

December 27, 2021

Keely Martin Bosler, Director
California Department of Finance
915 L Street
Sacramento, CA 95814

Dear Director Keely Martin Bosler,

In accordance with the State Leadership Accountability Act (Leadership Accountability), the California State Lottery Commission submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2021.

Should you have any questions please contact Harjinder Chima, Chief Deputy Director, at (916) 822-8175, hchima@calottery.com.

GOVERNANCE

Mission and Strategic Plan

Mission and Strategic Plan

In 1984, Proposition 37 amended the California Constitution to authorize the establishment of a statewide lottery. The purpose and intent of the California State Lottery Act (Lottery Act) provides additional monies to benefit public education without the imposition of additional or increased taxes. On April 8, 2010, Assembly Bill 142 amended the Lottery Act to reallocate revenues “so as to maximize the amount of funding allocated to public education.” This changed the California State Lottery’s (Lottery) funding formula to follow best practices.

Lottery’s Mission Statement:

The Lottery's mission is: Provide supplemental funding to education through the responsible sale of Lottery products.

Our mission is accomplished by ensuring integrity, security, fairness and transparency in the operation and administration of the Lottery and responsible sales of our products.

Strategic Plan and Objectives:

The Lottery’s current Strategic Plan was approved by the California State Lottery Commission (Commission) on May 28, 2020. The plan includes six strategic objectives:

- Modify operations to ensure health and safety and to recover from depressed sales
- Revisit retail strategies to adapt to the new consumer preferences
- Grow Draw Game sales particularly Jackpot Games and Hot Spot
- Defuse the barriers to play by changing consumer perceptions
- Better inform the Public and Stakeholders about the Lottery
- Transform the Corporate Culture in the Lottery organization

The strategic objectives revolve around the themes of:

- Adapting to the “New Normal” from the pandemic
- Transforming the Lottery into a mature yet modern and nimble organization
- Building trust and confidence among stakeholders and the public in general

Business Plan and Objectives:

At the Lottery, we continuously review our performance, based on short-term targets to ensure we operate at maximum efficiency. Each fiscal year, an individual business plan is developed from the strategic objectives. The Business Plan for Fiscal Year (FY) 2021-22 was approved by the Commission on June 24, 2021. This outlines the specific objectives, strategies, and tactics for the fiscal year with funding for the associated initiatives included in the Lottery’s budget. To continue growing funding to the Lottery’s beneficiary, California public education, and to move towards achieving the goals in the Strategic Plan, the Lottery’s FY 2021-22 Business Plan includes five objectives:

- Respond to Emerging Needs from Recent Trends and Events:
 - Changes in the workplace due to the pandemic; Develop a post-pandemic telework policy and program
 - Re-engagement with casual Scratchers consumers
- Focus Efforts to Reinvigorate Retail:
 - Acquire state-of-the-art-self-service machines
 - Research additional methods to sell products
- Strengthen Sales in Jackpot Games:
 - Add a third draw
 - Investigate changes to a product design
 - Increase advertising at retailer locations
- Defuse Barriers to Play by Changing Consumer Perceptions:
 - Reposition campaign to better connect the brand as a fun entertainment alternative
 - Deliver more information about the Lottery to counter myths
 - Asses and pilot methods to make product selection easier
- Transform the Lottery:
 - Improvement of internal infrastructure such as upgrades to the financial system, installation of cybersecurity safeguards, improvements to a distribution center and begin projects to transition paper-based workloads to automated processes
 - Research methods to improve efficiency and effectiveness of Lottery operations and improve the consumer and retailer experience in a cost-effective manner

Reporting Responsibilities

The Lottery does not have entities under its reporting responsibilities.

Control Environment

Ethical Values

The Lottery is dependent on the ethical values instilled in our day to day operations. The Lottery strives to maintain public trust as it is vital to remain successful. It is imperative that all staff demonstrate integrity, honesty and fairness in the operation and administration of the organization. This is crucial in reassuring consumers that games are operated fairly and that winning tickets will be honored.

Responsible Gaming

As a member of the global lottery industry, the Lottery is a strong supporter and promoter of responsible gaming. We dedicate significant resources to responsible gaming and pioneered the first problem gambling hotline in California.

- In February 2015, the California State Lottery became the first Lottery in the nation to receive a World Lottery Association (WLA) Responsible Gaming Level Four Certification. This is the highest level of internationally recognized certification for responsible gaming. In 2018 and 2021, we were honored to be recertified at level four for responsible gaming.
- The Lottery also holds the prestigious gaming security certification from the WLA, the Security Control Standard Certification. The California State Lottery is the only lottery in the United States to earn this certification since 2014.

Oversight

Oversight is performed at various levels at the Lottery, including internal and external entities such as:

California State Lottery Commission

As an initiative statute, the California State Lottery Act of 1984 (Lottery Act) created the California State Lottery Commission (Commission) and gave it broad powers to oversee the operation of a statewide lottery. This includes approving the Lottery's budget, strategic plan, and business plan to ensure the Lottery's mission is achieved. The Commission consists of five members appointed by the Governor with the advice and consent of the Senate. These appointments meet the requirements of the Lottery Act, which specifies that:

- No more than three members can be from the same political party.
- One member must be a certified public accountant.
- One member must have a minimum of five years of experience in law enforcement.

Lottery's Director

The Director of the California State Lottery is appointed by the Governor as the chief administrator of the Lottery. The Director supervises and administers the operation of the Lottery in accordance with the Lottery Act and regulations promulgated by the Commission, while promoting integrity, security, honesty and fairness.

Lottery's Audit Committee

Lottery's Audit Committee provides independent assurance in compliance with Government Code

sections 13886(a) and 13887(b) and reports to the Lottery Commission at least once a year. This report includes significant internal audits findings and management's responses, the effectiveness of the internal audit function and its conformity to applicable law and standards, the adequacy of the budget and staffing of the internal audit unit, and significant issues or conflicts which arise in connection with internal audits.

Lottery's Audit Program

Internal Audits provides independent objective assurance and consulting services to enhance and protect Lottery value by providing risk-based and objective assessments, recommendations, and insight. Internal Audits assists in accomplishing business objectives by performing systematic and disciplined audits and evaluations. Internal Audits coordinates all external audits, with the State Controller's Office (SCO) and independent audit firms, minimizing duplication of efforts and cost and ensures timely responses to external audit reports.

Workforce Management

The Lottery has designated a specialist for workforce and succession planning within the Human Resources Division. The specialist oversees and collaborates with all divisions to develop and implement workforce and succession planning activities to support the Lottery's workforce needs. These activities help the Lottery to reduce this risk by proactively and consistently reviewing and addressing its workforce needs and ensuring a strong bench strength for the organization's key positions.

Enterprise Risk Management

The Enterprise Risk Management (ERM) ensures the Lottery applies the practice of risk assessments with strategic initiatives applied to operational, financial, compliance, and reporting functions. ERM's goal is to generate an understanding of the Lottery's top risks that executive management collectively identifies as the current, most critical risks to the strategic success of meeting the Lottery's mission. In addition, ERM empowers Lottery staff to identify actions, activities and changes as they become an introduction to risks.

In January 2020, the Enterprise Risk and Optimization Section (EROS) was created within the ERM section, with the approval of the Lottery Commission. The objective of EROS is to ensure the Lottery maintains documented policies, programs, processes, and procedures, in a standardized format, based on the statutes of the Lottery Act and alignment of the Lottery Regulations. This includes detailed process evaluations to verify internal controls, increase efficiency and eliminate duplicity.

Documentation and Control Systems

The Lottery follows and emphasizes the Three Lines of Defense as the standard practice to comply with SLAA's directives.

First Line of Defense

- Supervisors and managers monitor performance to ensure accountability
- Establishment of internal control monitors is in progress in various divisions
- EROS' deliverable of creating and standardizing documentation throughout the Lottery is in

progress and will be utilized to ensure accountability

Second Line of Defense

Multiple divisions, sections and committees at the Lottery continue to perform governance, oversight, and compliance activities. Examples of these defense activities include:

- Policy Committee – Defines and approves departmental policies
- Information Security Committee – Oversees Information Security Management Systems
- Finance Division – Quality Review Unit validates transaction activities
- Ticket Theft Committee – Strengthens the relationship between the Lottery and its retailers, deter theft of Lottery products, and better protect both retailers and the Lottery from financial loss
- Retailer Risk Committee – Addresses issues impacting Lottery retailers
- Enterprise Business Analysis Unit – Facilitates the relationship between technical and business stakeholders to support successful project delivery
- EROS - Performs comprehensive process evaluations to ensure efficiency and compliance with policies and regulations, and serve as enterprise control monitors
- Information Technology Services Division (ITSD) Change Management – Facilitates the coordination, communication, planning and tracking of changes for Information Technology units
- Executive Management - Ensures the appropriate levels of approval are exercised and the correct optics are applied to the decision-making process

Third Line of Defense

- Internal Audit provides independent assurance, objective assessments, and recommendations

The Lottery's Directorate, Lottery Commission, Audit Committee, SCO, and independent audit firms provide governance and/or oversight to the three lines of defense.

Information and Communication

The Lottery fosters an environment that encourages employees throughout the department to consider risks and impacts on the enterprise when making decisions. Roles have been defined to monitor and communicate information regarding programs, operational, and administrative functions across the enterprise. Some of the practices are defined below:

- The Director of the Lottery provides a monthly status report on the performance of Lottery sales, profits and recent efforts that have taken place at the division level.
- The executive management facilitates communication and encourages collaboration between all levels of staff and management.
- Employee Engagement Survey (EES):
 - Confidential employee survey was administered for the Lottery by a third-party in 2020
 - Feedback was solicited on strengths and opportunities for improvement of the employee environment
 - Collective results were shared throughout the enterprise
 - The Lottery conducts quarterly staff meetings to address opportunities for improvement

within the division. During the first quarterly meeting, the survey results were discussed to begin to lay the groundwork to address various program challenges and employees' input was solicited

- EES Workgroups have been created within each division to address items identified in the survey
 - A weekly report is provided to the Governor's Office for activities that have external impact, such as release of new products and other activities the department attends or addresses.
 - By statute the Lottery also produces reports related to financial, operational, security and audit results.
 - Lottery Audit Committee reports significant audit findings and management responses to the Lottery Commission.
 - Project portfolio activity is presented to stakeholders on a monthly basis, which is then shared amongst the divisions.
 - Various types of communication are presented to department staff via email and posted to our intranet. The communications cover items from system alerts, Human Resource changes, job opportunity announcements, news and news releases from Public Affairs and Communications, Health & Safety tips, information from other departments such as the California Department of Public Health (CDPH), training opportunities from the California Human Resources (CalHR), payroll information from the State Controller's Office (SCO) and activities related to business change and educational items.
 - In response to the COVID-19 pandemic, the following internal communication items were implemented:
 - COVID-19 Intake Request Process is a centralized intake process regarding changes to state, county and/or city directives which may impact the Lottery. This process ensures information is communicated to and changes are approved by all impacted stakeholders.
 - Weekly COVID-19 Status Update Reports provided to executive management and stakeholders regarding changes to state, county or city directives which impact the Lottery.
 - California State Lottery's Safety Protocol is a centralized outline of state, county and city directives which impact the Lottery and employees. This is available to employees via the Lottery's intranet and employees are notified of updates or changes via email.
 - Information regarding potential exposure to COVID-19 at a Lottery facility is dispersed as quickly as possible via the Lottery Safety team.
 - Internal and Enterprise Control Monitoring and Change Control:
 - An enterprise change control framework to allow communication and management of program and process changes or risks identified is in discussion. This process will support the internal and enterprise monitoring efforts and will include a centralized intake to be managed by the enterprise control monitors.
 - Security and Privacy Newsletter is provided to staff via email to share information and tips for information security and privacy.
 - Retailer Forum is an event for retailers and Lottery team members which provides retailers the
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opportunity to share their thoughts, concerns, and experiences and for the Lottery to share information regarding multiple pertinent subjects.

- The Information Technology Service Division chairs a release management meeting that communicates items that are being released to production prior to the activity being executed.
- Divisions communicate amongst each other and report as to their latest activities in various change management meetings.

External Communications

The Public Affairs and Communication (PAC) section is the official voice of the Lottery. PAC's objective is to provide the most accurate information to Californians in order to maximize awareness of the Lottery's mission. The main channels of communication with the public are media requests and Public Records Act (PRA) requests. The process to respond to these communications are clearly defined and includes the necessary stakeholders and appropriate levels of approval to ensure quality information is provided.

Reporting Process

The Lottery's reporting process is inclusive of all staff. Employees are encouraged to identify areas of concern and inform their supervisors and internal control monitors if they are established in their division. As part of the three lines of defense, reporting these issues may also require informing impacted areas within or outside of their division, the enterprise control monitors and the Enterprise Risk Management section.

MONITORING

The information included here discusses the entity-wide, continuous process to ensure internal control systems are working as intended. The role of the executive monitoring sponsor includes facilitating and verifying that the California State Lottery Commission monitoring practices are implemented and functioning. The responsibilities as the executive monitoring sponsor(s) have been given to: KayLynn Weathers, Risk & Process Evaluation Manager.

Through our ongoing monitoring practices, the Lottery management ensures our internal control systems govern to meet our objectives related to baseline administrative, financial, operational, and reporting functions. As part of our ongoing monitoring practices we evaluate our internal controls when new mandates or enhancements are added, which ensures updated information is communicated and recorded for departmental staff across the enterprise.

Enterprise Risk and Optimization Section (EROS)

With the creation of EROS in January 2020, the Lottery has implemented a structured evaluation and documentation practice and internal control monitoring process for the department. The primary objectives will be to ensure programs and processes are aligned to policy and are being performed efficiently, and to strengthen internal control monitoring at all levels. Monitoring and reporting on controls at the enterprise level ensures communication, expectation, and compliance at the divisional level. Monitoring controls is essential to ensure controls are operating efficiently as required and focused on reducing audit findings. The approach to implement a fully functional internal control monitoring process will incorporate the practices as defined in Government Code sections 13400 thru 13407 is in progress: The EROS members designated as the Lottery's Enterprise Control Monitors

(ECMs) are assisting various program areas at the Lottery to identify Internal Control Monitors (ICMs) in their areas and provide guidance and support as they take on their roles and responsibilities as ICMs.

Internal Audit Division

The Internal Audit Division (Internal Audits) maintains a comprehensive audit program which follows the Institute of Internal Auditing's (IIA's) International Standards for the Professional Practice of Internal Auditing (Standards). IIA Standards require an external Peer Review at least once every 5 years, which is conducted based on the standards and guidelines published by the Association of Local Government Auditors (ALGA).

In addition, we utilize external resources to serve as independent evaluators of our internal control practices, which assists in maintaining a balance of impartiality and ensures the Lottery's integrity with our stakeholders. Examples of external resources include:

Independent Audit of Financial Statements

Annually, an independent audit firm performs financial audits of the Lottery's financial statements. Since the inception of the Lottery, the annual financial statements have been fairly and appropriately presented without any identified exceptions, and in compliance with Generally Accepted Accounting Principles. Further, in recognition of the Lottery's commitment to prepare financial statements reflecting transparency and full disclosure, the Government Finance Officers Association (GFOA) of the United States and Canada have awarded a Certificate of Achievement for Excellence in Financial Reporting to the Lottery for the past 17 consecutive fiscal years.

State Controller's Office (SCO) Audits

The State Controller's Office (SCO) conducts quarterly and annual post-audits of all accounts and transactions of the Lottery including quarterly transfers to education, vendor claim schedules, and all prize payments.

Independent Audit and Verification of Draw Games

An independent audit firm witnesses and reviews every lottery draw to ensure accurate completion of the draw procedures, including the verification of technology systems, draw machinery, and draw items such as lotto balls.

Independent Review and Audit of Security Measures

Although the Lottery Act requires the review of the Lottery's adopted security measures on a biennial basis, the Lottery has opted for more frequent reviews. The World Lottery Association/International Organization for Standardization auditors conduct an annual review of the Lottery's security and perform a comprehensive audit every three years. The audit includes a comprehensive study and evaluation of the required aspects of security in the operation of the Lottery.

RISK ASSESSMENT PROCESS

The following personnel were involved in the California State Lottery Commission risk assessment process: executive management, middle management, and front line management.

The following methods were used to identify risks: brainstorming meetings, employee engagement surveys, ongoing monitoring activities, audit/review results, other/prior risk assessments, external stakeholders, consideration of potential fraud, performance metrics, and other.

The following criteria were used to rank risks: likelihood of occurrence, potential impact to mission/goals/objectives, timing of potential event, potential impact of remediation efforts, and tolerance level for the type of risk.

The Lottery currently identifies risks by multiple methods such as:

- In the day to day operations through various practices including Strategic Planning, Project Portfolio Management practices, Information Security risk evaluations, and daily operational and infrastructure monitoring
- The Chief Enterprise Risk Officer or acting Chief Enterprise Risk Officer meets with division deputy directors on a monthly basis to discuss potential risks and areas of concerns
- Each division completes enterprise level risk assessments to address strategic and operational risks with the direction from the Enterprise Risk Management (ERM) section

Based on the description of the risk, its likelihood to occur and the impact it would have against the department's mission, ERM presented the risks of most concern to the directorate and executive management. The risks are listed under the risk and controls portion of this report.

RISKS AND CONTROLS

Risk: Workforce Development

The Lottery has a unique workforce with specialized positions such as sales, marketing, law enforcement, finance, auditing, information technology, and professional staff. The skillsets needed for these positions create challenges with workforce and succession planning efforts. This includes recruiting and retaining the necessary talent as individuals can often acquire higher pay and benefits in the private sector.

The Lottery's ability to be nimble and adjust quickly to changing environments has been limited by civil service requirements for some of the more unique positions. This has prevented the hiring of temporary staff and expanding the hours of operation as demands surged, as experienced during the pandemic.

The Lottery Act has a requirement that the Security and Law Enforcement Division's (SLED) Deputy Director have at least five years of law enforcement experience. This creates challenges in permanently filling this position with State of California classifications. The Lack of permanent leadership may cause the loss of continuity and knowledge transfer for the SLED management team.

Control: Workforce and Succession Planning

The Lottery established a designated specialist for workforce and succession planning for the organization. The specialist will proactively and consistently review, and address workforce needs to ensure a strong bench strength for the organization's key positions. The Lottery is currently in the process of finalizing its 2022-2025 Workforce and Succession Plan (WSP).

The plan's primary goals are to attract and hire quality talent to help meet the organization's

mission, improve retention to keep top employees, and establish a formal Succession Planning Program to ensure a skilled and knowledgeable workforce will be in place to support current and future organizational needs. It includes a comprehensive qualitative and quantitative data analysis of the Lottery workforce, identification of the organization's workforce gaps and risks, and focused activities that will be used to address the identified gaps and risks and continuously improve the Lottery workforce.

In addition, the Enterprise Risk and Optimization Section (EROS) continues documentation standardization efforts at the Lottery. The deliverables from these efforts will assist with monitoring, oversight, and succession planning.

Control: SLED Executive Leadership

Since the contract with the California Highway Patrol for SLED's Deputy Director and Assistant Deputy Director will expire on December 31, 2021, the Lottery is working diligently to permanently fill these positions.

Risk: Cybersecurity

The California State Lottery must defend its information assets against persistently advancing and evolving cyber risks. Our continuing cybersecurity enhancements and endeavors are to avert financial loss, prevent reputational harm, and prevent loss of confidentiality, integrity and availability of data and systems.

Control: Security Defense Posture

The continued fortification of security capabilities to predict, prevent and respond to ever-changing cyberthreats and the management of the overall depth of the Lottery's enterprise cybersecurity defenses and program strategies remains top of mind. During the first quarter of 2021-2022 Fiscal Year (FY), the Lottery continued to enhance and strengthen its security controls with improvements to harden its network and cloud environments by augmenting it with additional capabilities to predict, prevent and respond to ever-changing cyberthreats. The Lottery successfully updated its core gaming system, decommissioned 2003 servers, and deployed multi-factor authentication, Always-On Virtual Private Network (VPN), and CrowdStrike Advanced Endpoint Protection enterprise-wide.

Presently, in the second quarter of FY 2021-2022 the Lottery's enterprise cybersecurity initiatives include:

- Migration of mobile device management (MDM) from the AirWatch to the Intune MDM
- Implementation of the Varonis data security and data-centric audit and protections platform

Risk: Modernization of Consumers' Options

Although the Lottery is a public agency, we do not receive public funding. The Lottery generates revenue to accomplish our mission by selling our products. This is a unique function from most government agencies. The Lottery's strategic plan and business plan have critical roles in outlining the goals and objectives that are necessary to promote revenue growth. If the business and financial goals

are not met, there may be challenges in accomplishing our mission.

The sale of the products and the supporting activities must follow the rules and regulations in the Lottery Act. However, constraints of the Lottery Act limit the Lottery's ability to modernize and adapt to changing consumer preferences. In turn, this restricts sales growth and player expansion.

Control: Compliance with Policy

The controls for this risk include various activities, such as product design & development, retailer sales efforts, consumer engagement & marketing efforts, and retailer marketing & advertising efforts. In addition, the goals and objectives in the strategic and business plans include various activities focused on increasing revenue. It is a path to attain the overall financial goal. All activities will follow policies and procedures designed to mitigate risks by aligning with the current Lottery Act.

Risk: Automated Systems

The Lottery has legacy systems and processes which have been in place for long periods of time. As the core business functions have expanded in scope or volume, the aging systems may not support the necessary functions and the lack of automated systems allow the opportunity for risks to be introduced and impact efficiency.

Asset Management – The current system utilized by the Lottery is being decommissioned in March of 2022, as the Lottery transitions to a new procurement and accounting system. Delays and complications with the procurement of a new asset management system has left the Lottery in a position where all assets could be contained in an Excel spreadsheet. This could further the risk of the Lottery's ability to accurately track and manage assets once the current system is decommissioned. Operations and Finance currently track assets in different systems.

Correspondence – An automated system to scan and track the various type of daily correspondence received does not exist at the Lottery. Without scanned images of envelopes, it is not possible to track if and when correspondence claiming a prize was received.

Procurement – The current procurement system is outdated which causes limited support due to the age of the system. High turnover rate in procurement staff has resulted in lost knowledge and increased processing timeframes. Outdated procurement documentation is in various stages of development and implementation. Much of the documentation will be reliant upon the additional level of controls that will be available in the upgraded procurement system. Contract administration relies heavily on contract managers that are either not trained or lack accountability which may result in financial loss and degraded services.

Human Resources – Various processes which involve sensitive employee data are still paper-based. Many of the processes are dependent on or support subsequent processing in external departments which complicates the effort to transition our processes to automated systems. Paper-based, manual processes can create opportunities for risks to arise such as user error, longer processing timeframes, and unapproved disclosure of sensitive information.

Control: Asset Management

Assets tracked in different systems are reconciled monthly by Operations and Finance. This will continue until a new asset management system is procured and implemented.

Control: Correspondence

Staff manually count and track first class correspondence received daily to identify the number of pieces of mail to be delivered to each mail stop.

Control: Procurement

The Lottery will continue to utilize the existing eProcurement system. Two broad procurement policies have been issued to ensure adequate understanding that all procurements should have adequate competitive bidding when available. The first phase for the documentation of the procurement process involves forms, which have been developed. The Contract Administration Services (CAS) Unit continues to provide oversight and administration of the ten highest risk contracts totaling more than \$1.5 Billion. This will continue as the Lottery will be transitioning to a new procurement system in early 2022.

Control: Human Resources

The paper-based processes will continue to be performed in accordance with the established processes and procedures designed to mitigate risk by aligning with policies. However, wherever it is practicable, the Lottery will explore opportunities to automate workflows.

CONCLUSION

The California State Lottery Commission strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising risk mitigation strategies as appropriate. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.

Alva Vernon Johnson, Director

CC: California Legislature [Senate (2), Assembly (1)]
California State Auditor
California State Library
California State Controller
Director of California Department of Finance
Secretary of California Government Operations Agency