Department of Economic Security
Division of Developmental Disabilities ALTCS Contract

Annual Financial Report

15 Months Ended
September 30, 2019

A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General

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DEPUTY AUDITOR GENERAL

ARIZONA AUDITOR GENERAL
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JOSEPH D. MOORE
DEPUTY AUDITOR GENERAL

Independent auditors' report

Members of the Arizona State Legislature

Cara Christ, Ph.D., 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 15-month period ended September 30, 2019, 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 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 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Division's ALTCS Contract as of September 30, 2019, and the respective changes in financial position thereof for the 15-month period then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of matters

As discussed in Note 1 to the financial statements, 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 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, 2019, and the changes in its financial position for the 15-month period 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, the Division's ALTCS Contract's financial statements year-end changed from June 30 to September 30. Our opinion is not modified with respect to this matter.

Other matters

Supplementary information

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

Other reporting required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 4, 2020, 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 Perry, CPA, CFE
Auditor General

March 4, 2020

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Balance sheet—special revenue fund
As of the 15 months ended September 30, 2019

Assets	
Investments held by the State Treasurer	$ 171,714,213
Due from other state funds	1,822,859
Due from providers	3,198,065
Total assets	$ 176,735,137
Liabilities and fund balance	
Liabilities:	
Accrued administrative and payroll costs	$ 7,215,779
Accrued medical and healthcare claims	124,659,381
Due to other state funds	272,706
Total liabilities	132,147,866
Fund balance:	
Restricted for health and welfare	44,587,271
Total liabilities and fund balance	$ 176,735,137

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
For the 15 months ended September 30, 2019

Revenues:	
Capitation	$ 2,090,955,415
Investment earnings	3,936,217
Miscellaneous	37,205,102
Total revenues	2,132,096,734
Expenditures:	
Health and welfare:	
Aid to individuals	1,860,838,648
Allocated administrative expenditures	87,307,416
Case management	80,662,857
Professional and outside services	12,897,984
Premium tax	42,635,917
Total expenditures	2,084,342,822
Excess of revenues over expenditures	47,753,912
Other financing uses:	
Transfers to other state funds	(7,532,267)
Net change in fund balance	40,221,645
Fund balance, July 1, 2018	4,365,626
Fund balance, September 30, 2019	$ 44,587,271

See accompanying notes to financial statements.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to financial statements
As of the 15 months ended September 30, 2019

Note 1 - Summary of significant accounting policies

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

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 inpatient and outpatient 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.

The September 30, 2019, ALTCS Contract's financial statements reports a 15-month period because AHCCCS changed the ALTCS Contract's reporting period from a June 30 to a September 30 year-end.

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.

C. Basis of accounting

The ALTCS Contract's 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.

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 Department's information systems, with adjustments as necessary for events that are outside the lag patterns. Amounts are based on historical expenditure patterns.

Note 2 - Investments held by the State Treasurer

At September 30, 2019, the ALTCS Contract's investments with the State Treasurer were as follows:

	Amount
State Treasurer's investment pool 3	$171,714,213

Arizona Revised Statutes (A.R.S.) require state agencies' monies be deposited with the State Treasurer and further requires those deposits to be invested in various pooled funds. Investments in the State Treasurer's investment pools are valued at the pool's share price multiplied by the number of shares the ALTCS Contract held. The fair value of a participant's position in the pools approximates the value of that participant's pool shares. The State Board of Investment provides oversight for the State Treasurer's investment pools.

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

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Department of Economic Security does not have a formal interest rate risk policy. As of September 30, 2019, the State Treasurer's weighted average to maturity of its internal pool 3 investments is 1.13 years.

Note 3 - Accrued medical and healthcare claims

Accrued medical and healthcare claims totaling $124,659,381 include IBNR medical claims.

Note 4 - Miscellaneous revenues

Miscellaneous revenues during the 15-month period ended September 30, 2019, consisted of $ 36,460,100 in one-time assistance for developmental disabilities provider cost increases resulting from Laws 2018, Second Regular Session, Chapter 276, Section 122, and $745,002 of other revenues.

Note 5 - Acute care reinsurance

During the 15-month period ended September 30, 2019, the Division received reimbursements totaling $27,955,523 from AHCCCS for acute care reinsurance expenditures for claims for enrollees incurred in the 15-month period ended September 30, 2019, 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 $22,543,528 to health plans during the 15-month period ended September 30, 2019.

Note 6 - Aid to individuals expenditures

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

Institutional care:	
Skilled nursing	$ 3,423,346
Institutional care	16,244,899
Intermediate (intellectually or developmentally disabled)	14,906,925
Institutional care IBNR	1,279,043
Total institutional care	35,854,213

Home- and community-based services (HCBS):	
State-operated group home	$ 8,101,806
Vendor-operated group home	466,597,126
Adult developmental home	83,398,506
Home-based services	811,919,943
HCBS IBNR	120,852,919
Total HCBS	1,490,870,300
Acute care:	
Acute care	336,998,711
Acute care IBNR	2,527,419
Reinsurance	22,543,528
Reinsurance reimbursement	(27,955,523)
Total acute care	334,114,135
Total aid to individuals expenditures	$1,860,838,648

During the 15-month period ended September 30, 2019, the ALTCS Contract recorded allocated charges of $26,352,369 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 7 - Allocated administrative expenditures

During the 15-month period ended September 30, 2019, the ALTCS Contract recorded allocated administrative charges of $87,307,416 as expenditures for its share of the administrative and fiscal services the Department provided.

Note 8 - Premium tax

Arizona Revised Statutes (A.R.S.) §§36-2905 and 36-2944.01 require AHCCCS 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.

Note 9 - Transfers

Transfers to other state funds during the 15-month period ended September 30, 2019, consisted of $4,365,626 to the State’s general fund as a result of A.R.S. §36-2953(H); and $3,166,641 of interest to the state-funded long-term care fund, as authorized by AHCCCS.

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 15-month period ended September 30, 2019, the ALTCS Contract reimbursed the Division for $26,352,369 of health and rehabilitative services provided to enrollees, including administrative costs. The ALTCS Contract also reimbursed the Division as well as other divisions of the Department for $87,307,416 of administrative and fiscal services and the Arizona Department of Insurance for $42,635,917 of premium taxes.

Supplementary schedules

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Lag report for institutional care payments
For the 15 months ended September 30, 2019

	Quarter in which service was provided							
Quarter of payment	Current	1st Prior	2nd Prior	3rd Prior	4th Prior	5th Prior	6th Prior	Total
Current	$ 5,946,869	$ 1,410,243	$ 54,616	$ 1,822	$ 345	$ -	$ -	$ 7,413,895
1st Prior		5,688,500	1,589,584	59,643	12,690	12,182	-	7,362,599
2nd Prior			2,469,118	1,645,124	8,835	-	(3,593)	4,119,484
3rd Prior				5,729,817	1,663,176	61,730	17,204	7,471,927
4th Prior					6,644,679	1,878,381	98,124	8,621,184
5th Prior						6,144,039	2,359,362	8,503,401
6th Prior							6,210,737	6,210,737
Total	5,946,869	7,098,743	4,113,318	7,436,406	8,329,725	8,096,332	8,681,834	49,703,227
Expenses reported	6,700,835	6,903,163	6,826,825	6,920,596	8,502,794	9,617,829	7,532,444	53,004,486
Adjustment (1)	159,003	555,643	(2,709,845)	518,159	(173,069)	(1,521,497)	1,149,390	(2,022,216)
Remaining liability	$ 912,969	$ 360,063	$ 3,662	$ 2,349	$ -	$ -	$ -	$ 1,279,043

(1) Adjustment amounts each quarter fluctuate because of 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
For the 15 months ended September 30, 2019

Quarter in which service was provided

Quarter of payment	Current	1st Prior	2nd Prior	3rd Prior	4th Prior	5th Prior	6th Prior	Total
Current	$ 205,332,275	$ 95,155,284	$ 1,485,406	$ 61,152	$ 47,771	$ -	$ -	$ 302,081,888
1st Prior		195,925,055	92,187,162	1,189,017	147,076	54,693	(3,735)	289,499,268
2nd Prior			183,941,910	88,176,590	1,372,901	339,385	186,326	274,017,112
3rd Prior				188,178,710	84,687,608	1,542,230	585,591	274,994,139
4th Prior					188,595,331	88,053,026	2,193,402	278,841,759
5th Prior						181,744,309	86,901,612	268,645,921
6th Prior							171,646,344	171,646,344
Total	205,332,275	291,080,339	277,614,478	277,605,469	274,850,687	271,733,643	261,509,540	1,859,726,431
Expenses reported	320,983,833	296,042,452	277,233,319	279,095,675	280,998,090	282,916,135	274,248,124	2,011,517,628
Adjustment (1)	(4,024,675)	(569,361)	3,274,639	453,678	(6,151,483)	(11,182,492)	(12,738,584)	(30,938,278)
Remaining liability	$ 111,626,883	$ 4,392,752	$ 2,893,480	$ 1,943,884	$ (4,080)	$ -	$ -	$ 120,852,919

(1) Expenses reported do not include $36,516,931 of one-time payments for HCBS services relating to Laws 2018, Second Regular Session, Chapter 276, Section 122.
(2) Adjustment amounts each quarter fluctuate because of unpredictable variables that affect the business cycle.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Lag report for acute care payments
For the 15 months ended September 30, 2019

Quarter in which service was provided

Quarter of payment	Current	1st Prior	2nd Prior	3rd Prior	4th Prior	5th Prior	6th Prior	Total
Current	$ 61,017,642	$ 3,600,677	$ 343,003	$ 176,478	$ 741,466	$ -	$ -	$ 65,879,266
1st Prior		69,693,963	103,323	3,103	3,537	16,500	4,700,929	74,521,355
2nd Prior			79,662,119	672,134	532,223	17,632	66,056	80,950,164
3rd Prior				69,770,284	1,619,335	52,883	117,750	71,560,252
4th Prior					47,783,180	1,019,686	793,871	49,596,737
5th Prior						45,193,512	839,671	46,033,183
6th Prior							51,299,308	51,299,308
Total	61,017,642	73,294,640	80,108,445	70,621,999	50,679,741	46,300,213	57,817,585	439,840,265
Expenses reported (1)	77,020,933	77,231,658	79,605,264	73,742,501	54,469,303	50,793,763	51,299,307	464,162,730
Adjustment (2)	(15,426,270)	(3,342,908)	1,053,367	(2,648,212)	(3,455,750)	(4,493,550)	6,518,278	(21,795,046)
Remaining liability	$ 577,021	$ 594,110	$ 550,186	$ 472,290	$ 333,812	$ -	$ -	$ 2,527,419

(1) Acute Care Payments include fee for service, capitation, and reinsurance payments. Reinsurance reimbursements are not included.
(2) Adjustment amounts each quarter fluctuate because of unpredictable variables that affect the business cycle.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Related-party transactions
For the 15 months ended September 30, 2019

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/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	$14,906,925
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	11,445,444
Department of Economic Security, Division of Developmental Disabilities and all other divisions	Administrative and fiscal services	Allocated departmental overhead costs	87,307,416
Department of Insurance	Compliance with A.R.S. §§36-2905 and 36-2944.01	Premium tax payments	42,635,917