



REPORT HIGHLIGHTS

FINANCIAL STATEMENT AUDIT

Subject

The Department of Economic Security issues financial statements annually for the Division of Developmental Disabilities Arizona Long-Term Care System (ALTCS) Contract. The Division is responsible for preparing the financial statements, maintaining strong internal controls, and demonstrating compliance with its contractual arrangements with the Arizona Health Care Cost Containment (AHCCCS). As auditors, our job is to determine whether the Division has met its responsibilities.

Our Conclusion

A modified opinion was given on the ALTCS Contract financial statements because we were unable to audit certain medical and long-term care service claims of the ALTCS Contract due to deficiencies in internal control over claims processing. In addition, as illustrated on page 2, auditors noted instances of noncompliance with its contractual arrangements with AHCCCS.



2006

Year Ended June 30, 2006

Lack of Effective Controls Over the Arizona Long-Term Care Contract Resulted in a Modified Auditors' Report on its Financial Statements

The Department of Economic Security's Division of Developmental Disabilities (Division) is a contractor with the Arizona Health Care Cost Containment System (AHCCCS) to provide medical and long-term care services to eligible enrollees of the AHCCCS Arizona Long-Term Care System (ALTCS) program for the developmentally disabled. This program provides inpatient and outpatient medical and nursing services in addition to managed institutional and home- and community-based long-term care services to the program's eligible enrollees. During fiscal year 2006, the Division spent more than \$550 million for medical and long-term care services for program enrollees. Therefore, it is imperative that the Division maintain effective internal control policies and procedures over its claims process to help ensure claims are accurately paid, recorded, and reported. Annually, AHCCCS requires the Division to prepare financial statements for the ALTCS program. The results of our audit of these financial statements follows.

During the fiscal year, the Division implemented a new claims processing system to meet the federal Health Insurance Portability and Accountability Act (HIPAA) requirements for health care claims processors to accept provider claims that followed HIPAA electronic claim filing standards. However, due to insufficient testing of the new system and a poor implementation plan, the system did not always identify duplicate claims, did not always apply proper pay rates, made some payments for uncovered services, and rejected some valid claims.

Consequently, the Division's records did not permit the auditors to apply auditing procedures sufficient to determine whether certain medical and long-term care services claims paid during the year, totaling \$20 million, were accurate and the auditors' report on the Division's financial statements was modified.

The Division could have similar problems in fiscal year 2007; therefore, the fiscal year 2007 ALTCS financial statements may require substantial analysis and corrections to be accurate, and could again result in a modification to the auditors' report.

Condensed Financial Information

The Division's financial information is presented in a Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance.

Balance Sheet

The Balance Sheet reports all assets and

liabilities using the modified accrual basis of accounting. Fund balance, the difference between assets and liabilities, is one way to measure the Division's financial health. The table on the following page presents a condensed Balance Sheet at June 30, 2006.

Statement of Revenues, Expenditures, and Changes in Fund Balance

The Statement of Revenues, Expenditures, and Changes in Fund Balance presents information showing how fund balance changed during the most recent fiscal year.

During the year, the ALTCS Contract's fund balance decreased by \$7.1 million. The decrease can be primarily attributable to an 11.5 percent increase in expenditures. The increase in expenditures is the result of increased provider rates for qualified vendors as well as overpayments, which were a result of internal control deficiencies discussed on page 1.

Balance Sheet June 30, 2006 (In Millions)

Assets:	
Cash and investments held by State Treasurer	\$59.4
Due from providers	8.9
Due from other state funds	<u>3.4</u>
Total assets	<u>\$71.7</u>
Liabilities and Fund Balance:	
Accrued administrative and payroll costs	\$ 3.5
Accrued medical and healthcare claims	49.5
Due to other state funds	<u>1.7</u>
Total liabilities	<u>54.7</u>
Unreserved fund balance	<u>17.0</u>
Total liabilities and fund balance	<u>\$71.7</u>

Statement of Revenues, Expenditures, and Changes in Fund Balance Year Ended June 30, 2006 (In Millions)

Revenues:	
Capitation	\$620.4
Ventilator dependent	14.9
Fee for service	.9
Investment earnings	<u>3.5</u>
Total revenues	<u>639.7</u>
Expenditures:	
Health and welfare:	
Aid to individuals	557.9
Allocated administrative expenditures	43.4
Case management	30.5
Professional and outside services	<u>7.9</u>
Total expenditures	<u>639.7</u>
Excess of revenues over expenditures	
Other financing uses:	
Transfers to other state funds	<u>(7.1)</u>
Net change in fund balance	<u>(7.1)</u>
Fund balance—beginning	<u>24.1</u>
Fund balance—ending	<u>\$ 17.0</u>

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Contact person for this report:
Doug Haywood

Division Needs to Comply with AHCCCS Contractual Requirements

The Division's management is responsible for preparing accurate financial statements and demonstrating compliance with AHCCCS' contractual requirements. However, some of the contractual objectives were not fully achieved. To help ensure that the Division's management achieves these objectives, it should strengthen controls over AHCCCS contractual requirements to ensure the following:

- Ensure new system implementation plans are submitted to AHCCCS within required timeframe.
- Ensure that its new claims processing system controls are adequate and functioning properly.
- Ensure that the accounting system can generate accurate and timely accounting records.
- Ensure that claim information (i.e., encounter data) is submitted to AHCCCS within required timelines.
- Ensure that its methodology to estimate accrued long-term care costs is reasonable and consistent with methods established by AHCCCS.
- Ensure a monitoring system is in place to monitor its claims processing system to guard against fraud and abuse.

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Year Ended June 30, 2006