

**State of Arizona**  
**Department of Economic Security**  
**Division of Developmental Disabilities**  
**ALTCS Contract**  
**Management Letter**  
**Year Ended June 30, 2001**

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DEBRA K. DAVENPORT, CPA  
AUDITOR GENERAL

STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

WILLIAM THOMSON  
DEPUTY AUDITOR GENERAL

October 25, 2001

John L. Clayton, Director  
Department of Economic Security  
1717 West Jefferson Street, Site Code 010A  
Phoenix, AZ 85007

**Subject: Management Letter**

In planning and conducting our audit of the Department of Economic Security, Division of Developmental Disabilities, ALTCS Contract for the year ended June 30, 2001, we performed the following as required by U.S. generally accepted auditing standards and the *Arizona Administrative Code*, Title 9, Chapter 28, as detailed in the *Reporting Guide for Arizona Long-Term Care System (ALTCS) Program Contractors with the Arizona Health Care Cost Containment System*:

- Considered the Department of Economic Security, Division of Developmental Disabilities' internal controls over financial reporting and
- Tested its compliance with laws and regulations that could have a direct and material effect on the ALTCS Contract's financial statements.

Our audit disclosed internal control weaknesses and instances of noncompliance with laws and regulations. Management should correct these deficiencies to ensure that it fulfills its responsibility to establish and maintain adequate internal controls and comply with laws and regulations. Our recommendations are described in the accompanying summary.

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

Should you have any questions concerning its contents, please let us know.

Sincerely,

Debbie Davenport  
Auditor General

Attachment

## Background

The Department of Economic Security, Division of Developmental Disabilities contracts with the Arizona Health Care Cost Containment System (AHCCCS) to provide health care services to eligible enrollees of the AHCCCS Arizona Long-Term Care System (ALTCS) program for the developmentally disabled. The ALTCS program provides inpatient and outpatient medical and nursing services in addition to managed institutional and home- and community-based long-term care services.

### The Division Should Properly Account for Contract Liabilities

The Division is responsible for complying with provisions in the ALTCS contract and the *Reporting Guide for ALTCS Program Contractors with the AHCCCS* regarding the age of claims payable by type of service provided. However, the Division's automated claims system was not capable of calculating payables. Consequently, we noted the following instances of noncompliance:

- The Division's automated claims system was unable to calculate the aging for the medical claims payable schedule required by the AHCCCS. Specifically, the system could not calculate the number of days following the receipt of claims to the date paid for any reported but unpaid claims (RBUC). In addition, the system was unable to distinguish between RBUCs and incurred but not reported (IBNR) claims. As a result, the Division inappropriately determined the RBUC portion of the liability by calculating claims paid during the encumbrance period July 1 to July 30, 2001.
- The Division did not present a lag report for acute care or other medical payments in the supplementary schedules to its quarterly and annual financial statements.

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*Recommend establishing a reliable claims processing system.*

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The Department should establish a reliable claims processing system to help prepare required supplementary schedules in an accurate and timely manner. Doing so will help the Division comply with provisions in the ALTCS contract and the *Reporting Guide for ALTCS Program Contractors with the AHCCCS*.

### The Division Should Comply with Performance Measures

The Division is responsible for complying with ALTCS contract provisions regarding performance measures. The provisions help ensure that ALTCS monies are primarily used to provide medical services to eligible individuals.

During fiscal year 2000-2001, the Division had a medical expense ratio of 79 percent and a total administrative cost percentage of 12 percent. ALTCS contract provisions require the Division to maintain a medical expense ratio of at least 85 percent and a total administrative cost percentage of 10 percent or less.

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*Recommendation monitor  
performance measures  
quarterly*

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The Division should monitor performance measure ratios at least quarterly and make adjustments to help ensure that ALTCS monies are primarily used to provide medical services to eligible individuals as required by the ALTCS Contract provisions.



ARIZONA DEPARTMENT OF ECONOMIC SECURITY  
1717 W. Jefferson - P.O. Box 6123 - Phoenix, AZ 85005

Jane Dee Hull  
Governor

OCT 30 2001

John L. Clayton  
Director

Debbie Davenport, CPA  
Auditor General  
Office of the Auditor General  
2910 N. 44<sup>th</sup> Street, Suite 410  
Phoenix, AZ 85018

Dear Ms. Davenport:

The Division of Developmental Disabilities concurs with the findings in the Management Letter for the State of Arizona, Department of Economic Security, Division of Developmental Disabilities, Arizona Long Term Care System (ALTCS) Contract audit for the fiscal year ended June 30, 2001.

**The Division Should Properly Account for Contract Liabilities**

The Division concurs. The replacement of the aged acute care medical claims payable system was completed on October 15, 2001. The new system provides for the appropriate accounting of contractual liabilities as stipulated in the ALTCS contract provisions.

**The Division Should Comply with Performance Measures**

Medical Expense Ratio

The Division concurs. The lower medical expense ratio is attributed to the excess of revenues over expenditures in the fund balance at year-end. The trending of increased service levels experienced in State Fiscal Year 1999 and State Fiscal Year 2000 for home and community based services did not continue in State Fiscal Year 2001. The decrease in home and community based placements is attributed to the following:

- Contract limitations placed on the Division by the Attorney General in the areas of provider expansion and growth.
- The lack of providers due to the shortage of direct care staff. Providers have reported vacancies at 40% and higher.

If the equation excluded the excess, the medical expense ratio would be 83.45%.

Ms. Debbie Davenport  
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Administrative Cost Percentage

The Division concurs that, under the current administrative equation that includes case management expenditures, the administrative cost percentage exceeds the 10% ceiling. If case management expenditures continue to be included in the administrative cost percentage, it will be difficult for the Division to meet the standard. Additionally, as the Division implements automation projects, the administrative cost percentage will increase. The Division elevated these concerns at a January 9, 2001 meeting with Arizona Health Care Cost Containment System (AHCCCS) staff.

The Department's and Division's combined administrative cost for State Fiscal Year 2001 was 7.75%.

If you or your staff have any questions or require additional information please contact Ed Rapoport, Business Administrator, at 542-6893.

Sincerely,

  
John L. Clayton

C: Mike Koppelman  
Ric Zaharia  
Ed Rapoport