December 15, 2023

Joe Stephenshaw, Director
California Department of Finance
915 L Street
Sacramento, CA 95814

Dear Director Joe Stephenshaw,

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, 2023.

Should you have any questions please contact Harjinder Chima, 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:

We generate supplemental funding for public education from elementary schools to universities. With honesty and integrity, we build a better tomorrow for students and our communities through the responsible sale of entertaining Lottery products.

Strategic Plan and Objectives:

The Strategic Direction for the Lottery's was approved by the California State Lottery Commission (Commission) on June 29, 2023. The plan includes four strategic objectives:

- Expand Scratchers sales by removing barriers to play among infrequent players
- Grow Draw Game sales particularly Jackpot Games and Hot Spot
- Expand and utilize the Lottery's strong retail network
- Continue to improve knowledge and perceptions about the Lottery

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 to support the strategic objectives. The Business Plan for Fiscal Year (FY) 2023-24 was approved by the Commission on June 29, 2023.

To continue growing funding to the Lottery's beneficiary, California public education, the Lottery's FY 2023-24 Business Plan supports the four Strategic Direction objectives:

- Defuse Barriers to Play by Changing Consumer Perceptions:

    ◦ Reposition campaign to better connect the brand as a fun entertainment alternative
    ◦ Explore methods to make product selection easier

- Strengthen Draw Game Sales:

    ◦ Explore changes to a product design
    ◦ Pursue marketing and advertising opportunities
    ◦ Consider additional retail sales options

- Revisit Retail Strategies Adapting to New Consumer Preferences:

    ◦ Pursue opportunities in new tradechannels
    ◦ Explore methods to attract new retailers

- Continue to Inform Public and Stakeholders about the Lottery:

    ◦ Explore options with media and retail locations

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, fairness, accountability, and transparency in the operation and administration of the organization. This is crucial in reassuring consumers that games are operated fairly and that valid winning tickets will be honored.

Responsible Gaming

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

- In February 2015, the California State Lottery became the first 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 the same level.
- The Lottery also holds the prestigious gaming security certification from the WLA; the Security Control Standard Certification.

The Lottery's Commitment to Responsible Gaming includes implementing a Code of Conduct on Responsible Gaming. We incorporate responsible play practices into operations and employee training. Additionally, we partner with retailers to prevent illegal play, to protect our consumers through education, and to share updates on game development.

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 the Lottery's core values of teamwork, respect, diversity equity & inclusion, integrity, transparency, and accountability.

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. The Lottery completed its 2022-2025 Workforce and Succession Plan (WSP) with the most recent update in 2023. 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.

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 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:

- Change Management Governance Committee - Promotes change management best practices and strategies in all active and planned efforts
- EROS - Performs comprehensive process evaluations to ensure efficiency and compliance with policies and regulations, and serve as enterprise control monitors
- Executive Management - Ensures the appropriate levels of approval are exercised and the correct optics are applied to the decision-making process
- Finance Division - Quality Review Unit validates transaction activities
- Information Security Committee - Oversees Information Security Management Systems
- Information Technology Services Division (ITSD) Change Management - Facilitates the coordination, communication, planning and tracking of changes for Information Technology units
- Policy Committee - Facilitates approvals of departmental policies
- Retailer Risk Committee - Addresses issues impacting Lottery retailers
- 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

Third Line of Defense

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

The Lottery's Directorate, Commission, Lottery's 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 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:

- A monthly status report is sent to all Lottery employees 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.
- In response to a confidential employee survey conducted in 2020, the Lottery conducts quarterly staff meetings to address opportunities for improvement within the organization. An employee engagement survey will be conducted in December of 2023 to solicit current feedback on what areas are working well and areas where the work environment can be improved.
- 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 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, Wellness Committee 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 SCO and activities related to business change and educational items.
- In response to the COVID-19 pandemic, a COVID-19 Intake Request Process, a Lottery's Safety Protocol Process, and a Potential COVID-19 Exposure Notification Process were developed and implemented.
- Enterprise control monitoring and change control framework to allow communication and monitoring of process changes and risks are in discussion. This process will support the internal and enterprise monitoring efforts and will include a centralized intake system.
- 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 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) Division serves as the official voice of the Lottery. PAC leads outreach efforts to maximize awareness of the Lottery's mission and operations. The main channels of communication with the public are via media outlets and newsrooms, social and owned media, as well as responding to 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.

PAC crafts messages, talking points and fact sheets on many aspects of Lottery, helping to educate the public about the organization and its beneficiary. The Division also responds to media inquiries, writes press releases, stages press conferences, develops specific content for social media, and produces public service announcements and other Lottery business and corporate video projects, all in the name of serving the Lottery's overall public relations image and brand.

When it comes to PRA requests, PAC leverages an in-house tracking system which provides real-time status of all public inquiries. This tool adds a layer of control to ensure compliance with all PRA related timelines and activities.

In addition to the Lottery's PAC section, the Lottery's Deputy Director of Legislation and External Affairs (LEA) has responsibilities that include communication with Legislators, identification and monitoring of legislation that may impact the Lottery, and when necessary, initiation of bill analyses to demonstrate how specific legislation will impact Lottery operations.

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 ERM 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: Florence Bernal, Special Advisor to the Director.

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 awarded a Certificate of Achievement for Excellence in Financial Reporting to the Lottery for the past 18 consecutive fiscal years.

SCO Audits

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.

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, questionnaires, 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 regular 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 ERM section.

Based on the description of the risk, its likelihood to occur and the impact it would have against the department's mission, the risks of ongoing concern 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 and restrictions for some of the more unique positions.

Control: Workforce and Succession Planning

The Lottery established a designated specialist for workforce and succession planning. The specialist proactively and consistently reviews and addresses workforce needs to ensure a strong bench strength for the organization's key positions.

A Workforce and Succession Plan (WSP) has been developed to address workforce development issues. The primary goals are to attract and hire quality talent to help meet the organization's mission, improve retention, and oversee the Succession Planning Program to ensure a skilled and knowledgeable workforce will be in place to support current and future organizational needs. Activities have been completed or are in progress to strengthen this control, including:

- Implementation of an employment outreach assistance request form for hiring managers.
- Delivery of workforce and succession planning training to 88% of hiring managers on best practices for effective job advertisements to attract quality and diverse talent.
- Published the Lottery Careers public website as an informational resource for job seekers.
- Presented the Succession Planning Process to staff.
- Collection of each division's workforce planning and recruitment challenges has begun via a Workforce Risk Assessment Survey (WRAS).
- Provide quarterly analysis to executive management.

Additional activities have been planned to further support this control, including:

- Provide training on the State Application Process.
- Implement the Leadership Development program to support the leadership skills development and growth on an ongoing basis.
- Implement the employment outreach process for completing the assistance request form.
- Provide training to 80% of supervisors and managers to assist with workforce planning efforts.
- Develop of the Recruitment Plan based on divisional and organizational needs.
- Assist divisions with addressing workforce planning challenges to ensure focused efforts are closing the workforce gaps based on the results of the newly implemented WRAS.

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

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 was decommissioned in 2022, as the Lottery prepared to transition 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 as Operations and Finance currently track assets in different systems.

Human Resources - Various processes which involve sensitive employee data are paper-based. Many of the processes are dependent on or support subsequent processing in external departments which complicates the effort to transition 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. Activities have been completed or are in progress to strengthen this control:

- System requirements for the hardware portion of the Asset/Fleet Management Project are in progress.
- Recruitment for a new asset management analyst is in progress.
- Designated staff will attend training to utilize the existing Advanced Maintenance Management System (AMMS) software platform to track assets.
- Handheld scanning devices have been identified that will be procured to utilize for AMMS asset tracking beta testing and utilized for property inventory activities.

Additional activities have been planned to further support this control:

- Existing AMMS software system will be beta tested to track assets.
- Collaboration will continue with the Enterprise Project Management Office on an enterprise-wide solution to track assets.
- Oversight of asset disposal will be provided, which include revising asset management policies to reflect the additional program oversight.
- A pilot program is planned to establish lessons learned for future physical inventory audits.

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. The Lottery will explore opportunities to automate workflows, wherever it is practical. Activities have been completed or are in progress to strengthen this control, including:

- Participation in the California Employee Connect timesheet pilot by various divisions, both distribution centers and a district office. Expansion of this pilot is planned for additional divisions.
- Introduction to SCO's online process allowing employees to initiate, change or delete their direct deposit, and discontinuing the associated paper process
- Research regarding the ServiceNow Human Resources Service Delivery (HRSD) optimization options and identification of several processes which would benefit automation such as Request for Personnel Services and Performance Evaluation/ Probation Report.

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, Assembly]
    California State Auditor
    California State Library
    California State Controller
    Director of California Department of Finance
    Secretary of California Government Operations Agency