

**Regular Meeting of Board of Directors
New Mexico Lottery Authority
November 18, 2015
MINUTES**

Call to Order: Board Chair Dan Salzwedel called the meeting to order at 11:37 a.m. and asked for a roll call. Present and constituting a quorum were: Mark Koson; Amy Bailey, Dan Salzwedel and John Kubiak. Claude Austin and Sal Baragiola joined meeting via phone. P. Guerin absent.

Present from NMLA were; David Barden; Sylvia Jaramillo; Evelyn McKnight, Michael Boland and Wilma Atencio. Also present were T. Ahr with Ahr Law Offices, Randy Reeves and Matt Worley with Intralot; and Amy Carter with Moss Adams.

Approve Proposed Agenda: D. Salzwedel moved to amend the proposed agenda to item 5A-3 by adding "recommendation action" to Information, so it will read Information Recommendation Action for item 5A-3. D. Salzwedel reported that this will become the procedure for all agenda items. No other amendments were made. D. Salzwedel entertained a motion to approve the proposed agenda. J. Kubiak made a motion to approve the amended proposed agenda; second by A. Bailey. Carried; 6-0.

Approve Minutes of August 20, 2015 Board of Director's Meeting: D. Salzwedel entertained a motion to approve the August 20, 2015 minutes. A. Bailey moved to approve the minutes; second by M. Koson. Carried; 6-0.

Public Comment: No Public Comment.

Personnel – A. Bailey, Committee Chair:

Approve Minutes of August 20, Personnel Committee Meeting: A. Bailey entertained a motion to approve the August 20th Personnel Meeting Minutes. J. Kubiak made a motion to approve the committee meeting minutes as presented; second by M. Koson. Carried; 6-0.

NMLA Cafeteria Plan: A. Bailey reported that both E. McKnight and Tracy Ahr with Ahr Law offices presented the revised changes to the NMLA Cafeteria Plan in detail at the Personnel Committee Meeting. E. McKnight deferred to T. Ahr who provided a brief overview of changes to the full board on the revised NMLA Cafeteria Plan which was originally adopted in 1996 and updated in 2004. The updates and changes were made to comply with changes in the law in three major areas of the plan – HIPPA, plan administration that occurred in 2009 and compliance with the affordable care act relating to the Cafeteria Plan. This plan has three plans in one plan referred to as the Wrap Plan. The cafeteria plan must be in written format and covers the medical reimbursement component, dependent care component and premium insurance component that allow employees to use pre-tax dollars to pay for premiums. This plan also clarifies documentation required for medical reimbursements.

A. Bailey reported that this item was vetted in the Personnel committee meeting and the committee accepted the changes and recommends that the NMLA Cafeteria Plan be approved by the Board of Directors. A. Bailey made a motion to approve the NMLA Cafeteria Plan as presented for obligatory changes; second by D. Salzwedel. Carried; 6-0.

OTHER: A. Bailey reported that item #3 was modified to information recommendation and action item that D. Salzwedel will discuss. D. Salzwedel reported that this item was changed to information recommendation and action and what this essentially is an affirmation of conformance with the responsibilities of the board has, as it relates to the CEO and the requirements of his contract - all of which were executed in accordance with the provision and awarded as a matter of procedure on an

amended basis. This information provided to the full board prior to the meeting. D. Salzwedel has administered this with the CEO and this represents substantial compliance to the provisions of the agreement and to applaud the efforts of the CEO and doing a good job in running lottery operations to its current position.

No Questions or comments by Board.

D. Salzwedel entertained a motion to approve the document as submitted. M. Koson made a motion to accept and approve the report as presented; second by J. Kubiak. Carried; 6-0.

Finance/Audit – M. Koson, Committee Chair:

Approve Minutes of August 20, Finance Audit Committee Meeting: M. Koson made a motion to approve the committee meeting minutes as presented; second by J. Kubiak. Carried; 6-0.

Approve Minutes of October 20, Finance Audit Committee Meeting: M. Koson made a motion to approve the committee meeting minutes as presented; second by J. Kubiak. Carried; 6-0.

D. Salzwedel reported that all minutes have been submitted to the full board prior to Board Meeting and vetted by each individual.

Legal RFP: D. Barden reported that the lottery published the RFP for Legal Services; it became available on November 17th. The lottery conducted its due diligence by publishing it in the legal journal of the newspaper, with the State Bar of NM and the lottery website. The lottery is requesting that the Board of Directors authorize the Finance Audit Committee to vet and approve any agreement with attorneys or law firms the lottery might want to contract with. To date, the lottery has received up to 6 requests from law firms for a copy of the RFP. The timeline is fairly expedited; proposals are due December 22nd, the evaluation committee begins on January 4th and the lottery is hoping to have contracts in place by February 1, 2016. The RFP is written to target three specialized areas of law; Intellectual Property, Human Resources and General Counsel for litigations.

D. Salzwedel clarified the CEO's request that the Finance Audit Committee be given the authority by the full board to make decision on behalf of the full board. D. Barden concurred. D. Salzwedel reported that this isn't an unusual request. The CEO will contact the Chairman of the Finance Audit Committee to request a special meeting to award the contract(s).

M. Koson made a motion to authorize CEO to schedule a Finance Audit Committee meeting at a date to be determined to approve legal representation contracts; second by A. Bailey. Carried; 6-0.

FY '15 Financial Audit: M. Koson reported that the Finance Audit Committee and lottery staff met with Moss Adams to review and vet the FY 2015 Financial Audit prepared by Moss Adams on October 20th. The Attorney General's Office released the official approval on November 17, 2015 and the lottery is waiving the 5-day period to present to the full board today.

Amy Carter presented a brief overview of the FY 2015 Financial Audit page by page. Page 27 highlights the building purchase. Page 45 shows the debt service requirement for the promissory note payable to Wells Fargo for the building purchase. And Page 31 shows Section 457(b) Plan that the board adopted in May 2014 and became effective on August 2, 2015. This allows lottery employees to contribute to their retirement plan before taxes. There are 39 participants.

Moss Adams issued a clean opinion (unmodified opinion) on the Financial Statements. The audit was completed in accordance with government auditing standards. There were no audit findings for the 2015 financial audit.

D. Barden reported that he received a letter from Mr. Jamie Rumbaoa, who is an auditor with Moss Adams "I'm very happy with all the significant changes within the lottery this year, you guys are definitely going in the right direction and moving to the next level". This comment is based upon the lottery moving to the vendor system and its discontinued use of the AS/400 system that was in place since 1996. The lottery estimates \$8 million dollars in savings over the next 8 years, just by moving to the new gaming system, even though the contract has gone up. The significant savings comes by eliminating positions and moving those resources to other areas.

Both M. Koson and J. Kubiak commented that it is impressive to see effects like that which are tremendous and very positive. Not many organizations in this state of our size and complexity that have a clean audit. This is the second year in a row there's been no audit adjustment and the first year, since 2010 that the lottery has had no audit finding. A substantial and continued progress in maintaining high quality standards in accounting practices. The committee is appreciative of the CEO, S. Jaramillo and NMLA staff.

M. Koson made a motion to approve the FY 15 Financial Audit as presented; second by J. Kubiak. Carried; 6-0.

Disposal of Obsolete, Worn Out or Unusable Tangible Personal Property: S. Jaramillo reported that the board has been provided a list of 96 categories of various assets, such as computers, servers, printers, cabinets, chairs and various other items. This list is an additional list that was provided to the board at the last meeting. These items were found in anticipation of the conversion in having Intralot on the lottery premises as per the new online vendor contract. Intralot will have an area in the warehouse and offices in the main building. These items have been identified as no longer in use, have a current resale value of less than \$5,000, have been fully depreciated, and are either worn out, unusable or obsolete to the extent that the items are no longer economical or safe for the use by the lottery. The lottery's Capital Asset Management Policy states the lottery follow the Audit Act by first contacting the state for the first right of refusal. The lottery can dispose of these items through the annual public auction held by DPS, or we can advertise them in publications widely circulated throughout the state, or use an acceptable internet website that has been used by other public or corporate entities in the state or as the board requested at the last meeting that the computers be transferred to school districts in need of computer. S. Jaramillo requests approval for the disposal of these obsolete assets.

S. Baragiola asked if this disposal complies with the state procurement code and if the motion covers the procurement code. D. Salzwedel replied yes. M. Koson reported that "agency" policy would fall in the realm of the procurement code.

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; 6-0.

Financial Statements: S. Jaramillo provided an update on September financials. The lottery has returned \$9.85 million to the Legislative Lottery Scholarship program. The lottery has returned more than \$664.4 million to the State for education, since inception.

Net instant sales were approximately \$19.3 million and accounted for approximately 58.74% of net sales. Instant ticket sales have increased by \$1.4 million during this first quarter this year compared to last year – an increase of 7.94% and have surpassed the FY 16 budget by over \$461,000.

Net drawing game sales were approximately \$13.5 million. Powerball sales were over \$1 million less; Mega Million sales were over \$800,000 less and Hot Lotto sales were nearly \$400,000 less than the FY '16 budget. Roadrunner Cash sales were ahead of the budget by nearly \$900,000.

Total Operating Revenues for the FY were just over \$32.8 million, which were about \$1 million less than the FY 16 YTD Budget, but nearly \$1.5 million ahead of the first quarter last fiscal year.

Non-Operating Revenues were less than the first quarter's YTD budget and the first quarter of the last fiscal year.

Total Game Expenses ended the first quarter at 99.21% of the YTD budget—while operating revenues ended at 97.04% of budget—tracking within a couple of percentage points of each other. Actual game expenses were 66.72% of Gross Revenues; the Budget was 65.27% of gross revenues. Game Expenses were a slightly higher percentage in the first quarter of this fiscal year compared to last fiscal year mainly because Prize expense was running at 55.89% of gross revenues for the first quarter this year where last year it was 54.77% of gross Revenues.

Total Operating expenses ended the first quarter at 3.24% of total Gross Revenues. With the total operating expenses at 77.38% of the YTD budget—every line item in Operating expense for the first quarter is lower than the YTD FY 16 Budget for a total \$311,000 decrease in actual expenses compared to the YTD budget. Comparing the total operating expenses for this first quarter to last year shows a \$218,000 decrease. About \$142,000 of the decrease this year was in salaries, wages, and benefits.

One last line item that you see on your financial statements this fiscal year is Interest Expense. YTD interest expense is approximately \$11,000 on the amount borrowed to purchase the building.

The Net Return to the Legislative Scholarship fund for the first quarter was nearly \$9.9 million, which is about \$500,000 less than the YTD Budget but nearly \$450,000 more than last year for the first quarter—a 4.75% increase.

J. Kubiak asked if the continued decline in Powerball will become a mainstay for the lottery. D. Barden reported that he will address that in his update, but Powerball has made some changes that will become effective Jan/February 2016. Mega Millions has not implemented any changes. These games are jackpot driven games and very unpredictable.

V. Torrez joined meeting at 12:20 p.m.

A. Bailey left meeting at 12:20 p.m.

MUSL Compliance Audit: M. Boland reported that he has a two document report for his audit on the MUSL Minimum Game Security Standards Compliance Audit. This audit is on the audit plan, due to the priority placed on it, as a member of MUSL and compliance with MUSL Standards. M. Boland reported there are no observations and controls are in place. However, M. Boland reported that there is a separate schedule, an internal schedule which lists four recommendations as part of the audit. This internal schedule serves as best practice recommendations and serve as suggestions to enhance current controls or business practices. Three of the recommendations are in the area of Return of Ticket Stock - Standard 20 and one recommendation in the area of Ticket Validation - Standard 30.

All four recommendations were vetted with board and staff. Some of the rules, policies and practices of MUSL compliance are antiquated; however, until those rules, policies and practices have been updated, the lottery and internal audit needs to continue following the procedures as outlined.

M. Koson made a motion to approve the MUSL Compliance Audit Report as presented by M. Boland; second by J. Kubiak. Carried; 5-0.

Other: None.

CEO Update: D. Barden provided a brief update on lottery operations. D. Barden reported that the Whines case involving the misprinted ticket is scheduled for a summary judgment hearing on December 17th. D. Barden reported that no other lottery has lost a similar case. The legal fees will be paid by the Vendor.

D. Barden reported that two Board Members attended the NASPL Conference in Dallas, TX and suggested that all board members attend a NASPL conference in the future. These conferences provide an invaluable inside look at what the industry is doing and where it will be going in all areas, such as online gaming, instant tickets, marketing, sales and the future of lottery retailers.

D. Barden provided some highlights from his Legislative Update which compares FY 2014 to FY 2015 with the LFC committee:

- The lottery has returned over \$400 thousand more than last year.
- Scratchers are up 14.45% over last fiscal year. If scratcher sales were down, the lottery would be behind \$3 million in transfers to the lottery tuition fund.
- The lottery's operating expenses are down over last fiscal year
- A historical overview of salaries, wages, number of employees and operating expenses from FY 2007 - 3.89% to FY 2015 - 3.69%.
- Where the money goes - a snap shot of the lottery operations: In FY 14 - 54.4% went to prizes translating into \$74.1 million, 5% to cost of product, 6.5% to retailer commission, 30.1% to the lottery tuition fund and 4% to Administrative Costs.

In FY 2015 - 55.2% went to prizes translating into \$75.6 million paid to players. \$1.5 million more than last year. Cost of Product went down to 4.6%; retailer commission stayed the same at 6.5%. The lottery returned 30% to the lottery tuition fund, translating into \$41.1 million. \$1.1 million more than FY 14. This shows that you can return more dollars at a lower percentage. And 3.7% to Administrative Costs. D. Barden reported that if the lottery doesn't get relief in Santa Fe in the upcoming legislative session, the lottery will have to reduce its prize percentage payouts on scratchers.

- The advertising budget decreased by \$200 thousand dollars. The lottery purchased "annual" buys in return the lottery will receive \$1.1 million in added value for this fiscal year.
- The lottery signed a new online contract for 8 years with Intralot with a base pricing of 2.9988%. The lottery will save approximately \$8 million dollars over the life of the contract. The prior contract was 1.5%. The lottery will receive 1,250 new retailer terminals and related equipment. In addition the lottery will receive a retailer based portal with internal control systems and mobile apps. An estimated value of \$11 million dollars.
- Powerball sales continue to decline. Powerball will be instituting changes in 2016.
- The lottery will be launching "Pay at the Pump" in the near future with estimated \$2 million additional dollars.
- The lottery will add a Sunday drawing for its PICK 3 online game.
- Scratcher Payout amongst neighboring states is averaging 69% to 70.7%, while the lottery remains at 63.75%.
- The lottery has to expand its sales base from traditional retail solutions to more mobile solutions to remain relevant with future customers.

M. Koson and S. Baragiola left Board Meeting at 1:12 p.m.

Marketing Presentation: W. Ahlm reviewed current marketing and advertising initiatives via power point presentation.

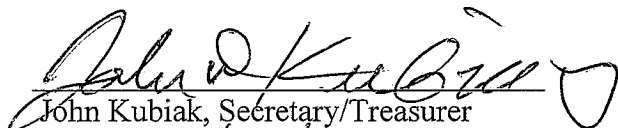
Other: D. Salzwedel reported that the Legislative initiative is gaining traction. Senator Smith will sponsor the bill this year and members of the board will be called upon to assist with moving the lottery's initiative forward.

Adjournment: D. Salzwedel entertained a motion to adjourn. J. Kubiak moved to adjourn the meeting; second by C. Austin. Carried; 3-0. The meeting adjourned at 1:32 p.m.



Dan Salzwedel, Chairman

Date 3/23/16



John Kubiak, Secretary/Treasurer

Date 3/23/16