

MINUTES

ARKANSAS LOTTERY COMMISSION

Wednesday, March 19, 2014

10:00 a.m.

**124 West Capitol Avenue, Third Floor
Little Rock, Arkansas**

Call to Order

Chairman George Hammons called the meeting to order. Commissioners Smokey Campbell, Julie Baldrige, Dianne Lamberth, Raymond Frazier, Bruce Engstrom, Mark Scott, Doug Pierce and Alex Streett were also present. Staff members present included Director Bishop Woosley, Matt Brown, Jean Block, Jerry Fetzer, Robert Stebbins, Joanna Bunten, Lance Huey, Angela Meredith, Patti Vick, Maria Craig, Terry Williams, Valerie Basham, and Jeremy Smith.

New Commissioner

Chairman Hammons welcomed Alex Streett, ALC's newest commissioner. Commissioner Streett is the senior partner at the Streett Law Firm, P.A., in Russellville. He replaces Commissioner Ben Pickard, who resigned from the commission in January when he was appointed to the Arkansas Higher Education Coordinating Board.

Approval of Minutes

The first order of business was the approval of the minutes of the meeting held on February 19, 2014. Commissioner Pierce noted that a few changes needed to be made to page 4, adding that the information he had provided was not precise. He said that he would e-mail the changes to Ms. Vick. Commissioner Campbell made a motion to accept the minutes as corrected and Commissioner Lamberth seconded the motion, and the minutes, as corrected, were unanimously approved.

Report from the Internal Auditor

Internal Auditor Brown was recognized to give his monthly Internal Audit Update (in file). Mr. Brown reported that there was an audit kick-off meeting on February 26 for Project No. 29, an audit of Payroll & Leave, with fieldwork scheduled to begin March 20. There was also an audit kick-off meeting held on March 12 for Project No. 7, an audit for Instant and Online Ticket Game Development. Fieldwork for that audit was expected to begin in early April.

Mr. Brown said that Project No. 8, an audit of Points for Prizes and Play It Again, was complete and a report was issued on March 4. An observation was made that there was no current SOC 2 or equivalent audit of MDI, which is a subsidiary of Scientific Games International (SGI) under contract with the ALC. The SOC 2 audit would focus on activities and operations undertaken to administer portions of the ALC's player loyalty programs. ALC management has requested that MDI undergo a SOC 2 audit and MDI/SGI has agreed to such audit at their expense. Internal Audit recommended that ALC management actively pursue and encourage current audit efforts

and that future audits also address Availability, Processing Integrity, and Privacy Trust Services Principles, and that this audit requirement be incorporated into any future extension or replacement of ALC contracts for player loyalty program services. ALC management agreed with the Internal Audit recommendation that the ALC should make this audit a requirement in either the extension or replacement of the vendor contract that governs the player loyalty programs that are set to expire in August of 2016, and that such audit requirements incorporated into the applicable vendor contract should specifically state which AICPA Trust Service Principles need to be covered. Additional follow-up will be necessary in order to consider the observation cleared.

Mr. Brown stated that Project No. 46, Instant Ticket Vendor Security Review, was scheduled to take place on March 3. This project was a coordinated (with an outside firm) security review of instant ticket vendor SGI. Internal Audit is expecting to receive a report and analyze the results no later than June 15.

Report from the Director

Director Woosley was recognized to give his report (in file). Mr. Woosley said he wanted to begin his report with good news and announced that Miranda Huffman of Lepanto came into the Little Rock claim center on March 18 to claim a \$3 million Mega Millions prize. He added that it was the second-largest prize in ASL history. The winning ticket was sold by Jordan's Kwik Stop in Lepanto. The store's representatives, who were in attendance, were presented with a large check which represented the 1% selling bonus of \$30,000. He stated that the most recent Mega Millions jackpot run of \$400 Million ended with the draw of March 18, which produced two grand prize winners, one each in Florida and Maryland. That run, from January 4 to March 18, generated almost \$4.7 million in Arkansas Mega Millions ticket sales.

He said that the current highest-ever Natural State Jackpot of \$295,000 was also good news. He added that management was very pleased with the success of the game, which has had several jackpots of over \$200,000. Sales for the game's current jackpot run, which began on January 15, were \$1.3 million to date.

He reported that in February the Arkansas Scholarship Lottery had reached the \$2 billion mark in sales. He added that over \$1.26 billion in prizes had been awarded and, more importantly, the lottery had earned over \$413 million in net proceeds.

Director Woosley then reported on the Comparative Income Statements. He reported that instant ticket sales in February 2014 were down about \$5.4 million compared to February 2013, a trend that has been ongoing the last 12 to 18 months. He said that the last four instant ticket launches had been adversely affected by the recent bad winter weather, but that instant ticket sales were starting to level out. Online tickets for February 2014 were up approximately \$2.5 million compared to February 2013, an increase he attributed to large online game jackpots. Although the February 2014 Income Before Transfers amount was larger than in February 2013, a \$2 Million instant ticket prize claimed in February 2014 reduced net proceeds to \$5.9 Million, or about \$537,000 less than February 2013 net proceeds.

In reviewing the Year-to-Date comparison, Director Woosley noted that instant ticket sales were down \$20 million, but that online ticket sales were up by \$10 Million. Net proceeds were down \$5.2 Million compared to year-to-date February 2013. The ADHE Transfer Analysis reflected that transfers to ADHE were down a total of \$5.7 million for the year, but Director Woosley stated that if current trends continued, [ALC] would meet the projected budget. He added that weekly ticket sales were on the upswing, that management typically preferred to see sales at or over \$1 Million per day, and that as of the week of February 16 that appeared to be happening.

Director Woosley showed a Powerball Sales Year to Date Slide, which illustrated that only three states had a gain in Powerball sales year to date. Arkansas's Powerball sales were in the middle of the pack, with a -9.90% change for the year. He said he would be going to a MUSL meeting in Arizona next week, where there would be discussion of a possible Powerball matrix change. He added that from a staffing standpoint, these changes could be frustrating, because every time there was a change to Powerball, all play slips had to be pulled and retailers and players had to be reeducated. Director Woosley also showed a slide on Mega Millions jackpot trends. The slide illustrated that in comparing jackpot runs in 2012 to 2013 and 2014, sales for the more recent jackpots were noticeably lower.

Director Woosley reported that the new Lucky for Life game, which would replace the current Decades of Dollars game, was close to coming to fruition. He said that the game should have more Arkansas winners [than Decades of Dollars]. The top prize will be \$2000 a day for life and the second prize is \$25,000 per year for life.

Next, Director Woosley updated the commission on the status of the lottery ticket theft recovery. He reported that ALC had received \$247,500 from Arkansas Fidelity Bond Trust Fund and National Union (Crime Policy) had recently agreed to pay ALC \$213,546.98 for its loss from cashed tickets. The total amount to the settlement of losses was \$461,046.98, an amount that came close to making ALC whole from the loss. The amount of \$13,526.02 was deducted from National Union's payment, which reflected unused leave by the employee and funds that ALC contributed toward Arkansas Public Employee Retirement (APERS); he said that ALC Legal was currently working to capture those funds.

Director Woosley presented a "Wish List" slide, which he had been asked to provide to the Commission during the February 2014 ALC meeting. Commissioner Engstrom requested that item number 8 of the "wish list," *Immediate consideration of contract renewal proposals from instant and online vendors*, be sent to the Vendor Committee. After much discussion, Chairman Hammons suggested that, over time, the Director should recommend individual items on the wish list to specific committees. Chairman Hammons added that, as a full commission, there should be no real discussion of committee assignments at this point. Commissioner Engstrom asked if that meant the Director could choose which committees would receive the wish list items. Commissioner Engstrom stated that it would be in the commission's best interest to retain control over assignment of issues. Chairman Hammons then asked Director Woosley to

submit recommendations to the commission and the commission would decide which committee would receive it. Commissioner Lamberth noted that the Audit and Legal Committee had the same members as the Vendor Committee. Director Woosley requested that there be a joint Vendor and Audit/Legal Committee meeting for the contract issues that the commission wanted to go through item by item and section by section because the process was lengthy and intensive. He also requested that the commission consider meeting every other month because the staff was currently working on the following: Performance Audit; the instant contract, line by line; the online contract, section by section; the advertising contract, section by section and possibly developing an RFP for same; a review of the claim center contracts and determining solutions for same; development of an employee survey related to staffing structure; Legislative Audit, who would be returning in a few months to conduct their annual audit ; preparations for end of fiscal year 2014; a possible Powerball matrix change; start of the Lucky for Life game; preparations for ALC's five-year anniversary; employee evaluations; contract reviews by Internal Audit; the national game review meeting; significant IT structural replacement of computers and servers; OrderPads; an advertising tracking study; retailer research study; and focusing on sales. He asked that the Commission not view the request as a complaint, but that with meetings every month, two weeks of every month were dedicated to commission meetings and two weeks of every month were devoted to other work. Chairman Hammons indicated that discussion of meeting every other month would be addressed at the next ALC meeting, after commissioners had taken some time to consider the request.

Reports from ALC Committees

Audit and Legal Committee: Nothing to report.

Higher Education Committee: Commissioner Frazier announced that the Higher Education Committee would meet at 9:30 a.m. on the day of the next commission meeting to discuss advertising with colleges and universities.

Personnel Committee: The scheduled personnel committee meeting (after ALC meeting) was cancelled.

Retail and Marketing Committee: Commissioner Pierce reported that all members were present. He stated that he had a motion to present to the commission but that he wanted to note for the record that all committee members who were present, as well those who were present ad hoc, desired to pursue the motion very slowly and thoughtfully, and they recognized ALC's retailers as valued partners. He stated that ALC did not want to do anything to harm the retailers and the ultimate goal was to try and find middle ground and to reach a solution that worked for ALC and for the retailers. Noting that the motion he was presenting had passed unanimously in committee, Commissioner Pierce made the following motion:

On behalf of the members of the Retail and Marketing Committee, I make a motion to empower the ALC Director to pursue the use of debit cards for purchasing lottery tickets.

Commissioner Scott seconded the motion and the motion passed without dissent.

Commissioner Scott asked that Director Woosley clarify what the next steps would be regarding debit cards. Director Woosley said the next step would probably be to send the request to the LOC and at some point, probably around October, the LOC would start mulling the legislative agenda. Director Woosley asked Patrick Ralston, Legislative Analyst for the LOC, if this was correct and Mr. Ralston confirmed that legislative working groups started around October. Director Woosley added that the Commission would meet with the LOC as the LOC saw fit, and that ALC would continue to meet with retailer groups to try and build consensus before the next legislative session. Commissioner Lamberth commented that the vote was to clarify that “debit” meant “cash” and to try to get that change through the legislature. She advised that the vote did not mean that once the legislative change was made, the commission would automatically accept the use of debit cards. The commission would have to revisit and discuss the debit card issue at that time.

Vendor Committee: Commissioner Scott reported that the Vendor Committee met at 9:00 this date and passed a motion that Director Woosley and his staff provide to the committee criteria that would be considered in the ALC request to Legislative Audit to produce (or have produced) a Performance Audit RFP. Also included in the motion was for staff to provide to the committee a list of eight to ten lotteries comparable to Arkansas. Commissioner Scott said that the committee would be meeting in two or three weeks, or some time before the next full commission meeting. Commissioner Scott said that the committee had recessed just prior to the full commission meeting and would meet again immediately following the Commission meeting to discuss monitor games.

Other Business

Chairman Hammons recognized Director Woosley, who reminded the commission that there had been a request that ALC’s instant ticket vendor give the commission an update of instant ticket sales. Director Woosley introduced Mr. Toben Molica and Martha Hernandez of Scientific Games International. Mr. Molica gave a PowerPoint presentation (in file). Mr. Molica stated that ALC had the most successful start-up of any lottery on record, and the consequences of that were precisely why ALC was in the current situation of lower ticket sales. The first graph he showed compared Arkansas to the four most recent lottery start-ups: Tennessee, South Carolina, North Carolina, and Oklahoma. He pointed out that the Arkansas Scholarship Lottery began its decline from the very beginning. He said that ALC had introduced its first \$10 game fairly early on, followed by its first \$20 game in the Spring of 2010. He said that Tennessee didn’t launch a \$20 ticket until year four. Mr. Molica said that ALC had put all of its bullets out immediately and did not save anything for sustained growth. He advised that a lottery would normally want to grow slowly and steadily, and that the other lotteries had different strategies in introducing higher price point tickets. He said that some of the decisions made early on by

ALC were not in the best interest of Arkansas. He said that in the instant ticket business, change didn't happen fast, and that change could take months and months. He advised that ALC now needed to behave like a more mature lottery. He said that questions should be asked, for example, how quickly are packs activated? He said that there were a much lower number of new packs being activated in Arkansas, and that the goal was to get the game packs activated. He stated that there were recent discussions of allowing partial returns for slow selling games. That would allow the retailers to empty their bins of slower selling games, replacing them with the new games. He also suggested possibly reducing the number of \$20 games, adding that four \$20 games were too many and that they should be considered spotlight games which appealed to a smaller segment of players. Commissioner Campbell asked if all state lotteries carried as many games as Arkansas. Mr. Molica responded that the average was 24 to 30 and that ASL was about average. He said that the Massachusetts lottery launched maybe 20 games a year, but they had 70-80 different games available for sale and that their games tended to last for years. Commissioner Campbell commented that when he visited lottery retailers, the displays looked too busy and surmised that maybe the retailers were selling too many. Mr. Molica said that it could certainly be a possibility and was worth reviewing. He said that a retailer focus group could provide a good deal of information regarding issues and concerns retailers had at the sales level. He added that ALC currently has the right number of games for best practices and that changing the dynamics of product mix could in fact be detrimental. Mr. Molica said that prize structures were an ongoing issue for players but that, in fact, it wasn't that players weren't winning as much, but that players weren't playing as much. He said that instant tickets were usually impulse purchases, and that if players didn't see the tickets, they wouldn't buy the tickets. He suggested reviewing the Players Club and perhaps consider re-launching the program. The last slide he presented was of a table of U.S. lottery ad budgets as percentage of sales. He advised that businesses needed to invest in their own success, that is, invest in advertising and promotions. He noted that Arkansas's ad budget was 1% of sales and that perhaps it should consider investing more money in the advertising budget. Commissioner Scott commented that the effectiveness of ASL advertising was just as important as the money spent.

Meeting Date

The next commission meeting was set for 10:00 a.m. on Wednesday, April 16, 2014.

There being no further business, the meeting was adjourned.