

**Finance Audit Committee Meeting
New Mexico Lottery Authority
June 07, 2017
MINUTES**

Call to Order: M. Koson called the meeting to order at 10:30 a.m., and asked for a roll call. Present and constituting a quorum were; Mark Koson and Dan Salzwedel. Mr. John Kubiak absent.

Present from NMLA were; David Barden, Sylvia Jaramillo, Wendy Ahlm, Michael Boland and Wilma Atencio. Also present were; John Zajdel with Intralot and Travis Dulany, Analyst with the Legislative Finance Committee.

Approve Proposed Agenda: M. Koson called for a motion to approve the proposed agenda. D. Salzwedel made a motion to amend the agenda by renumbering the second "III" to "IV" and renumber accordingly; second by M. Koson. Carried; 2-0.

Public Comment: None.

FINANCE AUDIT Committee Report – M, Koson, Committee Chair:

Advertising RFP: W. Ahlm provided an overview of the Advertising RFP. W. Ahlm reported that the current advertising contract expires June 30, 2017. The lottery issued an RFP for Professional Advertising and Related services on April 13, 2017. A legal notice was issued in the Albuquerque Journal for 5 days from April 13 - April 17, 2017 and was published on the NMLA website. The RFP notice was sent to 34 advertising agencies - 27 agencies requested a copy of the RFP. The deadline for the RFP was May 8, 2017. The lottery received 3 proposals from; Griffin and Associates (GA); Kilmer and Kilmer, Marshall Duran (K2MD) and Wilson-Binkley Advertising & Marketing (WB).

An evaluation committee was assigned by the CEO and evaluations on the proposals commenced. The proposals were evaluated based on the following criteria outlined in the RFP: experience and capability, responsiveness to NMLA, technical capabilities and samples of work. Each area was scored individually and the cost proposal was evaluated collectively by the committee. Agencies were asked to submit their gross mark-up on production and media services along with charges for any additional services that might be incurred. Based on a \$2 million annual advertising budget, the gross mark-ups were used to calculate their annual advertising fees. Production fees were calculated based on 10% of the budget and media fees were calculated based on 90% of the budget. Based on the total scoring, K2MD was determined to be the successful ad agency with a total 96.8 points versus 81.1 for GA and 80.1 for WB.

K2MD offers a cost savings of more than \$142,000 over the term of a 4-year contract compared to GA and K2MD allocates the most dollars to media and production based on their 0% mark-up for additional services and inclusion of services like strategic planning, production coordination and supervision, design and copywriting in non-billable services. K2MD's proposal equates to a 2.5% reduction in gross cost from their current contract rate – a savings of \$254,000 over the next four years. The total contract based on a \$2 million Advertising Budget for K2MD would be \$222,200.00.

The evaluation committee recommends that K2MD be awarded the Professional Advertising and Related Services Contract upon Board approval. W. Ahlm requests approval from the Finance Audit committee and Board to award the advertising contract to K2MD and authority for the CEO to execute a contract with K2MD effective July 1, 2017 for a four-year contract subject to provisions of the RFP.

D. Salzwedel asked if there was a reduction for both production and media at 2.5%. W. Ahlm reported yes. W. Ahlm reported that K2MD is devoted to the lottery and have been committed to the changes the

lottery has forgone in the past two years. K2MD has adapted and excelled in the changes in terms of how the lottery has gone to annual media buys which have resulted in additional added bonus buys at no cost to the lottery. In FY 2017, the lottery has received \$2.3 million in added bonus buys. K2MD provides additional services at no cost to the lottery and are always willing to lend a helping hand. As you know, the lottery now produces its own creative in house and gives the lottery autonomy.

D. Salzwedel asked whose initiative was it to go with the annual buys. W. Ahlm reported that it was Mr. D. Barden. The committee commended the CEO on this initiative.

M. Koson called for a motion to approve and award the Advertising RFP Contract. D. Salzwedel moved to accept the recommendation by NMLA to award the contract to K2MD; second by M. Koson. Carried; 2-0

FY 2018 Consolidated Original Annual Budget: S. Jaramillo presented the FY 2018 Consolidated Original Annual Budget to the finance audit committee and will be highlighting the major changes. The sales revenue by game are staying the same as FY 2017 revised annual budget with the exception of reducing sales for the Hot Lotto game which will be ending at the end of October 2017 and will be replaced by a new MUSL game called Lotto America. This game is scheduled to begin in November 2017. The lottery has also added \$600 thousand dollars for another new game called Miss/Match and reduced Quickster sales by \$300 thousand dollars because of adding this new game. The only other change is to our revenue; we increased tickets provided as prizes. The lottery refers to them as “free tickets” which are part of instant games which produce “churn” in our games to help with sales.

Game expenses are being adjusted to compensate for the changes in sales. The Total game expenses are 66.98% of Gross Revenue for FY 2018, while they were 67.22% for FY 2017 revised budget - .24% less than the FY 2018 budget.

Operating expenses are 3% of Gross revenues – a low percentage of gross revenues. And with this budget we are able to return 30% return; it is \$194 thousand dollars less than the FY 2017 revised annual budget which is due to the change in sales.

D. Salzwedel asked proportionally the percentage of decline in scratcher sales this year is what? S. Jaramillo reported at the end of April 2017, we are \$9.1 million dollars less than last year equating to a 13% drop. At the end of June 2017, the lottery will be down between 13% - 14%. The sales trend for summer is usually down.

D. Barden stated that the best year we had was not because of Powerball, but it was because of that one year period that the lottery increased prize payout that resulted in higher sales and coupled with Powerball sales, the lottery returned \$46 million. Even without the \$1 Billion Powerball jackpot the lottery would've had a great return. People are always stating that it's Powerball; the only product the lottery has control is scratchers. D. Barden reported that there was a recent newspaper article and in the article, the reporter basically stated “people aren't playing lottery, because they aren't winning”! In order to have scholarship funds, the lottery needs to sell lottery tickets – you sell more, your profits go up.

M. Koson had a question on the less tickets provided as prizes, if it is included in the budget (gross sales) as an off-setting number? S. Jaramillo reported yes, it is an off-setting number, because you don't actually have a sale, you're giving your retailers credit on their billing. They give a ticket away; you really don't sell that ticket and needs to be reduced as a sale - not a true sale. Packs are settled at \$300 dollars each and we don't know how many tickets are given out from every pack as free tickets. The lottery bills for a complete pack and you have to recognize the sales and as the free tickets are validated, you pull those sales out. Some tickets are never redeemed.

M. Koson called for a motion to approve the FY 2018 Consolidated Original Annual Budget. D. Salzwedel moved to accept and approve the FY 2018 Consolidated Original Annual Budget as presented; second by M. Koson. Carried; 2-0.

Financial Statement: S. Jaramillo provided a brief overview of the financial statements for April 2017 and highlighted the income statement. For the first ten months of FY 2017, the lottery has returned \$31.6 million dollars and has met the statutorily required 30% return each month. The net revenue is \$215,579 less than the FY 17 YTD Revised budget or 0.68% less than budget and \$7.6 million less than for the first ten months of fiscal year 2016 – a 19% decrease.

With the transfer that was made at the end of May, we have now returned over \$732.5 million to the State of New Mexico for education since the inception of the Lottery.

Net instant sales were approximately \$60.9 million, whereas last year net instant sales were nearly \$70.0 million. Instant ticket sales have decreased more than \$9.1 million from last year – a 13% drop. But we are \$1.4 million more than the revised budget – 2.33% more than the revised budget. But, if you look at the Original Budget the Board approved last June, were only at about 86% of that budget; we should be at \$73 million if we had kept up with revenue this year, but we are only at \$60.9 million. One of the reasons is the average instant ticket prize payout, we are only at 60.84%, last year we were at 63.29% and this is due to 30% return, we can't payout and give prizes like we did last year and that is why the lottery is down \$9.1 million.

In our best year in instant sales (FY 2007), the average prize payout expense was 63.13% and we were at \$90 million at that time and when we came under the 30% return, year after year, our instants have dropped. This translates to an estimated \$2.7 million loss to the scholarship fund so far, this year or a projected loss of over \$3 million annualized. This has to do with prize payout.

Net drawing game sales are approximately \$44.6 million. \$792 thousand less than the FY 17 YTD revised budget and were \$16.2 million less than for the first ten months of last year. This is due to Powerball run up we had last January, where it went up to \$1.5 billion.

Powerball sales are \$16.7 million less than last fiscal year. Powerball is also nearly \$1.4 million behind the YTD Revised Budget in April or 94.1% of the YTD Revised budget, but 73% of the YTD Original Budget. We went from \$30 million to \$28 million in our revised budget and unless something fantastic happens in the next 3 weeks, we won't hit our revised budget.

Mega Millions sales were ahead of last fiscal year by \$437 thousand; Roadrunner Cash sales were \$148 thousand less than last year and Hot Lotto sales were also less than last year by \$102 thousand. Pick 3 game sales were ahead of last year by \$332,000 by adding the Sunday draw. Compared to their YTD revised budgets, Mega Millions, Roadrunner Cash, Hot Lotto and Pick 3 were all ahead of their individual budget amounts.

Total Operating Revenues for the Fiscal Year were just over \$105.5 million, which were \$605,000 more than the FY 17 YTD Revised Budget or 0.58% more, but \$25.3 million less than last year mainly due to the drop in instant ticket sales and Powerball sales compared to last year.

Total Game Expenses for the first ten months were 99.85% of it's the revised budget—while net sales were 100.57% of the revised budget, both tracking in line with each other.

Operating expenses are at 3.51% of total Gross Revenues. You can see that costs are being held as much as possible and are all less than YTD FY 17 Revised Budget.

M. Koson asked the CEO what the optimal prize payout percentage is for NM compared to neighboring states. D. Barden stated that both Texas and Arizona are probably paying out 68%-70%. Some states are at 67%-68% or even higher. The lottery should be in the 65%-66% optimal range to stay competitive with neighboring states and resulting in more dollars for the state. Our neighboring states are happy that our players are purchasing lottery products in neighboring states and contributing to their beneficiaries.

M. Koson stated it would be interesting to see what happens with Oklahoma lottery now that they have eliminated their state mandate.

D. Salzwedel asked for a status update on Play at the Pump (PATP). D. Barden stated that our estimated sales are \$146,000 with 23 locations. We expect to have 50-60 additional locations within the next 3-4 months. D. Barden stated that 78% of customers pay with their debit and credit card when buying gas and 64% of customers pay at the pump and never go inside a convenience store.

Disposal of Obsolete, Worn Out or Unusable Tangible Personal Property: S. Jaramillo presented a memo to the committee and a list of items that the lottery would like approval to dispose of obsolete, worn out or unusable tangible personal property in accordance with the capital asset management policy. There are approximately 14 categories of various non-capital items that have a current resale value of five thousand dollars or less and are either worn out, unusable or obsolete and are no longer economical or safe for use by the lottery. The list includes: a camera, fax, laptop, modem, printer, rack server and other miscellaneous items.

M. Koson called for a motion to approve the Disposal of Obsolete, Worn Out or Unusable Tangible Personal Property. D. Salzwedel moved to approve the Disposal of Obsolete, Worn Out or Unusable Tangible Personal Property as presented; second by M. Koson. Carried; 2-0.

M. Boland joined meeting.

FY 2018 Internal Audit Plan: M. Boland presented the FY 2018 Internal Audit Plan which is developed on an annual basis with consensus of the CEO, executive staff and input from the Board of Directors. The plan is based primarily on a comprehensive priority assessment that guides internal audit's focus. The CEO has reviewed the plan and provided positive feedback. This plan will help Internal Audit to improve the effectiveness of lottery operations. Most of the items listed are new and based on discussions with executive staff and process owners on what their priorities are for the lottery. Three new areas are: Great Plains Access Engagement, the FSR Performance Engagement and MUSL Rule 2 Compliance and Alternate Lockdown Engagement.

The Great Plains access is a software program to ensure that there are appropriate segregation of duties, roles and permissions.

The FSR (Field Service Representative) Performance Engagement will provide an overview of the FSR's currently outsourced to Intralot. In this area, we want to quantify the lottery's expectations in using metrics and reports to determine that the expectations are being met. The same would apply to the lottery's CSR (Customer Service Representative) area and to ensure we are being effective with current staffing.

MUSL Rule 2 Compliance relates to the security of the drawing system. In this area, the lottery will complete an alternate lockdown procedure in the upcoming fiscal year. Internal Audit has audited MUSL Standards, but not MUSL Rule 2. Two entirely separate roles within MUSL.

M. Boland is requesting acceptance of the audit plan in addition, approval from the finance audit committee and full Board for the extension of the financial audit contract to CliftonLarsonAllen. The State Auditor has already approved the extension. M. Boland reported that the Purchasing Policy states

any banking or audit contract/extension requires Board approval. The initial contract was approved with the extensions at a prior meeting last year.

M. Koson asked M. Boland, what is the strategy of conducting audits on items across multiple quarters? M. Boland reported that some items and testing occur at different times throughout the fiscal year and by scheduling it throughout the year, this provides flexibility to the auditor and lottery.

D. Salzwedel moved to approve the FY 2018 Internal Audit Plan as presented and accept the extension of the FY 2017 Financial Audit Contract with CliftonLarsonAllen; second by M. Koson. Carried; 2-0.


Lottery Bucks Compliance Audit: M. Boland reported that this is a compliance audit on the Lottery Bucks that was introduced as a promotional tool to further the goals of the lottery and to ensure that lottery staff is following procedures in distributing the lottery bucks to players and there is sufficient accounting of the distribution. This is the eighth year of the program which will end on March 2018. A lottery buck is a coupon valued at one dollar and is redeemable by players at any authorized lottery retailer towards any lottery product. There were no observations and one recommendation to distribute more lottery bucks to players and increasing distribution will increase sales. It is further recommended that Intralot with their FSR's distribute more lottery bucks. The audit revealed that several FSR's did not distribute any lottery bucks during the period under testing.

J. Zajdel, General Manager of Intralot reported that the FSR's didn't understand the policy and have received training on the procedure and how to distribute.

M. Koson called for a motion to accept the Lottery Bucks Compliance Audit report. D. Salzwedel moved to accept the Lottery Bucks Compliance Audit report as presented; second by M. Koson. Carried; 2-0.

Other: None

ADJOURNMENT: M. Koson entertained a motion to adjourn the finance audit committee meeting. D. Salzwedel moved to adjourn the meeting; second by M. Koson. Carried; 2-0. The meeting adjourned at 11:31 a.m.


 Mark Koson, Committee Chair
 Date 8/33/17