

STATE OF ARIZONA
Department of Economic Security
Division of Children, Youth and Families
Comprehensive Medical and Dental Program
AHCCCS Line of Business

Financial Statements

June 30, 2010

Independent Auditors' Report

Neal Young, Director
Arizona Department of Economic Security

We have audited the accompanying financial statements of the State of Arizona, Department of Economic Security (the Department), Division of Children, Youth and Families (the Division), Comprehensive Medical and Dental Program (CMDP), Arizona Health Care Cost Containment System (AHCCCS) Line of Business as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the Department's and the Division's 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 financial statements of the Arizona Department of Economic Security, Division of Children, Youth and Families, Comprehensive Medical and Dental Program, AHCCCS Line of Business are intended to present the financial position and changes in financial position of only that portion of the General Fund of the State of Arizona that is attributable to the transactions of the Arizona Department of Economic Security, Division of Children, Youth and Families, Comprehensive Medical and Dental Program, AHCCCS Line of Business.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Arizona, Department of Economic Security, Division of Children, Youth and Families, Comprehensive Medical and Dental Program, Arizona Health Care Cost Containment System Line of Business as of June 30, 2010, and the changes in financial position thereof for the year ended in conformity with U.S. generally accepted accounting principles.

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Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2010 on our consideration of the State of Arizona, Department of Economic Security, Division of Children, Youth and Families, Comprehensive Medical and Dental Program, AHCCCS Line of Business' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the 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.

Feltz & Chapman P.C.

October 27, 2010

STATE OF ARIZONA
Department of Economic Security
Division of Children, Youth and Families
Comprehensive Medical and Dental Program, AHCCCS Line of Business
Balance Sheet - Special Revenue Fund
June 30, 2010

Assets:

Cash and investments held by the State Treasurer	\$ 8,676,678
Capitation receivable	1,098,771
Reinsurance receivable	<u>772,565</u>
Total assets	<u>\$ 10,548,014</u>

Liabilities and Fund Balance

Liabilities:

Medical claims payable	\$ 6,158,045
Accrued payroll and employee benefits	<u>200,840</u>
Total liabilities	6,358,885

Fund balance	<u>4,189,129</u>
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Total liabilities and fund balance	<u>\$ 10,548,014</u>
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The accompanying notes are an integral part of these financial statements.

STATE OF ARIZONA
Department of Economic Security
Division of Children, Youth and Families
Comprehensive Medical and Dental Program, AHCCCS Line of Business
Statement of Revenues, Expenditures, and Changes in
Fund Balance - Special Revenue Fund
Year Ended June 30, 2010

Revenues:	
Capitation	\$ 27,509,144
PPC capitation	<u>1,032,710</u>
Total revenues	<u>28,541,854</u>
Expenditures:	
Hospitalization	3,192,836
Medical compensation	6,808,770
Other medical	11,026,800
Allocated administrative expenditures	3,126,503
Premium tax	<u>576,299</u>
Total expenditures	<u>24,731,208</u>
Change in fund balance	3,810,646
Fund balance, July 1, 2009	<u>378,483</u>
Fund balance, June 30, 2010	<u>\$ 4,189,129</u>

The accompanying notes are an integral part of these financial statements.

STATE OF ARIZONA
Department of Economic Security
Division of Children, Youth and Families
Comprehensive Medical and Dental Program, AHCCCS Line of Business
Notes to Financial Statements
June 30, 2010

Note 1 – Summary of Significant Accounting Policies

The accounting policies of the State of Arizona, Department of Economic Security, Division of Children, Youth and Families, Comprehensive Medical and Dental Program (CMDP), Arizona Health Care Cost Containment System (AHCCCS) Line of Business, conform to generally accepted accounting principles as applicable to governmental units as adopted by the Governmental Accounting Standards Board. A summary of CMDP's more significant accounting policies follows.

A. Reporting Entity

CMDP is a health plan established by Arizona Revised Statutes § 8-512 to provide comprehensive medical and dental care for children in foster care. These services are provided to eligible children in all 15 Arizona counties through an intergovernmental agreement between the Department of Economic Security and the Arizona Health Care Cost Containment System (AHCCCS). The Department of Economic Security has operated CMDP as an acute care health plan since 1972.

For financial reporting purposes, the State of Arizona, Department of Economic Security, Division of Children, Youth and Families, AHCCCS Line of Business includes those portions of the State of Arizona's General Fund that are controlled by the Department of Economic Security. Further, CMDP's contract with AHCCCS includes those portions of the General Fund of the Department of Economic Security that are controlled by CMDP. Control by CMDP was determined on the basis of accountability. Fiscal responsibility for CMDP remains with the Department of Economic Security and, ultimately, with the State of Arizona. CMDP has contracted with AHCCCS to provide health care services to children determined to be eligible enrollees, and only the AHCCCS portion of CMDP is presented in the financial statements. CMDP provides inpatient, outpatient, dental and other medical services, including pharmacy, laboratory, and physical therapy, to children who are eligible enrollees of CMDP. CMDP receives monthly premiums from AHCCCS for all eligible enrollees.

B. Fund Accounting

CMDP's accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on CMDP's available resources are observed. The principles of fund accounting require that the 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 comprises its assets, liabilities, fund equity, revenues, and expenditures, as appropriate. CMDP's financial transactions are recorded and reported using the flow of current financial resources measurement focus as a special revenue fund since the proceeds are from specific revenue sources that are legally restricted to expenditures for specified purposes.

Although CMDP is considered a special revenue fund when reported on individually, it becomes a part of the Department of Economic Security's General Fund at the combined department level and a part of the State of Arizona's General Fund at the combined statewide level because one of its major sources of funding is state appropriations.

STATE OF ARIZONA
Department of Economic Security
Division of Children, Youth and Families
Comprehensive Medical and Dental Program, AHCCCS Line of Business
Notes to Financial Statements
June 30, 2010

Note 1 – Summary of Significant Accounting Policies – (continued)

C. Basis of Accounting

Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied, and determines when revenues and expenditures are recognized in the accounts and reported in the financial statements. The financial statements of CMDP are presented on the modified accrual basis of accounting. Revenues are recognized when they become measurable and available to finance current period expenditures. Expenditures are recognized when the related fund liability is incurred.

D. Medical Claims Payable

CMDP uses per member per month averages to develop the incurred but not reported claims portion of the medical claims payable amount reported, in accordance with the AHCCCS Reporting Guide for Acute Health Care Contractors, Revised October 1, 2009, § 5.01.

E. Premium Tax

CMDP is assessed a 2% premium tax by the Arizona Department of Insurance on revenues received from AHCCCS, and the tax totaled \$576,299 for the year ended June 30, 2010.

Note 2 – Acute Care Reinsurance and Third Party Liability

During the year ended June 30, 2010, CMDP received reimbursement in the amount of \$1,385,009 from AHCCCS for costs incurred in excess of a stated deductible per member per contract year. These revenues are reported as offsets to other medical expenditures.

Note 3 – Prior Period Coverage Settlement

CMDP recorded a liability in the amount of \$137,404 for prior period coverage reconciliations provided by AHCCCS. The amount of \$137,404 is reported as additions to other medical expenditures for the year ended June 30, 2010.

STATE OF ARIZONA
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Notes to Financial Statements
June 30, 2010

Note 4 – Allocated Administrative Expenditures

During the year ended June 30, 2010, CMDP recorded as expenditures allocated administrative charges of \$3,126,503 for its share of services provided by the Department of Economic Security.

Note 5 – Risk Management

CMDP 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 of Economic Security is a participant in the State of Arizona's (State) self-insurance program, and in the opinion of CMDP's management, any unfavorable outcomes from these risks would be covered by that self-insurance program. Accordingly, the Department of Economic Security has no risk of loss beyond adjustments to future years' premium payments to the State's self-insurance program. All estimated losses for unsettled claims and actions of the State are determined on an actuarial basis and are included in the *State of Arizona Comprehensive Annual Financial Report*.

Note 6 – Retirement Plan

Plan Description—CMDP contributes to a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System (System). Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The System is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2.

The System issues a comprehensive annual financial report that includes financial statements and required supplementary information. The most recent report may be obtained by writing the System, 3300 North Central Avenue, PO Box 33910, Phoenix, AZ 85067-3910 or by calling (602) 240-2000 or (800) 621-3778.

Funding Policy—The Arizona State Legislature establishes and may amend active plan members' and CMDP's contribution rates. For the year ended June 30, 2010, active plan members and CMDP were each required by statute to contribute at the actuarially determined rate of 9.4 percent (9.00 percent retirement and 0.40 percent long-term disability) of the members' annual covered payroll. CMDP's contributions to the System for the years ended June 30, 2010, 2009, and 2008 were \$138,877, \$172,239 and \$200,826, respectively, which were equal to the required contributions for the year.