



DRAFT MEETING TRANSCRIPTION

Finance Committee

Special Meeting

November 20, 2020 at 9:00 a.m.
via teleconference

Committee Members: Patti Maroney, Chair of the Finance Committee; Patrick Birney; and Manny Langella (all via teleconference).

Staff Members Present: Greg Smith, President & CEO; Paul Granato; Matthew Stone; and Annmarie Daigle.

Guests: Jessica Aniskoff; Angelo Lombardo; and Vanessa Rossitto of Blum Shapiro

I. Welcome:

(P. Maroney): Welcome to our Special Meeting of the Finance Committee on November 20, 2020. I'd like to call the meeting to order at 9:03 a.m.

(G. Smith): Just a reminder that in accordance with Governor Lamont's Executive Order 7B, the public has been provided access to our meeting via teleconference. That line is now open. There will be no in-person public attendance at this meeting pursuant to that order. The public dial-in information was provided via regular notice of this meeting. I will also point out to conform with meeting procedures, everyone please identify yourself for the record when speaking as we do have a public line open. We will post a transcript of the meeting on our website.

II. Approval of the June 5, 2020 Finance Committee Meeting Minutes:

(P. Maroney): Thank you. The first item on the agenda is approval of the June 5, 2020 Finance Committee Meeting Minutes. Do I have a motion on those?

(P. Birney): Patrick Birney, so moved.

(P. Maroney): Second. All in favor?

(All): Aye.

(P. Maroney): The minutes are accepted. Thank you.

III. Review of Audited Financial Statements for the period ended June 30, 2020:

(P. Maroney): Next is the review of the audited financial statements, I will turn that over to Paul.

(P. Granato): Thank you and good morning to everyone. This is Paul Granato, the Lottery's Chief Financial Officer. First I'd like to introduce the audit team who is with us here today. First is Vanessa Rossitto, our audit partner as well as Jessica Aniskoff and Angelo Lombardo. They will be going through a short presentation, which you'll see on your screen. I'd like to thank Blum Shapiro for their time, their effort, and most of all, their flexibility. We utilized technology very similar to what we are using today and they were able to complete the audit of the financial statements in a mostly remote fashion. So thank you to them and I'll turn it over to Vanessa now.

(V. Rossitto): Thanks Paul. I am Vanessa Rossitto, I am the engagement partner for the Lottery's audit and I will mirror those comments on our side, too. You were all very agreeable and amenable to doing everything electronic and I think everything went great. I think after the presentation -- Jessica Aniskoff is on the call, she was the manager, and Angelo Lombardo was the senior -- if they want to make some comments later as well, I think that would be great.

So onto the agenda, what we are talking about today, if you have any questions during the presentation, please interrupt me. We are going to talk about the engagement scope and reporting. I will go over some high level financial highlights and audit results. The two deliverables are the audited financial statements and the government auditing standards letter. You did receive the required communication, we call it the SAS 114 letter, which is a letter that is required by the AICPA, the Auditor's Communication with Those Charged with Governance. Then we will go over the very long list of upcoming GASB pronouncements for 2021 and 2022.

So to go over the responsibilities in the audit, management has their responsibilities and we have our responsibilities. Management is really responsible for the financial statements, for their preparation and fair presentation in accordance with standards in the GAAP and also for internal controls, meaning the design, implementation and maintenance of those controls and that the financial statements are free from material misstatement whether from error or fraud. So our responsibilities are to express an opinion on the financial statements based on our audit and also to plan and perform our audit to provide reasonable assurance about whether the financial statements are free from material error. So the term reasonable assurance means that we are not auditing every transaction of the Lottery. We do use an element of materiality in our audit and we evaluate as appropriate.

The scope, as mentioned before; we have issued an opinion on the financial statements under standards general accepted in the United States of America and also Government Auditing Standards, and we've also issued a Government Auditing Standards letter otherwise known as the Yellow Book Letter and this letter is a report on internal controls over financial reporting and also compliance. The results of those deliverables were an unmodified or clean opinion, or the highest form of opinion meaning no significant deficiencies or material weaknesses were reported in internal control or financial reporting. So great results.

So a high level review of the financial results, I thought it was easier to put up in the PowerPoint. This slide is looking at the Balance Sheet for the period 2020 compared to 2019 and we also have 2018 there as well. As far as your Assets, really nothing of note, the only thing that did change a little is Cash went down from the prior year and that was really a result of timing. I believe your Investments were less in 2020 than 2019, those are investments with the State of Connecticut funds. There's a couple of other categories on the Balance Sheet for these financial statements other than Assets and Liabilities and Net Position. We also have a category called Deferred Outflow and Deferred Inflow. This is just for government accounting. Deferred Outflow is just what it means, an outflow that is going to happen but it is deferred, so it is an asset. This amount did increase from the prior year, this has to do with your OPEB liability that you have with the State of Connecticut -- Other Post Employment Benefits -- so rather than recognizing this expense in the current period it is put on the Balance Sheet and amortized over four or five years. As far as Current Liabilities, that is down about \$10 million that your Prizes Payable was down from the prior year. Lastly, Long-term Liabilities did increase, this is due to the pension OPEB plan, so Pensions increased about \$9 million and OPEB increase \$20 million. Net Position was pretty static.

This next slide shows Revenue and Expenses and really as the whole state shut down because of

the pandemic, I think the results were pretty good considering. Revenues, Total Operating Revenues, you had an increase in Instant Sales of \$20 million and an increase Online Sales of \$18 million, and then you had a decrease in Multi-State Revenue of about \$69 million so overall revenues were down about \$28.7 million from the prior year. Costs and Expenses were pretty much consistent from year to year and then your Change in Net Position was down due to the revenues being down. You had a payment to the State of Connecticut General Fund of \$347.7 million and some other payments that you are required to make to the Chronic Gamblers' Fund and the Office of Policy and Management. You did have a decrease in Net Position of about \$6 million from last year.

(P. Birney): This is Patrick Birney. I have a quick question on this slide. This concept of change in net position, is not one that is fairly standard for me; I understand how the numbers work and how we get to the \$6 million change but what does that number signify?

(V. Rossitto): It is really your Net Income or Net Loss. It's the government way of saying Net Income and Net Loss.

(P. Birney): It's interesting because when I look at it, I've always looked at our profits as our payments to the General Fund. It strikes me as odd that we would report a negative number, a loss, when we've transferred \$347.7 million to the general fund, which I view as profit.

(V. Rossitto): There is a line, if you go up a couple of lines from that, Net Position Before Contributions to State Funds, that is really your Net Income, if you will, but because you are required to make contributions to the general fund, so that number is noted there.

(P. Birney): I do see that. That line item, net position, is required under governmental reporting requirements?

(V. Rossitto): The terminology is just a little different, if you looked at a commercial company you might see Retained Earnings. So it's the equivalent. Since the payment to the State of Connecticut is an expense of the Connecticut Lottery, we do have to include it in your financial statements and it does effect the Net Position or retained earnings if you will.

(P. Birney): Thank you; that retained earnings analogy does make sense to me now. Thank you.

(V. Rossitto): On this next slide, I already talked about which games increased and decreased so this is just a comparison of the last couple years. To move on to the Required Audit Communications, again this was a separate document that was issued, I'm going to summarize some of the highlights. In your financial statements the significant accounting policies are described in Note 1 to the financial statements. During the year there were no new GASB Standards adopted, in fact they delayed the implementation of a number of standards due to the pandemic. All financial statements have management estimates. We are required to communicate to those charged with governance which estimates are in your financial statements. In the Lottery's financial statements, management is estimating the useful lives of capital assets in order to calculate depreciation, so we look at those useful lives and make sure that they are close to what they were last year, that there is nothing that stands out. The Net Pension and OPEB Liability contained in your financial statement is an estimate. Both of those are State of Connecticut plans and based upon the assumptions created by the management of the state. And Revenue Recognition – Instant Tickets, fifty percent of the revenue recognition of the instant tickets that are opened, is the management's estimate. Again we compare that to prior years to make sure that it is reasonable.

Then further on to the Required Auditor Communication, there were no difficulties that we encountered, no disagreements with management or uncorrected misstatements. Blum Shapiro is independent of the Connecticut Lottery and management did not consult with another accounting firm for a second opinion.

Next is the laundry list of upcoming GASB Standards. Next year we probably won't have anything to consider as Statements 84, 90 or 92 do not apply to the Lottery but in 2022 there is Statement 87 which has to do with Leases. This is basically requiring the Lottery to account for any operating leases on the Balance Sheet just like a capital lease would be recorded, so I would say we need to start talking about this sooner rather than later as it will take a while to inventory everything and do amortization schedules. I know we will talk about that. Statement 80, 92, 93 and 97 we won't have to worry about. In 2023 there are three more, 91 and 94 probably do not apply; we will probably have to talk about 96 with respect to software agreements, which is pretty similar to the lease agreements so we'll talk about that.

So that is it, our contact information is here if you have any questions, please feel free to reach out to us. Jess or Angelo, I don't know if you want to make any comments about field work?

(J. Aniskoff): Yes, this is Jess Aniskoff, I was the Manager for the Lottery. I just want to say that the employees at the Lottery did a wonderful job of getting everything to us electronically; how we do audits this year has definitely changed and I know we've worked with Barbara and Paul, we have a secure portal that they uploaded everything on. We tried to make our requests ahead of time so that there was plenty of time to upload these documents and it went very smooth this year considering all of the changes we had to make very quickly.

(A. Lombardo): Yes, to piggyback off of what Jess said, this is Angelo Lombardo, I was the Senior on the engagement this year. I think me and Barbara made a great team. Anything she was unsure about she asked ahead of time and I gave her examples of what we looked at in prior years and I think all around it went very smoothly. Things we were a little different this year, pivoting to more of a remote environment but Barbara, Paul and I kept it in constant contact and they were very quick to get me answers to any questions or get me additional support I needed. Overall it was a very smooth audit.

(J. Aniskoff): And actually I wanted to say that we were ready a lot sooner with this audit. What held us up was the State OPEB so I know we are a little later than we have been in the past but that was out of the hands of the Lottery. Very soon, a few weeks after field work we were ready to go except having to wait for the OPEB reports.

(P. Birney): That is a question I had – what effects did pandemic have on the audit, it doesn't sound like much, was it just the delay of OPEB reports?

(V. Rossitto): This is Vanessa. I'm not sure what delayed the State of Connecticut with OPEB, they usually have this a little bit earlier. Jess, do you have any insight on that?

(J. Aniskoff): They had to do a whole new valuation this year. And from talking with the state I think something was held up in another group -- getting their information in for the valuation to be done.

(V. Rossitto): This is Vanessa. I think with a lot of the State of Connecticut not in the office because of the pandemic so getting the information to the actuaries was probably delayed, so indirectly a result of it.

(P. Maroney): This is Patti Maroney, I just want to thank everyone for all of the work that went into this. Again, it is a good product. It is always nice to see these clean audits.

(P. Granato): Thank you Patti. It's Paul again. Thank you Vanessa, Jessica and Angelo. I believe Item IV, the Auditor Communication Letter was also covered in the auditors' report.

V. Quarterly Insurance Company Rating Report:

Manny Langella joined the meeting at 9:30 a.m.

(P. Maroney): Thank you Paul. This is Patti Maroney, we can move on to the Quarterly Insurance Company Rating Report.

(P. Granato): Good morning again. This is Paul Granato, Chief Financial Officer. This is the quarterly summary of the insurance companies and their most recent credit rating. The insurance companies remained stable during this period. The one exception is Monarch Life Insurance, the third one from the bottom. They remain under regulatory supervision. Placed in regulatory supervision from the Massachusetts Department of Insurance 30 years ago. They continue to make all payments as agreed and have not missed any payments. We only have six remaining contracts with them. For the Committee's information, there are 147 insurance annuity contracts and 111 of them are within their normal period of amortization, we have 36 contracts that are paying in excess of their life expectancy that we had originally expected. That is good for the Lottery because that is a cost that we've paid and we are receiving that benefit as the annuitants live longer. It does not cost the Lottery any additional monies for that, we benefit. Does anyone have questions on that report?

(P. Birney): This is Patrick, I have a question. Often during the year the Board gets notification from our legal counsel about RFPs for these annuities. I was wondering, what is the market like, what kind of responses do you usually get on these annuity RFPs?

(P. Granato): This is Paul Granato. It varies Patrick. The environment right now is not a very favorable one for the annuity companies for them to be operating in because of the low interest rates but they still provide the service and they still provide a competitive bid. The numbers do vary. This past RFP we only had two bidders but we have had as many as five, if that gives you a range. It does depend on what we are looking for, this time it was for relatively small annuities, I am not sure if that has any impact on the number of bidders.

(P. Birney): Thank you.

VI. Review of Keno Sales Analysis for the period ended September 30, 2020:

(P. Maroney): Thank you Paul. Any other questions. If not, we can move on to the next agenda item, the Review of Keno Sales Analysis.

(P. Granato): Thank you Patti. So the Keno sales analysis is provided to you as well. We continue to see good performance from our Keno sales. For the quarter ending September 30 sales were \$30.3 million, up 13% from the immediate prior quarter and 14% from the same period a year ago. The Keno monitor locations account for 70% of all Keno sales while all other locations account for the remaining 30% of Keno sales. As a reminder – all locations sell Keno – the difference we are discussing are the locations where we have a monitor installed, the ones that display the activity of the actual Keno drawings. We reached a high point in the third quarter of \$31.6 million and we plan to be back in the same level by the time we roll around to the third quarter of fiscal 2021. Not surprising to see where we see the declines in Keno sales –

our traditional Keno sales outlets – restaurants and bars as well as fraternal organizations, they've been hit hardest by this obviously due to closures and restrictions placed on businesses. We definitely see the impact there. As we see those restrictions rolled back we will see our Keno sales return back to our normal levels. I am hoping that the color coding here will help you to see the variances. Are there any questions from the Committee?

(P. Maroney): Are we seeing any changes in the number of retailers who are interested in Keno, or has it died back because of the pandemic? It seems like there are more retailers now, has there been an impact?

(G. Smith): Patti, this is Greg. From the quarter that's being reported and the last quarter of fiscal 2020, we have had a very small effort for recruiting and opening up locations particularly in the social establishment area while they've been under restrictions for operations. We do have less than 50 of our social establishments who are not selling lottery at all currently which is good as that number was up in the 100 range in the beginning of May. We are seeing more of the social places coming back into business and selling lottery and at the same time we continue to see the sales growth in the convenience stores as customers shift their buying habits for Keno into those locations while the social places are less able to service crowds.

(P. Maroney): Yes, I was just comparing the last two quarters and I see the drop from the prior one. Thank you. Any other questions or comments?

VII. Review of Monthly and Year-to-date Financial Statements for the period ended October 31, 2020:

(P. Maroney): Then let's move to the next agenda item, the Review of the Monthly and Year-to-date Financial Statements.

(P. Granato): Thank you Patti. So we will now go over the monthly results for October 2020 and the comparative to budget and prior year. Looking on line 16, Total Sales were \$117.8 million that's \$8.8 million or 8.1% ahead of budget and nearly \$10 million ahead of last year. Close to \$118 million for the month is just great for us. One of the best Octobers I have ever seen. You can see the performance in the far right column – almost every game is up. Last year in October, the Lotto jackpot grew to \$28 million – which is a significant jackpot for Lotto. The sales for the month of October 2019 for Lotto were \$5.8 million, and this year the jackpot is approximately \$2 million and the sales are \$1.7 million. A decline of 4.1 million year-over-year so a big difference in sales for that game. The multi-state games were all down just slightly. Powerball, Mega Millions and Lucky for Life were all about the same. And we've replaced Lucky Links with Fast Play, on line 15 which is doing a much better job in providing revenue than Lucky Links. So overall we see the game performance continuing to be very strong through the month of October, nearly \$10 million ahead. Total prize payout was \$72.1 million with a 61.1% prize payout compared to sales. That compares very favorably to our 62.8% budgeted amount. There were really no strong anomalies here, every game is performing where we expect it to be. Our retailer commissions were right on line at 5.6% of Total Sales. The gaming systems at 1.2%, marketing at .7% was a little bit lower than our expectations. I think the spend is just slowing down a little bit during the pandemic. The production expenses were only .5%. That left us with a Gross Profit of 30.9%. Over 30%, I can't be any more pleased. That leaves us with a very scant, under 2% of Operating Expenses. Turning the page – we've kept Operating Expenses steady at just about \$2.1 million, but we are raising revenue so that means that we are increasing

our efficiency. Looking down to line 77, General Fund Contributions for the month of October, we returned \$32.7 million, over a million a day in profits.

Continuing on where we are year-to-date through October 31st. Looking again at Total Sales, this is for four months, \$474 million and again moving to the far right column, that's up \$49.8 million compared to budget and \$55.6 million compared to the prior year. That's an average of \$12-13 million per month that we are up, every month during these first four months. A nice position to be in. The Instant Tickets up nearly \$30 million ahead of last year at this time, the Daily Games, 25% growth year-over-year, those are really strong sales. Some of that however is being offset by the Lotto, on the next line. That is down \$11 million, that is due to that large jackpot last October, you can see that impact. Again the Multi-state Games, Powerball, Mega Millions and Lucky for Life, they continue to have a drag compared to the prior year. Although we are starting to see a little bit of a jackpot improvement we are not seeing a commensurate increase in sales yet at this time. Keno is up \$5 million ahead of last year, and Fast Play, again not offered last year but nearly \$16 million in sales for the first four months. A pretty phenomenal product for us to have out in the market right now. Overall prizes were \$289.3 million in the first four months, a 61% payout, again very favorable to our 62.6% budgeted amount through the first four months. Our Retailer Commissions were 5.6%, again right in line of where we expect to be a percentage of sales revenue. Gaming Systems at 1.1%, Marketing and Advertising at .8% and our Production Expenses still at just .5%. We have Gross Profit of 31%. Our Total Cost of Sales at 69% is not something that we would ever budget, but we have a favorable impact to the lower payouts on the daily games right now. Again, the payout structure is supposed to pay out nearly 50% and you can see in the prize expense category, the percentage payout for the daily games at 40%, 39.6, 47% and 37%. Those numbers should be closer to 50%, so those lower payouts in those daily games is providing us a benefit that is going right to the bottom line and right to our gross profit.

Moving on to our Operating Expenses, Total Operating Expenses were \$8.2 million compared to \$8.3 million in the prior year. We've kept our Operating Expenses very flat while still raising revenue. Going down to the General Fund line, we've returned \$138.9 million through the first four months, that's \$27 million ahead of budget and \$18 million ahead of the same period last year. Returning 29% of the revenue that we've raised is again not something that we would budget for but certainly a great position to be in as we close through the first four months of this fiscal year. Are there any questions on any of the categories of expenses you'd like me to go through?

(P. Birney): This is Patrick, just a comment. These numbers are staggering to me. Well done to the team. It's unbelievable that these increases are not being driven my multi-state games. And notwithstanding your earlier comment about the fraternal, I am happy to see that the Keno numbers are up too.

(P. Granato): To be fair, we are now starting to see a little bit of softening in our sales. They were really strong through July and August and through September but the numbers are starting to decline slightly -- still very strong at this point, 25% year-over-year growth in our daily games is just unheard of at this point in the fiscal year. We'll take it at this point, I know the Marketing team and Greg have some great ideas for continuing to improve that product, to continue to offer incentives to our players, for our retailers, I believe that with what we are putting forward in our Marketing efforts we will continue to see positive results.

(M. Langella): Manny Langella here, echoing everyone's comments on that, I'm all about sales efficiencies as well and I don't think it gets any better than the statements you just showed. But I think it would be important to dive in and understand that shift in behavior that's driving some of these numbers to see if this carries forward, is this the new norm, is this a post-COVID drop we might expect, I think it would be important to understand as we get into the marketing piece. All positive from my side too but a little bit of a red herring, as good as it is in these numbers, we'll take it while we can but we should really try to dive in more to understand that shift in behavior, which I know we're doing. Great job.

(P. Granato): Thanks. I do have a copy of the Balance Sheet, I know Vanessa went through it earlier; I could go through that with the Committee if you'd like.

(P. Maroney): Sure.

(P. Granato): The Statement of Net Position, I know we just talked about this, we have Current Assets of \$53 million, the largest piece of our Noncurrent Assets is our annuity portfolio bringing Total Assets to \$182 million. We have \$120 million in annuity contracts that are on our books. Vanessa referred earlier to our Long-term Liabilities, Long-term Liabilities are at \$247 million which is greatly in excess of our Assets which puts us in that negative net position. That is really just the recognition of our pro-rata share of Connecticut's full liability. We are considered a component unit and we need to recognize our share of that total liability which is in the billions and billions of dollars. That puts us in a negative net position and we will be in that position until these pension long-term liabilities get funded.

(G. Smith): This is Greg. A question for Paul, with the upcoming Board meeting in December will the Board receive the same presentation from the auditors?

(P. Granato): Yes, that is the plan, that they would get the same presentation that was provided today. And Blum Shapiro did provide their contact information, if anyone has any questions before then they can reach out to them directly or through Greg or myself.

(P. Maroney): Thank you. Any other items? Comments?

VIII. Adjournment:

(P. Maroney): I think then we are looking for a motion to adjourn.

(P. Birney): I'll move to adjourn.

(M. Langella): Second. Manny Langella.

(P. Maroney): All in favor?

(All): Aye.

(P. Maroney): Thank you everyone. We are adjourned at 9:55 a.m.

Respectfully submitted,

Matthew Stone
Corporate Secretary
Connecticut Lottery Corporation