

Audit and Legal Committee, Arkansas Lottery Commission
Draft Record
8.5.2011

Commissioner Pickard, Chair, called the meeting to order. Commissioners present were Committee members Commissioners Engstrom, Faris, and Malone (by conference call), along with Commissioner Frazier. Present for the ALC staff were Director Ernie Passailaigue, Internal Auditor Michael Hyde, Vice President Ernestine Middleton, Bishop Woosley, Julie Baldrige, Patricia Vick, and Whitney Hall.

Commissioner Pickard called on Mr. Hyde to present the status of the Internal Audit Plan (included in file). Mr. Hyde said the risk assessment would begin in late 2011; that the gaming system SSAS, done by the independent auditor, should be in report form in September 2011; he is in the process of reviewing the financial reports for FY2011; he reviewed the Education Trust Fund transfer process through June 30, 2011, and found a relatively small \$60,000 shortfall, which has been corrected—meeting with the Director and recommending documentation of process and a review by someone in Finance or the VP/Finance of the transfer after it is made by the CFO; noted a classification of expenses issue with promotional items and that he and the Director agreed they should be reclassified; he mentioned a monthly reconciliation of the Education Trust Fund and the amount remaining in the cash account. He reported the status of periodic reviews: the instant ticket annual review is 10 per cent complete; retailer sweeps about 20 per cent complete; online games about 80 per cent complete. He hopes to be close to completing these within one month.

He brought up a report on the Education Trust Account which is done monthly but reviewed the report thoroughly as it is the end of the Fiscal Year. He noted that the review was done on the account monthly because so much money is involved, and said each transaction was reviewed for compliance with the act and supporting documentation, as well as calculating the interest, in addition to getting independent confirmation directly from the bank. They also insure the funds are properly collateralized by the bank and also from the Arkansas Bankers Bank, verifying 105 per cent collateralization. He went over the schedules included in his report, noting a refund from ADHE of more than \$12 million, leaving a positive balance for the end of the Fiscal Year. He also brought forth the year-to-date schedule and reviewed earnings, transfers, and balances. The final schedule regards the shortfall trust account of \$20 million, which earns interest, transferred monthly to the Education Trust.

Commissioner Engstrom asked the Director why June is the worst sales month of the year. The Director explained the seasonality of the lottery business nationwide, noting that sales pick up in November or December and spike to their highest usually in February or March, after which they begin to fall. He also said that a number of accruals occur at year-end for example from other state agencies, pointing out the \$1.2 million for ADHE and the \$200,000 for the problem gambling program. Commissioner Engstrom asked if this was all done at the end of the year, and the Director responded that a portion was done during the year but the bulk was done at the end of the year. He said that other factors were the prize payouts and the funding of the \$1 million unclaimed prize reserve. He said that summer play is affected by people being out of their routines.

Mr. Hyde also presented an employee travel reimbursement report, done on a cash basis and compared to the general ledger. He said they were doing a fiscal year report for the complete fiscal year going backwards and to be performed henceforth. He noted that the MSRs were not included on the schedule. He pointed out that if travel is paid in a later month, it is in that month's report, and that other sources of travel expenditures such as MUSL travel as well as vendor-paid travel will be included. He said that licensing and renewal audits would be begun next week and would be coordinated with Legislative Audit to avoid duplication. Other projects will be done as time becomes available.

Commissioner Pickard asked whether Mr. Hyde had taken any action on the Commission authorization of his hiring a part-time accountant, and he replied that he was continuing to assess the workload before taking that step. He said that he would like to wait until the fiscal year Legislative Audit was complete. Commissioner Engstrom asked for a definition of "game load," and Mr. Hyde replied that it was when the files for the instant tickets are loaded into the gaming system.

Mr. Hyde reviewed the status report on the FY 2010 Legislative Audit findings. He noted that two findings have been cleared: all compensatory time is repaid and accounting software has been addressed. He noted that only two findings remain to be cleared: GAAP financial reports, which can't be resolved until all reports are reviewed and final; and the retroactive pay issue, which is on the agenda for today's meeting. Commissioner Pickard asked him to establish a line of communication between the Legislative Audit and the Commission during the current audit process, and said that although any Commissioner could ask questions, as Chair of the Audit and Legal Committee, he, or in his absence his designee from the Committee, and the Internal Auditor should from time to time meet with Legislative Audit in order to be kept apprised of all issues. Mr. Andy Babbitt, of Legislative Audit, was asked when the Legislative Audit would be completed, and he said it should be in October in order to get the information ready for the Legislative Audit Committee to meet in mid-November.

Next, the OPM response on the retroactive pay issue was brought forward for consideration. Commissioner Pickard said it was a management error, and noted that the issue occurred prior to OPM involvement in Lottery personnel matters. He said he would hate to see employees hurt by this matter, would make clear that it was never to happen again, and would ask the Chief Legal Counsel if there is a way to handle the matter without requiring the individuals to refund the money, which amounts to a total of around \$6300. Mr. Woosley responded that some issues cannot be resolved by the law. He said that potential liability of the Commission might be created if a legal resolution were to be sought. Commissioner Faris said that given the circumstances, he would move that retroactive pay was strongly discouraged in the future and that no further action to collect this money be foregone. The motion was seconded by Commissioners Malone and Engstrom and approved without dissent. Commissioner Malone asked Mr. Hyde and Mr. Babbitt whether this finding could ever be considered closed if no action is taken. Mr. Hyde answered that he believed that he could close it, and Mr. Babbitt answered by describing how the finding came about, noting that a letter had been issued, and that now it is up the legislature to determine what action will be required of Legislative Audit in the future. He went on to say that while he could not speak for the Legislature, they could very well decide that the matter would no longer be pursued. Commissioner Engstrom said that action to recover the money would likely cost in excess of \$6300 and therefore would be counterproductive. The approved motion will be presented to the full Commission at the next meeting.

For the next item, a discussion of the retailer licensing application, the Director noted that Mr. Barden had prepared a comparison review chart. Commissioner Engstrom said that he had asked for the item to be placed on the agenda and asked that it be tabled until the next meeting, which was done.

Next, the Committee discussed the Chief Fiscal Officer position. The Director noted that Mr. Miley resigned as of September 9 to go back to Jonesboro and that the process as outlined by the Commission was followed, with a hiring freeze exception form sent to OPM. He said they had put together a list of attributes to perform the work taking into account suggestions by the Commission and factors such as CAFR experience. He asked for suggestions for tweaks to the language and asked for direction. Commissioner Pickard said that he understands that the Director has discretion over this hiring issue and suggested, since Commissioner Engstrom is a member of the Arkansas CPA community, his expertise be utilized as the Director goes through this process. Commissioner Engstrom said the language was great and that time was of the essence. However, he cautioned that he did not

want to rush it too much since the position is so valuable, and he said he would be happy to help as needed.

Commissioner Frazier asked whether the Crowe Horwath training was being given to the outgoing CFO and was told by Director Passallaigue that the contract had not yet been reviewed by the LOC and therefore had not begun. The Director note that the Lottery was the only state agency in Arkansas required to do a CAFR report. He said that Mr. Babbitt had told him the State of Arkansas hired an outside firm to assist when they began doing CAFR reporting. Commissioner Engstrom said that he had opposed hiring the outside firm but that the new person would need time to get grounded and would be arriving in the middle of the time that the work on the CAFR should be done. Therefore, he said, he would be inclined not to pull back on the contract. The Director said the contract would not be executed until the LOC reviews it. It was discussed that the Lottery's work on the CAFR would need to be completed in mid-October in order to have it to GFOA for certification by December 31. Commissioner Pickard inquired whether the contract for \$55,000 required the full amount to be paid, and Mr. Woosley responded that it was an "up to" contract, allowing a downgrade of expenditure if less work is needed.

Director Passallaigue said that he would like to clear up the matter of South Carolina's annual report as compared to the circumstances of the Arkansas Lottery. He said that about three or four years into the existence of the South Carolina Lottery, his CFO came to him and suggested that his division's five CPAs prepare a Comprehensive Financial Report and get GFOA certified. He said that he didn't recall whether it took months or more than a year, but that it was done voluntarily and was not a statutory requirement. He noted that this is quite different from the tight timeline required by the Arkansas legislation.

The issue of outside legal counsel was brought forth for discussion. Commissioner Pickard thanked Mr. Woosley for his work and noted that the proposal was for retaining a firm for two years, with the option of adding five years on a yearly basis. He said he believed this should be enacted. He said that the Student Loan Authority Board contract, which the Commissioners have seen, is for up to \$85,000 annually but that he anticipated the likelihood that the ALC contract would be less expensive. Commissioner Engstrom moved, with a second from Commissioner Faris, that the RFQ for outside legal counsel be recommended to the full Commission, and the motion passed without dissent.

Commissioner Pickard asked for an update on litigation and Mr. Woosley reported that the trademark case was pending, with opposing counsel having asked for additional time to file a response to the interlocutory brief, pushing this to late in the year or early into 2012. He noted that the Frazier trial has been set for June 4 of 2012 and that the ruling on the Motion to Dismiss should come down in a few weeks. Commissioner Pickard asked Mr. Woosley to notify previous commissioners of the June 4, 2012, court date, since they may be called as witnesses.

There being no further business, the meeting was adjourned.