

December 11, 2019

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

Dear Ms. 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, 2019.

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

## **GOVERNANCE**

### **Mission and Strategic Plan**

In 1984, Proposition 37 amended the California Constitution to authorize the establishment of a statewide lottery. As an initiative statute, the California State Lottery Act of 1984 (Lottery Act) created the California State Lottery Commission and gave it broad powers to oversee the operation of a statewide lottery. The purpose and mission of the Lottery Act provides supplemental monies to benefit public education without the imposition of additional or increased taxes. The California State Lottery (Lottery) Commission consists of a five-person panel appointed by the Governor and confirmed by the State Senate.

The Lottery's current Strategic Plan contains five key themes to which all its major initiatives tie. These include:

- Build sales in Jackpot Games and Hot Spot
- Clear up myths about the Lottery and elevate the perception of the brand
- Be a responsible corporate citizen
- Put more fun and entertainment into the Lottery brand
- Improve the customer experience

The Business Plan for FY 2019-20 was approved by the Lottery Commission on June 20, 2019. This outlines the specific objectives, strategies, and tactics for the fiscal year with funding for the associated initiatives included in the Lottery's budget. In order to continue growing the dollars to the Lottery's beneficiary, California public education, and to move towards achieving the goals in the Strategic Plan, the Lottery's FY 2019-20 Business Plan includes the following objectives:

- Grow sales of all Jackpot Games and Hot Spot;
- Continue moderate growth of Scratchers sales;
- Improve the customer experience for players, retailers, and internal customers;
- Elevate perceptions about the Lottery to grow the player base.

## Control Environment

Maintaining public trust is vital for a lottery to remain successful. It is imperative that all Lottery staff demonstrate integrity, honesty, and fairness in the operation and administration of the organization. This is crucial in reassuring players that games are operated fairly and that winning tickets will be honored. The California State Lottery is dependent on the ethical values instilled in our day to day operations.

Oversight of the Lottery is performed at various levels. The Commission consists of five members appointed by the Governor and confirmed by 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 least five years of experience as a law enforcement officer.

The Commission approves the Lottery's budget and business plans to make sure we achieve our mission—providing supplemental funding for California's public schools and colleges.

The Lottery's executive staff are responsible for ensuring the appropriate levels of approval are exercised and the correct optics are applied to the decision-making process. Documentation of programs that define the internal controls exists but is being evaluated for uniformity and accessibility. In September 2019 the Lottery Commission approved the creation of a team to serve as internal control monitors. The objective of the team will be to ensure the department maintains documented policies and procedures based on the statutes of the Lottery Act and alignment of the Lottery Regulations. In addition, the Lottery maintains a comprehensive audit program. The Lottery not only employs internal auditing staff, but also contracts with the State Controller's Office (SCO) and independent firms to further ensure the integrity of all operations and transactions. Ensuring integrity, security, fairness and transparency in the operation and administration of the Lottery is crucial to our future success in increasing supplemental funding for public education.

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 of the United States and Canada have awarded a Certificate of Achievement for Excellence in Financial Reporting to the Lottery for the past 16 consecutive fiscal years. Additionally, the 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.

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.

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. Specifically, World Lottery Association/ International Organization for Standardization auditors conduct a review of Lottery security annually

and perform a comprehensive audit every three years. The audit includes a comprehensive study and evaluation of required aspects of security in the operation of the Lottery.

As a department the Lottery implemented a practice to participate in regular workforce and succession planning exercises to ensure we are proactively addressing the risk. Each year, the Lottery evaluates current vacancies and the generational demographics reflected within its workforce. This information is shared with the Deputy Director of each program during scheduled workforce and succession planning meetings. During these meetings, programs are asked to do an in-depth analysis of the business environment, review the strategic objectives, assess both current and future staffing needs, and identify workforce planning risks. This information is documented on a Lottery form called the Division Risk Assessment Worksheet (DRAW), a Workforce and Succession Planning tool that summarizes the business issues and risks that have been identified through the analysis. The form also provides management with a framework to create, document and track a plan of action to address each risk. During this process, managers meet with Human Resources to discuss identified risks, challenges and brainstorm possible solutions.

In the SLAA Corrective Action Plan filed in June of 2019 the Chief Enterprise Risk Officer planned to implement and document the three lines of defense model to ensure managers at the first line were evaluating performance and ensuring accountability. In June 2019 a new Director of the California State Lottery was appointed. With the new leadership the task of onboarding redirected efforts and delayed the implementation strategy scheduled for December of 2019. In September of 2019 the new Director authorized the Chief Enterprise Risk Officer to seek Lottery Commission approval for the creation of the Risk & Process Evaluation section. This office will continue with the plan to implement the three lines of defense and move towards a structured evaluation and documentation practice for the department. The primary objectives will be to (1) ensure programs and processes are aligned to policy and are being performed efficiently and (2) strengthen internal control monitoring at the executive level.

### **Information and Communication**

The Lottery has defined roles to monitor programs, operations and administrative functions across the enterprise. Some of the practices are defined below:

- On a monthly basis a status report is provided from the Director regarding the performance of Lottery sales, profits and recent efforts that have taken place at the division level.
- Project portfolio activity is presented to stakeholders on a monthly basis and that information is then shared amongst the divisions.
- Divisions communicate amongst each other and report as to their latest activities in various change management meetings.
- Various types of communication are presented to department staff via email and posted to our Intranet. The communications cover items from system alerts, HR changes, Health & Safety tips, activities related to business change and educational items.
- 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.
- Weekly a report is provided to the Governor's Office as to the 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.

## **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: Vincent Espinosa, Chief Enterprise Risk Officer.

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Through our ongoing monitoring practices, the Lottery management team 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. In addition, we utilize external resources such as the State Controller's Office, World Lottery Association and vendors 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.

Monitoring at the Lottery is in practice and the department does recognize the need for enhancement to evolve with the various aspects change brings. A plan to have fully implemented internal control monitoring in practice by December 2019 was delayed with the appointment of a new Lottery Director in June 2019. The plan is to continue with implementation of the three lines of defense at the division levels and create a unit at the enterprise level to perform internal control monitoring by February of 2020. The team's objective will evaluate Lottery policy, programs, procedures and documentation efforts and work with the divisions to remove duplicity, strengthen controls and document the outcomes. 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 lowering the number of 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

## **RISK ASSESSMENT PROCESS**

The following personnel were involved in the California State Lottery Commission risk assessment process: executive management.

The following methods were used to identify risks: brainstorming meetings, ongoing monitoring activities, audit/review results, other/prior risk assessments, 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.

Due to the change in leadership the Lottery did not have the bandwidth to perform an assessment from all levels of staff. The Chief Enterprise Risk Officer meets with division Deputies on a monthly basis and from those meetings was able to perform risk assessments and report the information provided. Once risks were formulated and controls were defined a presentation to executive management took place.

## **RISKS AND CONTROLS**

### **Risk: Leadership Tenor**

The California State Lottery has been in existence since 1984. During its 35 years the California State Lottery has had approximately 20 different Directors serving in either an appointed or acting role. The constant change in leadership impacts the ability for the department to establish a stable baseline of direction to obtain and sustain the Lottery's core mission.

#### **Control: Establishment of defined baseline fundamentals**

In June 2019 the new Director identified the lack of defined policies and documentation of current baseline administration and operation practices of the Lottery. To strengthen the definition of policies and define and document baseline processes and procedures, the director requested a solution be initialized to control the risk.

- Implementation of a Risk & Process Evaluation Team to serve as the monitors of internal controls for all Lottery business and information technology activities.
- Focus on Policy development and the documentation of procedures to remediate the lack of foundational operational direction.
- Establishment of a senior management orientation program will also improve the transition process of Lottery leadership.

This will be essential to succession planning for future Gubernatorial appointments.

### **Risk: Cybersecurity**

If external sources infiltrate the Lottery's various systems and databases, it could lead to financial loss, reputational damage and threaten the Lottery's confidentiality, integrity and availability of the services offered.

#### **Control: A. Strengthening of Security posture**

Strengthening its security controls and reducing security risk remains a top organizational priority for the Lottery. During the first quarter of 2019-2020, the Lottery continued its infrastructure upgrades and security control enhancements. The Lottery's Information Technology Services Division (ITSD) successfully upgraded both the database server and application for the Lottery records management system used by Lottery investigators and support staff throughout the state. Concurrent with that effort, deleted legacy case data that exceeded its retention schedule and in

the final testing phase of migrating remaining data into a new database. Deployment of additional advanced email protection controls continue.

What's Next For the second half of fiscal year 2019-20, the Lottery will focus on upgrading all end-of-life infrastructure and deploying ServiceNow for IT service management to replace its legacy service desk ticketing system. Vulnerability remediation will continue to be a priority and includes a workstation patching solution for mobile workforce that deploys the patches anytime the user is connected to the Internet.

**Risk: Being stagnant or not evolving quickly enough.**

The California State Lottery Act of 1984 limits the ability of the Lottery from evolving quickly enough to remain innovative and relevant to consumers to increase supplemental funding to public education.

**Control: A Fiscal Year 2019/2020 Plan**

In order to continue growing the dollars to its beneficiary, which is California public education, and to move towards achieving the goals in the Strategic Plan, the Lottery had four objectives for FY 2019-20. These include:

- Grow sales of all Jackpot Games and Hot Spot;
- Continue moderate growth of Scratchers sales;
- Improve the customer experience for players, retailers, and internal customers;
- Elevate perceptions about the Lottery to grow the player base.

To further ensure the Lottery continues to evolve and maintain its relevancy to the adults in California, it is time for the organization to create its next Strategic Plan that will cover the vision and key issues the Lottery must tackle over the next 3-5 years. A thorough review of the Lottery's business as well as external business and demographic trends is being conducted and then summarized and presented to Lottery management from early October through early November. From this, the organization will be developing its Strategic Plan over the next 4 – 5 months.

**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