



M E M O R A N D U M

Date: September 19, 2023

To: California State Lottery Commission

From: Alva V. Johnson, Director *AA*

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Information Technology Services Division

Subject: Item 8(e) –Internal Control System Contract Renewal

ISSUE

The California State Lottery's (Lottery) current Internal Control System (ICS) contract with Elsym Consulting, Inc. (Elsym) expires on October 13, 2023. The Lottery seeks approval to enter into a new five-year contract with two one-year extension options. The total contract amount is \$1,776,749.00, with the five-year term beginning October 14, 2023 and ending October 13, 2028.

BACKGROUND

In accordance with Multi-State Lottery Association (MUSL) and World Lottery Association (WLA) requirements, the Lottery must provide an ICS that independently validates Gaming System transactions in real-time. Along with the Lottery Gaming System, the ICS is one of two mission-critical systems managed and maintained by third-party vendors under a contract. Using third-party vendors to manage these systems ensures the security of all Lottery transactions.

The ICS services were included in the International Game Technology (IGT) Gaming Contract Number 7871 (Gaming Contract), along with Lottery Tax documentation preparation services, from the Gaming System contract inception through 2014. During this time, IGT subcontracted with Elsym to provide the gaming system ICS, 2nd Chance ICS, Jackpot Ticket Identification, and Tax services as required under the Gaming Contract.

In 2014, Amendment 12 (A12) was signed to separate the gaming system ICS, 2nd Chance ICS, Jackpot Ticket Identification, and Tax services from the Gaming Contract. The primary reasons for separating the ICS and additional services from the Gaming Contract were to realize potential cost savings and address a 2012 audit finding regarding the independence of the ICS. The gaming system ICS, 2nd Chance ICS, Jackpot Ticket Identification, and Tax services were simultaneously transferred from the Gaming Contract contact to a direct contract between the Lottery and Elsym under Lottery Contract Number 50017, with the initial contract expiring on October 13, 2019. The contract included an option to extend the contract for up to four additional one-year periods at the Lottery's discretion.

In 2019 the Lottery extended the current contract with Elsym by four years, exercising all four one-year options at one time. The options were executed via Amendment 3 (A03) to the ICS contract. In addition, Lottery negotiated for an ICS system upgrade to be compatible with the Lottery's new Gaming System platform, Aurora. Amendment A03 extended the Elsym ICS contract through October 13, 2023.

DISCUSSION

The Lottery currently receives four critical services within the ICS contract. The services included in the contract are:

1. **Gaming System ICS** – The ICS independently processes data in near real-time from the primary IGT gaming system to ensure that all data is accurate and to protect the Lottery from the threats associated with potentially fraudulent activity. Every gaming system transaction is verified and authenticated by the ICS. As such, the ICS system represents a major component in Lottery's efforts to ensure the integrity of our products and processes.
2. **2nd Chance ICS** – The 2nd Chance ICS ensures that only eligible non-winning tickets entered in the 2nd Chance system can win a 2nd Chance prize. The system helps to ensure the integrity of 2nd Chance Draws.
3. **Jackpot Ticket Identification** – Jackpot Ticket Identification Application is a system that validates the authenticity of high-value Powerball®, Mega Millions®, and Super Lotto Plus® tickets submitted by players. The system contributes to the integrity of the Lottery's high jackpot draw games by ensuring that only valid winning tickets can be claimed.
4. **Tax Document Preparation** – Tax document preparation services ensures compliance with Internal Revenue Service (IRS) regulations for Lottery income and

winnings. Using Gaming System data, this system automates the creation and delivery of the more than 130,000 tax documents the Lottery must send to retailers and players every year. This allows retailers and players to report income or winnings to the IRS timely and accurately and to keep the Lottery in compliance with IRS regulations for the taxation of Lottery earnings and winnings.

These services are essential for the Lottery to continue selling our products and maintaining the integrity of our systems.

Leveraging information from other state lotteries, including contracts and procurement solicitations for similar services and other public resources such as vendor websites, the Lottery performed market research. It determined that, at this time, Elsym is the only ICS vendor that can provide all four essential services at a competitive price.

Elsym is the only provider of ICS services that can assume full responsibility for managing all aspects of ICS operations while providing 24/7 support. It is not cost-effective or feasible for the Lottery to create a dedicated team to operate an ICS without assuming the risks of disruption to services during the transition and assuming the liabilities and risk of managing the system. Compared to the services offered by Elsym, a dedicated team is likely to cost several times the current monthly cost. Furthermore, the skills required for a dedicated team to operate and support an ICS are specialized skills not available within state service classifications and must be contracted out.

Creating 2nd Chance ICS, Jackpot Ticket Identification, and Tax document preparation systems in-house or contracting with one or more additional vendors for these services would introduce the risk of service disruptions and/or failure to comply with MUSL, WLA, or California Lottery Regulations. These options would also be cost-prohibitive compared to the services already provided by Elsym, with no appreciable improvement in services. Custom-built solutions are inherently unproven, which risks unidentified severe defects that could impact the Lottery's day-to-day operations and the integrity of our products and services. If the Lottery built the solution in-house, the risk would be placed on the Lottery and contribute to the Lottery's technical debt. Furthermore, the addition of multiple vendors would increase the administrative overhead of receiving these services and would therefore increase costs.

Continuing to contract with our existing vendor will minimize disruption to day-to-day business and mitigate any risk associated with introducing new products or services.

All the services the current contract provides are essential to meet regulatory or legal requirements that allow Lottery to continue selling draw game and Scratchers® products. Any interruption to these services or significant issues in implementing new services could

impact Lottery's ability to sell our products and would seriously impact the public's perception of the Lottery and its integrity. Failing to produce timely and accurate tax documents for our retailers and players could also make Lottery liable to significant penalties from the IRS.

Based on the Lottery's market research, the Lottery recommends approving a Non-Competitive Bid contract with Elsym. This is permissible under Lottery Regulations section 8.1.2.D, which provides that competitive bidding is not required under the following circumstance:

“The Director has determined, after a good faith effort to locate potential bidders, that only one viable source exists for the goods and/or services due to proprietary interests, licensing restrictions, or any other reason.”

Elsym is the leading ICS vendor within the United States and is currently the only vendor who can support all four services mentioned above that the Lottery requires. Elsym is also the only ICS vendor who will fully operate the ICS on behalf of the Lottery and provide 24/7/365 operator support services. This Non-Competitive Bid contract offers the benefit of having one vendor for all four services and is the lowest risk and most cost-effective option. Adopting our recommendation will minimize the risk of service disruptions and ensure that Lottery complies with applicable MUSL, WLA, and California Lottery Regulations.

RECOMMENDATION

The Lottery recommends that the California State Lottery Commission approve a five-year contract with Elsym, with two one-year extension options. The total contract amount is \$1,776,749.00, with the five-year term beginning October 14, 2023 and ending October 13, 2028.