

Audit Committee
Minutes of Special Meeting

Held on
April 6, 2016 at 2:30 p.m.

at
Connecticut Lottery Corporation
777 Brook Street
Rocky Hill, Connecticut

Committee Members: Michael Thompson, Chair; Patrick Birney; Robert Dakers; Jennifer Hamilton; and Robert Morgan.

Additional Board Members: Frank Farricker, Chairman of the Board.

CLC Staff Members: Anne Noble, President & CEO; Lana Glovach; Chelsea Turner; Annmarie Daigle; and Cynthia Hadden.

Call to Order: Mr. Thompson called the meeting to order at 2:40 p.m.

I. Approval of Minutes

On motion made by Mr. Morgan and seconded by Mr. Birney, the minutes of the February 4, 2016 Special Meeting of the Audit Committee were approved.

II. Review of 5 Card Cash Investigation and Restitution

Ms. Noble thanked the members of the Committee for reading the update that was sent out to them prior to the meeting and then gave a summary and answered questions about the update, which included how the thefts occurred; claims against Scientific Games (“SG”); and clarification of a recent *Journal Inquirer* (“JI”) article. Ms. Noble stated that Bill Ryan, Director of the Department of Consumer Protection (“DCP”) Gaming Division, stated to her that he had no indication that anyone at the Connecticut Lottery Corporation (“CLC”) had knowledge of the fraud by the retailers until it was reported to the DCP by the CLC in November 2015.

In response to a question from Mr. Birney, Ms. Noble clarified the meaning of the term “palming,” which is referred to in her update. Palming occurs when dishonest retailers intentionally deceive unwitting customers by keeping winning ticket(s) for themselves. As indicated in the update provided, the CLC took extra precautions to mitigate against the potential for palming in this game. The arrests in connection with this game were unrelated to palming, as noted in the update.

Next, Ms. Noble referred to the JI article. She explained that Paul Granato, the Chief Financial Officer at the CLC, conducted an analysis on the impact of incentive compensation in relation to ending the 5 Card Cash game. Mr. Granato concluded that there was zero impact, and he prepared a report to that effect.

In response to a question from Mr. Morgan, Ms. Noble discussed the chronology of events as described in her update concerning Gene’s Automotive, which was referenced in the JI article.

Ms. Noble explained that a Lottery Sales Representative, Kevin Wiggins, emailed or called Fred DuPuis, Director of Security, to tell him that an employee from Gene's Automotive indicated that he thought there might be a security concern.

Ms. Noble further explained, as set forth in her update, that Mr. DuPuis had Special Investigator Bob Balicki follow up. Ms. Noble continued as follows: according to Mr. Balicki, the employee from Gene's Automotive pointed out the contents of the customer history screen, which was already known to the CLC and DCP. She further reported that Mr. Balicki asked Steve Fox, Manager of Vendor Compliance, about the screen and shared what he learned with Mr. DuPuis. Ms. Noble stated that to the best of her knowledge, Mr. Balicki did not contact the retailer again until December 2015. This referral by Mr. Wiggins, according to Mr. DuPuis, was not a remarkable event to Security at the time. Mr. DuPuis understood that the customer history screen was being discussed with SG in connection with unrelated software changes, and he took no further action on that basis. Mr. Morgan inquired about Mr. Balicki's follow up with Gene's Automotive after his initial conversation with the retailer. Ms. Noble stated that regardless of the outcome or topic, appropriate customer service protocols suggest that Mr. Balicki should have communicated to Gene's Automotive a second time to state that he looked into the content of the customer history screen and determined that no further action from Security was required based on what he understood from the employee to be the issue.

Mr. Morgan asked for clarification regarding SG's programming of the customer history screen and changes made to a feature called the Repeat 20 key referenced in her update. Ms. Noble provided the Committee with additional information regarding the customer history screen, its development and longstanding use as an accounting tool for retailers. She explained the Repeat 20 key feature and changes made to that feature for the 5 Card Cash game to further mitigate against the risk of palming.

Ms. Noble explained that the customer history screen was programmed by SG, in the same manner as the screen is programmed for other games and for a legitimate accounting purpose. This was well documented and known to SG, the CLC and the DCP. Unlike the ticket, the cards themselves did not appear on the customer history screen. Rather, the numbers and suits appeared on the screen to be used ostensibly to trace a transaction that had jammed or not printed. Though the Lottery and DCP were aware this feature was programmed like other games, and the customer history screen was discussed on several occasions with SG and internally relative to the Repeat 20 key, at no time did SG suggest to the Lottery that the customer history screen as programmed could be exploited by retailers to cancel transactions and steal from the CLC. Nor did SG suggest the screen posed a meaningful risk for palming, which was accurate.

Ms. Noble stated that the DCP approved all software installations and activations, including anything related to the customer history screen and as set forth in technical specifications prepared by SG and reviewed by CLC and the DCP. Ms. Noble explained that she discussed the Repeat 20 change with Ms. Patterson, Vice President of Sales and Marketing, and Mr. Hunter, Chief Operating Officer, and considered the software proposals but did not view that feature on the terminal. Mr. Hunter properly handled matters related to the Repeat 20 key with SG and carefully weighed with SG any risk of palming arising from use of the Repeat 20 key. Along with another change to the game that added a progressive jackpot, called ALL IN, technical specifications for changes to the Repeat 20 key were prepared by SG to further mitigate against the unlikely risk of palming and were given to the DCP in June 2015 and implemented in October 2015.

The Repeat 20 key software changes did affect the content of the history screen. As alleged, retailers were delaying the printer with reports and non-5 Card Cash wagers and then cancelling

non-winning 5 Card Cash wagers. This conduct was not facilitated by entering repeated 5 Card Cash wagers into the system (a "Repeat 20"). Retailers using such a key would have to pay for the non-winning tickets, which they did not do.

Mr. Dakers noted that it was October 2015 when the unusual prize expense was noticed. He asked when the CLC became aware of this. Ms. Noble explained that prize expense variance is expected in every game. In October 2015, it was brought to her attention by Mr. Granato, the CFO, that the variance seemed unusual. If it were not for two jackpot winners in a short time frame, the expense may have continued to seem within the realm of what is normally observed.

Mr. Birney asked about the terminal swaps referenced in the update. Ms. Noble explained how and why that occurred. She then proceeded to review events leading to the discovery of the fraud as set forth in her update, which occurred in late October and early November 2015. The CLC had a mathematician verify that the game design itself was sound, and he concluded that it was. He also stated that the prize expense variance could not be explained by timing, the draw, or other known variables. Simultaneously, Mr. Hunter and Mr. Wagner, Director of Information Technology, were analyzing how the cards were drawn. The information technology department was able to trace unusual prize expense to particular retailers, and the CLC and the DCP worked together to remove terminals from select retailers for analysis of their internal computers or random number generators. The terminals were reported by SG as functioning correctly. Throughout the time when the CLC was trying to find the reason for the unusual prize expense, SG maintained that it had to do with free tickets that were offered as one of the prizes, which the CLC correctly eliminated as the source of the problem quickly, after having done its own analysis of the prize structure. A break came in the puzzle, when Mr. DuPuis received an email from the DCP that a retailer had accumulated a pile of winning tickets and behaved oddly. Mr. DuPuis and Mr. Balicki, aware of concerns about prize expense and specific terminals, promptly investigated this tip, and Mr. Balicki and Mr. Wagner then worked together and ultimately determined that select retailers were manipulating their terminals so as to cancel non-winning tickets and only print winning tickets for their own benefit.

Ms. Noble answered additional questions. Mr. Morgan asked why the number of winning tickets claimed did not alert anyone. Ms. Noble explained that most of these tickets were cashed in the field and did not accumulate at the CLC.

Ms. Noble explained that these dishonest retailers could not use the customer history screen alone to perpetrate fraud because they did not have enough time to view the wagers. They had to jam up the machine with reports or other wagers to slow the screen's normal rapid functioning to exploit this feature and cancel non-winning 5 Card Cash wagers.

Ms. Noble explained that, to prevent fraud, many steps were taken including careful attention to the location of the winning hands on the tickets and jumbling the order of the cards. To the best of her knowledge, no one at the CLC knew that the terminal could be manipulated in a manner to allow retailers to cancel and steal tickets in the manner now known.

Mr. Morgan asked if the DCP was undercover or doing an investigation when they noticed the unusual pile of winning tickets by the retailer's terminal. Ms. Noble stated that she did not know. Mr. DuPuis responded swiftly to the DCP.

Mr. Thompson asked how many retailers have been criminally charged. Ms. Noble responded that she thinks eight.

Mr. Ryan, present in the audience at this meeting, stated that eight warrants have been issued and that there will be more. He said that one arrest involved two sites. Then he said there were nine locations at this point but that he was not exactly sure.

Mr. Dakers asked about how many towns are involved, and it was explained that the fraud was spread out.

Mr. Thompson asked about other jurisdictions that offer the same game and whether Connecticut ("CT") was first. Ms. Noble explained that CT was not first and that there are other states, and Canada, that are currently offering this game, including SG states. Mr. Thompson asked if any other jurisdictions have had criminal problems as seen in CT. Ms. Noble explained no, not to the best of her knowledge.

Mr. Farricker asked whether 5 Card Cash was intended to be temporary or permanent in other states. Ms. Noble replied that she did not know.

III. Executive Session

At 3:28 p.m., Mr. Thompson reviewed the agenda and stated the items to be discussed in Executive Session:

- Attorney/Client Communications
 - Consideration of Action to enforce the corporation's legal rights in connection with 5 Card Cash
 - Update on 5 Card Cash Investigation
 - FOIA Appeal

On motion made by Mr. Birney, seconded by Mr. Morgan, and unanimously approved, the Audit Committee entered into Executive Session. Ms. Noble, Ms. Glovach, and Ms. Turner were invited to attend the Executive Session.

At 3:55 p.m., Mr. Morgan exited the meeting.

At 4:30 p.m., the Committee reconvened in regular session. Mr. Thompson stated that no actions or votes had taken place during Executive Session.

IV. Old Business

Status Update: Purchasing Policy. This update was tabled until the next Audit Committee meeting.

V. New Business

Procurement Status Report

- Contract for Recruitment
- Contract for Acceptance Testing

Public Auditors FY 2014, FY 2015 Audit

These reports were tabled until the next Audit Committee meeting.

VI. Adjournment

On motion made by Mr. Birney, seconded by Ms. Hamilton, and unanimously approved, the meeting was adjourned at 4:32 p.m.

Respectfully submitted,

Chelsea E. Turner
Corporate Secretary
Connecticut Lottery Corporation