



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, 2014



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, 2014

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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

Report on the Financial Statements

We have audited the accompanying financial statements of the State of Arizona, Department of Economic Security, Division of Developmental Disabilities, Arizona Long-Term Care System Contract (ALTCS Contract) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Division's ALTCS Contract's financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Division's ALTCS Contract as of June 30, 2014, and the respective changes in financial position thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in Note 1, the Division's ALTCS Contract's financial statements are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and major fund of the State of Arizona that is attributable to the transactions of the Division's ALTCS Contract. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of June 30, 2014, and the changes in its financial position, for the year ended in conformity with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Other Matters

Supplementary Information

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

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 18, 2014, 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* in considering the Division's internal control over financial reporting and compliance.

Debbie Davenport
Auditor General

November 18, 2014

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Balance Sheet—Special Revenue Fund
June 30, 2014

Assets	
Cash on deposit with the State Treasurer	\$ 16,972,795
Due from other state funds	67,725,541
Due from providers	<u>813,343</u>
 Total assets	 <u><u>\$ 85,511,679</u></u>
Liabilities and Fund Balance	
Liabilities:	
Accrued administrative and payroll costs	\$ 5,144,060
Accrued medical and healthcare claims	70,598,979
Due to other state funds	1,034,543
Due to providers	<u>816,614</u>
 Total liabilities	 <u>77,594,196</u>
 Fund balance:	
Restricted for health and welfare	<u>7,917,483</u>
 Total liabilities and fund balance	 <u><u>\$ 85,511,679</u></u>

See accompanying notes to financial statements.

Department of Economic Security
 Division of Developmental Disabilities
 ALTCS Contract
 Statement of Revenues, Expenditures, and Changes in
 Fund Balance—Special Revenue Fund
 June 30, 2014

Revenues:	
Capitation	\$ 1,010,977,616
Investment earnings	<u>892,300</u>
Total revenues	<u>1,011,869,916</u>
Expenditures:	
Health and welfare:	
Aid to individuals	900,185,879
Allocated administrative expenditures	44,560,338
Case management	47,251,705
Professional and outside services	4,851,498
Premium tax	<u>21,033,738</u>
Total expenditures	<u>1,017,883,158</u>
Deficiency of revenues under expenditures	(6,013,242)
Other financing uses:	
Transfers to other state funds	<u>(4,957,900)</u>
Net change in fund balance	(10,971,142)
Fund balance, July 1, 2013	<u>18,888,625</u>
Fund balance, June 30, 2014	<u>\$ 7,917,483</u>

See accompanying notes to financial statements.

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Notes to Financial Statements
June 30, 2014

Note 1 - Summary of Significant Accounting Policies

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

A. Reporting Entity

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

B. Fund Accounting

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

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

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

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Notes to Financial Statements
June 30, 2014

C. Basis of Accounting

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

D. Fund Balance Classifications

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

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

E. Capitation

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

F. Investment Earnings

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

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Notes to Financial Statements
June 30, 2014

G. Incurred But Not Reported (IBNR) Methodology

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

Note 2 - Cash 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, 2014, include:

- \$31,196 of interest earned;
- \$67,587,477 of capitation, reinsurance, and Primary Care Physician Rate Parity receivables due from AHCCCS; and
- \$106,868 due from the Department of Economic Security's General Fund for share of costs.

Note 4 - Primary Care Physician (PCP) Rate Parity–Cost Settlement Revenue

Section 1902(a)(13)(C) of the Social Security Act, as amended by The Patient Protection and Affordable Care Act (ACA) requires that managed care entities (i.e., AHCCCS Health Plans and Program Contractors) pay qualified PCPs (and other providers specified in the ACA) fees that are not less than the Medicare fee schedule in effect for calendar years 2013 and 2014, or the fee schedule rate that would result from applying the 2009 Medicare conversion factor, whichever is greater, for certain services designated by specific Current Procedural Terminology codes.

AHCCCS has identified payments attributable to the increased provider rates and the percentage of those payments eligible for 100 percent Federal Medical Assistance Percentages. After completing its validation and verification processes, AHCCCS calculated the additional amounts owed to the Division. Monies for enhanced payments were based on the Divisions' actual adjudicated encounters and are in addition to regular capitation rate payments.

The Division has accrued the receivable for the PCP Rate Parity Cost Settlement Revenue received from AHCCCS subsequent to June 30, 2014, in the amount of \$587,347. The Division accrued a liability for PCP Rate Parity Cost Settlement Revenue owed to Acute Care providers in the amount of \$565,205. This settlement covered state fiscal year 2014 with an adjudication period of August 1, 2013 through March 31, 2014.

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Notes to Financial Statements
June 30, 2014

Note 5 - Due from Providers

The amount due from providers at June 30, 2014, is \$813,343, as a result of post-payment reviews of long-term care home and community-based service providers.

Note 6 - Due to Other State Funds

Amounts due to other state funds at June 30, 2014, is \$1,034,543 as a result of premium tax payable to the Arizona Department of Insurance.

Note 7 - Due to Providers

Amounts due to providers at June 30, 2014, include:

- \$251,409 resulting from an accrual for retroactive home- and community-based service provider payments due to a rate change. The time period covered is August 1, 2013 through June 30, 2014.
- \$565,205 resulting from an accrual for retroactive provider payments due to PCP Rate Parity—Cost Settlement Revenue (see Note 4). The time period covered is August 1, 2013 through March 31, 2014.

Note 8 - Accrued Medical and Healthcare Claims

Accrued medical and healthcare claims totaling \$70,598,979 include IBNR medical claims.

Note 9 - Acute Care Reinsurance

During the year ended June 30, 2014, the Division received reimbursements totaling \$3,039,620 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 \$5,611,727 to the health plans during the year ended June 30, 2014, and had IBNR claims of \$280,000 for total acute care reinsurance expenditures of \$5,891,727.

Department of Economic Security
 Division of Developmental Disabilities
 ALTCS Contract
 Notes to Financial Statements
 June 30, 2014

Note 10 - 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	\$ 2,674,564
Institutional care	12,262,299
Intermediate (mentally retarded)	13,002,905
Institutional care IBNR	<u>1,536,955</u>
Total institutional care	<u>29,476,723</u>
Home- and community-based services (HCBS):	
State-operated group home	6,724,051
Vendor-operated group home	236,676,296
Adult developmental home	50,948,719
Home-based services	378,234,599
HCBS IBNR	<u>67,570,719</u>
Total HCBS	<u>740,154,384</u>
Acute care:	
Acute care	126,491,356
Acute care IBNR	1,211,309
Reinsurance	5,611,727
Reinsurance IBNR	280,000
Reinsurance reimbursement	<u>(3,039,620)</u>
Total acute care	<u>130,554,772</u>
Total aid to individuals expenditures	<u>\$900,185,879</u>

During the year ended June 30, 2014, the ALTCS Contract recorded allocated charges of \$23,591,604 as expenditures for direct care services, including administrative costs the Division provided to clients. The expenditures were charged to the ALTCS Contract as aid to individuals expenditures based on a federally approved cost allocation plan.

Note 11 - Allocated Administrative Expenditures

During the year ended June 30, 2014, the ALTCS Contract recorded allocated administrative charges of \$44,560,338 as expenditures for its share of the administrative and fiscal services the Department provided.

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Notes to Financial Statements
June 30, 2014

Note 12 - Premium Tax

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

Note 13 - Transfers

Transfers to other state funds during the year ended June 30, 2014, consisted of a \$4,957,900 transfer to the Department of Economic Security's State-Funded Long-Term Care Fund that may be used for operational and programmatic expenses as a result of Laws 2013, First Special Session, Chapter 10, Section 28.

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 Comprehensive Annual Financial Report*.

Note 16 - Related Party Transactions

During the year ended June 30, 2014, the ALTCS Contract reimbursed the Division for \$23,591,604 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 \$44,560,338 of administrative and fiscal services and the Arizona Department of Insurance for \$21,033,738 of premium taxes due.

Supplementary Schedules

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Lag Report for Institutional Care Payments
Year Ended June 30, 2014

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	\$ 6,145,866	\$ 1,467,041	\$ 29,277		\$ 68	\$ 29,100	\$ 1,600	\$ 7,672,952
1 st Prior		5,603,540	1,586,222	22,538	4,561			7,216,861
2 nd Prior			6,286,094	1,465,234	13,935	11,622	7,267	7,784,152
3 rd Prior				5,610,117	1,177,480		2,714	6,790,311
4 th Prior					5,945,337	1,254,679	32,957	7,232,973
5 th Prior						5,335,481	1,209,197	6,544,678
6 th Prior							5,906,740	5,906,740
Total	<u>6,145,866</u>	<u>7,070,581</u>	<u>7,901,593</u>	<u>7,097,889</u>	<u>7,141,381</u>	<u>6,630,882</u>	<u>7,160,475</u>	<u>49,148,667</u>
Expenses reported	7,373,172	7,328,704	7,525,689	7,249,158	5,923,924	6,814,418	6,962,032	49,177,097
Adjustment (1)	<u>79,106</u>	<u>(85,216)</u>	<u>416,249</u>	<u>(133,978)</u>	<u>1,217,457</u>	<u>(183,536)</u>	<u>198,443</u>	<u>1,508,525</u>
Remaining liability	<u>\$ 1,306,412</u>	<u>\$ 172,907</u>	<u>\$ 40,345</u>	<u>\$ 17,291</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,536,955</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, 2014

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	\$ 124,149,379	\$ 63,964,504	\$ 1,072,886	\$ 278,135	\$ 177,278	\$ 154,043	\$ 944,186	\$ 190,740,411
1 st Prior		117,115,234	61,255,245	815,066	340,970	166,666	10,148	179,703,329
2 nd Prior			121,715,000	61,060,536	1,119,477	386,507	112,784	184,394,304
3 rd Prior				121,011,542	58,463,033	863,460	188,075	180,526,110
4 th Prior					114,818,449	55,890,329	665,072	171,373,850
5 th Prior						105,630,239	53,235,009	158,865,248
6 th Prior							108,884,997	108,884,997
Total	<u>124,149,379</u>	<u>181,079,738</u>	<u>184,043,131</u>	<u>183,165,279</u>	<u>174,919,207</u>	<u>163,091,244</u>	<u>164,040,271</u>	<u>1,174,488,249</u>
Expenses reported	192,866,707	180,530,916	183,843,225	182,913,536	177,097,929	162,593,226	162,155,092	1,242,000,631
Adjustment (1)	<u>(6,552,273)</u>	<u>4,062,504</u>	<u>1,372,935</u>	<u>970,696</u>	<u>(2,178,722)</u>	<u>498,018</u>	<u>1,885,179</u>	<u>58,337</u>
Remaining liability	<u>\$ 62,165,055</u>	<u>\$ 3,513,682</u>	<u>\$ 1,173,029</u>	<u>\$ 718,953</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 67,570,719</u>

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

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Lag Report for Acute Care Payments
Year Ended June 30, 2014

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	\$ 29,668,887	\$ 616,887	\$ 163,528	\$ 81,215	\$ 14,922	\$ 7,365	\$ 466	\$ 30,553,270
1 st Prior		30,626,147	1,250,440	401,482	59,872	29,895	6,905	32,374,741
2 nd Prior			29,994,795	983,249	195,964	44,561	21,098	31,239,667
3 rd Prior				26,606,880	870,059	234,236	261,088	27,972,263
4 th Prior					31,269,714	1,002,842	449,634	32,722,190
5 th Prior						24,081,629	512,839	24,594,468
6 th Prior							28,630,382	28,630,382
Total	<u>29,668,887</u>	<u>31,243,034</u>	<u>31,408,763</u>	<u>28,072,826</u>	<u>32,410,531</u>	<u>25,400,528</u>	<u>29,882,412</u>	<u>208,086,981</u>
Expenses reported (2)	33,165,770	33,365,275	33,081,506	33,981,841	31,491,638	23,022,885	27,469,233	215,578,148
Adjustment (1)	<u>(2,452,967)</u>	<u>(1,898,544)</u>	<u>(1,538,525)</u>	<u>(5,819,537)</u>	<u>918,893</u>	<u>2,377,643</u>	<u>2,413,179</u>	<u>(5,999,858)</u>
Remaining liability	<u>\$ 1,043,916</u>	<u>\$ 223,697</u>	<u>\$ 134,218</u>	<u>\$ 89,478</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,491,309</u>

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

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

Department of Economic Security
Division of Developmental Disabilities
ALTCS Contract
Related Party Transactions
Year Ended June 30, 2014

<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	\$13,002,905
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	10,588,699
Department of Economic Security, Division of Developmental Disabilities and all other divisions	Administrative and fiscal services	Allocated departmental overhead costs	44,560,338
Department of Insurance	Compliance with Arizona Revised Statutes §§36-2905 and 36-2944.01	Premium tax payments	21,033,738

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AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
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MELANIE M. CHESNEY
DEPUTY 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

Clarence H. Carter, Director
Department of Economic Security

We have audited, in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the State of Arizona, Department of Economic Security, Division of Developmental Disabilities, Arizona Long Term Care System Contract (ALTCS Contract) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Division's ALTCS Contract's financial statements, and have issued our report thereon dated November 18, 2014.

Internal Control over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Division's ALTCS Contract's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division's ALTCS Contract's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, 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*.

Purpose of this Report

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

Debbie Davenport
Auditor General

November 18, 2014