

RECORD

VENDOR COMMITTEE

2.19.2014, 9:15 a.m., Little Rock Headquarters

The meeting was called to order by Commissioner Scott. Committee members present were Commissioners Baldrige, Campbell, Lamberth and Engstrom. Also present were ALC Chairman Hammons, Commissioner Pickard, Director Woosley, Auditor Brown and staff members Smith, Block, Bunten, Stebbins, Vick, and others.

Chairman Scott recognized Director Woosley, who introduced a Product, Advertising & Sales Review (in file) of the 2013 Arkansas Million Dollar Raffle (MDR). The Director stated that in reviewing the negative outcome of the game, the conclusion was that in the future, management would have to seriously consider before entering into any seasonal or niche games that would take away resources and man-hours based on the return ALC would receive from those games. Even if such a game sold beyond expectations, what it took away from the emphasis on ALC's "bread and butter," i.e., instant and online games, might make it not worth the risk.

Gaming Director Mike Smith reported on the planning of the game and made a comparison between the FY 2010 MDR to the 2013 MDR. He explained that reasons for changing the way the game was structured was based on feedback/lessons learned from the earlier game. The 2013 MDR had a defined and committed draw date, incentives (Early Bird drawings) were built in to generate excitement, and value purchase options were created (buy more, save more).

Sales Director Bunten reported on the marketing for the game, including creative development and media. A strong campaign utilized television, cable, radio, electronic billboards, signage, point-of-sale, banner advertising, social media, retailer newsletter, and retailer promotional items. Commissioner Scott asked Ms. Bunten what the total spend was in promoting the raffle. Ms. Bunten responded that over \$700,000 was spent. She added that ALC was running a little heavier year-to-date in advertising, partly because [the MDR] was a really big game and ALC had to use additional resources. Commissioner Engstrom asked if it could be considered a loss of over \$700,000, in addition to the \$284,000 loss. Ms. Bunten responded that ALC had a defined amount of advertising funds to spend each year, and that spending did not go beyond the budget, but that yes, resources were dedicated to the raffle. She added that [the raffle] advertising was still advertising the Lottery overall and therefore could not be considered money wasted, and that during the raffle period, ALC was still advertising instant ticket launches. Commissioner Engstrom said that he understood that, but in looking at it from an accounting standpoint, this was a product that ALC spent \$700,000 to promote, yet lost \$284,000, and that he was looking at it as an almost-million dollar loss. Director Woosley stated that one really couldn't assume that, that is, the product could have brought people into the store to buy other products and the ALC brand was extended [by the advertising]. He added that if one considered how much was spent on the first raffle, in which ALC gave away \$3 million, \$1.4 million was spent on advertising, \$186,000 went to

retailer commissions, and there was extra expense for MSR mileage and time, he could make the argument that the first raffle lost money.

Mr. Stebbins, Sales Director, gave an overview of the Sales Division's tasks for the MDR, which included communicating the launch of the game, distribution of point-of-sale materials, targeting stores with low raffle sales, and initiating clerk incentive promotions. He explained that the product was reviewed with the sales team prior to the launch and raffle information was e-mailed to the lottery retailers. The sales team made regular store visits, providing training and point-of-sale materials and promotional items. Sales team feedback on the MDR included: price (customers believed they were forced to spend \$30 to get the best value); holiday season impact; bad experience with the 2011 MDR; many players waited until the last minute to purchase a ticket; and, players did not have cash to purchase a ticket.

Commissioner Scott thanked Director Woosley, Mr. Smith, Ms. Bunten, and Mr. Stebbins for their reports and for the insight they provided.

Commissioner Scott then recognized Internal Auditor Brown to discuss the next item on the agenda, Performance Audits. Mr. Brown gave a brief explanation of performance audits and how ALC might use one. He listed the following items as benefits of a performance audit:

- Benchmark lottery performance in comparison to its peers
- To assess the efficiency and effectiveness of a lottery's performance (both cost and operational)
- To provide recommendations for improvement of a lottery's performance in sales
- Marketing/advertising/promotions
- Product portfolio
- Organization/structure
- Cost effectiveness
- Overall strategy

Mr. Brown used the North Carolina Educational Lottery (NCEL) Performance Audit as an example. He noted that the firm that performed the NCEL audit, Delahanty Consulting, LLC, had been used by ALC in the past (Scientific Games Headquarters – Instant Ticket Security Review) and engagement would continue through the FY 2014-16 Audit Plans.

Mr. Brown gave a brief background on how performance audits began in NCEL. He said that initially NCEL was required to have a performance audit performed, but "independent agency" was not specified in the legislation. The North Carolina Office of the State Auditor performed NCEL's first audit. NCEL did not receive any useful information from that particular audit because the state audit was more focused on benchmarking and accounting, as opposed to what a consultant with industry experience might do. NCEL went back to their legislature and asked that the statute

be changed to read that an “independent firm” would perform the audit. He stated that NCEL initiated a Request for Information (RFI) process to understand how an independent firm would perform the audit to comply with North Carolina’s legislative mandate. The RFI enabled NCEL to specify what needed to go into their RFP (Request for Proposal). Both the RFI and RFP served as the basis for developing the approach to the performance audit that they now follow. Their performance audit is segmented into two parts: (1) Performance Report Card and (2) Specific Analysis and Opportunity Identification. Mr. Brown explained that the performance report card mostly consisted of benchmarking against peers and trending of financial and operational information. The second part, the area of Specific Analysis, focuses on two or three areas for review, derived from collaboration between management and the consulting firm, with the idea of arriving at specific identification of opportunities to achieve key objectives.

Mr. Brown then explained the process NCEL used to determine which firm was chosen for the performance audit and he also discussed the final cost to NCEL, which was \$134,000. When Mr. Brown asked NCEL what benefits they felt they had derived from having the audit performed, they specified: (1) Social Media Use; (2) Instant Game Release Schedules; and (3) Return on Advertising (they cited this as providing value in discussion over legislation that would have eliminated all advertising).

Mr. Brown briefed the committee on Arkansas Code Annotated Section 23-115-2065(b)(3)(A), which states:

*“If the commission, the General Assembly, the Arkansas Lottery Commission Legislative Oversight Committee, or the Legislative Auditing Committee requests additional audits or performance reviews of the fiscal affairs or operations of the commission to be conducted by a private certified accountant or other consultant, the **division** [Internal Audit emphasis] shall select and contract with appropriate certified public accountants or consultants to provide the services.”*

He said that the statute has never been tested, but the RFP would have to be written in such a way as to ensure the services would have to be contracted out. Director Woosley added that the RFP would have to go to the Legislative Oversight Committee, to be forwarded to Legislative Audit for right of first refusal or that Legislative Audit would develop the RFP and send it out for bid.

There was much discussion regarding the scope and objectives of a performance audit, and whether or not ALC could possibly leverage the utilization of Internal Audit for cost savings. A phased approach could also contribute to cost savings.

Commissioner Engstrom requested that management provide a chart similar to the one on the NCEL report, page 6. He asked that staff determine its peer lotteries and compare Arkansas’s performance to those.

Commissioner Baldrige suggested that perhaps the Lottery vendors could assist with the cost of the performance audit. She also suggested that further discussion of a performance audit be brought to the full commission, or “committee of the whole.”

Commissioner Engstrom asked that everyone review the NCEL Performance Audit and limit the scope to that of which ALC did not have the expertise to do.

There being no further business, the meeting was adjourned.