

MINUTES
ARKANSAS LOTTERY COMMISSION
Monday, August 15, 2011
1 p.m.
ALC Conference Room
Third Floor
124 West Capitol Avenue
Little Rock, Arkansas

Chairman Lamberth called the meeting to order. In attendance also were Commissioners Malone, Pickard, Campbell, Engstrom, Faris, Frazier, Hammons and Shipp. The ASL was represented by Director Passailaigue, Internal Auditor Hyde, David Barden, Ernestine Middleton, Bishop Woosley, Julie Baldrige, Patricia Vick, Whitnie Hall, and Jeremy Smith.

The draft minutes for the July 13, 2011, meeting were considered. Commissioner Frazier noted that his name had been left off those in attendance. Commissioner Pickard noted that he had asked for a breakdown on the number of TVMs that were placed in new retail locations and in existing retail locations. With those changes, with a motion by Commissioner Faris, seconded by Commissioner Engstrom, the minutes were approved without dissent.

Commissioner Lamberth asked Director Passailaigue to review the circumstances surrounding the Internal Revenue Service penalty (spreadsheet included in file). The Director explained that IRS payments are based on threshold amounts, and that beginning in September 2009, the threshold set by the IRS was on a monthly basis. He said that when Powerball was added on October 31, 2009, there were larger prizes and the IRS payment schedule went weekly and then semi-weekly. Once prize withholdings exceed \$100,000, the IRS requires a tax payment within twenty-four hours. Annually, the Lottery is required to file a Form 945, which was filed in early 2010 for the calendar year 2009. This form lists the date the deposit was due to the IRS and the date on which it was paid. On April 26, 2010, the IRS sent a notice of delinquency and the finance staff contacted the IRS in Pennsylvania, asked for a waiver of penalties and interest, which was granted, he said. The staff assumed the waiver was "to date" since there would have been no way to cure the problem prior to April 26, when it was brought to their attention, but it was not, he said. He said that as a former practicing CPA, he would have had that issue resolved in writing, but that was not done.

Early in 2011, the staff filed Form 945 and received a notice of a penalty in excess of \$98,000. He said the staff demonstrated diligence after April 26, 2010, and had paid the IRS late only five times after that date. He pointed out that it appeared the IRS sometimes did not apply deposits directly for the withholding instance intended. He said that the transfers had been made through the Bank of the Ozarks computer system's automated clearinghouse (ACH), but, unknown to the accounting staff at the time, this process takes longer than 24 hours to clear. One penalty, \$60,693 for the Powerball jackpot winner in February 2010, constitutes the bulk of the penalty amount. He said the Lottery now is using the secured IRS website to make the transfers, and that the IRS

has the latitude to waive the penalties. As to where it stands at this time, he said that the request for a waiver was rejected on July 19 and the Lottery has 60 days to file an appeal to an IRS section in Pennsylvania, and he hopes that they will look favorably on the appeal. He said he was guardedly optimistic and that he wants the Lottery to put its best case forward. It was discussed that serious effort would be put forth to follow where the money that was remitted was applied, since the IRS schedule and the ALC schedule do not match. The Director asked that the Commission to hire a CPA firm or a tax attorney to help compile information for the appeal, which could be done immediately since the contract would be lower than \$25,000 threshold.

Commissioner Engstrom said, regarding the CPA firm or tax attorney, that he hoped qualifications could be considered over cost. Commissioner Frazier asked if the IRS could decide where to direct the application of the Lottery funds submitted, and Commissioner Engstrom said that the IRS could unless the Lottery gave specific instructions for application. Commissioner Pickard confirmed with the Director that he was first notified of this matter on Wednesday, August 10, asking the Internal Auditor if the CFO had ever disclosed the matter to him and receiving an answer in the negative. Mr. Hyde said that one aspect of the FY 2011 audit plan was tax filing, about which he had met in April with the CFO and the VP/Administration, but that this matter was not disclosed, and that he had learned about it on Wednesday, August 10. Commissioner Campbell noted that therefore there was an opportunity to disclose the issue to the Director but that it was not disclosed. Commissioner Engstrom suggested that, henceforth, the Lottery make a deposit in advance, with daily estimated deposits, to be cautious. The Director said he would put that in place today.

Commissioner Frazier moved to employ a tax attorney and call in a CPA if needed, with a second from Commissioner Faris. Commissioner Engstrom said he would volunteer his time to help. Commissioner Malone asked if this could be done in-house and whether the Commission was throwing good money after bad. Commissioner Engstrom said the ALC can employ a tax attorney by the hour and that the ALC staff can do the work with the attorney looking over their shoulders and giving instructions, stressing that this effort must be undertaken to save scholarships. Commissioner Campbell suggested soliciting the help of the Arkansas Congressmen and Senators. Director Passailaigue said that this should be kept as an IRS matter and that he hopes for a good result once the case is made. Commissioner Faris wondered whether other state lotteries had these problems, how they resolved them, and what mechanisms they had in place to avoid them. The Commissioners discussed the likely total cost of the tax attorney. The motion was approved without dissent.

Director Passailaigue presented his monthly report (included in file). He discussed that there were no instant ticket game closings that produced unclaimed prizes this July and presented a comparison between July 2010 and July 2011 in revenue, costs, and net income. He noted that gaming was up 22 per cent, with instant ticket sales up markedly and online sales down. Pointing out that games are closed out for business reasons rather than on a predictable schedule, he compared the actual figures versus the budgeted amounts for July 2011. He related a transfer analysis and Commissioner Engstrom asked for percentages of revenue and gaming costs. Mr. Passailaigue said that Points for Prizes expense had been reclassified to a contract cost. He pointed to revenue trends, noting that Fridays were uniformly the best day of the week for play. He said July prizes were 68.5%, going in the opposite direction from what was hoped. He noted that there were three quick \$1 Million instant ticket winners in the new game and

said that had raised the prize percentages and depleted the net proceeds. He said the introduction of the *Arkansas 50/50* raffle game would commence in October. He noted the Powerball run in August, during which sales trended upward, and said that the staff is working to raise the proportion of online sales to raise the percentage going to scholarships. Commissioner Hammons asked him what model he had used to arrive at these conclusions and was told Oklahoma. Commissioner Pickard asked about Tennessee and South Carolina and the Director responded that 15 per cent of South Carolina play is by residents of North Carolina and that it is more of an East Coast state, and that Tennessee had the second highest sales of instant tickets in the country, behind Arkansas.

Commissioner Pickard questioned the reasoning of a \$20 game with a 78% cost and Vice President Barden said it was only 2% higher than the \$10 game. Commissioner Pickard said that it didn't appear the profits were good on the \$20 game and the Director said that it was likely the only way to engage players who were real gamblers. Mr. Barden said it was the only way to have several \$1 Million "nice prizes." The Director said that some players don't like a high-stakes game where there is a good chance the big winner will be from another state. Mr. Barden reported that there have been 98 instant games launched since startup, with 51 currently active. He also pointed to Arkansas as having the most successful affinity program in the world, with more than 190,000 subscribers. He said that the new Powerball game, to debut in January, should build the online player base. Commissioner Hammons asked if there was a way to measure whether a game brings in new players. Mr. Barden said that the Points for Prizes program is a way to show players extra value for their lottery purchases and said that each game has its own niche.

The Fiscal Year 2012 Budget, with revisions, was presented for review. The changes were: increasing the ADHE administrative expense from \$240,000 to \$1,313,280 reflecting current estimates from ADHE of their cost to administer scholarship funds; increasing professional fees by \$55,100 for the CAFR RFQ ; increasing administrative costs by \$4,000 to upgrade Peachtree payroll services; and increasing net proceeds by \$1,000,000 reflecting the 2011 reserve set up in fiscal year 2011. By motion of Commissioner Malone, second by Commissioner Shipp, the amended budget was approved without dissent.

Following a short break, Mr. Barden presented initiatives under way to enhance online game participation (included in file). He described the new *Arkansas 50/50* game, with creation of media and Point of Sale materials ongoing. He said that he was studying what was happening in other states in order to improve the Arkansas Lottery. He spoke specifically of the work that Georgia is doing to promote the Decades of Dollars game. He discussed the upcoming change in Powerball and noted that online games would be added to the Players Club in January. . He said they also were looking at ways to expedite purchases. He said that player rewards work and mentioned that the online games would be included in the Players Club program soon. Commissioner Hammons said he was curious as to the ease of selling two types of tickets at retailers, mentioning that he had heard clerks say it is harder to do. Mr. Barden said that one reason for the success of the "mom and pop" retailers is that they ask for the sale. He said that, at the beginning of the lottery, the plans included measures to help the retailer, such as the serve-yourself ticket checkers at every location.

Chief Legal Counsel Bishop Woosley introduced the subject of the Lottery's crime insurance. He said that in September 2009, a policy was obtained to insure against damage from Employee theft, and that this policy had been renewed in September 2010. He said the annual cost was \$8,681 and asked whether the Commissioners would approve renewing the policy. By motion of Commissioner Pickard, with a second by Commissioner Frazier, the motion was approved without dissent.

The Commission began discussion of the Request for Qualifications (RFQ) for outside legal counsel, as approved by the Audit and Legal Committee, whose Chair, Commissioner Pickard, introduced the matter for an up or down vote. Commissioner Faris asked that the matter be tabled until the next meeting to give commissioners time to review it. He said he saw the service being used only on an as-needed basis. Commissioner Lamberth asked that the matter be placed on the agenda for the next ALC meeting.

Commissioner Pickard asked that the written record of the August 5 Audit and Legal Committee be attached to these minutes of the August 15 ALC meeting. He said that the Committee will establish a line of communication with the Legislative Auditors through the Internal Auditor and the Audit/Legal Chair or his designee. He brought forth the matter of retroactive pay received by two employees. Discussion followed, with consensus that the payments were not the fault of those who received it, that they were doing the work for which they were paid, and that the Chief Legal Counsel had discouraged pursuing the issue. Legislative Auditor Andy Babbitt said that it would be up to the legislature whether this would close the issue, but that there was a reasonable chance that it would. By motion of Commissioner Pickard, seconded by Commissioner Engstrom, the Commissioners without dissent voted to conclude the matter by taking no legal action on the retroactive pay matter.

Commissioner Engstrom inquired about the search for a new Chief Fiscal Officer. He said that the right choice would lessen the need to rely heavily on Crowe Horwath, although it was important during this transitional time to have them there as backup, as this is coming in the middle of the Legislative Audit and near the beginning of the fiscal year.

Internal Auditor Hyde presented his monthly audit report (included in file). He went through the FY2011 Audit Findings and the transfer recommendations. He said the Education Trust Fund report for July was close to completion. He noted that he was coordinating with and assisting Legislative Audit.

Commissioner Shipp, Chair of the Higher Education Committee, said she had no report but would present scholarship information when ADHE numbers become available.

Commissioner Hammons, Chair of the Personnel Committee, asked that the written record of the July 30 Personnel Committee be made a part of these August 15 minutes, removing one word, which change was made. He reported that the Committee had considered six requests and had approved the filling of the two Security positions; had declined to approve moving the Chief Legal Counsel from N910 to N912; and had asked for additional information before acting regarding the addition of a Human Resources specialist, the moving of the Director of Sales position from N910 to N909, and the addition of a Product Development Manager. He discussed the Personnel Committee plan for a two-day extended meeting for intensive discussions on lottery internal

operations and asked the staff to send out all tools and information one week prior to the meeting, once a date is selected. Commissioner Faris said he would like to have a presentation of the Personnel Manual. Commissioner Lamberth said a meeting Sunday and Monday might work best for the group and that she was communicating with Ms. Baldrige on the matter, and asked the Commissioners to be thinking about what information they would like to hear, including whether they would like to have time with representatives of major vendors, as well as employees. Director Passailaigue said he thought October or November would be the best time for the meeting.

Commissioner Campbell, Chair of the Retailer Committee, said that he is working on a plan to invite the members of the Retailer Advisory Board to meet for lunch with some or all of the Commissioners and then make a presentation to the full Commission.

Commissioner Lamberth thanked Jeremy Smith, IT Network Engineer for the Lottery, and let the Commissioners know that he serves on the DIS Video Infrastructure Committee as well as on the Security Working Group of Arkansas. She asked that next month's agenda include a history of the state's AV infrastructure initiative, a timetable, a list of state agencies and commissions that are or will soon be participating, and a discussion of how this expenditure maximize revenues and reduce costs. Ms. Middleton said, and Commissioner Lamberth agreed, that she would invite DIS to present.

The Chair set the next meeting for September 19 at 1 p.m. There being no further business, the meeting was adjourned.