



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Financial Audit

Department of Economic Security

Division of Developmental
Disabilities ALTCS Contract
Year Ended June 30, 2012



Debra K. Davenport
Auditor General

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Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Report on Audit of Financial Statements
Year Ended June 30, 2012

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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

Clarence H. Carter, Director
Department of Economic Security

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, 2012, as listed in the table of contents. These financial statements are the responsibility of the Department and its Division of Developmental Disabilities' management. Our responsibility is to express an opinion 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, 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 governmental activities and major fund of the State of Arizona that is attributable to the transactions of the ALTCS Contract. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of June 30, 2012, and the changes in its financial position, for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department of Economic Security, Division of Developmental Disabilities, ALTCS Contract as of June 30, 2012, and the changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the ALTCS Contract. The accompanying supplementary schedules listed in the table of contents are presented for purposes of additional analysis and are not required parts of the financial statements. Such information is the responsibility of the Department and its Division of Developmental Disabilities' management 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 supplementary schedules are fairly stated in all material respects in relation to the financial statements as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2012, 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 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* and should be considered in assessing the results of our audit.

Debbie Davenport
Auditor General

November 21, 2012

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Balance Sheet—Special Revenue Fund
June 30, 2012

Assets

Cash on deposit with the State Treasurer	\$15,283,536
Due from other state funds	66,291,073
Due from providers	<u>175,628</u>
 Total assets	 <u>\$81,750,237</u>

Liabilities and Fund Balance

Liabilities:	
Accrued administrative and payroll costs	\$ 3,958,145
Accrued medical and healthcare claims	61,803,778
Due to other state funds	<u>1,089,524</u>
 Total liabilities	 <u>66,851,447</u>
 Fund balance:	
Restricted for health and welfare	<u>14,898,790</u>
 Total liabilities and fund balance	 <u>\$81,750,237</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 June 30, 2012

Revenues:	
Capitation	\$915,951,960
Investment earnings	<u>1,057,015</u>
Total revenues	<u>917,008,975</u>
Expenditures:	
Health and welfare:	
Aid to individuals	793,668,907
Allocated administrative expenditures	37,774,487
Case management	39,848,616
Professional and outside services	3,719,372
Premium tax	<u>18,952,930</u>
Total expenditures	<u>893,964,312</u>
Excess of revenues over expenditures	23,044,663
Other financing uses:	
Transfers to other state funds	<u>(74,217,300)</u>
Net change in fund balance	(51,172,637)
Fund balance, July 1, 2011	<u>66,071,427</u>
Fund balance, June 30, 2012	<u>\$ 14,898,790</u>

See accompanying notes to financial statements.

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Notes to Financial Statements
June 30, 2012

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.

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Notes to Financial Statements
June 30, 2012

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.

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 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, 2012

G. Incurred But Not Recorded (IBNR) Methodology

The liability and expenditures reported for accrued medical and healthcare claims includes 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 on Deposit with the State Treasurer

Arizona Revised Statutes requires state agencies' monies to be deposited with the State Treasurer. Cash on deposit with the State Treasurer represents the ALTCS Contract's portion of those monies.

Note 3 - Due from Other State Funds

Amounts due from other state funds at June 30, 2012, include \$88,600 of interest earned, \$66,104,693 of capitation receivables due from AHCCCS, and \$97,780 due from the Department of Economic Security's General Fund for share of costs.

Note 4 - Accrued Medical and Healthcare Claims

Accrued medical and healthcare claims totaling \$61,803,778 include estimated incurred but not reported (IBNR) medical claims.

Note 5 - Acute Care Reinsurance

During the year ended June 30, 2012, the Division received reimbursements totaling \$8,902,431 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 \$7,080,018 to the health plans during the year ended June 30, 2012, and had IBNR claims of \$1,500,000 for total acute care reinsurance expenditures of \$8,580,018.

Department of Economic Security
 Division of Developmental Disabilities
 ALTCS Contract
 Notes to Financial Statements
 June 30, 2012

Note 6 - Aid to Individuals Expenditures

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

Institutional care:	
Skilled nursing	\$ 3,372,876
Institutional care	9,882,677
Intermediate (mentally retarded)	14,228,792
Institutional care IBNR	<u>1,446,147</u>
Total institutional care	<u>28,930,492</u>
Home- and community-based services (HCBS):	
State-operated group home	6,171,929
Vendor-operated group home	209,701,610
Adult developmental home	39,759,731
Home-based services	332,343,066
HCBS IBNR	<u>56,765,814</u>
Total HCBS	<u>644,742,150</u>
Acute care:	
Acute care	118,226,861
Acute care IBNR	2,091,817
Reinsurance	7,080,018
Reinsurance IBNR	1,500,000
Reinsurance reimbursement	<u>(8,902,431)</u>
Total acute care	<u>119,996,265</u>
Total aid to individuals expenditures	<u>\$793,668,907</u>

During the year ended June 30, 2012, the ALTCS Contract recorded allocated charges of \$25,679,033 as expenditures for direct care services, including administrative costs provided to clients by the Division. The expenditures were charged to the ALTCS Contract as aid to individuals expenditures based on a federally approved cost allocation plan.

Note 7 - Allocated Administrative Expenditures

During the year ended June 30, 2012, the ALTCS Contract recorded allocated administrative charges of \$37,774,487 as expenditures for its share of the administrative and fiscal services provided by the Department.

Note 8 - 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.

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Notes to Financial Statements
June 30, 2012

Note 9 - Transfers

Transfers to other state funds during the year ended June 30, 2012, consisted of \$30 million to the State General Fund as a result of Laws 2011, First Regular Session, Chapter 24, Section 108, and \$44.2 million to the State-Funded Long-Term Care Fund that may be used for operational and programmatic expenses as a result of Laws 2012, Second Regular Session, Chapter 299, Section 27.

Note 10 - 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 11 - 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 12 - Related Party Transactions

During the year ended June 30, 2012, the ALTCS Contract reimbursed the Division for \$25,679,033 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 \$37,774,487 of administrative and fiscal services, and the Arizona Department of Insurance for \$18,952,930 of premium taxes due.

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Supplementary Schedules

Department of Economic Security
 Division of Developmental Disabilities
 ALTCS Contract
 Medical Claims Payable (RBUCs and IBNRs)
 June 30, 2012

Account	Reported But Unpaid Claims (RBUCs)				Total RBUCs ¹	IBNR ¹	Total RBUCs and IBNRs
	1-30 days	31-60 days	61-90 days	Over 90 days			
Institutional care						\$ 1,446,147	\$ 1,446,147
HCBS						56,765,814	56,765,814
Acute care						<u>3,591,817</u>	<u>3,591,817</u>
Total claims payable						<u>\$61,803,778</u>	<u>\$61,803,778</u>

¹ Due to the timeliness of claims submission by providers as well as the immediate payment of billings by the Division's claims processing systems, RBUCs are not separately presented from the IBNR amount since any amount would be immaterial.

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Lag Report for Institutional Care Payments
Year Ended June 30, 2012

Quarter in Which Service Was Provided

<u>Quarter of Payment</u>	<u>Current</u>	<u>1st Prior</u>	<u>2nd Prior</u>	<u>3rd Prior</u>	<u>4th Prior</u>	<u>5th Prior</u>	<u>6th Prior</u>	<u>Total</u>
Current	\$6,482,537	\$1,302,481	\$ 22,570	\$ 9,620				\$ 7,817,208
1 st Prior		6,334,106	1,250,628	15,702	\$ 13,615			7,614,051
2 nd Prior			5,550,288	1,297,898	151,599	\$ 53,106		7,052,891
3 rd Prior				5,995,256	1,304,463	62,733	\$ 4,121	7,366,573
4 th Prior					6,835,113	1,226,212	29,994	8,091,319
5 th Prior						5,731,845	1,176,810	6,908,655
6 th Prior							<u>5,815,812</u>	<u>5,815,812</u>
Total	<u>6,482,537</u>	<u>7,636,587</u>	<u>6,823,486</u>	<u>7,318,476</u>	<u>8,304,790</u>	<u>7,073,896</u>	<u>7,026,737</u>	<u>50,666,509</u>
Expenses reported	7,413,331	7,364,294	6,909,880	7,242,987	8,354,017	7,003,834	6,504,478	50,792,821
Adjustment ¹	<u>298,431</u>	<u>434,985</u>	<u>(51,144)</u>	<u>94,469</u>	<u>(49,227)</u>	<u>70,062</u>	<u>522,259</u>	<u>1,319,835</u>
Remaining liability	<u>\$1,229,225</u>	<u>\$ 162,692</u>	<u>\$ 35,250</u>	<u>\$ 18,980</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 1,446,147</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, 2012

Quarter in Which Service Was Provided

<u>Quarter of Payment</u>	<u>Current</u>	<u>1st Prior</u>	<u>2nd Prior</u>	<u>3rd Prior</u>	<u>4th Prior</u>	<u>5th Prior</u>	<u>6th Prior</u>	<u>Total</u>
Current	\$106,757,330	\$ 54,093,288	\$ 494,264	\$ 378,733	\$ 41,891	\$ 2,429	\$ 5,719	\$ 161,773,654
1 st Prior		100,901,415	51,708,352	807,655	200,729	226,892	177,255	154,022,298
2 nd Prior			104,161,431	55,866,192	762,193	178,700	(98,864)	160,869,652
3 rd Prior				113,141,178	57,504,854	803,704	179,166	171,628,902
4 th Prior					107,142,571	55,747,600	802,535	163,692,706
5 th Prior						101,050,497	53,663,922	154,714,419
6 th Prior							105,137,488	105,137,488
Total	<u>106,757,330</u>	<u>154,994,703</u>	<u>156,364,047</u>	<u>170,193,758</u>	<u>165,652,238</u>	<u>158,009,822</u>	<u>159,867,221</u>	<u>1,071,839,119</u>
Expenses reported	163,266,415	154,043,549	157,195,142	170,237,044	165,298,376	157,145,072	162,314,617	1,129,500,215
Adjustment ¹	<u>(2,581,562)</u>	<u>2,654,129</u>	<u>(149,905)</u>	<u>410,840</u>	<u>353,862</u>	<u>864,750</u>	<u>(2,447,396)</u>	<u>(895,282)</u>
Remaining liability	<u>\$ 53,927,523</u>	<u>\$ 1,702,975</u>	<u>\$ 681,190</u>	<u>\$ 454,126</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 56,765,814</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 Payments²
Year Ended June 30, 2012

Quarter in Which Service Was Provided

<u>Quarter of Payment</u>	<u>Current</u>	<u>1st Prior</u>	<u>2nd Prior</u>	<u>3rd Prior</u>	<u>4th Prior</u>	<u>5th Prior</u>	<u>6th Prior</u>	<u>Total</u>
Current	\$29,853,205	\$ 568,238	\$ 139,194	\$ 210,646	\$ 26,229	\$ 4,511	\$ 23,806	\$ 30,825,829
1 st Prior		28,429,284	782,338	384,343	132,758	25,095		29,753,818
2 nd Prior			25,752,473	1,592,371	361,970	51,542	6,515	27,764,871
3 rd Prior				28,317,311	1,565,817	184,678	99,413	30,167,219
4 th Prior					28,483,992	2,146,970	563,447	31,194,409
5 th Prior						29,053,992	1,402,880	30,456,872
6 th Prior							<u>28,458,915</u>	<u>28,458,915</u>
Total	<u>29,853,205</u>	<u>28,997,522</u>	<u>26,674,005</u>	<u>30,504,671</u>	<u>30,570,766</u>	<u>31,466,788</u>	<u>30,554,976</u>	<u>208,621,933</u>
Expenses reported	32,425,121	33,150,944	30,852,980	32,469,651	33,568,576	30,326,727	29,983,183	222,777,182
Adjustment ¹	<u>(1,107,644)</u>	<u>(3,314,634)</u>	<u>(3,405,721)</u>	<u>(1,449,477)</u>	<u>(2,997,810)</u>	<u>1,140,061</u>	<u>571,793</u>	<u>(10,563,432)</u>
Remaining liability	<u>\$ 1,464,272</u>	<u>\$ 838,788</u>	<u>\$ 773,254</u>	<u>\$ 515,503</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 3,591,817</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
Utilization Data Report
Year Ended June 30, 2012

	<u>Medicare</u>		<u>Non-Medicare</u>		<u>Total</u>	
	<u>Current</u>	<u>YTD</u>	<u>Current</u>	<u>YTD</u>	<u>Current</u>	<u>YTD</u>
A. Enrollees	5,490	5,490	19,193	19,193	24,683	24,683
B. Member months (unduplicated)	16,425	64,582	57,351	226,284	73,776	290,866
Institutional total	414	1,715	152	605	566	2,320
1. Level 2	91	415	36	138	127	553
2. Level 3	323	1,300	116	467	439	1,767
Home- and community-based services total	15,122	59,258	50,841	200,166	65,963	259,424
1. Group Home (DD)	4,640	18,488	3,106	12,367	7,746	30,855
2. Individual Home	8,728	34,028	46,516	183,125	55,244	217,153
3. Other Adult Development Homes	1,754	6,742	1,219	4,674	2,973	11,416
Other Case Management Only	889	3,609	6,358	25,513	7,247	29,122
C. Acute patient day information ¹						
1. Admissions	-	3	13	42	13	45
2. Patient days	-	10	44	134	44	144
3. Discharges	-	3	13	42	13	45
4. Discharge days	-	10	44	134	44	144
5. Average length of stay (days)	-	3.33	3.38	3.19	3.38	3.20

¹ The acute patient day information includes only the American Indian Health Program membership.

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Related Party Transactions
Year Ended June 30, 2012

<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	\$14,228,792
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	11,450,241
Department of Economic Security, Division of Developmental Disabilities and all other divisions	Administrative and fiscal services	Allocated departmental overhead costs	37,774,487
Department of Insurance	Compliance with Arizona Revised Statutes §§36-2905 and 36-2944.01	Premium tax payments	18,952,930

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
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MELANIE M. CHESNEY
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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

Clarence H. Carter, Director
Department of Economic Security

We have audited the financial statements of the State of Arizona, Department of Economic Security, Division of Developmental Disabilities, Arizona Long Term Care System Contract (ALTCS Contract) as of and for the year ended June 30, 2012, and have issued our report thereon dated November 21, 2012. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

The Department's and its Division of Developmental Disabilities' management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Division's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control over financial reporting.

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 financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division's ALTCS Contract financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Debbie Davenport
Auditor General

November 21, 2012