



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

**Department of
Economic Security**

Division of Developmental
Disabilities ALTCS Contract
Year Ended June 30, 2008



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, 2008

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

DEBRA K. DAVENPORT, CPA
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**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, 2008, and have issued our report thereon dated December 2, 2008. 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 opinion 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 08-01 through 08-05 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 08-01, 08-02, and 08-05 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 08-01, 08-02, and 08-05.

Division responses to the findings 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), the Director of the Department of Economic Security, and management 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.

Debbie Davenport
Auditor General

December 2, 2008

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Schedule of Findings and Recommendations
Year Ended June 30, 2008

08-01

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 prone to error. For example, auditors noted errors in the compilation process that materially misstated due from other state funds and due to other state funds financial statement line items, and various amounts in the aid to individuals expenditures financial statement note by \$50,000 to \$6 million. The Division adjusted its financial statements and notes for all significant errors. This finding is considered a material weakness over financial reporting, and a similar recommendation was provided to the Division in the prior 2 years.

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. To accomplish this, the Division should verify that amounts are transferred to the financial statements accurately and that financial statement amounts reconcile to the underlying accounting information.

08-02

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 reported in the financial statements and supplementary schedules are accurate and consistently follow the methods established by AHCCCS. However, the 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. Furthermore, the Division did not follow its established methods for developing HCBS and institutional care IBNR amounts and did not obtain approval for the method used. In addition, the Division did not develop a lag schedule for ventilator services based on current patterns and actual payment information to estimate the ventilator dependent IBNR claims payable. Although the auditors determined the reasonableness of the institutional care, acute care, ventilator dependent, and other medical IBNR, the auditors could not determine the reasonableness of the Division's HCBS IBNR estimate. The Division revised its estimate and used another unapproved method. The auditors determined that the revised HCBS IBNR estimate was reasonable. Finally, the Division did not calculate the RBUCs for the HCBS and institutional care expenditures and therefore could not calculate the RBUC days outstanding. This finding is considered a material weakness over financial reporting, and a similar recommendation was provided to the Division in the prior 2 years.

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While auditors were able to determine the reasonableness of the estimates, the Division should ensure that amounts reported for claims payable in the Division's financial statements and supplementary schedules are calculated accurately and follow the methods established by AHCCCS. To accomplish this, the Division should develop and document logical estimation techniques for IBNR and RBUC claims payable 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.

08-03

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 employees authorized to process transactions or maintain a particular system.

The Division did not adequately limit logical access to its FOCUS and QMACS claims payment systems during fiscal year 2008 since it did not establish policies and procedures for computer access until January 2008. Specifically, auditors noted the Division did not always retain documentation to support that users' access was approved and did not terminate or suspend system access when there was no activity for certain users. Auditors also noted generic user accounts that were not assigned to a specific employee and could be used to make unauthorized changes to the systems. Several of these accounts included approval and update privileges. In addition, there was no audit log used to track the database administrator's activity in either system. Further, system users had incompatible responsibilities or capabilities that weren't necessary to fulfill their job responsibilities. Specifically, FOCUS users had the ability to change service rates, third party liability waiver information, and payment addresses and QMACS system users had the ability to issue payments and change access security privileges and eligibility. In addition, until July 2008, the help desk employees had access to all FOCUS user passwords. A similar recommendation was provided to the Division in the prior 2 years.

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 follow the procedures listed below:

- Limit logical access to the Division's computer systems to authorized users.
- Retain access request forms with the supervisor's approval.
- Change an employee's system access immediately when an employee transfers from one position to another.
- Eliminate access to all computer systems promptly when an employee leaves the Division.
- Eliminate all generic user accounts and assign each user account to an individual employee.
- Document all changes to financial information made by users with significant access.

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- Limit access to as few employees as possible and make sure access is compatible with each employee's job responsibilities.
- Eliminate access to all user passwords for the help desk employees.

08-04

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 always follow its policies and procedures for QMACS system program changes. For example, of the eight program changes made during fiscal year 2008, division users did not approve six of them. In addition, for one change, documentation was not retained showing the change was tested, and that the responsibilities of developing, testing, and implementing the change were appropriately separated among employees.

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.
- Retain documentation to support that program changes were authorized, tested, and approved.

08-05

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 similar deficiencies in internal controls over financial reporting and instances of noncompliance with the ALTCS Contract noted during the 2002 through 2007 audits, and the Division hasn't always assessed the effects of these reported deficiencies and decided to either correct them or conclude that they will not be corrected. Specifically, the Division has not implemented the recommendations for ensuring that its financial statements are accurate, following AHCCCS-approved methods to estimate its accrued long-term care costs, and strengthening computer access controls, as described in recommendations 08-01, 08-02, and 08-03, respectively. This finding is considered a material weakness over financial reporting.

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.



ARIZONA DEPARTMENT OF ECONOMIC SECURITY

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Janet Napolitano
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Director

DEC 10 2008

Ms. Debbie Davenport
Auditor General
Office of the Auditor General
2910 North 44th 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 2008. 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.

The Department agrees with the findings in the report and has identified and initiated work to implement the recommendations.

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

Sincerely,

Tracy L. Wareing
Director

Enclosure

**DES Response – Arizona Long-Term Care System (ALTCS)
Fiscal Year 2008 Contract Financial Audit Report on Internal Controls**

08-01

The Division needs to ensure its financial statements are accurate

Recommendation

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. To accomplish this, the Division should verify that amounts are transferred to the financial statements accurately and that financial statement amounts reconcile to the underlying accounting information.

DES Response

The Department concurs with the finding and acknowledges that the reconciliation process between FOCUS (the Division's claim payment system) and FMCS (the Department accounting system of record) is complex and yet an integral part of the financial statement preparation. The reconciliation process will continue to be reviewed and revised to ensure that it is accurate, well documented, and complete.

Over the past year, Financial Services Administration and Division staff has worked to improve the financial statement preparation and process. These improvements have included a strengthened internal review process. Additionally, the Department has begun an initiative to automate the financial statement process and is currently developing an in-house AHCCCS financial statement reporting application.

It is anticipated that the reporting application will be designed, developed, tested and implemented by the fourth quarter of fiscal year 2009. The application will increase the accuracy and completeness of the financial statements by reducing reliance on manual data input.

08-02

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

Recommendation

While auditors were able to determine the reasonableness of the estimates, the Division should ensure that amounts reported for claims payable in the Division's financial statements and supplementary schedules are calculated accurately and follow the methods established by AHCCCS. To accomplish this, the Division should develop and document logical estimation techniques for IBNR and RBUC claims payable 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 incurred but not reported (IBNR) amounts for home and community based services (HCBS) and institutional care required additional analysis that deviated from the AHCCCS-approved methods in

fiscal year 2008. This reflected the stabilization of the FOCUS claims payment system and service providers' improved claim submittals, which reduced payment lags. Schedules and methodologies are being reviewed to ensure that methodologies that generate lag schedules for IBNR amounts are effective and producing accurate results. Once this process is complete, the Division will provide AHCCCS with these revised methodologies to obtain their approval by the reporting deadline for the third quarter of fiscal year 2009.

Due to changes to ALTCS financial reporting guidelines that are effective in January 2009, the Division will no longer be required to report claims payable for reported but unpaid claims (RBUC) days outstanding for all services and incurred but not reported (IBNR) claims payable for ventilator dependent services.

08-03

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 follow the procedures listed below:

- Limit logical access to the Division's computer systems to authorized users.
- Retain access request forms with the supervisor's approval.
- Change an employee's system access immediately when an employee transfers from one position to another.
- Eliminate access to all computer systems promptly when an employee leaves the Division.
- Eliminate all generic user accounts and assign each user account to an individual employee.
- Document all changes to financial information made by users with significant access.
- Limit access to as few employees as possible and make sure access is compatible with each employee's job responsibilities.
- Eliminate access to all user passwords for the help desk employees.

DES Response

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

The Division's Information Technology Application Office conducted initial reviews, in the second quarter of fiscal year 2008, of job roles and responsibilities and appropriate access to FOCUS production data. As a result of this review, policies and procedures have been changed and strengthened. These changes will help to ensure that all access is compatible with an employees' job responsibilities and prevent improper access to, or misuse of, sensitive information. In addition, these changes will ensure that only authorized users have logical access to the FOCUS system and will prevent unauthorized use, damage, loss, or modifications of programs and equipment. Specifically, the following actions have been taken to:

- Limit logical access to the Division's computer systems to authorized users.
 - In January 2008, the Division implemented policies and procedures to ensure that only authorized users have logical access, such logical access is limited to essential employees, and that access is compatible with each employee's job responsibilities.

- Retain access request forms with the supervisor's approval.
 - For both FOCUS and QMACS systems, access is granted only through the use of the J-125 process, which includes retention (hard copy or electronic) of the supervisory approval document.
- Change an employee's system access immediately when an employee transfers from one position to another.
 - For both FOCUS and QMACS systems, access is granted only through the use of the J-125 process. That access is modified upon notification of an employee transfer from one position to another within the Division or Department.
- Eliminate access to all computer systems promptly when an employee leaves the Division.
 - For both FOCUS and QMACS systems, access is granted only through the use of the J-125 process. That access is terminated upon notification of an employee leaving the Division or Department.
- Eliminate all generic user accounts and assign each user account to an individual employee.
 - Use of all FOCUS generic user accounts was eliminated, effective April 24, 2008.
 - Certain "generic" accounts are necessary in the QMACS system for Windows authentication, which is required for stored procedures and other Microsoft processes. These accounts will be evaluated to determine if alternatives exist.
- Document all changes to financial information made by users with significant access.
 - Changes made to the QMACS database, through the user interface, are logged in the database. This logging identifies the user making the change. When automated processes update QMACS tables, SQL stored procedures are utilized; the SQL account is used for database logging.
 - Changes made to the FOCUS database follow Database Administrator's (DBA) policies and procedures that require all production releases are recorded in a log. The procedures include use and retention of all release approval documentation.
- Limit access to as few employees as possible and make sure access is compatible with each employee's job responsibilities.
 - For both FOCUS and QMACS systems, the additional process of terminating user's accounts that have not accessed in the previous 90 days was implemented in October 2008. This ensures that user access follows required roles.
- Eliminate access to all user passwords for the help desk employees.
 - FOCUS help desk support staff access to FOCUS production passwords (except for their own password) was eliminated, following implementation of Windows Authentication in July 2008. Due to technical limitations in the system, these employees continue to have access to user passwords for a small number of external users; however, these external users only have read-only access.
 - Implementation of Windows Authentication has eliminated the need for users to enter FOCUS passwords. Thus there is no longer a need to force the users to change their passwords after initial entry.

- The QMACS help desk sets the initial user password and can not view the password established by the user. The QMACS help desk will reset user passwords when requested to do so by the user.

08-04

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.
- Retain documentation to support that program changes were authorized, tested, and approved.

DES Response

The Department concurs with the finding and will ensure that QMACS system changes are executed in conformance with DES Standard Development Methodology (1-38-0056). This methodology requires all program changes to document user requirements, approve testing plans which contain expected results, and requires user and/or management approval before production implementation.

Production changes to the QMACS system are executed with a request from the user. However, because of the interface with the AHCCCS reference file, it has been difficult for the user to review and approve the results prior to production implementation. The Department will develop and implement a process that reviews program changes prior to updating the AHCCCS reference file. All supporting documentation for production changes including authorization, testing, and approval will be retained.

08-05

The Division needs to implement previously reported recommendations

Recommendation

To help ensure 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 plans 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 Department has been working toward implementation of each audit recommendation. Specifically:

- 08-01 – In response to last years similar finding, Division and Financial Services Administration staff have strengthened the internal processes for the preparation of the financial statement preparation and process. Additionally, effort has begun to automate the financial statement

process, which will improve the accuracy, completeness, and timelines of the financial statements. It is anticipated that testing will be complete for implementation for use with the fiscal year 2009, fourth quarter ALTCS financial statements.

- 08-02 – Schedules and methodologies for accounting for incurred but not reported (IBNR) amounts are currently under internal review and will be submitted to AHCCCS for approval by the reporting deadline for the third quarter of fiscal year 2009.
- 08-03 – Over the past 6 months the Department has implemented the following:
 - Policies and procedures were implemented in January 2008.
 - Generic user accounts were eliminated in April 2008.
 - Production passwords were eliminated with the implementation of Windows Authentication in July 2008.