

RECORD

AUDIT AND LEGAL COMMITTEE

7.16. 2014, 10:00 a.m., Little Rock Headquarters

The meeting was called to order by the Committee Chair, Commissioner Lamberth, who noted the presence of Committee members Baldrige, Engstrom, Hammons, Scott, and Street, as well as ALC Chairman Campbell. ALC Director Woosley and ALC Internal Auditor Brown and staff members Block, Ralston, Bunten, Vick, Fetzer, Parrish, and Craig were also present.

Minutes

The first order of business was the approval of the committee record of May 16, 2014. Commissioner Baldrige made the motion to approve the record, seconded by Commissioner Engstrom, and the motion passed unanimously.

Claim Center Leases

Commissioner Lamberth recognized Chief Legal Counsel Block to discuss the next order of business, Claim Center Leases. She explained that the three claim center leases will be up for expiration, extension, or renewal this year. The lease for the claim center in Springdale is expiring at the end of September and the research provided today (in file) is specific to that region. In late May Ms. Block's contact with the Arkansas Building Authority provided her with a list of 22 alternative sites in the Springdale/Fayetteville area. She forwarded the information to Committee Chair Lamberth, who asked former ALC Commissioner Mike Malone, who lives in the region, to provide feedback about the locations. Mr. Malone recommended a handful of sites and ALC Treasurer Parrish visited those locations. Mr. Parrish identified one location that was a clear standout, 3155 N. College Avenue in Fayetteville. This location will meet all of ALC's needs and would cost about \$10,000 less annually than the current claim center in Springdale. Ms. Block said that ALC would have to give 30 days written notice to terminate the current lease, but that there is also an option to extend the lease for not more than 90 days if necessary.

Commissioner Engstrom asked if ALC Security had looked at the recommended space. Ms. Block said that Mr. Parrish was involved in the selection of that site. Commissioner Engstrom asked that security look at the site if the committee votes to approve it.

Commissioner Hammons asked why ALC was considering moving the claim center location. Commissioner Lamberth said it was because of cost and location, that is, the site was more visible and less expensive. Commissioner Hammons noted the move of the claim center from Springdale to Fayetteville and asked why Fayetteville was chosen over Springdale. Commissioner Lamberth said that she had been given 22 locations [in Springdale and Fayetteville] by the Arkansas Building Authority along with a price structure and pictures of the buildings. Since she was not familiar with the area, she contacted former Commissioner Malone and asked him if he would do the drive-by research. She added that they needed to stay within the price range of about \$10 a square foot and the Fayetteville site seemed to be the best site for both the traffic patterns and the cost.

Commissioner Hammons asked what the initial cost would be for retrofitting the new location. Ms. Block said that the cost of retrofitting had not yet been discussed. Commissioner Hammons stated that he was just considering the weight of the expense of the move against the lease

savings. Commissioner Streett asked if the size of the new location would be sufficient and Ms. Block responded that the goal at the onset had in part been the consideration of smaller spaces. Commissioner Streett then asked if items would have to be removed from the existing location and Mr. Parrish told him that the teller windows would have to be removed and repairs made to the walls where the windows had been. Commissioner Streett said that would have to also be factored into the cost of moving versus the savings.

Commissioner Baldrige said that she was a little disappointed that there had been no research regarding super retailers in northwest Arkansas, and asked if there had been any effort to partner with city or state agencies in the area. Ms. Block responded that she had an opportunity to speak with ALC staff about super retailers, and they expressed concerns about accounting and tax reporting issues. For example, to raise the claim limits (i.e., to cash tickets over \$500), the statute would have to be changed. ALC has to issue a W2G form [used for reporting gambling winnings to the IRS] on any prize over \$600. It could also present legislative or internal audit issues. In addressing the partnering concern, Ms. Block said that at the onset, when she communicated with the Arkansas Building Authority contact, she did convey that ALC was also interested in lease sharing agreements options; the ABA contact was on notice and no such arrangements had been offered to ALC.

Chairman Campbell asked what the length of the new lease would be and Ms. Block responded that they were possibly considering a one-year lease to begin with. Commissioner Engstrom asked if the lease had renewal options and Ms. Block responded that all of the current leases had options to renew for one year. Commissioner Engstrom said that if ALC was going to have to retrofit the new location or locations and ALC planned on being there only one year, there would not be enough time to recoup the costs of the move. Commissioner Engstrom then asked if the new Fayetteville claim center would be large enough for the MSRs to use. Mr. Parrish responded that the Springdale claim center had a conference room which the MSRs used, but the Fayetteville site would not be large enough to hold all of the MSR materials. Director Woosley stated that the issue of the MSR materials was not a large enough issue to be a major concern, since materials could be mailed to the MSRs rather than to the claim centers.

Commissioner Hammons asked if similar assessments had been done on the other two claim centers and Ms. Block said that those leases expired on November 30. She added that she was waiting on information from the Arkansas Building Authority.

Commissioner Scott asked Internal Auditor Brown if he knew how many people actually used the Springdale claim center per month. Mr. Brown said that in the audit that he provided to the Commission in November 2013, the report covered the period of FY 2011 through the first quarter of FY 14. During that period, Springdale processed an average of 2.9 claims per day, or approximately 15 claims a week. Commissioner Scott also asked if locations along I-49 had been researched. Commissioner Lamberth said she was not sure whether or not any of the sites they researched were along that corridor, but that the search was limited to properties ranging around \$10-12 a square foot and under. Commissioner Scott then asked if anyone from the Lottery had talked to the Northwest Arkansas Airport. Director Woosley said that Robert Stebbins, ALC Sales Director, may have spoken with them. Director Woosley added that Robert was out of the office today but that he would ask him.

Commissioner Hammons asked how many claims were processed at the other two claim centers. Mr. Brown said that for the same period [FY 2011 through the first quarter of 2014], there were 3.5 claims processed per day in Jonesboro, in Camden 2.1 claims per day were processed, and in Little Rock 23.5 claims were processed per day.

Commissioner Engstrom asked what the alternative would be if the people in NW Arkansas did not have a claim center. Director Woosley said that they could mail their winning ticket or they could drive to Little Rock, and ALC would reimburse them for the mileage. Commissioner Engstrom asked how ALC verified age if the ticket was mailed in and Mr. Parrish said that a copy of a valid driver's license or some other form of valid ID was required. Commissioner Engstrom said that since there is already an effective way for anyone to redeem a ticket, that opened the door to examining the cost of the claim centers.

Commissioner Lamberth asked if there was any way to do month-to-month leases on the current locations while ALC researches the financial implications of moving the claim centers. Ms. Block said that the leases could be extended to the end of the year, essentially five months to consider. Commissioner Engstrom said he liked what had been done so far, and added that he considered the work very helpful.

Commissioner Baldrige said that other states engage "super retailers" and she would like the pros and cons of those arrangements presented to the Commission.

Commissioner Lamberth asked the committee to present a framework for Ms. Block to research and bring back to the committee. After some discussion, it was decided that the main issues to research would include: (a) the possibility of using "Super Retailers"; (b) the per-ticket cost (or percentage) that would be considered a reasonable amount in relation to the expense of claim center operations [Commissioners and ALC staff collaboration]; (c) the intangible value of keeping claim centers in their current geographical locations; and (d) a cost analysis (analyses) of moving claim center(s), especially if the lease is for one year only. She said that discussion of the claim center leases would be tabled until the information was compiled.

Draw Game Audits

Commissioner Lamberth recognized Mr. Brown to discuss the next item on the agenda, Draw Game Audits. Mr. Brown reminded the committee that there had been discussion of the Internal Audit division taking over the draw game function from Legislative Audit. He said that the current audit documentation is paper-based and if draw audit responsibilities are added to the Internal Audit division, the volume of paper will greatly increase. He presented an Automation Proposal (in file) as a solution. The audit documentation and workflow management would be performed electronically. The electronic solution would provide backup and protection of all audit documentation in the event of fire or natural disaster, provide opportunities for greater efficiency, and provide built-in features and resources that would help ensure compliance with standards. There would be a one-time user license cost of \$2,100-\$2,500 per user, with ongoing maintenance costs of \$420 to \$860 per user. Mr. Brown also proposed data analytic solutions, which would help ensure compliance with standards and best practices, would allow for more sophisticated analysis than standard Excel functions, and is the standard compared to other internal audit organizations (4 of 6 responding lotteries and 3 of 3 State entities use a data analytics solution). There would be a one-time user license cost of \$250 to \$2,640 per user, with

ongoing maintenance costs of \$50 to \$1,000 per user. Mr. Brown stated that he was not necessarily asking the Committee to take action on the proposals at this point, but that it was included in the expense of adding new employees to the Internal Audit division.

Mr. Brown then provided information on employee costs involved in taking over the draw audit function. He said that before anything could occur, the ALC Operational Rules would have to be amended and new C positions would need to be created, with LOC review. He recommended a full time employee, grade C 121, as well as a part-time employee, grade C 118. He presented a table of estimated employee costs, including data automation and analytics software, compared to what the current draw audits cost the agency.

Commissioner Hammons asked what the role would be of the part-time employee. Mr. Brown responded that the way his plan was drawn out, the part-time person would handle the evening drawings and the full-time person would handle the day-time drawings and would supplement existing staff.

There was a lengthy discussion about whether or not the Division of Legislative Audit (DLA) would still perform ALC audits. Mr. Brown explained that regardless of whether or not ALC performed its own draw audits, DLA is required by statute to perform audits on ALC. He said that there were some state agencies that had Internal Control audits, rather than Financial Statement audits, but that he had no doubt that DLA would continue to audit the agency.

Commissioner Engstrom asked if there were deadlines if ALC decided to make the transition to in-house draw audits. Mr. Brown said that DLA sets their draw audit schedule roughly six months in advance, but he did not think it would upset them if they set the schedule and ALC decided in the middle of it to perform their own draws. He said the bigger concerns, i.e., the milestones that would need to be reached, would be LOC approval for the position changes, getting the positions advertised and hiring of the new employee or employees.

Commissioner Lamberth asked Patrick Ralston how long it would take the LOC to approve the change in positions. He advised that there is a 30-day requirement on anything sent to the LOC, although that process can sometimes be expedited. He added that the next LOC meeting was scheduled for September.

Commissioner Engstrom made a motion that ALC begin performing draw game audits in-house and the motion was seconded by Commissioner Baldrige. The motion passed unanimously, to be presented to the full Commission at the next meeting.

Commissioner Lamberth asked the Committee if they would like to consider the automated system that had been discussed by Mr. Brown. Mr. Brown asked Commissioner Lamberth to allow him to follow the procurement process and then come back to the Committee with a recommendation for a specific product.

Commissioner Lamberth asked Mr. Brown if he was asking the Committee to consider having ALC audited like other state agencies, and Mr. Brown responded that he was not bringing any such proposal forward. Commissioner Engstrom asked that the subject be put on the agenda for the next meeting.

Proposed FY 2015-2017 Audit Plan

Commissioner Lamberth asked Mr. Brown to present the next agenda item, which was the proposed FY 2015-2017 Audit Plan (in file). He reminded the Committee that there is a current audit plan in place, approved last year by this Committee, which covers FY 2014-2016. He said that FY 2017 was added to maintain a three-year plan as required by law and to bring the schedule up to date. He said that the current risk assessment plan in place included the involvement of Division Directors, the ALC CFO, and ALC Director, using a risk assessment scoring process that is used for the development of each year's audit plan. **Commissioner Engstrom made a motion to approve the FY 2015-2017 Audit Plan as presented by the Internal Auditor, Commissioner Baldrige seconded the motion, and the motion passed unanimously.**

Proposed Internal Audit Charter Update

Commissioner Lamberth then recognized Mr. Brown to present the Proposed Internal Audit Charter Update (in file). Mr. Brown said that the only change was in the **Responsibility** section of the charter relating to when Internal Audit was required to present the annual update of the three-year audit plan. The change was the addition of a more definitive statement of the annual requirement, as well as a date by which time the annual requirement must be met. **Commissioner Engstrom made a motion to accept the change to the Internal Audit Charter and Commissioner Baldrige seconded the motion, which passed without dissent.**

Internal Audit External Assessment (Peer Review)

The next item on the agenda was discussion of an Internal Audit External Assessment (Peer Review) (in file). Mr. Brown explained to the Committee that this Assessment, also referred to as a Peer Review, is prescribed by the Institute of Internal Auditors (IIA) and measures conformance with the International Professional Practices Framework (IPPF) issued by the Institute of Internal Auditors. He said that NASPL Audit Steering Group (ASG) offers the Peer Review through the NASPL(ASG) Quality Assessment Review Program, which provides a mechanism for member lottery audit functions to comply with IIA standards. Member lotteries have to bear only the cost of airfare, lodging and meals for the two review team members who would be performing the External Assessment. He proposed to the Committee that ALC move forward with the Internal Audit External Assessment in January 2015, with an estimated cost of \$2,600.00 (airfare, lodging, and meals). **Commissioner Engstrom made a motion that the Internal Audit External Assessment move forward to be performed in January 2015. Commissioner Baldrige seconded the motion, and the motion passed unanimously.**

Commissioner Lamberth said that she was whole-heartedly in favor of the program and that she thought it gave everyone a real comfort level that ALC Internal Audit was doing Best Practices. She said she was also in favor of the ALC Internal Audit team being able to reciprocate and perform Peer Reviews with other lotteries, which would give ALC much credibility. She added that this would be considered part of Internal Audit job responsibilities and would not be counted against an employee's personal annual leave.

Human Resources Processes Follow-Up Audit

Commissioner Lamberth recognized Mr. Brown to present the final agenda item, Human Resources Processes Follow-up Audit (in file). Mr. Brown said that the IA team did some follow-up work centering on the employee performance evaluation process. He reported that

there was an observation made that ten employee evaluations were not completed by the May 31 deadline. Management responded that two of the ten evaluations that were open were for the Commission's two employees, whose evaluations were not completed until June 25. Of the remaining eight employees, management indicated that those evaluations remained open pending feedback resulting from the Commission employee evaluations that were performed on June 25.

Commissioner Scott asked Mr. Brown what category the eight employees were in and Mr. Brown responded that they were the Director's direct-reports.

Commissioner Lamberth said that the reason that was given to her regarding the delay was that the Director needed clarification to see where the employees fit on his performance review. Commissioner Scott asked her if she meant that the Director based the evaluations he gave his employees on the performance evaluation he received from the Commission, and Commissioner Lamberth responded that that was correct. She added that the Director needed to see if he was being ranked a certain way because the process below him was not being handled correctly. Director Woosley clarified that he was waiting on feedback from the Commissioners [regarding his performance review] and would complete the evaluations once that occurred.

Commissioner Baldrige stated that she had a conversation with Mr. Brown regarding the evaluation process of his single employee. She recalled that Mr. Brown said it was essential to evaluate his employee before he was evaluated so that his evaluation would in no way affect that employee's. Mr. Brown agreed that he had said that, and added that that was his personal opinion.

Commissioner Scott asked the Director if the standard should be that his employees wait until he receives his evaluation before they can be evaluated. Director Woosley responded that he did not believe that ALC had a standard, but that the goal was to have all of the evaluations done by May 31.

Other Business

Commissioner Hammons asked for an update on the Performance Audit Process. Mr. Brown reported that vendor questions were due this past Monday (July 14). Five prospective vendors had questions related to the RFP. He said that July 28 was the due date for the answers to those questions, but that he anticipated the questions would be answered and posted on the ASL website by the end of this week (July 18). Mr. Brown added that all proposals were due by August 18. Commissioner Hammons asked if there was a selection process and Mr. Brown responded that there would be an evaluation committee and he was currently considering who needs to be on that committee, but that he had not finalized that decision.

There being no further business, the meeting was adjourned.