A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit

Arizona Department of Education

Department Oversees Empowerment Scholarship Accounts Program Spending, but Should Strengthen its Oversight and Continue to Improve Other Aspects of Program Administration

June • 2016
Report No. 16-107

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

Debra K. Davenport
Auditor General

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DEPUTY AUDITOR GENERAL

June 29, 2016

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

The Honorable Diane Douglas, State Superintendent of Public Instruction
Arizona Department of Education

Transmitted herewith is a report of the Auditor General, *A Performance Audit of the Arizona Department of Education—Empowerment Scholarship Accounts Program*. This report is in response to Arizona Revised Statutes (A.R.S.) §41-2958 and was conducted under the authority vested in the Auditor General by A.R.S. §41-1279.03. I am also transmitting within this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona Department of Education agrees with all of the findings and plans to implement or implement in a different manner all of the recommendations directed to it.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Debbie Davenport
Auditor General

Attachment

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

Arizona Department of Education—Empowerment Scholarship Accounts Program

REPORT HIGHLIGHTS
PERFORMANCE AUDIT

Our Conclusion

The Arizona Department of Education (Department) administers the Empowerment Scholarship Accounts Program (Program), which provides state education monies to parents to pay for the educational expenses of their children who are not attending public schools and who meet statutory eligibility criteria. Statute also prescribes the educational expenditures that parents can make. The Department has established processes for distributing program monies and helping to ensure these monies are spent as required by statute, but should further strengthen its oversight of program spending. In addition, the Legislature should consider establishing a work group to determine if statutory changes are needed to further ensure appropriate spending of program monies. The Department should also continue to improve its eligibility determination process, complete its development and implementation of policies and procedures for safeguarding sensitive and personally identifiable information, and use its newly implemented information technology (IT) system to better manage program data.

2016

June • Report No. 16-107

Department should strengthen oversight of program spending

Program provides state education monies to parents of enrolled children—Parents may enroll their child in the Program if the child meets statutory eligibility requirements, such as having a disability, attending a public school that the Department has assigned a letter grade of D or F, or who are eligible to attend kindergarten at such a school. To enroll a child, parents must agree in writing to not enroll their child in public school, spend awarded program monies only for statutorily prescribed educational purposes of the enrolled child, such as private school tuition and textbooks, and not accept a school tuition organization (STO) scholarship. Once enrolled, the Department determines an annual program award amount for each child and in fiscal year 2016, estimated awards ranged from approximately $2,900 to $31,500. The higher program award amounts are generally provided to children with disabilities. Program award monies are deposited into program scholarship bank accounts established for each child, and parents receive a debit card to then use these monies to purchase educational materials and services for their enrolled children. The Department works with the Arizona Office of the State Treasurer (Treasurer's Office) to provide banking services for the Program.

Department has prevented and identified misspending of program monies—The Department has established various processes to help ensure program monies are spent appropriately, including preventing transactions at merchants whose goods and services are not related to education, such as fast food restaurants and lodging and hotels, and has worked with the Treasurer's Office and bank to automatically deny these transactions. It has also worked with the Treasurer's Office and bank to deny all cash withdrawals. In addition, the Department requires parents to submit quarterly expense reports and conducts reviews of these reports. Between August 2015 and January 2016, department staff identified more than $102,000 in misspending, which included parents who spent program monies after enrolling children in public school, parents who did not submit required quarterly expense reports, and parents who purchased unallowed items. When misspending is identified, the Department may suspend the program scholarship bank account to prevent further misspending, request repayment of the misspent monies, remove the child from the Program, and/or refer the parent to the Arizona Attorney General's Office for collections actions or a fraud investigation.

Additional steps are needed to better safeguard program monies—Although the Department has identified many instances of misspending, it should continue with its plans to adopt a risk-based approach for prioritizing its spending review to help ensure that it reviews the expenditures it identifies to be at higher risk for misspending in a timely manner. The Department reported that it has attempted to review all expenditures and will continue to do so, but given the volume of the quarterly expense reports it reviews and based on its available staff resources, we found that its expenditure reviews were not consistently conducted in a timely manner. In addition, the Department should develop and implement policies and procedures for more frequently and systematically monitoring spending using transaction reports that are generated by the bank's electronic, online system. During the audit, department staff were inconsistently using these reports. Further, the Department should continue its efforts to enhance its enforcement and recovery efforts by completing and implementing policies and procedures for taking timely and consistent enforcement actions when it identifies misspending.

Legislature should consider forming a work group to study options for further safeguarding program monies—We identified three additional issues that may place program monies at risk for loss and abuse that the Legislature should consider reviewing. These issues include parents' use of third-party payment services—PayPal and Square—which parents can use to make payments to merchants such as tutors and private schools, but where department staff have identified several potential instances of misspending; parents of children enrolled in the Program who may be benefiting financially from program monies; and the difficulty of identifying children enrolled in the Program who may have also received an STO scholarship.

Recommendations

The Department should:
- Continue with its plans to adopt a risk-based approach for prioritizing its spending review;
- Develop and implement policies and procedures for using the bank's electronic, online system to generate and review transaction reports to monitor spending; and
- Complete and implement policies and procedures for taking timely and consistent enforcement actions.

The Legislature should consider forming a work group to determine if statutory changes are needed to further safeguard program monies.

Department should continue its efforts to improve its eligibility determination process, safeguard sensitive information, and better manage program information

Program operations need improvement in three areas—First, the Department's processes for determining program eligibility have not consistently ensured that all program eligibility and program award decisions are correct and consistent. Based on a review of 20 program applications for children accepted into the Program in fiscal years 2012 through 2016, we found that the Department did not consistently verify submitted disability information and public school attendance, and inconsistently determined program award amounts. Second, the Department did not adequately protect sensitive information submitted by program applicants. Specifically, we found that files with personally identifiable information were not secured and access to electronic banking data was not limited to necessary department staff. Third, the Department's program data has been inaccurate and incomplete, hindering its ability to use this data to help manage the Program and accurately report on program results.

Department should continue to strengthen various aspects of the Program—The Department should continue with the efforts it initiated during the audit to improve its eligibility determination process, appropriately safeguard sensitive information, and better manage program data. Specifically, the Department should complete the development and implementation of policies and procedures for its eligibility determination process and safeguarding sensitive information. Additionally, the Department has partially implemented a new IT system and plans to expand this system's functionality throughout the summer of 2016 to help it better manage program data. The Department should complete the expansion of its new IT system and complete and implement policies and procedures for using this system.

Recommendations

The Department should:
- Complete the development and implementation of policies and procedures for its eligibility determination process and safeguarding sensitive information; and
- Complete the expansion of its new IT system and complete and implement policies and procedures for using this system.

TABLE OF CONTENTS

TABLE OF CONTENTS

Figures

Tables

INTRODUCTION
Scope and Objectives

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Education (Department)—Empowerment Scholarship Accounts Program (Program) pursuant to Arizona Revised Statutes (A.R.S.) §41-2958. This audit was conducted under the authority vested in the Auditor General by A.R.S. §41-1279.03 and is the second in a series of two reports on the Department. The first audit report addressed the Department's K-3 Reading Program (see Report No. 16-101).

This audit addresses processes the Department has established to help appropriately administer the Program, including processes for distributing and monitoring the spending of program monies and other department processes, such as eligibility determination and program data management.

Empowerment Scholarship Accounts Program provides education monies to parents of enrolled children

Department mission

The Department operates under the direction of the State Superintendent of Public Instruction to serve Arizona public schools and to execute the policies set by the State Board of Education and the State Board for Vocational and Technological Education. Its mission is to serve Arizona's education community, ensuring that every child has access to an excellent education. According to the Department, to meet its mission, the Department implements state academic standards, administers state-wide assessments, disseminates information, administers and allocates federal and state funds, provides program improvement assistance to public school districts and public charter schools (public schools), and actively engages parents and community members.

As part of these responsibilities, the Department administers the Program, which provides state education monies to parents and legal guardians (parents) to pay for the educational expenses of their children who are not attending public schools.

Program history and provisions

The Legislature established the Program to provide state education monies to parents to educate their children outside of the public education system. Specifically, in 2011, the Legislature enacted A.R.S. §§15-2401 through 15-2404 which, among other provisions, allow parents of a child who meets certain eligibility criteria to receive state education monies if they agree not to enroll the child in a public school. Parents are required to spend these monies for statutorily authorized educational expenses of the child, such as private school tuition or to buy curriculum or textbooks to educate the child.

Children must meet statutory eligibility requirements to enroll in Program—Parents may enroll any eligible child who is an Arizona resident in the Program. When the Legislature created the Program in 2011, only children identified as having disabilities were eligible to participate in the Program. In subsequent years, the Legislature has expanded program eligibility to include several other groups of school-age children.[1] As of the 2015-2016 school year, according to A.R.S. §15-2401, children meeting one of the following eligibility criteria and who are a resident of Arizona may be enrolled in the Program:

- Children identified as having a disability;[2]
- Children attending a public school that the Department has assigned a letter grade of D or F, or who are eligible to attend kindergarten at such a school;[3]
- Children of an active-duty member of the United States Armed Forces or children whose parent was killed in the line of duty while serving in the United States Armed Forces;
- Foster children and former foster children who have been adopted or placed with a permanent guardian;
- Children living on an Indian reservation in Arizona; and
- Siblings of current or previous program participants.[4]

In addition, all children, except children of a member of the United States Armed Forces, must meet at least one of the following criteria to qualify for program participation:

- Attended a public school full-time for at least the first 100 days of the fiscal year prior to the fiscal year the child would be enrolled in the Program;
- Is eligible to receive a scholarship for children with disabilities from a school tuition organization (STO);[5]
- Is eligible to enroll in a public school kindergarten;
- Previously participated in the Program; or
- Is eligible to enroll in a preschool for children with disabilities.

Once a child has qualified for program enrollment, he/she remains eligible for the Program until finishing high school, unless the child's parent fails to comply with certain program requirements (see page 4 for more information on these requirements).

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1 Legislation passed in 2012, 2014, and 2015 expanded program eligibility. For example, Laws 2015, Ch. 225, expanded program eligibility to include children living on an Indian reservation in Arizona.

2 According to A.R.S. §15-2401, a student can be identified as having a disability by a public school district or an independent third party.

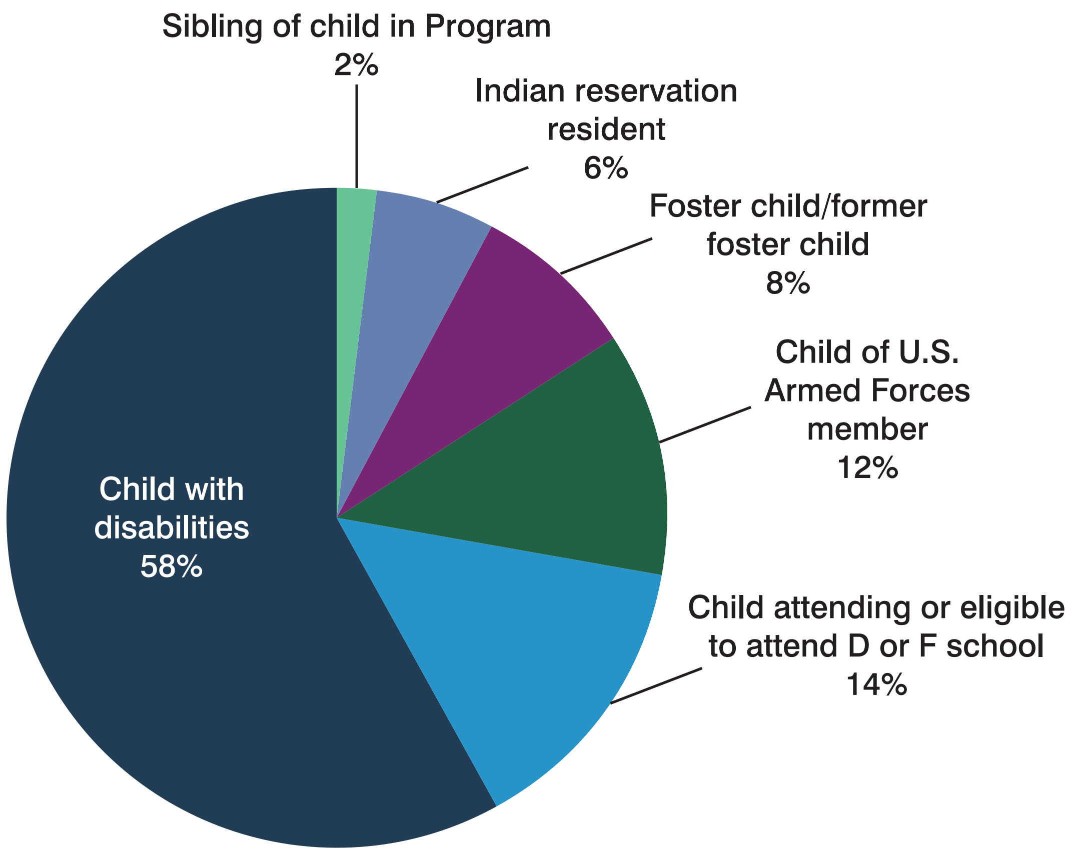
3 A.R.S. §15-241 requires the Department to assign A through D or F letter grades to public schools based on information such as each public school's state-wide standardized test scores, dropout rates, and graduation rates.

4 Laws 2016, Ch. 353, §1, further expanded these eligibility criteria beginning in August 2016 to include children of a parent who is legally blind as defined by A.R.S. §41-1973(C) or deaf or hard of hearing as defined by A.R.S. §36-1941. It also allowed siblings of an eligible child to enroll in the Program at the same time as the eligible child.

5 An STO is a nonprofit organization that receives contributions for the purpose of providing educational scholarships or tuition grants to qualified students to pay for private school tuition.

As shown in Figure 1, as of November 2015, children identified as having a disability represented 58 percent of the children enrolled in the Program. Children from schools assigned a letter grade of D or F and children whose parents or legal guardians are members of the United States armed forces accounted for 14 and 12 percent of eligible children enrolled in the Program, respectively.

Figure 1: Program participation by eligibility type As of November 2015 (Unaudited)



Source: Auditor General staff analysis of department-reported information as of November 6, 2015.

Parents must enroll children and agree to program requirements to receive program monies—To enroll children in the Program, parents must submit an application for each child and if the child is approved for program participation, sign a program agreement prior to receiving any program monies (see pages 5 through 7 for more information on the Department's process for distributing program monies to parents). Specifically, the Department has developed program applications for each of the statutory eligibility categories previously discussed on page 2. Applications are statutorily due to the Department no later than May 1 each year to apply for enrollment in the following fiscal year.[1] The Department also requires parents to submit supporting documentation to demonstrate children's eligibility, such as birth certificates, court documents, or Individualized Education Programs (IEPs) for children with disabilities (see Finding 2, pages 27 through 30, for information on the Department's process for reviewing program applications).[2] Parents may enroll multiple children in the program.

In addition, according to statute, parents must sign an agreement with the Department to enroll eligible children in the Program whereby they agree to the following:

- Not to enroll their child in a public school;
- Spend monies in the enrolled child's program scholarship bank account, which the Department establishes for each enrolled child for the purpose of distributing program monies, only for the enrolled child's statutorily approved educational expenses, such as private school tuition and textbooks (see textbox for examples of statutorily authorized educational expenses);
- Not use monies deposited in the enrolled child's program scholarship bank account for computer hardware or other technological devices, transportation of the child, or consumable educational supplies, including paper, pens, and markers (these are not statutorily approved educational expenses);
- Use a portion of the monies deposited in the child's program scholarship bank account each quarter to provide an education for the enrolled child in the subjects of reading, grammar, mathematics, social studies, and science;[3] and
- Not accept an STO scholarship for the enrolled child.[4]

Examples of statutorily approved educational expenses:

- Tuition at a private school;
- Textbooks and curriculum;
- Education therapies such as speech therapy;
- Tutoring or teaching services;
- Tuition or fees for a nonpublic online learning program;
- Fees for standardized achievement tests; and
- Tuition and fees at an eligible postsecondary institution.

Source: Auditor General staff analysis of A.R.S. §15-2402.

Parents must annually renew children's participation in the Program.

1 A.R.S. §15-2403 (G) allows the Department to determine a period between July 1 and May 1 of each year during which it will accept program applications. According to the Department's Web site, for fiscal year 2017 enrollment, the Department accepted applications between January 1 and April 1, 2016. However, Laws 2016, Ch. 353, §3 requires the Department to accept applications for enrollment year-round beginning in August 2016.

2 20 United States Code §1414(d)(2)(A) requires public schools to create an IEP for each student receiving special education services. IEPs are written statements that discuss a student's present levels of academic achievement and functional performance, measurable annual goals, and what special education and related services and aids should be provided to the student.

3 Laws 2016, Ch. 353, §2, revised this requirement from quarterly to annually beginning in August 2016.

4 Although children who are eligible to receive a scholarship for children with disabilities from an STO may enroll in the Program, a parent must agree not to accept an STO scholarship for an enrolled child in the same year the parent signs an agreement with the Department to enroll a child in the Program.

Although statute requires parents to use a portion of monies deposited in the child's program scholarship bank account each quarter to provide an education for the enrolled child, parents are not required to spend all of the monies deposited in the account each quarter. As a result, program scholarship bank accounts may continue to accumulate monies throughout a child's enrollment in the Program. Additionally, although children are no longer eligible to receive program awards after finishing high school, statute allows program scholarship bank accounts to remain open after high school graduation for parents to use for the enrolled child's postsecondary educational expenses, such as college tuition and textbooks.[1] Statute requires program scholarship bank accounts to be closed and any remaining monies returned to the State General Fund after the child graduates from a postsecondary institution. In addition, the account must be closed and any remaining monies returned to the State General Fund if the child does not attend a postsecondary institution for a period of 4 consecutive years after finishing high school. Further, the Department can also close a child's program scholarship bank account and transfer the remaining monies to the State General Fund if the parent re-enrolls the child in public school or does not comply with program requirements.

Department determines program award amounts, which vary widely based on eligibility criteria—Once a parent has enrolled a child in the Program, department staff determine an annual program award amount for each child, and these award amounts vary widely. Specifically, the Department determines the amount of each child's annual program award based on the amount of state education monies a public school would have received to educate that child in the fiscal year of the award (see page 8 for more information on how program awards are funded).[2] The amount of money a public school receives to educate a child differs depending on characteristics of the school, such as if it is an elementary school or a high school. Additionally, the amount of money a public school receives to educate a child differs depending on characteristics of the child, such as the child's grade level and if the child has any disabilities. As a result, in fiscal year 2016, estimated program awards ranged from approximately $2,900 to $31,500 per enrolled child (see Figure 2, page 6, for a range of estimated program awards). Higher program award amounts are generally provided to children identified as having a disability. For example, the Department reported that children with autism frequently receive program awards totaling as much as $25,000 annually. However, the majority of estimated program awards for fiscal year 2016 were less than $10,000 per enrolled child.

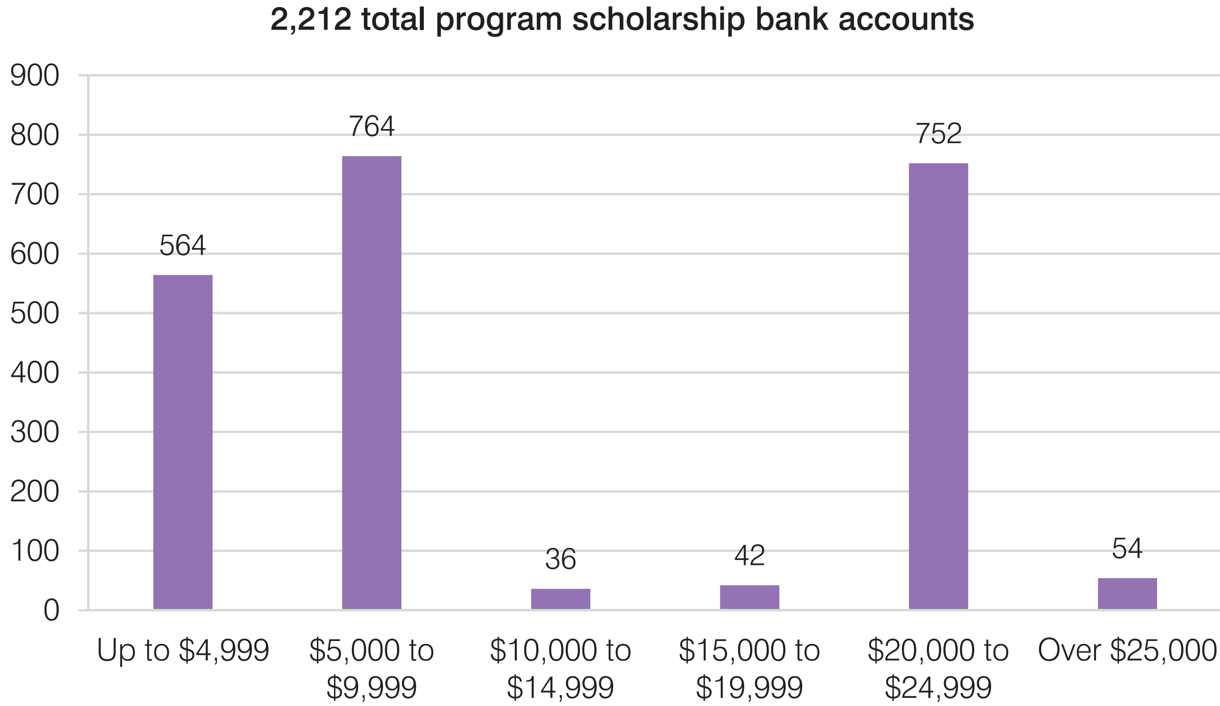
Department provides program monies to parents using program debit cards—The Department works with the Arizona Office of the State Treasurer (Treasurer's Office) to provide banking services for the Program. Specifically, the Treasurer's Office amended its existing contract with a multinational financial institution (bank) that provides various banking services to the State to also provide program scholarship bank accounts for enrolled children. Parents of children enrolled in the Program are then provided a debit card by the bank to access program monies.

According to the Treasurer's Office, department staff provide the Treasurer's Office with a list of parents with children enrolled in the Program, and the Treasurer's Office contacts the bank to request that a program scholarship bank account be opened for each enrolled child. The bank

1 Laws 2016, Ch. 112, §1 authorizes some children with disabilities to continue receiving program monies until they are 22 years old beginning in August 2016.

2 The Department determines program award amounts based on the public school the child attended in the fiscal year prior to enrolling in the Program. However, for children who enrolled in the Program as kindergartners, the program award is determined using the public school the child would have attended for kindergarten in the fiscal year of program enrollment.

Figure 2: Number of program scholarship bank accounts by ranges of estimated program monies awarded[1] Fiscal year 2016 (Unaudited)



[1] Estimates are calculated based on amount transferred into program scholarship bank accounts in August 2015.

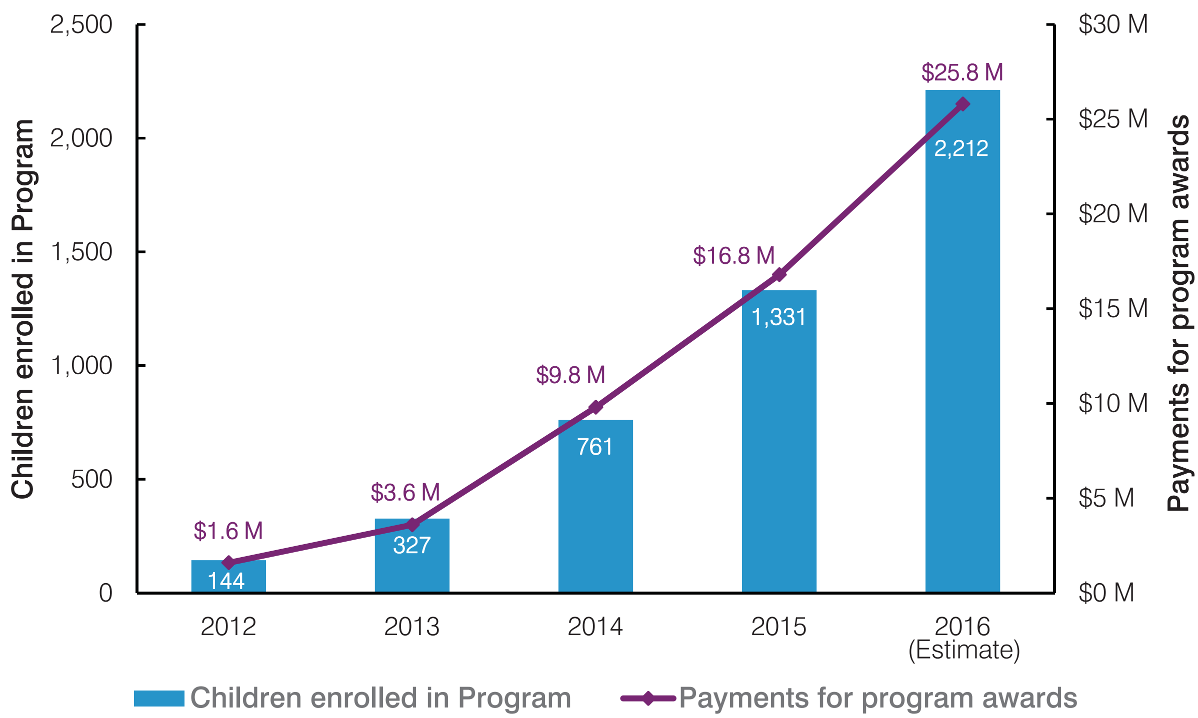
Source: Auditor General staff analysis of program scholarship bank account transaction data from August 2015 provided by the Treasurer's Office.

then mails a program debit card to each enrolled child's parent that he/she can use to make educational purchases on behalf of the enrolled child with program monies. Parents with multiple children enrolled in the Program will receive a separate debit card for each child's program scholarship bank account. On a quarterly basis, at the Department's request, the Treasurer's Office transfers awarded program monies into the program scholarship bank accounts. To determine whether parents' program debit card purchases comply with statute, department staff review spending to ensure monies were used for statutorily approved purposes and perform ongoing reviews to ensure that parents have complied with all statutory requirements (see Finding 1, pages 11 through 25, for more information on the Department's spending reviews).

The Program's use of debit cards as a method to provide program monies to parents is somewhat unique among similar programs in other states. Specifically, as of April 2016, four other states had established educational scholarship account programs similar to Arizona's, although two of these states' programs had yet to be implemented (see Appendix A, pages a-1 through a-6, and Appendix B, pages b-1 through b-4, for more information on the other states' programs). One state, which has yet to implement its program, plans to also use debit cards to provide its program monies to parents. However, the other states use different methods to provide program monies, such as by reimbursing parents for purchases.

Program growth—Since the Program began in fiscal year 2012, program enrollment and the amount of program monies paid for program awards annually have increased every year as the Legislature has expanded eligibility criteria (see Figure 3). Specifically, according to department records, the number of children enrolled in the Program has grown from fewer than 150 children in fiscal year 2012 to more than 2,200 children in fiscal year 2016. As enrollment has grown, the total amount of program monies paid for program awards has also increased, from approximately $1.6 million in fiscal year 2012 to an estimated $25.8 million in fiscal year 2016. As of June 2016, the Department reported that it had approved approximately 3,900 applications for fiscal year 2017 program enrollment. However, according to the Department, all approved applicants will not enroll in the Program. As a result, the Department estimated that more than 3,500 children will enroll in the Program in fiscal year 2017.

Figure 3: Number of children enrolled in Program and payments for program awards Fiscal years 2012 through 2016 (Unaudited)



Source: Auditor General staff analysis of program scholarship bank account transaction data from October 2011 through August 2015 provided by the Treasurer's Office and the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* for fiscal years 2012 through 2015; and department-prepared estimated financial information for fiscal year 2016.

Program staffing

As of January 2016, the Department reported that it had allocated 5.0 full-time equivalent (FTE) positions to administer the Program.[1] However, the Department reported that as of June 2016, it had increased the number of FTE allocated to the Program to 10 after the Department had been approved to receive an increased appropriation for program administration in fiscal year 2017.[2] These positions consisted of a program director, one administrative assistant, a fraud auditor, six program specialists, each of whom will manage the eligibility and program award determinations and spending reviews for an assigned caseload of children's program scholarship bank accounts, and a full-time temporary employee to assist with other program workload.

Program budget and finances

The Program is funded with state education monies that come primarily from the State General Fund. Specifically, the Program and the State's public schools receive State General Fund monies through the state equalization formula, which allocates monies to public schools for each student enrolled in the public school.[3] A.R.S. §15-2402 states that the Program shall be funded based on what an enrolled child's prior public school would have received to pay for general operations and maintenance through the state equalization formula for that particular child enrolled in the Program.[4,5] For each child enrolled in the Program, A.R.S. §15-2402 requires the Department to distribute the amount that would have been provided to the child's prior public school for the following purposes:

- **Program award—**90 percent. The program award is the amount available to the child's parent to pay for the child's educational expenses (see pages 5 through 7 for more information on how the Department provides these monies to parents). As shown in Table 1 on page 9, the Department distributed nearly $17 million for program awards in fiscal year 2015 and estimated that it would distribute nearly $26 million for program awards in fiscal year 2016.

- **Department's program administration—**4 percent. These monies are intended to pay for the Department's costs of administering the Program, but are subject to legislative appropriation. As a result, in fiscal year 2015, although the Department retained

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1 Laws 2015, Ch. 8, §34, appropriated 164.9 FTE positions to the Department for fiscal year 2016. However, none of these positions were specifically appropriated for the Program.

2 Laws 2016, Ch. 117, §37, appropriated $799,000 for the Department's program administration for fiscal year 2017, including $100,000 for one-time information technology changes. This appropriation was an increase of nearly $400,000 from the Department's fiscal year 2016 appropriation for program administration.

3 The state equalization formula is intended to ensure that public schools receive equal funding on a per-student basis. The equalization formula provides funding for public school districts through locally levied property taxes and State General Fund appropriated monies, and for public charter schools through State General Fund appropriated monies.

4 The child's prior school is the public school the child attended in the fiscal year prior to enrolling in the Program, or the public school the child would have attended in the year of enrollment if the child enrolled in the Program as a kindergartner.

5 A.R.S. §15-185(B)(4) allocates additional monies to public charter schools through the state equalization formula for each student enrolled in the public charter school. The Department includes these additional charter school monies in program funding.

Table 1: Schedule of revenues, expenditures, and other changes in fund balance Fiscal years 2014 through 2016 (Unaudited)

	2014 (Actual)	2015 (Actual)	2016 (Estimate)
Revenues			
State General Fund appropriations[1]	$ 10,391,229	$ 17,725,499	$ 27,090,530
Expenditures and transfers			
Payments for program awards[2]	9,830,642	16,773,619	25,800,000
Administrative expenditures and transfers:			
Personal services and related benefits	210,927	239,467	260,100
Professional and outside services			
Travel	706	394	
Other operating	23,937	27,287	140,000
Furniture, equipment, and software	1,286		
Total administrative expenditures	236,856	267,148	400,100
Transfers to other state agencies[3]	113,240	190,389	258,000
Total expenditures and transfers	10,180,738	17,231,156	26,458,100
Excess of revenues over expenditures and transfers	210,491	494,343	632,430
Fund balance, beginning of year	137,843	348,334	842,677
Fund balance, end of year[4]	$ 348,334	$ 842,677	$ 1,475,107

1 State General Fund appropriations were used to pay for program awards and related administrative expenditures.

2 Amounts are payments made for program awards to eligible students in accordance with statute less amounts returned to the State General Fund for accounts that were closed for various reasons, such as noncompliance with contract terms and voluntary withdrawal from the Program. The returned amounts were nearly $268,000 and $431,000 in fiscal years 2014 and 2015, respectively.

3 Amounts are primarily transfers to the Treasurer's Office for its program administration, as allowed by statute. The Department transferred more than the annually appropriated $40,000, requiring the Treasurer's Office to retain the additional monies in its Empowerment Scholarship Account Fund. In addition, fiscal year 2014 includes $1,400 transferred to the Department of Administration's Automation Projects Fund as required by Laws 2013, 1st S.S., Ch. 1, §127.

4 The cumulative estimated fund balance at the end of fiscal year 2016 primarily includes the Department's accumulated, unspent administrative monies that were more than the amounts appropriated by the Legislature. The Department was statutorily allowed to retain these monies. However, the monies are subject to appropriation before the Department can spend any of the fund balance.

Source: Auditor General staff analysis of the AFIS *Accounting Event Transaction File* for fiscal years 2014 and 2015 and the AFIS Management Information System *Status of General Ledger-Trial Balance* screen for fiscal years 2014 and 2015 as of October 20, 2015; and department-prepared financial information for fiscal year 2016.

approximately $760,000 for this purpose, it spent approximately $267,000 for program administration costs, including more than $239,000 for personal services and related benefits (see Table 1). These costs included $200,100 authorized by legislative appropriation for fiscal year 2015, as well as approximately $67,000 that the Legislature appropriated for fiscal year 2013 but which the Department had not previously spent. Because the amount the Department has retained as authorized by statute for each year the Program has been in existence has exceeded the amount the Legislature has appropriated to the Department for administrative costs by nearly $1.5 million, the Department estimated that it would accumulate a fund balance totaling this difference at the end of fiscal year 2016.[1]

- **Treasurer's Office program administration—**1 percent. These monies are intended to pay the Treasurer's Office's costs for administering its program responsibilities. As shown in Table 1 (see page 9), in fiscal years 2015 and 2016, the Department transferred more than $190,000 and an estimated $258,000, respectively, to the Treasurer's Office. These monies are also subject to legislative appropriation. As a result, according to state accounting records, in fiscal year 2015, the Treasurer's Office spent approximately $40,000 for program administration costs, as authorized by legislative appropriation, which was $150,000 less than what the Department transferred.

The remaining 5 percent of the amount that would have been provided to the child's former public school is not distributed to the Program and, as a result, remains available to fund public schools.

[1] The Department's appropriations for program administration are non-lapsing.

FINDING 1

The Department of Education (Department) should take steps to strengthen its oversight of spending in the Empowerment Scholarship Accounts Program (Program). The Department has established processes to distribute and oversee the spending of program monies, and it has prevented and identified some misspending of these monies. However, program monies are susceptible to loss and abuse and the Department should further strengthen its efforts to safeguard these monies. These efforts should include:

- Strengthening its spending review process, such as continuing to develop a risk-based approach for prioritizing its spending reviews and using all available tools to detect misspending;
- Completing its development and implementation of policies and procedures to strengthen its enforcement and recovery actions; and
- Improving its overall administration and oversight of program spending, such as continuing to take steps to provide supervisory review of department staff's work.

Finally, the Legislature should consider establishing a work group to determine if statutory changes are needed to further ensure appropriate spending of program monies.

Department should strengthen oversight of program spending

Department has prevented and identified misspending of program monies

The Department has established various processes to provide program monies to parents and legal guardians (parents) of children enrolled in the Program and to help ensure these monies are spent as required by statute. As discussed in the Introduction (see pages 1 through 5), according to Arizona Revised Statutes (A.R.S.) §15-2402, a parent may enroll any eligible child who is an Arizona resident in the Program. In addition, statute allows parents to spend program award monies for certain educational expenses of that child, including private school tuition, educational therapies for children with disabilities, private tutors, textbooks, and curriculum (see Introduction, page 4, for more information on allowed expenses). Further, according to statute, to enroll a child and be eligible to receive program monies, a parent must agree not to enroll the child in a public school district or charter school (public school) or accept a scholarship from a school tuition organization (STO).[1]

To provide parents with access to program award monies, the Department requests that the Arizona Office of the State Treasurer (Treasurer's Office) distribute monies directly to the program scholarship bank account that is established for each child enrolled in the program. The Treasurer's Office amended its existing contract with a multinational financial institution (bank) to provide individual program scholarship bank accounts for each child enrolled in the Program. The Department requests that the Treasurer's Office deposit a portion of the child's annual award monies into these accounts on a quarterly basis. The bank provides parents with a program debit card for each child's program scholarship bank account that they then can use to spend program monies that have been distributed to this account.

To help ensure the appropriateness of parents' program debit card purchases, the Department has taken the following steps to prevent, identify, and address spending that is not allowed by statute (misspending):

- **Preventing misspending**—To help prevent misspending, the Department has taken several steps, as follows:
  - *Requiring parents to sign a program agreement*—As authorized by A.R.S. §15-2402(B), the Department requires parents to sign an

[1] An STO is a nonprofit organization that receives contributions for the purpose of providing educational scholarships or tuition grants to qualified students to pay for private school tuition.

agreement when enrolling their children into the Program and each year thereafter when re-enrolling their children in the Program. The agreement outlines statutory requirements for appropriate spending and states that parents are not allowed to re-enroll their child in public school or receive a scholarship from an STO. In addition, as allowed by statute, the Department's agreement includes other requirements, such as requiring parents to submit quarterly expense reports detailing their program debit card purchases (see page 13 for more information on expense reports) and to repay any program monies that are inappropriately spent.[1] Parents must sign and date the agreement before receiving program monies. Additionally, consistent with statute, the agreement states that the Department may suspend a program scholarship bank account or remove a child or a parent from the Program for any violations of the agreement.[2]

- *Providing parents with a program handbook*—The Department has developed a parent handbook that provides guidance on appropriate and inappropriate spending of program monies. For example, the handbook explains requirements for submitting documentation to demonstrate the qualifications of tutors who are paid with program monies. It also explains that cash withdrawals from program scholarship bank accounts are prohibited. According to the Department, parent handbooks have been available since fiscal year 2015 and, as of fiscal year 2016, the Department began distributing parent handbooks to parents with enrolled children. Additionally, the Department has made the handbook available for download on its Web site.

- *Offering additional information for parents*—The Department has also provided optional training sessions to help inform parents about appropriate spending. According to department management, the Department began offering training sessions to parents during the first year of the Program and has since provided numerous trainings in Phoenix and Tucson. For example, the Department hosted a training on completing and submitting required expense reports in September 2015. The Department estimated that most of its training events have had approximately 20 to 30 attendees.[3] Additionally, the Department has posted answers to frequently asked questions about the Program on its Web site.

- *Preventing transactions at specific types of merchants*—The Department has worked with the Treasurer's Office and bank to automatically deny potentially inappropriate purchases. Specifically, national credit card companies have developed a system that assigns a merchant category code (MCC) to merchants based on the type of goods or services the merchant provides. For example, grocery stores or supermarkets are assigned a specific MCC while a private school is assigned a different MCC. The Department has identified MCCs that include statutorily allowed goods or services, such as the MCC for schools and educational services, and has worked

1 A.R.S. 15-2403(H) authorizes the Department to adopt additional rules and policies to administer the Program, including rules and policies for reviewing parents' program spending. The Department has not adopted any rules.

2 A.R.S. §15-2403(C) authorizes the Department to suspend program scholarship bank accounts and remove parents or children from the Program for violating statutory requirements or the terms of the program agreement. As a result, the Department can remove a parent and any or all of their enrolled children from the Program. However, the Department has removed a child from the Program for being re-enrolled in public school while allowing the child's sibling to remain in the Program.

3 Although the Department does not maintain attendance records for training sessions it has held, auditors attended two separate training sessions and observed approximately 20 attendees at one session and 50 attendees at the other session.

with the Treasurer's Office and the bank to automatically approve transactions in these categories. It has also identified MCCs not generally related to education, such as fast food restaurants and lodging and hotels, and has worked with the Treasurer's Office and the bank to automatically deny transactions in these categories (see textbox for examples of merchants for which the bank has denied transactions).

Examples of denied transactions October 2011 through August 2015

- Dating Web site
- Hotel
- Fast food restaurant
- Computer store
- Grocery store

Source: Auditor General staff analysis of program scholarship bank account transaction data from October 2011 through August 2015 provided by the Treasurer's Office.

- *Preventing cash withdrawals*—The Department has worked with the Treasurer's Office and bank to deny all cash withdrawals from program scholarship bank accounts. These denials include withdrawals from a bank teller or Automated Teller Machine (ATM), cash-back transactions during purchases, and obtaining cashier's checks. According to bank records, between October 2011 and August 2015, the bank denied more than 200 parents' attempts to withdraw cash from program scholarship bank accounts, including parents who attempted to withdraw cash multiple times.

- **Identifying and addressing misspending that has occurred—**To identify misspending and address it when it has occurred, the Department has taken the following steps:

  - *Requiring parents to submit quarterly expense reports*—The Department requires parents to submit quarterly expense reports listing each transaction made with their program debit card and provide documentation, such as receipts or invoices, to demonstrate the appropriateness of each purchase. The Department also requires parents to sign the expense report to certify that all purchases complied with the program agreement. According to the program handbook, the Department will withhold future award distributions until parents have submitted the required quarterly expense reports.

  - *Reviewing parents' expense reports*—Department staff review expense reports and the associated documentation parents have submitted to determine if the reported expenses were allowable. According to department management, department staff attempt to review every transaction on every expense report submited by parents. Through its review of quarterly expense reports, the Department has identified many instances of misspending. For example, as shown in Table 2 (see page 14), department staff identified more than $102,000 of misspent monies between August 2015 and January 2016.[1] Some types of misspending identified by department staff included parents who spent program monies after enrolling their children in public school, parents who did not submit quarterly expense reports as required by the program agreement, and parents who purchased items that were not allowed by statute, such as purchases from a grocery store and a telecommunications company (see page 21 for more information on how a parent was able to purchase items that were not allowed by statute).

[1] In August 2015, the Department began tracking parents' misspending. Prior to August 2015, the Department did not document the misspending it identified, except for 15 cases that it sent to the Attorney General's Office for fraud investigations and/or collections.

Table 2: Program monies misspent by number of program scholarship bank accounts and types of misspending August 2015 through January 2016 (Unaudited)

Type of misspending	Number of accounts	Misspent monies
Parent purchased items not allowed by statute or program agreement	100	$35,740
Parent did not submit a quarterly expense report or the required receipts/invoices to demonstrate appropriate spending, as required by the program agreement	11	31,155
Parent enrolled child in public school	25	33,215
Parent spent money on child who did not reside in Arizona	1	1,232
Parent accepted an STO scholarship for child	1	1,259
Total	138	$102,602

Source: Auditor General staff analysis of misspent program monies identified and tracked by department staff between August 2015 and January 2016.

- *Taking enforcement action when misspending is identified*—According to the Department, it has established the following procedures to respond to misspending:
  - First, the Department suspends the program scholarship bank account to prohibit any further spending.
  - Second, consistent with statute, the Department contacts the parent to obtain further documentation about the questionable transactions, and then allows the parent 10 days to respond with any further documentation or explanation.[1] The Department reported that if the parent fails to respond, the program scholarship bank account is closed and the parent is removed from the Program.
  - Finally, if the parent is unable to demonstrate that the purchase was appropriate, the Department requires the parent to repay the misspent monies.

According to the Department, when a parent does not agree to repay misspent monies or does not respond to requests for additional information, it closes the program scholarship bank account and then works with the Arizona Attorney General's Office (Attorney General's Office) to attempt to recover the misspent

[1] A.R.S. §15-2403(C) requires the Department to notify parents of a program scholarship bank account suspension and parents have 10 business days to respond and take corrective action. If the parent does not respond, the Department can close the program scholarship bank account and remove the child from the Program. This statute also authorizes the Department to remove a parent from the Program, meaning that all of the parent's children would be removed from the Program. A.R.S. §41-1092.03(B) allows parents 30 days to appeal the Department's program removal decisions to the Office of Administrative Hearings.

monies through the Attorney General's Office's formal collections process. Between October 2014 and May 2016, the Department referred 23 parents to the Attorney General's Office for collections.[1] Additionally, consistent with statute, the Department may request that the Attorney General's Office pursue a fraud investigation against parents who misspend a substantial amount of program monies.[2] According to the Department, it refers parents who misspend more than $1,000 to the Attorney General's Office for fraud investigation and Attorney General's Office records indicate that between August 2011 and May 2016, the Department referred 27 cases to the Attorney General's Office for fraud investigations.[3]

Department should take additional steps to better protect program monies

Although the Department's processes quickly provide program monies to parents and have identified many instances of misspending, the Department should take additional steps to better safeguard program monies. First, the Department should strengthen its oversight of parents' spending, including continuing its plans to adopt a risk-based approach for prioritizing its review of program spending, using transaction reports to systematically monitor spending, and developing and implementing policies and procedures for monitoring compliance with program spending requirements. In addition, the Department should complete its development and implementation of policies and procedures for guiding its enforcement and recovery actions to ensure that these actions are consistent and timely. The Department should also make other changes to improve its overall administration and oversight of program spending, such as continuing to take steps to provide supervisory review of department staff's work.

Department should improve spending oversight—The Department should develop and implement several additional processes, including supporting policies and procedures, to improve its oversight of program spending. Specifically, the Department should:

- **Continue its plans to adopt a risk-based approach for prioritizing its spending review—** To more timely identify instances of misspending, the Department should continue with its plans to develop and implement a risk-based approach for prioritizing spending reviews. As of April 2016, department staff reported that they have attempted to review all expenditures listed on all of the quarterly expense reports submitted by parents. However, the Department may have received more than 2,200 expense reports each quarter in fiscal year 2016 and based on the staff resources it was able to allocate to review these reports, these reviews were not consistently conducted in a timely manner. Specifically, the Department reported that department staff responsible for conducting spending reviews may not have been able to complete reviews quickly because their caseloads were too large. For example, as of March

1 According to the Department, it did not use the Attorney General's Office for collections prior to fiscal year 2015.

2 A.R.S. §15-2403(E) authorizes the Department to refer cases of substantial misuse of monies to the Attorney General's Office for investigation.

3 According to a department Assistant Attorney General, the Attorney General's Office's fraud unit suggested the $1,000 threshold for fraud cases, but reported that the Attorney General's Office may investigate misspending of smaller amounts if the Department provides evidence that the parent committed fraud.

2016, department staff were still reviewing expense reports submitted in December 2015 that reported spending from as early as September 2015. Untimely reviews may not allow the Department to quickly identify misspending and take appropriate action, such as suspending program scholarship bank accounts or withholding further program award distributions until the parent addresses the misspending.

Rapid program growth has likely contributed to this issue. Specifically, as discussed in the Introduction (see page 7), the number of children enrolled in the program has nearly doubled each year since the program began in fiscal year 2012 through fiscal year 2016. In addition, the Department anticipates continued program growth. For fiscal year 2017, the Department estimates more than 3,500 children will enroll in the Program.

According to the Department, it will continue to review all expenditures, but plans to develop a process for prioritizing the review of higher-risk expenditures. This approach is consistent with best practices for government grant and regulatory programs and should allow department staff to timely review those expense reports and/or specific expenditures that are at higher risk for misspending. For example, the United States Government Accountability Office (GAO), the National State Auditors Association, and the National Grants Management Association recommend using a risk-based approach for compliance reviews and fraud detection in government programs.[1]

Therefore, the Department should continue to develop and implement a risk-based approach for prioritizing its spending reviews, including associated policies and procedures, by:

- Establishing standard criteria or factors for assessing the risk of misspending for program scholarship bank accounts and expenditures. These criteria or factors could include the dollar amount of purchases, the type of merchant where the purchase occurred, and the spending history of the parent associated with the program scholarship bank account. For example, a payment to an established private school could be considered lower-risk than a purchase from a merchant that sells educational as well as noneducational merchandise;

- Using the established risk assessment criteria or factors to assess the misspending risk associated with program scholarship bank accounts and expenditures. Specifically, the Department should use the criteria or factors to identify certain program scholarship bank accounts, purchases, or merchants that are a higher risk for misspending and prioritize them for more timely review. For example, a program scholarship bank account with a large number of purchases or several large purchases within a short period of time could be considered a higher risk. Additionally, the Department should use the reports generated by an electronic, online system provided by the bank when assessing this risk. For example, the Department could compare parents' expense reports to the bank's system reports to identify program scholarship bank accounts and parents' expense reports that do not reconcile, which could be considered a

1 Santonastasso, M., Rissi, E., & Austin, M. (2009). Implementing a risk-based strategy for monitoring federal award portfolios. *Journal of the National Grants Management Association,* 17(1), 4-24; National State Auditor's Association (2014). *Carrying out a state regulatory program.* Lexington, KY; and United States Government Accountability Office (2015). *A framework for managing fraud risks in federal programs.* Washington, D.C.

high risk. See next bullet for more information on the bank's system and the reports it can generate; and

- Developing and implementing time frames for reviewing high-risk and other program scholarship bank accounts and expenditures based on their priority.

- **Use transaction reports to more frequently and systematically monitor spending**—As previously mentioned, the bank has provided the Department with access to an electronic, online system that can generate transaction reports for program scholarship bank accounts. For example, the system can generate a report that lists all approved and denied transactions, including attempted cash withdrawals, for all program scholarship bank accounts that have occurred over a specific time period, such as on a specific day or over the span of a week or month. As a result, analysis of these reports could allow department staff to identify unusual spending patterns and parents who have made multiple attempts to misspend program monies. During the course of the audit, although some department staff had access to the system, according to department staff, one staff person used the system to perform misspending investigations while its other staff did not use the system.

As of June 2016, the Department had developed draft policies and procedures that include guidance for conducting spending reviews. These draft policies and procedures include a policy indicating that staff should monitor parents' purchases for indicators of fraud or misspending, such as attempts to withdraw cash and denied transactions at merchants with unapproved MCCs (see textbox for an example of a parent who misspent after initial misspending attempts were denied). The bank's electronic, online system can generate reports that would allow department staff to perform this and other types of monitoring. In addition, as previously discussed, department staff could use the transaction reports as part of a risk-based prioritization approach for spending reviews.

Therefore, the Department should complete and implement its draft policies and procedures for conducting spending reviews, and incorporate policies and procedures for using the bank's electronic, online system functionality to more frequently and systematically monitor program spending. These policies and procedures should provide guidance for generating and reviewing various types of transaction reports to identify

Example of misspending that occurred after initial attempts were unsuccessful

In August 2015, using a program debit card, a parent attempted to withdraw cash four times and attempted several transactions at grocery and drug stores in one day. Although the bank denied these transactions, 6 days later, the parent used a program debit card to pay more than $500 to what appeared to be a tutor through a PayPal account, which bank records indicate was located in California.[1] In October 2015, the parent used a program debit card to make another payment of more than $700 to this same PayPal account. Department staff identified these purchases as misspending later in October after the parent did not submit the required quarterly expense report. Department staff reported that as of March 2016, the parent had not responded to the Department's requests for additional information regarding these purchases.

[1] PayPal, Inc. is a company that provides electronic, online money transfers that serve as alternatives to traditional payment methods such as checks and money orders (see pages 22 through 23 for more information on PayPal transactions).

Source: Auditor General staff analysis of program scholarship bank account transaction data from August 2015 through October 2015 provided by the Treasurer's Office.

misspending or attempted misspending, including attempted cash withdrawals; and time frames for how frequently department staff should create and review these reports.

In addition, the Department should provide all appropriate department staff with access to the bank's electronic, online system and work with the bank to provide training for appropriate department staff on how to generate and use the various transaction reports. Further, because the bank's electronic, online system allows a user to download the reports as electronic files that can be transferred into a spreadsheet program or database for review and analysis, the Department should work with its Information Technology division to develop a procedure for staff to input the various transaction reports into a spreadsheet or the Program's database for review and analysis.

- **Review public school enrollment before distributing program awards—**Although the Department reported that its staff periodically review public school enrollment status for children enrolled in the Program, it does not have a policy or procedure requiring staff to review children's public school enrollment before distributing program awards. Specifically, between August 2015 and January 2016, department staff identified 74 children enrolled in the Program who were also enrolled in a public school in violation of statute and the program agreement. Although the Department took steps to remove these children from the Program after it determined they were enrolled in public school, department records did not indicate whether its staff reviewed 70 of these children's public school enrollment status before distributing program award monies. Additionally, auditors' review of program scholarship bank account transaction data provided by the Treasurer's Office found that the Department distributed program award monies to 4 of the 74 children after department staff had identified the children were enrolled in public school. As a result, program monies were at risk for misspending by parents whose children were or may have been enrolled in public school. For example, parents of 25 of these 74 children spent program monies while their children were enrolled in public school.

  To enhance its processes in this area, the Department should develop and implement policies and procedures that require its staff to review public school enrollment data before each quarterly distribution of program monies. According to department staff, conducting this review may be a time-consuming process because each child must be manually checked against department enrollment data. Therefore, to improve the timeliness of these reviews, the Department should work with its Information Technology division to determine if it can automate the review of public school enrollment data for children in the Program.

- **Implement fraud reporting mechanisms—**The Department should implement fraud reporting mechanisms such as a fraud reporting hotline, a dedicated e-mail address for reporting fraud, or a fraud reporting mechanism on the Department's Web site. GAO indicates that government programs with the potential for fraud should use multiple fraud reporting mechanisms to increase the likelihood that individuals external to the agency will report potential fraud.[1] In addition, GAO indicates that these mechanisms can deter individuals from engaging in fraudulent behavior by increasing the likelihood that they

1 U.S. GAO, 2015.

will be discovered. The Department has previously discovered misspending with assistance from members of the public. For example, in November 2011, two parents with children enrolled in the Program collectively purchased more than $3,600 of books and curriculum from a bookstore using program debit cards, then returned the items for store gift cards. The parents then used the store gift cards to purchase noneducational items, including a snow globe, a World of Warcraft™ calendar, a sock monkey, and The Walking Dead™ board game. The bookstore notified the Department of the suspicious purchasing behavior, which the Department would not have been able to detect through its review of quarterly expense reports. The Department eventually removed the parents from the Program and referred them to the Attorney General's Office for a fraud investigation.

Department should strengthen its enforcement and recovery efforts—Although the Department has taken enforcement actions against parents who have misspent program monies and it has attempted to recover the misspent monies identified, it should continue to enhance its efforts in this area. Best practices for managing government programs indicate that responding promptly and consistently to fraud and misuse of monies serves to deter others from engaging in similar behavior, and reduces the likelihood that offenders will be able to commit similar acts in the future.[1] In addition, guidance from the Attorney General's Office indicates that agencies should refer cases of uncollectible debt to it in a timely manner to increase the likelihood of collections. However, the Department's enforcement and recovery actions have not always been consistent or timely. Specifically, the Department has:

- Allowed some parents to repay misspent funds and remain in the Program, but has removed other parents from the Program for misspending. These determinations have been based on department staff's judgment rather than an established policy;

- Not taken action against parents who attempted to misspend but were unsuccessful. For example, bank records indicated that, as of August 2015, approximately 150 children whose parents attempted to withdraw cash from program scholarship bank accounts remained in the Program;

- Not consistently forwarded parents who misspent program monies to the Attorney General's Office for fraud investigations or collections in a timely manner. Specifically, the Department identified several parents who misspent program monies between August 2015 and January 2016, including 35 children's parents who misspent more than $1,000 each. However, although most of these parents had not repaid the misspent monies as of January 2016, as of March 2016, the Department had not forwarded these parents to the Attorney General's Office for fraud investigations or collections. According to the Department, it had yet to send these cases to the Attorney General's Office because the department staff person responsible for this activity was out of the office on extended leave; and

- Recovered only a portion of the misspent monies it has identified. Specifically, as of January 2016, the Department had recovered approximately $14,500 of the $102,602 identified by department staff as misspent between August 2015 and January 2016 (see Table 2 on page 14 for additional information). In addition, Attorney General's Office records indicate that, as of March 2016, the Department had referred approximately $10,000 to the Attorney General's

1 U.S. GAO, 2015.

Office for collections but that these referrals have resulted in repayment of approximately $230.

To help ensure it takes timely and consistent enforcement action, as of June 2016, the Department had developed draft policies and procedures to guide its enforcement actions. These draft policies and procedures include guidance on when to suspend program scholarship bank accounts for suspected, attempted, or actual misspending, including attempted cash withdrawals, when to allow parents to repay misspent monies and remain in the Program, and when to remove parents for not repaying misspent monies. The Department should complete and implement its draft enforcement policies and procedures and incorporate guidance and instructions for:

- Determining when to remove parents from the Program for repeated attempts to misspend, such as attempts to withdraw cash from a program scholarship bank account;
- Completing investigations of suspected misspending and fraud; and
- Determining when to refer parents to the Attorney General's Office for fraud investigations or collections.

Department should take steps to improve administration and oversight of program spending—The Department should take other steps to improve its overall administration and oversight of program spending. Specifically, the Department should:

- **Improve internal controls to reduce the risk of loss or misuse of program monies—** The Department should develop and implement some additional policies and procedures to help further reduce the risk of loss or misuse of program monies. Specifically, during the course of the audit, the Department lacked several internal controls that the *State of Arizona Accounting Manual* requires and that are important for reducing the risk of loss or theft of program monies. Although auditors did not identify any instances of loss or theft, the Department should develop and implement policies and procedures for:
    - *Separating employee responsibilities*[1]—When a parent submits an application to enroll a child in the Program, the Department assigns the responsibility for that child's "case" to an employee, after which time that employee is responsible for determining the child's program eligibility, calculating the child's program award amount, and reviewing all spending from that child's program scholarship bank account. As a result, each employee that administers and oversees program scholarship bank accounts has responsibility for overseeing all aspects of those accounts, including spending. Without supervisory or other independent review, this process increases the risk that errors, fraud, or abuse could go undetected. As of June 2016, the Department reported that it did not plan to change employee responsibilities for overseeing the various aspects of children's participation in the Program. Conversely, it has implemented a supervisory review and approval process for department staff's program eligibility decisions and program award calculations as part of its development and implementation of a new

[1] For more information on the importance of adequate separation of responsibilities to help prevent fraud, see the Office of the Auditor General's Fraud Prevention Alert No. 14-402.

information technology system (see Finding 2, pages 34 through 35, for more information on the Department's new information technology system). However, it was still developing a similar process for spending reviews. Therefore, the Department should continue with the implementation of its supervisory review and approval process, including developing and implementing associated policies and procedures, and develop and implement policies and procedures that require supervisory review of department staff's determinations that a parent's program spending was appropriate.

- *Handling repayment of misspent monies*—According to department staff, one department employee is responsible for opening all program-specific mail, including mail that includes repayment checks from parents who have agreed to repay misspent monies, without having a second employee present to verify the receipt of any repaid monies. In addition, the employee does not restrictively endorse the checks upon receipt to reduce the risk that unauthorized persons could cash the checks. As a result, monies received through the mail are at risk for loss or theft. In addition, another employee is responsible for handling most of the repayment process, including logging all repayment checks, crediting the repaid monies, preparing the bank deposit, and reconciling the accounting of repaid monies. As a result, this employee has almost complete control over the repayment process without independent or supervisory review, increasing the risk of loss or theft of repaid monies. As of June 2016, the Department reported that it was in the process of developing and implementing policies and procedures for the proper handling of repaid monies, including requirements that two employees be present when opening mail that may contain payments, that checks are restrictively endorsed upon receipt, and other steps to help ensure that no one person has control over multiple aspects of the repayment process. Therefore, it should complete and implement these policies and procedures.

- **Continue to work with the Treasurer's Office and the bank to strengthen program debit card controls—**To more effectively and efficiently prevent and identify misspending, the Department should continue to work with the Treasurer's Office and the bank to strengthen the program debit card controls the bank provides. Specifically, although the bank denies purchases at merchants with MCCs that the Department has not approved, and the Department can suspend program scholarship bank accounts while it is investigating potential misspending, some parents have been able to circumvent these controls. For example, according to department staff, in August 2015, a parent successfully used a program debit card to spend more than $300 at a grocery store and $178 to pay a telecommunications company. The Department reported that it has worked with the Treasurer's Office and the bank to add additional controls to prevent these instances from reoccurring. However, as of April 2016, this issue had not been resolved. Therefore, the Department should continue to work with the bank and the Treasurer's Office to help prevent parents from circumventing program debit card controls.

  In addition, because the Department believes that attempted cash withdrawals are often a predictor of future misspending, in December 2015, it requested that the bank automatically suspend the program debit cards of parents who attempt to withdraw cash from program scholarship bank accounts. At that time, the bank reported that it could not provide this service. The Department should continue to work with the bank and the Treasurer's Office to suspend the program debit cards of parents who attempt to withdraw cash from program scholarship bank accounts.

Finally, once the Department completes and implements its policies and procedures in the areas recommended, it should provide training to all department staff responsible for implementing the policies and procedures. Additionally, the Department should ensure that any changes to policies and procedures are reflected in the program agreement and the parent handbook, as applicable, and it should take steps to notify parents of any changes to policies or procedures that are relevant to their participation in the Program.

Legislature should consider forming a work group to study options for further safeguarding program monies

The Legislature should consider establishing a work group to determine if statutory changes are needed to further ensure appropriate spending of program monies. Specifically, auditors identified three issues that may place program monies at risk for loss and abuse. These three areas are as follows:

- **Third-party payment services frequently used by parents may increase fraud risks—** The Department has allowed parents to use program debit cards to make payments using two third-party payment services, PayPal and Square.[1] According to the Department, it has allowed parents to use PayPal and Square for transactions because some merchants that provide statutorily allowed services, such as tutors, teaching assistants, and private schools, use PayPal and Square to accept payments. In fiscal year 2015, PayPal and Square payments totaled more than $3 million of the approximately $15 million spent with program debit cards. Although the Department reported that it had authorized program debit cards to be used for PayPal and Square payments for tutors, teaching assistants, and private schools, it has also allowed these PayPal and Square payments for other merchants. For example, in fiscal year 2015, parents used these payment mechanisms to pay medical service providers and an online retail store using program debit cards.

  However, PayPal and Square transactions may be at increased risk for fraud, theft, and misspending. Specifically, department staff have identified several instances where they believe this type of misspending has occurred. For example, as previously discussed, in August and October 2015, a parent used a program debit card to pay more than $1,200 to a PayPal account registered to a merchant who appeared to be a tutor (see textbox on page 17). In another instance, in August 2015, a parent used a program debit card to pay approximately $3,500 to a PayPal account with an account name that did not indicate the type of merchant or purpose of the transaction. In both cases, the parents did not submit an expense report or documentation to demonstrate the appropriateness of the transactions, and department staff reported that, as of March 2016, the parents had not responded to requests for additional information. Additionally, any individual who is willing to submit tax

[1] As previously discussed (see page 17), PayPal, Inc. is a company operating electronic, online money transfers. Using PayPal, parents can transfer money to anyone with a PayPal account using a program debit card. Square, Inc. is company that allows individuals and merchants to accept debit and credit card payments using hardware attached to mobile phone or a tablet computer.

identification information, such as a social security number or an employer identification number, and bank account information, can create a Square account or PayPal business account.

To help prevent or address misspending associated with program debit card purchases made using PayPal and Square, additional methods for handling these purchases may need to be considered. For example, a pre-approval process could help better protect program monies by ensuring the appropriateness of PayPal and Square purchases before they are made. In addition, a pre-approval process would allow department staff to quickly identify and address program debit card purchases made using PayPal and Square that are potentially inappropriate because they have not been pre-approved. Alternatively, other states with similar programs use a reimbursement method to help ensure appropriate spending (see Appendix A, page a-4, for more information on payment models used by other states with similar programs). However, statutory changes would be required to pursue either of these methods because A.R.S. §15-2403(B) only authorizes the Department to review parents' spending after it has occurred and does not authorize the Department to establish a pre-approval or reimbursement process for purchases made with program monies.

- **Parents with enrolled children may be benefiting financially from program monies—**A.R.S. §15-2402(H) states that a provider of services paid with program monies may not share, refund, or rebate any program monies with the parent or the enrolled child in any manner. However, although not specifically prohibited by statute, auditors identified a few parents with children enrolled in the Program who may have benefited financially from program monies. For example, a few parents with children enrolled in the Program operated private schools and made payments from their children's program scholarship bank accounts for tuition or fees to the schools they operated. Some of these parents also received program monies paid as tuition or fees from other parents with children enrolled in the Program. As a result, the parents may have received a financial benefit from program monies. For example, one parent with a child enrolled in the Program operated a private school and, as of August 2014, when this parent's child stopped participating in the Program, the school had received a total of more than $330,000 in program monies paid as tuition and/or fees. This amount included more than $37,000 from the parent who operated the school. During the audit, auditors identified at least two other schools operated by parents with enrolled children that received program monies in a similar way. Although these schools comply with the statutory definition of a qualified private school for the purposes of the Program, it is unclear whether the language in A.R.S. §15-2402(H) was intended to allow parents to benefit financially from program monies.

- **Children who have received an STO scholarship may be difficult to identify—**As previously discussed (see page 12), a child enrolled in the Program cannot accept a scholarship from an STO. Although the Department has been able to identify some parents who spent program monies and also accepted an STO scholarship, the Department does not have the authority to compel private schools or STOs to provide information on children receiving STO scholarships. Department staff reported that it had identified these instances only because the parents submitted private school invoices for program spending that also listed STO scholarship payments.[1] However, the Department would typically not have access to the information it would need to determine whether children enrolled in the Program are also receiving STO scholarships.

1 In these instances, the Department subsequently removed the children and parents from the Program and sought repayment of any misspent monies.

Statutory changes in these three areas may help to further ensure the appropriate spending of program monies. Therefore, the Legislature should consider establishing a work group to study and propose options for addressing purchases made using PayPal or Square, determining whether parents should be able to benefit financially from program monies, and identifying children who are enrolled in the Program, but also receive STO scholarships. Work group members should include appropriate stakeholders, such as legislators, parents with children enrolled in the Program, and representatives from the Department, the Treasurer's Office, and other stakeholder groups.

Recommendations:

1.1. The Department should continue to develop and implement a risk-based approach for prioritizing its spending reviews, including associated policies and procedures, by establishing standard criteria or factors for assessing the risk of misspending for program scholarship bank accounts and expenditures, using the established risk assessment criteria or factors to assess misspending risk, and developing and implementing time frames for reviewing high-risk and other program scholarship bank accounts and expenditures based on their priority.

1.2. The Department should complete and implement its draft policies and procedures for conducting spending reviews, and incorporate policies and procedures for using the bank's electronic, online system functionality to more frequently and systematically monitor program spending. These policies and procedures should provide guidance for generating and reviewing various types of transaction reports to identify misspending or attempted misspending, including attempted cash withdrawals; and time frames for how frequently department staff should create and review these reports.

1.3. The Department should provide all appropriate department staff with access to the bank's electronic, online system, work with the bank to provide training for appropriate department staff on how to generate and use the various transaction reports, and work with its Information Technology division to develop a procedure for staff to input the various transaction reports into a spreadsheet or the Program's database for review and analysis.

1.4. The Department should develop and implement policies and procedures that require its staff to review public school enrollment data before each quarterly distribution of program monies, and work with its Information Technology division to determine if it can automate the review of public school enrollment data for children in the Program.

1.5. The Department should implement fraud reporting mechanisms such as a fraud reporting hotline, a dedicated e-mail address for reporting fraud, or a fraud reporting mechanism on the Department's Web site.

1.6. The Department should complete and implement its draft enforcement policies and procedures, and incorporate guidance and instructions for determining when to remove parents from the Program for repeated attempts to misspend, such as attempts to withdraw cash from a program scholarship bank account; completing investigations of suspected misspending and fraud; and determining when to refer parents to the Attorney General's Office for fraud investigations or collections.

1.7. The Department should continue with the implementation of its supervisory review and approval process, including developing and implementing associated policies and procedures, and develop and implement policies and procedures that require supervisory review of department staff's determinations that a parent's program spending was appropriate.

1.8. The Department should complete and implement policies and procedures for the proper handling of repaid monies, including requirements that two employees be present when opening mail that may contain payments, that checks are restrictively endorsed upon receipt, and other steps to help ensure that no one person has control over multiple aspects of the repayment process.

1.9. The Department should continue to work with the bank and the Treasurer's Office to help prevent parents from circumventing program debit card controls, and to suspend the program debit cards of parents who attempt to withdraw cash from a program scholarship bank account.

1.10. Once the Department completes and implements its policies and procedures in the areas recommended, it should provide training to all department staff responsible for implementing the policies and procedures. Additionally, the Department should ensure that any changes to policies and procedures are reflected in the program agreement and the parent handbook, as applicable, and it should take steps to notify parents of any changes to policies or procedures that are relevant to their participation in the Program.

1.11. The Legislature should consider establishing a work group to study and propose options for addressing purchases made using PayPal or Square, determining whether parents should be able to benefit financially from program monies, and identifying children who are enrolled in the Program, but also receive STO scholarships. Work group members should include appropriate stakeholders, such as legislators, parents with children enrolled in the Program, and representatives from the Department, the Treasurer's Office, and other stakeholder groups.

FINDING 2

Department should continue its efforts to improve its eligibility determination process, appropriately safeguard sensitive information, and better manage program information

The Arizona Department of Education (Department) should strengthen its operation of various aspects of the Empowerment Scholarship Accounts Program (Program). Specifically, the Department should continue with its efforts to develop and implement various written policies and procedures and complete the expansion of its new information technology (IT) system to address the following three issues:

- First, the Department's eligibility determination process has not consistently ensured that all program eligibility and award decisions were appropriately made;
- Second, the Department has not adequately safeguarded sensitive information by securing paper files and limiting access to electronic information; and
- Third, the Department has not consistently managed program data in a way that facilitates the analysis and accurate reporting of this information.

Program operations need improvement in three areas

The Department's operation of the Program should be improved in three areas. First, the Department's processes for determining program eligibility have not consistently ensured that all program eligibility and program award decisions are correct and consistent. Second, it has not adequately protected sensitive information submitted by program applicants. Third, its program data has been inaccurate and incomplete, hindering its ability to use this data to help manage the Program and accurately report on program results.

Department processes for determining eligibility and program award amounts have not ensured the accuracy and consistency of these decisions—The Department is responsible for determining whether children are eligible to enroll in the Program and the amount of program award monies they may receive if eligible. To make this determination, the Department relies on application forms and supporting documents submitted by parents or legal guardians (parents) to determine whether the child is eligible under one of the categories listed in Arizona Revised Statutes (A.R.S.) §15-2401 (see Introduction, page 2, for a description of the statutory provisions for program eligibility). In addition, department staff review student attendance reports to verify that the child attended a public school district or public charter school (public school) during the first 100 days of the prior school year, unless the child is exempt from this requirement.[1] Once eligibility is established, department staff calculate the child's program award amount based on a statutory formula that provides a portion of the state education monies that would have otherwise been allocated to the public school the child last attended, or would have attended in the case of a child who is eligible to attend kindergarten (see Introduction, page 5, for more information on program award amounts).

However, the Department's program files lacked sufficient documentation to support the appropriateness and consistency of its eligibility

[1] As discussed in the Introduction (see page 2), A.R.S. §15-2401 requires most children to attend a public school for the first 100 days of the prior fiscal year, unless the child meets other eligibility criteria, such as being an incoming kindergartner.

and program award determination decisions for the applications auditors reviewed. Specifically, to assess the Department's process for determining program eligibility, auditors reviewed a random sample of 20 program applications for children who were accepted into the Program in fiscal years 2012 through 2016 (see Appendix C, page c-2, for more information on the methodology for selecting the applications).[1] The 20 applications reviewed included:

- 13 children identified as having a disability;
- 2 children of parents who were members of the U.S. armed forces;
- 2 children from schools assigned a D or F letter grade;[2]
- 2 children who were residents of an Indian reservation; and
- 1 foster child.

Auditors found that 11 of 20 eligibility determinations were appropriate, based on a review of available documentation. However, the other 9 application files lacked sufficient documentation to demonstrate that the eligibility determination decisions were appropriate. Further, for 2 of the 20 cases reviewed, department staff inconsistently determined the program award amount. Specifically, auditors identified the following:

- **Qualifications to receive additional program award monies not always verified—** The Department's process for determining whether children qualify for higher program awards based on disabilities has not consistently ensured that documentation submitted to demonstrate the nature of disabilities is accurate, thus increasing the risk for providing larger program awards than allowed by statute for some children. Specifically, children identified as having disabilities receive higher program awards based on the nature of the identified disabilities (see Introduction, page 5, for more information on how children's disabilities impact program award amounts).[3] The Department requires parents applying for the Program based on a child's disability to submit documentation demonstrating that a public school district has identified the child as having a disability. However, auditors' review of program applications found that the Department has not consistently verified the accuracy of this disability documentation. Specifically, 13 of the 20 applications auditors reviewed were for children identified as having a disability, and 6 of these applications lacked evidence that department staff had taken steps to verify the accuracy of the disability documentation submitted by parents, as follows:
    - One application was for a child who had previously attended public school and, as a result, department staff could have verified the nature of the child's disability using an

1 Auditors also reviewed a random sample of program applications for children who were not accepted into the Program between fiscal years 2012 through 2016. For all 16 applications reviewed, auditors found that the Department's determinations to deny the application were appropriate.

2 A.R.S. §15-241 requires the Department to assign A through D or F letter grades to public schools based on information such as each school's state-wide standardized test scores, dropout rates, and graduation rates.

3 According to auditors' analysis of department records, fiscal year 2016 award amounts were estimated to range from approximately $2,900 for a nondisabled student to $31,500 for a student with multiple disabilities.

internal department report.[1] However, the file for this application did not include a copy of the report or a notation from department staff that the disability documentation had been verified with the department report.

- One application was for a child who had previously attended public school, and the file for this application included a copy of an internal department report to verify the nature of the disability. However, the disability documentation submitted by the parent listed a different disability than the internal department report, and the file indicated that department staff had relied on the documentation submitted by the parent without taking any other steps to reconcile the discrepancy, such as contacting the public school district. Department staff reported that if they discover a discrepancy in the nature of the child's disability between the Department's internal report and the documentation submitted by the parent, they have been instructed to rely on the information submitted by the parent because it may be more up-to-date.

- Four applications were for a child who had not previously attended a public school or for children who had previously attended public school preschool. Although the parents of these children submitted documentation demonstrating that a public school district had identified the children as having a disability, because the children had not previously attended a public school or previously attended public school preschool, they would not have been included in the internal department report.[2] Department staff could have taken other steps to verify the nature of the child's disability, including contacting the public school district that identified these children's disabilities. However, these applications did not include any evidence that department staff had taken any steps to verify the nature of the child's disabilities. Conversely, in April 2016, a department staff member contacted a public school district to verify the disability documentation submitted by a parent because he believed the documentation may have been falsified. The school district subsequently provided the Department with disability documentation that listed different disabilities for this parent's two children than those submitted by the parent. As a result, the Department began investigating the parent for allegedly submitting falsified documentation. According to department records, this parent's children were awarded more than $24,000 in additional program award monies in fiscal year 2016 based on the potentially falsified documentation.[3]

- **Prior public school attendance and school ratings verification not documented**—Department staff did not consistently document verification of other information required for determining a child's program eligibility. First, the Department did not document its review of children's enrollment in a public school for the first 100 days of the prior school year for 3 of the 20 applications reviewed. Specifically, these 3 application files did not include attendance reports demonstrating that the child had been enrolled in a public school for 100 days.[4]

1 Department staff have the ability to review an internal department report that provides information about the nature of children's disabilities as reported by public schools.

2 One child had not previously attended a public school, and the internal department report lists only children who have previously attended a public school. Although the other three children had previously attended public school preschool, according to department staff, the internal department report does not always include information on preschool students and these three students were not included in the report.

3 Department staff identified the potentially falsified documentation when the parent applied to re-enroll her children in the Program for fiscal year 2017.

4 Of the 20 applications reviewed, only 13 were for children who would have needed to be in public school for 100 days. The remaining children did not need to meet the 100-day requirement because they met other eligibility criteria, such as being an incoming kindergartner.

Auditors later obtained documentation to confirm that the three children had been in public school for 100 days. However, absent this documentation, there was no assurance that department staff had confirmed required public school attendance. Second, 2 of the 20 applications were for children who attended a school that was assigned a D or F letter grade, but the application files did not contain documentation that department staff had confirmed that the school had been assigned a D or F grade. Although auditors were also able to later obtain this documentation, the application files did not indicate that department staff had checked the school letter grades before making the eligibility determination.

- **Program award amounts inconsistently determined—**Department staff inconsistently determined program award amounts in some instances. As discussed in the Introduction (see page 8), program award amounts are based on the monies an enrolled child's prior public school would have been provided for that child to pay for general operations and maintenance. As a result, department staff must identify a child's prior public school when determining a program award amount. For 2 of the 20 applications auditors reviewed, department staff determined the child's initial program award amount using one public school, but in subsequent years used a different public school. Specifically:

  - For one application, the child had attended two public schools during the fiscal year prior to program enrollment. Department staff initially determined the child's program award amount by selecting the public school the child last attended during the fiscal year prior to program enrollment. However, for the child's third year in the Program, department staff used the public school the child had first attended during the fiscal year prior to program enrollment to determine the child's program award.[1,2]

  - For the second application, department staff initially determined the child's program award amount by selecting a public school that was not correct based on the program application submitted by the parent and a public school attendance report. Two years later, when processing the parent's application to renew the child's enrollment in the Program, department staff identified and corrected the error and the resulting program award amount.

As a result of these problems, the Department may be providing program monies to children who are not eligible for the Program and/or determining incorrect program award amounts. Specifically, without sufficiently verifying eligibility documents, documenting that eligibility requirements are met, and consistently determining program award amounts, the Department is at risk for inappropriately approving applicants for program eligibility and/or awarding them inaccurate amounts.

Sensitive and confidential information about children and families may be at risk—In order to determine program eligibility, the Department collects sensitive information about children and parents, such as medical information, military orders, and court

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1 Statute does not specify how the Department should determine a child's prior public school

2 Auditors were unable to determine the difference between the program award amount received and the program award amount that might have been received if a different school had been selected because the Department could not provide the documentation for calculating the program award amounts in the previous years.

documents. In addition, the Department gathers other personally identifiable information, such as names, addresses, and Social Security numbers. Further, department staff have access to electronic banking data related to program scholarship bank accounts, including bank account numbers. If such information is not secured and access to the information appropriately restricted, children's and families' information can be inappropriately accessed, stolen, or misused. However, the Department has not taken adequate steps to protect this information. Specifically:

- **Paper files were unsecured—**Auditors observed several ways in which paper files containing personally identifiable information were at risk. First, unsecured bank boxes containing files of children and parents formerly in the Program were stacked in a hallway on the first floor of an office building allowing department employees who do not work in the Program access to this information. Second, although department cabinets and offices storing sensitive information have locks, some cabinets and offices were not locked overnight. Further, during working hours, some files containing personally identifiable information were left on desks in offices and cubicles and on open shelves while department staff were away. Although these locations were not accessible to the general public, guests or department staff who do not work in the Program could access this information.

- **Electronic banking data system lacked important access controls—**Access to banking system information should be limited to department staff who require it to perform their job duties (see Introduction, pages 5 through 6, for more information about bank services provided to the Program). However, the Department did not terminate a former staff person's access to the system, and the former staff person could have continued to use her login credentials until March 2016, 5 months after leaving the Department, when auditors identified that she still had access. As a result, during these 5 months, the former staff person had the ability to make unauthorized changes in the banking system, such as unsuspending program scholarship bank accounts that had been suspended for suspected misspending or fraud, and accessing sensitive account information, including bank routing and account numbers, which could be used to commit identity theft or to steal monies from program scholarship bank accountholders. Additionally, the Department had not obtained bank system access for the new department staff person who became responsible for using the system, and the department reported that when that staff person needed access to bank system information, he used the former staff person's account access credentials. As a result, the bank and the Department would have potentially been unable to detect any unauthorized access to the system by the former employee.

Department has not consistently managed program data for its use or for reporting purposes—To help manage the Program, department staff have developed program databases as repositories for program information, such as applications, eligibility documentation, program award amounts, and spending information. Between fiscal years 2012 and 2016, the Department developed several electronic databases to store program information. However, although the Department began using a new IT system in January 2016 (see pages 34 through 35 for more information on the new IT system), it has not historically been able to rely on its other databases or systems to provide complete and accurate information when generating required reports for department management, answering questions from the Legislature and other stakeholders, and administering and overseeing the Program. Specifically, auditors' review of the database department staff used (program database) to store applicant information, program award amounts, and spending information as of November 2015 found that:

- **Some applicants were missing from program database—**Some applicants who were denied eligibility or were approved for the Program were missing from the program database. Specifically, the program database did not include records for 3 applicants out of a random sample of 30 applications of children who were denied eligibility between fiscal years 2012 through 2016. Further, the program database did not include records for the parents of 13 children who received program monies between October 2011 and August 2015.[1] Without complete information in its program database, reports about applicants and participants may be incomplete, and department staff may not be overseeing the spending of all parents who receive program monies.

- **Spending records incomplete—**The program database lacked two types of spending information. First, according to department staff, when a child's program scholarship bank account has been closed or terminated, the Department's practice was to delete the historical spending records from the program database.[2] Second, department staff generally recorded only parents' self-reported program spending information in the program database as reported on parents' expense reports. The Department did not generally include in its program database the actual amounts shown on program scholarship bank account statements. As a result, the program database is missing information about some parents' spending that could be used for program oversight and reporting, such as analyzing and overseeing parents' spending and reporting on how parents have historically spent program monies.

- **Some data inconsistent or inaccurate—**The program database lacks consistent descriptions for the same information. For example, as of November 2015, the program database included eight different terms for describing PayPal fees paid with program debit cards.[3] As a result, department staff cannot easily analyze this type of information, such as parents' spending patterns using PayPal or possible inappropriate spending, or create useful reports. In addition, the program database contains some inaccurate information about parents' spending. Specifically, in a review of expense report information from a random sample of 17 files of children enrolled in the program between fiscal years 2012 through 2016, auditors found three instances where department staff had not entered correct or complete information into the program database. For example, in one case, department staff misclassified monies paid to a tutor as private school tuition and, as a result, the database inaccurately represents the amounts of program monies spent for tutors and private schools.

The Department has also stored program information in multiple locations, which can cause potential inefficiencies and inaccuracies. Specifically, according to department management,

1 Auditors identified these 10 parents of 13 children by comparing the Department's database to program scholarship bank account transaction data from October 2011 through August 2015 provided by the Arizona Office of the State Treasurer.

2 The Department can close a child's program scholarship bank account for a variety of reasons, such as if the child graduates from high school, or if the parent re-enrolls the child in a public school or violates statutory requirements for spending program monies (see Finding 1, pages 11 through 15, for more information about spending violations).

3 PayPal, Inc. is a company that provides electronic, online money transfers that serve as alternatives to traditional payment methods such as checks and money orders. Through PayPal, individuals may transfer money to other individuals as well as businesses using checking accounts, debit cards, and credit cards.

between fiscal years 2012 and 2016, it used multiple different worksheets and databases to store program data. In addition, as of April 2016, department staff continued to use their own electronic spreadsheets to track program award funding and receipt of quarterly expense reports for the children's program scholarship bank accounts the staff are assigned to monitor (see Finding 1, page 13, for more information on staff reviews of quarterly expense reports). As a result, the Department must combine data from multiple sources to provide management reports that aggregate program information. However, combining data from across multiple electronic sources to provide reports may be time-consuming and may result in duplicated or omitted information.

These issues may limit the Department's ability to use data to manage the Program. For example, accurate and detailed information on parents' spending could help the Department perform various analyses and develop a risk-based approach for identifying parents' misspending and preventing future misspending, as discussed in Finding 1 (see pages 15 through 17). Additionally, accurate information about the dates that department staff have completed tasks such as eligibility and spending reviews could allow supervisors to oversee the timeliness of department staff's work.

Finally, these issues may make it difficult for department staff to readily provide accurate reports for policymakers and other stakeholders. For example, A.R.S. §15-802 requires the Department to provide a list of children participating in the Program to the school superintendent of the county where the children reside. However, the program database did not include the county in which each child resides. To comply with this requirement, department staff reported that they developed the report by combining information separately tracked by each staff person. In addition, complete and accurate data within its program database could be used to provide reports on how much program award money is spent on private school tuition, curriculum, and post-secondary education, and how many children in the Program are in each eligibility category. Instead, when the Department receives requests for this type of information, it has had to provide the information by manually combining multiple sources of data because, according to department staff, the database lacked some of the requested information.

According to the Department, it was aware of many of the issues auditors identified. However, during the audit, it reported that it was not actively working to address them because it was in the process of developing and implementing a new IT system that, in part, was intended to address these issues (see pages 34 through 35 for more information on the Department's new IT system).

Department should continue to strengthen various aspects of the Program

The Department should continue with the efforts it initiated during the audit to improve its eligibility determination process, appropriately safeguard sensitive information, and better manage program data. Specifically, the Department should complete the development and implementation of policies and procedures for its eligibility determination process and safeguarding sensitive information. Additionally, the Department is in the process of developing and implementing a new IT system that will help it better manage program data, and it should take steps to ensure this IT system addresses the data management issues auditors identified.

Department should complete development and implementation of policies and procedures—During the audit, the Department began to develop and implement policies and procedures for the eligibility determination process and for handling sensitive and personally identifiable information. The Department should complete its development and implementation of these policies and procedures, expand them where needed to fully address the issues identified in this finding, and provide training to appropriate staff on the policies and procedures. Specifically:

- **Eligibility determination policies and procedures—**As of June 2016, the Department had developed draft policies and procedures to guide its staff in making eligibility decisions. These draft policies and procedures include important guidance for making program eligibility determinations, including specifying the documentation that must be submitted and reviewed to demonstrate eligibility, requirements for supervisory review of the application, and steps for staff to follow when reviewing the application. These policies and procedures should also incorporate guidance for when and how department staff should verify children's disability qualifications and to help staff identify which school should be used to determine the program award amount.

- **Sensitive and personally identifiable information policies and procedures—**As of June 2016, the Department reported that it was developing policies and procedures to guide its staff in handling sensitive and personally identifiable information related to the Program. The Department should ensure that these policies and procedures require that only authorized personnel have physical access to paper files containing this information, that files should be securely stored in locked cabinets or offices while unattended, that only department staff who require banking system or department information technology system access to perform their job duties have system login credentials, and the prompt termination of former department staff credentials to limit access to sensitive information.

Department's new IT system addresses some data management issues but further steps are needed—In January 2016, the Department began using a new IT system that allows parents to submit program applications using an online, electronic portal on the Department's Web site. In addition, as of June 2016, the Department had added the following program functionalities to the new IT system:

- Allows department staff to review program applications and calculate program awards electronically;

- Requires supervisors to review and approve department staff's eligibility decisions and award calculations;

- Generates and sends standard emails to parents for program acceptance, program denial, and requests for additional information; and

- Stores program applicant information.

In addition, according to the Department, throughout the summer of 2016, it anticipates expanding this new IT system's functionality to include allowing parents to submit expense reports through an electronic, online portal on the Department's Web site, enabling department staff and supervisors to review expense reports electronically, storing all historical and future program data, and generating program reports. The Department estimated it will complete this expansion in September 2016. Further, the Department had begun drafting policies and procedures for using the new IT system.

The Department should complete the expansion of its new IT system to include the previously mentioned functionalities, and complete and implement its draft policies and procedures for using the new IT system. These policies and procedures should incorporate guidance and instruction for entering program data into the new IT system in a standard and accurate way; using information provided by the bank, such as program scholarship bank account statements; for recording spending information in addition to using parents' self-reported expense reports; accurately entering historical program data into the new IT system; and providing supervisory oversight to check and maintain data accuracy and completeness.

Finally, as of June 2016, the Department reported that it was working to develop a records retention schedule and policy for the Program. Therefore, it should complete and implement this records retention schedule and policy, and incorporate guidance for retaining electronic records of all applicants, including those whose eligibility is denied and those whose program scholarship bank accounts are closed or terminated.

Recommendations:

2.1. The Department should complete its development and implementation of policies and procedures for its eligibility determination process and safeguarding sensitive and personally identifiable information, expand them where needed to fully address the issues identified in this finding, and provide training to appropriate staff on the policies and procedures. These policies and procedures should also:

   a. Incorporate guidance for when and how department staff should verify children's disability qualifications and to help staff identify which school should be used to determine the program award amount; and

   b. Limit physical and electronic access to sensitive and personally identifiable information to only authorized personnel, require the secure storage of this information, and require the prompt termination of former department staff credentials.

2.2. The Department should complete the expansion of its new IT system to include the previously mentioned functionalities (see pages 34 and 35), and complete and implement its draft policies and procedures for using the new system. These policies and procedures should incorporate guidance and instruction for entering program data into the new IT system in a standard and accurate way; using information provided by the bank, such as program scholarship bank account statements, for recording spending information in addition to using parents' self-reported expense reports; accurately entering historical program data into the new IT system; and providing supervisory oversight to check and maintain data accuracy and completeness.

2.3. The Department should complete and implement a records retention schedule and policy for the Program, and incorporate guidance for retaining electronic records of all applicants, including those whose eligibility is denied and those whose program scholarship bank accounts are closed or terminated.

APPENDIX A

Established school choice programs

The Arizona Department of Education's (Department) Empowerment Scholarship Accounts Program (Program) is a school choice program similar to programs established in two other states as of April 2016: the Florida Personal Learning Scholarship Accounts and Mississippi's Education Scholarship Account.[1] Comparative information for Arizona and these two other state programs is presented in Table 3 on the following pages and includes the comparable information listed below:[2]

- Administration responsibilities (see page a-2);
- Administration budget, funding, and staffing (see page a-3);
- Student awards (see page a-3);
- Payment model (see page a-4);
- Allowable uses of monies (see pages a-4 through a-5); and
- Student demographics and assessment requirements (see page a-5).

1 As of July 1, 2016, the Florida Personal Learning Scholarship Accounts will become the Gardiner Scholarship.

2 Information provided in Table 3 is as of fiscal year 2015, unless otherwise indicated.

Table 3: Comparative information for Arizona and other state school choice programs As of fiscal year 2015

Administration responsibilities			
	Year established	Agency/agencies responsible for program administration	Responsibilities
Arizona	2011	Arizona Department of Education Arizona Office of the State Treasurer (Treasurer's Office)	The Department: • Determines program eligibility; • Calculates program award amount; • Reviews parents' spending; • Recovers misspent program award monies, which may include working with the Arizona Attorney General's Office; and • Removes parents who do not repay misspent award monies or who are no longer eligible for the Program. The Treasurer's Office disburses program monies to participants' program scholarship bank accounts.
Florida	2014	Nonprofit Scholarship Funding Organizations[1] Florida Department of Education	Nonprofit Scholarship Funding Organizations: • Establish accounts for eligible students; • Prepare and submit student quarterly expenditure reports to the Florida Department of Education; • Review account expenditures; and • Return any unused monies to the Florida Department of Education. The Florida Department of Education: • Maintains a list of approved service providers, such as occupational therapists, physical therapists, and language specialists; • Investigates complaints; • Reviews the quarterly expenditure reports; and • Verifies that participating students are not enrolled in public schools.
Mississippi	2015[2]	Mississippi Department of Education	The Mississippi Department of Education: • Determines program eligibility; • Conducts random audits of participants' accounts; and • Removes educational service providers that commit fraud.

Administration budget, funding, and staffing

	Administrative budget	Funding mechanism	Staffing
Arizona	In fiscal year 2015, the Department and the Treasurer's Office were appropriated $200,100 and $40,000 for program administration, respectively.	Statute allows the Department to retain up to 5 percent of the amount that would have been provided for an enrolled child to that child's prior school to pay for general operations and maintenance to administer the Program. The Department must transfer 1 percent of this amount to the Treasurer's Office for its administrative duties related to the Program. However, the monies retained by the Department and transferred to the Treasurer's Office are subject to legislative appropriation.	As of June 2016, 10 department staff administer the Program and, according to the Treasurer's Office, six Treasurer's Office staff spend a portion of their time administering the Program.
Florida	The Florida Department of Education reported that it does not have an administrative budget for this program. The two Nonprofit Scholarship Funding Organizations reported $1,489,000 in administrative expenses for fiscal year 2015.	The Florida program received a legislative appropriation of $18.4 million for program awards and administration in fiscal year 2015.	Four Florida Department of Education staff spend a portion of their time on administrative tasks.
Mississippi	For fiscal year 2016, the Mississippi Department of Education may deduct up to $180,000.	The Mississippi Department of Education may deduct up to 6 percent from appropriations used to fund participants' accounts to cover the costs of overseeing these accounts and administering the program.	The Mississippi Department of Education reported that, as of May 2016, four Mississippi Department of Education staff spend a portion of their time administering its program.

Student awards

	Total monies awarded	Range of awards per student	Average award
Arizona	$16,774,000	$3,031 - 31,000	$12,900
Florida	15,976,000	5,000 - 18,971	10,000
Mississippi	2,820,000	6,500[3]	6,500[3]

Payment model	
Arizona	Child's program award monies are deposited in a program scholarship bank account on a quarterly basis, which a parent can spend with a program debit card. Parents must submit quarterly expense reports and associated documentation to the Department demonstrating the nature of the purchases.
Florida	The Nonprofit Scholarship Funding Organizations reimburse parents for eligible purchases and directly pay eligible vendors and service providers for services provided for a student.
Mississippi	Awards are paid to a student's parent on a quarterly reimbursement basis after submission of a reimbursement request. Additionally, awards can be paid directly to an educational service provider if approved by a student's parent.

Allowable uses of monies	
Arizona	• Private schools, eligible postsecondary institutions, or nonpublic online learning programs; • Textbooks at a private school or eligible postsecondary institution; • Educational therapies or services from a licensed/accredited paraprofessional or educational aide; • Tutoring or teaching services provided by an individual or accredited facility; • Curriculum; • Standardized tests, advanced placement (AP), or any examinations for college/university admission; • Contributions to a Coverdell education savings account for the benefit of a qualified student; • Management of the program scholarship bank accounts; • Services provided by a public school, including individual classes or extracurricular programs;[4] and • Insurance or surety bond payments.
Florida	• Instructional materials; • Curriculum; • Specialized services by approved providers that are selected by the parent; • Eligible private schools or postsecondary institutions, private tutoring programs, approved virtual programs, the Florida Virtual School, or approved online courses; • Standardized tests, AP and industry certification examinations, assessments related to postsecondary education, or other assessments; and • Contributions to the Stanley G. Tate Prepaid College Program for the benefit of the eligible student.
Mississippi	• Eligible schools, online learning programs or courses, or postsecondary institutions; • Textbooks; • Tutors; • Curriculum including supplemental materials required by a curriculum; • Transportation to and from an educational service provider; • Standardized tests, AP examinations or similar courses, and examinations for college/university admission; • Educational services or therapies from a licensed or certified practitioner or provider;

Mississippi cont'd	• Services provided by a public school, including individual classes and extracurricular programs; • Surety bond payments if required by the Mississippi Department of Education; • No more than $50 in annual consumable school supplies; and • Computer hardware, software, and other technological devices if an eligible school or licensed professional verifies that these items are essential for the student to meet his/her goals.

Student demographics and assessment requirements

	Eligible students	Participation for fiscal year 2016	Student assessment requirement
Arizona	Arizona residents who are at least one of the following:[5] • Children identified as having a disability; • Children attending a public school that the Department has assigned a letter grade of D or F, or who are eligible to attend kindergarten at such a school; • Foster children and former foster children who have been adopted or placed with a permanent guardian; • Children of an active-duty member of the United States armed forces or children whose parent was killed in the line of duty while serving in the United States armed forces; • Children living on an Indian reservation in Arizona; and • Siblings of current or previous program participant.	2,212	None
Florida	Eligible students must be: • Florida residents; • 3-4 years of age on or before September 1 of the year in which the student applies for program participation, or is eligible to enroll in K-12 in a Florida public school; and • Students with a disability and an Individualized Education Program (IEP).[6]	1,609	Requires students attending private schools to take a standardized test. For students in home education programs, a parent can choose if a student participates in an assessment.
Mississippi	Eligible students must: • Have a parent, legal guardian, custodian, or person with authority to act on behalf of the student who is a Mississippi resident; and • Have received an active IEP within the past 18 months.	333[7]	None

[1] As of April 2016, two Nonprofit Scholarship Funding Organizations help the Florida Department of Education administer the program.

[2] The Mississippi Program is a 5-year pilot program that will terminate on June 30, 2020.

[3] For fiscal year 2016, each recipient in Mississippi's program received a $6,500 award.

[4] According to the Program's parent handbook, program awards may be used to pay for individual classes and fees for extracurricular programs provided by a public school, such as drama club, band, cheerleading, sports, art classes, music classes.

[5] Additionally, all children, except children of a member of the United States Armed Forces, must meet at least one of the following criteria to participate in the Program: have attended a public school full-time for at least the first 100 days of the fiscal year prior to the fiscal year the child would receive an ESA; be eligible to receive a scholarship for children with disabilities from a school tuition organization (STO); be eligible to enroll in a public school kindergarten; previously participated in the Program; or be eligible to enroll in a preschool for children with disabilities.

[6] 20 United States Code §1414(d)(2)(A) requires public schools to create an IEP for each student receiving special education services. IEPs are written statements that discuss a student's present levels of academic achievement and functional performance, measurable annual goals, and what special education and related services and aids should be provided to the student.

[7] According to Mississippi Department of Education staff, this number is as of March 31, 2016. Mississippi Code Annotated limited program enrollment to 500 students in school year 2015-2016, with new enrollment limited to a maximum of 500 additional students each year thereafter.

Source: Auditor General staff analysis of applicable program rules, laws, and statutes for Arizona, Florida, and Mississippi; review of the State of Arizona Appropriations Report for FY 2015, department documents, Florida Department of Education documents and Web site, Florida Nonprofit Scholarship Funding Organizations' financial statements and documents, and Mississippi Department of Education documents; interviews with Treasurer's Office staff, department staff, Florida Department of Education staff, Florida Nonprofit Scholarship Funding Organizations' staff, and Mississippi Department of Education staff; and analysis of unaudited department data and Florida Nonprofit Scholarship Funding Organization's data.

APPENDIX B Planned school choice programs

Auditors identified school choice programs in two other states that, as of April 2016, are not yet operational: the Nevada Education Savings Account (Nevada) and Tennessee's Individualized Education Accounts (Tennessee). Specifically, as of January 11, 2016, a court injunction has prevented implementation of the Nevada program and the Tennessee program will not begin providing awards until January 2017. Comparative information for these programs is presented in Table 4 on the following pages and includes the comparable information listed below:[1]

- Administration responsibilities (see page b-2);
- Administration budget, funding, and staffing (see page b-2);
- Estimated student awards (see page b-2);
- Payment model (see page b-3)
- Allowable uses of monies (see page b-3); and
- Student demographics and assessment requirements (see page b-4).

1 Information provided in Table 4 is as of fiscal year 2015, unless otherwise indicated.

Table 4: Comparative information for planned school choice programs As of fiscal year 2015

Administration responsibilities

	Year established	Agency/agencies responsible for program administration	Responsibilities
Nevada	2015	Office of the Nevada State Treasurer	If litigation is resolved in favor of this program, the Office of the Nevada State Treasurer will: • Manage applications for program participation; • Qualify financial management firms to maintain participant accounts; • Freeze or dissolve accounts if monies are misused; and • Conduct account audits.
Tennessee	2015	Tennessee Department of Education	The Tennessee Department of Education will:[1] • Remit monies to participants' accounts; • Establish application and participation timelines; and • Adopt policies necessary for program administration.

Administration budget, funding, and staffing

Nevada	Statute allows the Office of the Nevada State Treasurer to deduct no more than 3 percent of each participant's grant for administrative costs to operate the program. The Office of the Nevada State Treasurer reported that these deductions will be used to pay off a loan it received from that state's general fund for its program's administrative budget. Specifically, the Office of the Nevada State Treasurer reported that it had borrowed approximately $245,000.
Tennessee	The Tennessee Department of Education received $300,000 by appropriation for program administration in fiscal year 2016. The Tennessee Code Annotated also allows the Tennessee Department of Education to deduct up to 4 percent from appropriations used to fund awards to cover the costs of overseeing and administering the program.

Estimated student awards

Nevada	The Office of the Nevada State Treasurer estimated that students with a disability or with low-household income would have received $5,700 for the 2015-2016 school year. Nevada statutes define low-household income as less than 185 percent of the federal poverty line. For all other students, the award amount was estimated to be $5,100 for the 2015-2016 school year.[2]
Tennessee	The Tennessee Department of Education estimates that when it issues awards in January 2017, the average amount will be approximately $6,300.

Payment model	
Nevada	The Office of the Nevada State Treasurer will pay awards directly to a participating entity that provides services to a student who is enrolled in the program such as a private school, an accredited school or tutoring agency, or program of distance education not offered by a public school or the Nevada Department of Education.[3] The Office of the Nevada State Treasurer will reimburse participants for out-of-pocket expenses such as supplies or therapies for students.
Tennessee	The Tennessee Department of Education is planning to use a debit card system to distribute funds to program participants on at least a quarterly basis.

Allowable uses of monies	
Nevada	• A participating entity in which the child is enrolled; • Textbooks required for a child who enrolls in a school that is a participating entity; • Tutoring or other teaching services provided by a tutor or tutoring facility that is a participating entity; • A program of distance education that is a participating entity; • Standardized tests, AP or similar examination, or examination required for college/university admission; • Special instruction or special services if the child has a disability; • Textbooks required by a participating entity; • Management of education savings account; • Transportation required for the child to travel to a participating entity of up to $750 per school year; and • Curriculum or any supplemental materials required to administer the curriculum.
Tennessee	• Participating school, nonpublic online learning program/course, or eligible postsecondary institution; • Textbooks required by a participating school or an eligible postsecondary institution; • Tutoring services provided by an accredited tutor; • Curriculum, including any supplemental materials required by the curriculum; • Transportation paid to a fee-for-service transportation provider; • Standardized tests, AP examinations, or any examinations related to college/university admission; • Contributions to a Coverdell education savings account for the benefit of participating student, if the expenses are allowed in the program's statutes; • Educational therapies/services for participating students from a licensed/accredited practitioner/provider; • Services provided under a contract with a public school; • Management of the individualized education account by private financial management firms; and • Technology that is used for a student's educational needs and is approved by the Tennessee Department of Education or a physician.

Student demographics and assessment requirements

	Eligible students	Student assessment requirement
Nevada	Eligible students must: • Be between the ages of 5-18; • Be Nevada residents; and • Have attended a Nevada public school for 100 days immediately prior to applying, except for students between the ages of 5 and 7 or who are children of active-duty service members stationed in Nevada.	Requires participants to take the same examinations in mathematics and English language arts that the state requires students in Nevada public schools to take or any norm-referenced examination in these subjects.
Tennessee	Eligible students must: • Be Tennessee residents; • Have a statutorily defined disability and an active IEP; and • Be either attending a Tennessee public school for the first time, or previously enrolled in a Tennessee public school during the two semesters immediately preceding the semester when the student received the award.	Students in third- through eighth-grade must take either the Tennessee Comprehensive Assessment Program tests that all third- through eighth-grade students in state public schools must take, or a norm-referenced assessment in English language arts and mathematics.

1 According to the Tennessee Department of Education, it will provide the first awards for its program in January 2017.

2 Implementation of the Nevada program has been delayed by litigation.

3 According to Nevada statutes, a participating entity includes private schools, eligible institutions such as accredited colleges and universities, tutors, or parents that have applied to the Office of the Nevada State Treasurer for participation in this program.

Source Auditor General staff analysis of applicable program rules, laws, and statutes for Nevada and Tennessee; review of Office of the Nevada State Treasurer documents and Tennessee Department of Education documents and Web site; and interviews with Office of the Nevada State Treasurer staff and Tennessee Department of Education staff.

APPENDIX C

Methodology

This appendix provides information on the methods auditors used to meet the audit objectives.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Auditor General and staff express appreciation to the State Superintendent of Public Instruction, Arizona Department of Education (Department) staff, and Arizona Office of the State Treasurer (Treasurer's Office) staff for their cooperation and assistance throughout the audit.

Auditors used various methods to study the issues addressed in this report. These methods included reviewing statutory requirements for the Empowerment Scholarship Accounts Program (Program); reviewing department policies and procedures and the Department's Web site; analyzing program scholarship bank account transaction data from October 2011 through August 2015 provided by the Treasurer's Office; interviewing department staff, Arizona Attorney General's Office (Attorney General's Office) staff, and Treasurer's Office staff; and reviewing documentation related to the Program

Auditors also used the following specific methods to address the audit's objectives:

- To obtain information on the Department's processes for overseeing parents' and legal guardians' (parents) program spending, auditors analyzed department records for parents who department staff identified as having misspent program monies between August 2015 and January 2016; reviewed department staffs' records of parent spending; reviewed information the Attorney General's Office provided; attended two informational meetings the Department provided for stakeholders regarding general program information, appropriate spending, and completing and submitting expense reports; and attended a meeting between the Department, the Treasurer's Office, and bank representatives. Auditors also reviewed best practices from the National Grants Management Association, the National State Auditors Association, and the United States Government Accountability Office.[1]

  Auditors also reviewed a judgmental sample of 43 program scholarship bank accounts for enrolled children whose parents spent program monies between October 2011 and August 2015 and identified examples of deficiencies in the Department's process for overseeing program spending.

  Specifically, auditors selected a sample of 43 program scholarship bank accounts from the population of 2,906 accounts that had program-spending transactions between October 2011 and August 2015, as follows:

  - Randomly selected 10 accounts;

[1] Santonastasso, M., Rissi, E., & Austin, M. (2009). Implementing a risk-based strategy for monitoring federal award portfolios. *Journal of the National Grants Management Association*, 17(1), 4-24; National State Auditor's Association. (2014). *Carrying out a state regulatory program*. Lexington, KY; and United States Government Accountability Office. (2015). *A framework for managing fraud risks in federal programs*. Washington, D.C.

- ◦ Judgmentally selected 26 accounts based on attributes of the program scholarship bank accounts, such as accounts with the highest number of denied transactions, the largest dollar amount of denied transactions, transactions that should have been denied because the merchant was listed on the Department's list of unapproved merchant types, and attempted cash transactions; accounts for parents who had been issued multiple program debit cards; and accounts assigned to specific department staff; and

- ◦ Judgmentally selected 7 accounts that department staff identified as examples of misspending.

For the 43 accounts, auditors reviewed parents' expense reports and other documentation submitted to the Department; analyzed program scholarship bank account transaction data from October 2011 through May 2016 using the bank's Web site; and reviewed reports generated by the electronic, online system provided by the bank that can generate transaction reports for program scholarship bank accounts.

- To assess the Department's oversight of the Program's eligibility review process, auditors reviewed a random sample of 20 application files for parents who spent program monies between October 2011 and August 2015; and a random sample of 30 applications for individuals who applied to the Program between August 2011 and November 2015 but who did not receive program monies either because they were determined to be ineligible for the Program (16 applications) or they chose not to participate in the Program (14 applications). Auditors reviewed information from these files, including program applications, documentation parents submitted, and documentation and notations department staff placed in the files.

- To assess the Department's handling of sensitive information, auditors observed physical locations at the Department where program applicants' files were stored; reviewed program application forms and applicants' files to assess the types of information the Department stored; and reviewed documentation the Treasurer's Office provided demonstrating which staff had access to the bank's electronic, online system that can generate transaction reports for program scholarship bank accounts.

- To assess program data completeness and accuracy, auditors compared records in the Department's electronic program database used to record program information as of November 2015 with information in applicant files selected for auditors' assessment of the Department's program eligibility review process; information on expense reports parents submitted; and program scholarship bank account transaction data the Treasurer's Office provided.

- To obtain information for the Introduction section of the report, auditors compiled and analyzed unaudited information from the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* for fiscal years 2012 through 2015 and the AFIS Management Information *System Status of General Ledger-Trial Balance* screen for fiscal years 2014 and 2015 as of October 20, 2015, and department-prepared financial information for fiscal year 2016. In addition, auditors reviewed department-provided information about full-time equivalent positions for the Program; and department-provided documentation.

- To obtain information for Appendices A and B, auditors interviewed staff at and reviewed documents and Web sites from the Florida Department of Education, two Florida Nonprofit Scholarship Funding Organizations, the Mississippi Department of Education, the Office of the Nevada State Treasurer, and the Tennessee Department of Education. Additionally, auditors reviewed applicable program rules, laws, and statutes from the states of Florida, Mississippi, Nevada, and Tennessee; and analyzed unaudited data from the Florida Nonprofit Scholarship Funding Organizations.

- Auditors' work on internal controls included reviewing the Department's policies and procedures for detecting fraud and misspending of program monies and responding when misspending is identified; reviewing the Department's process for handling repayment of misspent monies; reviewing the Department's eligibility and program award-determination processes; reviewing department policies for protecting sensitive information; and reviewing the Department's practices for managing program data. Auditors also reviewed best practices for internal controls from the United States Government Accountability Office.[1] Auditors' conclusions on these internal controls are reported in Finding 1 and Finding 2 of the report.

1 United States Government Accountability Office. (2014). *Standards for internal control in the federal government.* Washington D.C.

AGENCY RESPONSE

State of Arizona
Department of Education
Office of Diane M. Douglas
Superintendent of Public Instruction

June 23, 2016

Debbie Davenport
Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Davenport:

The Department of Education appreciates the opportunity to respond to this audit report. Before proceeding with our response to each recommendation individually, the Department would like to emphasize its continued commitment to effectively and efficiently administering the Empowerment Scholarship Program. The Department is proud of its excellent track record of overseeing and administering all aspects of the Program and has always kept identifying potential fraud and misspending at the forefront of its efforts. To that end, the relatively few issues that auditors identified in both audit findings were of a technical nature and did not identify any additional instances of fraud or misspending that the Department had not already identified through its own processes. Moreover, the Department would like to emphasize that it was already in the process of implementing the majority of the recommendations made by auditors and we will continue our efforts to strengthen our oversight and administration of the Program.

1.1.The Department should continue to develop and implement a risk-based approach for prioritizing its spending reviews, including associated policies and procedures, by establishing standard criteria or factors for assessing the risk of misspending for program scholarship bank accounts and expenditures, using the established risk assessment criteria or factors to assess misspending risk, and developing and implementing time frames for reviewing high-risk and other program scholarship bank accounts and expenditures based on their priority.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. As auditors have noted in the report, the Department has taken many steps to prevent misspending. In fact, all misspending identified in the report had already been identified by Department staff and reported to auditors. The Department will continue to review all expense reports submitted quarterly by parents. And in addition, the Department will continue to develop its risk-based program to identify potential misspending between the quarterly reporting periods.*

1.2. The Department should complete and implement its draft policies and procedures for conducting spending reviews, and incorporate policies and procedures for using the bank's electronic, online system functionality to more frequently and systematically monitor program spending. These policies and procedures should provide guidance for generating and reviewing various types of transaction reports to identify misspending or attempted misspending, including attempted cash withdrawals; and time frames for how frequently department staff should create and review these reports.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. This recommendation is a continuation of the previous recommendation, and the two could have been combined. As auditors have noted in the report, the Department is already developing a risk-based program approach to spending reviews, which includes utilization of the bank's electronic, online system functionality to identify potential misspending.*

1.3. The Department should provide all appropriate department staff with access to the bank's electronic, online system, work with the bank to provide training for appropriate department staff on how to generate and use the various transaction reports, and work with its Information Technology division to develop a procedure for staff to input the various transaction reports into a spreadsheet or the Program's database for review and analysis.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. This recommendation is a continuation of the previous recommendation, which the Department has agreed to implement.*

1.4. The Department should develop and implement policies and procedures that require its staff to review public school enrollment data before each quarterly distribution of program monies, and work with its Information Technology division to determine if it can automate the review of public school enrollment data for children in the Program.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented, provided that the Department continues to receive additional and necessary funding from the Legislature. Department staff currently review public school enrollment data as part of its eligibility determination process. To add an additional level of review four more times per year for 3,500 students requires additional resources that have not been provided to the Department historically. As noted by auditors in the report, the Department was appropriated $400,100 to administer the program with 2,212 participants. In stark contrast, Florida's department spent $1,489,000 to administer a program with only 1609 participants.*

1.5. The Department should implement fraud reporting mechanisms such as a fraud reporting hotline, a dedicated e-mail address for reporting fraud, or a fraud reporting mechanism on the Department's Web site.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented.*

1.6. The Department should complete and implement its draft enforcement policies and procedures, and incorporate guidance and instructions for determining when to remove parents from the Program for repeated attempts to misspend, such as attempts to withdraw cash from a program scholarship bank account; completing investigations of suspected misspending and fraud; and determining when to refer parents to the Attorney General's Office for fraud investigations or collections.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. As auditors have noted in the report, the Department is already in the process of developing a policies and procedures manual. This manual will include all relevant guidance for staff regarding enforcement aspects of the program, including procedures for conducting investigations of suspected misspending and fraud and determining when to refer parents to the Attorney General's Office for fraud investigations or collections.*

1.7. The Department should continue with the implementation of its supervisory review and approval process, including developing and implementing associated policies and procedures, and develop and implement policies and procedures that require supervisory review of department staff's determinations that a parent's program spending was appropriate.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. As noted by auditors in the report, the Department is already in the process of implementing a supervisory review and approval process of all aspects of the Program. This process includes developing and implementing policies and procedures at both the staff and supervisory levels and will help ensure that parents' program spending is appropriate. The Department began using a new IT system in January 2016 with a workflow system that requires a supervisor review of department staff's eligibility decisions, and award calculations, with enhanced capability by September 2016 of reviewing expense reports electronically.*

1.8. The Department should complete and implement policies and procedures for the proper handling of repaid monies, including requirements that two employees be present when opening mail that may contain payments, that checks are restrictively endorsed upon receipt, and other steps to help ensure that no one person has control over multiple aspects of the repayment process.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. As noted by auditors in the report, the Department is already developing multiple processes to ensure proper segregation of duties among Program staff. First, the policies and procedures that are in the process of being developed include specific steps Program staff must take to ensure that duties such as mail handling and receipt of checks are properly segregated among staff. Additionally, the Department's Program system includes multiple built in checks and balances to segregate duties relating to the repayment process.*

1.9. The Department should continue to work with the bank and the Treasurer's Office to help prevent parents from circumventing program debit card controls, and to suspend the program debit cards of parents who attempt to withdraw cash from a program scholarship bank account.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented with the understanding that the Department has no control over the State Treasurer's Office or its relationship with the bank.*

1.10. Once the Department completes and implements its policies and procedures in the areas recommended, it should provide training to all department staff responsible for implementing the policies and procedures. Additionally, the Department should ensure that any changes to policies and procedures are reflected in the program agreement and the parent handbook, as applicable, and it should take steps to notify parents of any changes to policies or procedures that are relevant to their participation in the Program.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. As auditors have noted in the report, the Department is already in the process of developing and implementing a policies and procedures manual. As it has done in the past with all procedural directions given to staff, the Department will provide training to all applicable staff, as well as notifying parents of changes in the Program.*

2.1. The Department should complete its development and implementation of policies and procedures for its eligibility determination process and safeguarding sensitive and personally identifiable information, expand them where needed to fully address the issues identified in this finding, and provide training to appropriate staff on the policies and procedures. These policies and procedures should also:

a. Incorporate guidance for when and how department staff should verify children's disability qualifications and to help staff identify which school should be used to determine the program award amount;

Department Response: *The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented. As noted by auditors in the report, the Department is already in the process of developing and implementing policies and procedures to include all aspects of its eligibility and determination process. However, it is the Department's position that verifying students' disability qualifications is neither appropriate nor feasible. The policies and procedures will include directions for staff to follow in the event that they have questions about a student's disability determination documentation. However, Program staff will not actively question the disability determination of a student made by a particular school.*

b. Limit physical and electronic access to sensitive and personally identifiable information to only authorized personnel, require the secure storage of this information, and require the prompt termination of former department staff credentials.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department is already in the process of incorporating* *the limiting of physical and electronic access to student data into its policies and procedures which includes prompt termination of former Program staff credentials.*

2.2. The Department should complete the expansion of its new IT system to include the previously mentioned functionalities (see pages 34 and 35), and complete and implement its draft policies and procedures for using the new system. These policies and procedures should incorporate guidance and instruction for entering program data into the new IT system in a standard and accurate way; using information provided by the bank, such as program scholarship bank account statements, for recording spending information in addition to using parents' self-reported expense reports; accurately entering historical program data into the new IT system; and providing supervisory oversight to check and maintain data accuracy and completeness.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. As noted by auditors in the report, the Department is already in the process of completing its new IT system for the Program along with associated policies and procedures to guide staff in using it. The Department's new IT system was operational in January 2016, allowing parents to submit Program applications online. By June 2016, additional functionality of the new IT system went live as mentioned on pages 34 and 35. The Department will ensure that all necessary topics relating to system use and supervisory oversight are incorporated into these policies and procedures.*

2.3. The Department should complete and implement a records retention schedule and policy for the Program, and incorporate guidance for retaining electronic records of all applicants, including those whose eligibility is denied and those whose program scholarship bank accounts are closed or terminated.

Department Response: *The finding of the Auditor General is agreed to and the audit recommendation will be implemented. As discussed with auditors during the audit, the Department has undertaken an agency-wide endeavor to implement a records retention process which includes policies and procedures, training for all staff, and a retention schedule for every type of record handled by the Department.*

Sincerely,

Michael Bradley
Chief of Staff

Performance Audit Division reports issued within the last 12 months

15-CR1	Independent Review—Arizona's Child Safety System and the Arizona Department of Child Safety
15-CR1SUPP	Supplemental Report to the Independent Review—Arizona's Child Safety System and the Arizona Department of Child Safety
15-106	Arizona State Retirement System
15-CR2	Independent Operational Review of the Arizona State Retirement System's Investment Strategies, Alternative Asset Investment Procedures, and Fees Paid to External Investment Managers
15-107	Arizona Sports and Tourism Authority
15-108	Arizona Department of Administration—Personnel Reform Implementation
15-109	Arizona Department of Administration—Sunset Factors
15-110	Arizona Foster Care Review Board
15-111	Public Safety Personnel Retirement System
15-CR3	Independent Operational Review of the Public Safety Personnel Retirement System Investment Strategies, Alternative Asset Investment Procedures, and Fees Paid to External Investment Managers
15-112	Arizona Commerce Authority
15-113	Arizona Department of Transportation—Transportation Revenues
15-114	Arizona Department of Transportation—Sunset Factors
15-115	Arizona Radiation Regulatory Agency, Arizona Radiation Regulatory Hearing Board, and Medical Radiologic Technology Board of Examiners
15-116	Arizona Department of Revenue—Security of Taxpayer Information
15-117	Arizona Department of Revenue—Sunset Factors
15-118	Arizona Department of Child Safety—Child Safety, Removal, and Risk Assessment Practices
15-119	Arizona Department of Environmental Quality— Vehicle Emissions Inspection Program
15-120	A Comparison of Arizona's Two State Retirement Systems
15-121	Alternatives to Traditional Defined Benefit Plans
16-101	Arizona Department of Education—K-3 Reading Program
16-102	Arizona Department of Child Safety—Differential Response and Case Screening
16-103	Arizona State Board of Respiratory Care Examiners
16-104	Arizona Board of Osteopathic Examiners in Medicine and Surgery
16-105	Arizona Criminal Justice Commission
16-106	Pinal County Transportation Excise Tax

Future Performance Audit Division reports

State of Arizona Acupuncture Board of Examiners