



MEMORANDUM

To: California State Lottery Commission **Date:** March 25, 2009

From: Joan M. Borucki
Director

Prepared By: Roberto Zavala, Chief
Internal Audits Office

Subject: Item 9(f) – Lottery Security Audit Contract

ISSUE

Should the California State Lottery Commission (Commission) approve the expenditure authority to award the Security Evaluation Services Contract to KPMG?

RECOMMENDATION

The California State Lottery (Lottery) staff recommends that the Commission approve and award KPMG the Security Evaluation Services contract for \$336,000 for one year.

BACKGROUND

An independent audit of Lottery security was first required after the first nine months of sales to the public. The Commission engaged an independent firm experienced in security procedures, including but not limited to, computer security and systems security, to conduct a comprehensive study and evaluation of all aspects of security in the operation of the Lottery. This study includes; personnel security, Lottery Game Retailer security, Lottery Contractors security, security of manufacturing operations of Lottery Contractors, security against ticket counterfeiting and alterations and other means of fraudulently winning, security of drawings, computer security, data communications security, data base security, security controls and physical security, security in distribution, security involving validation and payment procedures, security involving unclaimed prizes, security aspects applicable to each particular Lottery Game, security against locating winners in Lottery Games having preprinted winners, and any other aspects of security applicable to the Lottery and its operations. The independent firm then prepares a report containing the overall evaluation of the Lottery in terms of each aspect of security and presents it to the Commission, the Governor, the Controller,

the Treasurer, the Attorney General, and the Legislature. The portion of the report containing specific recommendations is exempt from public disclosure and is presented only to the Commission, the Attorney General, the Controller and the Governor. Similar audits of security are conducted every two years.

The Lottery's Internal Audits Office is the designated contract manager and coordinates with the Security and Law Enforcement Division and the Information Technology Services Division to ensure the Security Audit meets the needs of the Lottery. The Internal Audits Office contracts with an independent audit firm to perform a Security Audit every two years.

Past Security Audits have been routinely performed every two years. The latest audit was completed in December 2006. These audits use a scope of services described in the Lottery Act published years ago. The Act describes 16 key elements that need to be reviewed by the independent audit firm as part of their Security Audit and was included in the Request for Proposal (RFP).

DISCUSSION

The California Lottery Act (Act) Section, 8880.46 requires that a study and evaluation be conducted by an independent firm every two years. The Act does not require that the independent firm follow generally accepted audit standards; therefore, past Security Audits have been limited to studies or evaluations. The past review cost \$139,000. That said, testing conducted on past Security Audits has been limited in nature and only performed on areas specified in the California Lottery Act. While this may have been a satisfactory approach when the Lottery was first established, a comprehensive audit is now needed. A comprehensive audit will ensure that significant high risk activities and supporting areas are examined to determine the adequacy of controls to mitigate risks and reduce exposure to loss. As mandated, part of this examination will incorporate, where applicable, all the functional security requirements, as detailed in the State of California's Government Code section 8880.46. After establishing a baseline of high risk areas, future audits can be scaled back. This audit is expected to cost \$336,000 initially, and less in subsequent years.

A comprehensive statement of work was developed by Internal Audits and was used as the basis for a Request for Information (RFI). The California Lottery submitted the RFI to 11 prospective firms. A team composed of representatives from the California Lottery's Information Technology Services Division, Security and Law Enforcement Division, and Internal Audits was set up to review responses to the RFI. The California Lottery received four responses. After interviewing the four firms, the team requested price and milestone schedules from three of the four firms interviewed. After reviewing these documents, the team believes that KPMG has the resources, expertise, and is best suited to perform the comprehensive audit that the California Lottery seeks.