



TEXAS LOTTERY DIVISION OF TEXAS DEPARTMENT OF LICENSING AND REGULATION

Internal Audit Services AN INTERNAL AUDIT OF **TLD's Budget Function**

Report No. 25-005
October 8, 2025

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 may impact these risks and internal controls in ways that this report cannot anticipate. Additionally, this report reflects work performed under the Texas Lottery Commission (TLC) prior to its transition to the Texas Department of Licensing and Regulation (TDLR) on September 1, 2025. The scope, procedures, and conclusions are based on TLC's budget processes in effect during the audit period.

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 2025 Annual Internal Audit Plan. *Note: TLC formally transitioned to the Texas Department of Licensing and Regulation (TDLR) effective September 1, 2025. Although this audit was initiated and completed while TLC operated as a separate entity, this report is being issued under the Texas Lottery Division (TLD) of TDLR. While this report refers to TLC, the opportunities for improvement identified remain relevant and, if implemented, would enhance the budgetary processes of both TLD and TDLR.*

Business Objectives and Scope

The business objective of the Budget Function is to establish management controls that ensure effective budget planning, development, monitoring, reporting, and amendments.

The audit scope period was September 1, 2023, to February 28, 2025.

Audit Focus

- Budget Planning
- Budget Development
- Budget Monitoring and Reporting
- Internal Customer Survey

Audit Conclusions

TLC's internal controls over budget planning, development, monitoring, reporting, and amendments are generally effective in supporting operational efficiency and informed decision-making.

As part of this audit, we also performed a review of the Operational Transition Plan developed by the Office of the Controller (OC) to support the transfer of TLC functions to the Texas Department of Licensing and Regulation (TDLR) effective September 1, 2025. This review focused on evaluating TLC's readiness across budget, infrastructure, and compliance areas to ensure continuity and minimize disruption. The full plan is included as **Appendix A**.

Internal Control Rating

Generally Effective.

What Did We Recommend?

We noted no findings and therefore had no recommendations related to findings.

We noted two opportunities for improvement, areas where the internal controls or processes are effective as designed but could be enhanced. We have listed the recommendations for the opportunities for improvements below:

1. TLC Financial Operations should consider reviewing the Budget Function procedures to ensure they are current and aligned with existing operational practices.
2. TLC Financial Operations should consider including executive assistants in emails sent to division directors when communicating deadlines for budget items. This minor adjustment could help ensure timely follow-up and improve coordination within divisions.

Number of Findings by Residual Risk Rating

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

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!

Introduction

We performed this audit as part of the approved FY 2025 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 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

The business objective of the Budget Function is to establish management controls that ensure effective budget planning, development, monitoring, reporting, and amendments. As such, the purpose of this audit was to assess TLC processes to determine whether TLC's Budget Operations are efficient and the processes are effective at achieving TLC's objectives for budget.

The audit scope was September 1, 2023, to February 28, 2025.

This audit identified no findings and two improvement opportunities, which resulted in an overall internal control rating of **Generally Effective**. **Exhibit 1** describes the internal control rating.

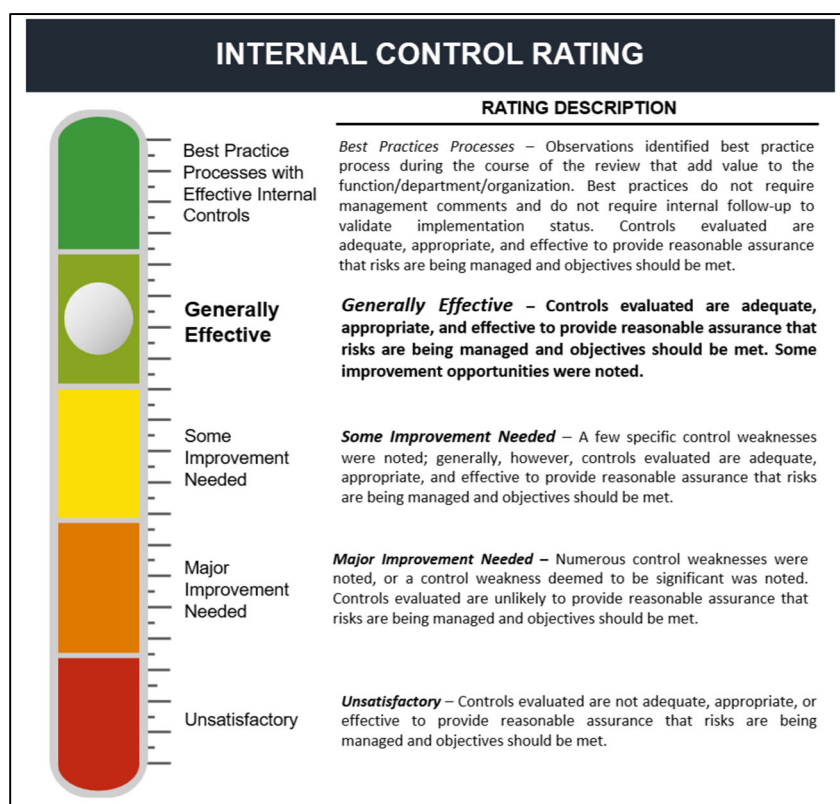


Exhibit 1. Internal Control Rating

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. See the findings and management response section of this report for a discussion of all issues identified, recommendations, and management responses.

Background

The Texas Lottery Commission (TLC) Financial Operations, operating under the Office of the Controller (OC), is responsible for developing, managing, and monitoring the agency's financial resources in alignment with strategic goals and state fiscal regulations. This function plays a vital role in supporting TLC operations by allocating resources efficiently, forecasting expenditures, and promoting data-driven, transparent budgetary decisions.

The Financial Operations team works collaboratively across divisions to produce essential financial deliverables, including the Legislative Appropriations Request (LAR), Operating Budget, and Annual Financial Report (AFR). These documents are necessary for communicating TLC's financial needs and performance to oversight entities such as the Legislative Budget Board (LBB), the Governor's Office of Budget and Policy, and the State Auditor's Office.

Additionally, Financial Operations is responsible for executing and monitoring the operating budget. This includes tracking expenditures against appropriations, processing budget adjustments, and providing financial analysis to support informed decision-making. The team ensures compliance with applicable statutes such as the General Appropriations Act (GAA) and the Texas Government Code and adheres to guidance issued by the Comptroller of Public Accounts (CPA) and other regulatory bodies.

Budget development and oversight are facilitated through close coordination between Financial Operations, budget liaisons, and agency divisions. TLC follows a biennial budget planning cycle as discussed below:

Year One (Even-Numbered Years)

Budget development begins with the salary schedule, prioritized due to its budgetary impact and statutory requirements (e.g., longevity pay).

- Budget liaisons within Financial Operations prepare recommendations using standardized templates that incorporate historical expenditures and projected needs.
- Templates are distributed to divisions via email and stored on a shared network drive to ensure transparency.
- Financial Operations Management collaborates with liaisons to refine the budget, resolving discrepancies through direct engagement with divisions and subject matter experts.
- Divisions conduct internal reviews, meet to discuss changes, and coordinate with liaisons to finalize their budgets.
- Finalized budgets are approved by each division, followed by the Executive Director's approval.
- The consolidated budget is then presented at a Commission meeting for formal adoption.

Year Two (Odd-Numbered Years)

With baseline figures established, the budget process begins earlier and focuses on updated divisional needs and operational improvements.

- Budget Analyst coordinates with divisions to determine monthly adjustments based on budgetary needs.
- Divisions submit requisitions to ensure readiness for the fiscal year beginning in September.
- Financial Operations encumbers salary funds and monitors expenditures using the MIP Fund Accounting system, TLC's primary tool for budget entry and reporting.

Throughout both years, OC conducts monthly budget monitoring using standardized templates and detailed financial reports. These include reconciliations, salary savings, and performance metrics.

- Budget amendments are tracked and justified through a formal template process managed by OC.
- Quarterly reports are submitted to the TLC Commissioners summarizing budget allocation percentages and encumbrance status, reinforcing transparency, and alignment with agency-wide financial goals.

Based on our comprehensive understanding of TLC procedures and detailed inquiries with the Financial Operations Manager, we have developed a high-level process flow (**Exhibit 2**).

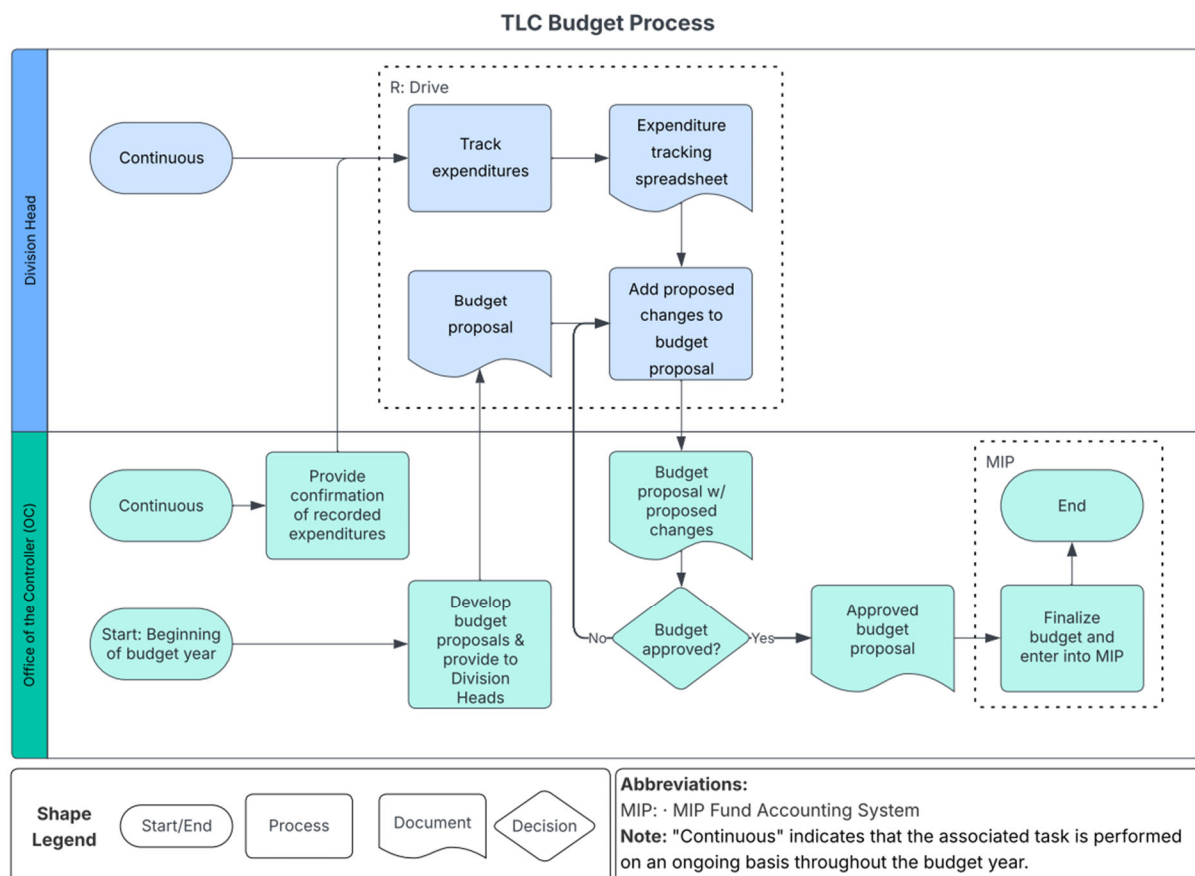


Exhibit 2 – TLC Budget Process Flow

The process is designed to enhance efficiency, accuracy, and compliance with TLC's operational standards.

Detailed Findings and Management Response

Business Objective #1: Governance

The purpose of governance is to establish a foundation for an organization's internal control system, ensuring its objectives are met. This foundation is built on integrity and ethical values. Governance involves active oversight, setting strategic objectives, and establishing a clear organizational structure. It also ensures that personnel have the necessary skills and knowledge to perform their duties and are held accountable for their actions.

Business Risk Rating (Inherent): High

Business Risk Rating (Residual): Low

Business Objective:

To establish policies and procedures that guide budget processes and ensure compliance with state regulations for planning, development, and reporting.

| | |
|--------------------------------------|--|
| Criteria: | <ul style="list-style-type: none"> • COSO Internal Controls-Integrated Framework |
| Management Controls in Place: | <ul style="list-style-type: none"> • Documented policies and procedures are in place which guide the budget function processes, including budget planning, development, monitoring, reporting, and amendments. |
| Testing Procedures: | <ul style="list-style-type: none"> • Inquired with TLC Financial Operations to confirm the existence of policies and procedures. • Validated the existence and evaluated the adequacy of internal policies and procedures to determine alignment with state regulations and relevant statutes. |

Conclusion:

TLC has established policies and procedures that guide budget processes and ensure compliance with state regulations for planning, development, and reporting. While these procedures are generally effective, incorporating the opportunity for improvement (OFI) below will further enhance their efficiency.

No control deficiencies were noted.

Opportunities for Improvement

The Budget procedures do not provide evidence of a review, within TLC's review cycle of 2 years. Periodic reviews ensure the procedures align with current processes and are up to date with state regulations. Specifically:

- The OC-BU-006 Budget Development procedure has not been reviewed since July 2022.
- The OC-BU-005 Monthly Financial Review procedure has not been reviewed since February 2023.
- The OC-BU-003 Monthly Financial Summary Report procedure has not been reviewed since March 2022.

Improvement Recommendations

TLC should consider reviewing the Budget Function procedures to ensure they are current and aligned with existing operational practices.

Business Objective #2: Operations & Technology

The purpose of operations is to ensure that an organization effectively and efficiently achieves its objectives. This involves the implementation of processes and activities that align with the organization's strategic goals. Operations focus on optimizing resources, maintaining high-quality standards, and fostering continuous

improvement. It also ensures that risks are managed appropriately, and that the organization can adapt to changing conditions and demands.

Business Risk Rating (Inherent): High

Business Risk Rating (Residual): Low

Business Objective:

To have a management control structure in place that ensures efficient and effective budget development and implementation.

| | |
|--------------------------------------|---|
| Criteria: | <ul style="list-style-type: none"> General Appropriations Act for the 2024-2025 Biennium, Article IX - General Provisions COSO Internal Controls-Integrated Framework |
| Management Controls in Place: | <ul style="list-style-type: none"> Documented policies and procedures are in place which guide the budget development process. Collaboration between Budget Liaisons, Division Heads, and Financial Operations Management ensures alignment and accuracy. The budget development process incorporates multiple layers of review and approval to ensure accuracy, statutory compliance, and operational alignment across fiscal years. |
| Testing Procedures: | <ul style="list-style-type: none"> Inquired with the Financial Operations Manager, Budget Liaisons, and Division Representatives to confirm collaboration and role clarity. Inspected budget development timelines and documentation for evidence of timely completion and submission to governing bodies. Surveyed Division Heads about the Budget Function's development process to assess whether the process and deadlines were perceived as adequate. |

Conclusion:

The TLC OC has established a management control structure to ensure efficient and effective budget development and implementation.

Interviews with Division Representatives confirmed that all divisions were included in the budget development process, ensuring a comprehensive budget that addresses the agency's full range of needs. Additionally, feedback collected from Division Heads through a structured survey indicated that the process is effective, highlighting the usefulness of provided tools, the reasonableness of deadlines, and the prompt availability of budget staff for support. While survey responses were generally positive, feedback was provided regarding email communications not consistently including executive assistants, which may impact timely follow-up and coordination across divisions. Incorporating the OFI below will further enhance communication and coordination in the budget development process.

A sample of reporting deliverables required by the Legislative Budget Board (LBB), which included the operating budget for fiscal year 2024, was tested for timely completion and submission. All sampled deliverables were submitted on time and in accordance with LBB requirements.

No control deficiencies were noted.

Opportunities for Improvement

Feedback received through the survey indicated that executive assistants are not consistently included in budget-related email communications sent to division directors. As a result, key support staff may be unaware of budget deadlines, which can delay follow-up actions and hinder coordination across divisions.

Improvement Recommendations

TLC Financial Operations should consider including executive assistants on emails sent to division directors when communicating budget deadlines. This adjustment would support timely follow-up and improve coordination and alignment across divisions.

Business Objective #3: Communication and Reporting

The purpose of Information and Communication is to support the identification, capture, and exchange of relevant and reliable information in a timely manner. This enables personnel at all levels of the organization to carry out their responsibilities effectively and ensures that internal and external stakeholders receive accurate and complete information necessary for decision-making and accountability.

Business Risk Rating (Inherent): High

Business Risk Rating (Residual): Low

Business Objective:

To have a management control structure in place to ensure effective budget reporting mechanisms.

| | |
|--------------------------------------|---|
| Criteria: | <ul style="list-style-type: none"> General Appropriations Act for the 2024-2025 Biennium, Article IX - General Provisions COSO Internal Controls-Integrated Framework |
| Management Controls in Place: | <ul style="list-style-type: none"> Documented policies and procedures are in place which guide the monthly reporting process. Budget reports undergo a formal management review process prior to distribution to ensure accuracy and completeness. |
| Testing Procedures: | <ul style="list-style-type: none"> Inquiries with the Financial Operations Manager to confirm the existence of formal reporting mechanisms. Reviewed samples of monthly financial reviews and summary reports for completeness and divisional breakdowns. Surveyed Division Heads about the Budget Function's reporting process and frequency to assess whether the process was perceived as adequate. |

Conclusion:

TLC has established a management control structure that includes reporting mechanisms designed to support effective budget oversight.

Inquiries with budget function management confirmed that formal reporting methods, such as monthly financial reviews and summary reports, are in place and are actively used to monitor expenditures and communicate budget status. These reports include division-level summaries and are distributed to division heads to promote transparency and accountability.

A sample of monthly reports was tested to validate the existence and evaluate the effectiveness of reporting mechanisms for budget processes. The reports were found to be consistent, timely, and aligned with internal

procedures. The reports included detailed financial data, explanations for budget adjustments, and supporting checklists and templates to ensure completeness.

Survey responses from division heads indicated general satisfaction with the reporting process. Most respondents found the frequency and content of reports adequate for managing their budgets.

No control deficiencies were noted.

APPENDIX A

OPERATIONAL TRANSITION PLAN: TLC TO TDLR – KEY CONSIDERATIONS AND READINESS STEPS

This Operational Transition Plan outlines the key areas of consideration identified for the transition of the Texas Lottery Commission (TLC) to the Texas Department of Licensing and Regulation (TDLR). The areas are prioritized based on their significance in maintaining operational continuity and minimizing disruption. Where applicable, each section includes relevant regulations, along with preparation steps and agency responsibilities. Status updates are responses provided by TLC.

This is a “living document” that reflects information current as of August 15, 2025. Since that time, several items have been partially or fully addressed, re-evaluated, or deemed no longer applicable. The Internal Audit Division will continue to monitor the transition to ensure adequate audit coverage and alignment with evolving operational needs.

1. Budget Codes

What it is: Budget codes classify expenditures and revenues.

Current Regulation: TLC uses codes defined by the Texas Comptroller’s Uniform Statewide Accounting System (USAS), which aligns with Texas Government Code Sections 403.021 and 403.071.

Preparation:

- TLC:
 - Prepare a complete mapping of TLC’s current Chart of Accounts to the statewide Centralized Accounting and Payroll/Personnel System (CAPPS) structure, including object codes, fund types, and appropriation numbers.
 - Include the corresponding CAPPS codes as a cross-walk between systems.
- TDLR:
 - Ensure CAPPS is configured to accommodate TLC’s accounting structure, or plan for a phased alignment.
Note: Texas Comptroller of Public Accounts (CPA) is coordinating this effort and provides Centralized Accounting and Payroll/Personnel System (CAPPS) workbooks and templates to guide the process.

Status: TLC received new appropriations for AY26/27 and a new set of appropriations for AY25 as rider appropriation. TLC, TDLR and CPA CAPPS deployment teams are working on the General Ledger (GL) configurations for the CAPPS Financials chart of accounts using TDLR existing nomenclature for appropriation numbers, PCAs, Accounts (COBJs) and other chart field codes. Final chart of accounts expected the week of July 28. This will allow the creation of budget documents for 09/01/2025.

2. Infrastructure Items and Cost Allocations

What it is: Includes IT systems, office space, and equipment.

Preparation:

- TLC:
 - Inventory all infrastructure assets, including network, servers, etc. and their costs.
 - Use the CAPPs user testing environment to train staff on how to navigate and operate within the CAPPs system.
 - Transition of financial accounting from MIP Fund Accounting (MIP) system to CAPPs using the parallel adoption method.
 - Transition of inventory from State Property Accounting (SPA) system to CAPPs using an interface.
 - Document a backup plan in case migration efforts fail.
 - Provide documentation and assessment of current facilities to support TDLR's evaluation for potential office relocation or expansion.
 - Identify physical equipment eligible for transfer, including condition, location, and usage history.
 - Coordinate with TDLR to review asset compatibility and assist in planning logistics for equipment transfer.
- TDLR:
 - Plan for integration or migration of systems and assets.
 - Review TLC's facility documentation to assess suitability for office relocation or expansion.
 - Analyze TLC's equipment inventory to determine transfer feasibility, including logistics, asset condition, and infrastructure compatibility.
 - Collaborate with TLC to finalize recommendations and develop a transition plan based on assessments of facilities and equipment.

Status: TLC inventory currently reported in SPA will be transferred to TDLR with the assistance of the CPA CAPPs deployment team. An interface to transfer the inventory to TDLR CAPPs is being considered as the method to complete this process.

The CPA's deployment team is working with CPA's security team to provide TLC staff access to the user acceptance testing region currently under Agency 452 TDLR.

TLC uses MIP information system for financial accounting records, transaction recording, and reporting. TLC plans to continue using MIP for its Aurora/ICS gaming system data to validate the new import being developed for the CAPPs FIN GL module. This parallel method is dependent on the successful development of the new GL import, minimal changes to the TLC chart of accounts, and the ability of Elysm Consulting's system to maintain two imports with potentially different coding blocks, which are sets of financial classification elements (such as fund, program, and object codes) used to categorize and record transactions in accounting systems.

3. Organizational Culture

What it is: Refers to the shared values, behaviors, and practices that shape how employees interact and perform their work.

Preparation:

- TLC:
 - Share TLC's mission and vision with TDLR to foster mutual understanding and alignment in collaborative efforts.
 - Highlight TLC's core values (e.g., integrity, transparency, public trust) and how they shape decision-making and stakeholder engagement.
 - Document key cultural norms, communication styles, and leadership practices that influence lottery operations.
 - Identify cultural strengths that could be adopted by TDLR to enhance shared operations and public service delivery.
 - Prepare examples of how TLC's values are operationalized in daily work and decision-making.
- TDLR:
 - Assess cultural alignment and identify areas requiring change management, staff engagement, or training to ensure a smooth transition.
 - Share TDLR's mission, vision, and core values to facilitate a side-by-side comparison with TLC.
 - Highlight practices that support TDLR's regulatory and customer service goals, especially those that could be integrated into a unified culture.

- Identify cultural elements that may conflict or complement TLC’s approach, and propose strategies for harmonization.
- Recommend joint working sessions to co-develop a common set of values, guiding principles, and behavioral expectations.

Status: TDLR executive management expects a “lift and shift” approach to the functions of lottery and bingo operations. This means that existing processes, systems, and responsibilities from TLC will be transferred to TDLR largely as-is, with minimal redesign or restructuring. The goal is to preserve operational continuity and avoid disruption during the transition.

Due to vacancies, administrative functions may see a matrix management approach to administrative divisions.

TDLR executive management expects to announce an organizational structure near the beginning of August 2025.

After critical September 1, 2025 transitions milestones are met, a closer review of policies, procedures and organizational structure will begin.

4. Biannual Revenue

What it is: TLC generates ~\$3 billion biannually.

Current Regulation: Revenue is allocated to education and veterans' programs under Texas Government Code §466.

Preparation:

- TLC:
 - Provide existing documentation of historical revenue flows and allocations.
- TDLR:
 - Establish systems to track and report biannual revenue, ensuring continuity in fund distribution to designated entities.

Status: Lottery financial operations are expected to remain the same for the FY26-27 biennium. Statute requirements for the independent review of the lottery financials remains and expect to continue the procurement of an external audit firm for this function. CPA Fiscal Management will provide guidance for the FY2026 annual financial report since currently TDLR is considered a “simple reporting” agency whose AFR requirements are completed by or before November 1st.

5. Prize Check Signatory Responsibilities

What it is: Authorized individuals sign off on prize payments.

Current Regulation: Governed by TLC internal controls and Texas Government Code §466.

Preparation:

- TLC:
 - Provide established signatory protocols and internal control documentation to TDLR.
- TDLR:
 - Assess TLC’s current signatory protocols and internal control documentation to determine whether to adopt them or implement new authority and control procedures aligned with statutory requirements.

Status: With the changes from SB3070, the executive director is authorized to make prize payments. Prize payments of \$600 or more can only be made by the director [§466.402(b)]. TLC will coordinate with the TDLR executive director to update existing internal controls to ensure compliance. TLC has requested a meeting with Texas Treasury Safekeeping Trust Corporation for the necessary signature authority changes.

6. Riders – Adherence

What it is: Riders are legislative directives attached to appropriations bills.

Current Regulation: TLC must comply with riders in the General Appropriations Act (GAA).

Preparation:

- TLC:
 - Identify all current riders affecting lottery operations and compliance procedures.
- TDLR:
 - Integrate rider compliance into budget planning and compliance frameworks and internal audits.

Status: Riders which currently exist for TLC have also transferred over to TDLR for the FY26-27 biennium. TLC staff will cross-train with appropriate TDLR staff for its continuance. There are two new riders requiring Lottery Operations Division, or its succeeding division, to report retailer information to the LBB on a quarterly basis. Staff will be meeting with LBB for its first report due in December 2025.

7. Bingo Statutes – Must Collect Fees to Cover Costs

What it is: Bingo operations must be self-sustaining.

Current Regulation: Governed by Texas Occupations Code Chapter 2001.

Preparation:

- TLC:
 - Share cost-recovery models and fee structures with TDLR.
- TDLR:
 - Ensure fee schedules are sufficient to cover regulatory costs.

Status: Bingo operations and its financial operations will remain status quo for FY26. The current module to cover costs consists of license and other incidental fee collection, but also the State's portion of the prize fee funds. Combined, these deposits sufficiently cover Bingo expenditures up to the amounts appropriated in the General Appropriations Act. TDLR may be interested in exploring the license and penalty fee structure to reduce the dependency on the prize fee funds.

8. Salaries from TDLR Covered in Part by Lottery Account

What it is: Some TDLR staff may be funded by lottery revenues.

Preparation:

- TLC:
 - Clarify which TDLR and TLC roles will be funded by lottery accounts and what percentage of compensation is included.
- TDLR:
 - Budget accordingly and ensure transparency in salary allocations.

Status: TDLR executive management may be exploring how certain management or administrative positions in the TDLR organization will be also fulfilling duties or oversight of lottery operations. As such, their prorated hours can be subject to "costs incurred in the operation and administration of the lottery" [TGC §466.355(b)(2)]. Discussions of the upcoming organizational structure and its designation will need to include current budget constraints and impacts to CAPPs HR budgeting tools.

9. Absorbed Operational Costs

What it is: TLC may absorb certain operational costs, such as infrastructure, staffing, or administrative support, that are not reimbursed by other entities (e.g., the state or vendors). These costs are referred to as absorbed costs, as TLC pays for them directly without external funding or reimbursement.

Preparation:

- TLC:
 - Identify all absorbed costs and assess their financial and operational impact.
- TDLR:
 - Evaluate whether to continue absorbing these costs or restructure funding.

Status: Pending discussions.