

Finance Audit Committee Meeting
New Mexico Lottery Authority
January 12, 2015
MINUTES

Call to Order: Committee Chair M. Koson called the meeting to order at 1:13 p.m., and asked for a roll call. Present and constituting a quorum were; M. Koson, D. Salzwedel, and J. Kubiak via telephone.

Present were: Lottery employees S. Jaramillo, M. Boland, and W. Atencio; Intralot employees M. Worley and R. Reeves.

Approve Proposed Agenda: M. Koson made a motion to amend the proposed agenda by moving item 3C to 3A; renumbering agenda items accordingly; second by J. Kubiak. All in favor, 2-0

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

Internal Audit Reports:

15-001 Payable Management Audit Report: M. Boland presented the Payable Management Audit Report to the committee with an overview. The audit was completed due to the high dollar value and complexity of the payable management processes. The report had been vetted with D. Barden and S. Jaramillo. The audit report had two observations. A separate report/schedule that stays within the lottery contained the recommendations for the payables management audit.

M. Boland reported on two observations and after considerable discussion the Committee instructed Mr. Boland to review his observations with executive staff and to bring back a revised document that would reflect the Committee's view on materiality since the issues did not rise to the level of a material weakness in our internal controls.

D. Barden joined meeting by telephone. D. Barden clarified that since audit reports are sent to Santa Fe and recommendations are usually reserved for internal use that observations should be reserved for material issues and other lesser issues should be addressed by recommendations.

The Finance Audit Committee made a recommendation to accept the report and remand it to staff for perfecting. J. Kubiak seconds this recommendation.

Administrative Facility: D. Barden reported that based on the Finance and Audit Committee's prior direction staff made inquiries regarding purchasing the lottery's current building or other buildings. Based on guidance from the Committee to save on additional operating expenses the CEO needed to continue to streamline and save in all areas. The Committee after reviewing staff analysis, determined that purchasing a building could provide significant long term operational savings and more money for the scholarship fund.

S. Jaramillo provided documentation on the proposals.

The lottery made a purchase offer on the existing building which was subject to final approval by the Board. The offer was never acknowledged by the owner, but the owner did reduce the asking price on the building to \$3.5 million. The CEO and Chief of Staff continue to look at other properties.

S. Jaramillo reported that the lottery evaluated what it pays currently to lease a building and the potential to purchase a building. If the lottery purchases a building and finances it over 14 years saving could be in excess of \$800,000.

Discussion continued between the Committee members and staff regarding moving some unclaimed prize funds into a reserve fund to establish a project reserve fund until the full Board acts on whether to move forward with the project, and if so, how to ultimately fund any potential acquisition.

D. Barden reported that at the direction of the Chairman, the lottery requested an independent legal opinion on the Lottery Act as it pertains specifically to the use of the unclaimed prize fund as the lottery historically has used the fund for meeting its monthly statutory 30% transfer and increasing prizes in scratcher games. D. Barden reported that without the unclaimed prize fund the lottery would fall short of its transfer goals approximately 80% of the time. There are only two statutory requirements placed on all funds by the Act: at least a 50% prize payout to players and a requirement to return 30% to the state for the Legislative Lottery Scholarship fund. These are the only two requirements and the lottery may use the unclaimed prize fund for business purposes as authorized in the Act. According to the legal opinion, the statute is very broad as the lottery is an entrepreneurial authority. The ability to use these funds is only limited by prize payouts of at least 50% and the 30% transfer requirement.

J. Kubiak said that the Finance Audit Committee should authorize the CEO to continue to evaluate property and proceed with the purchase of real estate that is economically justifiable, contingent upon approval by the Board, including the ultimate funding mechanism.

M. Koson commented that we have been using some of the unclaimed prize money to meet our 30% mandate to the state, so if that money goes away, the lottery won't be able to meet the 30% obligation. J. Kubiak responded that the lottery needs to ensure that we have adequate cash reserves for those months we fall short. That's more of a financing decision at this point in time in how to acquire and pay for the building.

D. Barden added that if the legislature comes in and takes the unclaimed prize money, then the lottery won't be able to hit the 30%.

D. Barden reported that the lottery is looking at additional equipment for the Lucky Numbers Bingo game. Our evaluation is that the lottery would like to purchase 100 Multi Purpose Terminals (MPs) which has the potential to increase sales. This would be a one-time purchase of \$1.6 million, but the lottery is seeking a Return On Investment (ROI) from the vendor.

D. Barden requested committee guidance because the purchase of this equipment wasn't in the budget. The CEO has the authority to procure this equipment under the contract, but it is unclear if the CEO has the authority in the budget. The Finance Audit Committee approved the CEO's request to purchase the 100 MPs at a cost of up to \$1.6 million as the equipment was in the contract.

Discussion continued on a building reserve fund.

M. Koson asked if the lottery is confident that if we create reserve funds, can the lottery meet the 30% requirement in the future?

S. Jaramillo is confident that if we reserve \$3.4 million that the lottery would be okay for the immediate future, but advised that the lottery continues to use \$400,000 to \$800,000 monthly from the unclaimed prize fund to meet transfer requirements. Because we have raised our instant payout, while our online sales have gone down, prize payout expense percentage is up, so the lottery needs to pull it back down and meet our budget. The budget is 54% for payout.

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A lengthy deliberation took place today with the Finance Audit Committee members, CEO and Chief Of Staff on the cost savings/cost benefits to the Lottery owning its building.

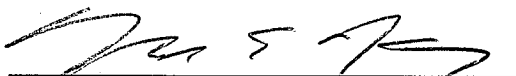
D. Salzwedel made a motion that in keeping with our fiduciary responsibility to reduce expenses and maximize revenues, that the Finance Audit Committee recommend to the Lottery Board of Directors that no more than \$3.4 million of existing lottery funds be re-allocated to establish a reserve fund for a permanent lottery building, subject to the Board's final action and that the establishment of the fund be retroactive to December 31, 2014; second by M. Koson. All in favor, 3-0.

Financial Overview: S. Jaramillo provided an up-to-date budget overview. Instant sales are ahead by \$4.7 million. Online sales are trailing. Powerball is trailing by \$6.5 million; Mega Millions is trailing by \$1.9 million and Roadrunner Cash by \$1.6 million. Overall drawing games are behind last year by \$8.5 million or 23%. The lottery in total is only 5% or \$3.8 million -- behind last year, because of strong scratcher sales.

The largest Powerball jackpot this fiscal year has been \$228.5 million followed by \$202 million. Last fiscal year, we had a \$448.4 million jackpot by August 2013, a \$399.4 million jackpot by September 2013, and a \$213.4 million jackpot in October 2013.

For Mega Millions this fiscal year, we had a run up in November to \$326 million. In Fiscal Year 2014, there was a run up to \$648 million in December 2013. For Roadrunner Cash, we had a record-setting jackpot of \$890,000 in November 2013. The largest Roadrunner Cash jackpot this year has been \$275,000 in September 2014.

ADJOURNMENT: M. Koson entertained a motion to adjourn the meeting. D. Salzwedel moved to adjourn the meeting; second by J. Kubiak. All in favor, 3-0. The meeting adjourned at 3:18 p.m.



 Mark Koson, Committee Chair
 Date 2/27/15