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Redefining Accountability:

A Path to Empowerment in Arizona's ESA Program

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Executive Summary

The Arizona Empowerment Scholarship Account (ESA) program is a state-funded initiative that allows eligible students to receive public funding in the form of an education savings account, which can be used for various educational expenses, including private school tuition, online learning programs, and other approved educational goods and services. The ESA program is administered by the Arizona Department of Education (Department) and currently enrolls over 70,000 students across the state.

This report examines the existing approach to program oversight and finds that there are better ways to ensure students have access to a vibrant and innovative ESA program while maintaining accountability and transparency of public resources. The historical context reveals a lack of clear direction (by both policymakers and administrators), frequent turnover in leadership, and a persistent drive to demonstrate 100% compliance, creating a hesitancy to deviate from an all-encompassing approach. This commitment to scrutinizing every aspect of spending hinders proactive initiatives to align with best practice, due to the reluctance to be perceived as reducing accountability. However, we contend that true accountability emerges through a targeted focus on high-risk purchasing and accounts, a perspective we highlight in our recommendations for enhancing program efficiency.

Without these recommended improvements, Arizona's ESA program could lose its ability to be liberating to families and become an overregulated, top-down program requiring more bureaucracy and oversight of individual parents than the oversight over the hundreds of millions of dollars spent at public schools. This approach is antithetical to the founding of the program and leads to a world where parents become accountable to the government rather than the government being accountable to parents.

According to the Department's own data, it now takes between 30 and 60 days for parents to receive approval or reimbursement for transactions through its own and now-required marketplace. This is not sustainable; Medicaid programs, for example, target wait times of no more than two weeks for many patient appointments[i].

To improve the program, we first recommend that policymakers adopt a student-centered mindset that ensures the program covers ordinary goods and services related to a child's education, that the state should be agnostic as to how or where a child learns, and that parents are trusted to make wise decisions for their child -- and thus no policies should place additional burdens on parents to justify their parenting and child's learning.

This requires a deep belief in parents and that parents are best situated to be the true arbiters of whether their child is in a learning environment that meets their needs. There is no greater accountability than a parent having full autonomy and authority over their child's learning. This fact is paramount when reviewing and recommending improvements to existing accountability and transparency requirements. To accomplish this, our report suggests that policymakers look to other, similar public programs for comparable reporting, accountability and transparency standards.

Our key findings include:

- Compared to other public programs and given available data, the Arizona ESA program has experienced relatively low rates of misuse. A handful of high-profile cases appear to have disproportionately shaped public perceptions of the program. Most ESA participants are middle-income households receiving relatively modest scholarships.

- Generally, the accountability standards used to track expenditures of ESA funds are stricter and more onerous than those used in comparable programs. These additional accountability measures make the use of the ESA program more cumbersome for parents when compared to other programs, like a Tuition Tax Credit Scholarship administered by a School Tuition Organization (STO).

- ESA administration should not rely on “always allowed” or “always prohibited” tests for most goods and services. Families should be able to use ESA funds for ordinary goods and services used to educate the child. Whether a good or service is being used for a statutorily permitted educational purpose is subjective and must be answered in context – based on its “ordinary use” and/or “primary use.”

- The current spirited public debate on the ESA program is occurring partly because of the degree of transparency the program exhibits. Observers can examine detailed transaction-level records from the ESA program through detailed quarterly reports on program enrollment and utilization. Few (if any) other comparable programs provide similar details.

- Ultimately, the success of the ESA program requires the opportunity for robust participation – by providers and parents. If the program is viewed as too cumbersome or risky to participate in, folks will default to other options. Policymakers must strike a balance between accountability and usability in the ESA program when compared to other options to ensure competition has a chance to engender improvement.

Finally, our report finds that the perception of widespread misuse and lack of accountability – more than its actual presence – has led administrators to over-correct, making the program more cumbersome and difficult to use than it needs to be. This report suggests that the Department return to its statutory framework – allow families to make educational-purchases in a timely fashion and continue to implement safeguards to monitor and review these purchases against misuse on the basis of risk.

It is critically important that administrators and policymakers recognize that the ESA program is a relationship between the state and parents, not a relationship between the state and educational providers. Changes which undermine that structure will result in new frictions.

About the Authors

Glenn Farley is CSI Arizona's director of policy & Research. Before joining CSI in 2022, Glenn worked in the Office of the Arizona Governor, most recently as Gov. Doug Ducey's chief economist and a policy advisor. In that role, he advised on issues of tax, fiscal, and regulatory policy, and was one of the governor's lead architects of his two major tax reforms – including the 2021 income tax omnibus which phased in a 2.50% flat tax (the lowest in the country). Glenn also led the budget team that produced the Executive revenue forecasts and caseload spending numbers that have helped ensure the longest run of structurally balanced budgets in State history. Glenn has a master's degree in economics from Arizona State University's WP Carey College of Business, as well as a B.S. from Arizona State University. He was born and raised in Arizona where he now lives with his wife and two daughters.

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Common Sense Institute is a non-partisan research organization dedicated to the protection and promotion of Arizona's economy. CSI is at the forefront of important discussions concerning the future of free enterprise and aims to have an impact on the issues that matter most to Arizonans. CSI's mission is to examine the fiscal impacts of policies, initiatives, and proposed laws so that Arizonans are educated and informed on issues impacting their lives. CSI employs rigorous research techniques and dynamic modeling to evaluate the potential impact of these measures on the Arizona economy and individual opportunity.

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A Primer on ESA Cost & Administration

By law, parents are entitled to use monies in their child's Empowerment Scholarship Account for purchasing qualifying educational goods and services upon submitting a qualifying application to the Department of Education ("Department") and signing a valid agreement.[ii iii] The state Treasurer's office is required to provide financial management of these accounts, though it may contract with a financial management firm. The Department must conduct random, quarterly, and annual audits of accounts as needed to ensure compliance with the eligible use agreements. The State Board of Education is required to adopt rules and policies necessary to administer the program.

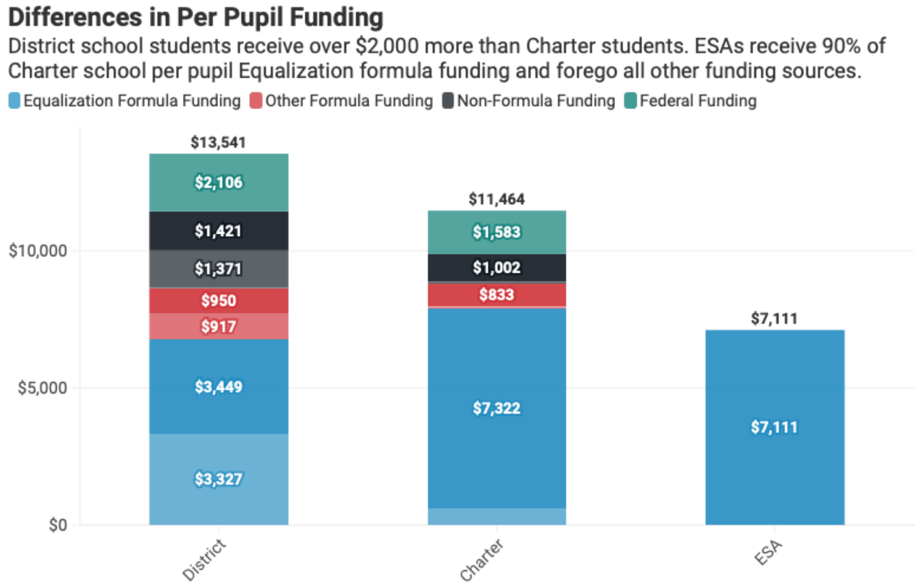
Since 2019, the Treasurer and the Department have partnered with ClassWallet – a third-party financial management firm and online marketplace – to administer the Empowerment Scholarship funds. ClassWallet is compensated through a 2.5% fee assessed on all transactions through its marketplace or vendor payment systems.

The Department is required to develop and post an annual handbook that includes information relating to the policies and processes of the ESA program, and the handbook is required to comply with the rules adopted by the State Board of Education. According to the *2023-2024 Empowerment Scholarship Account Program Parent Handbook*,[iv] ESA funds may be accessed in four ways through the ClassWallet system:

1. **Marketplace:** Parents may purchase goods and services from online vendors through the ClassWallet marketplace.
2. **Direct Vendor Payment:** Vendors and providers (like a private school) can pre-register with ClassWallet and be paid directly through the ClassWallet system. In this case, a completed invoice must be uploaded to support the payment.
3. **Debit Card:** Parents may use a "prepaid debit card" to pay for goods and services outside the ClassWallet system. Parents are required to upload receipts and supporting credentials to ClassWallet.
4. **Reimbursement:** "If an Account Holder cannot make a purchase or pay for an educational service using one of the ways listed above, they may be eligible for the reimbursement option."

Even though the debit card option is included in the Handbook, in February 2023, the Department "paused" new debit card issuances for ESA families.[v] CSI believes the "pause" persists as of this writing, but specific and timely written guidance from the Department on the subject is unavailable. Applicable ESA rules and written policies imply that debit cards remain a valid option. CSI is additionally aware of anecdotal complaints about the reliability and timeliness of the reimbursement option. Parents have complained about receiving quarterly reimbursement for tuition bills that were paid lump-sum at the beginning of the academic year, despite the statutory option for lump-sum reimbursement.

Figure 1



Source: JLBC (2023) • Darker areas represent estimates of the share of funding by type that comes from State sources, like the General Fund. Avg ESA awards are higher than estimated here because over 20% of current participants are students with special needs; according to ACS, the disabilities rate among the entire Arizona school-aged-population is closer to 6%..

Questions about the cost of the ESA program persist. CSI has continued to update its fiscal analysis of program costs as new information becomes available and in response to the changing nature of the inquiry. Most recently, the House Ad Hoc Study Committee on Empowerment Scholarship Accounts focused on what fund sources ultimately pay for different classes of students and in what amount. We note the following stylized facts about the relative costs of an Empowerment Scholarship Account:

- **On average, ESA students are educated at a lower cost to taxpayers than district school students.**
- Public school funding in Arizona is a complex combination of numerous formula and non-formula programs, and funds are acquired from various federal, state and local sources. In general, though, the General Fund is the payer of last resort (meaning it is the last to add money to the funding pot and, therefore, the first to bring money out).

Setting aside the complexities and nuances imbedded in education funding, for most students at most schools the General fund bears both the costs and savings from students moving within the K-12 education system.

Program Transparency

Since "universal eligibility" expansion in 2022, Arizona's ESA program has grown rapidly. As of December 2023, it enrolls over 71,000 students, which, if it were a public school district, would make it the state's largest. Despite its growing popularity among Arizona families, the program has been unfairly maligned by allegations of misuse, lack of transparency, and lack of oversight.

"More questions than answers on school vouchers as oversight committee wraps up."

Tucson Sentinel
Nov. 15, 2023

In practice, the state specifically – and the public generally – know far more about the use of ESA monies than they do any other comparable program, including in many ways the use of monies by public schools. The Department's quarterly reports to the state board list every denied transaction and the reason for the rejection. We know, for example, an attempted purchase at OdySea Aquarium was denied because "tourist attractions are not allowed."[vi] We do not know – and likely have no way of knowing – whether any public school has ever spent taxpayer money at OdySea Aquarium. Further, adding to the confusion, the Department has suggested Odysea is an allowable expense, but was improperly coded in the financial system.

Using data provided by the Department in its quarterly reports and elsewhere, CSI can ascertain:

- How many students are receiving ESA funds and their approximate award amounts.
- The school district in which the student resided (which in turn informs their approximate zip code and from their other relevant social demographic characteristics, like household income).
- What items the Department always disallows for purchase with ESA funds.[vii]
- What items the Department allows for purchase.[viii]
- Various procedural timelines related to how long it takes to process an application; approve an invoice or expense; etc.
- Precisely how many transactions of various types are attempted, approved, and rejected through the ClassWallet system.
- **Using this data, CSI estimated that approximately 60% of ESA recipients as of late 2023 had family incomes below $75,000. Fifty-two percent of Arizona families have comparable incomes – meaning ESA recipients are likely *lower income* than the average Arizona family, given their general resident zip codes.**

Figure 2

ESA Students by Median Income

As estimated by approximate Zip code of residence, middle-income families are disproportionate users of the ESA program as of late-2023.

Household Income Range	Median income of ESA families	% of ESA Students	% of Arizona Households With at least 1 child
$0-$34,999	$ 30,000	5%	23%
$35,000-$49,999	$ 40,797	21%	12%
$50,000-$74,999	$ 62,083	33%	17%
$75,000+	$ 98,866	41%	48%

Source: Arizona Dept of Education, American Community Survey 2020, National Center for Education Statistics • NCES and ADE data was used for geographic purposes; ACS data to estimate incomes by geography.

For context, often this kind of information is not readily available for other programs. The state's longstanding Tuition Tax Credit Scholarship program does not report the total number of students receiving scholarships, award amounts per student, approximate place of residence for awardees, or other details. CSI flagged this issue when attempting to project how large the ESA program would grow in its May 2023 forecast because the Tuition Tax Credit Scholarship program acts effectively as a substitute for an ESA, and a student cannot enroll in both.

Program Oversight

For years, the Department has been moving ESA administration towards transaction-level scrutiny – the technical ability to review transactions with ESA money in real-time and limit expenditures to a curated list of approved goods and services from registered education service providers and retailers. The transition to a closed digital platform that includes an online marketplace, approved vendor lists, and other equivalents has accelerated this process from a practical and technical perspective. One of the consequences of implementing a closed purchasing platform in which goods, services and vendors have to be pre-approved to be included has been program policies that are not necessarily supported by specific rules or statutes: "Tourist attractions are never allowed,"[ix] "food is never allowed," attempted purchases at Walmart being rejected because "grocery stores sell food which is disallowed," etc. These actions are part of a well-intentioned effort to prevent misuse and to respond to continued accusations of lack of oversight – levied at the program since its inception. **Unfortunately, this effort has moved the program far afield of both its statutory and foundational framework to a place where it is burdened by *too much oversight*, rather than too little.**

"A fundamental tension exists between controlling fraud and optimizing customer experience, because tighter fraud and customer protection controls often add friction to the customer experience."

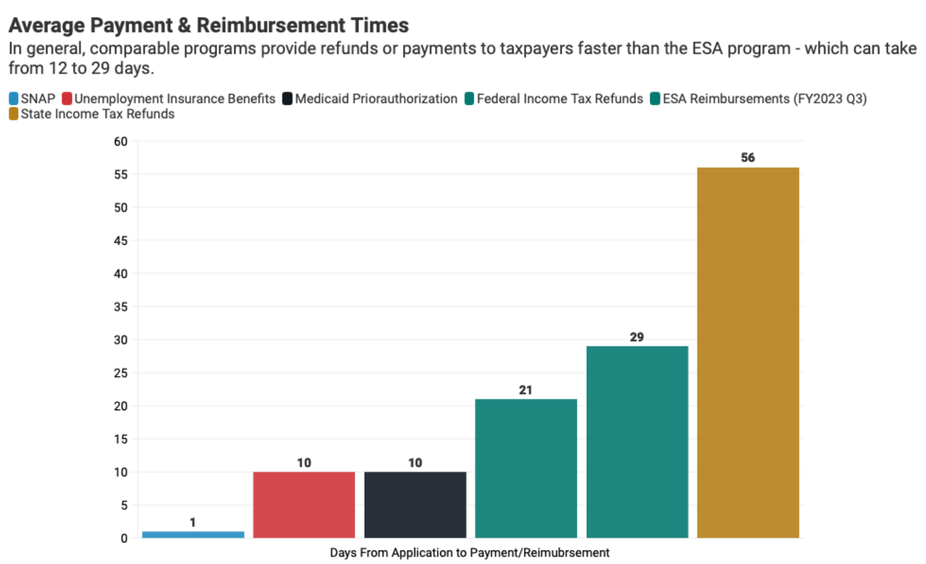
McKinsey & Company
2022

Researchers and analysts generally recognize that organizations must balance their public obligation to prevent fraud and misuse against the participant's ability to access program benefits quickly and easily. Otherwise, participants will avoid the program altogether, and overall social utility will fall.[x] An example of this is when changes are made to school lunch programs with the intention of making the food healthier, but without considering what students actually want to eat. Such changes can have the unintended consequence of reducing overall health outcomes, as students may choose to opt-out of the school lunch program and instead consume fast or junk food[xi]. A study by the Melbourne Institute of Applied Economic and Social Research suggests that paperwork burdens and bureaucratic inconvenience associated with applying for and using public benefits programs represent a "cost" to otherwise "free" services and have the effect of lowering participation rates[xii].

As of November 2023, Arizona's ESA program has over 70,000 participants making an estimated 800,000 transactions annually. **Assuming 10 minutes of processing time per order, it would take ADE staff over 133,000 hours of work every year to process and approve purchase orders (the equivalent of 67 full-time staff).** Manually reviewing and approving vendor reimbursements or purchase orders before fulfillment and in real-time is untenable, and the problem will get worse as the program grows. Following the suspension of new debit card issuances, parents are often forced to make their ESA-approved purchases out-of-pocket and then wait up to 29 days[1] for the expense to be manually reviewed, approved, and reimbursed.[xiii]

No other public program of comparable size is expected to work like this. Generally, the standard is selective audits (either randomly or on suspicion of fraud or misuse) to enforce program policies. A degree of inefficiency is tolerated as a cost of business, and during program stress, tolerance for waste and misuse often increases. For example, the U.S. Department of Labor now estimates that fraud in its pandemic-related unemployment insurance program between 2020 and 2022 was $45.6 billion.[xiv] To manage Arizona's Medicaid program, Arizona Health Care Cost Containment System (AHCCCS) makes lump-sum payments to intermediary health plans based on the general assumption that payment requests are accurate and subject to follow-up audits. Given withholding and reporting requirements, the Internal Revenue Service relies on taxpayers to accurately report their income on an annual tax return and remit the correct tax to the government – often taking years to audit suspicious returns later.

Figure 3



Source: Dept of Revenue, Dept of Economic Security, Dept of Education • ESA reimbursement times are sourced from the Dept. of Education's two most recent ESA Quarterly Reports. The Q4 value is a weighted average of reimbursed and rejected processing times.

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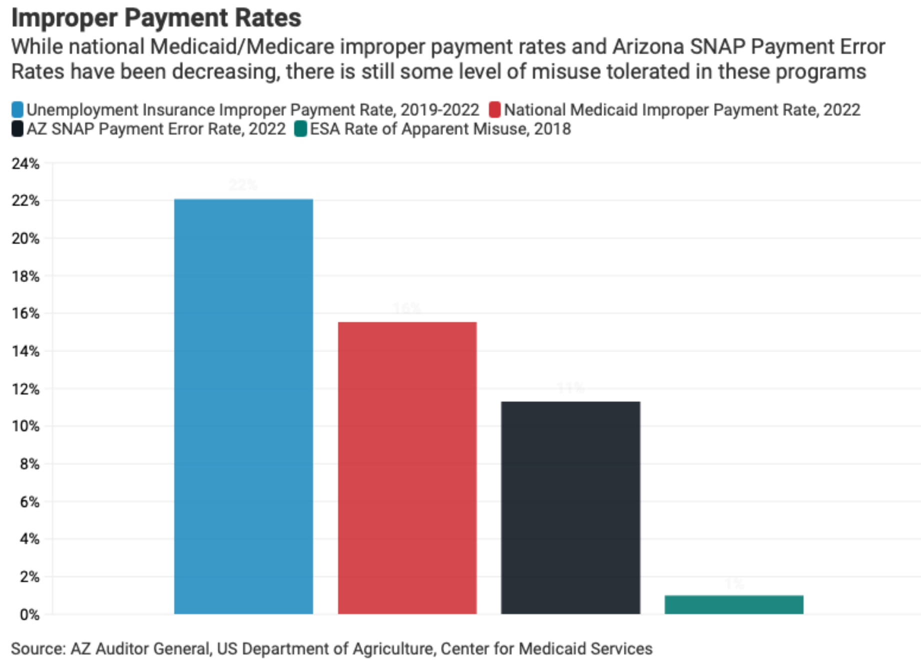
[1] During the 3rd quarter of FY 2023, reimbursement submission approval by a staffer took an average of 29 days, according to ADE. During the 4th quarter, the Department reported a range of 12-20 days depending on the type of transaction.

The Department has acknowledged these issues for months but plans to try to address them through technological solutions and efficiency gains. We would encourage ADE to consider that the issue is not the speed or efficiency with which it is approaching this problem (which, by all accounts, is laudable given the program is functioning at all at its current size and volume) but rather the nature of the approach itself. This disconnect becomes particularly acute considering the scale of (known and reported) misuse rates in the ESA program relative to its peer programs. Given Auditor General reports to date, **improper payment rates in the ESA program are a fraction of those in other government programs like Medicaid, Unemployment Insurance, and SNAP[2].**

Figure 4



[2] We do note that the Auditor General findings cited here pre-date universal eligibility expansion. At the time, the program was much smaller, but also less restrictive of fund use and had a higher average award amount. Still, it is probable that improper payment rates have changed since 2018; policymakers should consider requiring regular review of the program by an independent auditor to assess its performance.

A Note on Accountability

It is often noted that ESA recipients are not required to administer a statewide assessment, do not receive letter grades, nor do they track or report other metrics reported by the state's public schools (e.g., graduation rates). Because families are closest to their children, they are the true arbiters of whether that child is learning in their current environment.

In general, it is difficult for parents to assess what (and how well) their children will learn in a contemporary traditional school. The standard measures of achievement and academic performance – report cards, diplomas, school letter grades, etc. – increasingly lack material connection to educational attainment. It is unclear how forcing this system onto the ESA program would alleviate this problem. Instead, it would impose significant new compliance costs – and likely without improving outcomes in either system.

Policymakers must not judge the future of educational options, driven by families empowered to choose their preferences, in the same ways that the status quo has been judged in the past.

The education status quo insists that these metrics are adequate to determine individual progress, yet it has failed to meet its own benchmarks. Policymakers must not judge the future of educational options, driven by families empowered to choose their preferences, in the same ways that the status quo has been judged in the past. Accountability for the individual process of education means much more than that which can be counted.

A Better Path Forward

The present-day ESA program has been forcefully assembled over more than a decade on a 2011 framework that targeted a specific, small constituency (students with disabilities) with very specific needs (specialized services given their needs). As we discuss further below, the gradual expansion of both eligible uses and participants in the program has created significant disconnects between legacy and new participants and made the response by the Department and other administrators more difficult.

Alongside these statutory changes, the Department itself has forged a parallel path relative to the Legislature regarding its management of the ESA program. In 2013, even as the Legislature debated a bill that would strengthen program audit requirements, the Department publicly stated that it did not and probably never could audit every ESA account. Instead, as early as 2013, the Department was committing itself to develop technological systems that would approve or deny transactions at the point-of-sale based on some master list of "approved purchases." This process culminated with the suspension of new "debit cards," followed by reports from parents and participants experiencing tremendous pressure to funnel all purchases and activity through the Department's contracted third-party online marketplace and vendor systems.

Instead, the Department and policymakers -- considering the size of the program and the varied educational uses --should revisit the expenditure review requirements and procedures. The Arizona Empowerment Scholarship Account is a sizable public program akin to unemployment insurance, nutritional and other assistance, or low-income health insurance. It is also a program that by design empowers parents to make independent choices and decisions in the best interests of their children, subject to public oversight and statutory controls.

To that end, we suggest the following structural best practices for the ESA program:

- **ESA funds should cover expenditures on ordinary goods and services used to educate the child.** The operative question observers and administrators should ask when auditing a purchase is about intent more than the substance of the item itself. "Food" may be a legitimate educational expense if its purchase was part of a bona fide instructional experience – like a cooking class – just as a car may or may not be a legitimate business expense based on whether it was used more for business or personal purposes. So, it makes little sense to speak of food as "never being allowed" or purchases at Walmart as "never being allowed" because it happens to sell groceries.
- **The state should be relatively agnostic about where the good or service is purchased.** An educational item purchased at Best Buy or Walmart is, on its face, no more or less likely to be used for legitimate educational purposes than one bought on Amazon or at a teaching supplies store. While there may or may not be wisdom to adopting an approved retailer model like other public programs, principles of cost efficiency and consumer utility favor providing more choice in vendors rather than less.
- **The Department should provide a mechanism for families to make purchases outside of a closed platform and develop policies and procedures to regularly audit transaction activity.** For more than a decade, the Department has moved in a different direction – attempting to develop a list of approved and disapproved purchases and audit them at point-of-sale. The Department's initiative to automate the expense review and approval process is laudable from an efficiency standpoint, but requiring pre-approval of every dollar spent in the program is not required by law and restricts spending to a finite list of goods and services. In addition to allowing families to purchase from a preapproved list, the Department should adopt a quarterly, annual, and random audit process to review a sample of transactions that occur outside of the marketplace.
- **The Department should continue to develop and implement safeguards to prevent egregious cases of misuse.** This can be accomplished through a highly selective and targeted analytic system to prevent blatant misuse – for example, declining purchases at bars and restaurants, medical facilities, etc.
- **Disciplinary action should continue to follow written procedures and remove access to ESA funds quickly on a bona fide violation while preserving it otherwise.** The Department has implemented policies and procedures to identify and remove students simultaneously enrolled 1in public school to prevent misuse of funds. The Department has also implemented a process to refer cases of misuse to the State Board of Education, who can and has referred cases to the Attorney General's Office.
- **The Department should focus compliance attention on accounts based on risk assessment, such as time on the program, number of transactions, transaction dollar amount, and type or location of expenditure.** The average ESA award is approximately $9,500, yet half of awardees receive $7,200 or less and more than two-thirds of awards are spent on tuition and fees at private schools. Opportunities for misuse in such cases are objectively fewer than for recipients of significantly larger amounts, which make up a minority of accounts. ADE should be targeting its enforcement efforts.

Any approach the Department adopts should adhere closely to the statutory framework and adopted administrative rules for the program. To the extent administrators have a different vision than is contemplated by statute or rule, they should work with the Legislature and State Board of Education to codify the approach rather than proceeding on a parallel path. In general, the Department and policymakers would be well served to look at existing policies and procedures employed by successful public programs that have had to make the kinds of subjective judgments required by the ESA statute. The Internal Revenue Service, for example, makes extensive use of tests like "**primary use**" (is the preponderance of time use of the good or service for educational purposes) and "**ordinary and necessary**" (is the ordinary use of a good or service educational in nature, and is its use necessary to complete an education).[xv]

A risk-based approach to timely financial audits of program accounts can ensure misuse is caught and corrected reasonably quickly while minimizing hassle and inconvenience for the vast majority of purchases that – by the program's current and historic accountings – are bona fide.

The Department has done its best given the confusing and conflicting direction it has received from various external stakeholders. The current statute is being used to serve populations with diverse needs. It is also unclear what the Legislature intends the Department to cover and not with ESA funds; it has alternated between explicitly prohibiting and allowing the same goods (e.g., personal laptop computers) in very short periods. The Legislature has also retained and expanded the existing core statutory structure (structured around financial audits of active ESA accounts accessed directly by parents) even as the Department has moved towards a direct-service model via its online marketplace.

The result has proven costly and frustrating for ESA families. Clarity is needed to minimize public financial risk while preserving customer satisfaction.

The Bottom Line

Educational choice policies are like any other public benefits program: a balance must be struck between two competing but essential interests. The public administrator should protect and facilitate an individual's right to receive benefits to which they are granted by law. Still, the government is also responsible for protecting taxpayers and ensuring public funds are used legally and responsibly.

The current approach to the ESA program is prioritizing scrutinizing every dollar spent at the expense of timely, efficient access by participating families. This approach has become increasingly unmanageable as the program has grown and has lead administrators to respond defensively to resource constraints (e.g., suspending debit cards earlier this year) rather than actual abuse.

Policymakers and administrators should adopt a flexible approach that empowers ESA recipients to make lawful use of their funds, subject to random and regular review under a clearly-articulated, written procedure. Results of this process should be reported to the public.

Appendix: A Legislative History of the Arizona ESA Program

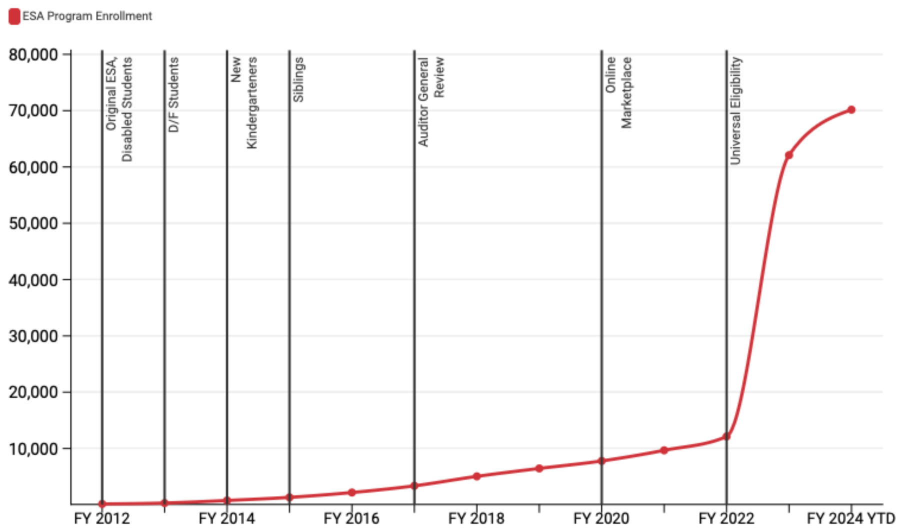
SB 1553: The Original 2011 Law

Created in 2011, Arizona's Empowerment Scholarship Account (ESA) program originally provided prior public-school students with disabilities the opportunity to obtain specialized educational services from private providers (schools and tutors) outside of a traditional public-school environment.

Figure 5

ESA Program Changes Over Time

Rapid initial eligibility changes resulted in relatively tepid enrollment growth, until 'universal eligibility' last year.



Source: Arizona Department of Education, CSI estimates

To participate in the program, a child must have had a diagnosed disability and (with limited exceptions) have enrolled previously in a public school. While the statutory language on allowable uses was then – as today - opaque, it appears clear the intent was to limit eligible uses to private school tuition or equivalent costs for participation in traditional, structured classroom learning environments. Indeed, continued scholarship eligibility in the original 2011 bill text presupposed the child's ongoing attendance of a "qualified school."[xvi]

The 2011 law made the Office of the State Treasurer responsible for the movement of money in and out of the parents' individual accounts and general account administration. The Department was tasked with reviewing and approving membership applications for the program, determining the correct ESA award amounts, and notifying the treasurer of this value, and enforcing the ESA eligible uses statutes through (required) random annual and (permissive) "as needed" audits of ESA spending.

Critically, we note the following key features of ESA account administration under their original 2011 law: limited eligible population of students[3] who had both diagnosed medical disabilities under state or federal law and (generally) previously attended a public school; limited eligible uses targeting private schooling

[3] According to Census data, approximately 5% of household's self-report their school-aged children have a disability, and according to ADE approximately 15% of public-school children had disabilities. CSI estimates that only about 100 students were enrolled in the ESA program one year after its creation.

or professional tutoring and not allowing most non-classroom-related educational expenses; and an enforcement structure wherein ADE was limited to approving contracts subject to parents agreement to comply and random annual audit.

Of note: no authority was granted to the Department of Education to monitor and approve or deny transactions in real-time (indeed, the program structure suggests the Department has no role in the real-time use of account funds, which instead falls to the treasurer and the parent),[4] and the limited number of eligible expenditure categories left no real question as to the educational purpose of purchases (tuition, tutoring and required classroom textbooks are all prima facie "educational expenses").

HB 2622: The 2012 Expansion to General Education Students

The first significant expansion of the ESA program occurred in 2012 – just one year after its creation. Unfortunately, while the expansion largely upended the foundational order of the program (by both eliminating the requirement that a student have a disability and explicitly allowing expenditures on 'classroom equivalents' presumably intended for students and coursework outside a traditional classroom environment), it was "made to fit into" the existing 2011 ESA framework that contemplated a much smaller eligible student universe and a much narrower usage profile.

The first and most scrutable change was to eligibility; gone were exclusive requirements that a student have a disability and a be prior public-school student. Added were numerous new eligibility categories, including (the two broadest new eligibility categories) students attending D or F public schools under the state's letter grade system and the children of active-duty military parents. According to legislative testimony at the time, this expansion was anticipated to allow up to 200,000 students to enroll in the ESA program (or about a fifth of the state's then-K-12 population).

A second and less clear change was to the eligible uses of funds. Previously, the language was relatively narrow: the Legislature intended most ESA funds to be used for tuition and equivalent fees for traditional (but non-public) professional classroom settings and equivalents. And in practice, according to 2013 testimony by ADE, 90% of ESA funds were being used for this purpose.[xvii] However, an original permissible use was for "curriculum." Though undefined in the statute, the standard dictionary definition of the word is "the courses offered by an educational institution" or "a set of courses constituting an area of specialization."[xviii] The rules for interpreting statute require the use of standard definitions and the narrow construing of terms in their statutory context when they aren't directly defined. The 2011 framework then suggests the intended use here was still relatively narrow (for example, perhaps online courses taken through a structured curricula ending in a degree or certificate from places like Coursera).

The 2012 expansion added a statutory definition (superseding the common usage approach above), which read, "'Curriculum' means a complete course of study for a particular content area or grade level, including any supplemental materials required by the curriculum" (our emphasis). In general, the definition of "supplemental materials" is vast, subjective, and dependent on the specific course being supplemented

[3] Meriam-Webster defines audit as "a formal examination of an organization's or individuals accounts or financial situation". The audited entity is required to produce receipts and other records to support claims made on prior official documents, like a tax return. By its nature an audit is backwards looking and not done in real-time.

(though arguably, the use of "required by the curriculum" remains limiting). This becomes the first time ESA funds could be used to cover a vast range of goods and services that might plausibly be needed for a given curriculum (for example, power tools for a woodworking class) and that their ultimate use for allowed educational purposes becomes not prima facie but inherently subjective.

Unfortunately, as we have discussed, the administrative execution of this expansion tried to provide objective "yes-no" guidance on a product-by-product and service-by-service basis, rather than acknowledging this now-subjective reality.

Also in 2012, the Legislature added the first explicit prohibitions for eligible uses of ESA funds, which is consistent with our interpretation above; it only makes sense to prohibit these specific purchases if they might otherwise be allowable under, for example, the definition of "curriculum" above. Prohibited purchases included transportation costs, computers, and technological devices, and "consumable educational supplies, including paper, pens or markers."

HB 2458: The 2013 Oversight Changes

In 2013 – less than two years after the creation of the program and at a time when enrollment was probably less than 300 students – the Arizona Legislature passed, and then-Gov. Brewer signed HB 2458.

The 2013 statutory changes now required ADE to conduct annual audits of all empowerment scholarship accounts, in addition to now-required random and quarterly "as needed" audits. The changes also strengthened enforcement language, allowing ADE and the treasurer to suspend ESA accounts and refer possible criminal violations for prosecution.

Notably, while the statutory structure had changed from random auditing of a sample of accounts to regular required annual audits, the underlying enforcement premise remained the same: the Legislature authorized the treasurer to administer the ESA accounts and funds themselves and parents to access those funds for allowed purposes; ADE was, at first, expected to audit those uses after the fact, but after 2013, audits were to be conducted at least annually. There is no clear statutory language requiring the Department to review every transaction in real-time (or nearly real-time). Also, while the statutory review by ADE is described as an audit, this term and process are undefined (both in 2013 and today).

Though, as of 2013 – by the Department's own testimony at the Arizona Legislature – ADE had already embarked on a very different path. To CSI's knowledge, the Department had and has never adopted a formal process for conducting "audits" – regular or as needed – of the ESA accounts. In legislative testimony delivered on Jan. 28, 2013, the Department testified that it has "staff review every single receipt" and that it will not release quarterly allotments until program participants had submitted all receipts for the prior quarter. ADE states that it adopted this posture initially to "disabuse" the public of the notion that they could make free use (or abuse of) the program monies. The Department spoke to the goal of moving towards more random and professional audits by hired or contracted auditors but provided no timeline.

While the process described does imply it was, at that time, ex post (receipts were reviewed after the purchase was made, presumably), it is otherwise already inconsistent with both the original 2011 statute and even the changes being discussed that were made in 2013 (and persist today). Also, strikingly, Rep. Paul Boyer, the sponsor of HB 2458 in 2013, described in testimony about the language changes his belief that the Department lacked the resources to audit every single account (even as he sponsored legislation that required it). It is also from this 2013 testimony by ADE that it begins to become clear that the Department has approached the administration of ESA accounts from a position of allowable and not allowable purchases – that is, a good or service itself was either allowed (in which case its purchase is always approved and presumed valid) or not allowed (in which case the purchase is never approved).[xix]

SB 1363: 2013's Eligibility & Formula Changes

In addition to the new oversight requirements in HB 2458, the 2013 legislative session saw the passage of eligibility changes (eliminating the requirement of prior public-school attendance for otherwise qualifying students) and changes to the funding formula (likely intended to address the ambiguity created by enrolling new students who had not previously attended public school).

Under the new statutory language, an otherwise qualifying student (generally at the time, a student with a disability, a student who would be or is attending a D or F school, and the child of a military family) could now obtain an ESA upon reaching kindergarten age and without attending a public school for 100 days.

This otherwise intuitive expansion created an administerial problem given it was (again) attached to the framework of the original and much more narrowly construed 2012 law: how to fund a student who hadn't previously attended public school. The 2011 law allocated to the ESA student the amount of base support funding that would have otherwise been provided to their "prior school district;" the prior funding formula did not include any reference to the charter funding formulas, which are similar (for base support level) but also include charter "additional assistance" (supplementary funding for capital needs not available to district schools).

The Legislature resolved this by specifying that all students receive the sum of "the base support level and additional assistance" provided them by law if that "particular student…were attending a charter school." While this change resolved the ambiguity by clearly providing all ESA students a fixed amount – and tying that amount to their equivalent charter funding which accounts for all aspects of K-12 program costs, including capital costs – it created its own confusion for administrators and policymakers. For example, a legislative budget office Fiscal Note from the time strongly suggests legislative analysts believed only prior charter school students would receive the additional assistance funding (an estimated 15% of

ESA program participants at the time).[xx] This is not how the program has been administered; according to legislative testimony given by ADE in 2013, the prior program did (between 2011 and 2013) provide enrolling ESA students with the amount of base support funding they were receiving during their prior public school attendance, but the change in law would presume all students received their equivalent charter school funding regardless of prior (or not) public school attendance.[xxi]

HB 2139 & HB 2150: Expansion to Siblings & Certain Military Families in 2014

In 2014, the Legislature continued the now-annual exercise of changing the original 2011 language by opening the program to siblings of existing ESA participants and the children of military parents who were killed in the line of duty. In practice, these changes were minor relative to those made in 2012 and 2013.

SB 1237: Changes to the ESA Account Funding Schedule

In 2014, the Legislature empowered the Department of Education to change the funding schedule for a student's ESA account if the change was "necessary" for the operation of the account. By law, since 2011, ESA students received their formula allocation in quarterly allotments over the course of the fiscal year.

One can imagine the issues this might create for families enrolled in traditional private schools who pay the tuition lump-sum at the start of the academic year. Since 2014, ADE has had the authority to allot funds differently, such as all at once at the beginning of the year to pay an annual tuition bill, but it's unclear how often (if at all) this is used in practice.

SB 1280: 2016's Program Eligibility Changes

In 2016, and partly in response to findings to be imminently revealed in a report by the state's Auditor General, the Legislature explicitly prohibited a previous participant in the ESA program from continuing eligibility if the student "failed to comply with" or "knowingly misused" ESA monies.

2016 Auditor General Performance Report

In June 2016, the Auditor General published its first comprehensive performance audit of the state's Empowerment Scholarship Account program and the Department of Education's administration. While the performance audit identified various issues with the structure and administration of the program, the findings were grouped into two high-level improvement areas:

- The Department should strengthen its oversight of program spending.
- The Department should continue to improve its eligibility determination process, appropriately safeguard sensitive information, and better manage program information.

Notably, the Auditor General noted student eligibility as of late 2015: nearly 60% of ESA participants in the program's fourth year had disabilities (the original eligible population under the 2011 law); the largest eligible group (students attending D or F public schools) made up only 14% of ESA participants. This disproportionate program use by students with disabilities would persist in practice until so-called "universal eligibility" despite various piecemeal expansions of eligibility during the years between. For context, at the time, CSI estimated approximately 13% of K-12 students had disabilities while 20% attended a D or F school.

The Auditor General explicitly notes that the treasurer – on notice from ADE – deposits monies quarterly; no mention is made of the allowance in state law for annual lump-sum deposits in the review.

According to the performance audit review, as of 2016, the Department was administering ESA accounts by opening bank accounts with a "multinational financial institution" on behalf of the participating child (via the Treasurer's Office), and the bank then issued a debit card to the enrolling parents for use on the child's behalf. Department staff then "reviewed spending to ensure monies were used for statutorily approved purposes."[xxii] The review required parents to submit quarterly expense reports to the Department, including receipts and invoices for all purchases made over the prior three months with the debit card. Department staff then "attempt to review" every transaction on every expense report submitted.

The Auditor General notes that between August 2015 and January 2016, the Department identified $102,000 in "misspent monies;" the report fails to mention total spending over the period, but CSI can estimate this value at approximately $10.7 million based on figures available elsewhere. **This implies an effective misuse rate of 0.95% over the first half of the school year in 2016.** Further, nearly a third of misuse was due to the parent not submitting an expense report – what in Medicaid is today called a "procedural denial," meaning this was a paperwork issue and not an explicit finding of misbehavior. We lack the evidence to determine whether the underlying expense was valid or not.

This process as described appears consistent with the statutory structure of the program by this time. Recall, by law:

- An applying parent is required to attest that they will use the ESA funds for valid educational purchases when opening an account.
- The Department is required to open – and the treasurer to fund – an ESA account on valid application and contract signature.
- The Department is required to conduct "random, quarterly and annual" audits of accounts "as needed" to ensure compliance with statute.

The 2016 structure required parents to submit applications, sign affidavits and contracts, access funds in real-time via personal electronic debit cards, but submit quarterly expense reports for Department review.

Notably, while the Auditor General recommended the Department make use of "risk-based" and "electronic, online" systems and reports to conduct more timely reviews of expenditure reports and prevent future misspending, it did not find fault with the core process and systems the Department had been using since 2011. Nowhere in its report does it mention or recommend establishing a "marketplace" or partnering with a single point-of-contact third-party vendor to handle all ESA transactions.

SB 1431: 2017's (Unsuccessful) Initial 'Universal' Expansion

In 2017, the Legislature enacted (and the governor signed) SB 1431 – which among various program changes, would have allowed over four years for any student eligible to attend public school in Arizona to participate in the ESA program. However, the law limited the total size of the program by establishing strict enrollment caps; annual enrollment could not exceed 0.5% of the state's entire K-12 public school enrollment (approximately 5,500 children at the time), and from and after school year 2023, enrollment could not exceed the 2022 level (even if that were below the prior 0.5% enrollment cap).

Ultimately, this change was successfully referred to the ballot for review by voters before going into effect, and in a 2018 special election, voters repealed the expansion.

2018 Auditor General Follow-up Report

A 24-month follow-up review of the Department's administration of the ESA program, and response to its comprehensive 2016 report by the Auditor General again faulted the timeliness of the Department's recovery and remediation efforts. Still, it did not update the AG's core findings from its 2016 review regarding overall misuse rates.

Much of the follow-up report was devoted to commenting on the Departments treatment of ESA accounts that repeatedly attempted to use their debit cards to withdraw cash (according to the AG, 62 of over 5,300 accounts active at the time). While an interesting attempted misuse (noting, though, trying to make a cash purchase with ESA funds may be misuse under the Department's administratively-developed program terms, it is not prima facie proof of abuse – that would depend on what program participant intended to purchase), this in itself is not particularly compelling reason to reverse course. These attempts were automatically blocked and to CSI's knowledge no participant has ever successfully withdrawn cash using a debit card issued under the ESA program.

Nonetheless, the 2018 follow-up and its general criticism of the Department's timeliness in responding to transactions that had been automatically denied would become the impetus for later changes moving towards a more centralized management system and ultimately wholesale suspension of the debit card program.

HB 2749: 2019's Requirement to Contract with a Third-Party Administrator

In 2019 – and likely in direct response to the 2018 Auditor General follow-up report – the Legislature, as part of its annual Education omnibus, imposed on the Department of Education a requirement that it contract with a "third-party administrator to assist the Department in the financial administration of" ESA accounts.

When the requirement was imposed, the Department and treasurer were already embarking on exploring a third-party vendor contract for purposes of managing the "financial administration" of the program. Indeed, this language would be repealed, as the contract (ultimately awarded to ClassWallet, who remains the third-party administrator today) was awarded under the existing language that had been available to the Treasurer's Office (the program's financial minister) since 2011.

SB 1224: 2020's Expansion to Eligible Use

In 2020, the Legislature passed SB 1224 – which again expanded the definition of "curriculum" to include supplementary materials required or recommended by a course of study. The additional change, though minor, demonstrates again both the Legislature's intent that "curriculum" in the contest of the ESA statutes now (after 2012) be read broadly and generally. Policymakers also moved rulemaking authority – the supplementary policymaking process after statute – from the Department to the State Board of Education.

The Legislature demonstrates here both its ability to make statutory changes when stakeholders object to its administrative direction and its intention that terms be interpreted broadly and subjectively in the context of their use. For example, an ordinary household item not ordinarily used for educational purposes may be "required or recommended" by any number of course curriculums.

2020 Auditor General Special Review & the Online Marketplace

In 2020, at the request of the Joint Legislative Audit Committee, the Auditor General conducted another "special audit" of the ESA program and the Department. The impetus for the audit was parent complaints about the program's administration – in particular, long wait times and missed deadlines. For example, one parent could not receive an ESA award in time to pay their child's private school tuition; after paying out of pocket, when the award was received the Department would not permit the parent to reimburse themselves.

According to the review, during calendar 2019, the Department and the treasurer had already contracted with ClassWallet to "assist with the Program's financial management." A sidebar included in the audit notes that – according to the Department – ClassWallet would be used to "pay for" qualifying purchases from vendors that have "opted into" ClassWallet's online marketplace. The Department implied intent to fully transition all ESA accounts into this online marketplace and discontinue the use of the debit card/expense report process when that transfer was completed.

Notably, this transition occurred without any legal change in the ESA's statutory framework – confirmed by the state's Auditor General in its legislatively-mandated review of the program.

According to the Auditor General, a parent would attempt to purchase through the ClassWallet online marketplace – including uploading any supporting invoices presumably provided by the vendor outside of the marketplace – and then the Department would receive an alert to review and approve the purchase (in real time). While the Auditor General commented on the infeasibility of the Department taking ten days to review these pre-approval transaction requests, **it made no comment on the radical departure from the programs nearly ten-year-old existing structural framework, nor the apparent departure of this new structure from the statutory framework.**

By definition, an "audit" presupposes financial transactions have already occurred. Indeed, all the Auditor General's reviews to date and Departments stated plans and responses were premised on the assumption that the state would continue to open and fund ESA accounts, parents would continue to have more-or-less real-time discretion to make purchases with those accounts, and the Department would review quarterly expense reports "as needed" to ensure compliance.

HB 2853: 2022's 'Universal Eligibility' Expansion

Finally, in 2022, the Legislature passed – and the governor signed – HB 2853, which expanded ESA program eligibility to any child who is a resident of Arizona and otherwise eligible to attend a public K-12 school. This first-in-the-nation universal eligibility resulted in rapid program growth; within twelve months of the change enrollment would grow by 50,000 children (to five times its prior size). As of November 13, 2023, more than 70,000 students were enrolled in the ESA program.

Additionally, HB 2853 repealed prohibitions on purchasing "consumable educational supplies" and included explicit permission to purchase "computer hardware and technological devices" and certain public transportation services.

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