

**Regular Meeting of Board of Directors
New Mexico Lottery Authority
November 04, 2014
MINUTES**

Call to Order: Board Chair Dan Salzwedel called the meeting to order at 9 a.m. and asked for a roll call. Present and constituting a quorum were; Mark Koson, Amy Bailey, Dan Salzwedel, John Kubiak, Salvatore Baragiola and Claude Austin via telephonic.

The following employees were present from NMLA: David Barden, Sylvia Jaramillo, Evelyn McKnight, Karla Wilkinson, Pam Poteat, Dave Ramirez, Vince Torrez, Wilma Atencio, Mary Stanford, Julie Gilmore, Michael Boland and Linda Hamlin. Also present were Randy Reeves and Matt Worley from Intralot; Mary Smith of Attorney General's office; Vanessa Alarid with GTECH; Charlie Scannella with SGI; and Corrine Zajac-Clarkson, Jaime Rumbaoa and Dhaval Patel with Moss Adams.

Approve Proposed Agenda: D. Salzwedel called for a motion to approve the proposed agenda. J. Kubiak made a motion to amend the proposed agenda and move item C3 "FY 14 Financial Audit" and discuss after Public Comment. Item C-3 became item 5 and all other items were renumbered accordingly; second by A. Bailey. All in favor, 6-0.

Approve Minutes of July 01, Board of Director's Meeting: D. Salzwedel called for a motion to approve the minutes from the July 01, 2014 Board meeting. J. Kubiak moved to approve the minutes as presented; second by M. Koson. All in favor, 6-0.

Public Comment: D. Salzwedel asked anyone who wished to speak publicly to complete a form. No Public Comment.

FY 14 Financial Audit: M. Koson reported that the Finance Audit Committee and lottery staff met with Moss Adams to review and vet the FY 2014 Financial Audit prepared by Moss Adams on October 6.

C. Zajac-Clarkson presented an overview of the FY 2014 Financial Audit. The audit report was released by the State Auditor last week. Moss Adams issued a clean opinion (unmodified opinion) on the Financial Statements. The audit was completed in accordance with government auditing standards. There was one modified audit finding, a continuation from a prior year's audit. The finding relates to the testing of the Disaster Recovery Plan which wasn't completed due to the lottery migrating to a new back-office system with its online vendor Intralot. After the new back-office system is up, it was recommended that the Disaster Recovery Plan be tested.

M. Koson made a motion to approve the FY 14 Financial Audit as presented; second by J. Kubiak. No questions or comments. All in favor, 6-0.

CEO Update: D. Barden reported that the lottery is signing a contract with Scientific Games International (SGI) for the "Points and Rewards Promotion."

D. Barden updated the Board on his progress in reviewing contracts/extensions with vendors. D. Barden reported that the statutory requirement for the Procurement Code Provision allows a total of eight years for an extension and does not accommodate a 10-year extension. Based on this, the lottery has one year left in its contract with Intralot. The original contract with Intralot began in 2008 and the extension expires in 2018. An RFP Procurement would need to go out by November 2015. The CEO is hoping that changes can be made in the upcoming legislative session that would allow a 10-year extension. If not, the lottery will go out to bid for its online vendor next year. Missouri Lottery went out to bid recently and

signed a contract for its online drawing services at a rate of 4.25%, which is considerably higher than New Mexico's rate at 1.5%. The rates will likely increase in 2016 or 2018, impacting returns to Legislative Lottery Scholarships.

D. Barden provided some highlights from his LFC Presentation on October 31.

Instant tickets sales are up. Net ticket sales are down by \$3.1 million. Powerball sales are down by 44%, while PICK 3 sales are up 27%. Drawing Automation is in effect. Operating expenses from FY 2013 to FY 2014 are up slightly (3.58% to 4.05%). Wages and salaries went up slightly from 1.91% to 2.06%, as a result of a payout to a former employee. The lottery is ensuring that all expenditures are necessary to carry out the statutory mandate to maximize our revenue for the scholarships. The lottery is in line with its mandate by returning 30.1% to the lottery tuition fund.

Where the money goes – FY 14 \$136.1 million in Gross Revenues. 54.4% to prizes (\$74.1 million); 5% cost of product (\$6.8 million); 6.5% retailer commissions (\$8.8 million); 30.1% to lottery tuition fund (\$40.9 million) and 4.0% is administrative costs (\$5.5 million).

Internal controls and expense management were implemented in the areas of media buys, Instant ticket contract, hiring an in-house animator, back-office migration, drawing automation, jackpot signage, adding a midday PICK 3 drawing, eliminating retailer credit on an annual basis to a per-incident process and organizational restructuring. All these changes have resulted in significant savings. It also allows staff to focus on mission critical projects. The back-office migration will be completed in March 2015.

The lottery added Monopoly Millionaires' Club to its game portfolio. It is a game with a top prize between \$15 million and \$25 million. When the top prize is hit, a second drawing for \$1 million prizes will make between 10 and 30 millionaires across the country. We have a game for everyone at every price point. Mega Millions and Hot Lotto at \$1; Powerball at \$2; and Monopoly Millionaires' Club at \$5. All multi-state games have a payout of 50%. Powerball continues to underperform. The MUSL group will make changes to Powerball in early 2015. A new in-state game called Lucky Numbers Bingo is scheduled to launch on November 9. Tickets will be \$2 each. Because the game lends itself well to group play, the lottery has recruited retailers that have a social setting.

The prize payout for the lottery's in-state games range between 55.38% and 62.80%. The "Super Tuesday" strategy is working and has helped Scratcher sales climb 10%. The increase can also be attributed to advertising in new places such as city transit busses. The prize payout for the \$1, \$2, \$3, \$5, \$10 and \$20 scratchers range between 55.73% and 68.13%. New Mexico has the nation's lowest prize payout. Arizona, Colorado and Texas have payouts of 66% to 68%. Per-capita sales for Scratchers are \$33 and New Mexico's per-capita sales are currently ranked 38, out of 42 US Lotteries.

The future outlook is technology, especially mobile technology. For example, 90% of adults own a cell phone, 87% use the internet and users check their phones 120 times a day. The lottery industry is looking for ways to incorporate this technology into their business model. Today, 32 lotteries offer mobile websites and 19 lotteries will be offering a mobile app. The newest innovation is a "Play at the Pump" feature. This feature will enable the sale of lottery at gas pumps, ATMs and other unmanned POS devices. California and Missouri plan to offer this feature soon.

P. Guerin joined the meeting at 9:35 a.m.

The lottery's goal for the upcoming legislative session is to make suggestions of new language to the Lottery Act in the following sections:

- Section 6-24-24B “30% requirement,” suggesting new language that the “transfer of funds will occur on a quarterly basis” and “to the extent practicable transmit at least thirty percent of the gross revenue of the previous quarter”.
- Section 6-24-19 “Procurement Code Provision,” suggesting new language that contract extension terms are “not to exceed ten years” to better accommodate the technology investments unique to the lottery’s needs for instant ticket printing and computer gaming systems contracts..
- Section 6-24-8G “Adoption of rules by board,” suggesting new language to cover technology, i.e. Internet, mobile devices, cable television and to add the term “systems” to mechanical devices.
- Section 6-24-15D “Lottery tickets, sales,” suggesting new language to cover debit cards and using credit cards to purchase lottery products of \$20 or less.

M. Koson asked if there is a process timeline for a RFP for the gaming system. D. Barden replied that a RFP has not been compiled, but a timeline will be sent to the full committee.

M. Koson asked what percentage of overall sales came from the three national games of Powerball, Mega Millions and Hot Lotto, which have a 50% prize payout. S. Jaramillo replied that the percentage was small and represented almost \$3 million of the \$142 million for this fiscal year. *(Note: The \$3 million amount is for Monopoly Millionaires’ Club. For the three national games of Powerball, Mega Millions and Hot Lotto, the amount is almost \$52 million of the \$142 million for this fiscal year)*

M. Koson asked what New Mexico’s ideal Scratcher payout would be? D. Barden replied that New Mexico should be on par with bordering states at 68%.

M. Koson asked about costs associated with Pay at the Pump applications? D. Barden replied that the cost would be incurred by the vendor.

M. Koson asked for further clarity regarding suggested wording changes to the statutory requirement, specifically that while the lottery may not return 30%, the revenue amount would be more. D. Barden replied that this was correct and that the lottery will continue to work on the wording for the statutory requirement.

M. Koson recommended that the lottery stay within the timeline for the disaster recovery plan in testing the back-office system.

Board Resolution: D. Barden presented a resolution which directs the CEO to advise and inform stakeholders that additional dollars may be generated for scholarships based upon adherence to industry best practices, fulfilling the board’s request to seek a legislative amendment that will help the lottery’s fulfill its statutory mandate to maximize revenues for education.

A. Bailey made a motion to approve the Board Resolution as presented; second by J. Kubiak. All in favor, 7-0.

OPERATIONS Committee Report – S. Baragiola, Committee Chair: S. Baragiola reported that the Operations Committee met on September 23 to review, discuss and approve the Monopoly Millionaires’ Club Game Rule as presented.

Approve Minutes of September 23, Operations Committee Meeting: S. Baragiola made a motion to approve the committee meeting minutes of September 23, 2014 as presented; second by P. Guerin. All in favor, 7-0.

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

Approve Minutes of October 6, Finance Audit Committee Meeting: M. Koson reported that the Finance Audit Committee met on October 6, 2014 with Moss Adams. M. Koson made a motion to approve the committee meeting minutes of October 6, 2014 as presented; second by J. Kubiak. All in favor, 7-0.

Prize Expense and Unclaimed Prize Policy: D. Barden reported that the Prize Expense and Unclaimed Prize Policy has been updated to include Monopoly Millionaires' Club and Lucky Numbers Bingo. In addition, language in the policy has been updated to include "for such other purposes as may be approved by the lottery board" pertaining to how unclaimed prizes may be used. This will provide the board and lottery flexibility in using these funds for business purposes other than using it to balance the fund in meeting the 30% mandate.

M. Koson made a motion to approve the Prize Expense and Unclaimed Prize Policy as presented; second by S. Baragiola. All in favor, 7-0.

Financial Statements: S. Jaramillo presented a detailed review of the September 2014 financial statements. With the transfer, the lottery has returned more than \$622.8 million to education since 1996. The lottery's net income return through September 30, 2014 was over \$9.4 million. This amount was 4.26% less than the YTD Budget and 9.9% less this year than last year's return to the Scholarship Fund.

Net sales were \$31.3 million dollars, \$2.1 million less than the YTD Budget. Net Instant ticket sales made up 57.00% of these net sales, while net drawing game sales made up 43.00% of net sales. Net Instant ticket sales were nearly \$17.9 million dollars, an increase of 8.9% this year. Total net drawing game sales were \$13.5 million dollars, 25% less this year. This reduction in drawing game sales compared to last year can be attributed to Powerball sales, which are \$5.6 million less this year than last, a 47% drop. The Powerball jackpots have reached only \$228.5 million in September, \$124.9 million and \$90 million in July and \$60 million in August. There have not been any large jackpot run-ups during the first quarter. Mega Millions, Roadrunner Cash, Hot Lotto and Pick 3 drawing games are keeping pace or outdistancing both the YTD budget and last year. Game expenses followed closely in line with net sales. Net sales were 93.60% of the YTD Budget. Game membership surpassed the budget due to the membership expense for the new game, Monopoly Millionaires' Club, which was not forecast due to not having an amount available at the time the budget was finalized. Operating expenses were 83.24% of the YTD Budget. All line items in Operating expenses were lower than the YTD budget.

D. Salzwedel asked for clarification on game membership for Monopoly Millionaires' Club. S. Jaramillo reported that any time a lottery participates in a MUSL game, a membership is required. This amount is divided by the total number of lotteries participating. In this case, our amount is \$24,000 dollars. The lottery pays for game membership for Powerball, Hot Lotto and Mega Million. The amount is pro-rated based upon sales for each state. This fee covers participation in the game, drawings, advertising and drawing staff. The membership fee differs among the games.

Internal Audit Reports:

14-006 Online and Instant Scratcher Reconstructions Audit Report: M. Boland presented the Online and Instant Scratcher Reconstruction audit report for approval. The online and instant ticket reconstructions are used by lotteries to determine how the game is played. A reconstruction is requested by lotteries, in this case, by the lottery's Security Division, when a player or retailer has an issue/dispute with a ticket or when a ticket is damaged. The reconstruction process also applies to GLEPS (Guaranteed Low End Prize Structures), which ensures that low-tier parameters comply with the associated working paper requirements. This audit was conducted to ensure that internal controls and operational procedures are sufficiently designed and operating effectively.

There were five observations noted by the Internal Auditor. This process has never been audited and was last monitored in 2006 or 2007, so the number of observations was relatively high, which is understandable. Recommendations were made to the EVP of Security who has implemented these recommendations. New processes and procedures are now in place and this has remediated all the observations noted. The security division staff has been fully trained in following these processes and procedures.

M. Koson made a motion to approve the Online and Instant Scratcher Reconstruction audit report as presented; second by J. Kubiak. All in favor, 7-0.

14-007 Annual Inventory Observation Report: M. Boland presented the Annual Inventory Observation report for approval. M. Boland reported that the annual inventory observation took place on June 30 by the Internal Auditor. This observation takes places annually at the end of the fiscal year and covers the Instant tickets and premium items located in the warehouse and claim center. The instant tickets have no value until activated. There were no observations.

J. Kubiak made a motion to approve the Annual Inventory Observation report as presented; second by A. Bailey. All in favor, 7-0.

Drawing Services Automation: M. Boland reported that the lottery's online drawings are now automated. The first drawing under the automation process started on October 27, 2014 without any issues. By transitioning to an automated process, there are significant cost savings, enhanced internal controls, flexibility to add and delete games, improved disaster recovery preparedness since equipment is offsite, and a more efficient and secure process. The lottery staff once required to conduct drawings can now be assigned to support other mission-critical positions/jobs.

PERSONNEL Committee Report – A. Bailey, Committee Chair: No activity to report.

BOARD CHAIR

Announcements: D. Salzwedel reported that the LFC Presentation by the CEO went well and the feedback from legislators was positive.

Other Items – Information Only: No Report.

ADJOURNMENT: D. Salzwedel entertained a motion to adjourn the meeting. A. Bailey moved to adjourn the meeting; second by M. Koson. All in favor, 7-0. The meeting adjourned at 11:05 a.m.



Dan Salzwedel, Chairman

Date 2-27-15



John Kubiak, Secretary/Treasurer

Date 2-27-15