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Accountability and Oversight Of the California Lottery

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Assembly Committee on Accountability and
Administrative Review

Hon. Hector De La Torre, Chair





The Lottery: An Unusual Department, Requiring a Particular Type of Legislative Oversight

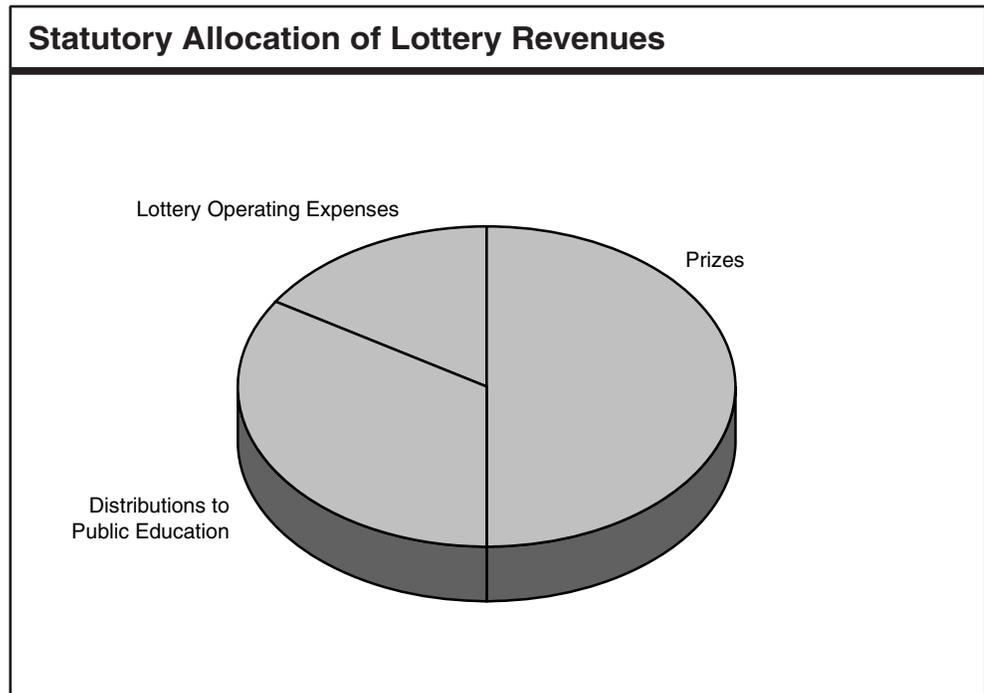
- ☑ ***A Retail Sales Organization.*** Unlike the typical state department (which provides services to residents, operates institutional care or custody programs, or regulates activities in the private economy), the California Lottery runs a large, statewide retail sales business.

- ☑ ***Implications for Legislative Oversight Activities.*** The lottery's unusual characteristics mean that legislative oversight should have a distinct focus: whether the Lottery is maximizing sales in order to achieve its primary mission of providing supplemental funding to public educational entities.

- ☑ ***Balancing Oversight With the Lottery's Independence.*** The 1984 voter-approved Lottery Act already gives the lottery more independence from legislative control than the typical state department. Some independence is beneficial as the lottery responds to changing consumer tastes. Yet, the voter measure recognizes that the Legislature has an ongoing role in oversight. For example, by a two-thirds vote, the Legislature can amend the Lottery Act if the amendments further the act's purposes.



Voter-Approved Lottery Act Contains Rigid Fiscal Formulas



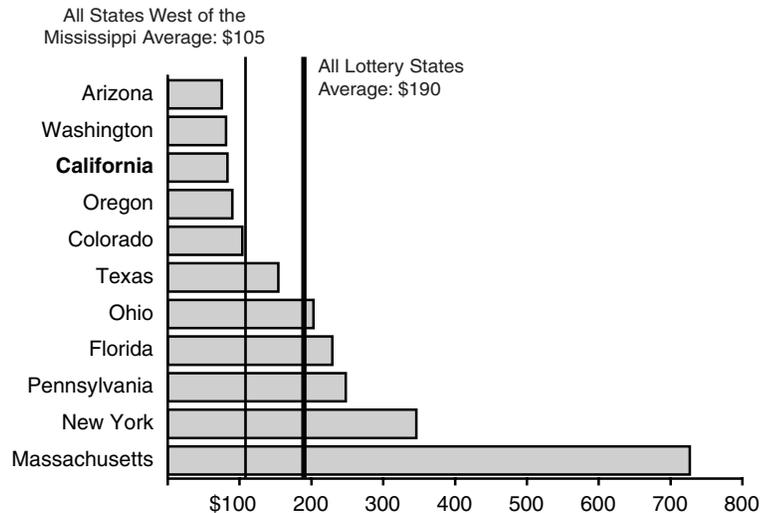
Strict Requirements on Use of Lottery Sales Revenues.

As shown in the figure above, the voter-approved Lottery Act requires approximately 50 percent of lottery sales revenues to be distributed as prizes, about 34 percent to be distributed to public educational entities, and no more than 16 percent to be used for lottery operating expenses—principally lottery retailer compensation.



Lottery Sales Lag Those in Other States

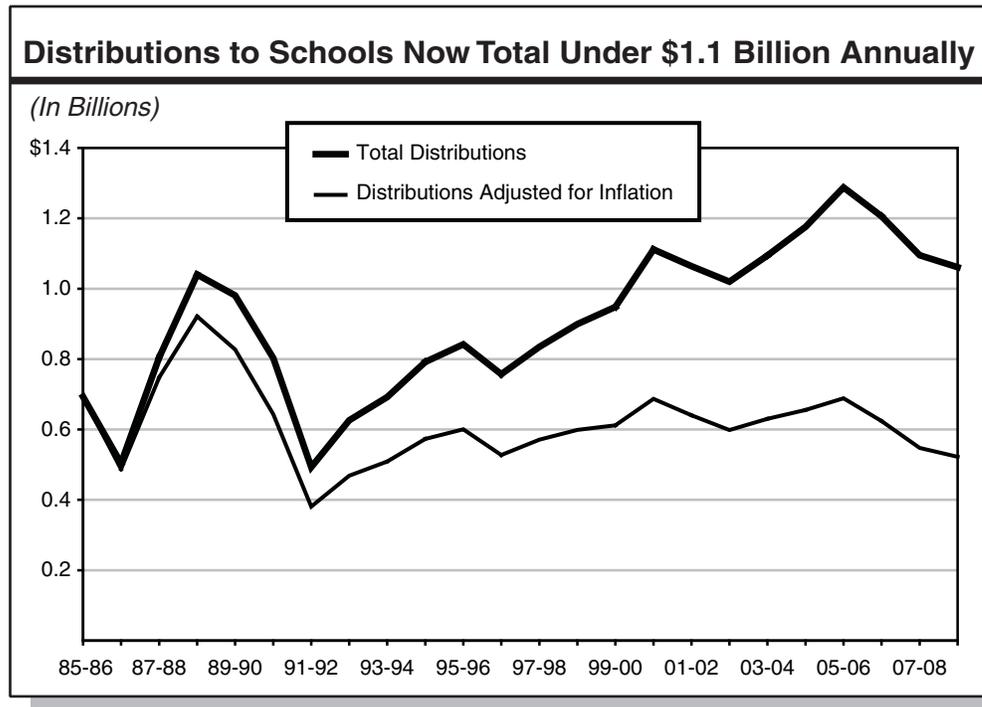
2007-08 Lottery Sales Per Resident in Selected States



More Flexibility Could Foster Sales Improvements. Other states' lotteries generally have more flexibility to offer higher prize payouts, and, as shown in the figure above, these other lotteries usually generate more in per resident sales than the California Lottery. If the lottery had more flexibility on prize payouts, it likely could generate more sales and distribute more money to public education than it would otherwise. (Voters rejected the lottery borrowing measure, Proposition 1C, at the May 2009 special election. This borrowing measure also would have given the Lottery more flexibility on prize payouts.)



Lottery Sales Have Been Volatile Over Time



Sales Have Declined Since 2005-06. Trends in lottery sales drive the lottery's distributions to education—shown above—up or down each year. The recent downturn in lottery sales is the latest of several downward trends in sales over the years. Lottery distributions to education have not kept up with inflation for much of the lottery's existence. (Lottery funds provided just 1.2 percent of funding for K-12 education in 2008-09.)



Sales Trends Have "Leveled Off" Recently. Despite the weak economy, lottery sales have leveled off in recent months. Recently bolstered business planning initiatives may be partly responsible for this.



What Does the Legislature Need to Do In Its Oversight Role?

In our view, when conducting oversight of the California Lottery, the Legislature should focus on a few key objectives:

- Focus on Trends in Sales and Distributions to Education.*** The voters approved the Lottery Act to provide supplemental funding to education. Lottery sales drive the amount of funding it can provide to education. Accordingly, ensuring that the lottery is doing the best it can to generate sales and educational funding should be the main focus of legislative oversight.
- Try to Sharpen the Lottery's Lines of Accountability.*** In the past, turnover of gubernatorial appointees to lottery executive positions and the failure of Governors to meet their legal requirement to fill lottery commission vacancies within 30 days have made it difficult for the Legislature to hold lottery commissioners and executive staff accountable for their performance. The Legislature should consider whether changes to the appointment process should be made to increase accountability.
- Institute Oversight Through the Budget Process.*** The lottery has not been subject to the normal budget process, which requires departments to submit changes in administrative expenditures for legislative review. Administrative expenditures play a key role in how the lottery markets its products to retailers and consumers and—as in the case of the planned new lottery headquarters building—can involve significant sums of money. We have long recommended that lottery sales earmarked for lottery administration be deposited in a separate special fund and that those moneys be made subject to annual appropriation by the Legislature.



What Does the Legislature Need to Do In Its Oversight Role?

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- ☑ ***Regular Consideration of Lottery Act Amendments to Enhance Sales.*** Policy and fiscal committees of the Legislature should continue routine efforts to engage lottery commissioners and executive staff for proposals to amend the Lottery Act (in ways that further the act's purposes) and facilitate greater sales and distributions to education. As technology and consumer tastes change, the Lottery Act needs to change as well. Significant improvements in sales probably will require a loosening of the Lottery Act's current rigid fiscal formulas. In some cases, voter approval of amendments may be required.

- ☑ ***Respect the Lottery's Independence.*** Enhanced legislative oversight need not be inconsistent with the lottery's substantial degree of independence. Legislative oversight, for example, should avoid "micromanaging" lottery advertising campaigns, retailer compensation efforts, and game selections. Instead, the goal of legislative oversight should be to hold commissioners and executive staff accountable for lottery sales and distributions to education.