

**Joint Meeting of the Audit Committee and Finance Committee
Special Meeting Minutes**

Held on
Thursday, November 6, 2014 at 11:00 a.m.

at the
Connecticut Lottery Corporation
777 Brook Street
Rocky Hill, Connecticut 06067

Committee Members: Patrick Birney, Chairperson of the Finance Committee; Bob Morgan, Chairperson of the Audit Committee; Robert Dakers; Michael Thompson (teleconference); and Steve Bafundo (teleconference). Mr. Dakers exited the meeting at 12:29 p.m. and Mr. Birney exited the meeting at 12:34 p.m.

Board Members: None

Staff Members: Anne Noble, President & CEO; Paul Granato; Lana Glovach; Chelsea Turner; Steven Wagner; Cynthia Hadden; and Jessica Hayton.

Call to Order: Mr. Morgan called the meeting to order at 11:10 a.m.

- I. Approval of Audit Committee Minutes:
On motion made by Mr. Thompson and seconded by Mr. Birney, the minutes of the September 16, 2014 meeting were unanimously approved.
- II. Approval of Finance Committee Minutes:
On motion made by Mr. Birney and seconded by Mr. Dakers, the minutes of the June 17, 2014 meeting were unanimously approved.
- III. Review of Draft Financial Statements for the Period ended September 30, 2014:
Mr. Granato began the meeting with a brief overview of the first quarter financials. All in all, the Lottery experienced a strong first quarter.

Mr. Granato presented the following highlights:

Highlights - For 3 months ended September 30, 2014 (*Prior Year Comparison*):

- Sales for the quarter are \$271.8 million, down \$8.7 million or 3.1% from last year. However, Mr. Granato pointed out that sales for FY 2011 and 2012 were \$250 million and \$263 million respectively, and that sales overall are showing improvement. Mr. Birney agreed and commented that the Lottery had a solid first quarter.
- Instant ticket sales totaled \$160.7 million. Compared to last year at this time, instant ticket sales are down \$1.1 million or 0.7%.

- The Daily 3/4 games sales totaled \$55.5 million. Compared to last year, the Daily 3/4 games are down \$5.5 million or 8.9%. Daily 3/4 game sales correlate directly to prize expense. Prize expense is down 29.4% compared to last year. The months of July, August and September saw the lowest prize payouts in twelve years.
- Lower prize expense for Lucky for Life also affected sales revenue. Lucky for Life sales totaled \$5.3 million and prize expense totaled \$2.4 million. Compared to last year, sales are down \$1.7 million and prize expense is down \$2.3 million.
- MegaMillions is performing on track with last year; however, Powerball sales are down \$14.7 million compared to prior year. The jackpot games have not had any significant runs in the first quarter to boost sales.
- Five Card Cash totaled \$15.3 million in sales and has had a strong financial performance through the first quarter.
- Overall prize expense is down \$8.8 million or 5.1% compared to last year. Every game, except MegaMillions, experienced a lower prize payout compared to the same period a year earlier. The decline in prize expense helped offset the decline in sales.
- Retailer commissions are proportionate to sales revenue.
- Marketing & advertising expenses totaled \$2.8 million which is on par with last year.
- Production expenses totaled \$2.9 million, up \$200,000 or 7.5% compared to the prior year. The increase is partly due to the number of instant games released. This year 17 new instant games were released compared with 15 from the previous year.
- Overall costs of sales totaled \$188.7 million, down \$9.3 million or 4.7% compared to last year.
- Total operating expenses for the quarter were \$5.3 million, up \$124.6 thousand from last year. Salaries and benefits increased year over year due to wage increases and salary adjustments. Other operating expenses saw a decrease of \$53.6 thousand due, in part, to the lower cost of leasing state vehicles. In addition, the Lottery recently recovered \$26,000 in bad debt from a 1998 matter.
- General Fund transfers totaled \$76.6 million for the quarter which is \$3.0 million less than last year. Mr. Granato and Ms. Noble noted that as of the date of this meeting, General Fund transfers are now 5.2% ahead of budget and also ahead of last October.

Highlights – For 3 months ended September 30, 2014 (*Budget Comparison*):

- Sales are \$3.1 million or 1.2% ahead of budget. This is mainly attributed to the ongoing success of Five Card Cash. Ms. Noble commented that Five Card Cash has had a positive effect on Lottery sales.
- Jackpot games are performing under budget. MegaMillions is \$1.9 million behind budget and Powerball is \$6.7 million behind budget. Mr. Granato explained that revenue for these games is primarily driven by large jackpots and that these games did not have a large jackpot in the 1st quarter.
- Prize Expense is on budget.
- Operating expenses are under budget by \$168.6 thousand. All categories had a positive spend variance which means we spent less than anticipated.
- General Fund transfers, for the quarter ended September 30, were \$4.0 million or 5.4% ahead of budget.

IV. Executive Session:

On motion made by Mr. Birney and seconded by Mr. Dakers, and unanimously approved, the Committee moved into Executive Session at 11:20 a.m. Ms. Noble, Mr. Granato, Ms. Glovach, and Ms. Turner were invited to stay for the Executive Session to discuss the following:

- Attorney/Client Communications Re:
 - GASB 68
 - Pending Claims & Litigation
 - Lease at 777 Brook Street

The Committee reconvened in regular session at 12:19 p.m. Mr. Morgan stated that no actions or votes were taken during Executive Session.

V. Old Business:

The possibility of a line of credit was discussed in order to balance the need for cash on hand and the ability to transfer maximum funds to the state.

There was discussion about obtaining an unsecured line of credit. The line of credit would be used for managing short term cash needs in instances of extraordinary prize expense. Mr. Birney stated that the costs for the line of credit are a cost of doing business.

Discussion followed and Management will obtain quotes from various financial institutions and report back to the Committee with its findings. Mr. Birney requested that management develop procedures to explain how the internal compliance will be monitored.

VI. New Business:

- Game Ticket Update

Four counterfeit tickets were presented during the timeframe of September 16, 2014 through September 26, 2014. The tickets were investigated promptly by the Department of Consumer Protection and there is currently an arrest warrant for the alleged perpetrator.

- Distribution of Public Auditor's Report

The State of Connecticut Auditors' Report for the Fiscal Years ended June 30, 2013 & 2012 was distributed to Committee members. Ms. Noble reported to the Committee that the State Auditors had two minor findings. The findings were promptly addressed by the Lottery. Mr. Birney was pleased with the Auditors' Report.

- Status of System Conversion

Mr. Granato reported to the Committee the Lottery's intent to convert to a new financial reporting software system. The Lottery's current software system is not user friendly and the annual maintenance cost was as high as \$150,000. Mr. Granato reported on the due diligence completed to date and the recommended software solution.

Anticipated annual maintenance costs are approximately \$5,000 for a new system;

however, the initial costs for the software along with installation and training support will most likely exceed \$50,000 so the Lottery will go out to bid. The Project Team will have interdepartmental coverage from Finance, Information Technology and Purchasing. Mr. Morgan asked about the implementation timeframe. The new software will not be implemented until calendar year 2016. Mr. Morgan and Mr. Birney requested the Committee be kept apprised of costs associated with the conversion and also the progress.

- Role of Committees

The role of the Audit Committee and Finance Committee was discussed. Traditionally, according to the minutes, the role of the Audit Committee is to oversee any audits as well as accountability and governance issues of the Lottery which would include compliance and legal issues. Committee members discussed that, at times, certain topics will impact both Committees, however they would not recommend merging the Audit and Finance Committees. At this time, GASB issues will remain with Audit and the financial software conversion will remain with Finance.

VII. Adjournment:

On motion made by Mr. Bafundo and seconded by Mr. Thompson, and unanimously approved, the meeting was adjourned at 12:50 p.m.

Respectfully Submitted,

By: Paul A. Granato
Chief Financial Officer
Connecticut Lottery Corporation