Oklahoma Lottery Commission
Minutes of Meeting
April 18, 2006 – 1:30 p.m.

Members Present:

Mr. Orbison, Chairman	Ms. Ball
Dr. Dzialo, Secretary	Mr. Charlton
Mr. Riley, Treasurer	Mr. Paul

Members Absent:
Mr. Norick, Vice-Chairman

Others Present:

Maryanne Maletz, State Regents	David Douglas, SGI
Lynn Rogers, AG's Office	Brian Ervin
Jim Scroggins, OLC	Rollo Redburn, OLC
Allen Blankinship, SGI	Claudia San Pedro, OSF
Pat Hall, SGI	Greg Sawyer, State Regents
Angel Riggs, Tulsa World News	Penny Nicholson, OLC

ITEM ONE

Call to Order. Roll Call and Announcement of Quorum

Roll Call: Mr. Orbison, Mr. Riley, Dr. Dzialo, Ms. Ball, Mr. Charlton and Mr. Paul were present. Mr. Norick was absent. Mr. Orbison declared a quorum.

ITEM 2

Announcement of Filing of Regular Meeting Notice and Posting of the Agenda in Accordance With the Open Meeting Act

Posting of Regular Meeting Notice and Agenda were confirmed, in accordance with the Open Meetings Act.

Mr. Orbison and the other Board members offered their congratulations to Mr. Scroggins on being selected to receive a prestigious Lifetime Achievement Award at the PGRI meeting in July.

ITEM 3

Approval of Minutes of the February 21, 2006 Regular Meeting

Mr. Charlton made a motion to approve the minutes of the February 21st regular Board meeting. Mr. Riley seconded the motion.

Roll Call: Mr. Orbison, Mr. Riley, Ms. Ball, Mr. Charlton and Mr. Paul voted to approve. Dr. Dzialo abstained. The motion was carried.

ITEM 4

Executive Director's Report

Because there were several representatives of other State agencies attending the Board meeting, Mr. Scroggins invited the members of the audience to introduce themselves.

Mr. Scroggins distributed copies of the most recent Combined Sales report and discussed some of the figures. He pointed out that there was a slump in sales for Week 27 (4/9/06 – 4/15/06). He explained that high gas prices, the Easter weekend, a large Mega Millions jackpot in Texas, plus a usual decline of sales over the summer months were some of the factors responsible for the slump.

Mr. Scroggins distributed copies of a reports on High Tier Prizes and Unclaimed Prizes and discussed some of the figures.

Mr. Scroggins reported the 2,058 retailers are currently operating as lottery vendors. He reported an additional 41 vendors were approved and ready for installation, 70 were awaiting clearance on tax/credit issues, and 45 incomplete applications were being worked by lottery staff. If all of these pending applications are eventually approved and installed, the total will be 2,214.

Mr. Scroggins pointed out a Player Activated Terminal (PAT) at the back of the room and offered to demonstrate its function following the meeting. He stated that PAT's are primarily designed for the grocery store environment, and that 12 machines have been placed in various Homeland Stores as a pilot project – 2 in Edmond, 2 in Norman, 5 in Oklahoma City, 2 in Shawnee, and 1 in Yukon. Ultimately there will be about 134 PAT's placed in Homeland, Buy For Less, Loves, Albertson's, and Drug Warehouse stores around the state.

Mr. Scroggins reported on the progress of establishing Super Retailers (retailers authorized to cash prizes between $600 and $5,000). Mr. Scroggins explained that the initial difficulty in establishing Super Retailers has been figuring out a method to withhold Child Support offsets that does not violate confidentiality laws. The solution finally adopted is to have Super Retailers obtain the basic information from the claimant and fax it to the Claims Office in Oklahoma City. There it will be checked for any necessary withholding and that information will be provided back to the retailer, who will then prepare the check. Mr. Scroggins stated that two pilot Super Retailers will begin operations on Monday, April 24th. He reported that plans have been made to set up an additional twelve Super Retailers at Homeland stores throughout the State. He explained that in order to obtain full coverage across the state, other retailer(s) would probably need to be selected for the Panhandle and McAlester regions. Mr. Paul asked if the Super Retailers would be drawing prize checks directly on the lottery account. Mr. Scroggins replied that prizes would be handled like other prize payments, with the retailers writing the checks from their accounts and then being reimbursed by the Lottery. Super Retailers will receive the standard .75% bonus on prizes cashed. For prize claims over $5,000, the Super Retailer will obtain all information and convey it to the Oklahoma City claims office where it will be checked for offsets, evidence of fraud etc. The Oklahoma City office will then prepare the prize check and make arrangements to deliver it to the winning claimant. In those cases, the retailer will receive a $10 flat fee for preparing the paperwork. Mr. Scroggins stated that it will be a great convenience to large-prize winners throughout the State to be able to claim their prizes without traveling to Oklahoma City.

Mr. Scroggins pointed out a Lottery Play Station positioned next to the PAT at the back of the room. He reported that 563 of these stations have been deployed in the field. He also pointed to a sample of a lighted Powerball jackpot sign that will be placed in 825 field locations. The signs are designed to automatically update the jackpot amount after each drawing. Businesses have been chosen to receive these first 825 signs based on sales levels of $3,000 or more per week. Mr. Scroggins stated he hoped to be able to have similar signs placed at more locations in the future.

Mr. Scroggins distributed a copy of a report on the Pick 3 Doubler promotion. He noted that there was a 58% increase in sales during the promotion, as well as a continued upswing in sales over the three weeks following the promotion. Mr. Riley asked if there was a noticeable increase on the last night of the promotion when it was certain the orange ball would be drawn, and Mr. Scroggins replied that there was, although he did not recall the precise figures.

Mr. Scroggins asked the Board members to consider whether the Oklahoma Lottery should make a proposal to host the NASPL Fall Conference in 2009. Studies have indicated that hosting the conference brings approximately $1.2 million into the local economy over the four to five day conference period. As hosts, the commission would have various obligations, such as printing materials, arranging for committee chairmen and speakers, hosting a directors' dinner, coordinating volunteers, transportation, arranging the award's banquet, designing a website, etc. He stated that he felt that Oklahoma City would be an excellent location for the conference because of the close proximity of hotel accommodations to the convention center.

Mr. Scroggins reported that the Governor approved the lottery Rules yesterday, but that the Legislature could still pass resolutions to be added to the Rules. The only Rules' issue currently pending would require the lottery to prepare and post on our website games sales and prize reports within thirty days of the end of a game. Mr. Scroggins stated that the lottery commission will probably do that whether or not the legislation passed.

Ms. Ball asked about the status of the formation of the retailer committee. Mr. Scroggins reported that ten potential members have been identified by himself and Mr. Orbison, and that the next step is to send them a letter inviting them to serve on the committee. If they agree to serve and the Trustees are in agreement, Mr. Orbison will make the formal appointments. Mr. Scroggins said that he felt that the proposed members represented a good cross-section of lottery retailers, including large and small businesses, grocery stores, convenience stores, etc. He pointed out that State law forbids compensation of any kind to members of the committee, including reimbursement of expenses, which might be a problem for some retailers. Mr. Charlton asked if the members of the retailer committee would be able to meet electronically in order to avoid some travel expense. Mr. Orbison replied that his recollection of the Act was that they would be bound by the same Open Meeting requirements as the Board of Trustees.

Ms. Ball asked about any other pending legislation pertaining to the lottery. Mr. Scroggins stated that HB 2408, which contains advertising restrictions, has now been amended into SB 1915, and will now go back to the Senate for consideration. The other active bill, which restricts certain businesses from being lottery retailers (check cashers, payday loan companies, etc.), has been passed in the House and Senate and is currently awaiting the Governor's signature.

ITEM 5
Discussion and Possible Action to Accelerate the Transfer of Net Proceeds to the State Treasury

Mr. Orbison thanked Ms. San Pedro, Greg Sawyer, and Maryanne Maletz for attending the meeting to answer questions about the issue of accelerated transfers. Mr. Redburn was asked to explain events leading up to consideration of this agenda item.

Mr. Redburn stated that approximately two months ago, the State Regents for Higher Education requested that the Lottery Commission make an early distribution of quarterly earnings to the Lottery Trust Fund in order to assist them with a financial issue involving endowed chairs.

Since that time, Claudia San Pedro, Director of State Finance, met with Lottery Commission officials to request that the Lottery Commission make regular monthly distributions to the Trust fund in an amount sufficient to satisfy the Regents' monthly debt service on bond issues (slightly less than $3 million per month). At Mr. Orbison's request, Mr. Redburn made some rough calculations to determine what the loss of interest would be if the Commission agreed to this request. Mr. Redburn estimated a loss of approximately $125,000 over the course of the year.

Mr. Redburn stated that just this morning the Lottery had not received but was made aware of a letter from Paul Riser, the Chancellor for the Oklahoma State Regents for Higher Education, dated April 5, 2006, requesting that distributions to the Regents be made for the full amount of their share of revenue on a regular monthly basis. Mr. Redburn calculated that based on revenue estimates provided to the Board of Equalization, the Legislature will appropriate approximately $117.7 million from the Lottery Trust Fund for the upcoming fiscal year. The Regents' 45% share of that figure is $53 million. Mr. Redburn estimated that transferring the total amount of the Regents' share of appropriations on a monthly basis would result in loss of approximately $200,000 in interest income over the course of one year. Mr. Orbison asked for clarification on how this figure was derived, and Mr. Redburn explained the method he used. Dr. Dzialo asked if the calculation was for a full year, or partial year. Mr. Redburn replied that it was calculated on a full twelve-month fiscal year.

Ms. Ball expressed concern that the Lottery Board's primary obligation is to raise as much money as possible for education, and that regular early distributions would have an adverse effect on overall profits.

Ms. Maletz, vice chancellor for budget and finance for the State Regents, addressed the Board and apologized that their letter of request had not been received by the Board in time for them to consider it prior to the meeting. She reminded the Board that allocations from the Lottery Trust Fund could be used for three purposes -- debt service for the capital bond issue, scholarships, and endowed chairs. Now that the bonds have been issued and the cash flow examined, the Regents have determined that they must have funds on a monthly basis in order to satisfy the debt service on the bonds.

Mr. Riley observed that although the Lottery Commission is responsible for the transfer of revenue to the Trust fund, the actual division among the beneficiaries is done by the Office of State Finance. Mr. Riley stated that he became aware a few weeks ago of issues related to the debt service on the Regents' bond issue. There was concern that the Regents would not have enough funds available to make their April, May and June debt service payments. He stated that after examining the most recent figures he was confident that the accelerated transfer done in April provided them sufficient funds to avoid a shortfall in FY06. Mr. Riley stated that he had felt confident that as of the start of the new fiscal year on July 1st, the Regents would know what their appropriations would be and would be able to arrange their cash flows accordingly. He explained that although he was committed to doing whatever was necessary to avoid a potential default on a bond, he did not see that that danger currently exists. In reading the newest letter of request from the Regents, he noted a sentence suggesting that one of the "needs" is to allow the Regents to accumulate monies for disbursements in February of next year and the following September for scholarships. He expressed concern that allowing the Regents to accumulate funds would mean that the resulting interest would accrue entirely to them also, whereas interest accrued by the Lottery Commission would be split among all the beneficiaries according to the Statute. He feared that the Lottery Commission could be placed in the position of being liable for that diverted interest.

In summary, Mr. Riley restated that his initial concern was that a State agency not be inadvertently placed in a position of defaulting on a bond obligation. The most current information he has seen indicates that there is no immediate concern for default on the bond issues at this time.

Mr. Paul stated that he and other members of the Board certainly wished to be team players; however, the Board is obligated to act prudently in their primary duty, which is to effectively manage the affairs of the Lottery Commission. He stated that he shared Mr. Riley's concern that regular monthly transfers to the Regents would result in unequal treatment of the beneficiaries. He also expressed concern that if other beneficiaries also requested monthly distributions, the loss of interest income would be substantially more than the $200,000 amount calculated by Mr. Redburn.

In addition, Mr. Paul pointed out that the Lottery Commission was itself operating on fairly thin financial margins. The Act requires that 30% of gross income (and after two years, 35%) go to education. In order to be successful, lottery prizes need to be at around 50% of gross income, leaving only 20% (and after two years only 15%) for the Lottery Commission to cover all its financial obligations for running the lottery. Regular, early distributions coupled with unknown and/or unanticipated costs could put the Commission in jeopardy of being unable to fulfill its own financial obligations. He added that the Commission was happy to assist the Regents in a real emergency, but that it was unclear that an emergency continued to exist at this point. Mr. Paul noted that a decision to deny the Regents' request at this time would not result in loss of benefits to any of the beneficiaries of the Oklahoma Lottery Act.

Dr. Dzialo expressed her agreement with the points raised by Mr. Paul and Mr. Riley.

Mr. Orbison asked if the Board had any other concerns with this issue other than the loss of interest income.

Mr. Paul pointed out that it would impose an additional burden on the Lottery Commission financial staff, requiring twelve distributions per year rather than four.

Mr. Riley stated that the issue could become quite complex. He explained that due to the cycle of ticket sales to retailers, the lottery could have $6-$10 million in outstanding receivables at any given time. The potential of "a perfect storm" of events, such as a large jackpot payout, large accounts payable, payroll, etc., could leave the lottery with insufficient cash on hand to meet its financial obligations.

Mr. Redburn agreed with Mr. Riley. The early distribution that was already made did not jeopardize lottery operations, but under certain circumstances, regular early distributions could create cash flow problems for the lottery. This would be especially true with the most recent request from the Regents, which asks for early distribution of their entire share of proceeds, rather than just an amount sufficient for debt service. Mr. Orbison reiterated the point that if monthly distributions were made to the Regents, other beneficiaries would be perfectly justified in requesting that their share of lottery proceeds be dispersed monthly as well.

Mr. Paul pointed out that the Lottery Commission could not ear-mark funds transfers for distribution to a particular beneficiary. He questioned whether it was possible for accelerated transfers to go solely to one beneficiary rather than be divided according to the statute. Ms. San Pedro stated that the Office of State Finance was responsible for distributions and that they could apportion these funds to higher education for debt service, since that is a primary financial obligation. Mr. Charlton asked Ms. San Pedro what would happen if the Lottery Commission was left with insufficient funds to make equitable distribution to the other beneficiaries at the end of the quarter. Ms. San Pedro explained that revenue would be monitored on a weekly basis in order to ensure distributions to the Regents did not exceed available funds.

Mr. Rogers, of the Attorney General's Office, addressed the Board and stated that a default on a bond payment would be disastrous to the State and could not be allowed to happen. He pointed out that bond payments are structured to require monthly payments.

Mr. Orbison stated that the Lottery Commission wished to do everything they could to assist education. However, before departing from the statutory requirements the Board would have to be convinced that a true necessity exists and that it was not just a matter of convenience. He stated he and other Board members were not clear about why lottery funds were the only resort higher education had for this obligation.

Ms. San Pedro replied that lottery funds were identified as the first revenue source for the bond issue, and that without lottery revenue the bond issue would not have been possible. However, because lottery revenue is a new source, the Legislature also backed the bond issue with "other revenue sources," if it became necessary. Ms. San Pedro asked Mr. Redburn if he had looked at scenarios wherein the amount of the early transfer would be just enough for debt service. Mr. Redburn replied that he thought that an amount sufficient to cover debt service might be feasible, but that more than that could create cash-flow difficulties for the Lottery Commission.

Ms. Ball asked if the Regents were aware of the plan for quarterly distributions of lottery proceeds when they undertook the bond issue. Mr. Rogers pointed out that the wording of the Act was that distributions could be made "on or before" the specified date.

Mr. Charlton noted that the bond documents indicated repayment could be made "from such other sources as may be necessary." He asked what the other revenue sources were and whether the Regents could look to these other sources to solve their cash flow problem. Ms. San Pedro replied that the intent of the Legislature was that the Lottery would be the primary source for debt repayment, and unless the lottery generated insufficient funds, these other sources would not be tapped. The issue is not a shortage of funds, but rather a problem of cash flow. The bond issue is structured with regular monthly payments while the distribution of lottery funds is structured to take place quarterly. Ms. Maletz added that the Legislature had not made any other funds available to the Regents, because the funds generated by the lottery were thought to be sufficient for the debt service. Ms. Maletz also explained the difficulties of cash flow related to endowed chairs and scholarship funds.

Mr. Orbison expressed concern about the newest request by the Regents for very large, irrevocable monthly distributions for the thirty-year life of the bonds. He asked if it would be possible to accommodate the request for early distributions, but discount the loss of interest from the distributed amount. Discussion was held about how the interest could be calculated and what the impact would be. Mr. Riley observed that this action might retain the perception of fairness, but would not, in fact, result in avoiding the loss of interest. Mr. Riley stated that since the Lottery Commission could not ear-mark transfers, the larger issue is making transfers monthly rather than quarterly. He stated that he remained unconvinced that a true need exists at this time, but if the Regents wanted to present further evidence of a true need at a later time, the Board of Trustees could certainly reconsider their request.

Dr. Dzialo asked if the threat of bond default had been resolved for the current fiscal year, and Ms. San Pedro stated that it had been, although cash flow would continue to be a problem in the next fiscal year. Ms. San Pedro explained that the Office of State Finance frequently deals with the issue of resolving cash flow problems with State agencies. Ms. Ball stated that it appeared that the lottery statute was written incorrectly. If the Board abides by the Statute as written, then everyone else must also adjust their figures to abide by quarterly distributions. Ms. San Pedro pointed out that the Statute was worded "on or before" which provides some flexibility. Ms. Ball stated that she and the other Trustees just want to raise all the revenue possible for education, and did not want to see any of the beneficiaries lose anything. Ms. San Pedro commended the Trustees for that goal, but stressed that the bond obligation was a special need which affects the credit and reputation of the entire State.

Ms. Maletz stated that the Legislature had been pressing the Regents to know how much “cold, hard cash” they required for next year. Based on what she was hearing from the of the Board of Trustees, she stated that they would tell the Legislature that the Lottery Commission intended to stay with quarterly distributions and they must plan their cash-flow needs with that assumption. She stated that she was still very concerned that they would not have enough cash to meet their monthly obligations next year. She stated that she hoped that they would be able to come back to the Trustees with further requests if it became necessary to meet the debt service obligations. Mr. Riley expressed concern that the Regents might create the impression with the Legislature that the Lottery was unable generate the projected revenue figures, which is not the case.

Mr. Orbison, Mr. Riley and Mr. Paul reiterated that the Lottery Commission wants to be accommodating, and would be willing to reconsider the issue when further information is made available. They also restated that they would certainly act in an emergency, such as to avoid default on bond payments.

Mr. Redburn stated he wanted to answer Mr. Charlton’s earlier question, as he felt it had not been addressed. He stated that during his 29 years at State Finance, he did see instances where legislation was written in such a way that the money appropriated for a certain purpose was not available when it needed to be. He stated that in his opinion, this was one of those instances. The Statute requires quarterly deposits while the bond issues require monthly payments. As a possible solution he proposed a plan which would require Legislative action to be implemented. Under the plan, the lottery would make a monthly transfer of $3 million to the Lottery Trust Fund. The Office of State Finance would distribute these funds to the beneficiaries as they saw fit. If it was given to the Regents and they needed more, they would simply have to figure out how to address their additional needs. The Lottery currently owes the State $500,000 for start-up funding. Under Mr. Redburn’s proposal, any loss of interest income would be calculated and applied to the Lottery Commission’s outstanding $500,000 debt to the State. The Trustees discussed the pros and cons of such an arrangement and whether it would result in equitable treatment of the beneficiaries.

Mr. Orbison summarized the Board’s position saying that they were willing to help the Regents and other beneficiaries to the extent necessary, but were not ready to make a commitment to regular, monthly early distributions to the Regents. He stated that if the Regents wished to return with evidence in support of their request, the Board would be happy to reconsider the issue. Mr. Paul and Dr. Dzialo agreed with the Chairman’s summary.

ITEM 6
Report of Audit and Finance Committee (Mr. Paul)

Mr. Paul reported that an Audit and Finance Committee meeting scheduled for 11:00 a.m. on this date had been cancelled due to the fact that the internal auditor, Carl Selby, was unable to attend. The committee meeting has been rescheduled for May 16th at 11:00 a.m.

Mr. Paul reported that on Monday, April 3rd, the Audit and Finance committee members had met with staff members and with the Scientific Games’ outside auditor (via conference call) to discuss the issues that the Lottery Commission wished to see examined in the SAS 70 audit of Scientific Games. He stated that he was pleased with the cooperation and expertise of the outside audit staff. He stated the Carl Selby and Mr. Riley had also met with the Lottery Commission outside audit firm, Cole and Reed, to obtain their input. He reported that the Audit and Finance Committee plans to meet in June and have the outside auditors attend and present a pre-audit report. The Committee also plans to meet again with outside auditors in September for a post-audit review.

ITEM 7
Presentation of Financial Report and Status of Internal Controls (Mr. Riley)

Mr. Riley reported meeting last week with the outside auditor and the lottery commission financial staff to “close the loop” and bring together all the processes of studying, installing, and evaluating internal controls, both for the Lottery Commission and Scientific Games. He stated that they discussed the controls to be tested in order to avoid problems with the SAS 70 cycle. The SAS 70 testing cycle is for a minimum of six months, and a maximum of twelve months. He noted that since some outsourced procedures did not commence operations in Oklahoma on

October 12th he was concerned that there would be an insufficient time period for evaluation. He told the auditors that the Lottery Commission needs to know what the testing results are in April and May because if there are any controls that need to be strengthened, the remediation period would be May and June. If they don't start testing until after June, there will be no opportunity to remediate before June 30th. He stated that the Scientific Games, auditor would be here at the end of April to do onsite testing of controls that were especially designed for the Oklahoma Lottery Commission. He reported that he has been very pleased with the process so far.

Mr. Riley also reported that the quarterly financial statement would be available at the May 16th meeting.

Mr. Paul thanked Mr. Riley for his report. He stated that the Lottery Commission internal auditor, Carl Selby, has indicated to the Audit and Finance Committee that everything is going well within the Commission and that he has had total cooperation from all of the Lottery Commission staff.

ITEM 8

New Business

There were no specific items of new business.

In general discussion, Mr. Paul asked if at some point in the future the Chairman would consider holding meetings in other locations, such as Tulsa, Lawton, Muskogee, or Stillwater. The Trustees discussed the possibility and generally agreed it would be a good idea and could be combined with events such as open houses, school visits, etc.

Mr. Riley suggested that the Trustees give Mr. Scroggins the go-ahead to bid on the 2009 NASPL Fall Conference. The other Trustees agreed. Mr. Scroggins commented that several of the people who will vote on choosing the NASPL conference site had met in Oklahoma City in January at the Multi-State meeting and had had an opportunity to see the facilities and amenities available here.

Mr. Orbison announced to the Board the Dr. Dzialo had been reappointed to the Board of Trustees for a five-year period.

ITEM 9

Adjournment.

Dr. Dzialo made a motion to adjourn the meeting. Mr. Charlton seconded the motion.

Roll Call: Mr. Orbison, Mr. Riley, Dr. Dzialo, Ms. Ball, Mr. Charlton and Mr. Paul voted to approve and the meeting was adjourned.

Submitted by:

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Linda Dzialo, Secretary

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James Orbison, Chairman