

California State Senate

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May 20, 2019

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Assembly Member Rudy Salas, Chair
Joint Legislative Audit Committee
Legislative Office Building, Room 104
Sacramento, California 95814

Dear Chairman Salas:

This letter is to request that the Joint Legislative Audit Committee (JLAC) authorize an audit of the California State Lottery to review the growing disparity between record-breaking revenues and the lottery's contribution to our state's public education system.

Publicly available figures from the California State Lottery show that for Fiscal Year 2016-2017 there was reportedly \$6.2 billion in total revenue and \$1.5 billion in supplemental aid given to public education. Revenue for the most recent fiscal year is expected to reach nearly \$7 billion. As outlined by the enclosed graph, revenues to the lottery and subsequent education funding have grown increasingly disparate. Total revenues have skyrocketed in the last ten years but funding for education has only increased marginally. The relatively flat funding stream for education is out of sync with the spirit of why the California electorate created the lottery in the first place.

In recent years, the lottery has been marked by problematic business practices and controversies. For example, the California Lottery Commission has had to settle lawsuits filed by former lottery employees over their diligence in verifying the winners of jackpots, which together were worth nearly \$3 million. Questionable claims made by former lottery employees may have resulted in unclaimed prizes being incorrectly awarded. This is important not least because state law requires that any unclaimed prizes be diverted back into the lottery education fund.

Moreover, reports have also highlighted questionable spending decisions by the lottery. In news sources from December 2018, it was reported that the lottery spent roughly \$17,000 for baseball bat shaped pens and \$14,000 for baseball hats and \$15,000 for duffel bags. Spending in other areas should be examined to ensure that every dollar that is due to the students of California is accounted for and invested wisely in the future.

Just this year, the California State Controller audited the Office Revolving Fund (ORF) and Travel Expenses. Over a four year period, they found that “lottery mismanagement allows for poor spending practices.” The Controller identified \$300,000 in “prohibited and questionable costs.”

While periodic audits are carried out by the State Controller in a narrow fashion, the Controller generally observes if the lottery is meeting the letter of the law, not whether they are putting the lottery is making public schools their number one interest. And some audits don’t take place until the Controller is tipped off. The lottery has not been audited by the State Auditor in twenty-two years and I believe they are now deserving of a comprehensive audit.

Every dollar wasted at the lottery is another dollar taken from our public schools. It is clear that the lottery has a culture more focused on the lottery rather than students. According to one report, Bill Hertoghe -- a former director of security for the California Lottery – “rarely heard talk about the share of money for education when he worked there,” and [h]e described the lottery’s priorities as: "Sales: priority No. 1. No. 2: sales. No 3: sales."

In light of these facts and stagnant contributions to education, I respectfully request that the State Auditor conduct a review of the California State Lottery to determine the following:

- 1) Is the California State Lottery making questionable expenditures – such as promotional materials or other non-essentials -- that would otherwise be used for public education funding?
- 2) Are bidding practices at the lottery economically efficient? For example, the lottery applies a “best value” bidding process while other state departments use a “lowest cost” standard.
- 3) Are the operations and administrative functions (notwithstanding funds paid to vendors) of the state lottery efficient and focused on maximizing savings to ensure the greatest benefit to education funds?
- 4) Between 2012 to 2017, the number of employees at the lottery grew by over thirty percent. Does the lottery suffer from inflated bureaucracies, salaries, or benefits, and is the increased number of employees year-over-year justifiable?
- 5) What is the California State Lottery’s method of verifying that the prize claimant is the actual winner, and has it impeded unclaimed prizes from being afforded to public education?
- 6) Is the lottery appropriately using funds to support the operations of the lottery, including game costs, contracted professional services, advertising costs and other expenses?
- 7) Does the lottery perform any routine analysis of how expenditures and business decisions are impacting revenues for public schools?

California Government Code Section 8880.1 states it is the purpose of the California State Lottery to provide “additional monies to benefit education,” and the Legislature would benefit from a comprehensive audit to determine if this still the goal the lottery is striving to accomplish. With recently alleged improprieties involving staff, a history of lawsuits, poor mismanagement, and both prohibited and questionable spending decisions, the public should be reassured that the California State Lottery is acting in good faith and in the interest of California’s students.

I respectfully ask that the Joint Legislative Audit Committee approve this audit of the California State Lottery.

Sincerely,



SENATOR LING LING CHANG
Senate District 29