



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 System (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.



2007

Year Ended June 30, 2007

Division Takes Steps to Improve Controls Over Medical and Healthcare Services Payments

The Department of Economic Security's Division of Developmental Disabilities (Division) is a contractor with AHCCCS to provide medical and healthcare 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 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.

During the fiscal year 2006, the Division implemented a new claims processing system to meet the federal Health Insurance Portability and Accountability Act (HIPAA) mandates requiring healthcare claims processors to accept provider claims that follow HIPAA electronic

claim filing standards. However, because of 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.

During fiscal year 2007, the Division continued working on the system to correct these problems. As of January 2007, the Division had reprocessed fiscal year 2006 and 2007 manually paid claims and continued to investigate and resolve overpayments to providers as a result of the deficiencies with its claim processing system described above. 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.

Condensed Financial Information

The Division's ALTCS Contract 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 the Division's Balance Sheet at June 30, 2007.

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.

As shown in the table, the ALTCS Contract's fund balance decreased by \$17.7 million during fiscal year 2007. Accordingly to the Division, there was a shortfall resulting from the non-ventilator dependent individuals capitation rate that was less than the approved actuarial rate. In order to resolve the shortfall by means other than seeking a General Fund supplemental appropriation, the Division requested authority to spend other sources, including the use of the fund balance.

Assets:	
Cash and investments held by State Treasurer	\$45.9
Due from other state funds	5.2
Due from providers	4.9
Total assets	<u>\$56.0</u>
Liabilities and Fund Balance:	
Accrued administrative and payroll costs	\$ 3.6
Accrued medical and healthcare claims	53.1
Due to other state funds	0.1
Total liabilities	<u>56.8</u>
Fund deficit	<u>(0.8)</u>
Total liabilities and fund balance	<u>\$56.0</u>

Revenues:	
Capitation	\$689.6
Ventilator dependent	16.2
Fee for service	0.8
Investment earnings	4.1
Total revenues	<u>710.7</u>
Expenditures:	
Health and welfare:	
Aid to individuals	636.1
Allocated administrative expenditures	30.0
Case management	36.1
Professional and outside services	7.8
Premium tax	14.6
Total expenditures	<u>724.6</u>
Deficiency of revenues over expenditures	(13.9)
Other financing uses:	
Transfers to other state funds	(3.8)
Net change in fund balance	<u>(17.7)</u>
Fund balance—beginning	<u>16.9</u>
Fund deficit—ending	<u>\$ (0.8)</u>

TO OBTAIN MORE INFORMATION

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Division Needs to Strengthen Internal Controls and Comply with AHCCCS Contractual Requirements

The Division's management is responsible for preparing accurate financial statements and demonstrating compliance with AHCCCS' contractual requirements. However, the Division did not always meet these objectives. To help ensure that the Division's management achieves these objectives, it should strengthen controls to ensure:

- The claims processing system controls are adequate and functioning properly.
- The accounting system can generate accurate accounting records and the financial statements are accurate and complete.
- Computer access controls are strengthened to help prevent or detect unauthorized access to sensitive data.
- Computer program changes are properly authorized, tested, reviewed, and approved.
- The methodology to estimate accrued long-term care costs is reasonable and consistent with methods established by AHCCCS.

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Year Ended June 30, 2007