



A REPORT  
TO THE  
ARIZONA LEGISLATURE

Financial Audit Division

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Financial Audit

# Department of Economic Security

Division of Developmental  
Disabilities ALTCS Contract  
Year Ended June 30, 2015

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**Debra K. Davenport**  
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.



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Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Report on Audit of Financial Statements  
Year Ended June 30, 2015

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

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

**MELANIE M. CHESNEY**  
DEPUTY AUDITOR GENERAL

**Independent Auditors' Report**

Members of the Arizona State Legislature

Timothy Jeffries, Director  
Department of Economic Security

**Report on the Financial Statements**

We have audited the accompanying financial statements of the State of Arizona, Department of Economic Security, Division of Developmental Disabilities, Arizona Long Term Care System Contract (ALTCS Contract), as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Division's ALTCS Contract's financial statements as listed in the table of contents.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditors' Responsibility***

Our responsibility is to express opinions on these financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Division's ALTCS Contract as of June 30, 2015, and the respective changes in financial position thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

## **Emphasis of Matter**

As discussed in Note 1, the Division's ALTCS Contract's financial statements are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and major fund of the State of Arizona that is attributable to the transactions of the Division's ALTCS Contract. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of June 30, 2015, and the changes in its financial position for the year then ended in conformity with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

## **Other Matters**

### *Supplementary Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Division's ALTCS Contract's financial statements. The supplementary schedules listed in the table of contents are presented for purposes of additional analysis and are not required parts of the financial statements.

The supplementary schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with U.S. generally accepted auditing standards. In our opinion, the supplementary schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.

## **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated November 24, 2015, on our consideration of the Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control over financial reporting and compliance.

Debbie Davenport  
Auditor General

November 24, 2015

Department of Economic Security  
 Division of Developmental Disabilities  
 ALTCS Contract  
 Balance Sheet—Special Revenue Fund  
 June 30, 2015

<b>Assets</b>	
Cash and investments held by the State Treasurer	\$ 14,962,509
Due from other state funds	95,136,781
Due from providers	<u>1,692,153</u>
Total assets	<u><u>\$ 111,791,443</u></u>
<b>Liabilities and Fund Balance</b>	
Liabilities:	
Accrued administrative and payroll costs	\$ 3,607,636
Accrued medical and healthcare claims	70,743,001
Due to other state funds	1,886,827
Due to providers	<u>739,276</u>
Total liabilities	<u>76,976,740</u>
Fund balance:	
Restricted for health and welfare	<u>34,814,703</u>
Total liabilities and fund balance	<u><u>\$ 111,791,443</u></u>

See accompanying notes to financial statements.

Department of Economic Security  
 Division of Developmental Disabilities  
 ALTCS Contract  
 Statement of Revenues, Expenditures, and Changes in  
 Fund Balance—Special Revenue Fund  
 June 30, 2015

Revenues:	
Capitation	\$ 1,119,615,594
Investment earnings	774,140
Miscellaneous	<u>75</u>
Total revenues	<u>1,120,389,809</u>
Expenditures:	
Health and welfare:	
Aid to individuals	957,422,643
Allocated administrative expenditures	49,063,699
Case management	48,853,525
Professional and outside services	4,918,570
Premium tax	<u>23,268,676</u>
Total expenditures	<u>1,083,527,113</u>
Excess of revenues over expenditures	36,862,696
Other financing uses:	
Transfers to other state funds	<u>(9,965,476)</u>
Net change in fund balance	26,897,220
Fund balance, July 1, 2014	<u>7,917,483</u>
Fund balance, June 30, 2015	<u><u>\$ 34,814,703</u></u>

See accompanying notes to financial statements.

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Notes to Financial Statements  
June 30, 2015

Note 1 - Summary of Significant Accounting Policies

The accounting policies of the Department of Economic Security (Department), Division of Developmental Disabilities (Division), Arizona Long Term Care System Contract (ALTCS Contract), conform to U.S. generally accepted accounting principles applicable to governmental units adopted by the Governmental Accounting Standards Board.

A. Reporting Entity

For financial reporting purposes, the ALTCS Contract includes only that portion of the State's General Fund that is attributable to the ALTCS Contract's transactions. The Division is responsible for administering the ALTCS Contract. Control by the Division was determined on the basis of accountability. Fiscal responsibility for the Division remains with the Department and, ultimately, with the State. The Division is a contractor with the Arizona Health Care Cost Containment System (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 in-patient and out-patient medical and nursing services in addition to managed institutional and home- and community-based, long-term care services to eligible enrollees of the AHCCCS ALTCS program. The Division receives monthly premiums from AHCCCS for all eligible enrollees under the AHCCCS ALTCS program for the developmentally disabled.

B. Fund Accounting

The Division's accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on the Division's available resources are observed. The principles of fund accounting require that resources be classified for accounting and reporting purposes into funds in accordance with the activities or objectives specified for those resources. Each fund is considered a separate accounting entity, and its operations are accounted for in a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenues, and expenditures.

The ALTCS Contract's financial transactions are reported as a special revenue fund since the proceeds are from specific revenue sources that are legally restricted to expenditures for specified purposes.

Although the ALTCS Contract is considered a special revenue fund when reported on individually, it becomes a part of the State's General Fund at the combined state-wide level.



Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Notes to Financial Statements  
June 30, 2015

### C. Basis of Accounting

The ALTCS Contract financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when they become both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Division considers capitation revenues to be available if they are collected within 90 days of the end of the current fiscal year and considers all other revenues to be available if they are collected within 30 days of the end of the current fiscal year. All ALTCS Contract revenue sources are susceptible to accrual. Expenditures are recognized when the related fund liability is incurred.

### D. Fund Balance Classifications

Fund balance is reported separately within classifications based on a hierarchy of the constraints placed on the use of those resources. The classifications are based on the relative strength of the constraints that control how the specific amounts can be spent. The classifications are nonspendable, restricted, and unrestricted, which includes committed, assigned, and unassigned fund balance classifications.

Restricted fund balances are those that have externally imposed restrictions on their usage by creditors, such as through debt covenants, grantors, contributors, or laws and regulations. Deficits in fund balance, if any, are reported as unassigned.

### E. Capitation

The ALTCS Contract receives fixed capitation payments from AHCCCS based on certain rates for each AHCCCS member enrolled in the Division's ALTCS Contract program. The ALTCS Contract is required to provide all covered healthcare services to its members, regardless of the cost of care. If there are monies remaining, the ALTCS Contract retains the monies as profit; if the costs are higher than the amount of capitation payments from AHCCCS, the ALTCS Contract absorbs the loss.

### F. Investment Earnings

Investment earnings is composed of interest earned on the ALTCS Contract's portion of monies deposited with the State Treasurer.

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Notes to Financial Statements  
June 30, 2015

G. Incurred But Not Reported (IBNR) Methodology

The liability and expenditures reported for accrued medical and healthcare claims include IBNR medical claims, which are estimated using lag data provided by the Division's information systems, with adjustments as necessary for events that are outside the lag patterns. Amounts are based on historical expenditure patterns.

Note 2 - Cash and Investments Held by the State Treasurer

Arizona Revised Statutes (A.R.S.) requires state agencies' monies to be deposited with the State Treasurer, and further requires those deposits to be invested in various pooled funds. Cash and investments held by the State Treasurer represent the ALTCS Contract's portion of those monies. The State Treasurer invests idle contract monies in an internal investment pool (Pool 3) and distributes interest to the ALTCS Contract. Interest earned from these invested monies is allocated monthly based on the average daily balance. Participant shares in the pool are purchased and sold based on the Net Position Value of the shares. As a result, the ALTCS Contract's portion of the pool is not identified with specific investments. The ALTCS Contract's portion of these deposits and investments is reported at fair value, measured on a monthly basis, which approximates the ALTCS Contract's value of participant pool shares.

The State Treasurer's internal investment pool 3 is not required to be registered and is not registered with the Securities and Exchange Commission under the 1940 Investment Advisors Act. The activities and performance of the pool is reviewed monthly by the State Board of Investments in accordance with A.R.S. §35-311.

At June 30, 2015, the ALTCS Contract's deposits with the State Treasurer were as follows:

	<b>Amount</b>
State Treasurer's investment pool 3	\$17,484,374
Cash deposits (projected liquidity deficit)	<u>(2,521,865)</u>
	<u>\$14,962,509</u>

**Credit Risk**—Credit risk is the risk that an issuer or counterparty to an investment will not fulfill its obligations. The Department of Economic Security does not have a formal investment policy with respect to credit risk. The State Treasurer's investment pool 3 is unrated.

**Interest Rate Risk**—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Department of Economic Security does not have a formal interest rate risk policy. As of June 30, 2015, the State Treasurer's weighted average to maturity of its investments is 2.91 years.

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Notes to Financial Statements  
June 30, 2015

Note 3 - Due from Other State Funds

Amounts due from other state funds at June 30, 2015, include:

- \$30,897 of interest earned;
- \$94,587,168 of capitation, reinsurance; and
- \$518,716 of Premium Tax.

Note 4 - Due from Providers

The amount due from providers at June 30, 2015, is \$1,692,153, as a result of post-payment reviews of long-term care home and community-based service providers.

Note 5 - Due to Other State Funds

Amounts due to other state funds at June 30, 2015, is \$1,886,827 as a result of premium tax payable to the Arizona Department of Insurance.

Note 6 - Accrued Medical and Healthcare Claims

Accrued medical and healthcare claims totaling \$70,743,001 include IBNR medical claims.

Note 7 - Acute Care Reinsurance

During the year ended June 30, 2015, the Division received reimbursements totaling \$3,452,276 from AHCCCS for acute care reinsurance expenditures for claims for enrollees incurred in prior fiscal years. These reimbursements are recorded as a reduction of aid to individuals expenditures.

The Division subcontracts with various health plans to provide acute care services to ALTCS enrollees. These health plans must submit clean reinsurance claims to the Division within 15 months from the date of service.

The Division disbursed a total of \$4,550,994 to the health plans during the year ended June 30, 2015, and had IBNR claims of \$1,032,197 for total acute care reinsurance expenditures of \$5,583,191.

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Notes to Financial Statements  
June 30, 2015

Note 8 - Aid to Individuals Expenditures

Aid to individuals expenditures consists of expenditures summarized by type of service setting or service provided, as applicable:

Institutional care:	
Skilled nursing	\$ 2,702,512
Institutional care	11,466,134
Intermediate (mentally retarded)	12,859,556
Institutional care IBNR	<u>1,302,741</u>
Total institutional care	<u>28,330,943</u>
Home- and community-based services (HCBS):	
State-operated group home	5,703,397
Vendor-operated group home	249,134,545
Adult developmental home	54,920,138
Home-based services	410,911,234
HCBS IBNR	<u>66,963,746</u>
Total HCBS	<u>787,633,060</u>
Acute care:	
Acute care	137,883,408
Acute care IBNR	1,444,317
Reinsurance	4,550,994
Reinsurance IBNR	1,032,197
Reinsurance reimbursement	<u>(3,452,276)</u>
Total acute care	<u>141,458,640</u>
Total aid to individuals expenditures	<u>\$957,422,643</u>

During the year ended June 30, 2015, the ALTCS Contract recorded allocated charges of \$22,513,103 as expenditures for direct care services, including administrative costs the Division provided to clients. The expenditures were charged to the ALTCS Contract as aid to individuals expenditures based on a federally approved cost allocation plan.

Note 9 - Allocated Administrative Expenditures

During the year ended June 30, 2015, the ALTCS Contract recorded allocated administrative charges of \$49,063,699 as expenditures for its share of the administrative and fiscal services the Department provided.

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Notes to Financial Statements  
June 30, 2015

Note 10 - Premium Tax

Arizona Revised Statutes §§36-2905 and 36-2944.01 require AHCCCS to pay a 2 percent premium tax on all capitation and other reimbursements paid to the ALTCS Contract. These premium taxes are reported as expenditures and are paid to the Arizona Department of Insurance.

Note 11 - Transfers

Transfers to other state funds during the year ended June 30, 2015, consisted of \$7,917,483 to the State General Fund as a result of Laws 2013, First Special Session, Chapter 1, Section 27, and \$2,047,993 to the State-Funded Long-Term Care Fund.

Note 12 - Commitments and Contingencies

The State has the ultimate fiscal responsibility for the ALTCS Contract. Accordingly, any claims requiring additional resources require the Legislature's approval. Although there is a possibility that claims could be asserted that would require additional resources for the ALTCS Contract, in the division management's opinion, the possibility is low that valid claims will be asserted and claim amounts cannot reasonably be estimated.

Note 13 - Risk Management

The Division is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; medical malpractice; and natural disasters. The Department is a participant in the State's self-insurance program, and in the division management's opinion, any unfavorable outcomes from these risks would be covered by that self-insurance program. Accordingly, the Department has no risk of loss beyond adjustments to future years' premium payments to the State's self-insurance program. All estimated losses for the State's unsettled claims and actions are determined on an actuarial basis and are included in the *State of Arizona Comprehensive Annual Financial Report*.

Note 14 - Related Party Transactions

During the year ended June 30, 2015, the ALTCS Contract reimbursed the Division for \$22,513,103 of health and rehabilitative services provided to enrollees, including administrative costs. The ALTCS Contract also reimbursed the Division as well as other department divisions for \$49,063,699 of administrative and fiscal services and the Arizona Department of Insurance for \$23,268,676 of premium taxes due.

## Supplementary Schedules

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Lag Report for Institutional Care Payments  
Year Ended June 30, 2015

Quarter in Which Service Was Provided

<u>Quarter of Payment</u>	<u>Current</u>	<u>1<sup>st</sup> Prior</u>	<u>2<sup>nd</sup> Prior</u>	<u>3<sup>rd</sup> Prior</u>	<u>4<sup>th</sup> Prior</u>	<u>5<sup>th</sup> Prior</u>	<u>6<sup>th</sup> Prior</u>	<u>Total</u>
Current	\$ 6,166,397	\$ 1,409,776	\$ 20,275	\$ 5,458				\$ 7,601,906
1 <sup>st</sup> Prior		5,423,840	1,392,024	4,898	\$ 9,986			6,830,748
2 <sup>nd</sup> Prior			5,757,969	1,439,932	32,147	\$ 7,923	\$ 634	7,238,605
3 <sup>rd</sup> Prior				5,823,737	1,456,866	35,617	39,987	7,356,207
4 <sup>th</sup> Prior					6,145,866	1,467,041	29,277	7,642,184
5 <sup>th</sup> Prior						5,603,540	1,586,222	7,189,762
6 <sup>th</sup> Prior							6,286,094	6,286,094
Total	6,166,397	6,833,616	7,170,268	7,274,025	7,644,865	7,114,121	7,942,214	50,145,506
Expenses reported	7,153,633	6,878,427	6,767,856	7,531,027	7,373,172	7,328,704	7,525,689	50,558,508
Adjustment (1)	259,333	(5,849)	419,402	(256,782)	271,693	(214,583)	416,525	889,739
Remaining liability	<u>\$ 1,246,569</u>	<u>\$ 38,962</u>	<u>\$ 16,990</u>	<u>\$ 220</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,302,741</u>

(1) Adjustment amounts each quarter fluctuate due to unpredictable variables that affect the business cycle.

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Lag Report for Home- and Community-Based Services Payments  
Year Ended June 30, 2015

Quarter in Which Service Was Provided

<u>Quarter of Payment</u>	<u>Current</u>	<u>1<sup>st</sup> Prior</u>	<u>2<sup>nd</sup> Prior</u>	<u>3<sup>rd</sup> Prior</u>	<u>4<sup>th</sup> Prior</u>	<u>5<sup>th</sup> Prior</u>	<u>6<sup>th</sup> Prior</u>	<u>Total</u>
Current	\$ 136,590,096	\$ 68,298,348	\$ 1,082,266	\$ 539,738	\$ 69,902	\$ 1,233	\$ 835	\$ 206,582,418
1 <sup>st</sup> Prior		123,614,517	66,302,292	1,198,985	469,811	244,401	(3,945)	191,826,061
2 <sup>nd</sup> Prior			128,926,617	64,399,442	923,346	382,043	(1,003,356)	193,628,092
3 <sup>rd</sup> Prior				130,947,546	65,492,614	1,191,930	635,122	198,267,212
4 <sup>th</sup> Prior					124,149,379	63,964,504	1,072,886	189,186,769
5 <sup>th</sup> Prior						117,115,234	61,255,245	178,370,479
6 <sup>th</sup> Prior							121,715,000	121,715,000
Total	<u>136,590,096</u>	<u>191,912,865</u>	<u>196,311,175</u>	<u>197,085,711</u>	<u>191,105,052</u>	<u>182,899,345</u>	<u>183,671,787</u>	<u>1,279,576,031</u>
Expenses reported	202,509,970	192,117,881	196,301,570	196,703,639	192,866,707	180,530,916	183,843,225	1,344,873,908
Adjustment (1)	<u>(1,189,814)</u>	<u>1,021,782</u>	<u>923,988</u>	<u>477,589</u>	<u>(1,764,667)</u>	<u>2,368,429</u>	<u>(171,438)</u>	<u>1,665,869</u>
Remaining liability	<u>\$ 64,730,060</u>	<u>\$ 1,226,798</u>	<u>\$ 914,383</u>	<u>\$ 95,517</u>	<u>\$ (3,012)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 66,963,746</u>

(1) Adjustment amounts each quarter fluctuate due to unpredictable variables that affect the business cycle.



Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Lag Report for Acute Care Payments  
Year Ended June 30, 2015

Quarter in Which Service Was Provided

<u>Quarter of Payment</u>	<u>Current</u>	<u>1<sup>st</sup> Prior</u>	<u>2<sup>nd</sup> Prior</u>	<u>3<sup>rd</sup> Prior</u>	<u>4<sup>th</sup> Prior</u>	<u>5<sup>th</sup> Prior</u>	<u>6<sup>th</sup> Prior</u>	<u>Total</u>
Current	\$ 34,265,532	\$ 651,202	\$ 191,014	\$ 93,008	\$ 8,352	\$ 22,004	\$ 2,216	\$ 35,233,328
1 <sup>st</sup> Prior		30,945,905	1,437,672	1,288,260	60,050	22,562	2,475	33,756,924
2 <sup>nd</sup> Prior			31,288,454	888,095	434,445	216,943	353,944	33,181,881
3 <sup>rd</sup> Prior				30,472,898	477,494	383,338	188,271	31,522,001
4 <sup>th</sup> Prior					29,668,887	616,887	163,528	30,449,302
5 <sup>th</sup> Prior						30,626,147	1,250,440	31,876,587
6 <sup>th</sup> Prior							29,994,795	29,994,795
Total	<u>34,265,532</u>	<u>31,597,107</u>	<u>32,917,140</u>	<u>32,742,261</u>	<u>30,649,228</u>	<u>31,887,881</u>	<u>31,955,669</u>	<u>226,014,818</u>
Expenses reported (2)	37,994,631	35,162,106	37,609,908	33,404,995	33,165,770	33,365,275	33,081,506	243,784,191
Adjustment (1)	<u>(2,310,293)</u>	<u>(3,109,959)</u>	<u>(4,329,735)</u>	<u>(427,350)</u>	<u>(2,513,692)</u>	<u>(1,475,993)</u>	<u>(1,125,837)</u>	<u>(15,292,859)</u>
Remaining liability	<u>\$ 1,418,806</u>	<u>\$ 455,040</u>	<u>\$ 363,033</u>	<u>\$ 235,384</u>	<u>\$ 2,850</u>	<u>\$ 1,401</u>	<u>\$ -</u>	<u>\$ 2,476,514</u>

(1) Adjustment amounts each quarter fluctuate due to unpredictable variables that affect the business cycle.

(2) Acute Care Payments include fee for service, capitation, and reinsurance payments. Reinsurance reimbursements are not included.

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Related Party Transactions  
Year Ended June 30, 2015

<u>Related Party and Relationship</u>	<u>Service Provided</u>	<u>Description of Transactions or Payment Terms Agreement</u>	<u>Amount</u>
Department of Economic Security, Division of Developmental Disabilities, Intermediate Care Facility/Mentally Retarded, State Facilities	Health and rehabilitative services and administrative costs	Allocated by Title XIX case management time reporting, member days count, and modified total direct costs	\$12,859,556
Department of Economic Security, Division of Developmental Disabilities, State-Operated Group Homes, Home-Based Services, State Facilities	Health and rehabilitative services and administrative costs	Allocated by Title XIX case management time reporting, member days count, and modified total direct costs	9,653,547
Department of Economic Security, Division of Developmental Disabilities and all other divisions	Administrative and fiscal services	Allocated departmental overhead costs	49,063,699
Department of Insurance	Compliance with Arizona Revised Statutes §§36-2905 and 36-2944.01	Premium tax payments	23,268,676

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**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

Timothy Jeffries, Director  
Department of Economic Security

We have audited, 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, the financial statements of the State of Arizona, Department of Economic Security, Division of Development Disabilities, Arizona Long Term Care System Contract (ALTCS Contract) as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the Division's ALTCS Contract's financial statements, and have issued our report thereon dated November 24, 2015.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Division's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control.

A deficiency in internal control 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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Division's ALTCS Contract's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying Schedule of Findings and Recommendations as item 2015-01, that we consider to be a significant deficiency.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Division's ALTCS Contract's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## **Division of Development Disabilities Response to Findings**

The Division of Development Disabilities' response to the finding identified in our audit is presented on page 21. The Division's response was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Division's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Debbie Davenport  
Auditor General

November 24, 2015

Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Schedule of Findings and Recommendations  
Year Ended June 30, 2015

Financial Statement Findings

**2015-01**

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**The Department of Economic Security should update and test its disaster recovery plan over its information technology resources**

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Criteria: It is critical that the Department of Economic Security (Department) have a comprehensive, up-to-date disaster recovery plan for its information technology (IT) resources, which includes its systems, network, infrastructure, and data, to provide for the continuity of operations and to ensure that it can recover information and data in the event of a disaster, system or equipment failure, or other interruption. Also, the plan should be evaluated, tested, and updated annually.

Condition and context: The Department had a disaster recovery plan for its IT resources; however, the Department did not evaluate, test, and update its plan annually.

Effect: Inadequate disaster recovery controls subject the Department to risks of not being able to provide for continuity of operations; inaccurate or incomplete financial, or management information; expensive recovery efforts; and financial losses. In addition, the disruption of services in the event of a system or equipment failure or other interruption could result in significant harm or inconvenience to the State and its citizens.

Cause: The Department did not follow its policies and procedures to ensure its disaster recovery plan is sufficiently tested and evaluated annually.

Recommendation: To help ensure the continuity of the Department's operations and to help ensure that electronic information and data are not lost in the event of a disaster, system or equipment failure, or other interruption, the Department should evaluate, test, and update its disaster recovery plan annually and retain documentation of all disaster recovery plan tests and those tests' results.

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DEPARTMENT OF ECONOMIC SECURITY

*Your Partner For A Stronger Arizona*

Douglas Ducey  
Governor

Timothy Jeffries  
Director

November 24, 2015

Debbie Davenport  
Auditor General  
2910 N. 44th St., Ste. 410  
Phoenix, AZ 85018

Dear Ms. Davenport:

We have prepared the accompanying Corrective Action Plan as required by the standards applicable to financial audits contained in Government Auditing Standards. Specifically, we are providing you with the names of the contact people responsible for corrective action, the corrective action planned, and the anticipated completion date.

Sincerely,

Bryon Winston  
DDD Business Operations Administrator



Department of Economic Security  
Division of Developmental Disabilities  
ALTCS Contract  
Corrective Action Plan  
Year Ended June 30, 2015

Financial Statement Findings

**2015-01**

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**The Department of Economic Security should update and test its disaster recovery plan over its information technology systems**

Name of contact person and title: D. Allen Platt, Interim Deputy Chief Information Officer

Anticipated completion date: June 30, 2018

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Contingency Planning is comprised of both a Continuity of Operations Plan (COOP) focused on process continuity and a Disaster Recovery Plan (DRP) focused on the supporting technology. This Corrective Action Plan addresses the disaster recovery findings of the OAG audit.

The current DES Disaster Recovery Plan has been in place since 1999. There was a formal review of the Plan in 2006 and it was last updated in 2011. The last failover drill was completed in 2010 and included a failover to an IBM mainframe located in Boulder, Colorado. Currently encrypted data from the mainframe is simultaneously stored in a secondary secured location. For SFY 2015, DES received funding for moving the DES Data Center into a purpose built, Tier III data center operated by a third party. The facility risk of outages is anticipated to be greatly reduced by this move. DES is on schedule to complete this move by end of SFY16.

Milestones Anticipated Completion Date

- A. Migrate the data center to new location -- SFY16 on target
- B. Review and modify Recovery Plan -- SFY16 on target
- C. Perform annual test -- SFY16 successful testing continues working toward full annual DR testing as problems with testing are discovered and resolved
- D. Document overall testing strategies, testing frequencies, and test results -- SFY17 on target
- E. Implement technology appropriate to ensure continuity of operations -- SFY18 will see DES creating a DR environment with implementation and testing of this new environment in SFY18