### CALIFORNIA STATE LOTTERY COMMISSION

Minutes – October 15, 2008 San Bernardino, California

## 1. Call to Order

Chairperson John Mass called the public meeting of the California State Lottery Commission to order at 10:00 a.m. at the San Bernardino County Government Center, 385 North Arrowhead Ave., San Bernardino, CA 92415.

## 2. Pledge of Allegiance

John Mass led the Pledge of Allegiance.

## 3. Roll Call

Mass asked Elisa Topete to call the roll.

### **Commission Members Present:**

Commissioner Rachel Montes Commissioner Cynthia Flores Chairman John Mass

## **CSL Staff and presenters:**

Joan Borucki, Director

Kate Killeen, Acting Chief Legal Counsel

Michael Brennan, Deputy Director of Sales/Marketing

Bill Hertoghe, Deputy Director of Security/Law Enforcement

Susan Kossack, Deputy Director of Marketing

Ellen Ishimoto, Deputy Director of Information Technology Services

Michael Ota, Deputy Director of Finance

Marty Rubio, Manager of Internal Audits

Brian Reynolds, Director of Global Public Sector, Grant Thornton

Elisa Topete, Assistant to the Commission

Mary Montelongo, Recording Secretary

# 4. Consider Approval of the Agenda

Mass asked if any of the Commissioners wanted to make changes to the October 15, 2008 agenda as proposed. Flores moved to approve the amended agenda. Seconded by Montes. The motion passed unanimously (3-0).

# 5. Approval of Minutes

Mass asked if there were any additions or corrections to the August 20, 2008 minutes. Flores moved to approve the minutes. Seconded by Montes. The motion passed unanimously (3-0).

# 6. Commission Liaison Reports

### **Commissioner Flores:**

As Audit Liaison, staff updated Flores on the State Controller's Office (SCO) Audits, specifically on six open audits the Lottery currently has. The first is the Office Revolving Fund, which started on February 26, 2008; the CAL-Card program, which started April 2, 2008; the Draw Observation Contract, which started on May 8, 2008; the Fleet Management Program, which started July 28, 2008; the GTECH Contract, which started July 30 2008; and the Fourth Quarter Transfer Review, which started September 2, 2008. The SCO has completed field work and held an exit conference on the Office Revolving Fund and the Draw Observation Contract; however, draft audit reports are pending. The SCO continues to perform field work on the CAL-Card Program, the GTECH Contract, the Fleet Management Program, and the Fourth Quarter Transfer Review.

The KPMG auditors continue field work on the Annual Financial Statement Audit for the year-ending June 30, 2008. The audit report is scheduled for release in mid-October 2008. This audit started in June 2008.

### **Commissioner Montes:**

Montes had nothing to report.

### **Chairman Mass:**

As Procurement Liaison, Mass was briefed by staff and requested approval on the following: A non competitive contract with Emerson Network Power, Liebert Services, Inc. to provide full service maintenance and remote monitoring of critical equipment alarms for the Lottery's Liebert power distribution and environmental monitoring systems. The contract term is October 1, 2008 through September 30, 2011, with the option to extend two additional one-year periods. The contract amount is \$198,112.86.

As Marketing Liaison, Mass was updated by staff on the Happy Cow Scratchers® copromotion with the Milk Advisory Board and the "Only" TV campaign airing through October 12. The California Lottery Free Gas Give-Away promotion was very successful and Mass publicly thanked Senator Florez for suggesting the idea. Mass was updated on the California Breeder's Cup and the "Make Me a Millionaire" Scratchers® promotion.

# 7. Director's Report

Joan Borucki, Director, thanked Security/Law Enforcement (S/LED), Marketing, Communications, and Administrative staff who worked on the Gas Give-Away promotion. The events went very smoothly and the Lottery received great responses and positive press.

### a. MEGA Millions® Director's Report and NASPL

Borucki reported on the National Association of State and Provincial Lotteries (NASPL) Conference. The MEGA Millions® Directors' Meeting was also held at the conference. The director's failed to hold the election of new officers, but will possibly elect them at the spring meeting because there are a number of gubernatorial elections coming in November that may impact who the directors are. Also discussed at the meeting was the downward trend in sales for MEGA Millions®, which is directly correlated to the number of jackpots it is experiencing. The fewer the jackpots, the fewer the sales, the fewer the sales, the smaller the jackpots. Borucki has discussed the Lottery's' Business Plan which is about shifting the jackpot paradigm and is trying to get the other MEGA Millions® Directors interested in doing something more aggressive at the smaller jackpot levels.

Borucki stated that Powerball just welcomed Florida to its ranks, which is a big addition that will add sales and will then also generate more rising jackpots, which then impacts MEGA Millions® sales. Powerball is looking at changing its matrix in order to generate larger jackpots faster. As a result, MEGA Millions® has formed two teams; a marketing team to develop some proposals that would be more of a national campaign, and a Game Development Committee to look at what the team could do to with the current game, perhaps an add-on game, or an additional game to generate new interest in MEGA Millions®. The team has also been approached by the Powerball group for interest in doing a joint game between the two, which would then become a national-type game. At this time, the MEGA Millions® group is not interested and feel the need to concentrate on its own game first. There will be a follow-up MEGA Millions® Director's meeting in New York at the annual LaFleurs Conference.

NASPL is quite a large group of Lottery Directors in North America. There are also various World Lottery Association members who attend to make it a good time to network with others in the industry, other lottery directors and other marketing staff. Borucki was selected as chair of two subcommittees, one being the annual conference selection and the other being the education committee.

Discussion by Commissioners.

#### b. Legislative and Outreach Updates

Borucki reported on Assembly Bill (AB) 1654 which could give the Lottery more revenue allocation and flexibility. The bill removes the 34 percent publication allocation requirement and grants the flexibility to the Commission to manage the allocation between prize pay-outs and net revenues. It allows the Lottery Commission to determine prize pay-outs and approve Lottery-related expenditures. AB 1654 also authorizes the director of the Department of Finance to designate a portion of the Lottery's net revenues for transfer to something called the Lottery Assets Fund, created by this bill, and provides clarification in addition that the Lottery is exempt from the Public Contract Code. The bill reduces the Lottery's maximum administrative expense allocations from 16 to 13 percent. It allows retained earnings up to 16 percent of sales, and requires net revenues remaining after allocations for prizes, administrative

expenses, anti-gambling programs, and revenue securitization to be transferred to the Department Retirement Fund in the State Treasury. It authorizes the Legislature to appropriate those monies for infrastructure bond debts and economic recovery funds. Finally, the bill commits the Lottery to a problem gambling awareness and treatment contribution of at least \$1 million per year to the Office of Problem Gambling.

Parts of the changes are subject to a ballot initiative and according to the bill, would need to go on the next statewide election. According to the legislation, the prize payouts would go on the ballot as well as the ability of the Department of Finance to use the Lottery's revenues for something other than education. There are changes in section 8880.56 of the Lottery Act and the changes were included in AB 1654. The changes are there to clarify the previously vague role of both the director and the Commission in establishing a number of different programs within the Lottery; everything from public relations to employee incentives. The language puts the authority in the Commission's hands, not the director, to make decisions regarding funding. The changes in the legislation do not sanction parties, nor do they negate the regulations that the Commissioners passed in May, which is the adoption of the standard Department of Personnel Administration practices for employee incentive programs.

Borucki stated that AB 1741 gives the Director of the Department of Finance the authority to secure ties to Lottery revenues and lays out all the conditions under which they can do that. It does not put any restrictions on how many times the Department of Finance can go out to the market or how much. Senate Constitutional Amendment (SCA) 12 is the Lottery's Constitutional Amendment to add to the purpose of the Lottery. Education was not eliminated as a purpose, but a purpose was added to the Lottery Act.

Communications continues to work with Marketing on earned media and the Breeder's Cup. The Lottery attended the League of California Cities and staff will attend the Association of County School Administrators in San Diego in November and the California State Association of Counties in December.

Discussion by Commissioners

### c. Quarterly Recruitment Status

Michael Brennan, Deputy Director of Sales/Marketing, spoke of the recruitment plan that was brought to the Commission in March 2008, to add 2,250 retailers over the next three years. By 2010, the Lottery intends to have the retailer density down to 1,679-to-1, with over 22,500 retailers. The goal this fiscal year is 775 net retailers, with an additional CVS number of about 350. The main recruitment goals continue to be increased sales overall and increased retailer density. The focus will be on profitable traditional and non-traditional retailers, and to decrease the number of underperforming retailers. Staff will also explore new business models as a means to attract quality business partners and expand the Lottery's trade channels to meet the changing shopping trends with the continued philosophy of quality, not just quantity. From April 2007 to 2008, there were 1,931 new retailers recruited and 774 of those were terminated for various reasons. The annual net gain during that year was 1,157 new

retail locations. Currently, the Lottery has 20,325 active status retailers with about 190 at any one time on inactive status for various retail reasons.

Staff will be focusing on specific zip code targets to reduce the player terminal ratio in the areas where there are strong draw sales. Through September, 2008, the Lottery has had 604 new retailers recruited and a total of 1,125, if you include replacements for change of ownerships. There have been 406 retailers terminated for various reasons; the Lottery has a net gain of 198 currently selling as new net retailers. There are 323 retailers that are pending and approved, waiting for installation of equipment, so a net gain to date including those would be 521. GTECH will have equipment ready for installation at the end of October and staff estimates 90 installs a week with retailer training starting the beginning of October 20.

Discussion by Commissioners

## d. Marketing Update

Brennan reported that the Happy Cows Scratchers® is going strong and the "Moo That Tune" contests have been received warmly at state fairs, leading to the Lottery's very first YouTube viral video. The second chance consumer promotion continues where players can win one of five \$1,000 prizes by entering non-winning tickets. Over 7 million tickets have been sold and the Lottery is still selling at \$400,000 clips per week with two of the five drawings left to go. The Gas Giveaway was very successful and was done in a very quick turn-around time, due to the wonderful job staff did in putting it all together. The Breeder's Cup started on October 12 and players who purchase \$5 or more on a single ticket for any draw game (excluding Fantasy 5) receive an entry coupon for a chance to win \$10,000 by entering in the bonus draw website promotion.

Brennan showed the new Point of Sale that will be in stores for the holiday season, which includes the "Make Me a Millionaire" new TV ticket. There is also the "Let It Dough Doubler, Jingle Bucks," and the "Candy Cane" crossword that is also available as a second-chance drawing to get onto the TV show. The tickets will be going to the retailers very soon. Brennan stated that the "Only" campaign had a Hispanic version of it and was awarded the silver winner for the Hispanic Creative Advertising Awards out of one category. Brennan congratulated the Marketing team and Casanova Pendrill for the campaign.

Borucki pointed out the Lottery's new logo and stated that six to eight different teams of employees from all over the organization put together a new brand image training to be presented to all Lottery employees to help them understand why there is a new logo. The teams did their presentations to senior management and did an excellent job at finding different and creative ways to convey the message.

Discussion by Commissioners.

### e. Consumer Protection Update

Bill Hertoghe, Deputy Director of S/LED, spoke of the monitored probation that was started over a year ago. S/LED puts a retailer on probation as opposed to termination or a warning. The probations are monitored and are paid for by the retailer. Investigators go to those particular stores on a quarterly or semiannual basis and do inspections and follow-up on the probation. Terminations are slightly up due to the Retailer Compliance Program; S/LED's sting operations. The Subsequent Arrest Reviews are notifications by the Depenarement of Justice of retailers that have been arrested for any crime. Staff will review to see if it will impact the retailers' contracts and 52 were done in a quarter.

Hertoghe went over the Consumer Protection Strategic Plan, which includes a mission statement that is specific to the strategic plan for the consumer protection. Most notable are the principles of engineering, education, and enforcement. Borucki added that the plan includes a number of initiatives that the Lottery is either doing currently or looking to do them in the future. S/LED will return to the Commission as the plan will need inclusion in next year's budget for funding and Commission approval.

Discussion by Commissioners

### f. Grant Thornton Presentation

Borucki stated that one of the Lottery's key Business Plan strategies is to modernize operations. One component of this strategy is to update the Lottery's financial back-office systems. Grant Thornton was hired to perform a review to evaluate current operations and identify strategies for modernizing financial management operations.

Brian Reynolds, Director of the Global Public Sector for Grant Thornton, led a team of people with internal controls and accounting experience, experience implementing and procuring financial management systems, experience reviewing policies, procedures, and best practices around financial management. The team looked at the systems and data interfaces. Policy and procedures were examined to see how well documentation was used and reviewed, and to make sure that all operations are conducted in a standardized and predictable manner. The analysis was completed with the help of Lottery staff, technicians, supervisors and managers and involved documentation review, interviews, workshops, survey instruments and managerial surveys.

The team started with an inventory of current processes, subprocesses, and activities of everyday operations within the financial management operation. The operations were organized in terms of seven process areas, 36 material subprocesses, and roughly 700 activities. The team looked at the total revenues and total assets managed or affected by the various business products, financial management business processes, and were categorized as the most likely to lead to a material misstatement in the financial statements. Grant Thornton performed a managerial survey to determine a rough order of what it costs to actually execute those processes, and came up with the top 11 most

expensive processes to actually execute. Some of the 11 recommendations have to do with policies, procedures, and long-standing daily activities. Others had to do with broader recommendations such as reengineering some of the processes, introduction of automation, removal or remediation of manual interfaces, or shortcomings in the systems that require manual intervention or manual machination of the data. The recommendations were designed to support the Business Plan, improve current and future operations, and allow for more efficient operations. When sales do increase and the variety of games that need to be introduced really becomes more variant, the manual paper-driven operations will become a handicap.

Reynolds summarized Grant Thornton's recommendations in three categories as follows: "Implementations in Progress, Near-Term Improvements, and Longer-Term Improvements" (see slide attachment). Ellen Ishimoto, Deputy Director of Information Technology Services, and Michael Ota, Deputy Director of Finance, presented the "Lottery's Implementation Strategies" for each category of recommendations.

Ishimoto stated that Lottery staff is working on an action plan called the "Business Intelligence Initiative" which will work on delivering information to the decision-makers of the Lottery. Staff will be looking at the Lottery's information needs and what shape the systems are in to come up with a strategic roadmap to implement a business intelligence solution that will address Grant Thornton's recommendations in the "Implementations in Progress" category.

Ota stated the "Near-Term Improvements" recommendations are items the Lottery can initiate this fiscal year. Ota then stated the recommendations under "Longer-Term Improvements" present a significant challenge to the Lottery because of the resource investment that will be required to undertake these efforts. This resource investment will be in the form of staff time being redirected from ongoing operations and the potential need for consultants to help guide process reengineering efforts.

But the Lottery will assess the ability to take incremental steps this fiscal year to initiate the "Longer-Term Improvements" because of the potential benefits that will be realized from Grant Thornton's recommendations. The Lottery endorses Grant Thornton's report and feels it is a great tool to modernize operations and to continue the commitment to be good stewards of Lottery revenues.

Discussion by Commissioners

## 8. Consent Calendar

There were no items on the Consent Calendar.

# 9. Action Items

a. <u>Scratchers® Game Profiles for Games 581, 582, 583, 584, 585, and 586.</u>
Susan Kossack, Deputy Director of Marketing, presented the Scratchers® games to be launched in February and March 2009. Game 581 is a cross-culturally

popular Chinese calendar for 2009, the Year of the Ox. The \$1 Key Symbol Match playstyle has a specific variant, an automatic win. The top prize is \$800 and the overall odds of winning are 1 in 4.76. Game 482 is a \$2 seasonal heart-theme with a top prize of \$14,000. It has a Key Number Match playstyle with a specific variant. A special feature of the game is that it is the first to have al cash prizes; free tickets are not included in Game 482. The overall odds of winning are 1 in 5.47.

Scratchers® 583 is a \$3 money-themed game with a Key Number Match playstyle and two specific variants; a multiplier and an auto-win. The game offers all cash prizes; the first starts at \$5. The overall odds of winning are 1 in 5.95 and the top prize is \$25,000. Game 584 is a \$1 crossword game. Players can win up to three times on a ticket, including a top prize of \$1,000. Overall odds are 1 in 4.87.

Game 585 is a \$2 luck-themed game featuring shamrocks, a pot of gold and a \$17,000 top prize. It has a Key Number Match playstyle with two specific variants. Overall odds of winning are 1 in 4.68. Game 586 is a \$3 game and has a Match 3 feature. The top prize is \$20,000 and the overall odds of winning are 1 in 4.26.

Discussion by Commissioners.

Mass asked if anyone from the audience had any questions on Action Item 9(a). No one came forward so he proceeded to the motion of approval.

Montes made the motion to approve Action Item 9(a). Seconded by Flores. The motion passed unanimously (3-0).

b. Amendment to Pollard Banknote Limited Partnership (LP) Contract
Kossack requested Commission approval of an amendment for \$10 million to the
contract for Pollard Banknote as a result of a formal competitive bid. Pollard
Banknote was awarded a supplemental contract for Scratchers® printing in July
2005. The contract expenditure authority is currently \$10 million. A total of \$7.6
million has been expended to date.

In the summer of 2006 and 2007, due to press capacity issues with the Lottery's primary printer Scientific Games, several games were reassigned to Pollard Banknote for printing at that time. As a result, the Lottery is approaching exceeding the originally anticipated printing pace. The total contract amount needs to be increased to accommodate anticipated printing assignments for the remainder of the contract period through the end of the fiscal year. Based on staff analysis, an additional \$10 million in funding for the contract would satisfy possible future production requirements through the term of the contract, June 30, 2009.

Mass asked if anyone from the audience had any questions on Action Item 9(b). No one came forward so he proceeded to the motion of approval.

Flores made the motion to approve Action Item 9(b). Seconded by Montes. The motion passed unanimously (3-0).

## c. Regulations for New TV Game Show

Kossack requests approval of necessary amendments to the California Lottery Omnibus Regulations to accommodate the Lottery's new TV game show and authorize the Lottery Director to approve the prize structure and selection method of determining winners for the new TV game show. In 2006, the awareness and image study completed amongst the Lottery's key-player groups showed lack of excitement and entertainment with the current game show. The Big Spin® is being replaced with the new contemporary TV show, "Make Me a Millionaire."

The minimum prize on the new show is \$2,000. The annuitized grand prize starts at a million and increases by \$200,000 each week that it is not won. The odds of winning the grand prize are 1 in 14. The amendments allow the Lottery the greater flexibility for participation on the show. The Lottery will be able to offer participation on the show through multiple avenues, including promotional programs such as second chance draws; an opportunity to link other Scratchers®.

Montes asked Borucki to add an amendment to Item 9(c) in that the Chair will be notified of any approvals done by the Director in regards to the new TV game show and a report will be given at the next regularly scheduled Commission Meeting. Borucki also stated that there is \$14 million a year that will be set aside for allocation of prizes on the show. There is no other game show on the air that sets aside a magnitude of this kind for prizes.

Discussion by Commissioners.

Mass asked if anyone from the audience had any questions on Action Item 9(c). No one came forward so he proceeded to the motion of approval.

Montes made the motion to approve Action Item 9(c) with the amendment. Seconded by Flores. The motion passed unanimously (3-0).

## d. Contract Award for Draw Auditing and Review Services

Marty Rubio, Internal Audits Manager, requested Commission approval of the contract award to KPMG LLP for draw auditing and review services. The contract is for a three-year term with the option to extend up to three additional years under the same terms and conditions. The total contract authority is \$788,100 for the three-year term.

The Lottery is required by Government Code Section 8880.30 to ensure that a representative of an independent certified public accounting firm, witness all draws of winning numbers, second-chance draws, and finalists for any Lottery game, and to inspect equipment used in such draws, both before and after each draw. The audit firm is also responsible for reporting compliance with Lottery draw procedures.

The current contract expires on December 31, 2008, and in preparation for a new contract to become effective January 1, 2009, a Request for Proposal (RFP) was developed. On June 24, 2008, the RFP was posted on the Lottery's website and a letter of notification mailed to all interested vendors on the Lottery's Contract and Procurement Services Section's database. The RFP was advertised in the Small Business Exchange, Contracts Register, and Challenge News. The three firms who submitted bid proposals were KPMG, Macias Gini & O'Connell, and Stonefield Josephson.

Each proposal was reviewed for compliance with mandatory requirements and for all the required information pursuant to mandatory submittals criteria as stated in the RFP. The overall results for the rated evaluation phase included: KPMG's rating of "Significantly Exceeds," Macias Gini & O'Connell's rating of "Exceeds," and Sontefield Josephson's rating of "Meets." KPMG was selected as the apparent successful bidder based on the rating and the lowest cost proposal.

Mass asked if anyone from the audience had any questions on Action Item 9(d). No one came forward so he proceeded to the motion of approval.

Flores made the motion to approve Action Item 9(d). Seconded by Montes. The motion passed unanimously (3-0).

# 10. Commissioner General Discussion

# 11. Scheduling Next Meetings

The next Commission meetings for 2008 are tentatively scheduled for December 3, 2008, January 28, March 18, April 15, May 20, July 8, August 19, October 21, and December 3 at the Lottery Headquarters in Sacramento. The times for the meetings will be determined.

# 12. Public Discussion

Mass asked if anyone from the public had anything to discuss. No one had signed up prior to the meeting and no one came forward, so he proceeded to the next item on the agenda.

# 13. Adjournment

Meeting adjourned at 11:40 a.m.