

Arkansas



Scholarship Lottery

Timeline
March 27, 2012

SECTION 3.3 OF RFP

B

- Development of control procedures for software change management and documentation, including updating of service and operational manuals, written procedures and updating of the source code maintained in an escrow account;
- Development of data security requirements, including data encryption, transaction logging with time stamp, terminal and central system re-send and ticket printing confirmation;
- Ensuring that every transaction is written to at least three (3) media before authorization is given to print the ticket, which includes the primary and secondary central systems and the hot backup system at the alternate site;
- Requiring the use of User ID/password for access to authorized software and related programs residing in the terminals and management workstations, and to provide an audit trail of sign-on attempts and successes on non-erasable/modifiable magnetic media;
- Use of validation algorithms for inquiry, validation, and reporting on any winning wagers;
- Serial number encryption for external serial numbers printed on the tickets;
- Establishment of an escrow account for storing of software source code onsite; and
- Establishing appropriate network security firewalls to prevent unauthorized access to the gaming or communications network, and to monitor and prevent viruses from attacking the system.

3.3 TELEMARKETING AND TICKET ORDERING AND INVENTORY CONTROL SYSTEM

The Successful Vendor will provide a Customer Relations Management System that includes telemarketing and ticket ordering software and systems. Telemarketing sales and ordering functions will be handled and ordering functions will be handled by ALC employees. The Proposal should describe, at a minimum, how the software accomplishes the ticket order entry processing for:

- Retailer initiated orders;
- Inventory distribution management;
- Reissues of returned packs;
- Emergency orders;
- Capability to restrict a retailer from ordering;
- Tracking and confirmation of pack deliveries;
- Real-time monitoring of warehouse inventory;
- Initial allocations for new games;
- Other reporting capabilities;
- Sales and account information available to telemarketers; and
- Call features and scheduling.

At a minimum, the system must have the capability to perform as follows:

- Handle all instant ticket processes and functions from any instant ticket printer.
- Accept and process ticket inventory data files produced by a secondary instant ticket vendor for up to seven (7) instant games a year for purposes of warehousing and distribution to retailers.
- Create and provide inventory data files of packs ordered, distributed and returned for transfer to the online gaming system on a daily, or more frequent, basis as determined by the ALC.
- Accept and process ticket inventory data files (i.e., pack statuses, etc.) and retailer file maintenance data files from the online gaming system on a daily, or more frequent, basis as determined by the ALC.
- Allow the creation of ad-hoc reports online, and to print certain reports as may be desired by the user.
- Restrict system access to only authorize ALC staff and others as approved by the ALC.

A Vendor must describe in its response the following:

- How the system will allow the ALC staff appropriate access via proposed hardware/software communication configuration to the software applications;
- A proposed plan for interfaces between the instant inventory system and an online gaming system;
- A proposed backup system plan to ensure little or no interruption of services, and the business recovery plans to return to normal processing; and
- The proposed security plan including system software (i.e., passwords, data transfer integrity, etc.) and physical controls.

3.4 OTHER REQUIREMENTS

SGI OFFICIAL PROPOSAL PRICE SHEET



E1 E1

OFFICIAL PROPOSAL PRICE SHEET

The undersigned agrees to provide Instant Ticket Lottery Game Services to the Arkansas Lottery Commission in accordance with the Request for Proposal, and any amendments or addendums hereto for proposal no. ALC - ALC-090001. Proposer is required to provide the percentage, in the format shown below, as well as to attach hereto an itemized listing of the pricing for each of the component parts and services that comprise the lump sum price.

DESCRIPTION	PERCENTAGE (Written in Words and Number)
-------------	---

<u>Instant Ticket Lottery Game Services</u>	<u>1.7500% (one point seventy five percent) or 1.1500% * (one point fifteen percent)</u>
---	--

OR

* The price of 1.1500% requires the Lottery to implement "Properties Plus™" at the rate of 2.5078% of the prize fund for all tickets, regardless of which vendor prints the tickets. "Properties Plus™" is funded solely from the Prize fund, and therefore is a zero net incremental cost to the Lottery.

1. **BY SUBMISSION OF A PROPOSAL, THE PROPOSER CERTIFIES:**
 - 1.1 Prices in this proposal have been arrived at independently, without consultation, communication or agreement for the purpose of restricting competition.

SGI OFFICIAL PROPOSAL PRICE SHEET

Official Proposal Price Sheet

E2

Beginning date as owner of sole proprietorship: _____

Provide the names of all individuals authorized to sign for the Proposer. *- authorized*

NAME (printed or typed)

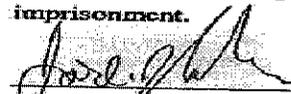
TITLE

James C. Kennedy

Senior Vice President, Sales & Global Marketing

VERIFICATION

I certify under penalty of perjury, that I am a responsible official (as identified above) for the business entity described above as Proposer, that I have personally examined and am familiar with the information submitted in this disclosure and all attachments, and that the information is true, accurate, and complete. I am aware that there are significant penalties for submitting false information, including criminal sanctions, which can lead to imposition of a fine and/or imprisonment.



(Signature)

James C. Kennedy, Senior Vice President, Sales & Global Marketing
(Name and Title) (Typed or Printed)

7-27-09

(Date)

The components and services that comprise the percentage shown on the Proposal Price Sheet are:

- Marketing and Support Services
- Instant Ticket Printing
- Distribution and warehousing
- Instant ticket dispensers
- Distribution of instant tickets
- In special instances, delivery of other ALC materials such as point of sale material, game supplies, retailer manuals, and newsletters, per RFP section 3.9 as amended by the second addendum to the RFP dated July 15, 2009.

VENDOR SCORING GRID

F

Criteria	Maximum				%	%	%
	Points	<u>GTECH</u>	<u>Pollard</u>	<u>SGI</u>	<u>GTECH</u>	<u>Pollard</u>	<u>SGI</u>
Cost	50.000	44.83	35.68	50.00	1.9520%	2.4523%	1.7500%

Criteria	Maximum				ESUP	ESUP	ESUP
	Points	<u>GTECH</u>	<u>Pollard</u>	<u>SGI</u>	<u>GTECH</u>	<u>Pollard</u>	<u>SGI</u>
Early Start Up Date (ESUD)	5.000	5.000	2.414	4.8276	9/30/2009	10/15/2009	10/1/2009
Number of Days ESUP					29	14	28

ALC MINUTES, AUGUST 5, 2009

pending LOC review. Commissioner Malone asked what the LOC review entailed and whether the contract award could be executed by the Commission with this contingency attached. Mr. Woosley answered in the affirmative and stated this was the guidance provided by the LOC. Further, Mr. Woosley indicated the Oversight review process is defined in the statute, that a major procurement contract must be filed with the LOC, and the LOC would conduct a review, and then issue an opinion within 30 days, based upon its review of the documentation. Commission staff was provided guidance on the mechanics of this process on July 31st and supplemented on August 3rd, by the LOC. Commissioner Malone inquired that, if this resolution was passed as worded, whether this would be the Commission's final action necessary to award the Online Contract; and, Mr. Woosley answered affirmatively. Commissioner Shipp asked if this would preclude any further contractual negotiations between the Commission and the Successful Vendor; Mr. Woosley stated that there would be a signing of the contract, which would include a satisfaction of the bond requirement. Mr. Passallaigue stated that the Staff is satisfied with the major elements of the Successful Vendor's proposal. The motion was unanimously approved.

Instant Ticket RFP Intent to Award and Execution Pending LOC Review

Mr. Woosley was recognized to discuss a Staff proposal for the Commission to adopt a resolution of both Intent to Award and Execute the Instant Ticket Contract, pending LOC review. Mr. Woosley directed the Commission's attention to the Executive Summary, the Evaluation Scoring Spreadsheet, and the Official Price Proposal Sheet submitted by the vendor that achieved the highest number of points on the RFP's Evaluation Criteria, Scientific Games Incorporated (SGI). Mr. Woosley also noted that SGI's Official Price Proposal Sheet offered the Commission a percentage rate of 1.75, the lowest percentage rate proffered by the three vendors that bid on the Instant Ticket RFP. Mr. Woosley directed the Commission's attention to a comparison of Instant Ticket vendors and prices prepared by *LeFleur's Magazine*, which may be helpful in the deliberations of the Commission. Mr. Woosley stated that SGI was ranked number one of the three vendors submitting proposals on the Instant Ticket RFP, based upon the points awarded by the Evaluators selected to review the proposals. It was Staff's recommendation that the Commission approve both Intent to Award and also Execution of a contract with SGI, based on its receiving the highest number of points. Commissioner Hammons asked about the evaluation process; Mr. Woosley conducted an in depth discussion of the mechanics of the evaluation criteria, the relationship to the RFP and the awarding of points, noting a scoring grid was utilized by the Evaluators that referenced back into the RFP. Commissioner Hammons then asked whether there was evidence of minority-owned business participation proposed by the vendors and Mr. Woosley stated that this element was specifically and thoroughly scored by the Evaluators in each proposal submitted. Commissioner Hammons further inquired whether the cost element was a driving factor in vendor ranking and Mr. Woosley pointed to the fact that cost was weighted at 50 percent of the Evaluation Criteria pursuant

G

1.75

INTENT TO AWARD

H

Arkansas Scholarship Lottery

500 President Clinton Avenue, #215

Post Office Box 3238

Little Rock, AR 72203-3238

INTENT TO AWARD

Bid Number: ALC – 090001

Bid Opening Date: July 29, 2009

Commodity Services: Instant Ticket Lottery Game Services

Projected Total Value: one point seventy five percent (1.7500%) of total net sales

Posting date: August 5, 2009

Vendor: Scientific Games International, Inc.

Contact: Bishop Woosley – (501) 683-1890 - bishop.woosley@arkansas.gov

LOC REQUEST FOR REVIEW

Arkansas Scholarship Lottery

500 President Clinton Avenue, #215

Post Office Box 3238

Little Rock, AR 72203-3238

(501) 683-1890

TERM CONTRACT AWARD

This is a term contract issued by the office of state procurement. This is not authority to ship. A separate purchase order will be issued. This contract constitutes acceptance of your bid along with all terms and conditions therein and signifies the offerors's knowledge and acceptance of all terms and conditions set forth within the invitation to bid.

Procurement Director: Bishop Woosley **Contract/Bid No.:** ALC-090001

Description: Instant Ticket Lottery Game Services

Contract period: seven (7) years from date of award, with an option for renewal up to three (3) additional times in one (1) year increments or a portion thereof.

Contract value: one point seventy five percent (1.7500%) of net sales as defined under Section 5.1.2 of the Instant Ticket Lottery Game Services RFP.

Commodity class(es):

Purchase request no:

Agency Contact & Phone Number: Bishop Woosley (501) 683-1890

Delivery Requirements: as specified in bid

Prices are F.O.B. destination, inside delivery and unless otherwise specified.

Invoice to:
Arkansas Lottery Commission
P.O. Box 3238
Little Rock, AR 72203

Deliver to:
Requesting agency

Contract award to:
Scientific Games International, Inc.
1500 Bluegrass Lakes Parkway
Alpharetta, Georgia 30004

Contact person: James C. Kennedy
Telephone number: 770-663-6735
Fax No: 678-624-4115
Vendor No:
Federal ID No: 58-1943521

Arkansas Lottery Commission Director of Procurement:

By: _____ Date: _____

LOC MEETING, AUGUST 13, 2009

with advertising/marketing experience and one with IT Gaming experience and they provided the score. It was a per functionary calculation with the cost and proposed early start-up date. The early start up date was the premium because of what the vendor stated they could do to satisfy the terms and conditions of the contract. Scientific Games was the lowest percentage of cost, and also the most competitive start-up date of October 1. Scientific Games is the world premiere lottery vendor with scratch off tickets and a number of states around the country utilize Scientific Games as either a primary vendor or a secondary vendor. J

In this contract, "the successful vendor agrees to grant the ALC non exclusive property usage rights for online games and properties owned by the vendor at no cost during the term of the contract period of this proposal" was put in as an amendment.

75 Mr. Bishop Woosley responded to Rep. Hyde's question about how the contract specifies that Scientific Games must distribute instant tickets from seven different vendors, but limit the total from other vendors tickets to not exceed 5 % of total annual volume of ticket sales for the first two years, then subsequent years it can't exceed to 15%. It wasn't specified in the RFP, even though this is a normal term in the RFP industry because the ALC didn't want to limit themselves and wanted Scientific Games to set it themselves, because they could possibly come in lower than the other proposals. Then, he stated that Scientific Games will participate and bear all of the cost of training the retailers, that it is built into the 1.75% in the price proposal sheet. Since the retailers are the lifeblood, this is a big incentive for them to come in and recruit and train as many retailers as possible to have them up and ready. There was a disclosure of pending litigation provided to the Bureau of Legislative Research's attorney Dan Parker yesterday, it was reviewed, and that even though there was some ongoing litigation, there was nothing detrimental that would prevent them from successfully completing the terms of the contract with the ALC.

Several committee members stated for the record that they were unable to open email file containing the Contract and wanted to abstain from review: Rep. Maloch, Rep. Williams and Rep. Roebuck.

The Committee has Concluded their Review of the Instant Ticket Contract.

REVIEW OF THE ADVERTISING CONTRACT

Mr. Woosley stated the process for the advertising contracts were opened to proposals and the ALC received six proposals, but due to the terms of the compliance process, only two were able to be passed onto the evaluators. Mr. Passailaigue stated that there were six good proposals, but that the criteria must be met and only two made the cut and they were the Rainey Agency and the Communications Group.

The two bidders made presentations, evaluations continued, were scored, and based upon the costs and presentations, the Communications Group was given the intent to award the contract. There were four evaluators who scored the bidders on 40% cost and 60% subjective criteria. Since two of the proposals came from South Carolina vendors, Mr. Passailaigue removed himself from the process and any other that had ties to South Carolina. Mr. Woosley continued that after the two had complied with the RFP requirements, they were passed to the evaluators and were reviewed individually, then in a group on Friday of that week. They were then informed to return the following Tuesday with oral presentations. They were given a 40 minute time for an oral presentation in a public forum. Both completed their presentation within 35 minutes and then had about a ten minute question and answer period with anything in response to the RFP or the presentation. After the evaluation, they did individual scoring and they came up with the one who received

RECITAL OF SELECTED OPTIONS



L

RFP #ALC-090001

DATE: TUESDAY, AUGUST 25, 2009

Revisions to Original Pricing Schedule (Dated July 29, 2009) between the Arkansas Lottery Commission and Scientific Games International Agreement for Additional Service Options and Fees.

DESCRIPTION OF SERVICE	PERCENTAGE/PER 1,000 (Written in Words and Number)
Instant Ticket Lottery Game Services	1.6900% (one point sixty nine percent)
Web Site Marketing Services (Player's Club/ Internet Marketing)	0.0900% (zero point zero nine percent)
Play It Again™ and Second Chance Drawing Management Services	0.1400% (zero point fourteen percent)
The three prices shown above are based upon the lottery implementing all three services.	
Points for Prizes/Rewards/Merchandise Prizes and Fulfillment	1.500% (one point fifty percent) of the prize fund for all instant games included in program

Play it
Again
not
discussed
in May
2009

RECITAL OF SELECTED OPTIONS

Recital of Selected Options

L2

Failsafe™ — Keyless validation bar code
(applies to all instant tickets)

\$1.89 per 1,000 tickets for all tickets printed
and delivered

Tel-Sell operations provided by Scientific
Games

Included in the Instant Ticket Lottery Game
Services

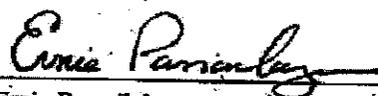
OPTIONAL:

Delivery of POS materials to Lottery Regional
offices

0.1628% of total instant ticket sales.
Services provided by a local Minority
Business Enterprise

All prices are based upon Scientific Games being the exclusive instant ticket provider throughout the entire term of the contract.

ARKANSAS LOTTERY COMMISSION



August 25, 2009

Ernie Passailaigue
Executive Director

SCIENTIFIC GAMES INTERNATIONAL, INC.



8-31-09

James C. Kennedy
Senior Vice President

ORDER/PRICE CONFIRMATION

M1

Order/Price Confirmation

Scientific Games International
1500 Bluegrass Lakes Parkway
Alpharetta, GA 30004

This letter constitutes the order of the ARKANSAS SCHOLARSHIP LOTTERY for 5,040,000 ($\pm 5\%$) tickets of Instant Game No. 002 "ARKANSAS RICHES" as fully described in Version 1 of the "Game Specifications" document dated 8/19/2009 with Prize Structure Version A dated August 12, 2009. Final invoice will be based on total number of tickets sold based on percentage of sales. (1.1500%)

You are hereby authorized to proceed with the production of game tickets and performance of the associated services according to the specifications contained herein.

No
2.3078%

Options	Quantity	Price
FailSafe™ Barcode		\$1.89 per 1000
Full UV		No Charge
Total Price For Options (estimated)		Total price per 1000: \$1.89

Working
Papers

ACKNOWLEDGED AND ACCEPTED:

Martha Hernandez
Scientific Games International (Printed)

Martha Hernandez
Scientific Games International (Signature)

August 25, 2009
Date

ACKNOWLEDGED AND ACCEPTED:

DAVID BARBER
Arkansas Scholarship Lottery (Printed)

David Barber
Arkansas Scholarship Lottery (Signature)

August 25, 2009
Date

Version with wrong price schedule
1.15%

ORDER/PRICE CONFIRMATION

M2

Order/Price Confirmation

Scientific Games International
1500 Bluegrass Lakes Parkway
Alpharetta, GA 30004

This letter constitutes the order of the ARKANSAS SCHOLARSHIP LOTTERY for 5,040,000 ($\pm 5\%$) tickets of Instant Game No. 002 "ARKANSAS RICHES" as fully described in Version 1 of the "Game Specifications" document dated 8/19/2009 with Prize Structure Version A dated August 12, 2009. Final invoice will be based on total number of tickets sold based on percentage of sales. (1.9200%)

Instant Ticket Lottery Game Services: 1.6900%
Web Site Marketing Services (Player's Club/ Internet Marketing): 0.0900%
Play It Again™ and Second Chance Drawing Management Services: 0.1400%

The three prices shown above are based upon the lottery implementing all three services.

Points for Prizes Rewards/Merchandise Prizes and Fulfillment: 1.50% of the prize fund for all instant games included in program.

You are hereby authorized to proceed with the production of game tickets and performance of the associated services according to the specifications contained herein.

Options	Quantity	Price
FailSafe™ Barcode		\$1.89 per 1000
Full UV		No Charge
Total Price For Options (estimated)		Total price per 1000: \$1.89

ACKNOWLEDGED AND ACCEPTED:

Scientific Games International (Printed)

Scientific Games International (Signature)

Date

ACKNOWLEDGED AND ACCEPTED:

DAVID W BARDEN
Arkansas Scholarship Lottery (Printed)

David W Barden
Arkansas Scholarship Lottery (Signature)

Date

10/2/09

All terms
Working
papers

Correct prize structure
1.9200%
1.5000% } Q3

INSTANT RFP E-MAIL TO INTERNAL AUDITOR DATED SEPTEMBER 21, 2009

N

Bishop Woosley

From: Bishop Woosley
Sent: Monday, September 21, 2009 9:31 AM
To: Michael Hyde
Attachments: Instant RFP Contractual Services Agreement.pdf; Recital of Selected Options.pdf; Official Proposal Pirce Sheet.pdf

W. Bishop Woosley

Arkansas Lottery Commission
Director of Procurement



Arkansas Lottery Commission/Union Plaza
124 West Capitol Avenue, Suite 1400
Little Rock, AR 72201

Mailing address:
P.O. Box 3238
Little Rock, AR 72203-3238

Office Number (501) 683-1890
Office Fax (501) 683-1878

Confidentiality Notice

This communication is for exclusive use by the person(s) to whom it is addressed, and may contain information that is confidential or privileged and exempt from disclosure under applicable law. If you are not an intended recipient, please be aware that any disclosure, dissemination, distribution or copying of the communication, or the use of its contents, is prohibited. If you have received this message in error, please immediately notify me of your inadvertent receipt and delete this message from all the data storage systems.

SGI INSTANT TICKET INVOICE

0



RECEIVED
 OCT 13 2009
 BY: *SJA*

Out in Peachtree

Chicago 20090903
 Date: 10/04/2009

ARKANSAS LOTTERY - INSTANT SALES FOR WEEK ENDING 10/04/2009

Price Point	Game Name	% of Sales	\$ Gross Sales	\$ Return On Sales	\$ Net Ticket Sales	Gross Ticks Sold	Ticks Return	Net Ticks Sold	SGI Net Revenue
\$1.00	AR0001	0.0182	\$1,681,700.00	\$2.89	\$1,684,700.00	2,603,700	0	2,603,700	\$49,981.04
\$2.00	AR0002	0.0182	\$1,749,600.00	\$80.00	\$1,740,000.00	870,300	300	870,000	\$33,408.00
\$2.00	AR0003	0.0182	\$2,114,700.00	\$2.00	\$2,114,700.00	1,057,360	0	1,057,360	\$40,602.24
\$5.00	AR0004	0.0182	\$3,522,700.00	\$300.00	\$3,522,000.00	504,546	60	504,480	\$48,430.08
Totals:			\$8,961,700.00	\$800.00	\$8,960,000.00	5,035,906	360	5,035,530	\$172,431.36

Remit To for EFT or ACH:
 Scientific Games Corp., Agent
 JP Morgan Chase
 23766 Network Place
 Chicago, IL 60673-1237
 ABA# 021-000-021
 Chgs# 0002
 SWIFT Code CHASUS33
 Department: 4
 Account Number 301177730165
 Reference: Scientific Games International, Inc.

Instant Lottery Game Services	1.65%	\$151,775.52
Play It Again and 2nd Chance Management Services	0.14%	\$12,573.32
Website Marketing Services	0.09%	\$8,082.72
		\$172,431.56

} 1.92%

Christine Middleton

o/c # 5200-6-65-00000

REVIEW OF GAME DESIGN AND GAME PROGRAMMING PROCESSES

Arkansas Lottery Commission
Review of Game Design and Game Programming Processes (Draft)
Report Date: TBD

Michael F. Hyde, CPA, CIA, CISA, CFE

Internal Auditor

Q1

Finding #2

Arkansas Scholarship Lottery management should review instant ticket game working papers for accuracy and signify approval by signing the documents.

The Scientific Games' instant ticket game working papers include two documents, the Customer Specifications for Instant Games and the Instant Ticket Game Specifications.

Customer Specifications for Instant Games

The Customer Specifications for Instant Games includes all of the information that rarely changes from game to game, such as; book/ticket number format, ticket-back markings, validation number format, packaging and shipping specifications, contact information, etc. Should any of the specifications change, an updated version of the document is executed. The Customer Specifications eliminates the need for Lottery management to review information that rarely changes for each instant ticket game developed. The confirmation page for this agreement states the following:

"These customer specifications have been approved by the Arkansas Scholarship Lottery and Scientific Games International, Inc. (SGI), effective as of the execution date below and apply to production of game tickets and performance of associated services in accordance with the requirements of the Contract for Instant Ticket Manufacturing & Services between the commission and SGI.

Any changes to these specifications must be in writing and approved by the Executive Director or his designee."

Internal Audit noted that the Customer Specifications for Instant Games Version 1.0 dated August 13, 2009 and Version 1.1 dated September 16, 2009 were not signed by either the Lottery or Scientific Games indicating the documents had been reviewed or approved. The first instant ticket game was printed by Scientific Games on September 3, 2009. Version 1.2 dated December 9, 2009 was signed by a Scientific Games representative and the Lottery's Vice President of Gaming Operations on December 14, 2009.

Sept 3, 2009

REVIEW OF GAME DESIGN AND GAME PROGRAMMING PROCESSES

Arkansas Lottery Commission
Review of Game Design and Game Programming Processes (Draft)
Report Date: TBD

Michael F. Hyde, CPA, CIA, CISA, CFE

Internal Auditor

Q2

Internal Audit also noted that the Customer Specifications for Instant Games Version 1.2 did not include a description of the changes made from the prior version in the section entitled "Updates". The only change stated in the "Updates" section of the document was the change made from Version 1.0 to 1.1. Internal Audit noted that at least 20 changes were made between Version 1.1 and Version 1.2, including removing the requirement that Scientific Games provide audit reports for individual instant ticket games which contradicts the Instant Ticket Game Lottery Services Contract (See Finding #5). Internal Audit also noted Version 1.2 removed the ticket-back marking statement "Proceeds Support Education". However, a review of the instant tickets printed prior to December 9, 2009 revealed that this statement has never been included on the back of the Arkansas Scholarship Lottery instant tickets.

The Customer Specifications for Instant Games is prepared by Scientific Games' personnel and reviewed by the Lottery prior to approval. The content of the "Updates" section would seem to be essential to adequately review the report for the criterion which changed from the previous version, especially when there are numerous changes.

The Customer Specifications for Instant Games should be reviewed for completeness and accuracy, and signed by both parties prior to the production of instant ticket games. Without a signed document, the Lottery did not have a valid customer specifications agreement with Scientific Games for instant ticket games printed between September 3, 2009 and December 14, 2009.

Instant Ticket Game Specifications Working Papers

The Instant Ticket Game Specifications contains the variable information that changes from game to game, such as game name, number, date, version, ticket size and paper stock to be used, ticket art, prize structure, order quantities, schedule, etc. The document is prepared by Scientific Games personnel. Following a review process by the Lottery staff, the working papers are approved and signed by Lottery management and Scientific Games. The game programming specifications found in the working papers is ultimately utilized to develop game software that produces instant ticket data for the production of a particular game.

Internal Audit's review of the Game Specifications of four instant ticket games revealed the following:

REVIEW OF GAME DESIGN AND GAME PROGRAMMING PROCESSES

Arkansas Lottery Commission
Review of Game Design and Game Programming Processes (Draft)
Report Date: TBD

Michael F. Hyde, CPA, CIA, CISA, CFE

Internal Auditor

Q3

- The price confirmations in three of the four Instant Ticket Game Specifications reviewed were not consistent with the pricing schedule in the contract between the Lottery and Scientific Games. These errors were corrected with subsequent Post Executed Changes.
- An instance in which the wrong prize structure was referenced in the approved Game Specifications.
- An instance in which the Game Specifications for an Instant Ticket Game was not signed by the Lottery or Scientific Games.

Conclusion Finding #2

Internal controls can break down when authorizers do not sign agreements or fail to adequately review documents they must sign for errors and omissions. Lottery management's failure to properly review and execute agreements by signature could result in instant ticket games not being produced as intended and/or expose the Arkansas Lottery Commission to unnecessary legal issues.

Internal Audit recommends the following:

1. Lottery management establishes policies and procedures that ensure that instant ticket game working papers are approved, by signature, prior to production of the affected instant ticket games.
2. Lottery management establishes policies and procedures to ensure that instant ticket game working papers are complete and accurate prior to approval (e.g., checklist).

The policies and procedures developed should be documented (See Finding #1).

Management Response – Finding #2 (Internal Audit Comments in Blue)

Brief Answer:

ALC staff already reviews instant ticket game working papers for accuracy, gives approvals after a positive review, and signs off on any documents where appropriate. That all games to date have been produced without mistake or error is the direct result of our current procedure.

DLA INDEPENDENT AUDITOR'S REPORT DATED OCTOBER 19, 2010

R1

SCHEDULE OF FINDINGS AND RESPONSES

2010-1

Ark. Code Ann. § 23-115-208(e)(6) requires the Agency to "prepare the financial statements, including the related notes to the financial statements, of the commission in accordance with generally accepted accounting principles (GAAP) and in accordance with guidelines and timeliness established by the Chief Fiscal Officer of the State to permit incorporation into the state's financial statements and to permit the audit of the state's financial statements and the commission's financial statements in a timely manner". The Agency did not prepare the June 30, 2010 financial statements and related notes in accordance with GAAP. The failure to prepare the financial statements and related notes in accordance with GAAP resulted in errors and omissions that could adversely affect the inclusion of the Arkansas Lottery Commission Financial Statements and related notes in the State's Comprehensive Annual Financial Report.

We recommend the Agency strengthen internal control over financial reporting by ensuring appropriate employees are qualified and knowledgeable of all applicable Governmental Accounting Standards and prepare the financial statements and related notes in accordance with GAAP.

Management response: The ALC has received guidance from DLA for the past year on the preparation of financial statements and the development of a financial accounting and reporting system. The assistance was used and relied upon to develop interim financial statements that were presented periodically to stakeholders as required by state law. Those interim financial reports utilized a format that was informative as to ALC's financial condition and results of operations from the books and records of the Agency. An emphasis of these financial reports was on the computation of net proceeds available to fund scholarships. This reporting system was then used to prepare our annual report.

The ALC was informed at a meeting with DLA on October 16, 2010, that the format used for the preparation of interim financial statements did not conform to the requirements of Ark. Code Ann. §23-115-206, i.e., the format of the financial statements and the related footnotes must conform to generally accepted accounting principles.

As a result of this finding, all financial statements are being reformatted to meet this requirement. The financial information contained in the original format was correct and accurate.

2010-2

Ark. Code Ann. § 23-115-205(a)(20) states that the Commission may enter into contracts with the terms and conditions as necessary. In addition, Ark. Code Ann. § 23-115-701(a)(1) states that each major procurement contract shall be filed with the Arkansas Lottery Commission Legislative Oversight Committee (LOC) for review before the execution date of the contract. The Commission approved and LOC reviewed the instant ticket lottery game service contract with a stated cost of 1.76% of net sales. Subsequent to this review, Management entered into a *Recital of Selected Options* with a cost of 1.92% of net sales plus an additional cost of 1.5% of the prize fund. The estimated cost of the *Recital of Selected Options* compared to the original reviewed price proposal is an estimated additional \$3.9 million per year. In addition to the *Recital of Selected Options*, Management entered into three licensing agreements with the vendor with a total estimated cost of \$871,861. The subsequent *Recital of Selected Options* and three licensing agreements were not approved by the Commission or reviewed by LOC. Lack of appropriate review of contracts and modifications of contracts could lead to a lack of transparency to the LOC and public.

We recommend the Agency ensure compliance with State law by submitting appropriate documents for review by the Arkansas Lottery Commission Legislative Oversight Committee.

Management response: The Arkansas Scholarship Lottery Act ("Act") grants the ALC the power to "enter into contracts of terms and conditions that the commission determines." Ark. Code Ann. §23-115-206(a)(20). The Act further allows the ALC to "arrange for the solicitation and receipt of competitive bids for major procurement contracts," with the specific requirement that these proposed major procurement contracts be filed with the Arkansas Lottery Legislative Oversight Committee ("LOC") for review before the execution date of the major procurement contract. Ark. Code Ann. §23-115-701(c)(2) and (e)(1).

1.75 %
Commission
Approved
LOC
Reviewed

DLA INDEPENDENT AUDITOR'S REPORT DATED OCTOBER 19, 2010

R2

Management response: (Continued)

On June 19, 2009, the ALC published an Instant Ticket Lottery Game Services Request for Proposal ("RFP") with two (2) subsequent addendums. This RFP was drafted and published by the commission with intent of providing the ALC with maximum flexibility to provide Arkansans with an innovative, diverse and large catalogue of instant ticket games and products to choose from with the goal of operating the lottery in a manner which maximized revenues as was required under Ark. Code Ann. §23-115-102(2)(B). In fact, Section 2.1 of the RFP specifically expresses the ALC objective to "provide for innovation and the ability to respond to changes in the industry and the demands of the marketplace." In light of the legislative intent noted in the Act and the stated objectives of the ALC, the RFP included provisions which invited prospective vendors to submit additional and alternate pricing for items included within their catalogue, including, but not limited to, other products and games. Section 1.26 of the RFP specifically states "vendors may expand items to identify all proposed services. A separate listing, which must include pricing, may be submitted with summary pricing." This invitation for additional pricing was in addition to the percentage of net sales pricing requested. In light of these provisions, it was clearly the intent of the ALC to invite, and contract for, additional and alternate options under the contract for the efficient and effective operations of the lottery. Additionally, it was the stated intent of the ALC to solicit this pricing for the specific purpose of binding vendors to those prices during the term of the contract to avoid potential future increases in game or product prices based on market demand.

In response to the RFP, Scientific Games International ("SGI") submitted an Instant Ticket Lottery Game Services Technical Proposal, Start-Up Marketing Plan and Official Proposal Price Sheet ("Response"). This Response included a lump sum price for net sales percentage, a listing of each component part and services that comprised the lump sum price and a listing of additional invited options from the catalogue of games, products and services offered by SGI. In addition to other services, including Play It Again and Second Chance Drawing Administration, the additional invited options contained a "Licensed property table" which included one hundred and forty four (144) licensed property games for the ALC to choose from during the course of the seven (7) year contract.

Upon receipt of the various RFP responses from SGI, GTECH and Pollard Banknote, an evaluation team of lottery professionals began the intensive evaluation process of reviewing all proposals submitted in light of the information requested in the RFP. The evaluation included review of and scoring for the alternate and additional products and games submitted by vendors.

At the conclusion of the evaluation process, the evaluations and scoring were submitted to the ALC for review. The RFP and Response were reviewed by the ALC on August 5, 2009. After review of the RFP, the Response, the notes and scores compiled by the panel of experts evaluating the vendor responses and thorough discussion of the responses from the three vendors, the ALC voted to award the instant ticket contract to SGI, contingent upon review by the LOC. All documents reviewed by the ALC in making its decision to award the contract to SGI were provided to the LOC for review. This included all RFP and Response documents. On August 13, 2009, the instant ticket contract documents were reviewed by the LOC.

In light of the foregoing, access to and the use of the licensed property portfolio of SGI is already included in the contract between the parties based on the fact that the information has been reviewed, considered and approved by the ALC and reviewed by the LOC. These additional and alternate products and games were requested by the ALC, provided by SGI in response, evaluated and approved by the ALC and sent to the LOC for review. Based on the content of the documents approved by the contracting parties, and the content of the document sent to the LOC for review, it is the obvious intent of both parties that these items be included in the terms of the contract.

Even if one were to assume that the narrow and rigid interpretation of the contract between the ALC and SGI is correct, the fact remains that the additional and alternate invited options submitted by SGI were included in the original documents submitted to the LOC for review. These items have already been evaluated and approved by the ALC and forwarded with the contract documents to the LOC for review. These documents included the licensed property catalogue owned by the vendor. Under the definition for "major procurement contract" as set forth in Ark. Code Ann. §23-115-103(14)(A)(vi), which includes contracts over seventy five thousand dollars (\$75,000.00) for "tickets," each term included in the licensing agreements cited by the DLA have been reviewed under the law.

Accordingly, under either scenario noted above, no further review is required under the law.

DLA INDEPENDENT AUDITOR'S REPORT DATED OCTOBER 19, 2010

R3

DLA disagreed

R3

We have evaluated the validity of the Agency's response to finding 2010-2 and it remains our position the LOC review of the items noted in 2010-2 are required under State law.

We also noted certain additional matters that we have reported to management of the Agency in a separate letter dated October 19, 2010.

The Agency's response to the findings identified in our audit, excluding management letter findings is described above. We did not audit the Agency's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Legislative Joint Auditing Committee, state executive and oversight management, agency management, Arkansas Lottery Commission and other parties as required by Arkansas Code and is not intended to be and should not be used by anyone other than these specified parties. However, pursuant to Ark. Code Ann. § 10-4-417, all reports presented to the Legislative Joint Auditing Committee are matters of public record and distribution is not limited.

DIVISION OF LEGISLATIVE AUDIT

Charles F. Fiser

Charles F. Fiser, CPA
Deputy Legislative Auditor

Little Rock, Arkansas
October 19, 2010

DLA INDEPENDENT AUDITOR'S REPORT DATED OCTOBER 19, 2010

Points for Prizes 2010 audit

KY

R4

10. The instant ticket lottery game service contract requires a fee paid to the vendor of 1.5% of the prize fund for the costs associated with the Points for Prizes™ program. The Agency paid the vendor \$3.3 million to operate the program during the year ended June 30, 2010. Agency personnel were unable to provide an adequate explanation as to calculation of the fee and specifically, how to determine the value of the prize fund. Agency personnel appeared to lack knowledge required to calculate the fee independent of the vendor. The Agency's inability to understand and recalculate the fee could cause vendor overpayments to occur thus reducing funds available for scholarships.

We recommend the Agency strengthen internal controls surrounding the Points for Prizes™ program by ensuring Agency employees adequately review and understand the methodology for calculating payments to the instant ticket lottery game service vendor.

11. Travel regulation R1-19-4-903 states mileage shall be reimbursed and computed using map mileage. The auditor was unable to adequately test marketing sales representatives' travel due to insufficient documentation. Information provided on the employees' travel reimbursement forms was vague and/or incomplete limiting the Agency's ability to properly review the supporting documentation prior to payment. In addition, the auditor was unable to verify miles traveled in order to recalculate mileage reimbursement for accuracy. Travel reimbursements for marketing sales representatives totaled \$198,983, including one employee who was reimbursed \$18,858 for 44,900 miles driven during a ten month period of time. Insufficient supporting documentation could allow errors or misappropriation of assets to occur and go undetected by the Agency, leading to overpayments made to Agency employees.

We recommend the Agency implement procedures requiring adequate documentation of travel made by the Agency's marketing sales representatives to allow for a proper review of travel reimbursements.

This letter is intended solely for the information and use of the Legislative Joint Auditing Committee, state executive and oversight management, agency management, Arkansas Lottery Commission and other parties as required by Arkansas Code and is not intended to be and should not be used by anyone other than these specified parties. However, pursuant to Ark. Code Ann. § 10-4-417, all reports presented to the Legislative Joint Auditing Committee are matters of public record and distribution is not limited.

DIVISION OF LEGISLATIVE AUDIT

Charles F. Fiser

Charles F. Fiser, CPA
Deputy Legislative Auditor

Little Rock, Arkansas
October 19, 2010

ALC MEETING, DECEMBER 9, 2010

V

- The official DLA 2010 Audit report and the official ALC response documents were provided on November 3, 2009, to the Arkansas Lottery Chair and Audit Committee Chair via email and U.S. Mail. The email is included as Attachment **F**.
- The 2010 Internal Audit Plan status Report for December 9, 2010, states that the audit to review "Payments to Scientific Games (Instant Ticket Games)" which was to review payments to Scientific Games to ensure compliance with contract was removed from the 2010 Audit Plan. The reason given was that "Payments to Scientific Games to be included as part of individual instant ticket games end-of-game audits. Also, area reviewed by external audit." The last page of that report is included as Attachment **U**.
- Since the response to the DLA findings was made on November 2, 2010, the ALC staff has appeared before the ALC on at least four (4) separate occasions (the last time being 11 months later) to report on the status of the 2010 audit findings and steps taken by the ALC to address those findings. The relevant dated agendas and minutes are below and included as Attachment **V**. Below are several relevant notes from the December 9, 2010, which occurred subsequent to the release of the 2010 DLA audit:

1. December 9, 2010

Note: at the December 9, 2010, meeting Finding #2 regarding the failure to obtain approval and review of the contract amendment changing the percentage from 1.75 to 1.92 was discussed in detail. Representatives from the Division of Legislative Audit appeared and provided commentary on the audit findings.

Note: During that discussion, the subject of adding the service of Tel-sell to the Instant Ticket contract was discussed by Director Passailaigue. He noted that the service of Tel-sell was originally going to be done internally and that the plan for the ALC was to hire 7 people to provide that service (see attachment B noted above). He assigned a value of over \$700,000.00 to that service provided in the Recital of Selected Options.

At that meeting, Division of Legislative Audit urged the Commission to reach out LOC to seek a curative solution to resolve Finding #2. After a request from Chairlady Lamberth for input on how to move forward from the other Commissioners, and discussion and suggestions from Commissioners Derrick Smith, Mike Malone and Smokey Campbell, the ALC resolved to reach out to the LOC for a solution on how to resolve Finding #2.

LOC MINUTES, FEBRUARY 16, 2011

MINUTES

HOUSE & SENATE INTERIM ARKANSAS LOTTERY COMMISSION LEGISLATIVE OVERSIGHT COMMITTEES

Z1

February 16, 2011

The Arkansas Lottery Commission Legislative Oversight Committee met Wednesday, February 16, 2011, upon adjournment of both Chambers, in Room 138, at the State Capitol, Little Rock, Arkansas.

Lottery Commission Legislative Oversight members attending were: Senators Johnny Key, Chair, David Johnson, Mary Ann Salmon, David Wyatt, and Jonathan Dismang, Representatives Mark Perry, Chair, Barry Hyde, Darrin Williams, Mary Slinkard, and Matthew Shepherd.

Other legislators attending were: Senators Linda Chesterfield, Joyce Elliott, and Eddie Williams, Representatives David Fielding, Fredrick Love, Reginald Murdock, and Traey Steele.

The Arkansas Lottery Commission Legislative Oversight Committee was called to order by Senator Johnny Key, Chair.

Review Minutes from the December 30, 2010 Meeting (Exhibit B)

Representative Steele stated the minutes need to be amended to state his motion was carried without objection.

Representative Williams made a motion to accept the amended minutes. Representative Hyde seconded the motion, and without objection, the minutes were approved as amended.

Senator Key stated without objection, the Recommended Changes to the Arkansas Scholarship Lottery Act would be moved up on the agenda to be covered next.

Update from Legislative Audit (Handouts 1 and 2)

Andy Babbitt, Supervising Senior Auditor, Division of Legislative Audit gave an update on the audit report findings. The first finding, relating to the preparation of annual financial statements, will be evaluated during the next annual audit, as the next financial statements are not required until June 30, 2011. The second finding, relating to contract review by the oversight committee, is considered resolved. On the 11 management issue findings, the agency appears to have made significant improvements. The agency was able to provide additional documentation for travel expenses, new policies have been put in place, and the control environment for cash receipts has been improved. A follow up by Legislative Audit will occur and be presented to the committee during the next few months.

Update on the Arkansas Lottery Commission (Exhibit D-1 and D-2)

Mike Hyde, Internal Auditor, Arkansas Lottery Commission, gave an update on the Lottery Commission's response to the Legislative Audit report findings. Mr. Hyde stated as of February 8, 2011, two of the 13 findings have been cleared. Several findings have factors that need to occur prior to management's final corrective action.

- Finding #1 cannot be cleared until the June 30, 2011 financial statements are completed and audited.
- Management Findings #2 and #5 require more transactions to take place for review.
- Management Findings #1 and #7 are waiting on pending legislation.
- Management Finding #4 was pending the release of the Attorney General's finding, which has just occurred.
- Management Finding #6 is pending a consultation with Department of Finance and Administration.

LOC MINUTES, MAY 11, 2011

MINUTES

ARKANSAS LOTTERY COMMISSION LEGISLATIVE OVERSIGHT COMMITTEE

May 11, 2011

Z2

The Arkansas Lottery Commission Legislative Oversight Committee met Wednesday, May 11, 2011, at 10 a.m., in Room B, at the Big MAC Building, Little Rock, Arkansas.

Lottery Commission Legislative Oversight members attending were: Senators Johnny Key, Chair, David Johnson, Mary Ann Salmon, Robert Thompson, David Wyatt, and Jonathan Dismang, Representatives Mark Perry, Chair, Bobby Pierce, Barry Hyde, Darrin Williams, Mary Slinkard, and Matthew Shepherd.

Other legislators attending were: Senator Paul Bookout, Representatives Jonathan Barnett, Jerry Brown, John Catlett, Gary Deffenbaugh, Justin Harris, Homer Lenderman, Mike Patterson, Garry Smith, and Butch Wilkins.

The Arkansas Lottery Commission Legislative Oversight Committee was called to order by Senator Johnny Key, Chair.

Review Minutes from the March 1, 2011 Meeting (Exhibit B)

Representative Pierce made a motion to approve the minutes. Representative Slinkard seconded the motion, and without objection, the motion carried.

Summary of Legislation passed by the 88th General Assembly (Handout 1)

Cheryl Reinhart, Staff Attorney, Bureau of Legislative Research, gave an overview of Legislation effecting the Lottery which was passed this Session.

Progress Report on FY2010 Audit Report Findings (Handout 2, Exhibit D)

Michael Hyde, Internal Auditor, Arkansas Lottery Commission, stated at this time eight of the 13 findings have been cleared, and 23 of the 30 objectives have also been satisfied. Of the five findings that have not yet cleared:

Finding 1: Pending the release of the yearend financial statements in July 2011.

Finding 2: Pending the establishment of policies and procedures to ensure the ineligible player database is kept current.

Finding 3: Pending repayment of all compensatory time, which is expected to be complete in July 2011.

Finding 4: Awaiting determination of whether repayment will be sought for retroactive payments to employees.

Finding 5: Pending a cost proposal from DF&A on using AASIS.

Andy Babbitt, Supervisor Senior Auditor, Division of Legislative Audit, stated the audit finding pertaining to vendor contracts appears to now be in compliance. The Lottery has entered into two contracts which were compliant. In regards to retroactive pay, it was recommended that DF&A review the files to determine whether employees were correctly paid.

Bishop Woosley, Attorney, Arkansas Lottery Commission, stated there is not an issue with sending documentation on retroactive payments to DF&A or OPM for review. However, from a legal stand point he can not recommend to the Commission that they seek reimbursement for money which was legally owed.

Senator Key stated the Committee would like to continue receiving updates on the Audit Report Findings until all findings have been cleared.

LOC MINUTES, AUGUST 24, 2011

Z3

Legislative Audit Report (Handout 2)

Andy Babbitt, Supervisor Senior Auditor, Division of Legislative Audit, reviewed the five issues which were pending from the previous report.

1. **Preparation of financial statements:** Lottery Commission has begun a contract with Crowe Horwath for completion on Comprehensive Annual Financial Report.
2. **Ineligible Player Database:** The database is working, and policies and procedures are now in place to insure compliance.
3. **Compensatory Time:** As of June 29, 2011, all compensatory time has been repaid.
4. **Retroactive Pay:** During the Commission meeting on August 15, 2011, a motion was made not to seek reimbursement.
5. **Payroll System:** A recent software release from the current vendor will address the control issues.

Representative Perry stated without objection, the report was considered reviewed.

Lottery Commission Report (Exhibit F)

Mr. Passailaigue gave an overview of Lottery Commission's finances for FY2011. The net income for FY2011 was \$94,164,308, and was \$10 million under the budgeted net income. The Lottery transferred \$7,146,103 to the Department of Higher Education, for scholarships in July.

Mr. Passailaigue stated the Lottery received the first IRS penalty notification in April 2010. The CFO contacted the IRS, and the IRS waived the penalty. A second penalty notice was received in April 2011, the CFO again contacted IRS. The CFO believed when the previous year's penalty was waived, that the waiver included all penalties up to the date the waiver was given. In July, the IRS rejected the abatement request. Mr. Passailaigue was informed about issue in August, at which time he informed the Commission and legal counsel. At his suggestion, the Commission agreed to hire a tax attorney. The tax attorney selected is working pro bono on the issue. There is a 60 day appeal period, which will end in mid-September. The Lottery began making daily tax payments thru EFTSP after the first penalty notice to ensure no further late payments were made. The penalty will be listed as contingent liability on year end statements financial statements.

Lottery Auditor Report (Exhibit H)

Michael Hyde, Internal Auditor, Arkansas Lottery Commission, stated 12 of the 13 audit findings had been cleared. The finding on financial statements is only finding still pending. However, this year's financial statements are in the process of being finalized by Legislative Audit.

Mr. Hyde agreed with Senator Dismang, that according to GAAP, the continued liability should be shown on the face of the financial statements, since initial response from the IRS was to deny abatement. The IRS issue was not disclosed to him. He has developed a three year audit plan, using a risk assessment, and the plan was approved by commission. The IRS issue was not original seen as a high risk area, however it will now be included in the audit plan.

In answer to Senator Pritchard question, Mr. Woosley stated reimbursement is not being requested because it is a legal issue, as the statute may not apply, since the Lottery Commission is not under OPM. If the Commission sued, it would leave itself open to employment claims, and would subject itself to liability and unnecessary fees.

Representative Perry stated without objection, the report was considered reviewed.

Briefing on Escrow and Data Storage Issues for the Arkansas Lottery

Byron Booth, Jr. VP of Governmental Relations, and Steve Beck, Regional VP, Intralot, gave an overview of data storage for the lottery. There is a duplex system running within the state, and a DR system set up in Ohio, as an out of state back up. The system in the lottery building, does a backup every night, and once a

LOC MINUTES, SEPTEMBER 29, 2011

Z4

MINUTES

ARKANSAS LOTTERY COMMISSION LEGISLATIVE OVERSIGHT COMMITTEE

September 29, 2011

The Arkansas Lottery Commission Legislative Oversight Committee met Thursday, September 29, 2011, at 10 a.m., in Room B, at the Big Mac Building, Little Rock, Arkansas.

Lottery Commission Legislative Oversight members attending were: Senators Johnny Key, Chair, Mary Ann Salmon, Robert Thompson, and Jonathan Dismang, Representatives Mark Perry, Chair, Bobby Pierce, Barry Hyde, Darin Williams, and Matthew Shepherd.

Other legislators attending were: Senators Paul Bookout, Mike Fletcher, and Larry Teague, Representatives Denny Altes, Tommy Baker, John Burris, Billy Gaskall, Jeremy Gilliam, Clark Hall, Kim Hammer, Buddy Lovell, James McLean, Reginald Murdock, Mike Patterson, Leado Post, James Ratliff, Nate Steel, Thomas Wren and Marshall Wright.

The Arkansas Lottery Commission Legislative Oversight Committee was called to order by Senator Johnny Key, Chair.

Review Minutes from the August 24, 2011 Meeting (Exhibit B)

Representative Shepherd made a motion to approve the minutes. Representative Perry seconded the motion, and without objection, the minutes were approved.

Lottery Director's Report (Exhibit C)

Ernie Passalunghi, Director, Arkansas Lottery Commission, stated during the month of August, the Lottery generated approximately \$38 million. In the first two months of the fiscal year, the Lottery has grossed \$72.4 million. Transfers to the scholarship fund are down \$732,353, below budgeted transfers.

Lottery Commission Internal Audit Report (Exhibit D)

Michael Hyde, Internal Auditor, Arkansas Lottery Commission, stated the finding on financial statements is the only finding which has not been cleared. It is expected to be cleared by the next report, on the 1st of October. Mr. Hyde stated any issues he has come across during the past year, have been turned in to the Commission.

Near-Term Lottery Operations

Senator Key welcomed Julie Baldridge, Director, Public Affairs and Legislative Relations, Arkansas Lottery Commission, who will be assuming the Interim Director position.

Ms. Baldridge stated her primary concern is the stability of revenues and stability within the workplace, until a new director is found.

Near-Term Gaming Update (Handout A)

David Barden, Vice President of Gaming Operations, Arkansas Lottery Commission, stated 85% of sales are of instant games. The new Fast Play game will allow buyers to become comfortable with terminal generated tickets, similar to those used in online games. The Lottery is also considering doing monthly promotions during 2012, however these promotions are subject to Commission approval. Arkansas has started the trend for Player Rewards programs.

Update on Director Search

Dianne Lamberth, Chair, Arkansas Lottery Commission, stated the Personnel Subcommittee, of the Commission, will begin meeting on October 3, 2011, to establish the qualifications for the director search. The Subcommittee will then bring those qualifications to the Commission for review, and the

INTERNAL AUDIT REPORT DATED APRIL 8, 2011

Arkansas Lottery Commission – Internal Audit

Review of Findings and Recommendations from the Division of Legislative Audit's
June 30, 2010 Audit Report and Management Letter

Status Report – August 5, 2011

BB1

Legislative Audit Management Letter Finding #10:

The instant ticket lottery game service contract requires a fee paid to the vendor of 1.5% of the prize fund for the costs associated with the Points for Prizes™ program. The Agency paid the vendor \$3.3 million to operate the program during the year ended June 30, 2010. Agency personnel were unable to provide an adequate explanation as to calculation of the fee and specifically, how to determine the value of the prize fund. Agency personnel appeared to lack knowledge required to calculate the fee independent of the vendor. The Agency's inability to understand and recalculate the fee could cause vendor overpayments to occur thus reducing funds available for scholarships.

Legislative Audit Recommendation for Management Letter Finding #10:

We recommend the Agency strengthen internal controls surrounding the Points for Prizes™ program by ensuring Agency employees adequately review and understand the methodology for calculating payments to the instant ticket lottery game service vendor.

NOTE – This finding was cleared by Internal Audit on April 8, 2011.

Audit Objective #26

Determine that the Lottery and the instant ticket game vendor have clarified the calculation for the "Points for Prizes" fee.

No Findings or Recommendations. Scientific Games provided a formula for the calculation of the Points for Prizes in a document dated February 1, 2011. Lottery management concurs with the formula.

Audit Objective #27

Determine that the Lottery is remitting to the instant ticket game vendor the correct amount for the "Points for Prizes" fee.

No Findings or Recommendations. Based on a test of transactions conducted by Internal Audit, the billing amount for the Points for Prizes is being calculated in accordance with the formula agreed upon by Lottery management and Scientific Games.

INTERNAL AUDIT REPORT DATED APRIL 8, 2011

BB2

Arkansas Lottery Commission – Internal Audit

BBZ

Review of Findings and Recommendations from the Division of Legislative Audit's
June 30, 2010 Audit Report and Management Letter

Status Report – April 8, 2011

Audit Report Finding 2010-2:

Ark. Code Ann. § 23-116-206 (a) (20) states that the Commission may enter into contracts with the terms and conditions as necessary. In addition, Ark. Code Ann. § 23-116-701 (e) (1) states that each major procurement contract shall be filed with the Arkansas Lottery Commission Legislative Oversight Committee (LOC) for review before the execution date of the contract. The Commission approved and LOC reviewed the instant ticket lottery game service contract with a stated cost of 1.75% of net sales. Subsequent to this review, Management entered into a *Recital of Selected Options* with a cost of 1.92% of net sales plus an additional cost of 1.5% of the prize pool. The estimated cost of the *Recital of Selected Options* compared to the original reviewed price proposal is an additional \$3.9 million per year. In addition to the *Recital of Selected Options*, Management entered into three licensing agreements with the vendor with a total estimated cost of \$671,861. The subsequent *Recital of Selected Options* and three licensing agreements were not approved by the Commission or reviewed by LOC. Lack of appropriate review of contracts and modifications of contracts could lead to a lack of transparency to the LOC and public.

Recommendation for Finding 2010-2:

We recommend the Agency ensure compliance with State law by submitting appropriate documents for review by the Arkansas Lottery Commission Legislative Oversight Committee.

NOTE – This finding was cleared by Internal Audit on March 8, 2011.

Audit Objective #2

Determine that the Arkansas Lottery Commission Legislative Oversight Committee and Arkansas Lottery Commission have reached an agreement concerning the submission of appropriate contract documents for review by the Arkansas Lottery Commission Legislative Oversight Committee.

No Findings or Recommendations. Lottery management has agreed to provide immediate notice to the Arkansas Lottery Commission Legislative Oversight Committee of all agreements described in a letter from the Co-chairs of the Committee dated December 14, 2010.

CONTRACT COST ANALYSIS SUMMARY

9/28/2009 through 2/29/2012

EE

Difference in Instant Services Pricing 1.15% and 1.92%	\$7,499,600.64
Difference in Points for Prizes Pricing 2.3078% and 1.5%	-5,547,553.37 PFP Difference
Change in Pricing	<u>\$1,952,047.27</u>
Merchandise Fees (out of game)	\$200,000.00
Linked Game Program fees less trips	<u>\$604,762.53</u>
Merchandise Fees + Linked Game Fees	\$804,762.53
Total Difference	\$2,756,809.80

CONCLUSION QUESTION:

Invalidation of a contract (1.92% & 1.5%) that has been:

- Approved
- Reviewed
- Reapproved by ratification and acquiescence in December 2010
- Re-reviewed by LOC through the audit process
- In force since August 31, 2009
- Under which we have sold almost 350,000,000 tickets
- Sales of more than 1 billion dollars

In order to lodge a multimillion dollar lawsuit based on a contract price (1.15% & 2.3078%) that was:

- Never approved
- Never reviewed
- Never in force
- Never been operated under by either party
- Not one prize or ticket sold under this contract