

Finance Audit Committee Meeting
New Mexico Lottery Authority
June 10, 2015
MINUTES

Call to Order: Operations Committee Chair M. Koson called the meeting to order at 11:11 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 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.

FY 2016 Consolidated Original Budget: S. Jaramillo presented the FY 2016 Consolidated Original Annual Budget. Significant changes are:

- Increasing instant sales by \$4.5 million; a 5.63% increase compared to the FY '15 Revised Annual Budget; and a 12.67% increase or \$9.5 million compared to the FY '15 Original Annual Budget;
- Instant sales will end close to \$81.5 million this year; a \$3 million increase compared to actuals;
- Powerball sales will remain the same as the FY '15 Revised Budget of \$30 million, but will remain lower than the FY '15 Original Annual Budget by \$8 million dollars;
- The lottery is projecting that Powerball sales will end at \$28 million dollars due to a Powerball jackpot run up that got hit last week.
- Mega Millions sales will remain the same as the FY '15 Revised Budget of \$12 million; an increase of \$3 million compared to the Original Annual Budget;
- Hot Lotto sales will remain the same as the FY '15 Revised Annual Budget, an increase of \$1 million compared to the Original Annual Budget;
- Overall, the lottery is increasing Net Ticket Sales by \$3.4 million compared to the FY 15 Revised Annual Budget, a decrease of \$1.36 million compared to the FY 15 Original Annual Budget.

Direct Game expenses changes are as follows:

- The prize expense payout percentage was lowered to 53.26% to meet the 30% mandate to the state. The prize payout for the FY '15 Revised Budget was 54.53%; and was 54.00% for the FY 15 Original Budget;
- On-line vendor fees increased due to the possibility of an increase in the cost for the new contract starting either late in the second quarter or early in the third quarter of FY 16. This contractual change is projected to cost the Lottery at least an additional \$2 million in FY 16.
- Advertising was decreased by \$200,000 for the FY '16 Original Budget; compared to the FY '15 Revised Budget and \$300,000 for the FY '15 Original budget. This decrease is due to savings and added value that D. Barden and W. Ahlm achieved through annual buys of advertising.
- Ticket vendor fees are increasing as a result of the added instant ticket sales projected, but are still staying at less than 1% of gross revenues.
- Drawing game expenses are zero in FY '16 due to the automation of the drawing process that took place in October 2014.

Operating Expenses changes are as follows:

- Salaries, Wages and Benefits decreased by \$320,000 compared to the FY '15 Original Annual Budget. This change occurred with the re-organization of the lottery and elimination of some positions through attrition and transferring of positions.
- Other expenses, such as Leases, Property taxes, and insurance; Utilities and Maintenance; Depreciation and amortization; and professional fees have also been reduced.
- Leases, Property taxes and insurance have reduced significantly due to the purchase of the lottery building. The lottery is hoping to close on the building by June 30. The building will be depreciated for 38 years. Overall the lottery will be saving approximately \$160,000 for FY '16 by purchasing its own building.
- Overall, total operating expenses have been reduced by \$192,000 - a 3.56% decrease from the FY '15 Revised Budget and \$639,000 – a 10.93% decrease from the FY '15 Original Budget.

The 30% return to the Legislative Scholarship fund is projected at \$42.4 million. This is \$1.02 million more than the FY 15 Revised Budget, but \$409,000 less than the FY 15 Original Budget.

M. Koson asked when does the lottery expect changes to Powerball and how will it impact the Budget. D. Barden reported that changes will take place in October. S. Jaramillo reported there will be an impact; however, the lottery is being conservative at this time and only budgeting \$30 million. The changes will not take effect until after the first quarter. Changes will be made accordingly with the Revised Budget in March/April 2016.

J. Kubiak asked if there will be any staff increase or salary adjustments. D. Barden reported that the lottery is currently restructuring and reorganizing and looking for other cost saving measures to offset the anticipated additional \$2 million increase for the new online vendor contract that is set to expire in November 2015. The online vendor fee is anticipated to increase from 1.5% to 3% or 4%. Over the past several years, the legislature has been inquiring about the lottery's operational expenses; there will be an additional decrease for the Salaries, Wages and Benefits.

D. Barden reported that 10 stores are ready for the "Pay at the Pump" feature. These 10 stores are Murphy Stores and the infrastructure is there and ready.

S. Jaramillo requests recommendation from the Finance Audit Committee of the FY 16 Consolidated Original Annual Budget.

J. Kubiak made a motion that the Finance Audit committee recommends the FY 2016 Consolidated Original Budget as presented be recommended for approval by the full board; second by D. Salzwedel. Carried; 3-0.

Financial Statements: S. Jaramillo provided an update on April financials. The Net Income Return through April 30, 2015 was nearly \$34.7 million. Net sales were nearly \$115.6 million dollars; under budget by \$91,000, but ahead over last year by \$1.04 million due to instant ticket sales. Net Instant ticket sales were \$67 million dollars, exceeding the YTD Revised Budget by more than \$49,000 and nearly \$9.5 million more than last year; an increase of 16.47% this year. Total net drawing game sales were more than \$48.4 million dollars; under budget by 140,000 dollars and nearly \$8.5 million less than last fiscal year. All game expenses are trending with our sales at 99.59% and our sales are at 99.92%. Every line item is under budget. Operating expenses were 95.92% of the Revised Budget. All line items in Operating expenses were lower than the Revised Budget. The lottery is slightly ahead of budget for our return of 30%; \$428,622 or 1.25% more than the Revised Budget thru April; and \$189,631 dollars more than last year. The lottery returned 30.11% last year with fewer dollars to the scholarship fund. This proves that returning less percentage can mean more dollars returned to the scholarship fund.

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Capital Asset Policy: S. Jaramillo presented the Capital Asset Management Policy. This policy was revised to reflect new assets that the Lottery is purchasing, such as the building and any changes that this purchase may entail, works of art and to clarify language within the policy, such as Finance to Administration, tenant improvements to building improvements like renovations, land improvements and infrastructure and equipment. The life of capital assets has been updated to reflect the purchase of the lottery building.

D. Salzwedel made a motion that the Finance Audit Committee accepts and recommends the Capital Asset Policy as presented be recommended for approval by the full board; second by J. Kubiak. Carried; 3-0.

FY 2016 Internal Audit Plan: M. Boland presented the FY 2016 Internal Audit Plan. This plan identifies audit areas, preparing schedule of audit area description, establishing risk criteria and prioritizes the risk areas. The Internal Auditor will prepare the audit risk model, which prioritizes the audit areas by total risk, description of each audit activity and time dedicated to each area. The Internal Audit identifies the risk area; High, Moderate, Low based on industry risk factors defined within the audit plan. The High risk areas are items dedicated to the computer system and areas managed by the MIS division. Moderate areas are items that need to be audit, such as Financials and Instant Game review. Low risk areas are items that require monitoring, such as fleet, travel, assets, etc. Flexibility is built into the plan in the event management wishes to look at other areas not identified in the plan.

Multi-State Lottery Association "MUSL" is deemed a High risk area because the lottery needs to be in compliance with their Standards, specifically Rule 2, which oversees the computer system and ticket validations. The lottery's audit plan captures areas that are not audited by MUSL. MUSL conducts audit on each member (44 states) on a rotating schedule, the last audit/certification took place 8 years ago. The lottery is due for an audit this year. D. Barden reported that MUSL is updating their standards and compliance requirements.

J. Kubiak reported that he is surprised as mature as the lottery is, there are areas considered High Risk and asked if there are any High risk areas that are not on the audit plan. M. Boland reported all items that are deemed High risk are on the list. M. Boland further explained the formula used to derive what is considered high, moderate, low risk. Discussion continued on the value and the term "risk" and its definition. The term risk is used internally only and doesn't have any impact outside the lottery.

The Finance Audit Committee recommends that the term "risk" be changed to "priority"; High Risk to High Priority, Moderate Risk to Moderate Priority, etc. and to review the weighted factors on each area that will be audited on an annual basis. Some items that may be deemed high may be actually deemed moderate or priority/critical. For example the computer system - technology is always evolving and changing. The committee further recommends that Internal Audit conduct a review/survey of all US lotteries and their Internal Audit Plan and identify if there is a template used nationally. The committee requests a semi-annual audit report.

D. Barden reported that the Network System will be on the audit plan for next year and deemed a high priority.

J. Kubiak made a motion that the Finance Audit committee recommends that the Internal Audit report be accepted with the revision requested by changing the term risk to priority; 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 12:21 p.m.



Mark Koson, Committee Chairman

8-20-15
Date