Report Highlights

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Annual financial statement audit

The fiscal year 2024 financial information the Division reported in its Arizona Long Term Care System (ALTCS) Contract's financial statements is reliable. However, the ALTCS Contract had a deficit, and we reported deficiencies over financial reporting, summarized on pages 4 through 5.

Audit's purpose

To express our opinion on the Division's Arizona Long Term Care System (ALTCS) Contract's financial statements and, if applicable, to report findings over noncompliance with certain laws and regulations or other financial deficiencies.

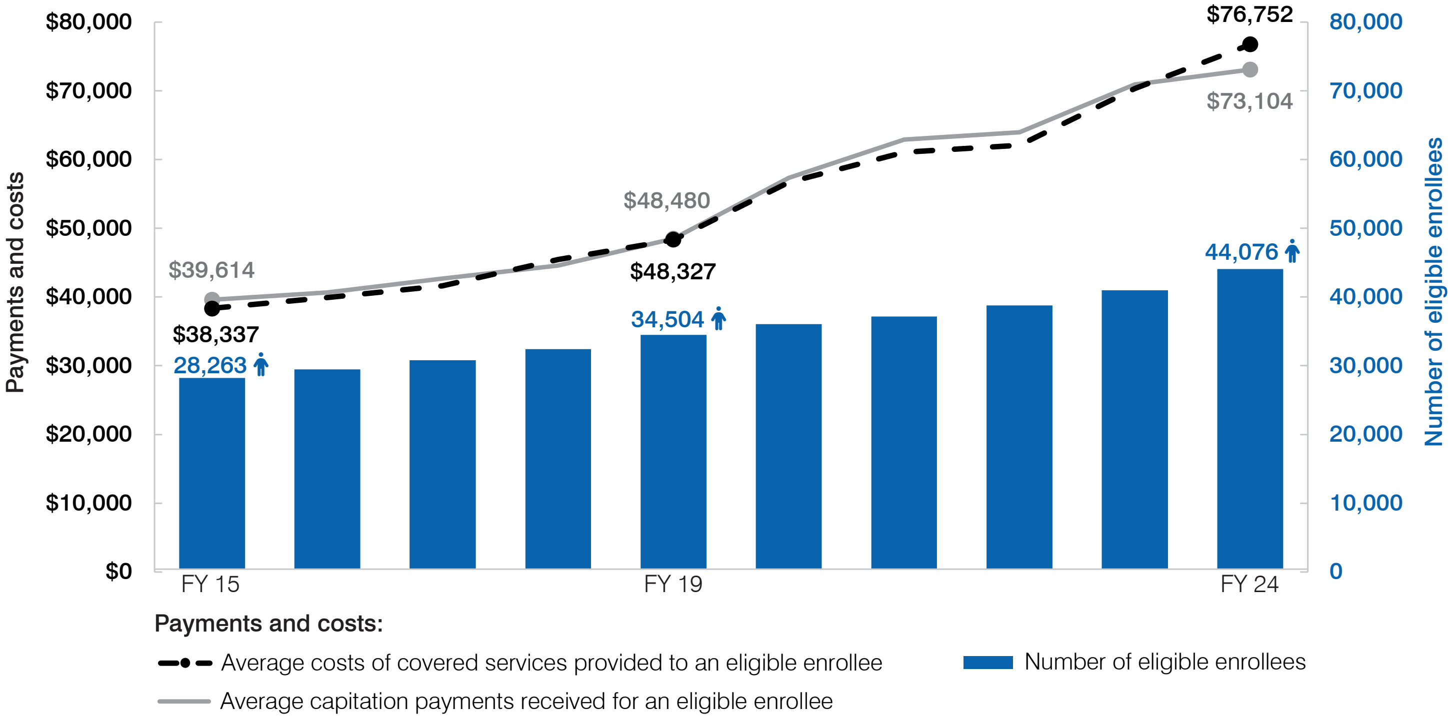
Division is a contractor with Arizona's Medicaid agency to provide services to eligible enrollees who are developmentally disabled

The Division is a contractor with the Arizona Health Care Cost Containment System (AHCCCS), Arizona's Medicaid agency. The Division administers a managed-healthcare plan through the ALTCS Contract and provides medical services and long-term healthcare services to eligible enrollees of the AHCCCS program who are developmentally disabled. The ALTCS Contract requires the Division to provide all covered healthcare services to eligible enrollees regardless of the cost of care. AHCCCS pays the Division premiums based on a set amount for each eligible enrollee, also known as capitation payments.

As shown in Figure 1 on page 2, the number of eligible enrollees, average covered service costs for an eligible enrollee, and average capitation payments for an eligible enrollee have all increased during the past 10 years, with the average capitation payment being less than the average cost of covered services in fiscal year 2024. Specifically, the number of eligible enrollees who are developmentally disabled and received services from the Division has increased from approximately 28,000 to 44,000 during the 10-year period from fiscal year 2015 through fiscal year 2024. During this same time, both the average costs of covered services for an eligible enrollee and the average capitation payments the Division received from AHCCCS for an eligible enrollee increased, with service costs almost doubling. Specifically, average capitation payments increased from approximately $39,600 to $73,100, and average service costs almost doubled from approximately $38,300 to $76,800. The ALTCS Contract's Annual Financial Report should be read to fully understand its financial information.

Figure 1

Number of eligible enrollees and average capitation payments and costs for covered services to an eligible enrollee have increased between fiscal years (FYs) 2015 and 2024[1]



1 The ALTCS Contract's financial statements fiscal year-end changed from June 30 to September 30, beginning with the 2019 report as directed by AHCCCS. This resulted in the FY 2019 financial statements including 15 months of financial activity. Therefore, we averaged the figure's data for FY 19 so that it would be comparable with all other fiscal years representing 12 months' financial activity.

Source: Auditor General staff summary of information obtained from the Division's ALTCS Contract's Annual Financial Report and the Division's enrollee data.

ALTCS Contract had $94.1 million fund deficit in fiscal year 2024

For the year ended September 30, 2024 (fiscal year 2024), the ALTCS Contract's costs of covered services and transfers to other State funds exceeded capitation payments and other revenues, resulting in a fund deficit of $94.1 million. Pursuant to 42 Code of Federal Regulations (CFR) §438.4(a), capitation rates are projected to provide for all reasonable, appropriate, and attainable costs that are required under the terms of the contract. However, the capitation revenues the Division received from AHCCCS were not sufficient to cover all the Division's costs to provide required medical and long-term healthcare services to eligible enrollees who have developmental disabilities. As previously mentioned, the Division must provide the services regardless of their cost. Specifically, the capitation revenue the Division received in fiscal year 2024 increased 10.9% from the prior year, while the cost of covered services (i.e., total expenses) increased by 17.3%. The majority of the cost increase for covered services was in the aid to individuals service category, which consists of 3 types of aid: home and community-based services, physical and behavioral health services, and institutional care. Home and community-based services, which are for enrollees in State- and vendor-operated group homes and adult developmental homes and home-based enrollees, saw the most substantial increase of $380.6 million from the prior fiscal year.

Further, the required transfer of the ALTCS Contract's fiscal year 2023 fund balance to the State General Fund, pursuant to Arizona Revised Statutes §36-2953, and the transfer of interest earnings, permitted by the Division's contract with AHCCCS, contributed to the overall fund deficit for fiscal year 2024.[1] Specifically, as shown in Figure 2 on page 3, in fiscal year 2024, a total of $111.9 million was transferred to other State funds, which included the $100.6 million fiscal year 2023 fund balance that was reverted back to the State General Fund and $11.3 million of interest earnings that was transferred to the State-funded Long-Term Care Services fund. Further, of the $11.3 million of interest earnings that was transferred, the Division inappropriately transferred $5.5 million of ALTCS fund monies to the State General Fund in fiscal year 2024.[2] During the preceding 5 years, other State funds received a total of $467.6 million of these monies. The transferred

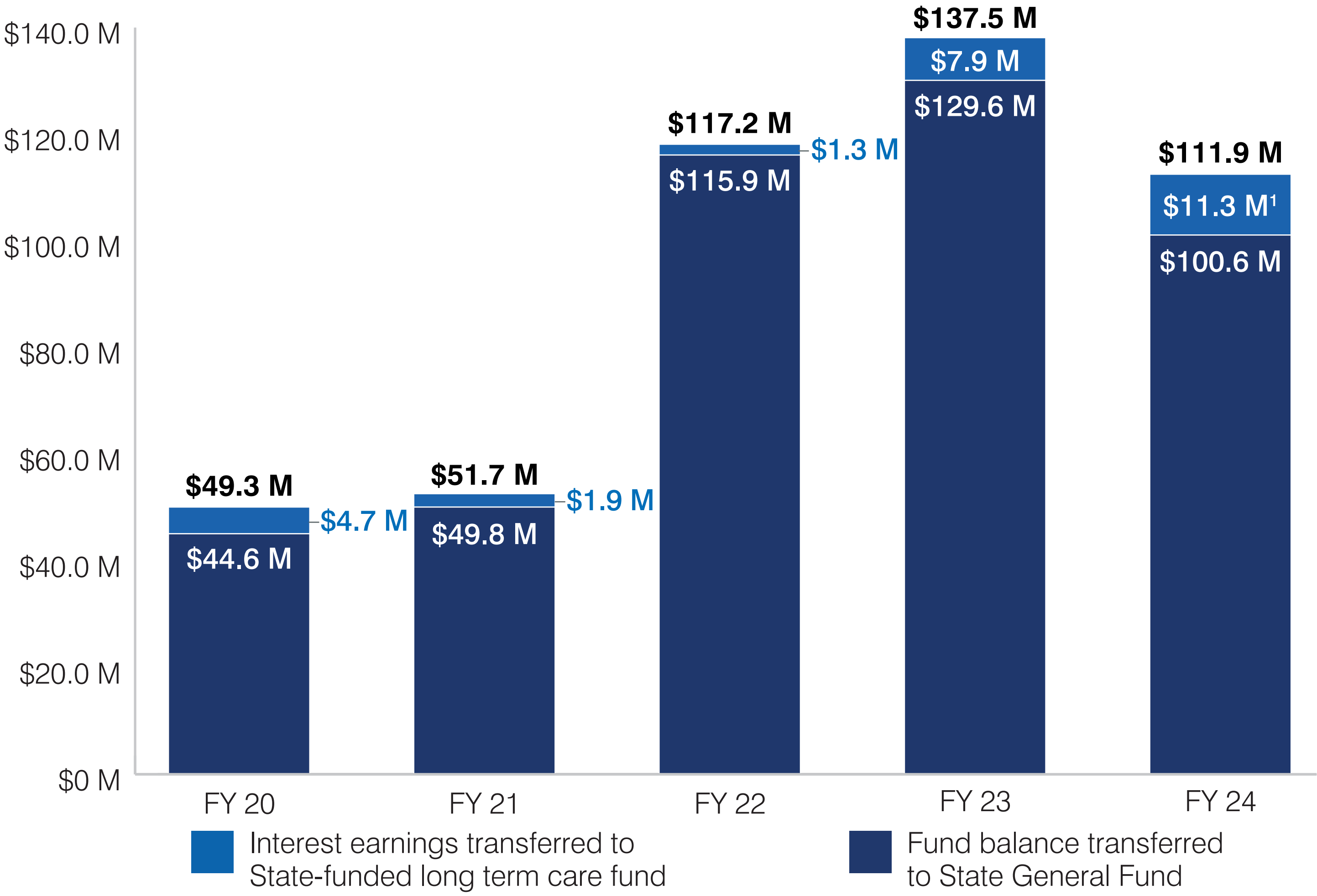
1 Contract #YH6-0014, Section D: Program Requirements, 45. Advances, Equity Distributions, Loans, and Investments.

2 For more information, see the Auditor findings and recommendations on page 4 and Finding 2024-03 included in the *Department of Economic Security, Division of Developmental Disabilities, ALTCS Contract Annual Financial Report, year ended September 30, 2024*.

amounts represent the ALTCS Contract's equity, meaning the unexpended and unencumbered capitated payments at the end of the fiscal year as well as the Contract's interest earnings.

Figure 2

$467.6 million of ALTCS Contracts monies were transferred to other State funds as required by statute and permitted by contract in FYs 2020 through 2024[1]



1 The Division inappropriately transferred $5.5 million of ALTCS fund monies to the State General Fund in fiscal year 2024. For more information, see the Auditor findings and recommendations on page 4 and Finding 2024-03 included in the *Department of Economic Security, Division of Developmental Disabilities, ALTCS Contract Annual Financial Report, year-ended September 30, 2024*.

Source: Auditor General staff summary of information obtained from the Division's ALTCS Contract's Annual Financial Report.

The Division's contract with AHCCCS contains a risk corridor that limits the Division's losses to 1% and its profits to 6%.[3,4] No sooner than 15 months after the contract year-end, or December 30, 2025, AHCCCS will reconcile the Division's fiscal year 2024 total retained medical cost expenses to net retained capitation paid to the Division for the same period to determine if the Division's losses were outside of the risk corridor. Division management estimates that the reconciliation process for fiscal year 2024 will result in the Division receiving $115.3 million of additional capitation revenue from AHCCCS in a future fiscal year. According to AHCCCS management, any monies that need to be paid to the Division as a result of the reconciliation will be funded according to the federal medical assistance percentage (FMAP).[5] The FMAP for the State of Arizona in effect at September 30, 2024, was 67.93%.[6] The State will fund the remaining 32.07%.

---

3 Contract #YH6-0014, Section D: Program Requirements, 51. Compensation.

4 States can use risk corridors to mitigate financial risks to both the state and contractors of a managed-care plan. Risk corridors allow the plan and state to share in costs or savings beyond a certain threshold. Retrieved 4/3/2025 from https://www.macpac.gov/wp-content/uploads/2022/03/Managed-care-capitation-issue-brief.pdf

5 The FMAP is the rate at which the federal government matches state contributions to the Medicaid programs (FY 2024 State Appropriations Report, page 39).

6 https://www.federalregister.gov/documents/2024/11/29/2024-27938/adjustments-for-disaster-recovery-states-to-the-fiscal-year-2024-and-fiscal-year-2025-federal

Contract year 2024 Medical Loss Ratio Report indicated that capitation revenues were not sufficient to pay for Division's costs to provide healthcare services to eligible enrollees plus administrative and other costs

The Division's contract with AHCCCS requires the Division to submit a report to AHCCCS with data on the proportion of premium revenues spent on covered services to improve health quality, also known as the MLR. In addition, an Independent Auditor's Attestation is required for the annual MLR Report every 3 years. We conducted an attestation of the Division's contract year 2024 MLR Report. Specifically, the numerator of the MLR includes incurred claims and expenditures for activities that improve healthcare quality. The denominator is premium revenue, which consists of capitation and miscellaneous revenue, less taxes and licensing and regulatory fees. Federal regulations require that all managed-care organizations maintain an MLR of at least 85%.[7] In contract year 2024, the Division had an MLR of 98.1%, indicating that the Division spent 98.1% of premium revenue on covered health services. The Division has additional costs, such as allocated administrative expenditures, professional and outside services, and sub-capitation block administrative expenditures that are not included in the calculation of the MLR. As a result, the MLR indicates that premium revenues were not sufficient to cover all the Division's costs to provide healthcare services to eligible enrollees plus cover administrative and other costs, which corroborates the financial statements reporting a fund deficit at the fiscal year ended September 30, 2024.

MLR formula and Division's FY 24 MLR

$$\text{Medical loss ratio} = \frac{\text{Incurred claims} + \text{expenditures that improve healthcare quality}}{\text{Capitation} + \text{miscellaneous revenue} - \text{taxes and regulatory fees}}$$

Division's FY 24 medical loss ratio = 98.1%

Auditor findings and recommendations

Summarized below are our findings and recommendations included in the ALTCS Contract's Annual Financial Report where there is further information and the Division's responses.

- The Department of Economic Security, which manages the information technology (IT) systems and data the Division uses, needs to continue to develop, document, and implement effective policies and procedures over its IT systems and data to identify and respond to risks and to prevent, detect, and respond to unauthorized or inappropriate access or use, manipulation, damage, or loss of IT systems and data, including financial and sensitive information. We found that the Department of Economic Security's control procedures over IT systems and data were not sufficient, which could result in unauthorized or inappropriate access and/or the loss of confidentiality or integrity of systems and data. We initially reported similar findings in fiscal year 2015. See Findings 2024-01 and 2024-02.

- The Division needs to develop and implement policies and procedures to ensure compliance with State law requirements to transfer only capitated payments in the ALTCS fund that are unexpended and unencumbered at the end of the fiscal year on or before June 30 of the following fiscal year to the State General Fund. We found that the Division inappropriately transferred $5.5 million of ALTCS fund monies to the State General Fund, resulting in an increased ALTCS fund deficit and less monies available to spend on medical and healthcare services. The Division should work with AHCCCS, the Arizona Department of Administration, and the Legislature, as necessary, to restore the ALTCS fund balance for the inappropriate transfer identified. See Finding 2024-03.

[7] 42 CFR §438.8 MLR standards.

- The Division needs to improve its process for preparing its financial statements to ensure they are accurate and issued in a timely manner. Specifically, the Division needs to provide accurate and key financial information to us by the agreed-upon deadlines established at the beginning of the audit and prepare the financial statements in accordance with requirements by developing and implementing policies and procedures to monitor the contracted CPA firm's progress and to review the accounting records prior to providing them to the contracted CPA firm and to us to review the financial statements. We found that the Division failed to provide key financial information to us timely, and its draft financial statements contained misstatements, which delayed their issuance and increased the risk that those relying on the reported financial information could be misinformed. See Finding 2024-04.

Auditor General website report links

- The September 30, 2024, Department of Economic Security, Division of Developmental Disabilities, ALTCS Contract, Annual Financial Report, that is summarized in these highlights can be found at this link. This report should be read to fully understand the ALTCS Contract's overall financial picture and our reporting responsibilities.

- The ALTCS Contract's reports from prior years are available at this link.