

North Carolina Education Lottery Commission Meeting

Meeting Minutes
Tuesday, June 5, 2018

Commissioners in Attendance: Courtney Crowder, Chairman
Tony Rand
Morgan Beam
Buddy Bengel
Randy Jones
Jody Tyson
Chris Shew
Amy Ellis

Absent: Doug Baker

Staff in Attendance: Mark Michalko
Sarah Hardin
Bill Jourdain
Quan Kirk
Frank Suarez, Jr.
Mike Suggs
George Walker
Terri Avery-Fowler

The North Carolina Education Lottery meeting was held on Tuesday, June 5, 2018, at 9:00 a.m. at the NCEL headquarters located at 2728 Capital Blvd, Raleigh, NC.

Chairman Crowder opened the meeting and greeted all Commissioners and meeting attendees.

Commissioners stood for the pledge of allegiance led by Commissioner Buddy Bengel.

Approval of March 13, 2018 Minutes

Chairman Crowder presented the minutes from the March 13, 2018 Commission meeting for Commission approval. Commissioner Tyson made a motion to approve the minutes. Commissioner Bengel seconded. The minutes were unanimously approved.

Finance and Audit Report

George Walker, Director of MIS, gave an overview of the procurement process for the Enterprise Content Management System and Related Services RFP and Report and Recommendation for Contract award. This new system will digitize NCEL paper files for searching capability and to increase storage and security. After an in-depth analysis and evaluation, Mr. Walker and the review committee recommended the contract be awarded to FileSolve, a Division of Patterson Pope, as the apparent successful contractor. A motion was made by Commissioner Bengel to accept the recommendation to award the Enterprise Content Management System and Related Services Contract to FileSolve, a Division of Patterson Pope. The motion was seconded by Commissioner Rand. The recommendation was unanimously approved.

Bill Jourdain, Deputy Director of Finance, Administration & Security gave the financial reports for April 2018 and 10 months of FY2018.

In the Statement of Net Position on page 3, April 2018 ended with Total Assets of \$181 million which included \$91.6 million in cash and \$78.8 million in Annuity Award Investments. Accounts Receivable totaled \$6.4 million of which \$5.8 million represents net receipts from the gaming system to be collected via electronic funds transfer in May.

Total liabilities of \$187 million included \$48 million in outstanding prize awards and vendor accounts payable, \$78.8 million in long term annuity prize awards payable and \$54 million due to the Education Lottery Fund.

In the Statement of Revenues, Expenses and Changes in Net Position on page 4, operating revenue for the month of April 2018 totaled \$226.5 million. Ticket Sales for the month of April 2018 totaled \$226.1 million as compared to \$207.9 million in April 2017, an 8.7% increase or \$18.2 million. Net revenue earned for Education in the month of April 2018 totaled \$54.4 million, a 6.5% or \$3.3 million increase over April 2017.

Total Operating Revenue for the first ten (10) months of fiscal year 2018 totaled \$2.18 billion. Ticket sales for the first ten (10) months of fiscal year 2018 totaled \$2.17 billion and 8.1% increase or \$163.1 million over the first ten (10) months of fiscal year 2017. Sales are led by the Instant product line, and the continued positive performance of these games, resulting in a 5.3% increase or \$75 million over the first ten (10) months of fiscal year 2017. As a result of these numbers, fiscal year 2018 sales are running 5.08% or \$105.1 million ahead of our original budget target.

Total gaming expenses including player prizes (\$1.384 billion), retailer commissions and incentives (\$152 million) and Gaming System Services & Licenses (\$37 million) through April 2018 totaled \$1.574 billion or 72.1% of total revenue. Total NCEL operational expenses, including salaries and benefits, advertising and marketing and operational overhead totaled \$46.7 million or 2.1% of total revenue. As a result of these numbers, the NCEL's administrative expenses, as identified in G.S. 18C-162-3.3 which limits expenditures to 8% of total revenue, totaled \$84.6 million or 3.9% of total revenue.

Net Revenue earned for the Education Lottery Fund for the ten (10) months of fiscal year 2018 totaled \$557.8 million or 25.6% of total revenue, an increase of \$54.7 million or 10.9% over fiscal year 2017. The total net revenue number through April is running 9.6% or \$48.8 million ahead of our FY 2018 budget target.

During the third quarter of fiscal year 2018, the NCEL initiated cash transfers of \$174 million to the Office of State Budget and Management and were deposited in the Education Lottery Fund. These transfers represented the net revenue earned by the NCEL during the months of January through March, 2018.

The total net revenue transferred to the State of North Carolina since inception is \$5.73 billion.

Fiscal Year 2019 Budget:

The FY 2019 budget document submitted for commission review and approval is based on the most recent version proposed by the North Carolina State Legislature. The previous version presented at the May budget workshop was based on Governor Cooper's initial budget proposal.

The differences in the budgets are detailed on last page of the budget handout to the Commissioners. We will continue to monitor the budget process so we can appropriately assess our authorized spending levels once the Legislature and Governor Cooper finalize an agreement. This budget includes the following highlights:

- Total anticipated revenue of \$2.69 billion
- Total gaming expenses of \$1.95 billion or 72.58%
 - Prizes - \$1.71 billion or 63.81%
 - Retailer Comm. & Incent. - \$189.2 million or 7.03%
 - Gaming Systems & Licenses - \$46.6 million or 1.74%
- Total Administrative expenses of \$67.8 million or 2.52%
 - Salaries & Benefits - \$23.2 million or 0.86%
 - Advertising - \$26.0 million or 0.97%
 - Marketing - \$6.2 million or 0.23%
 - Other Admin. - \$12.4 million or 0.46%
- Transfer to DHHS – Compulsive Gambling - \$1.0 million
- Transfer to ALE – Compl. & Backgrnd. - \$2.1 million
- Net proceeds to Education - \$667.7 million or 24.90%
- Salaries and Benefits:
 - We are proposing to reassign eight (8) vacant positions, one to the Executive team for the minority business enterprise coordinator, and seven (7) to sales to support our expanding retailer base.
 - We have included a salary reserve for \$657,000 to allow for legislated salary Cost of Living increase of 2% per employee and a 5% placeholder to set aside funding for the possible adjustments recommended in the Compensation and Classification study authorized by the Commission. The NCEL does not receive a salary appropriation from the State for any salary initiatives and therefore must budget for the anticipated expenditure out of the proceeds from Ticket Sales.
- The NCEL's fixed administrative expenses will experience a net increase of \$2.9 million increase in overall administration spending. The total net increase includes a \$2 million increase in advertising, a \$1.6 million increase in salaries and benefits and a decrease of \$0.7 million in marketing and other operational costs.

Differences Noted since the May 9 presentation:

- Adjustment to overall prize expenses realizing a \$820,000 savings.
- Increase in salaries and benefits of \$146,000 due to legislative mandated Cost of Living increase of 2%.
- Increase in Operating Service costs of \$307,000 due to updated contractual commitments.
- These net adjustments are projected to generate an additional \$367,000 for education.

The Legislature's Budget released on May 28 identified a state appropriation of \$744 million of NCEL funds for NCEL supported education programs. The balance of the budget appropriation, over and above the NCEL revenue projection consensus (\$667.3 million) is to be funded from the Lottery reserve fund. The current balance of the fund is \$117.8 million.

Commissioner Tyson made a motion to adopt the FY2019 Budget. The motion was seconded by Commissioner Shew. The FY2019 Budget was unanimously approved.

Mike Suggs, Director of Internal Audit, presented on the internal audit reports.

- Audit of Prize Validation

- Audit of Product Development and End-of-Games
- Evaluation of IGT Security Controls in the Development and Production of Instant Tickets
 - Commissioners asked that Mr. Suggs research all aspects of the South Carolina Lottery incident and results. They would like to know why the incident happened and how to prevent it from happening here in North Carolina.
- Report on Past Audit Recommendations

Operations and Personnel Committee Report

Commissioner Jody Tyson, Committee Chair, provided an overview of the committee meeting that took place on May 29, 2018 and requested the Commissioners to approve the following amended Policies:

- 4.17 Recruitment Selection Policy
 - Updates the Policy to include current practices. Changes mandatory posting of positions from ten (10) business days to seven (7) calendar days.
 - Internal only postings will require the approval of the Executive Director.

A motion was made by Commissioner Rand to accept the revisions to the Recruitment and Selection Policy. The motion was seconded by Commissioner Beam. The amended policy was unanimously approved.

- 4.33 Background Screening
 - Background refresh screening for current employees has been eliminated.
 - A background check will be performed for new employees and any employee that is promoted to Director or above position.
 - The proposal to remove fingerprinting from the policy will be revisited after more research is completed and presented to the Committee for further discussion.
 - A revised version will be presented to the Committee before the full Commission meeting for final review and recommendation for approval.

A motion was made by Commissioner Rand to accept the revisions to the Background Screening Policy. The motion was seconded by Commissioner Tyson. The amended policy was unanimously approved.

Commissioner Tyson provided a status update regarding the compensation study. Human Resources staff are still working on the proposed salary structure (placing positions into grades). The study should be completed by the end of the year. All recommendations will be presented to the Operations and Personnel Committee for discussion before being recommended to the full commission for approval.

Advertising Update

Marketing and Advertising has updated the Responsible Marketing and Advertising Guidelines and Policy.

- 7.05 Responsible Marketing and Advertising Guidelines and Policy
 - Checklist has been created to formalize all processes.
 - Advertising Complaints Tracking – Added to the Guidelines & database for accountability purposes; Commission will be notified when there are twenty (20) or more complaints made about specific ads.

A motion was made by Commissioner Rand to accept the revisions to the Responsible Marketing and Advertising Guidelines. The amended Policy was seconded by Commissioner Jones. The motion was unanimously approved.

Revenue Generating Committee Report

Commissioner Tony Rand, Committee Chair, provided an overview of the committee meeting that took place on May 30, 2018.

Frank Suarez, Deputy Executive Director of Brand Management & Communications, gave an overview of the FY19 Brand Management Plan. He reported that FY18 sales were up 8% and return were up 11% compared to FY17 year to date; calendar year 2017 growth rate was up 3.7% and outpaced industry by 0.5%; almost every draw game has shown an increase this year, with draw games up 10%; scratch-off sales are also up 5.1%; and average monthly online play sales are up 143% since the website redesign (compared to the same period in FY17).

- FY19 Brand Management will focus on:
 - Continuing to Build the Brand with Renewed Focus on Beneficiary Messaging
 - Optimizing Traditional Media and Leverage New Media to Extend Reach
 - Maintaining and Growing Instant Sales
 - Significantly Increasing Draw Game Efforts

A copy of the advertising calendar and timeline and a Keno Live Events Link will be sent to Commissioners.

It was suggested that NCEL research and contact Historically Black Colleges and Universities as an option for a potential college basketball ticket.

Sales Force Update

Terri Avery, Deputy Executive Director of Sales, gave a brief sales force update.

- Keno launched eight (8) months ago, currently at \$25 million (8 cents per cap); average about \$800,000 per week
- 23 retailer locations are waiting for installation of Keno (to be completed by the end of the fiscal year)
- 545 retailers selling Keno; anticipated growth to about 800 in the next fiscal year
- This time last year there were approximately 6,800 retailers, this year to date there are 7,106 a significant increase with the addition of Keno retailers

Sports Betting

Mark Michalko, Executive Director, gave a brief overview of NCEL's position on sports betting. Currently staff is gathering data and researching studies done by MUSL, NASPL and other organizations. Currently there are 14 states that have introduced bills into legislation, 5 states are ready to go, and 8 states have recommended that their lottery be the regulating authority for sports betting. NCEL will continue to monitor legislative activities regarding this matter and make sure we are adequately prepared should they move forward with sports betting.

Executive Director's Report

Mark Michalko, Executive Director, asked Commissioners to review the HUB Report and Contracts over \$90,000 that were provided in their packets. There were no questions.

Sarah Hardin, Director of Corporate and Government Affairs, gave a legislative update. Legislators are currently in short session. The purpose of the short session is to make any necessary adjustments to the budget and to look at any unfinished business from the previous year's long session. The General Assembly passed the budget and it has been sent to Governor Cooper.

NCEL interest(s) include:

- Lottery reserve fund is now required to maintain a 5% minimum balance. This allows the balance to grow as the lottery grows.
- Eligible active duty military members serving during war or during a national emergency will have the ability to submit a delayed claim for a lottery prize
- Appropriation of \$744 million of lottery proceeds for FY19 will be used for the following:
 - \$385.9 million to non-instructional personnel
 - \$78.25 million to Pre-kindergarten
 - \$100 million to school construction
 - \$117.3 million to needs based school capital (language will be sent to commissioners)
 - \$10.7 million to UNC needs based financial aid
 - \$21.83 million to LEA transportation
- All state employees' salaries will be raised to a minimum of \$15 per hour or \$31,200 annually.
- There will be a 2% raise for state employees and five (5) bonus days
- House Bill 952 & Senate Bill 716 – Lottery/Joint Lottery Oversight Recommendations – Will increase advertising budget from 1% to 2%. The bill will not be discussed in the short session.
- Senate Bill 790 & House Bill 1036 (referred to as study bill) – Bill contains recommendations of program evaluations. Bill has two (2) parts; (1) requires reporting to Lottery Oversight Committee on retailer growth and NCEL's efforts to measure effectiveness of advertising; (2) study by legislative research commission. If passed, the study must be completed by December 1, 2018. The study will be completed at the legislature by the legislature. No actions will be required by NCEL.
- Senate Bill 739 – Lottery School Safety Grant – If passed, will allocate \$60 to grant program for schools that re implementing safety initiatives.

Closed Session

Commissioner Rand made a motion for NCEL Commissioners to go into closed session to discuss personnel matter(s) pursuant 143-318.11 (a)(1) – Discuss a confidential personnel matter or prevent disclosure of privileged or confidential information. The motion was seconded by Commissioner Tyson. The Commissioners went into closed session from 11:30am to 12:44pm.

Open Session

Commissioner Tyson stated that he would like to entertain the recommendation made by the NCEL staff to the Revenue Generating Committee regarding issuance of the Online Play System RFP. Commissioner Tyson made a motion that the commission authorize staff to issue an RFP for a new online play system, formerly known as our subscription system, and that this system will have the capability to offer digital instants, subject to proper approval of the commission, should the commission decides to move forward with digital instants in the future. The motion was seconded by Commissioner Bengel. The authorization for the NCEL staff to release the online play system RFP was unanimously approved.

With no other business to discuss, the meeting was adjourned at 12:46pm.


Chairman


Date