



A REPORT  
TO THE  
ARIZONA LEGISLATURE

Financial Audit Division

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Report on Internal Control and Compliance

**Department of  
Economic Security**

Division of Developmental  
Disabilities ALTCS Contract  
Year Ended June 30, 2007

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**Debra K. Davenport**  
Auditor General

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Department of Economic Security  
Division of Developmental Disabilities ALTCS Contract  
Report on Internal Control and Compliance  
Year Ended June 30, 2007

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Financial Statement Audit	



**STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL**

**DEBRA K. DAVENPORT, CPA**  
AUDITOR GENERAL

**WILLIAM THOMSON**  
DEPUTY AUDITOR GENERAL

**Independent Auditors' Report on Internal Control over Financial Reporting  
and on Compliance and Other Matters Based on an Audit of Financial  
Statements Performed in Accordance with *Government Auditing Standards***

Members of the Arizona State Legislature

Tracy Wareing, Director  
Department of Economic Security

We have audited the financial statements of the State of Arizona, Department of Economic Security, Division of Developmental Disabilities, Arizona Long-Term Care System ALTCS Contract (ALTCS Contract) as of and for the year ended June 30, 2007, and have issued our report thereon dated May 19, 2008. Our report was qualified because of a scope limitation. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control over Financial Reporting**

In planning and performing our audit, we considered the Division's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Division's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the ALTCS Contract financial statements that is more than inconsequential will not be prevented or detected by the Division's internal control. We consider items 07-01 through 07-06 described in the accompanying Schedule of Findings and Recommendations to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Division's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 07-01 through 07-05 to be material weaknesses.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Division's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, and which are described in the accompanying Schedule of Findings and Recommendations as items 07-05, and 07-06.

Division responses to the recommendations identified in our audit have been included herein. We did not audit the Division's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Arizona Health Care Cost Containment System (AHCCCS), and the Director of the Department of Economic Security and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited.

Dennis L. Mattheisen, CPA  
Financial Audit Director

May 19, 2008

Department of Economic Security  
Division of Developmental Disabilities ALTCS Contract  
Schedule of Findings and Recommendations  
Year Ended June 30, 2007

07-01

**The Division should establish effective internal control policies and procedures over its claims processing system**

During fiscal year 2007, the Division spent more than \$636 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. The claims processing system's adjudication process should be designed to efficiently and effectively evaluate claims for propriety and determine the amounts to be paid. However, the claims processing system did not meet this objective because it did not always identify duplicate claims, did not always apply proper pay rates, made some payments for uncovered services, and rejected some valid claims.

In February 2006, the Division implemented a new medical claims processing system to meet the Health Insurance Portability and Accountability Act (HIPAA) requirements for healthcare claims processors to accept provider claims that followed HIPAA electronic claim filing standards. The Division encountered system problems described above and, as a result, turned off edit checks and processed claims manually.

During fiscal year 2007, the Division continued working on the system to correct the problems. As of January 2007, the Division had reprocessed all 2006 and 2007 manually-paid claims and reconciled the reprocessed claims to the manual payments. It also established estimated receivables from providers for overpayments. The Division is continuing to investigate and resolve differences with providers, and as these differences are resolved, the estimated receivable has been adjusted accordingly. However, the Division's records did not permit the auditors to apply auditing procedures sufficient to determine whether certain medical and long-term care service claims paid during fiscal year 2006 and 2007, totaling \$11.5 million, were accurate. Of the total \$11.5 million, \$5.5 million is reported as aid to individuals expenditures, \$2.7 million of these claims is reported as a reduction to beginning fund balance, and \$3.3 million is reported as due from providers.

This finding is considered a material weakness, and a similar recommendation was provided to the Division in the prior year.

To help strengthen control over claims processing, the Division should correct all system deficiencies and perform test procedures to help ensure that the system is accurately processing, recording, paying, and reporting claims. In addition, the Division should continue efforts to account for and recover provider overpayments.

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07-02

**The Division needs to ensure its financial statements are accurate**

The Department of Economic Security and the Division's management depend on accurate financial information to fulfill their oversight responsibility and report accurate information to AHCCCS, the public, and other interested parties. To achieve this objective, the Division needs to improve internal control over its general ledger accounting to help ensure its accounting records and financial reports are accurate and complete. The Division used spreadsheets to account for and accumulate various financial transactions for financial reporting. However, this process was time-consuming and prone to error. For example, auditors noted errors in the compilation process that materially misstated various amounts in the aid to individuals expenditures financial statement note by \$1 to \$3 million. The Division adjusted its financial statements and notes for all significant errors. This finding is considered a material weakness, and a similar recommendation was provided to the Division in the prior year.

To help ensure that the Division's financial statements are accurate and complete the Division should implement a system that can account for, accumulate, and accurately report all health plan financial transactions.

07-03

**The Division should strengthen computer access controls**

System access controls help ensure that only authorized users have access to the Division's computer systems and sensitive data. These controls are critical in preventing or detecting unauthorized use, damage, loss, or modification of programs and equipment, and misuse of sensitive information. System access controls restrict not only physical access to the Division's systems, but also logical access to those systems. Access to the Division's computer systems should be limited to those individuals authorized to process transactions or maintain a particular system.

The Division did not adequately limit logical access to its computer systems during fiscal year 2007 since it did not establish policies and procedures for computer access until January 2008. Specifically, in many instances, division employees had incompatible capabilities, including the ability to authorize member services, modify member information, and authorize payments to providers. Further, auditors noted several generic user accounts that were not assigned to a specific employee and could be used to make unauthorized changes to the system. Several of these accounts included approval and update privileges. In addition, quality assurance and help desk employees had access to all user passwords. This finding is considered a material weakness, and a similar recommendation was provided to the Division in the prior year.

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To help strengthen system access controls to prevent or detect unauthorized use, damage, loss, or modification of programs and equipment, and misuse of sensitive information, the Division should establish policies and procedures to ensure that:

- Only authorized users have logical access to the Division's computer system.
- Logical access is compatible with each employee's job responsibilities.
- All generic user accounts are eliminated, and each user account is assigned only to individual employees.
- The quality assurance and help desk do not have access to all user passwords.

07-04

**The Division should strengthen controls over computer program changes**

To help ensure that an information system functions as designed, it is essential that changes to the application software be properly authorized, tested, reviewed, and approved before changes are implemented. However, the Division did not have a documented and approved process to ensure computer program changes met these objectives until July 2007. Although the Division used an issue-tracking system to record and report the progress of computer program changes, the Division did not retain documentation to support that program changes had been authorized, tested, and reviewed. This finding is considered a material weakness, and a similar recommendation was provided to the Division in the prior year.

To help ensure that changes to its computer programs meet user needs and objectives, and are adequately developed, thoroughly tested, and properly applied, the Division should monitor and enforce written policies and procedures to ensure that management and users:

- Authorize, review, and approve all program changes to the information systems prior to implementation.
- Review and approve the testing methods.
- Document expected testing results and whether these results were achieved.
- Retain documentation to support that program changes were authorized, tested, and reviewed.

07-05

**The Division needs to implement previously reported recommendations**

The Division is responsible for preparing the financial statements, maintaining strong internal controls, and complying with its ALTCS contract. An appropriately designed internal control system should include appropriate policies and procedures to assess the effects of reported deficiencies, design an appropriate corrective action plan, and ensure that the plan is followed and implemented. However, auditors have provided detailed recommendations to the Division to correct deficiencies in internal controls over financial reporting and instances of noncompliance with the ALTCS Contract noted during the 2002 through 2006 audits, and the Division hasn't always assessed the effects of these reported deficiencies and decide to either correct them or conclude that they will not be corrected. Specifically, the Division has not



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implemented the recommendations for establishing effective internal control policies and procedures over its claims processing system, ensuring that its financial statements are accurate, strengthening computer access and program change controls, and following AHCCCS-approved methods to estimate its accrued long-term care costs, as described in recommendations 07-01, 07-02, 07-03, 07-04, and 07-06, respectively. This finding is considered a material weakness.

To help ensure that the Division fulfills its responsibility to establish and maintain adequate internal controls and comply with the ALTCS Contract, the Division should perform risk assessments to determine the effects of reported deficiencies, design an appropriate corrective action plan, and ensure that the plan is followed and implemented.

07-06

**The Division should follow AHCCCS-approved methods to estimate its accrued long-term care costs**

The Division's management is responsible for preparing accurate financial statements and complying with AHCCCS accounting and reporting requirements. As part of this objective, management should ensure that its accounting estimates for claims payable and aid to individuals expenditures reported in the financial statements and supplementary schedules are accurate and consistently follow the methods established by AHCCCS. However, Division has not developed AHCCCS-approved methods to identify and report institutional care and home- and community-based services (HCBS) reported but unpaid claims (RBUC) payable, or estimate acute care incurred but not reported (IBNR) and RBUC claims payable. In addition, the Division should develop a lag schedule for ventilator services based on current patterns and actual payment information to estimate the ventilator dependent IBNR claims payable. Furthermore, the lag schedules did not agree to the financial statements and the acute care IBNR and RBUC schedule was not calculated in accordance with procedures. Finally, the Division did not calculate the RBUCs for the HCBS and institutional care expenditures and therefore could not calculate the RBUC days outstanding. A similar recommendation was provided to the Division in the prior year.

While auditors were able to determine the reasonableness of the estimates and the Division corrected all significant errors, the Division should ensure that amounts reported for claims payable in the Division's financial statements and supplementary schedules is reviewed for accuracy and follow the methods established by AHCCCS. In addition, the Division should develop and document logical estimation techniques for IBNR and RBUC claims payable and have the techniques approved by AHCCCS to ensure consistent application. Further, the Division should periodically evaluate those techniques to help ensure they are current and effective, and are producing accurate results.



ARIZONA DEPARTMENT OF ECONOMIC SECURITY

1717 W. Jefferson • P.O. Box 6123 • Phoenix, AZ 85005

Janet Napolitano  
Governor

Tracy L. Wareing  
Director

JUN 06 2008

Ms. Debbie Davenport  
Auditor General, Office of the Auditor General  
2910 North 44<sup>th</sup> Street, Suite 410  
Phoenix, Arizona 85018

Dear Ms. Davenport:

Thank you for the opportunity to respond to the Department of Economic Security, Division of Developmental Disabilities' (DDD) Arizona Long-Term Care System Financial Audit for SFY 2007. We appreciate the professional approach and unwavering commitment the auditors took during the course of this review. The purpose of this letter is to forward the Department's written responses to the report.

As you are aware, in 2006, DDD implemented an enhanced data management system, FOCUS, and immediately experienced problems with the claims payment system module for the first nine months of operation which encompassed two state fiscal year audit periods. As a result, the auditors performed more extensive test work than required by the scope and complexity of the audit. The Department welcomes the Auditor General's review as a means to continue to enhance and refine internal controls associated with the claims payment system module and financial reporting.

The Department agrees with the findings in the report and has identified and initiated work to implement the recommendations. It is anticipated that system enhancements will be on-going, and the change management procedures initiated by the Department will ensure that future enhancements are executing properly prior to production implementation.

If you have any questions, please contact Barbara Brent, Assistant Director, Division of Developmental Disabilities, at (602) 542-6857 or me at (602) 542-5757.

Sincerely,

Tracy L. Wareing  
Director

Enclosure



**DES Response – Arizona Long -Term Care System (ALTCS)  
Fiscal Year 2007 Contract Financial Audit Report on Internal Controls**

**07-01**

The Department of Economic Security's Division of Developmental Disabilities should establish effective internal control policies and procedures over its claims processing system.

**Recommendation**

To help strengthen control over claims processing, the Division should correct all system deficiencies and perform test procedures to help ensure that the system is accurately processing, recording, paying, and reporting claims. In addition, the Division should continue efforts to account for and recover provider overpayments.

***DES Response***

The Department of Economic Security's (Department) Division of Developmental Disabilities (Division) is committed to ensuring that all Division operations have effective internal control policies and procedures over claims processing systems and that they are implemented and monitored accordingly. The Department concurs with the finding and will continue to implement the audit recommendations.

The new automated system, FOCUS, includes approximately 150 system edits used to determine if a claim is accurate and recorded against the proper funding stream. This is significantly more than the 20 edits in the previous ASSISTS system. However, when FOCUS was initially implemented, not all of the 150 edits were executing properly. As the Division identified system deficiencies, corrective actions were initiated and completed and have been working properly since January 2007.

As reported in the finding, as of January 2007, the Division had reprocessed and reconciled all 2006 and 2007 claims that were initially paid outside the FOCUS system edits. The Division also established estimated receivables from providers for any incorrect billings and is continuing to investigate and resolve differences with providers. As these differences are resolved, the estimated receivables are adjusted accordingly.

The Division holds itself accountable for the responsible use of public dollars and is committed to the reconciliation and recovery process.

**07-02**

The Division needs to ensure its financial statements are accurate.

**Recommendation**

The help ensure that the Division's financial statements are accurate and complete the Division should implement a system that can account for, accumulate, and accurately report all health plan financial transactions.



### ***DES Response***

The Department concurs with the finding and will continue to explore options for a viable solution to implement the audit recommendations.

Based on the Auditor General's May 2007 recommendation, the Department purchased the Quick Books ledger accounting software program anticipating that the program could be used to accumulate and accurately report all long-term care financial transactions including non-cash adjustments. This has not resolved the issues raised by the auditors.

The Department acknowledges that the reconciliation process between FOCUS (the Division's claim payment system) and FMCS (the Department accounting system of record) is a complex and yet an integral part of the financial statement preparation. The reconciliation process will be revised to ensure that it is accurate, well documented, and complete. In addition, the Financial Services Administration and Division staff will work to improve the financial statement preparation and process by adding layers of review to help ensure that errors are minimized and that financial statements are completed in a more accurate and timely manner.

### **07-03**

The Division should strengthen computer access controls.

### **Recommendation**

To help strengthen system access controls to prevent or detect unauthorized use, damage, loss, or modification of programs and equipment, and misuse of sensitive information, the Division should establish policies and procedures to ensure that:

- Only authorized users have logical access to the Division's computer system.
- Logical access is compatible with each employee's job responsibilities.
- All generic user accounts are eliminated, and each user account should be assigned only to individual employees.
- The quality assurance and help desk do not have access to all user passwords.

### ***DES Response***

The Department concurs with the finding and is completing implementation of the audit recommendations.

The Division's Information Technology Application office has reviewed job roles and responsibilities and their corresponding access to FOCUS production data to prevent unauthorized use, damage, loss, or modifications of programs and equipment. Based on this review, a corrective action plan has been developed and is being implemented. These changes ensure that all access is compatible with an employee's job responsibilities and will prevent improper access to, or misuse of sensitive information (login IDs). These changes will also ensure that only authorized users have logical access to the FOCUS system. In addition, policies and procedures will be changed and strengthened. Changes already implemented or planned include:



- Use of all generic user accounts has been eliminated, effective April 24, 2008.
- Access to FOCUS production passwords (except for their own password) by Quality Assurance Personnel has been eliminated, effective March 2007.
- Procedures for migrating databases from production to the quality assurance environment have been implemented that require the Data Base Administrator's to run a script to change all passwords except for the Quality Assurance Personnel, effective December 1, 2006.
- Implementation of Windows Authentication which will eliminate the need for Production Support staff to have access to internal user password files is planned to be completed by July 1, 2008.

#### **07-04**

The Division should strengthen controls over computer program changes.

#### **Recommendation**

To help ensure that changes to its computer programs meet user needs and objectives, and are adequately developed, thoroughly tested, and properly applied, the Division should monitor and enforce written policies and procedures to ensure that management and users:

- Authorize, review, and approve all program changes to the information systems prior to implementation.
- Review and approve the testing methods.
- Document expected testing results and whether these results were achieved.
- Retain documentation to support that program changes were authorized, tested, and reviewed.

#### ***DES Response***

The Department concurs with the finding, has completed the recommended changes via policy methodology, and has been working on implementation of the recommendation for the past 10 months.

Effective July 2007, the Division mandated that all computer program changes be accomplished in conformance with the DES Standard Development Methodology (1-38-0056). This methodology requires, for all program changes, development of documented user requirements, approved testing plans containing expected results, and user and/or management approval before production implementation. This process ensures that, during implementation, system changes and enhancements are executing accurately and efficiently.

#### **07-05**

The Division needs to implement previously reported recommendations.



### **Recommendation**

To help ensure that the Division fulfills its responsibility to establish and maintain adequate internal controls and comply with the ALTCS Contract, the Division should perform risk assessments to determine the effects of deficiencies, design an appropriate corrective action plan, and ensure that the plan is followed and implemented.

### ***DES Response***

The Department concurs with the finding and is continuing to implement the recommendations.

As previously discussed under each recommendation, the Division has been working toward implementation of each audit recommendation. Specifically,

- 07-01 – The Division identified system deficiencies; corrective actions were initiated and completed and have been working properly since January 2007.
- 07-02 – In response to last years finding, the Department purchased and tested a ledger accounting software program, but during testing it was determined that it did not support the ALTCS financial requirements.

In order to address this finding, the Financial Services Administration and Division staff will work to improve the financial statement preparation and process by adding layers to review to help ensure that errors are minimized and that financial statements are completed in a more accurate and timely manner.

- 07-03 – This recommendation required an enhancement to the FOCUS security module and was fairly complex to completely implement. However, initial implementation of this recommendation began in March 2007. As various solutions to the recommendation were identified they were implemented. The complete implementation is scheduled for July 2008.
- 07-04 – Effective July 2007, the Division mandated that all computer program changes be accomplished in conformance with the DES Standard Development Methodology (1-38-0056).
- 07-06 – Currently, these methods are being reviewed within the Division and will be submitted to AHCCCS for their review and approval by August 2008.

### **07-06**

The Division should follow AHCCCS-approved methods to estimate its accrued long-term care costs.

### **Recommendation**

The Division should ensure that amounts reported for claims payable in the Division's financial statements and supplementary schedules are reviewed for accuracy and follow

the methods established by AHCCCS. In addition, the Division should develop and document logical estimation techniques for IBNR and RBUC claims payable and have the techniques approved by AHCCCS to ensure consistent application. Further, the Division should periodically evaluate those techniques to help ensure they are current and effective, and are producing accurate results.

***DES Response***

The Department concurs with the finding and will implement the audit recommendation.

The Division acknowledges its responsibility for preparing financial statements that include accounting estimates for home and community based services (HCBS) and institutional activities and medical service claim liabilities. The quarterly lag schedules for HCBS, institutional activities and medical services have been completed and will be part of the fiscal year 2008 quarterly and annual financial statements.

Currently, these schedules and methodologies are being reviewed to ensure that estimate methodologies and lag schedules for all services are effective and producing accurate results. Once this process is complete, the Division will provide AHCCCS with these revised methodologies to obtain its approval by August 2008.