

**Finance Audit Committee Meeting**  
**New Mexico Lottery Authority**  
**August 20, 2015**  
**MINUTES**

**Call to Order:** Finance Audit Committee Chair M. Koson called the meeting to order at 9:55 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 and Wilma Atencio. Also present were C. Austin; P. Guerin; A. Bailey; E. McKnight, C. Hunter with Barnett Law Firm; Amy Carter and Corrine Zajac-Clarkson with Moss Adams; Terry Patterson and Steve Beck with Intralot.

**Approve Proposed Agenda:** M. Koson moved to move item 4A to after 4G. M. Koson called for a motion to approve the amended agenda. D. Salzwedel moved to accept the proposed agenda as amended; second by J. Kubiak. Carried; 3-0.

**Public Comment:** No Public Comment.

**Annual Inventory Observation:** M. Boland presented the Annual Inventory Observation FY 2015 report for approval. This observation takes place annually at the end of each fiscal year – June 30. Audit's role is to ensure the completeness and existence of the inventory and to observe and ensure the procedures are followed. This covers the Instant tickets and premium items located in the warehouse and claim center. There were no observations. Strong controls over inventory are in place. M. Boland reported that the inventory count is done in-house by security and warehouse staff members. A master list is generated and a two-member team counts the inventory to ensure completeness. Audit will select a random sample/proportion of inventory items to check based on the master list to ensure completeness, accuracy and its existence.

M. Koson entertained a motion to approve the Annual Inventory Observation Report as a committee. J. Kubiak made a motion to approve the Annual Inventory Observation report as presented; second by D. Salzwedel. Carried; 3-0.

**Intralot SSAE16 – 2015 Report:** M. Boland presented the Intralot SSAE16 – 2015 Report. The whole report is 156 pages but for expediency the Board of Directors received the two-page Service Auditor's report showing results of the review. The 156 page report covers in detail all control areas tested. Intralot received a clean report with no observations and no recommendations. Controls are appropriately designed, in place and working effectively.

This process started in April with assistance from the Internal Audit, MIS, Intralot and the CPA Firm – A-Lign. This review takes place every other year, per the RFP. All aspects of the gaming system were tested and user controls were reviewed for accuracy. The results of this comprehensive review of the gaming system can give the lottery comfort that the lottery's data is secure and processing correctly. The SSAE-16 review is most beneficial to the external financial auditors and may serve as a guide to the gaming system areas which may require testing.

J. Kubiak requested M. Boland to explain why this audit is important. M. Boland reported that this review is important to the lottery because it assesses gaming system controls, which handles all gaming transactions for the lottery which feed into our financials. Intralot hosts the lottery's gaming system. The lottery must have comfort that Intralot has appropriate controls in place that are designed and operating effectively. The CPA firm provides this assurance through their review.

D. Salzwedel asked why this report is important to a vendor. M. Boland reported that the testing of the Vendor's gaming system is required, per the RFP. Besides receiving assurance that their controls are designed and operating effectively, the Vendor can use a clean report as a marketing tool for new customers.

D. Barden did report that Intralot has 11 states and when one of those states gets audited and a potential issue is highlighted in a similar gaming system, the fix is then funneled down to all customers. The stability of the system is what is being tested and audited. Each lottery has its own timeline for this audit – essentially the gaming system is being audited once a year. The lottery will continue testing its system, due to the new contract that will take effect in November 2015.

J. Kubiak asked if the lottery has an internal individual who is capable of understanding the security on the lottery's data. D. Barden reported that the lottery's system had not been audited in the past 8 years, so the lottery just completed a security audit with Risk Sense, a nationally known company in this field. Risk Sense provided recommendations to the lottery. The lottery will implement the recommendations and will continue ongoing testing twice a year. The system is stable and the lottery is confident with the controls and processes in place.

**Disposal of Obsolete, Worn Out or Unusable Tangible Personal Property:** S. Jaramillo presented a list for disposal of obsolete, worn out or unusable tangible personal property. This year's list is comprised of 319 items in 44 different categories. The items listed are obsolete, old equipment, some stemming from 1996, 1999. The items listed have been replaced over the years with new equipment, such as the back office system, CRM system, old servers, packing stations, computers, cameras, monitors and an x-ray machine that was no longer supported. In addition, there are 47 Lottery Information Centers (LIC) listed; however, the lottery would like to dispose of up to 425 LIC's in the upcoming year if they are replaced out in the field. All the items are fully depreciated, broken or obsolete with zero value.

Following the lottery's policy and the state process, with obtaining first right of refusal from the state; the lottery has taken items to the DPS Auction in Santa Fe the past several years. The policy also allows the lottery to place an ad in the newspaper for Bulk Buy or use the Internet for bidding options.

M. Koson asked if some of the computer equipment can be donated to schools. S. Jaramillo reported yes, we can. As a state agency/instrumentality, you can transfer to other state government agencies. Donations to schools are not part of our policy, but if the Board approves, the lottery can go that route and make changes to the policy. The lottery would need to certify to the State Auditor that all files on the computers have been wiped cleaned. Committee members suggest that the lottery look into transferring the computer items to small school districts in the state.

M. Koson made a motion to allow the lottery administration to dispose of obsolete equipment with State School Districts or as otherwise provided by agency policy; second by J. Kubiak. Carried; 3-0.

**Update on NASPL Conference:** S. Jaramillo provided a brief overview of the NASPL Professional Development Conference.

**Audit Entrance Meeting:** S. Jaramillo introduced members of Moss Adams to Finance Audit Committee. Moss Adams distributed a booklet that outlines the service team, scope of services, auditor's responsibility, areas of audit emphasis (risk areas), expectations and timeline of the upcoming FY 2015 Financial Audit. Presentation provided by Amy Carter and Corrine Zajak-Clarkson. A. Carter reported that Mr. Jeff Bridgens and Scott Eliason are no longer with Moss Adams. The audit will take 2 weeks (300-400 total hours) beginning August 24<sup>th</sup>. The exit conference will take place 60 days from August 24. Audits are due to the State Auditor by December 1, 2015.

M. Boland requested a copy of the modification letter, which details A. Carter as the engagement lead.

C. Austin, P. Guerin, Ph.D. and A. Bailey, E. McKnight, T. Patterson and S. Beck joined meeting.

**Financial Statements:** S. Jaramillo will provide a detail update on June financials at Board Meeting.

**Lottery Gaming System and Associated Products and Services Contract:** D. Barden provided an overview on the pending Gaming System Contract. D. Barden reported that it took six months to put the RFP out and the lottery received one response from Intralot.

D. Barden has advised the Board, Legislators and staff that the Online Vendor Contract would expire in 2015 and that the price of the new contract would increase significantly, possibly doubling our online rate. Over the past eight years, the lottery has had one of the lowest online fee rate in the lottery industry at 1.5%. The average rate is approximately 4%.

The lottery has been in negotiations with Intralot for the past 6-8 weeks. The lottery received a good proposal from Intralot. Part of the Base Proposal that the lottery required the vendor to bid on was the inclusion of 500 new photon terminals for its retailers. This Photon terminal is one of the best in the lottery industry. It has little to no moving parts and includes a camera that will allow a photo to be taken when loading tickets.

The initial submission pricing from Intralot was:

- 5-year contract at a rate of 3.39% with 500 New Photon Terminals.
- 8-year contract at a rate of 3.26% with 500 New Photon Terminals
- 8-year contract at a rate of 2.9988% using all existing equipment.

The lottery hoped that the 2.9988% would be the new rate with 500 new Photon Terminals.

The RFP invited options within the RFP scope. Those invited options were in the areas of the Customer Service, Pick and Pack and Lottery Sales Representatives (LSR's). The lottery examined its current operations, expenditures, purchase of the lottery building and the necessity of reducing costs for the new gaming system contract; as such the lottery looked at outsourcing these three areas to the Vendor for cost efficiencies. During the negotiation process, the lottery discussed the option of getting new photons for all the retailers, which will help increase our retailer base; however the cost for 1200 new Photons was valued at \$3.6 million. The lottery recognized the disadvantages of having old equipment (15-year old) in the field that may breakdown or process the information at a slower rate than new equipment. The retailers will see a remarkable improvement in processing transactions with the new equipment.

Through a combination of factors like having the vendor move into our building and rent/lease the space from the lottery at a value of approximately \$1 million over the course of 8-years, the length of the contract, this would enable the lottery to leverage the building in obtaining Photon Terminals. Another factor was to shift some cost to the vendor by moving the LSR's to the vendor. By making this change, this would bring the number of staff to adequately service the 1200 retailers across NM and reduce cost to the lottery. D. Barden reported that if this shift doesn't work in the future, the lottery could essentially move the LSR's back.

The contract proposal incorporates the following:

- Base Price Online Fee Rate – 2.9988%; 2.5% on net sales above \$146.5 million
- Vendor will move and share space within the NM Lottery Building
- Receive 1250 New Photon Terminals
- Move Lottery Sales Representative Team and vehicles to Intralot
- Reduce Performance Bond from \$10 million to \$5 million

D. Barden indicated that these are the major elements to the contract, but they are not all inclusive in nature. By moving forward with the contract, the lottery expects to see a growth of 4% in sales per year over the 8-year contract with Intralot.

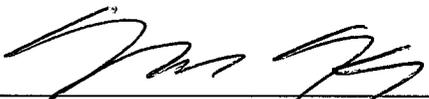
P. Guerin asked for clarification on lottery sales representatives move to Intralot and what would be the relationship with retailers and increasing the number of retailers. D. Barden reported that the current LSR's will need to apply for their positions with Intralot. Intralot has assured that all nine employees would be given the opportunity to apply and interview and most likely will be hired, but all LSR's would be subject to Intralot's hiring practices.

M. Koson asked how soon the lottery will get the new equipment. S. Beck reported that it will take six months to produce, once the contract is signed and six weeks to get them all in.

M. Koson made a motion to recommend the Lottery Gaming System and Associated Products and Services Contract as presented to the full board; second by D. Salzwedel. Carried; 3-0.

**Other:** None.

**ADJOURNMENT:** D. Salzwedel moved to adjourn the Finance Audit Committee meeting; second by J. Kubiak. Carried; 3-0. Meeting adjourned at 11:34 a.m.

  
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Mark Koson, Committee Chairman

11/18/15  
Date