

**Finance Audit Committee Meeting
New Mexico Lottery Authority
March 14, 2018
MINUTES**

Call to Order: M. Koson called the meeting to order at 11:02 a.m. and asked for a roll call. Present and constituting a quorum were; Mark Koson, Dan Salzwedel and John Kubiak.

Present from NMLA were; David Barden, Sylvia Jaramillo, Michael Boland, Wendy Ahlm and Wilma Atencio.

Approve Proposed Agenda: M. Koson called for a motion to approve the proposed agenda. D. Salzwedel moved to accept the proposed agenda as presented; second by J. Kubiak. Carried; 3-0.

Public Comment: None.

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

Lockdown Alternative Review: M. Boland reported that last year in September 2017, MUSL approved a revision to its Rule 2, which allows for lotteries to implement lockdown procedures during an imbalance between the Internal Control System (ICS) operated by the lottery's 3rd party vendor - Elysm and the Computer Gaming System (CGS) operated by Intralot. Every wager prior to a drawing is recorded and for whatever reason a transaction may not get reported by one of the systems and that's when an imbalance occurs. These new procedures allow security to receive the pre-draw data from both the ICS and CGS prior to the draw regardless if there's an imbalance or not and this process ensures that no manipulation has occurred. Since this is a new process, it was prudent of the lottery to ensure security and integrity of the process was in place. Internal Audit (IA) reports that the process is sufficiently designed with controls in place. IA offered recommendations to security and IT; some recommendations were fully implemented during the review and others will be implemented as they become available. The lottery is in compliance with MUSL.

M. Koson asked how often an imbalance occurs. M. Boland reported not very often and doesn't recall the last time it has occurred at NMLA. D. Barden reported that imbalances occur across the country and the lottery last experienced an imbalance two years ago. When an imbalance occurs, the lottery with the imbalance cannot proceed with the draw and the results cannot be distributed until all data has been balanced by security and IT. Under the old process the balancing could last for hours, with this new process, the drawing can proceed without further delay. The lottery's procedure is similar to other lotteries who use the alternative lockdown process.

M. Koson called for a motion to accept the Lockdown Alternative Review report. J. Kubiak moved to accept the Lockdown Alternative Review report as presented; second by D. Salzwedel. Carried; 3-0

Retailer Compensation Plan: S. Jaramillo presented the Retailer Compensation Plan Policy to the committee for approval. The major change made to the Retailer Compensation Plan is on page 4 of 4, where Hot Lotto was changed to its replacement game, Lotto America. Hot Lotto ended in October 2017 and Lotto America started on November 12, 2017. The same bonus amount for retailers of \$10,000 applies to the new Lotto America game - jackpot/grand prize ticket that is sold in New Mexico as was applicable to the old game, Hot Lotto. All other changes were minor technical changes.

D. Salzwedel reiterated that any technical/editorial changes that doesn't change the intent or change the policy can be changed and approved by the CEO without further approval from the Board of Directors.

Any Policies updated with content, plan changes or the intent of the policy, must be presented and approved by the Board.

D. Barden reported at some point the Finance Audit committee and Board will need to discuss bonuses and retailer commission rates. This was the topic of discussion at the legislature. This is the one area the lottery pays - about 1% higher compared to many other lotteries. The lottery has always paid 6% on retailer commission rates since start up, which was set by the executive staff at that time. D. Salzwedel reported that he was advised by a retailer that the commission rate was set up initially to entice retailers to join the lottery. D. Salzwedel asked what the outcome would be if the rate was reduced. D. Barden reported that the lottery would probably lose retailers. D. Barden has asked the Director of Sales to working on alternative plans for retailer commission – an incentive that would be based on performance and criteria to get that commission.

M. Koson called for a motion to approve the Retailer Compensation Plan as presented. D. Salzwedel moved to approve as presented; second by J. Kubiak. Carried; 3-0.

Financial Statement: S. Jaramillo provided a highlight of the financial statements for January 2018. S. Jaramillo reported that the difference in sales compared to budget. Instant sales are \$3 million ahead of the budget or 7.9% ahead, but we are behind last year by \$56,000. For February 2018, we are \$2 million ahead of budget and \$25,000 less than last year. Sales look pretty good compared to budget, but instant sales are declining.

Drawing game sales are \$6 million ahead of both the budget and almost \$7 million ahead of last year. Sales trend in the last quarter of the fiscal year tend to decrease; this is due to summer being upon us and players are spending their cash elsewhere such as attending graduations, weddings and holidays/vacations.

D. Barden reported that we are up \$6.7 million for online game sales and we are on the cusp/middle of another Powerball Jackpot run up and we don't know where we will up with Powerball sales. Powerball is currently at \$420 million and Mega Millions is at \$360 million. S. Jaramillo advised to keep in mind that online sales tend to drop after a Jackpot gets hit. The lottery's budget is based upon 1-2 run ups and the lottery has already had 2 run ups for both Powerball and Mega Millions.

D. Salzwedel asked what this means for the 30% in terms of what the lottery contributes. S. Jaramillo stated the lottery should be up by ½ million dollars based on projections. The lottery should return \$38,376 million for the fiscal year.

D. Barden reported that we will be down almost \$2 million at the end of the year in scratchers, what we don't know is where we will end up with Powerball. D. Barden directed committee members to the PB Jackpot sign which shows what has been happening over the past couple of years with online Jackpots and Jackpot fatigue. The sign details the number of jackpot drawings from one fiscal year to another fiscal year, same number of drawings, but the sales figures from one fiscal year to another is significantly opposite which indicates that players are only interested in BIG Jackpots and only play when the Jackpots are HIGH. Even with the recent changes to the game and odds, the Jackpots take longer to grow. D. Barden stated this is why Instant Tickets sales are important to the lottery, you can't control Online Games.

J. Kubiak asked if the lottery is digging into the unclaimed prize fund or continuing to erode into the reserves to meet the 30% return. S. Jaramillo stated yes, the lottery is using the unclaimed prize fund and it has come down to \$1 million at the end of January. S. Jaramillo reported that with the CEO's approval, S. Jaramillo has been making sure the reserves are okay, so we have cash flow to pay our bills if the legislature takes away the unclaimed prize fund. If the unclaimed prize fund is taken, that brings the

lottery's money down by \$1 million dollars. Thankfully the Board of Directors passed a resolution a few years back for funding our reserves. We now have a surplus instead of a deficit.

D. Salzwedel asked if the unclaimed prize fund is higher or lower compared to three years ago. S. Jaramillo stated that its much lower because the lottery used the fund to increase prize payouts in our scratcher program when the lottery conducted a test a few years back which garnered the tuition fund and additional \$3 million and the lottery returned \$46 million to the state. In addition, the lottery uses the unclaimed prize fund about 82% of the time to meet its 30% return since the mandate was instituted in 2007. D. Barden reported that the unclaimed prize fund is lower because we aren't selling tickets; therefore, there aren't as many unclaimed prizes. If we don't close any of our games, you don't get any of those unclaimed prizes. It's when you end a game, the claim period for a game - that whatever is left over that hasn't been paid out that we recognize.

It has been 18 months since the lottery put out a \$20 ticket. D. Barden reported that we can manage like Oklahoma, they didn't have a \$20 or \$10 ticket. The next step would be, if we get there is to start pulling the \$10 instant tickets. J. Kubiak stated that would kill lottery sales and dollar returns. D. Barden agreed.

D. Salzwedel asked what proportion of our total sales, are the \$10 tickets. D. Barden stated that he doesn't have the exact number, but the \$20 ticket was \$12 million in sales and estimates that the \$10 ticket is 20% of sales – this is based on 4-5 \$10 games. If there are no changes with the 30% mandate and the legislature moves to take the unclaimed prize fund and places a cap on operations, the lottery is looking at \$60 million in annual sales. If we are at \$70 million based on our revised budget this year and we end up pulling the \$10 tickets because we can't pay the prizes, the lottery is looking "at least" a \$10-\$13 million reduction which places your annual sales at \$60 million resulting in \$3-\$4 million dollars less to the lottery tuition fund putting us at \$35 million dollars return to the state what was initially projected by the lottery at the beginning of this year's legislature. S. Jaramillo reported that some players may migrate to the \$5 ticket while others will get mad and not play anymore.

S. Jaramillo reported that we have transferred \$24.1 million to the scholarship fund in fiscal year 2018. With this return, the net revenue for the fiscal year is nearly \$3.1 million more than the FY 18 YTD budget, but only \$2 million more than for the same period in fiscal year 2017. The lottery has used the unclaimed prize fund to meet its 30% mandate five of the seven months for FY 2018.

J. Kubiak inquired about the Balance Sheet specifically the prepaids and capital asset. S. Jaramillo reported that renewal of the Insurance Premiums was paid in January instead of February, the lottery prepaid for "Gloss" on one of the IGT Instant Tickets before the game has launched, a deferred amount for the Intralot Contract and the lottery prepaid a prize for the SGI Willy Wonka Ticket – the prize will be awarded at the end of the game. As for capital assets, the lottery replaced the roof on this building for \$119 thousand dollars. D. Barden reported that the lottery tries to repair or replace one part of the building instead of having all the major expenses come in at one time. S. Jaramillo reported that the lottery will be replacing the carpet and tile as well. J. Kubiak advised that the lottery look into a research study in which companies will advise what big ticket items need to be replaced, like the HVAC and parking lots. S. Jaramillo reported that the lottery is looking into getting the parking lot repaired or repaved, we have several areas that are cracking, not only in the asphalt but the concrete that adjoins all the surrounding properties.

M. Koson asked if the lottery is considering adding additional employees to any areas in the near future. D. Barden reported that the lottery is looking at adding 2-3 additional staff members including a communications person who will assist the lottery in its legislative efforts. Discussion on the 2018 Legislature and the lottery's efforts took place among committee members and management.

FY 2018 Consolidated Revised Annual Budget: S. Jaramillo provided an overview of the revised annual budget. Committee members received a recap sheet of the Consolidated budget showing the changes.

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| Instant ticket sales | Reduced by \$500,000 |
| Powerball sales | Increased by \$1,000,000 |
| Mega Millions sales | Increased by \$1,500,000 and |
| Lotto America sales | Increased by \$1,000,000* |

*The lottery planned on \$2 million dollars for Lotto America and added another million. All drawing game sales were reviewed collectively by D. Barden, S. Jaramillo and K. Wilkinson and were adjusted conservatively since online sales are hard to predict.

Increasing the sales by \$3.4 million added \$1 million more to the scholarship fund - over \$540,000 what the lottery transferred from last year.

Game expense line items were reduced due to the changes in sales but remained close percentage wise to what they had been in the FY 18 Original Annual Budget-as indicated in green highlights.

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| Advertising | reduced by \$174,000 |
| Salaries, wages, and benefits | reduced by \$118,000 |
| Professional fees | reduced by \$66,000 |
| Travel | reduced by \$25,000 |

Overall, operating expenses were reduced by \$251,000 of the original budget.

S. Jaramillo reported that the term used by the legislature for operating expenses would be anything less than the 53.76%, so we are at 16.24% for operating expense of the revised FY 2018 budget still not the 15% the legislature wants, but if the lottery were to reduce the retailer commission by 1%, the lottery would need to look at where to save the additional .24%. D. Barden reminded the committee that when sales increases that percentage - 16.24% comes down. In all earnest, if the lottery has to meet the 15% cap in operating expenses, the only place that is left to cut would be retailer commissions. D. Barden reiterated that he will be adding 2-3 employees next fiscal year.

D. Barden reported that pulling the \$10 instant ticket translates into 26% of sales - \$19 million in annual sales and \$6 million dollars less to the scholarship fund.

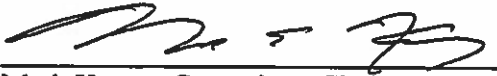
M. Koson asked if the lottery is required to complete a revised budget.

M. Koson called for a motion to approve the Revised Annual Budget. D. Salzwedel moved for approval of the FY 2018 Consolidated Revised Annual Budget; second by J. Kubiak. Carried; 3-0.

Other: D. Barden reported that S. Baragiola requested a cost savings report for the past several fiscal years and handed out a document to the committee members. The lottery estimates \$18 million in cost saving efforts in a four-year period.

D. Barden also reported that the recent signed legislation of HB 187 extending contracts from an 8-year term to 10-years and with the recent awarding of the RFP for Instant Ticket Printing with SGI, it would be prudent of the lottery to extend the contract for 2 additional years. The committee recommended the CEO to proceed.

ADJOURNMENT: M. Koson entertained a motion to adjourn the meeting. J. Kubiak moved to adjourn the meeting; second by D. Salzwedel. Carried; 3-0. The meeting adjourned at 12:42 p.m.



Mark Koson, Committee Chair

Date 6/21/18