

**Finance Audit Committee Meeting
New Mexico Lottery Authority
April 2, 2019**

MINUTES

Call to Order: Board Chair Dan Salzwedel called the meeting to order at 11:30 a.m. and asked for a roll call. Present and constituting a quorum were: Aubrey McGowen, and Dan Salzwedel.

Present from NMLA were: David Barden, Carolyn Cabell, Karla Wilkinson, Sylvia Jaramillo, Kevin Duda, and Wilma Atencio.

Approve Proposed Agenda: D. Salzwedel entertained a motion to approve proposed agenda as presented. A. McGowen made a motion to approve the proposed agenda; second by D. Salzwedel. Carried; 2-0.

Public Comment: None.

REPORTS:

Finance Audit Committee:

FY 2019 Consolidated Revised Annual Budget: S. Jaramillo reported that the Committee has been given a copy of the revised budget along with a recap sheet of the consolidated budget showing the major changes.

- Instant sales will remain unchanged at \$75 million
- Powerball sales were decreased by \$4.5 million
- Mega Millions sales were increased by \$11 million
- Roadrunner Cash sales were increased by \$500,000
- Pick 3 sales were increased by \$1 million
- Pick 4 sales were decreased by \$700,000
- Net ticket sales had an overall increase of \$7.27 million

S. Jaramillo reported that Powerball sales were decreased despite the recent jackpot runup. Prior to the runup, the Lottery was at 89% of Powerball budget and we may end up a little higher, but it won't be substantial. As soon as the jackpot was hit, sales dropped dramatically. The Lottery normally builds two to three jackpots into our budget and we've had two so far.

D. Barden reported we are running five draws behind each jackpot. The sales now are well behind what we were bringing in two to three years ago. When the jackpot gets hit, sales decrease. The time of the year also impacts our estimates as we head into the slowest part of the year. While the total for the year might come in higher because of current Powerball sales, we believe it would be better to be conservative in the revised budget. Powerball and Mega Millions are both lagging in sales and jackpots nationally. Powerball is looking at new promotions in the future.

D. Barden reported that lagging draw game sales are one reason we regularly talk about having better instant game payouts; our portfolio would be better off. However, the 30% mandate continues to hamper us while other states continue to see increases with their instant product.

S. Jaramillo reported that we brought in more money with the runup this last time, but we don't know if will sustain itself to be able to project higher on Powerball. Recent history shows that it won't. The revised

budget for Powerball is conservative so that stakeholders do not rely on a higher amount for scholarships that does not occur.

D. Barden reported that in 2016 when we had the \$1.5 billion jackpot, our sales were \$8.7 million, and it took 20 draws to get to \$1.5 billion. When we had the \$750 million jackpot, it took 27 draws and we had only \$1.4 million in sales.

D. Salzwedel stated there's a significant difference between Mega Millions and Powerball. S. Jaramillo reported that we increased Mega Millions by \$11 million due to the \$1.5 billion jackpot bringing in more sales than projected. The budget for Mega Millions last year was \$11 million and this year we're going up to \$21.5 million.

The Lottery is projecting a \$41.5 million return to the state. S. Jaramillo reported that the Lottery used about \$2.3 million in unclaimed prizes and have used the unclaimed prizes seven of the eight months of this fiscal year.

S. Jaramillo reported that every line in Operating Expenses were reduced. The largest reduction was to salaries, wages, and benefits. Operating expenses were reduced by \$243,000. We've been holding operating expense as much as we can.

D. Salzwedel asked about the \$45,000 drop in utilities. S. Jaramillo reported that the Lottery has completed some projects at the facility such as converting to LED lighting within the building and outside. The Lottery also replaced the roof with better technology and switched to a white roof which has helped with heating and cooling. D. Barden reported that even in the warehouse if you're not in a particular area, the lights shut off automatically after a certain time period.

D. Salzwedel asked how much is left under amortization for the building. S. Jaramillo reported quite a lot because we chose the expected useful life that was left. We put the building on a 5-year amortization. S. Jaramillo reported we have one more year after this to pay off the building.

D. Barden reported we also have reserve funds. D. Salzwedel stated as we move into the future it is important that we retain that fund. S. Jaramillo stated that the reserve fund was one of the best things the Board of Directors have done. By having a reserve fund, the Lottery retains cash flow. This is important because without the reserve, if the use of unclaimed prizes were to be taken, we wouldn't be able to pay our vendors. D. Barden reported that there has been discussion to put more in the reserve funds. The external auditors have also recommended that the Lottery put more into its reserve funds. Both D. Salzwedel and A. McGowen recommend that the reserve fund be identified in the financial audit. D. Salzwedel asked that the auditors make a note in the financial audit stating that the management procedures enacted over the last three to five years should stay in place. S. Jaramillo reported that she will insert the information in her comments section for future Board meetings.

D. Salzwedel entertained a motion to approve the FY 2019 Consolidated Revised Annual Budget. A. McGowen made a motion to approve the FY 2019 Consolidated Revised Annual Budget; second by D. Salzwedel.

S. Jaramillo reported she has one additional item that would result in an amendment to the motion. S. Jaramillo reported that the Lottery is obtaining a data server for the IT department which is already listed in the budget under capital asset expenditure for \$7,000 and could go up to \$30,000.

C. Cabell reported that the IT department is currently obtaining specifications for the server and it should fall between \$7,000 and \$30,000 and we wanted that flexibility should it be more. D. Salzwedel asked why. D. Barden reported that the Lottery is looking for a more robust server for reporting which would allow

staff to run their own reports, which would be a significant time saver. It is the CEO's goal that Intralot pay for this server and he will have that discussion with the vendor. This need was illustrated during our recent Pick 4 issues when we couldn't run reports as quickly as we needed them.

D. Salzwedel asked why there is a discrepancy in the amounts. C. Cabell reported we recently received specifications from the vendor and what they recommended we obtain was more than we anticipated. D. Barden reported we initially guessed the amount when preparing the budget and we did not know all of the specifications.

S. Jaramillo wanted to point out that either amount (\$7,000 or \$30,000) won't affect the financials because it won't be in place until May or June, so the depreciation will be covered by what we have already budgeted. S. Jaramillo requested that the Committee consider approving this revised budget with the condition that the \$7,000 may change to a higher amount. S. Jaramillo suggested this to be part of the amended motion.

A. McGowen made a motion to approve and amend the FY 2019 Consolidated Revised Annual Budget and adjusted budget with the notation that the capital asset expenditure will be increased to \$162,500 for the data server by adding an additional \$30,00 to this specific line item; second by D. Salzwedel. Carried; 2-0.

Financial Statements: S. Jaramillo reported on the February 2019 financial statements. The Lottery has returned nearly \$3.216 million for the month to the Legislative Lottery Scholarship program. With this transfer, we have transferred nearly \$28.7 million to the scholarship fund for the year. The Lottery has met the statutorily required 30% return. The Lottery has used \$2.379 million in unclaimed prize funds to meet the 30% return in seven of the eight months of the year.

During the last 11 years, eight months, the Lottery has used unclaimed prizes over 83.57% of the time to meet the mandated return, translating into 117 months out of the 140 months. During this time, the Lottery has returned nearly \$41 million to the scholarship fund. This year the average balance of the unclaimed fund has been about \$2.7 million with a low of \$1.6 million and a high of \$3.5 million. The unclaimed balance ebbs and flows depending on jackpot runups for Powerball and Mega Millions when players don't claim their small prizes. Also, when instant games are being closed, we see an increase of unclaimed prizes.

D. Salzwedel asked the status of a sports lottery game. D. Barden reported we have draft specifications and staff are reviewing them. Also, we were waiting to see if the Legislature would take action to prohibit such a game. D. Salzwedel asked how long it will be before we launch the game. D. Barden reported it would be at least six months. D. Barden stated he believed the vendor was also waiting to see happened legislatively. D. Barden reported the vendor is having issues related to resources. D. Salzwedel asked for a briefing at another time.

S. Jaramillo reported the net income for the fiscal year is nearly \$3.3 million more than the FY 19 YTD budget or 12.95% more, but only \$1.5 million more than the same period in fiscal year 2018. This increase is mainly due to Powerball and Mega Millions sales, which helped to more than double sales for the month to \$21.8 million.

Net instant ticket sales were approximately \$48.8 million, whereas YTD Net Instant Sales through last February were approximately \$47.9 million – an increase of \$854,000 or 1.78% from last year. Net Instant sales surpassed the budget by nearly \$1.2 million or 2.51%.

Net drawing game sales were approximately \$46.9 million. Net drawing sales ended approximately \$9.3 million or 24.75% more than the YTD 2019 Budget. Net drawing sales were approximately \$4.1 million more than the same eight months of last year.

Total Game Expenses ended at 112.15% of the YTD Budget while total net sales ended at 112.32% of budget, tracking close to each other.

Total Operating expenses ended February at 3.23% of Gross Revenues. Each line item of operating expenses for this fiscal year are being held as much as possible and are less than budgeted amounts.

Retailer Compensation Plan Policy: D. Barden reported that the Lottery has discussed issues with retailer commission for several years. The Committee has been presented with a policy update that allows the CEO to make an adjustment of 1% to the current commission rate of 6%. D. Barden reported that down the road, the Lottery would like to revamp the entire retailer commission structure to allow for incentivizing retailers that properly display our products, such as putting our dispensers on top of the counters. The Lottery needs to be more proactive from a sales approach.

A handout out from La Fleur's magazine was provided to members that lists what other US lotteries pay in retailer commission rates. Half of the US lotteries pay a 5% commission rate, while the NM Lottery pays 6%. Most states also don't have a 30% mandate. As our vendor contracts continue to increase, adjusting retailer commission would be the only area we have available to make sure we meet our day-to-day operations while still meeting the 30% mandate.

D. Barden reported that the changes to the policy are minimal and allow the CEO to make an adjustment to the commission rate, notify the retailers of this change, and update the Board of the changes. The proposed changes are:

- Language has been added to clarify that the CEO may reduce the sales commission per this policy and that the CEO may negotiate a reduced sales commission rate with a retailer.
- Language had been added to explain that the CEO may reduce the retailer sales commission to "meet the annual approved budget or to meet statutory transfer requirements to the Lottery Tuition Fund," and to describe the process for implementing that decision.
- Notation of revision history, logos, and formatting were updated throughout.

D. Barden reported that unless the 30% mandate goes away, at some point the Lottery must reduce the commission rate, especially if contract rates continue to increase. D. Barden stated that from the beginning the Lottery set the retailer commission rates too high compared to the rest of the lottery industry.

D. Salzwedel clarified that the Lottery is requesting the ability to reduce the commission rate to 5% and the flexibility to incentivize retailers by performance. D. Barden reported that it will be a performance driven measure that allows us to use the commission to incentivize retailers.

A. McGowen reiterated that the policy update states it would allow the CEO to reduce the commission rate by 1%. The policy is not setting the commission rate at 5%; it allows for a reduction of up to 1%. D. Barden agreed and stated that any change more than 1% would need to be approved by the Board.

D. Barden reported that with that 1% flexibility the Lottery will work on a plan to incentivize retailers by giving them more money for doing the things at retail that we need done to increase sales. Currently, the retailers can choose not to follow best practices with lottery dispensers and other materials. Recently a retailer wanted to pull 118 play centers and we can't afford to lose 118 stores. The Lottery has no way to impact retail behavior.

The Committee wants the CEO and Lottery to have the flexibility to make necessary changes to the Retailer Commission Plan Policy to incentivize retailers in a structured plan that will be outlined by the Lottery. The Committee will recommend that the CEO proceed with this plan and that such a plan may not require the CEO to come back before the Committee or full Board.

D. Salzwedel entertained a motion to approve the Retailer Compensation Plan Policy. A. McGowen made a motion to approve the Retailer Compensation Plan Policy; second by D. Salzwedel. Carried; 2-0.

Other: None.

Adjournment: D. Salzwedel entertained a motion to adjourn. A. McGowen moved to adjourn the meeting; second by D. Salzwedel. Carried; 2-0. The meeting adjourned at 12:27 p.m.



Dan Salzwedel, Chairman

Date: 6-26-19