across multiple divisions to ensure complaints are tracked, investigated, and resolved in accordance with established procedures. Testing performed over CAMP case processing activities indicated that key controls related to complaint intake, case routing, investigation, and disposition were operating effectively and supported by documented procedures.

We had no findings and therefore had no recommendations. However, opportunities to improve existing controls and processes were identified.

Audit Focus Areas	Internal Control Rating	Findings	Opportunities for Improvement
✓ Retailer Compliance Requirements ✓ Retailer Activity Monitoring ✓ Retailer Violation Processes	Generally Effective	None	1. Effective monitoring of complaint cases is hampered by limitations of the CAMP system. For example: • Complaint data within the CAMP system is not readily extractable for reporting and analysis purposes by the end user. Users are unable to directly generate structured datasets and must instead request data extracts from IT. In some cases, system-generated outputs are limited to PDF formats, which are not conducive to analysis. • Case Type and Subtype fields in CAMP system are not being fully utilized when logging or processing complaints. • There were 3 opened in error cases identified while sampling compliant cases. • Procedures state a notification is sent from CAMP to enforcement telling them case was closed by Operations

Audit Focus Areas	Internal Control Rating	Findings	Opportunities for Improvement
			division; however this is not occurring. 2. Supporting documentation of complaint case review was not available due to emails from a prior retail services manager no longer being accessible. While reviews may have been performed, the absence of retained evidence limits verification that the review was completed.

Audit: 26-006 Retailer Incentive and Bonus Programs
Inherent Risk: High
Residual Risk: Low
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.

Audit Focus Areas	Internal Control Rating	Findings	Opportunities for Improvement
✓ Retailer Incentive Program Changes ✓ Retailer Bonus Program Processes	Generally Effective	None	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.

IV. CONSULTING SERVICES AND NON-AUDIT SERVICES COMPLETED

Internal audit did not provide any consulting or non-audit services to TDLR in FY2026.

V. EXTERNAL QUALITY ASSURANCE REVIEW (PEER REVIEW)

MJ has been a member of the AICPA since 1987 and is subject to the AICPA's peer review process every three years. Our commitment to quality is underscored by the fact that with exception of the most previous review, we have consistently received an unqualified opinion in external peer review reports on the quality of our accounting and auditing practice by the AICPA.

After a thorough review of our procedures and work practices, which include reviews of our nonprofit, governmental, and commercial engagements, the reviewers concluded that except for deficiencies described, the auditing practice of McConnell & Jones LLP applicable to engagements not subject to PCAOB permanent inspection in effect for the year ended June 30, 2023, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of pass, pass with deficiency(ies), or fail. McConnell & Jones LLP has received a peer review rating of pass with deficiencies.

Issues noted by the peer reviewer were related to another practice line in the firm and not the risk advisory services practice. MJ developed an action plan to remediate the deficiencies noted and the follow-up review noted that the deficiencies had been successfully remediated. We provide a copy of our most recent peer review letter below.

ADKF | with you all the way

Member of the AICPA & TXCPA
Registered with Public Company Accounting Oversight Board

Report on the Firm's System of Quality Control

July 19, 2024

To the Partners
McConnell & Jones LLP
and the National Peer Review Committee

We have reviewed the system of quality control for the accounting and auditing practice of **McConnell & Jones LLP** applicable to engagements not subject to PCAOB permanent inspection in effect for the year ended June 30, 2023. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a system review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing and complying with a system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with the requirements of applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with the requirements of applicable professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of and compliance with the firm's system of quality control based on our review.

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under *Government Auditing*
d audits of employee benefit
as communicated by the firm,
nt performance – supervision
the engagements in order for
sion and review on employee
as not adequate causing these
s. As a result, the following
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d they document the linkage
In the audit of a 403(b) plan,
ar audit but did not carry the
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service organization. In the
ting Standards, the firm failed
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This resulted in two employee
fessional standards.
nment Auditing Standards and
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as not been suitably complied
re consistently performed in
nvolved discussing areas for
employee benefit plans. In
s, but those reviews were not
completed timely. As a result, the items noted in 1a and 1b caused two employee benefit plan audits and one single audit that did not conform to professional standards.

Opinion

In our opinion, except for the deficiencies previously described, the system of quality control for the accounting and auditing practice of **McConnell & Jones LLP** applicable to engagements not subject to PCAOB permanent inspection in effect for the year ended June 30, 2023, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass, pass with deficiency(ies), or fail*. **McConnell & Jones LLP** has received a peer review rating of *pass with deficiencies.*

ADKF, PC
ADKF, P.C.

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VI. FISCAL YEAR 2027 INTERNAL AUDIT PLAN

TDLR is in the process of selecting an internal audit service provider as the time of this report. The selected contractor will complete a comprehensive risk assessment and develop the FY2027 Annual Internal Audit Plan which will be submitted for Commission approval and then provided to the required oversight agencies.

VII. EXTERNAL AUDIT SERVICES PROCURED IN FISCAL YEAR 2026

The following represent external audit services that were procured by TDLR for the Texas Lottery and Charitable Bingo Operations in fiscal year 2026.

Audit / Review	Auditor
Drawings Studio Independent Auditor Certifications	BKD Partners
Internal Audit Services	McConnell Jones

VIII. REPORTING SUSPECTED FRAUD AND ABUSE

TDLR has implemented measures to comply with Article IX, Section 7.10, the General Appropriations Act (81st Legislature) and Texas Government Code, Section 321.022. These measures include, but are not limited to, the following:

The Texas Lottery included a link to the State Auditor's Office (SAO) website for fraud reporting at the footer of the TDLR website. In addition, information on reporting suspected fraud to the State Auditor's Office is included in the agency's policies and procedures.

TDLR utilizes EthicsPoint Reporting. EthicsPoint is a third-party vendor that provides an Internet and telephone-based reporting system that can be accessed by Commission employees. This system is intended to supplement the existing avenues within the Commission for employees to report concerns. All EthicsPoint complaints are reviewed by the agency's General Counsel and reported to SAO as applicable.