



**Annual Financial Report and
Report on Internal Control and on Compliance
Year Ended September 30, 2025**

**Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract**



Lindsey A. Perry
Auditor General

Arizona Auditor General's mission

The Arizona Auditor General's mission is to provide independent and impartial information, impactful recommendations, and stakeholder education to improve Arizona government for its citizens. To this end, the Office conducts financial statement audits and provides certain accounting services to the State and political subdivisions, investigates possible criminal violations involving public officials and public monies, and conducts performance audits and special reviews of school districts, State agencies, and the programs they administer.

The Joint Legislative Audit Committee

The Joint Legislative Audit Committee consists of 5 Senate members appointed by the Senate President and 5 House members appointed by the House Speaker. The Committee is responsible for overseeing the Office, including (1) overseeing all audit functions of the Legislature and State agencies, including sunset, performance, special, and financial audits; special research requests; and the preparation and introduction of legislation resulting from audit report findings; (2) requiring State agencies to comply with audit findings and recommendations; (3) receiving status reports regarding the progress of school districts to implement recommendations; and (4) scheduling hearings to review the status of State agencies and school districts.

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FINANCIAL STATEMENT FINDING: 2025-01	20
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Division of Developmental Disabilities failed to provide key financial information to auditors timely, which delayed their issuance and increased the risk that those relying on the reported financial information could be misinformed

FINANCIAL STATEMENT FINDING: 2025-02	22
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The Department's deficiencies in its process for managing and documenting its risks may put its operations and IT systems and data at unintended and unnecessary risk of potential harm

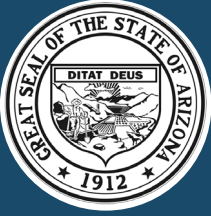
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The Department's control procedures over IT systems and data were not sufficient, which increases the risk that the Department may not adequately protect those systems and data

DEPARTMENT/DIVISION RESPONSE AND CORRECTIVE ACTION PLAN

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ARIZONA AUDITOR GENERAL

Lindsey A. Perry, Auditor General

Independent auditors' report

Members of the Arizona State Legislature

Michael Wisehart, Director
Department of Economic Security

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of the State of Arizona, Department of Economic Security, Division of Developmental Disabilities (Division), Arizona Long Term Care System Contract (ALTCS Contract), as of and for the year ended September 30, 2025, 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the ALTCS Contract as of September 30, 2025, and the respective changes in financial position thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

Basis for opinion

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 U.S. Comptroller General. Our responsibilities under those standards are further described in the auditors' responsibilities for the audit of the financial statements section of our report. We are required to be independent of the Division and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of matter

As discussed in Note 1 to the financial statements, the ALTCS Contract's financial statements are intended to present the financial position and the changes in financial position of only that portion of the major fund of the State of Arizona that is attributable to the Division's ALTCS Contract's transactions. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of September 30, 2025, 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.

As discussed in Note 1 to the financial statements, for the year ended September 30, 2025, the ALTCS Contract's financial statements adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 102, *Certain Risk Disclosures*. Our opinion is not modified with respect to this matter.

Management's responsibilities for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles, and for 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' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue a report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*, we:

- ▶ Exercise professional judgment and maintain professional skepticism throughout the audit.
- ▶ Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- ▶ Obtain an understanding of internal control relevant to the audit 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.
- ▶ Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

We are required to communicate with those charged with governance regarding, among other matters, the audit's planned scope and timing, significant audit findings, and certain internal control-related matters that we identified during the audit.

Supplementary information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the ALTCS Contract's financial statements. The accompanying schedule of related-party transactions is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is management's responsibility and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The 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 accompanying schedule of related-party transactions is 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 April 17, 2026, 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 grant agreements and other matters. The purpose of that report is solely 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 the effectiveness of the Division's 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.

Lindsey A. Perry

Lindsey A. Perry, CPA, CFE
Auditor General

April 17, 2026

The Division prepared the subsequent pages of the Annual Financial Report.

Financial statements and supplementary schedule

The financial statements include the Arizona Long Term Care System Contract's (ALTCS Contract) financial activity as of and for the year ended September 30, 2025, and related notes, which are an integral part of the financial statements, as required by 42 Code of Federal Regulations §438.3(m).

The supplementary schedule includes related-party transactions for the purposes of additional analysis as required by the Arizona Health Care Cost Containment System's *Financial Reporting Guide for ALTCS E/PD Contractors*, effective October 1, 2024.

The results of our auditing procedures on the financial statements and supplementary schedule are described in the independent auditors' report.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Balance Sheet—Special Revenue Fund
September 30, 2025

Assets

Cash and investments held by the State Treasurer	\$ 153,957,878
Due from other State funds	34,650,920
Due from providers	<u>8,908,831</u>
 Total assets	 <u>197,517,629</u>

Liabilities and fund balance

Accrued payroll costs	6,353,844
Accrued medical and healthcare claims	252,672,513
Due to other State funds	1,247,030
Due to Providers	<u>16,305,843</u>
 Total liabilities	 <u>276,579,230</u>

Fund deficit	
Unassigned	<u>(79,061,601)</u>
 Total liabilities and fund deficit	 <u>\$ 197,517,629</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
Year ended September 30, 2025

Revenues:	
Capitation	\$ 3,872,434,247
Investment earnings	5,678,894
Miscellaneous	<u>130,245,238</u>
Total revenues	<u>4,008,358,379</u>
Expenditures:	
Health and welfare:	
Aid to individuals	3,654,340,371
Allocated administrative expenditures	113,197,463
Case management	91,898,086
Professional and outside services	10,232,254
Sub-capitation block administrative	42,865,253
Premium tax	<u>80,828,197</u>
Total expenditures	<u>3,993,361,624</u>
Excess of revenues over expenditures	14,996,755
Net change in fund balance	14,996,755
Fund deficit, October 1, 2024	<u>(94,058,356)</u>
Fund deficit, September 30, 2025	<u><u>\$ (79,061,601)</u></u>

See accompanying notes to financial statements.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to Financial Statements
September 30, 2025

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.

For the year ended September 30, 2025, the Division implemented the provisions of GASB Statement No. 102—*Certain Risk Disclosures*, which had a material effect on the ALTCS Contract's financial statements. This Statement requires a government to assess whether an event or events associated with a concentration or constraint that could cause the substantial impact have occurred, have begun to occur, or are more likely than not to begin to occur within 12 months of the date the financial statements are issued. If a government determines that those criteria for disclosure have been met for a concentration or constraint, it should disclose information in notes to financial statements in sufficient detail to enable users of financial statements to understand the nature of the circumstances disclosed and the government's vulnerability to the risk of a substantial impact. Additional information on the impact of this statement can be found in Note 17—Concentration Risk: Reliance on State Match Funding for Federal Medicaid Funds.

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, 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
September 30, 2025

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 balances of the other governmental funds 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 are composed of interest earned on the ALTCS Contract's portion of monies deposited with the State Treasurer.

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.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to Financial Statements
September 30, 2025

H. Provider contract settlements

AHCCCS' risk mitigation strategies within the managed-care programs are designed to protect the State against excessive contractor profits and contractors from excessive losses. The provider contract settlement process may result in amounts due from providers and due to other State funds or amounts due to providers.

I. American Rescue Plan Act of 2021 (ARP)

On March 11, 2021, President Biden signed the American Rescue Plan (ARP) Act of 2021 (Pub.L. 117-2) into law. Section 9817 of the ARP Act provides qualifying states with a temporary 10 percentage point increase to the federal medical assistance percentage (FMAP) for certain Medicaid expenditures for home and community-based services (HCBS). On May 13, 2021, Centers for Medicare and Medicaid Services (CMS) published State Medicaid Director Letter (SMDL) #21-003, which further clarified the qualifying services, improvement activities, and reporting requirements expected of states under Section 9817 of the ARP Act.

In its American Rescue Plan (ARP) Act Home and Community Based Services (HCBS) spending plan, AHCCCS received federal approval to allocate ARP funds over three years in one-time State-directed provider payments to recruit and retain a knowledgeable and well-trained workforce. These time-limited payments were to be made in State Fiscal Years (SFY) 2022, 2023, and 2024. AHCCCS concluded the time-limited ARP payments with a final payment in the spring of 2024 where providers had until February 28, 2025 to spend the funds appropriately.

The Division as a qualified managed-care organization received ARP funds to distribute directed payments to its qualified vendors, who attested to the use of funds. These revenues and expenditures have not been reflected in the ALTCS contract's financial statements. The main purpose of the financial statements is to inform stakeholders of the fund balance remaining from capitation payments, which is used to calculate the funds sweep back to the State of Arizona (A.R.S. §36-2953). The federal legislation that required ARP funds to supplement and not supplant any level of State funds expended for home and community-based services for eligible individuals through programs was in effect as of April 1, 2021. The ARP-directed payment funds are recorded separately from the ALTCS program by the Division and are not part of the ALTCS Contract's ending fund balance so that any residual amounts leftover at the end of a contract period are not swept back to the State funds. Any residual amounts of ARP funds are returned to AHCCCS.

In addition, a portion of the Division's contract year ended 2025 capitation revenue was matched with ARP funds specifically for the Parents as Paid Care Givers program (PPCG). These funds were used to offset costs related to the PPCG program through March 31, 2025.

J. Reclassification of interest income receivable resulting from an error correction

During fiscal year 2025, the Division reclassified the beginning balance of \$4,306,001 for the investment income receivable related to the State Treasurer's investments (see Note 2) from investment income

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to Financial Statements
September 30, 2025

receivable to due from other state funds. The interest income was received by DES in the prior fiscal year and recorded in the State-funded Long-Term Care Services fund, and therefore, it was not a receivable from an outside entity. There was no effect on beginning fund balance.

Note 2 – Cash and investments held by the State Treasurer

Arizona Revised Statutes (A.R.S.) require 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 are 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. The Net Position Value is determined by dividing the fair value of the investment pool by the total shares of the pool outstanding. 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 register (and is not registered) with the Securities and Exchange Commission (SEC) under the Dodd-Frank Act of 2010. The activities and performance of the pools are reviewed monthly by the State Board of Investment in accordance with A.R.S. §35-311.

At September 30, 2025, the ALTCS Contract's deposits with the State Treasurer were as follows:

	Amount
State Treasurer's investment pool 3	\$153,957,878

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation to the holder of the investments. 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, 2025, the State Treasurer's weighted average to maturity of its internal Pool 3 investments is 0.9 years.

Note 3 – Due from other State funds

Amounts due from other State funds totaling \$34,650,920 at September 30, 2025, include:

- \$23,096,112 of costs related to ALTCS members exceeding the cost effectiveness study thresholds.
- \$9,984,895 of investment earnings due from other State funds.
- \$1,256,058 of Tribal Health Plan funds held by AHCCCS.
- \$313,855 of ALTCS capitation revenue.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to Financial Statements
September 30, 2025

Note 4 – Due from providers

Due from providers totaling \$8,908,831 at September 30, 2025, include:

- \$8,555,742 of net receivables from United Healthcare.
- \$275,815 from Hospital Enhanced Access Leading to Health Improvements Initiative payment reconciliations due from participating providers.
- \$77,274 of share of cost for individuals in a institutional setting.

Note 5 – Due to other State funds

Due to other State funds totaling \$1,247,030 at September 30, 2025, include:

- \$1,243,264 of capitated American Rescue Plan (ARP) funds received and payable to AHCCCS.
- \$3,766 of premium tax payable to the Arizona Department of Insurance and Financial Institutions.

Note 6 – Accrued medical and healthcare claims

Accrued medical and healthcare claims totaling \$252,672,513 at September 30, 2025, include IBNR medical claims.

Note 7 – Fund deficit

The fund deficit at September 30, 2025, was \$79,061,601. While the current year produced a net gain, the gain was not sufficient to fully erase the beginning fund deficit. Per AHCCCS contract number #YH6-0014, Amendment 82, Section D, Part 51, "AHCCCS will reconcile the Contractor's total retained medical cost expenses (prospective and prior period coverage) to net retained capitation paid to the Contractor (prospective and prior period coverage)." The AHCCCS contract allows for an initial reconciliation no sooner than six months after the end of the period to be reconciled. A final reconciliation will be performed no sooner than 15 months after the end of the period to be reconciled. The Department's estimate of the reconciliation amount was \$122,600,000, which would represent additional capitation revenue to be recognized in a future contract year, at which point the fund deficit will be eliminated.

Note 8 – Miscellaneous revenues

Miscellaneous revenues totaling \$130,245,238 during the period ended September 30, 2025, include:

- \$75,854,449 of revenue for hospital reimbursement rate increases of dental and physician fees as a result of the Hospital Enhanced Access Leading to Health Improvements Initiative.
- \$21,492,525 of revenue as a result from provider contract settlements (See Note 1 Part H).
- \$15,022,468 of revenue for professional and dental provider increases as a result of the Access to Professional Services Initiative.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to Financial Statements
September 30, 2025

- \$11,707,233 of revenue for pediatric services provider cost increases as a result of the Pediatric Services Initiative.
- \$4,808,414 of revenue for inpatient and outpatient cost increases as a result of the Safety Net Services Initiative.
- \$586,987 of revenue related to the premium tax portion of reinsurance revenue.
- \$556,079 of State and Local Governmental revenue.
- \$217,083 of revenue from a recoupment of provider claims.

Note 9 – Aid to individuals expenditures

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

Institutional care:

Intermediate (intellectually or developmentally disabled)	<u>\$ 36,366,320</u>
Total institutional care	<u>36,366,320</u>

Home- and community-based services (HCBS):

State-operated group home	\$7,453,233
Vendor-operated group home	837,021,156
Adult developmental home	114,294,065
Child developmental home	11,202,610
Home-based services	1,891,296,396
Differential Adjusted Payments	12,424,970
Value-based purchasing arrangements	<u>5,571,629</u>
Total HCBS	<u>2,879,264,059</u>

Physical and behavioral health:

Physical and behavioral health care	\$ 751,612,600
Reinsurance	37,989,339
Reinsurance reimbursement	<u>(50,891,947)</u>
Total physical and behavioral health	<u>738,709,992</u>
Total aid to individuals expenditures	<u>\$3,654,340,371</u>

During the year ended September 30, 2025, the ALTCS Contract recorded allocated charges of \$28,335,807 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.

During the year ended September 30, 2025, the Division received reimbursements totaling \$50,891,947 from AHCCCS for acute care expenditures for claims for enrollees incurred in the current and 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 \$37,989,339 to the health plans during the year ended September 30, 2025.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to Financial Statements
September 30, 2025

Note 10 – Case management expenditures

During the year ended September 30, 2025, the ALTCS Contract recorded allocated case management charges of \$91,898,086 as expenditures for its share of the case management services the Department provided.

Note 11 – Allocated administrative expenditures

During the year ended September 30, 2025, the ALTCS Contract recorded allocated administrative charges of \$113,197,463 as expenditures for its share of the administrative and fiscal services the Department provided.

Note 12 – Sub-capitation block administrative expenditures

During the year ended September 30, 2025, the ALTCS Contract recorded sub-capitation block administrative expenses of \$42,865,252 as expenditures for its share of the administrative payments to the Mercy Care and United Healthcare.

Note 13 – Premium tax expenditures

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

Note 14 – 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 15 – 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 Annual Comprehensive Financial Report*.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to Financial Statements
September 30, 2025

Note 16 – Related-party transactions

During the year ended September 30, 2025, the ALTCS Contract reimbursed the Division for \$28,335,807 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 \$113,197,463 of administrative and fiscal services and the Arizona Department of Insurance and Financial Institutions for \$80,828,197 of premium taxes due.

Note 17 – Concentration Risk: Reliance on State Match Funding for Federal Medicaid Funds

The Division's ALTCS Contract program receives capitation payments from the Arizona Health Care Cost Containment System (AHCCCS), which are funded through a combination of federal Medicaid matching funds and Arizona State General Fund appropriations. Under the federal-state Medicaid matching framework, the state is required to appropriate state dollars to match federal Medicaid funds on a prescribed ratio (currently approximately 65% federal / 35% state). The Division's program operations depend critically on this state funding commitment to draw down and maintain access to federal funds.

During the contract year ended September 30, 2025, the ALTCS Contract program served developmentally disabled individuals throughout Arizona, providing institutional care, home- and community-based services (HCBS), and physical and behavioral health services. Total expenditures were approximately nearly \$4 billion, representing the combined impact of federal and State Medicaid dollars channeled through AHCCCS capitation payments.

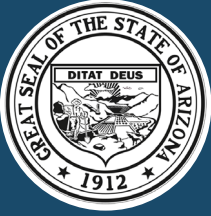
Concentration Risk: The Division is vulnerable to substantial loss of both federal and State Medicaid funding should the State reduce its required State match dollars in future years. State General Fund constraints, competing priorities, or changes in appropriations methodology could result in an inability to access federal dollars proportional to any reduction in State match. Given that the program serves an eligible population with substantial long-term care needs that cannot be arbitrarily reduced (per the entitlement nature of the program), a loss of State match funding would directly eliminate equivalent federal funding and force the program to curtail or eliminate services unless alternative funding sources are secured.

Vulnerability: As of the date these financial statements were issued, the Department requested supplemental funds in the amount of \$128,135,400 as part of the governor's FY2027 Executive Recommendation Report that was given to the Legislature. The request covers two issues for the Division's funding. First, the supplemental request addresses the need for State funds to match the current capitation rates. Both membership growth and capitation rate growth far exceeded the assumptions made in the FY2026 Enacted Budget, primarily due to lagging data collection of per member costs. Second, the supplemental request addresses a need for a change to the current capitation rate. Laws 2025, Chapter 93 included several DDD reforms, such as requiring the Department to implement a new assessment tool. Due to unforeseen delays in the implementation of the tool, the Arizona Health Care Cost Containment System (AHCCCS) has determined that a mid-year capitation rate adjustment is needed to adequately fund DDD member costs. The Division, in conjunction with AHCCCS and the Department of Economic Security, continues to monitor state budget developments and participate in appropriations discussions to ensure sustained funding commitments.

Supplementary schedule

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Related-party transactions
September 30, 2025

Related party and relationship	Service provided	Description of transactions or payment terms agreement	Amount
Department of Economic Security, Division of Developmental Disabilities, Intermediate Care Facility/Individuals with Intellectual Disabilities, 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	\$ 20,882,584
Department of Economic Security, Division of Developmental Disabilities, State-Operated Group Homes, 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	7,453,223
Department of Economic Security, Division of Developmental Disabilities and all other divisions	Administrative and fiscal services	Allocated departmental overhead costs	113,197,463
Department of Insurance and Financial Institutions	Compliance with A.R.S. §§36-2905 and 36-2944.01	Premium tax payments	80,828,197



**ARIZONA
AUDITOR
GENERAL**

Lindsey A. Perry, Auditor General

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

Michael Wisehart, 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 U.S. Comptroller General, the financial statements of the State of Arizona, Department of Economic Security (Department), Division of Developmental Disabilities (Division), Arizona Long Term Care System Contract (ALTCS Contract), of and for the year ended September 30, 2025, and the related notes to the financial statements, which collectively comprise the ALTCS Contract's financial statements, and have issued our report thereon dated April 17, 2026.

Report on 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) as a basis for designing 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and recommendations, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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 ALTCS Contract's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and recommendations as items 2025-01 and 2025-03 to be material weaknesses.

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. We consider the deficiency described in the accompanying schedule of findings and recommendations as item 2025-02 to be a significant deficiency.

Report on compliance and other matters

As part of obtaining reasonable assurance about whether the Division's financial statements are free from 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 financial statements. 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 response to findings

Government Auditing Standards requires the auditor to perform limited procedures on the Division's responses to the findings identified in our audit that are presented in its corrective action plan at the end of this report. The Division is responsible for preparing a corrective action plan to address each finding. Because the Division is part of the Department, which is ultimately responsible for designing, implementing, and maintaining internal control, the Division response includes a Department response for certain findings. The responses and corrective action plan were not subjected to the other auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on them.

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.

Lindsey A. Perry

Lindsey A. Perry, CPA, CFE
Auditor General

April 17, 2026

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

The subsequent pages present the Arizona Auditor General’s findings and recommendations resulting from our audit of the Division’s financial statements.

Division of Developmental Disabilities failed to provide key financial information to auditors timely, which delayed their issuance and increased the risk that those relying on the reported financial information could be misinformed

Condition

The Department of Economic Security—Division of Developmental Disabilities (Division) failed to provide key financial information in time to meet its contractually required audit deadlines for the Arizona Long Term Care System (ALTCS) contract's financial statements. Specifically, the Division failed to submit accurate financial statements and associated note disclosures for audit by December 30, 2025, and a statement of actuarial opinion on claims reserves for claims incurred as of September 30, 2025, by January 30, 2026, as agreed upon, and did not provide this information until February 13, 2026.

Effect

The Division's providing late financial information for audit delayed by over 1 month the issuance of the ALTCS Contract's *Annual Financial Report* for the fiscal year ended September 30, 2025. As a result, the Division did not provide timely financial information to the Arizona Health Care Cost Containment System (AHCCCS), State legislators, federal grantors, and other stakeholders who rely on it to make important decisions about ALTCS' operations and financial position.

Cause

The Division's contract with a third-party actuary to provide a statement of actuarial opinion on claims reserves for claims incurred as of September 30, 2025 (actuarial report), did not allow the Division enough time to meet agreed-upon deadlines established at the beginning of the audit for providing us with accurate financial statements and associated note disclosures, along with a final actuarial report. Specifically, the contract, which was executed on January 14, 2026, required the actuary to provide an actuarial report on January 23, 2026. The purpose of the actuarial report was to assess the reasonability of the Division's estimate for claims reserves for claims incurred as of September 30, 2025, which is reported in the financial statements as accrued medical and healthcare claims liability. However, the contract did not allow enough time for the Division to make the necessary changes to its estimate after the actuary informed the Division on February 3, 2026, that its estimate was outside the reasonable range. The Division revised its estimate on February 11, 2026, which resulted in an increase to its accrued medical and healthcare claims liability by \$68.5 million, and adjusted its financial statements and associated note disclosures initially provided to us on December 31, 2025.

Criteria

The Division's ALTCS contract with AHCCCS requires it to issue its audited *Annual Financial Report* within 150 days of the ALTCS contract's fiscal year-end of September 30, or by February 27, 2026.

Developing and implementing policies and procedures for preparing financial information for the ALTCS contract's financial statements, including providing key information for audit by agreed-upon dates after reconciling financial statement information to the underlying accounting records, is an essential part of internal control standards, such as the *Standards for Internal Control in Federal Government* issued by the Comptroller General of the United States, and is integral to ensuring the Division's financial reporting and related compliance objectives are achieved.¹

Recommendations to the Division

1. Provide accurate and key financial information to us by the agreed-upon deadlines established at the beginning of the audit to ensure timely issuance of the ALTCS contract's audited financial statements.
2. Establish timelines for procuring third-party actuarial services that allow enough time to meet agreed-upon deadlines established at the beginning of the audit for providing accurate financial statements and associated note disclosures, along with an actuarial report.

This finding is similar to prior-year finding 2024-04 and was initially reported in fiscal year 2022.

Views of responsible officials

Division management concurs with this finding. The Division's corrective action plan at the end of this report includes the views and planned corrective action of its responsible officials regarding these recommendations. We are not required to audit and have not audited these responses and planned corrective actions and therefore provide no assurances as to their accuracy.

¹ U.S. Government Accountability Office (GAO). (2014). *Standards for Internal Control in the Federal Government*. Retrieved on 2/19/2026 from <https://www.gao.gov/assets/670/665712.pdf>

The Department's deficiencies in its process for managing and documenting its risks may put its operations and IT systems and data at unintended and unnecessary risk of potential harm

Condition

The Department of Economic Security's (Department) process for managing and documenting its risks did not include an overall risk-assessment process that included identifying, analyzing, and responding to the Department-wide information technology (IT) risks, such as potential harm from unauthorized access, use, disclosure, disruption, modification, or destruction of IT systems and data. Also, it did not include identifying, classifying, and inventorying sensitive information that might need stronger access and security controls.

Effect

The Department's administration and IT management may put the Department's operations and IT systems and data at unintended and unnecessary risk of potential harm.

Cause

The Department reported its policies and procedures were incomplete, and some developed policies and procedures were not fully implemented because of limited staffing.

Criteria

The Department is required to follow the State's IT policies the Arizona Strategic Enterprise Technology Office established to help effectively manage risk at the Department. Effectively managing risk includes an entity-wide risk-assessment process that involves members of the Department's administration and IT management. An effective risk-assessment process helps the Department determine the risks it faces as the Department seeks to achieve its objectives to not only report accurate financial information and protect its IT systems and data but to also carry out its overall mission and compliance and service objectives. Additionally, an effective risk-management process provides the Department the basis for developing appropriate responses based on identified risk tolerances and specific potential risks to which the Department might be subjected. To help ensure the Department's objectives can be met, an effective annual risk assessment considers IT risk in the Department's operating environment, analyzes and prioritizes each identified risk, and develops a plan to respond to each risk within the context of the Department's defined objectives and risk tolerances. Finally, effectively managing risk includes the Department's process for identifying, classifying, and inventorying sensitive information that might need stronger access and security controls to address the risk of unauthorized access and use, modification, or loss of sensitive information.

Recommendations to the Department

3. Identify, analyze, and reduce risks to help prevent undesirable incidents and outcomes that could impact business functions and IT systems and data.
4. Plan for where to allocate resources and where to implement critical controls.
5. Ask responsible administrative officials and management over finance, IT, and other entity functions for input in the Department's process for managing risk.
6. Perform an annual Department-wide IT risk-assessment process that includes evaluating and documenting risks and safeguards. Such risks may include inappropriate access that would affect financial data, system changes that could adversely impact or disrupt system operations, and inadequate or outdated system security.
7. Evaluate and manage the risks of holding sensitive information by identifying, classifying, and inventorying the information the Department holds to assess where stronger access and security controls may be needed to protect data in accordance with State statutes and federal regulations.

This finding is similar to prior-year finding 2024-01 and was initially reported in fiscal year 2015.

Views of responsible officials

Department management concurs with this finding. The Department's corrective action plan at the end of this report includes the views and planned corrective action of its responsible officials regarding these recommendations. We are not required to audit and have not audited these responses and planned corrective actions and therefore provide no assurances as to their accuracy.

The Department's control procedures over IT systems and data were not sufficient, which increases the risk that the Department may not adequately protect those systems and data

Condition

The Department of Economic Security's (Department) control procedures were not sufficiently developed and implemented to respond to risks associated with its IT systems and data.

The Department lacked sufficient procedures over the following:

▶ **Restricting access**

Procedures did not consistently help prevent or detect unauthorized or inappropriate access to its IT systems and data.

▶ **Managing system configurations**

Procedures did not ensure configuration settings were securely maintained.

▶ **Securing systems and data**

IT security policies and procedures lacked controls to prevent unauthorized or inappropriate access or use, manipulation, damage, or loss.

▶ **Ensuring operations continue**

Contingency plan lacked key elements related to restoring operations in the event of a disaster or other system interruption.

Effect

There is an increased risk that the Department may not adequately protect its IT systems and data, which could result in unauthorized or inappropriate access and/or the loss of confidentiality or integrity of systems and data. It also increases the Department's risk of not being able to effectively continue daily operations and completely and accurately recover vital IT systems and data in the event of a disaster or system interruption.

Cause

The Department reported some of its policies and procedures were incomplete and/or outdated, and others were not fully implemented because of limited staffing.

Criteria

The Department is required to follow the State's IT policies the Arizona Strategic Enterprise Technology Office (ASET) established to implement effective internal controls that protect its IT systems and ensure the integrity and accuracy of the data it maintains, as follows:

▶ **Restrict access through logical controls**

Help to ensure systems and data are accessed by users who have a need, systems and data access granted is appropriate, and key systems and data access is monitored and reviewed.

▶ **Manage system configurations through well-defined, documented configuration-management process**

Ensures the Department's IT system configurations are documented. This helps limit the possibility of an adverse impact on the system's security or operation.

▶ **Secure systems and data through IT security internal control policies and procedures**

Help prevent, detect, and respond to instances of unauthorized or inappropriate access or use, manipulation, damage, or loss to its IT systems and data.

▶ **Ensure operations continue through a comprehensive, documented, and tested contingency plan**

Provides the preparation necessary to place the plan in operation and helps to ensure business operations continue and systems and data can be recovered in the event of a disaster, system or equipment failure, or other interruption.

Recommendations to the Department

1. Make it a priority to develop and document comprehensive IT policies and procedures and develop a process to ensure the procedures are being consistently followed.
2. Monitor Department employees' adherence to the IT policies and procedures on a periodic basis to ensure they are consistently followed and inform employees of updates to the policies and procedures throughout the year.
3. Work with ASET on ways to implement audit recommendations.

Restrict access

To restrict access to its IT systems and data, develop, document, and implement processes to:

4. Review account access to ensure it remains appropriate and necessary.
5. Evaluate the use and appropriateness of accounts shared by 2 or more users and manage the credentials for such accounts.

6. Enhance authentication requirements for IT systems.

Manage system configurations

To configure IT systems securely, develop, document, and implement processes to:

7. Maintain configurations for all system services, assets, and infrastructure; manage configuration changes; and monitor the system for unauthorized or unintended configuration changes.

Secure systems and data

To secure IT systems and data, develop, document, and implement processes to:

8. Provide all employees ongoing training on IT security risks and their responsibilities to ensure systems and data are protected.

Ensure operations continue

To ensure operations continue, implement processes to:

9. Test the contingency plan.

This finding is similar to prior-year finding 2024-02 and was initially reported in fiscal year 2015.

Views of responsible officials

Department management concurs with this finding. The Department's corrective action plan at the end of this report includes the views and planned corrective action of its responsible officials regarding these recommendations. We are not required to audit and have not audited these responses and planned corrective actions and therefore provide no assurances as to their accuracy.

The subsequent pages were written by the Department/Division to provide a response to the findings and to indicate their intention regarding implementation of the recommendations resulting from the audit conducted by the Arizona Auditor General.

Katie Hobbs
Governor



Michael Wisehart
Director

April 14, 2026

Lindsey Perry
Auditor General
2910 N 44th St., Ste.410
Phoenix, AZ 85018

Dear Mrs. Perry:

We have prepared the accompanying corrective action plan as required by the standards applicable to financial audits contained in Government Auditing Standards. Specifically, for each finding, we are providing you with our responsible officials' views, the names of the contact people responsible for corrective action, the corrective action planned, and the anticipated completion date.

Sincerely,

A handwritten signature in blue ink that reads "Patrick S. Hays".

Patrick S. Hays, CPA
Deputy Assistant Director of Business Operations Division of
Developmental Disabilities

2025-01

Division of Developmental Disabilities failed to provide key financial information to auditors timely, which delayed their issuance and increased the risk that those relying on the reported financial information could be misinformed

Name of contact person and title: Brandon Senior, Deputy Business Administrator and Patrick Hays, Deputy Assistant Director of Business Operations

Anticipated completion date: August 1, 2026

Agency's Response: Concur

The Department of Economic Security's Division of Developmental Disabilities (Division) will continue to address the audit recommendations as follows:

The Division understands the importance of timely financial reporting to inform stakeholders. The Division is committed to improving items outlined in the findings.

The Division is required to procure an outside entity to perform the actuarial review of the incurred but not reported medical expenditure estimates (IBNR). The Division follows state procurement policies and procedures. During the last contract year, the Division issued a request for proposals from the vendors under the statewide contract. There was no response to the request from the statewide contracted vendors, causing the delay in finalizing the annual statements since the Division had to contract directly with a vendor. This issue is resolved for the current contract year because the Division entered into a three year contract with a vendor to perform the actuarial review of the IBNR estimate. This will allow the Division to proceed now with the current year review in order to prevent any timeliness issue.

2025-02

The Department's deficiencies in its process for managing and documenting its risks may put its operations and IT systems and data at unintended and unnecessary risk of potential harm

Name of contact person and title: Robert Parker, SR Information Security Manager

Anticipated completion date: July 2027

Agency's Response: Concur

The Department of Economic Security (Department/DES) agrees with the audit recommendations and will continue strengthening its process for managing and documenting its risks. The Department maintains informal processes to identify, assess, and manage risks that may affect business operations, information technology systems, and sensitive data, and will continue enhancing these processes to support effective risk oversight.

As part of these efforts, DES is reviewing and updating its governance, policies, and procedures to ensure alignment with applicable standards and regulatory requirements, including those established by the National Institute of Standards and Technology (NIST). The Department will also continue coordinating with internal stakeholders to support a comprehensive approach to risk identification, mitigation, and resource prioritization.

DES will also continue working toward strengthening department-wide risk assessment activities and improving processes for identifying, classifying, and safeguarding sensitive information. These efforts are intended to support effective internal controls and ensure the protection of data in accordance with State statutes and applicable federal regulations.

2025-03

The Department's control procedures over IT systems and data were not sufficient, which increases the risk that the Department may not adequately protect those systems and data

Name of contact person and title: Robert Parker, Sr. Information Security Manager

Anticipated completion date: July 2026

Agency's Response: Concur

The Department of Economic Security (Department/DES) agrees with the audit recommendations and will continue strengthening its control procedures over IT systems and data. The Department is reviewing and updating its IT policies, procedures, and related governance processes to support consistent implementation and alignment with applicable standards and statewide guidance.

As part of these efforts, DES will continue working with ASET and internal stakeholders to enhance controls related to access management, authentication, system configuration, security awareness training, and contingency planning. The Department will also continue evaluating opportunities to improve oversight and monitoring processes to help ensure systems and data are appropriately protected and that critical operations can continue in the event of disruptions.

DES will address these recommendations as part of its ongoing efforts to strengthen its information security program and maintain compliance with applicable State and federal requirements.