

CALIFORNIA STATE LOTTERY

Final Review Report

UNITY COURIER SERVICES, INC.

CONTRACT PROCUREMENT

July 1, 2020, through September 30, 2021



MALIA M. COHEN

CALIFORNIA STATE CONTROLLER

March 2026



STATE CONTROLLER'S OFFICE | DIVISION OF AUDITS

Post Office Box 942850 | Sacramento, CA 94250

Sacramento Office: 3301 C Street, Suite 700 | Sacramento, CA 95816 | 916-324-8907

Monterey Park Office: 901 Corporate Center Drive, Suite 200 | Monterey Park, CA 91754 | 323-981-6802

www.sco.ca.gov



MALIA M. COHEN
CALIFORNIA STATE CONTROLLER

March 5, 2026

Ms. Harjinder K. Shergill-Chima, Director
California State Lottery
700 North Tenth Street
Sacramento, CA 95811

Dear Director Shergill-Chima:

The State Controller's Office reviewed the California State Lottery's (Lottery) procurement of the Unity Courier Services, Inc. (Unity) contract for the period of July 1, 2020, through September 30, 2021. Our review objectives were to determine whether the procurement of the Unity contract was performed in accordance with the California State Lottery Act of 1984, the *California Lottery Regulations*, and Lottery policies and procedures; and promoted the best interests of the public and the Lottery in obtaining the lowest price and best value for services.

Based on our review, we noted the following:

- The Lottery did not adequately evaluate the Unity bid;
- The Lottery lacked updated competitive bidding procedures; and
- Unity did not disclose its bankruptcy in its documentation, and the Lottery did not adequately investigate or analyze the impact of the bankruptcy.

Ms. Harjinder K. Shergill-Chima

March 5, 2026

Page 2 of 3

If you have any questions regarding this report, please contact Roochel Espilla, Chief, State Agency Audits Bureau, by telephone at 916-323-5744. Thank you.

Sincerely,

Original signed by

Kimberly A. Tarvin, CPA

Chief, Division of Audits

Copy: Florence Bernal, Chief Deputy Director

California State Lottery

Nicholas Buchen, Deputy Director of Finance

California State Lottery

Sara Sheikholislam, Deputy Director of Internal Audits

California State Lottery

Emily Nguyen, Audit Manager

Internal Audits

California State Lottery

Mimi Alemu, External Audits Liaison

Internal Audits

California State Lottery

Jean Cooper, Deputy Director of Operations

California State Lottery

Sharon Allen, Deputy Director of Sales and Marketing

California State Lottery

Anthony Garrison-Engbrecht, Ph.D., Chair

California State Lottery Commission

Keetha Mills, Vice Chair

California State Lottery Commission

Ms. Harjinder K. Shergill-Chima

March 5, 2026

Page 3 of 3

Tiffani Alvidrez, Commissioner

California State Lottery Commission

Sergeant Ukau Dungca, Commissioner

California State Lottery Commission

Alexandre Rasouli, M.D., Commissioner

California State Lottery Commission

CONTENTS

SUMMARY	1
BACKGROUND	1
REVIEW AUTHORITY	2
OBJECTIVES, SCOPE, AND METHODOLOGY	3
CONCLUSION	4
VIEWS OF RESPONSIBLE OFFICIALS	4
RESTRICTED USE	5
FINDINGS AND RECOMMENDATIONS	6
ATTACHMENT—CALIFORNIA STATE LOTTERY’S RESPONSE TO DRAFT REVIEW REPORT	29

SUMMARY

The State Controller's Office (SCO) reviewed the California State Lottery's (Lottery) procurement of the Unity Courier Services, Inc. (Unity) contract for the period of July 1, 2020, through September 30, 2021.

Based on our review, we noted the following:

- The Lottery did not adequately evaluate the Unity bid;
- The Lottery lacked updated competitive bidding procedures; and
- Unity did not disclose its bankruptcy in its disclosure documentation, and the Lottery did not adequately investigate or analyze the impact of the bankruptcy.

BACKGROUND

On November 6, 1984, California voters passed Proposition 37, the California State Lottery Act of 1984 (Lottery Act), which authorized the creation of a state-operated lottery. The Lottery Act is codified in Government Code (GC) section 8880 et seq. The Lottery Act created the California State Lottery Commission (Commission) and gave it broad powers to oversee the operations of a statewide lottery. The purpose of the Lottery Act is to provide supplemental money to benefit public education without the imposition of additional or increased taxes.

The Lottery's eight divisions support the Lottery's sole mission, to supplement funding for California's public schools and colleges. As of February 1, 2023, the Lottery has 1,079 budgeted positions; staff are located at Lottery Headquarters in Sacramento, two distribution centers, and nine district offices.

Unity Courier Services, Inc. Contract

On December 14, 2020, the Lottery released Invitation for Bid (IFB) Number 50160, “Scratchers Ticket Delivery and Return Services.” On January 11, 2020, Unity submitted a proposal for courier services. The Lottery entered into an agreement with Unity on February 19, 2021, to provide Scratchers ticket-delivery services to Lottery retailer locations statewide. The contract term is from March 1, 2021, through February 28, 2026, and the maximum agreement amount is \$48,000,000.

Unity was contracted to provide all material, vehicles, qualified personnel, fuel, logistics, licenses, insurance, financial security, tools, labor, and equipment necessary to perform Scratchers ticket-delivery services to Lottery retailer locations statewide. Delivery services include, but are not limited to:

- General delivery services of Scratchers tickets to retailer locations;
- Return services from retailer locations to the Lottery’s Northern Distribution Center;
- Delivery services for Point of Sale and other marketing materials to Lottery district offices and distribution centers;
- Collection services for each day’s ticket shipment, excluding weekends and state holidays, from the Lottery’s distribution centers; and
- Account management services to assist the Lottery with customer service, including delivery-issue resolution, technical support, training, and reports, as needed.

REVIEW AUTHORITY

We conducted this review pursuant to GC section 8880.46.6, which authorizes the SCO to conduct special post-payment audits as necessary, and gives access and authority to examine any and all records of the Commission, its distributing agencies, lottery contractors, and lottery

game retailers. In addition, GC section 12410 provides the SCO with general authority to audit the disbursement of state money for correctness, legality, and sufficient provisions of law for payment; and GC section 12411 requires the SCO to suggest plans for the improvement and management of public revenues.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review objectives were to determine whether the procurement of the Unity contract:

- Was performed in accordance with the Lottery Act, the *California Lottery Regulations*, and Lottery policies and procedures; and
- Promoted the best interests of the public and the Lottery in obtaining the lowest price and best value for services.

The review period was July 1, 2020, through September 30, 2021.

To achieve our objectives, we performed the following procedures:

- We reviewed the State Administrative Manual; the *California Lottery Regulations* (approved May 27, 2021); the Lottery's policies and procedures; and applicable laws, rules, and regulations as they relate to the procurement process.
- We reviewed prior review and audit reports issued by the SCO, external agencies, the Lottery's Internal Audits Office, and any other Lottery unit. We also followed up on any prior findings.
- We performed walkthroughs at distribution centers and interviewed individuals involved in the Lottery's procurement and award processes.
- We gained an understanding of and evaluated internal controls over the procurement process as they related to the objectives and scope of our review.

- We tested the procedural compliance of processes related to the procurement and awarding of the Unity contract.

CONCLUSION

Our review found the following:

- The Lottery did not adequately evaluate the Unity bid;
- The Lottery lacked updated competitive bidding procedures; and
- Unity did not disclose its bankruptcy in its disclosure documentation, and the Lottery did not adequately investigate or analyze the impact of the bankruptcy.

VIEWS OF RESPONSIBLE OFFICIALS

We issued a draft report on April 3, 2025. The Lottery's representative responded by letter dated April 11, 2025. The Lottery disagreed with aspects of Finding 1, disagreed with Finding 2, and did not agree or disagree with Finding 3. The Lottery partially agreed with our recommendations, provided additional information and context, and indicated that it has initiated corrective actions. Our comments on the Lottery's response to the findings are included in the Findings and Recommendations section. This final review report includes the Lottery's response as an attachment.

RESTRICTED USE

This report is intended for the information and use of the Lottery, the Commission, and the SCO; it is not intended to be, and should not be, used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

Kimberly A. Tarvin, CPA

Chief, Division of Audits

March 5, 2026

FINDINGS AND RECOMMENDATIONS

Finding 1—The Lottery Did Not Adequately Evaluate the Unity Bid

Several Lottery units and divisions are involved in the procurement process. The Lottery's Sales and Marketing Division was responsible for initiating the solicitation for the Scratchers ticket-delivery and return services contract, and worked with the Procurement Services and Support Unit of the Operations Division to determine the form of solicitation to be used to procure the contract. The Lottery's Security and Law Enforcement Division (SLED) and the Financial Analysis and Risk Management (FARM) Unit of the Finance Division performed disclosure reviews. The evaluation team, comprised of staff and management from the Operations and the Sales and Marketing Divisions, reviewed and scored the bids received. The bid submission deadline was January 12, 2021. The winning bid was selected on January 15, 2021, and presented to the Commission for approval on January 28, 2021.

We reviewed each division's and unit's roles and processes for the procurement of the Scratchers ticket-delivery and return services contract, and determined that deficiencies existed in the solicitation process.

California Lottery Regulations section 8.1.1. requires that bidders be evaluated based on several factors, including "quality, competence, experience, past performance, efficiency, reliability, financial viability, durability, adaptability, timely performance, integrity, security, and price." Based on our review of bid documents, discussions with Lottery staff members, and our understanding of the procurement process for this solicitation, the Lottery did not adequately evaluate the Unity bid before awarding the contract.

The Lottery Should Require Additional Documentation to Support the Bidder's Declarations on the Self-Certification Form

The evaluation team is responsible for ensuring that bidders meet minimum qualifications at the time of the bid submission. These minimum qualifications are necessary to ensure that

contractors are capable of meeting contract obligations related to the delivery of approximately 1.3 million ticket deliveries each year. Interruptions in delivery services rendering tickets unavailable for purchase could result in lost revenue. The evaluation team's assessment of Unity's bid was based primarily on information provided by two professional references and a bidder self-certification. The Lottery should have required additional documentation from Unity so that the evaluation team could make a better, informed decision.

IFB Number 50160 includes a self-certification that bidders for the Scratchers ticket-delivery and return services contract were required to sign. The certification attests to a bidder's ability to meet the minimum qualifications at the time of the bid submission. Minimum bidder qualifications Number 1 and Number 2 explicitly state that the bidder must "have the demonstrated ability." However, our review of Unity's bid documents showed that the evaluation team did not require Unity to explain or demonstrate its ability to meet any of the minimum bidder qualifications. The evaluation team did not require any documentation other than the bidder certification form. The Lottery could have better assessed the bidder's ability to meet the Lottery's delivery requirements if it had verified whether the information that the bidder disclosed was valid and sufficient.

Section B, "Bidder Certification," of IFB Number 50160 states that bidders must:

1. Have the demonstrated ability to perform delivery services utilizing vehicles capable of performing the work to Lottery facilities and all Lottery retailers throughout California within two business days of receiving a shipment, as outlined in the Scope of Work.
2. Have the demonstrated ability to provide Bidder-employed or contracted, readily identifiable personnel.
3. Have a minimum of three years of similar delivery experience performing the services specified as outlined in the Scope of Work. For purposes of this solicitation document, "similar" is defined as picking up items from a customer and delivering

the items to others on a regular basis, within a specified timeframe, and in a secure manner;

4. Have a minimum of six months experience in providing a computerized method for recording and retrieving proof of delivery information;
5. Have processing/distribution centers in both Northern and Southern California with Information Technology and Security personnel;
6. Have a current and valid California Department of Motor Vehicles (DMV) Motor Carrier Operating (MCO) Permit; and
7. Meet the requirements set forth in Section II, Bid Requirements.

Section D.4)d), "Evaluation and Selection," of IFB Number 50160 states, "award if made, will be to the lowest responsive responsible bidder."

References Provided by the Bidder Should Demonstrate That the Bidder Has Past Delivery Experience Comparable to the Lottery's Requirements

The volume of Unity's past deliveries, as shown by the two references provided, was significantly less than the delivery volume required by the Lottery. As a result, the evaluation team should have made further inquiries to determine whether the bidder had other customers with delivery volumes similar to the Lottery's or whether the bidder had the resources to readily meet the Lottery's delivery needs.

One of Unity's references stated that Unity picks up and delivers 10-15 parcels of Scratchers tickets per day, which equates to approximately 2,600-3,900 parcels a year; the other reference stated that Unity picks up and delivers 7,800-8,000 parcels a week, which equates to approximately 405,600-416,000 parcels a year. These amounts are significantly less than the delivery projection of approximately 1.3 million ticket deliveries per year stated in the Lottery's IFB.

The IFB for Scratchers ticket-delivery and return services states that the Lottery processes approximately 113,000 Scratchers ticket deliveries per month, and that tickets should be delivered to Lottery retailers within two business days of receiving a shipment. According to the IFB, the weight of ticket pick-up and delivery from each distribution center might be up to 90,000 pounds. The quantity of tickets delivered, the time constraints for delivery, and the weight of some deliveries add complexity to the necessary services. The delivery of Scratchers tickets is critical to Lottery sales, and in facilitating the launch of new products, restocking retailer inventory, and monitoring sales. To mitigate the risk of entering into a multi-million-dollar contract with a courier unable to meet the demands of the scope of work under contract, the Lottery should have thoroughly assessed and evaluated Unity's experience and capabilities during the bid evaluation process.

In addition, the Lottery used an outdated contract operating manual during this solicitation. The Evaluation Committee Guidelines do not include procedures for the evaluation process, and no other procedures existed to guide the evaluation process for the Unity contract. This issue is further discussed in Finding 2.

Section 8.1.1., "General Rule," of the *California Lottery Regulations*, states:

Except as provided by section 8.1.2., the Lottery will use a formal competitive process to procure goods or services involving an expenditure of more than \$100,000, to ensure that it obtains the best value for the Lottery. Factors to be considered in evaluating bidders may include, but are not limited to, quality, competence, experience, past performance, efficiency, reliability, financial viability, durability, adaptability, timely performance, integrity, security, and price.

SLED Should Have Performed a Physical Inspection of the Unity Facility Before the Contract was Awarded

SLED's procedures for conducting disclosure investigations of potential Lottery contractors and subcontractors are essential to determine bidder qualifications as set forth in GC section 8880.57. The procedures include physically inspecting the bidder's facility, when

applicable. However, SLED did not inspect Unity's facilities until after the contract was awarded.

Per discussions with SLED's Special Investigations and Gaming Security Unit, the disclosure investigation process was expedited in preparation for an upcoming Commission meeting at which the Sales and Marketing Division planned to present the Unity contract for approval. On Friday, January 15, 2021, the Procurement Services and Support Unit requested that SLED complete a General Background Disclosure review of Unity before the January 28, 2021, Commission meeting. The Supervising Lottery Agent responded that the request had been received and would be assigned to an investigator on Tuesday, January 19, 2021. The agent stated in an email to the Procurement Services and Support Unit that it was unlikely that the disclosure investigation would be concluded before the Commission meeting.

However, the disclosure investigation process was completed within seven business days, and the Unity contract was presented to the Commission on January 28, 2021. Per the Special Investigations and Gaming Unit, the expedited process did not allow sufficient time to conduct a facility inspection before the contract was awarded.

Conducting physical inspections of a bidder's facilities during the disclosure investigation process allows the Lottery to assess personnel and facility security, to ensure that Lottery assets would be securely maintained. As large quantities of Scratchers tickets must be stored, processed, and handled at a bidder's distribution centers, it is essential to ensure that the Scratchers tickets will be maintained in an adequately secure manner. Failing to assess bidders' facilities prior to awarding a contract limits SLED's ability to identify potential security risks that could affect the outcome of the investigation process. The disclosure investigation process is further discussed in Finding 3.

The Disclosure Investigations procedure used by SLED states, in part:

The Investigator will prepare an investigative report and submit the report to the Supervising Investigator for the review and approval. The Supervising Investigator, at

the completion of the report review/approval process, will notify the Contract Manager and the Contract Administrator of the results of the investigation.

20. Conduct the following inquiries:

i. Physical inspection of bidder's facility, when applicable

GC section 8880.56(a) states, in part:

. . . In all procurement decisions, the director shall, subject to the approval of the commission, award contracts to the responsible supplier submitting the lowest and best proposal that maximizes the benefits to the state in relation to the areas of security, competence, experience, and timely performance, shall take into account the particularly sensitive nature of the California State Lottery and shall act to promote and ensure integrity, security, honesty, and fairness in the operation and administration of the lottery and the objective of raising net revenues for the benefit of the public purpose described in this chapter.

FARM Unit

During the disclosure investigation process, the FARM Unit reviews and analyzes bidders' financial documents. The FARM Unit performs these Financial Disclosure Reviews (FDR) to evaluate bidders' level of financial risk. The FARM Unit requests from each bidder three years of financial statements, including income statements, balance sheets, and statements of cash flow, so it can gain an adequate understanding of a bidder's financial standing and mitigate risk.

Unity provided only four of the nine financial documents needed to conduct a complete FDR. In addition, the four financial documents were unaudited, and one did not appear to have been generated by an accounting system. The FARM Unit nevertheless performed its analysis with what was provided, and finalized Unity's FDR. The FARM Unit's FDR of Unity was forwarded to SLED on January 27, 2021.

The FARM Unit's FDR did not contain the following necessary components:

- Section 3 – Balance Sheet
 - Cash Ratio (Cash/Current Liabilities) for 2018 and 2019
 - Debt Ratio (Total Liabilities/Total Assets) for 2018 and 2019
 - Current Ratio (Current Assets/Current Liabilities) for 2018 and 2019
- Section 4 – Statement of Cash Flow
 - Operation Cash Flow Ratio (Operating Cash Flow/Current Liabilities) for 2018, 2019, and 2020
- Section 5 – Other Disclosures
 - Litigations associated with the contractor
 - Long term debt obligations
 - Available credit line

The FARM Unit manager informed us that an FDR focuses on a company's short-term solvency; therefore, only one year of solvency is evaluated. The FARM Unit did not take into consideration Unity's ability to meet its long-term debt obligations, although the intended term of the contract was five years with the option to extend. Per the FARM Unit manager, the terms and conditions of the contract were not communicated to the FARM Unit; therefore, staff members were unaware that they were conducting an FDR analysis for a multi-million-dollar contract. The FARM Unit staff members disclosed that Unity provided additional financial documentation; however, those documents were not included in the analysis because the FARM Unit had already finalized and provided the FDR to SLED in order to meet the expedited deadline.

In addition, the FARM Unit did not conduct any analyses to determine the effect of a bankruptcy on Unity's ability to continue as a going concern. Unity filed for Chapter 11 bankruptcy in 2017, due to its inability to reach a settlement with claimants in a class-action suit for unpaid wages, brought by employees of a company that Unity acquired in 2008. Unity filed Chapter 11 bankruptcy in order to reorganize and to satisfy the \$5,128,705 judgement. The FARM Unit's analysis of Unity states that "the bankruptcy does pose some risk"; however, it did not analyze the outcome of the bankruptcy or the potential financial obligation. We spoke with FARM Unit staff members to gain an understanding of the bankruptcy and to determine whether a potential judgement was considered in the analysis. The FARM Unit manager stated that the FARM Unit's role in the FDR was only to document the bankruptcy, not to determine the effects of the bankruptcy.

No Lottery procedures identify the specific criteria the FARM Unit should use to determine whether risk levels are acceptable or unacceptable during the FDR process. Without such criteria, there are no benchmarks with which to distinguish between low-, medium-, and high-risk levels; and no way to determine what risk levels the Lottery considers acceptable or unacceptable. Although FDRs are reviewed and approved by management, we found no evidence that the FARM Unit's FDR of Unity was based on established criteria. Therefore, we were unable to determine whether the FARM Unit thoroughly evaluated the risk level when performing its FDR of Unity.

To adequately mitigate risk, the FARM Unit should obtain, analyze, and thoroughly describe all required information in every FDR. If the disclosure process reveals risk, further analysis should be conducted to determine the magnitude and the potential effects of the risk on the contractual agreement with the Lottery. All potential risks should be communicated in detail to SLED and the evaluation team.

GC section 13402 states:

Agency heads are responsible for the establishment and maintenance of a system or systems of internal control, and effective and objective ongoing monitoring of the internal controls within their state agencies. This responsibility includes documenting the

system, communicating system requirements to employees, and ensuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

GC section 13403(a) states, in part:

As used in this chapter, “internal control” means a process, including a continuous built-in component of operations, effected by a state agency’s oversight body, management, and other personnel that provide reasonable assurance that the state agency’s objectives will be achieved. . . .

According to PR-FM-0007 FDR, the purpose of the FDR process is “To mitigate risk from potential contracted vendors by reviewing financial documents and providing analysis for SLED’s disclosure investigations process.”

Recommendation

We recommend that the Lottery strengthen its bid evaluation process by:

- Establishing evaluation procedures to guide Lottery staff members in thoroughly assessing all best-value factors for potential contractors including requiring additional documentation to ensure that the contract can meet the service levels required by the contract;
- Conduct physical inspections of potential contractors’ facilities before awarding contracts that involve the storage of Lottery assets;
- Revise the FDR to include management review and approval of the contractors’ financial standing, criteria for unacceptable levels of risk, and an evaluation of long-term solvency for large, long-term contracts; and
- Documenting the communication of analyses and results from the FARM Unit’s FDRs to SLED and the evaluation team.

Lottery's Response

The Lottery does not fully agree with the finding; however, the Lottery does agree with SCO's recommendation to establish evaluation procedures to support the evaluation team to assess all best value factors for potential contractors to ensure they are able to perform the scope of work under contract. The Lottery evaluated all responses in accordance with the criteria identified in the solicitation. The evaluation team contacted references and were satisfied with the information that was received. The evaluation team is comprised of subject matter experts who understand the services that are being solicited and therefore have the knowledge and experience required to assess whether the references provided are comparable to the services required by the Lottery. The Lottery has taken this recommendation as an opportunity to develop an Evaluation Team Guideline completed and released in February 2023 that further defines the process for evaluating formal competitive solicitations to ensure the best value factors identified in the corresponding solicitation document (IFB or RFP) are met.

The Lottery does not agree with SCO's recommendation that it is a requirement to conduct physical inspections of potential contractors' facilities prior to contract award for contracts that involve the storage of Lottery assets. According to the Lottery Act, a disclosure investigation was not required for the type of service that Unity was providing to the Lottery because courier service is "services which are common to the ordinary operations of state agencies" per GC [section] 8880.57. Additionally, SLED has discretion to conduct physical inspections, as there is no statutory or policy requirement. However, SLED was not advised to conduct physical inspections of the facilities until after [Unity] had been announced as the apparent successful bidder and the contract was awarded and presented to the Commissioners for approval. SLED subsequently completed the inspections and sent its findings to the designated contract manager.

The Lottery agrees with SCO's recommendation to revise the FDR to include management approval of the contractor's financial standing, criteria for unacceptable risk, an evaluation of long-term solvency for long term, large contracts, and a

requirement to formally communicate FDR analysis to SLED and the evaluation team. Finance has completed the following relative to this recommendation: (1) updated the FDR process to include a management review and approval of all FDRs before they proceed to SLED; (2) developed a rating system and criteria for unacceptable risk as well as a rating system and criteria for long-term solvency; and (3) has included formal communication of the FDR analysis to SLED in the FDR procedure.

It is important to note that defining absolute criteria for risk may prove difficult, as the degree and quality of documentation received may vary. Further, potential contractors come from varied industries, where the risk degree of certain metrics may change. The Lottery agrees that criteria can be established to give overall risk parameters; however, having strict parameters may prevent the Lottery from doing business with otherwise viable contractors. Further, the FARM Unit analyzes short-term insolvency as a more accurate assessment period. Metrics like cash flow, short-term debt, and revenues may indicate a firm's potential to go out of business in the short term. The FARM Unit is not the arbiter of good business practices for all industries, nor is it possible to predict with precision long-term outcomes. Long-term forecasts can be provided but should not be significant in decision-making due to the lack of clarity for this kind of analysis.

The FARM Unit's role in the procurement process is to conduct an impartial FDR to assess bidding vendors' short-term financial condition and identify notable financial risks. The FARM Unit is neither a decision-making entity in vendor selection nor an evaluation team member. Instead, the FARM Unit provides analysis to inform the broader evaluation process and enable the evaluation team to make informed decisions. In the case of Unity, FARM completed its financial analysis based on the documentation available at the time and under the time constraints present during the disclosure investigation process. While the FARM Unit does not issue judgments regarding a vendor's suitability, the Lottery recognizes that its analysis plays a critical role in risk awareness and procurement due diligence.

As part of the FARM Unit's commitment to continuous improvement, procedural enhancements have been implemented since the procurement of the Unity contract. These include refined documentation standards, strengthened internal protocols for incomplete submissions, and efforts to improve the clarity and consistency of financial risk summaries. These updates are intended to better support the evaluation process in future procurements.

SCO Comment

Our finding and recommendation remain unchanged. The Lottery partially agreed with the finding and recommendation. We acknowledge and appreciate the Lottery's decision to take corrective actions to improve its bid evaluation process.

The Lottery also asserted that it evaluated all responses from the bidders in accordance with the criteria. However, as discussed in the report, our review found that the documentation required from Unity was not sufficient to demonstrate compliance with the evaluation criteria. In the absence of adequate supporting documentation, the Lottery could not reasonably ensure that the evaluations were informed and objective. Therefore, while the corrective measures are a positive step, the assertion that the evaluation process fully adhered to the established criteria is not fully supported by available evidence.

Furthermore, the Lottery disagreed with our recommendation to strengthen its bid evaluation process by conducting physical inspections of potential contractors' facilities before awarding contracts that involve the storage of Lottery assets. The Lottery asserted that a disclosure investigation of Unity was not required because the services covered by the contract are considered "common to the ordinary operations of state agencies" per GC section 8880.57. This assertion is inconsistent with the Lottery's own actions during the procurement process. As discussed in the report, the Lottery did, in fact, initiate and conduct a disclosure investigation of Unity. However, the investigation was expedited, which did not allow sufficient time to conduct a facility inspection before the contract was awarded.

Although we acknowledge the Lottery's position that applying criteria for assessing risks related to a potential contractor's financial standing may be challenging due to differences between various industries, the absence of defined risk parameters weakens the disclosure investigation process. Establishing minimum standards or thresholds for acceptable financial risks is a key component of due diligence and supports transparency and accountability of the Lottery's evaluation of potential vendors. Such criteria can be designed to allow flexibility while still providing a clear framework for identifying vendors that pose potential risks to the Lottery.

We also note the Lottery's statement that short-term solvency analysis provides a more accurate assessment than long-term solvency analysis, given the uncertainty of long-term contracts. Although short-term measures offer useful insights into a vendor's immediate financial health, they do not fully capture the vendor's long-term financial stability and capacity to sustain performance throughout a contract period. Considering both short- and long-term solvency provides a more balanced assessment, particularly for multi-year contracts where vendor stability is critical to contract success, or when a vendor has a history of financial distress or bankruptcy.

Finding 2—Lack of Updated Competitive Bidding Procedures

The Lottery has not updated its procurement procedures manual since 2007. The Lottery Act requires the Commission to adopt and publish competitive bidding procedures for the award of any procurement or contract involving an expenditure of more than \$100,000.

Having and using up-to-date, sufficiently detailed procedure manuals is essential in maintaining effective internal controls over any complex process. Procedure manuals provide readily available guidance for performing duties and carrying out organizational policies. Furthermore, they mitigate the risk of noncompliance with laws, rules, and regulations; reduce the risk of omitting important steps in processes; ensure consistency and uniformity of processes; provide clarity on how to perform tasks; and describe duties and responsibilities of the various staff members and units involved.

The Lottery's Acquisition Administration Section Chief stated in an email dated May 4, 2022, "The Lottery did not have well documented or updated policies and procedures at the time of this solicitation." It appears that some procedures from the Lottery's *Interim Contract Operating Manual*, dated August 1, 2007, were performed. However, the Lottery informed us that, in general, it does not use the *Interim Contract Operating Manual* precisely because it is outdated. Instead, the Lottery used State of California government best practices, the *California Lottery Regulations*, and the Lottery Act as guidelines to carry out this procurement solicitation. However, the Lottery Act and the *California Lottery Regulations* provide only general guidelines and policies for the competitive bidding process; neither of these documents provides sufficient detail for staff to carry out all the steps required in the procurement process.

In recent audit reports, both the California State Auditor and the Lottery's Internal Audits Office have identified the same issue.

The lack of an updated procurement procedure manual contributed to the issues discussed in Finding 1. The Lottery stated that it is in the process of finalizing a new *Procurement and Contract Procedure Manual* to guide the solicitation process from the procurement planning phase to contract award.

Page 22 of the California State Auditor's Report Number 2019-112, dated February 2020, states:

. . . The Lottery lacks sufficient formalized guidance for its procurement staff. Although the contracts unit manager and the Lottery's former chief counsel provided us with the Lottery's policies and procedures for procurements, the contracts unit manager informed us that these documents were outdated. . . . Because obtaining the best possible rates on its procured goods and services will help the Lottery ensure that it is funding education at the maximum possible level, it is critical that it create and implement updated policies and procedures.

The recommendation for Audit Finding Number 3 in the October 15, 2019 Contract Development Services (CDS) internal audit report states:

CDS should continue working on updating the Contract Operating Manual. CDS should ensure that an updated Manual contains current information on contracting policies and regulations. If necessary, CDS should seek assistance from other Lottery units to facilitate the updating of the Manual.

GC section 8880.56(b)(1) states, in part:

To ensure the fullest competition, the commission shall adopt and publish competitive bidding procedures for the award of any procurement or contract involving an expenditure of more than one hundred thousand dollars (\$100,000). The competitive bidding procedures shall include, but not be limited to, requirements for submission of bids and accompanying documentation, guidelines for the use of requests for proposals, invitations to bid, or other methods of bidding, and a bid protest procedure. . . .

GC section 13402 states:

Agency heads are responsible for the establishment and maintenance of a system or systems of internal control, and effective and objective ongoing monitoring of the internal controls within their state agencies. This responsibility includes documenting the system, communicating system requirements to employees, and ensuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions.

GC section 13403(a) states, in part:

As used in this chapter, “internal control” means a process, including a continuous built-in component of operations, effected by a state agency’s oversight body, management, and other personnel that provide reasonable assurance that the state agency’s objectives will be achieved. The following five components of internal control, if

effectively designed, implemented, and operated in an integrated manner, constitute an effective internal control system:

(1) “Control environment” means the foundation for an internal control system that provides the discipline and structure to help a state agency achieve its objectives. . .

Recommendation

We recommend that the Lottery:

- Update its *Interim Contract Operating Manual* to guide the procurement process from pre-solicitation to contract award; and
- Establish formal competitive bidding procedures for the award of any procurement or contract involving an expenditure of more than \$100,000; the procedures should include requirements for submission of bids and accompanying documentation; guidelines for the use of requests for proposals, invitations to bid, or other methods of bidding; and a bid protest procedure as required by the Lottery Act.

Lottery’s Response

The Lottery does not agree with the finding; however, the Lottery partially agrees with the recommendations. The Lottery did follow the formal solicitation process outlined in [California] *Lottery Regulations*. The detailed step-by-step process for solicitations, while not specifically documented, was based on the standard process utilized by other State agencies.

The Lottery notes that the *California Lottery Regulations* include procedures for formal solicitations. However, the Lottery understands the benefit of more detailed internal procedures for application of the rules detailed in both the California Lottery Act and *California Lottery Regulations*. The Lottery’s Procurement Program administers activities consistent with the California Lottery Act, *California Lottery Regulations*, Lottery Procurement Program Policy, Non-Competitive bid process, and resources

specific for solicitation of goods and/or services. As the Lottery's Procurement Services and Support Unit has worked to put these resources and tools in place, the finalization of its internal procedure manual took time to finalize. The internal manual was completed in January 2023. The manual provides guidance on the procurement processes from the pre-solicitation phase of conducting market research to contract award which is more detailed guidance on processes already in place, including:

- *[California] Lottery Regulations*
- Solicitation process (effective 2020), and
- Changes that resulted with the implementation of the Lottery's Epicor Procurement System upgrade in April 2022.

In addition, the Lottery has also taken this recommendation as an opportunity to develop an Evaluation Team Guideline, completed in February 2023, that further defines the process for evaluating formal competitive solicitations to ensure the best value factors identified in the corresponding solicitation document (IFB or RFP) are met.

SCO Comment

Our finding and recommendation remain unchanged. The Lottery partially agreed with the recommendation. We acknowledge and appreciate the Lottery's decision to take corrective actions to improve its procurement process.

We also acknowledge the Lottery's position that the detailed, step-by-step process is based on practices by other state agencies. However, the Lottery also stated that this process was not formally documented. The absence of written descriptions of the process, regardless of its alignment with best practices, do not provide assurance that the process is consistently applied, communicated to staff, and monitored by management.

Finding 3—Impact of the Bidder’s Bankruptcy not Adequately Investigated or Analyzed

The Lottery’s disclosure investigation process requires bidders to complete disclosure documentation in accordance with GC section 8880.57. On the general background disclosure documentation submitted with its bid documents, Unity answered “no” to the question, “Has the business ever been the subject of a bankruptcy, insolvency or reorganization of any judgment or pending litigation involving fraud or deceit?” However, during the disclosure investigation process, the SLED Supervising Lottery Agent discovered that Unity had filed for bankruptcy in 2017. The bankruptcy was later confirmed by Unity’s former owner and was communicated to SLED’s management. However, SLED did not question Unity as to why it submitted false documentation or why Unity did not disclose the bankruptcy in its disclosure documentation. In addition, the evaluation team was never informed by SLED or the FARM Unit of the bankruptcy or the discrepancy in the disclosure documentation.

The Supervising Lottery Agent stated that SLED would take exception to the contractor moving forward in the disclosure investigation process only if the background investigation revealed that the contractor had committed felonies or certain types of misdemeanors. SLED’s case management report stated that during the investigation of Unity, no significant adverse or disqualifying information was discovered concerning Unity’s ability to contract with the Lottery.

According to the disclosure investigation case management report, the purpose of the disclosure investigation process is to allow for an evaluation of the competence, integrity, and character of potential Lottery vendors. Providing false or conflicting information to the Lottery reflects badly on Unity’s integrity. Furthermore, according to the Lottery Act, false statements in the disclosure investigation process may cause the Commission to deny or cancel a contract with the Lottery. In addition, section D.4)c), “Evaluation and Selection,” of IFB Number 50160 states that bids that contain false or misleading statements may be rejected. The Lottery did not provide us with a justification or other supporting documentation to explain why Unity’s false statement did not disqualify it from winning the bid.

SLED's Disclosure Investigations procedures state that the Supervising Investigator and the Contract Manager should be advised about information that could adversely affect the bidder's performance or negatively impact the Lottery. We were not able to inquire with the Supervising Investigator or his direct manager because he no longer works for the Lottery. However, the Chairperson of the evaluation team stated that he had not been informed of the bankruptcy. SLED's email to the evaluation team simply stated that the disclosure investigation had been completed for Unity, and that it "did not identify any disqualifying information."

Unity's bankruptcy, as well as the false statement in the disclosure documents found during the disclosure investigation, should have been disclosed to the evaluation team. Furthermore, SLED, the FARM Unit, and/or the Lottery's Legal Services Unit should have thoroughly analyzed and documented the bankruptcy's effects, as the bankruptcy could have adversely affected Unity's performance and potentially harmed the Lottery.

GC section 8880.57 states, in part:

In order to allow an evaluation of the competence, integrity, and character of potential Lottery Contractors for the California State Lottery, any person, corporation, trust, association, partnership, or joint venture that submits a bid, proposal, or offer as part of procurement for a contract for any goods or services for the California State Lottery, other than materials, supplies, services, and equipment which are common to the ordinary operations of state agencies, shall comply with each of the following . . .

(b) After receipt of a bid, proposal, or offer, but prior to the award of a contract, the Commission may require a potential Lottery Contractor to provide any or all of the following information . . .

(5) A disclosure of the details of any bankruptcy, insolvency, or reorganization, or any judgment or pending litigation involving fraud or deceit against the bidder. . . .

(d) No contract with any bidder who has not complied with the disclosure requirements described in this section shall be entered into or be enforceable. Any contract with

any lottery contractor who does not comply with these requirements for maintaining the currency of the disclosures during the term of the contract as may be specified in the contract may be terminated by the Commission. In addition, the Commission may deny or cancel a contract with a lottery contractor or any of the persons or entities included in paragraphs (1) to (7), inclusive, of subdivision (a) if any of the following apply:

(1) False statements have been made in any information which is required under this section. . . .

(e) This section shall be construed broadly and liberally to achieve the end of full disclosure of all information necessary to allow for a full and complete evaluation of the competence, integrity, and character of potential suppliers of the California State Lottery Commission.

Section D.4)c), "Evaluation and Selection," of IFB Number 50160 states, "Bids that contain false or misleading statements, or which provide references, which do not support an attribute or condition claimed by the bidder may be rejected."

Item C.22 of SLED's Disclosure Investigations procedure states, "As appropriate during the investigation, advises Supervising Investigator and Contract Manager of information developed, which could adversely affect the bidder's performance or negatively impact the Lottery."

Recommendation

We recommend that the Lottery:

- Investigate all potential false statements made by potential Lottery contractors, document the outcome of investigations, and inform the Commission when appropriate;
- Establish guidelines for the disclosure investigation process that define what constitutes a disqualifying factor for potential contractors; and

- Formally document and inform the evaluation team of the details of the investigation before awarding contracts.

Lottery's Response

The Lottery agrees with SCO's recommendation to investigate all conflicting or potential false documents provided by potential Lottery contractors, document the outcome of the investigation, and inform the Commission when applicable. An analysis will be performed on any public filing in the future as it pertains to short-term risks.

The FARM Unit's responsibility during the disclosure investigation process includes reviewing and documenting available financial data, including any known bankruptcies. In the case of Unity, the FARM Unit documented the existence of a 2017 Chapter 11 bankruptcy based on the materials available at the time. However, the FARM Unit also acknowledges the inherent subjectivity in evaluating the future impact of a bankruptcy on a vendor's long-term solvency. Chapter 11 bankruptcy is a legal mechanism for corporate restructuring, and its outcomes can vary widely. Assessing whether such an event will ultimately strengthen or weaken a company's viability often requires access to legal, operational, and market information beyond the FARM Unit's purview. Accordingly, the FARM Unit's role remains to document relevant financial information factually and to communicate any identified risks to support broader decision-making. This approach aligns with the Lottery's statutory objective through sound and logical financial practices.

The Lottery agrees with timely and transparent communication between functional units during procurement. To that end, the FARM Unit has committed to enhancing its communication protocols with internal partners such as SLED and evaluation teams, particularly in time-sensitive solicitations. These efforts are intended to ensure that all relevant information is made available early in the review process, allowing adequate time for those charged with vendor evaluation and contract award to consider it.

It is important to note that the FARM Unit's scope does not include interpreting bidder disclosure responses, such as omissions or potential false statements. While the FARM Unit may document such items when identified, determining materiality and any necessary follow-up actions fall outside the FARM Unit's responsibility and reside with other entities involved in the procurement and legal review process.

The Lottery disagrees with SCO's recommendation to establish guidelines that define what constitutes as a disqualifying factor for potential contractors in the disclosure investigation process since [GC section] 8880.57(d) of the [California] Lottery Act serves as the requirement:

8880.57(d) – No contract with any bidder who has not complied with the disclosure requirements described in this section shall be entered into or be enforceable. Any contract with any lottery contractor who does not comply with these requirements for maintaining the currency of the disclosures during the term of the contract as may be specified in the contract may be terminated by the Commission. In addition, the Commission may deny or cancel a contract with a lottery contractor or any of the persons or entities included in paragraphs (1) to (7), inclusive, of subdivision (a) if any of the following apply:

- (1) False statements have been made in any information which is required under this section.
- (2) Any of the persons or entities have been convicted of a crime punishable as a felony.
- (3) Any of the persons or entities have been convicted of an offense involving dishonesty or any gambling-related offense.

The Lottery will continue to use GC [section] 8880.57(d) for potential contractors. GC [section] 8880.57(d) is added to the procedures.

The Lottery agrees with SCO's recommendation that the evaluation team should be formally informed of the details of the disclosure investigation before contract award. Moving forward, the disclosure findings will be formally communicated with the evaluation team. This has been added to the Disclosure Investigation Policy.

SCO Comment

Our finding and recommendation remain unchanged. The Lottery partially agreed with the recommendation. We acknowledge and appreciate the Lottery's decision to take corrective actions to improve its disclosure evaluation process.

We also acknowledge the Lottery's position that assessing the long-term impact of bankruptcy involves some degree of professional judgment; however, the existence of subjectivity does not eliminate the need for documented and risk-based evaluation processes. Best practices recognize that a past bankruptcy filing is a significant indicator of financial instability and should be considered as part of any solvency assessment, even when full legal, operational, or market details are unavailable.

In addition, we acknowledge the Lottery's position that the follow-up on Unity's initial non-disclosure of its bankruptcy and on its effects on the contract success was outside the purview of the FARM Unit and is a shared responsibility among all teams involved in the procurement process. As stated in the finding, SLED, the FARM Unit, and/or the Lottery's Legal Services Unit should have thoroughly analyzed and documented the effect of the bankruptcy on contract success.

Furthermore, although the Lottery disagreed with our recommendation to establish guidelines that define disqualifying factors for potential contractors because GC section 8880.57(d) already defines disqualifying factors, the Lottery also stated that GC section 8880.57(d) has been added to its procedures.

ATTACHMENT—CALIFORNIA STATE LOTTERY’S RESPONSE TO DRAFT AUDIT REPORT

Docusign Envelope ID: 2867314B-00AC-4795-A566-CC2E221595E3



April 11, 2025

Roochel Espilla, Chief
State Agency Audits Bureau
State Controller’s Office
Division of Audits
Post Office Box 942850
Sacramento, California 94250

Subject: California Lottery’s Response to the Unity Contract Review

Dear Mr. Espilla:

The California State Lottery (Lottery) appreciates the State Controller’s Office’s (SCO) effort and time in fulfilling our request to complete a review of the Unity Courier Services Inc. (Unity) contract process. Thank you for the opportunity to review and respond to the draft report. We find the report findings and recommendations helpful and constructive.

Below is the Lottery’s response to the findings and recommendations provided in the draft audit report:

FINDING 1 – The Lottery did not adequately evaluate the Unity bid

SCO RECOMMENDATION:

We recommend that the Lottery strengthen its bid evaluation process by:

- Establish evaluation procedures to guide Lottery staff members in thoroughly assessing all best-value factors for potential contractors including requiring additional documentation to ensure that the contract can meet the service levels required by the contract;
- Conduct physical inspections of potential contractors’ facilities before awarding contracts that involve the storage of Lottery assets;
- Revise the FDR to include management review and approval of the contractors’ financial standing, criteria for unacceptable levels of risk, and an evaluation of long-term solvency for large, long-term contracts; and
- Documenting the communication of analyses and results from the FARM Unit’s FDRs to SLED and the evaluation team.

DocuSign Envelope ID: 2867314B-00AC-4795-A566-CC2E221595E3

Mr. Espilla
April 11, 2025
Page 2

LOTTERY RESPONSE:

The Lottery does not fully agree with the finding; however, the Lottery does agree with SCO's recommendation to establish evaluation procedures to support the evaluation team to assess all best value factors for potential contractors to ensure they are able to perform the scope of work under contract. The Lottery evaluated all responses in accordance with the criteria identified in the solicitation. The evaluation team contacted references and were satisfied with the information that was received. The evaluation team is comprised of subject matter experts who understand the services that are being solicited and therefore have the knowledge and experience required to assess whether the references provided are comparable to the services required by the Lottery. The Lottery has taken this recommendation as an opportunity to develop an Evaluation Team Guideline completed and released in February 2023 that further defines the process for evaluating formal competitive solicitations to ensure the best value factors identified in the corresponding solicitation document (IFB or RFP) are met.

The Lottery does not agree with SCO's recommendation that it is a requirement to conduct physical inspections of potential contractors' facilities prior to contract award for contracts that involve the storage of Lottery assets. According to the Lottery Act, a disclosure investigation was not required for the type of service that Unity was providing to the Lottery because courier service is "services which are common to the ordinary operations of state agencies" per GC 8880.57. Additionally, SLED has discretion to conduct physical inspections, as there is no statutory or policy requirement. However, SLED was not advised to conduct physical inspections of the facilities until after the Unity had been announced as the apparent successful bidder and the contract was awarded and presented to the Commissioners for approval. SLED subsequently completed the inspections and sent its findings to the designated contract manager.

The Lottery agrees with SCO's recommendation to revise the FDR to include management approval of the contractor's financial standing, criteria for unacceptable risk, an evaluation of long-term solvency for long term, large contracts, and a requirement to formally communicate FDR analysis to SLED and the evaluation team. Finance has completed the following relative to this recommendation: (1) updated the FDR process to include a management review and approval of all FDRs before they proceed to SLED; (2) developed a rating system and criteria for unacceptable risk as well as a rating system and criteria for long-term solvency; and (3) has included formal communication of the FDR analysis to SLED in the FDR procedure.

It is important to note that defining absolute criteria for risk may prove difficult, as the degree and quality of documentation received may vary. Further, potential contractors come from varied industries, where the risk degree of certain metrics may change. The Lottery agrees that criteria can be established to give overall risk parameters; however, having strict parameters may prevent the Lottery from doing business with otherwise viable contractors. Further, the FARM Unit analyzes short-term insolvency as a more accurate assessment period. Metrics like cash flow, short-term debt, and revenues may indicate a firm's potential to go out of business in the short term. The FARM Unit is not the arbiter of good business practices for all industries, nor is it possible to predict with precision long-term outcomes. Long-term forecasts can be provided but should not be significant in decision-making due to the lack of clarity for this kind of analysis.

DocuSign Envelope ID: 2867314B-00AC-4795-A566-CC2E221595E3

Mr. Espilla
April 11, 2025
Page 3

The FARM's Unit's role in the procurement process is to conduct an impartial FDR to assess bidding vendors' short-term financial condition and identify notable financial risks. The FARM Unit is neither a decision-making entity in vendor selection nor an evaluation team member. Instead, the FARM Unit provides analysis to inform the broader evaluation process and enable the evaluation team to make informed decisions. In the case of Unity, FARM completed its financial analysis based on the documentation available at the time and under the time constraints present during the disclosure investigation process. While the FARM Unit does not issue judgments regarding a vendor's suitability, the Lottery recognizes that its analysis plays a critical role in risk awareness and procurement due diligence.

As part of the FARM Unit's commitment to continuous improvement, procedural enhancements have been implemented since the procurement of the Unity contract. These include refined documentation standards, strengthened internal protocols for incomplete submissions, and efforts to improve the clarity and consistency of financial risk summaries. These updates are intended to better support the evaluation process in future procurements.

FINDING 2 – Lack of updated competitive bidding procedures

SCO RECOMMENDATION:

We recommend that the Lottery:

- Update its Interim Contract Operating Manual to guide the procurement process from pre-solicitation to contract award; and
- Establish formal competitive bidding procedures, for the award of any procurement or contract involving an expenditure of more than \$100,000; the procedures should include requirements for submission of bids and accompanying documentation; guidelines for the use of requests for proposals, invitations to bid, or other methods of bidding, and a bid protest procedure as required by Lottery Act.

LOTTERY RESPONSE:

The Lottery does not agree with the finding; however, the Lottery partially agrees with the recommendations. The Lottery did follow the formal solicitation process outlined in Lottery Regulations. The detailed step-by-step process for solicitations, while not specifically documented, was based on the standard process utilized by other State agencies.

The Lottery notes that the California Lottery Regulations include procedures for formal solicitations. However, the Lottery understands the benefit of more detailed internal procedures for application of the rules detailed in both the California Lottery Act and California Lottery Regulations. The Lottery's Procurement Program administers activities consistent with the California Lottery Act, California Lottery Regulations, Lottery Procurement Program Policy, Non-Competitive bid process, and resources specific for solicitation of goods and/or services. As the Lottery's Procurement Services and Support Unit has

DocuSign Envelope ID: 2867314B-00AC-4795-A566-CC2E221595E3

Mr. Espilla
April 11, 2025
Page 4

worked to put these resources and tools in place, the finalization of its internal procedure manual took time to finalize. The internal manual was completed in January 2023. The manual provides guidance on the procurement processes from the pre-solicitation phase of conducting market research to contract award which is more detailed guidance on processes already in place, including:

- Lottery Regulations
- Solicitation process (effective 2020), and
- Changes that resulted with the implementation of the Lottery's Epicor Procurement System upgrade in April 2022.

In addition, the Lottery has also taken this recommendation as an opportunity to develop an Evaluation Team Guideline, completed in February 2023, that further defines the process for evaluating formal competitive solicitations to ensure the best value factors identified in the corresponding solicitation document (IFB or RFP) are met.

FINDING 3 – Impact of the bidder's bankruptcy not adequately investigated or analyzed

SCO RECOMMENDATION:

We recommend that the Lottery:

- Investigate all potential false statements made by potential Lottery contractors, document the outcome of investigations, and inform the Commission when appropriate;
- Establish guidelines for the disclosure investigation process that define what constitutes a disqualifying factor for potential contractors; and
- Formally document and inform the evaluation team of the details of the investigation before awarding contracts.

LOTTERY RESPONSE:

The Lottery agrees with SCO's recommendation to investigate all conflicting or potential false documents provided by potential Lottery contractors, document the outcome of the investigation, and inform the Commission when applicable. An analysis will be performed on any public filing in the future as it pertains to short-term risks.

The FARM Unit's responsibility during the disclosure investigation process includes reviewing and documenting available financial data, including any known bankruptcies. In the case of Unity, the FARM Unit documented the existence of a 2017 Chapter 11 bankruptcy based on the materials available at the time. However, the FARM Unit also acknowledges the inherent subjectivity in evaluating the future impact of a bankruptcy on a vendor's long-term solvency. Chapter 11 bankruptcy is a legal mechanism for corporate restructuring, and its outcomes can vary widely. Assessing whether such an event will ultimately strengthen or weaken a company's viability often requires access to legal, operational, and market information beyond the FARM Unit's purview. Accordingly, the FARM Unit's role remains to document relevant financial information factually and to communicate any identified risks to support broader

DocuSign Envelope ID: 2867314B-00AC-4795-A566-CC2E221595E3

Mr. Espilla
April 11, 2025
Page 5

decision-making. This approach aligns with the Lottery's statutory objective through sound and logical financial practices.

The Lottery agrees with timely and transparent communication between functional units during procurement. To that end, the FARM Unit has committed to enhancing its communication protocols with internal partners such as SLED and evaluation teams, particularly in time-sensitive solicitations. These efforts are intended to ensure that all relevant information is made available early in the review process, allowing adequate time for those charged with vendor evaluation and contract award to consider it.

It is important to note that the FARM Unit's scope does not include interpreting bidder disclosure responses, such as omissions or potential false statements. While the FARM Unit may document such items when identified, determining materiality and any necessary follow-up actions fall outside the FARM Unit's responsibility and reside with other entities involved in the procurement and legal review process.

The Lottery disagrees with SCO's recommendation to establish guidelines that define what constitutes as a disqualifying factor for potential contractors in the disclosure investigation process since Government Code 8880.57(d) of the CA Lottery Act serves as the requirement:

8880.57(d) - No contract with any bidder who has not complied with the disclosure requirements described in this section shall be entered into or be enforceable. Any contract with any lottery contractor who does not comply with these requirements for maintaining the currency of the disclosures during the term of the contract as may be specified in the contract may be terminated by the Commission. In addition, the Commission may deny or cancel a contract with a lottery contractor or any of the persons or entities included in paragraphs (1) to (7), inclusive, of subdivision (a) if any of the following apply:

- (1) False statements have been made in any information which is required under this section.
- (2) Any of the persons or entities have been convicted of a crime punishable as a felony.
- (3) Any of the persons or entities have been convicted of an offense involving dishonesty or any gambling-related offense.

The Lottery will continue to use GC 8880.57(d) for potential contractors. GC 8880.57(d) is added to the procedures.

The Lottery agrees with SCO's recommendation that the evaluation team should be formally informed of the details of the disclosure investigation before contract award. Moving forward, the disclosure findings will be formally communicated with the evaluation team. This has been added to the Disclosure Investigation Policy.

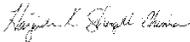
The Lottery appreciates SCO's time and assessment of the Unity Contract Review. The Lottery takes its mission seriously and understands the importance of performing duties in a cost-effective and transparent manner to ensure public resources are safeguarded.

DocuSign Envelope ID: 2867314B-00AC-4795-A566-CC2E221595E3

Mr. Espilla
April 11, 2025
Page 6

Thank you again for the opportunity to review and respond to the report. If you have any additional questions, please contact Deputy Director of Internal Audits, Sara Sheikholislam at (916) 639-2877.

Sincerely,

DocuSigned by:

F6354300A259415...

Harjinder K. Shergill-Chima, Director