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

Annual Financial Report

September 30, 2024

A Report to the Arizona Legislature

**Lindsey A. Perry**
Auditor General

ARIZONA Auditor General
Making a Positive Difference

The Arizona Auditor General's mission is to provide independent and impartial information and specific recommendations to improve the operations of State and local government entities. To this end, the Office provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits and special reviews of school districts, State agencies, and the programs they administer.

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AUDITOR GENERAL

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AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

# Independent auditors' report

Members of the Arizona State Legislature

Michael Wisehart, Director
Department of Economic Security

## Report on the audit of the financial statements

### *Opinion*

We have audited the accompanying financial statements of the State of Arizona, Department of Economic Security, Division of Developmental Disabilities (Division), Arizona Long Term Care System Contract (ALTCS Contract), as of and for the year ended September 30, 2024, and the related notes to the financial statements, which collectively comprise the Division's ALTCS Contract's financial statements as listed in the table of contents.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the ALTCS Contract as of September 30, 2024, and the respective changes in financial position thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

### *Basis for opinion*

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

### *Emphasis of matter*

As discussed in Note 1 to the financial statements, the ALTCS Contract's financial statements are intended to present the financial position and the changes in financial position of only that portion of the major fund of the State of Arizona that is attributable to the Division's ALTCS Contract's transactions. They do not purport to, and do not, present fairly the financial position of the State of Arizona as of September 30, 2024, and the changes in its financial position for the year then ended in conformity with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

### *Management's responsibilities for the financial statements*

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

### *Auditors' responsibilities for the audit of the financial statements*

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

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

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control. Accordingly, we express no such opinion.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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

### *Supplementary information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the ALTCS Contract's financial statements. The accompanying schedule of related-party transactions is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is management's responsibility and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with U.S. generally accepted auditing standards. In our opinion, the accompanying schedule of related-party transactions is fairly stated, in all material respects, in relation to the financial statements as a whole.

## Other reporting required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 13, 2025, 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 at a future date. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Division's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control over financial reporting and compliance.

Lindsey A. Perry

Lindsey A. Perry, CPA, CFE
Auditor General

June 13, 2025

# Department of Economic Security
## Division of Developmental Disabilities ALTCS Contract
## Balance sheet—special revenue fund
## September 30, 2024

| | |
|---|---|
| **Assets** | |
| Cash and investments held by the State Treasurer | $ 76,885,318 |
| Due from other State funds | 4,389,578 |
| Investment income receivable | 4,306,001 |
| Due from providers | 1,664,200 |
| Total assets | 87,245,097 |
| **Liabilities and fund balance** | |
| Accrued administrative and payroll costs | $ 9,528,190 |
| Accrued medical and healthcare claims | 170,480,745 |
| Due to other State funds | 1,294,518 |
| Total liabilities | 181,303,453 |
| Fund deficit | |
| Unassigned | (94,058,356) |
| Total liabilities and fund deficit | $ 87,245,097 |

See accompanying notes to financial statements.

# Department of Economic Security
## Division of Developmental Disabilities ALTCS Contract
## Statement of revenues, expenditures, and changes in fund balance—special revenue fund
## Year ended September 30, 2024

| | |
|---|---|
| Revenues: | |
| Capitation | $ 3,222,141,174 |
| Investment earnings | 10,183,110 |
| Miscellaneous | 67,914,914 |
| Total revenues | 3,300,239,198 |
| Expenditures: | |
| Health and welfare: | |
| Aid to individuals | 3,055,605,175 |
| Allocated administrative expenditures | 109,327,876 |
| Case management | 100,308,754 |
| Professional and outside services | 13,847,486 |
| Sub-capitation block administrative | 38,662,791 |
| Premium tax | 65,190,882 |
| Total expenditures | 3,382,942,964 |
| Excess of revenues over expenditures | (82,703,766) |
| Other financing uses: | |
| Transfers to other State funds | (111,929,142) |
| Net change in fund balance | (194,632,908) |
| Fund balance, October 1, 2023 | 100,574,552 |
| Fund deficit, September 30, 2024 | $ (94,058,356) |

See accompanying notes to financial statements.

## 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.

### 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 non-spendable, restricted, and unrestricted, which includes committed, assigned, and unassigned fund balance classifications.

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

Deficits in fund balances of the other governmental funds are reported as unassigned.

### E. Capitation

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

### F. Investment earnings

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

### G. Incurred but not reported (IBNR) methodology

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

### H. Provider contract settlements

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

### I. American Rescue Plan Act of 2021 (ARP)

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

(SMDL) #21-003, which further clarified the qualifying services, improvement activities, and reporting requirements expected of states under Section 9817 of the ARP Act.

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

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

## Note 2 – Cash and investments held by the State Treasurer

Arizona Revised Statutes ("A.R.S.") require State agencies' monies to be deposited with the State Treasurer and further requires those deposits to be invested in various pooled funds. Cash and investments held by the State Treasurer represent the ALTCS Contract's portion of those monies. The State Treasurer invests idle contract monies in an internal investment pool (Pool 3) and an external investment pool (Pool 500) and distributes interest to the ALTCS Contract. Interest earned from these invested monies are allocated monthly based on the average daily balance. Participant shares in the pool are purchased and sold based on the Net Position Value of the shares. The Net Position Value is determined by dividing the fair value of the investment pool by the total shares of the pool outstanding. As a result, the ALTCS Contract's portion of the pool is not identified with specific investments. The ALTCS Contract's portion of these deposits and investments is reported at fair value, measured on a monthly basis, which approximates the ALTCS Contract's value of participant pool shares.

The State Treasurer's internal investment Pool 3 and external investment Pool 500 are not required to register (and are not registered) with the Securities and Exchange Commission ("SEC") under the Dodd-Frank Act of 2010. The activities and performance of the pools are reviewed monthly by the State Board of Investment in accordance with A.R.S. §35-311.

At September 30, 2024, the ALTCS Contract's deposits with the State Treasurer were as follows:

| | Amount |
|---|---|
| State Treasurer's investment pool 3 | $45,912,631 |
| State Treasurer's investment pool 500 | 30,972,687 |
| | $76,885,318 |

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation to the holder of the investments. The Department of Economic Security does not have a formal investment policy with respect to credit risk. The State Treasurer's investment Pool 3 and Pool 500 are unrated.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Department of Economic Security does not have a formal interest rate risk policy. As of June 30, 2024, the State Treasurer's weighted average to maturity of its internal Pool 3 investments is 1.11 years and its external investment Pool 500 is 2.12 years.

## Note 3 – Due from other State funds

Amounts due from other State funds totaling $4,389,578 at September 30, 2024, include:

- $2,562,685 of ALTCS capitation revenue.
- $1,826,893 of Tribal Health Plan funds held by AHCCCS.

## Note 4 – Due from providers

Due from providers totaling $1,664,200 at September 30, 2024, include:

- $1,580,236 of Hospital Enhanced Access Leading to Health Improvements Initiative payments due from participating providers.
- $83,964 as a result of a provider's portion for long-term care services.

## Note 5 – Due to other State funds

Due to other State funds totaling $1,294,518 at September 30, 2024, include:

- $1,243,264 of capitated American Rescue Plan (ARP) funds received and payable to AHCCCS.
- $51,254 of premium tax payable to the Arizona Department of Insurance.

## Note 6 – Accrued administrative and payroll costs

Accrued administrative and payroll costs totaling $9,528,190 at September 30, 2024, include:

- $8,161,948 of accrued payroll costs.
- $1,366,242 of accrued administrative costs for items purchased and received but not paid for as of September 30, 2024.

## Note 7 – Accrued medical and healthcare claims

Accrued medical and healthcare claims totaling $170,480,745 at September 30, 2024, include IBNR medical claims.

## Note 8 – Fund deficit

The fund balance deficit at September 30, 2024, was $94,058,356. The deficit reflects the costs of covered services to members that exceeded the capitation revenue. Deficits have occurred because the entitlement nature of this program prevents the Division from arbitrarily reducing services to individuals with developmental disabilities. Per AHCCCS contract number #YH6-0014, Amendment 79, Section D, Part 51, "AHCCCS will reconcile the Contractor's total retained medical cost expenses (prospective and prior period coverage) to net retained capitation paid to the Contractor (prospective and prior period coverage)." The AHCCCS contract allows for an initial reconciliation no sooner than six months after the end of the period to be reconciled. A final reconciliation will be performed no sooner than 15 months after the end of the period to be reconciled. The Department's estimate of the reconciliation amount was $115,318,000 which would represent additional capitation revenue to be recognized in a future contract year at which point the fund balance deficit for the contract year ending September 30, 2024, would be eliminated.

## Note 9 – Miscellaneous revenues

Miscellaneous revenues totaling $67,914,914 during the period ended September 30, 2024, include:

- $43,402,904 of revenue for hospital reimbursement rate increases of dental and physician fees as a result of the Hospital Enhanced Access Leading to Health Improvements Initiative.
- $12,588,875 of revenue for pediatric services provider cost increases as a result of the Pediatric Services Initiative.
- $7,261,585 of revenue for professional and dental provider increases as a result of the Access to Professional Services Initiative.
- $4,094,554 of revenue from a recoupment of provider claims.
- $343,567 of State and Local Governmental revenue.
- $223,429 of revenue related to the premium tax portion of reinsurance revenue.

## Note 10 – Physical and behavioral health reinsurance

During the year ended September 30, 2024, the Division received reimbursements totaling $20,462,000 from AHCCCS for acute care expenditures for claims for enrollees incurred in the current and prior fiscal years. These reimbursements are recorded as a reduction of aid to individuals expenditures.

The Division subcontracts with various health plans to provide acute care services to ALTCS enrollees. These health plans must submit clean reinsurance claims to the Division within 15 months from the date of service.

The Division disbursed a total of $32,900,461 to the health plans during the year ended September 30, 2024.

## Note 11 – Aid to individuals expenditures

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

| | |
|---|---|
| **Institutional care:** | |
| Intermediate (intellectually or developmentally disabled) | $ 28,607,981 |
| Total institutional care | 28,607,981 |
| | |
| **Home- and community-based services (HCBS):** | |
| State-operated group home | 7,888,927 |
| Vendor-operated group home | 773,671,655 |
| Adult developmental home | 110,635,696 |
| Child developmental home | 11,000,930 |
| Home-based services | 1,494,742,787 |
| Value-based purchasing arrangements | 23,518,585 |
| Total HCBS | 2,421,458,580 |
| | |
| **Physical and behavioral health:** | |
| Physical and behavioral health care | $ 593,100,153 |
| Reinsurance | 32,900,461 |
| Reinsurance reimbursement | (20,462,000) |
| Total physical and behavioral health | 605,538,614 |
| Total aid to individuals expenditures | $3,055,605,175 |

During the year ended September 30, 2024, the ALTCS Contract recorded allocated charges of $25,294,354 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 12 – Case management expenditures

During the year ended September 30, 2024, the ALTCS Contract recorded allocated case management charges of $100,308,754 as expenditures for its share of the case management services the Department provided.

## Note 13 – Allocated administrative expenditures

During the year ended September 30, 2024, the ALTCS Contract recorded allocated administrative charges of $109,327,876 as expenditures for its share of the administrative and fiscal services the Department provided.

## Note 14 – Sub-capitation block administrative expenditures

During the year ended September 30, 2024, the ALTCS Contract recorded sub-capitation block administrative expenses of $38,662,791 as expenditures for its share of the administrative payments to the Mercy Care and United Healthcare.

## Note 15 – Premium tax expenditures

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

## Note 16 – Transfers

Transfers to other State funds totaling $111,929,142 during the year ended September 30, 2024, include:

- $100,574,552 to the State's general fund as a result of A.R.S. §36-2953(H).
- $11,354,590 of interest to the State-funded long-term care fund, as authorized by AHCCCS.

## Note 17 – 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 18 – Risk management

The Division is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; medical malpractice; and natural disasters. The Department is a participant in the State's self-insurance program, and in the division management's opinion, any unfavorable outcomes from these risks would be covered by that self-insurance program. Accordingly, the Department has no risk of loss beyond adjustments to future years' premium payments to the State's self-insurance program. All estimated losses for the State's unsettled claims and actions are determined on an actuarial basis and are included in the *State of Arizona Annual Comprehensive Financial Report*.

## Note 19 – Related-party transactions

During the year ended September 30, 2024, the ALTCS Contract reimbursed the Division for $25,294,354 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 $109,327,876 of administrative and fiscal services and the Arizona Department of Insurance and Financial Institutions for $65,190,882 of premium taxes due.

# Supplementary schedule

# Department of Economic Security
## Division of Developmental Disabilities ALTCS Contract
## Related-party transactions
## September 30, 2024

| Related party and relationship | Service provided | Description of transactions or payment terms agreement | Amount |
|---|---|---|---|
| Department of Economic Security, Division of Developmental Disabilities, Intermediate Care Facility/Individuals with Intellectual Disabilities, State Facilities | Health and rehabilitative services and administrative costs | Allocated by Title XIX case management time reporting, member days count, and modified total direct costs | $ 17,405,427 |
| Department of Economic Security, Division of Developmental Disabilities, State-Operated Group Homes, State Facilities | Health and rehabilitative services and administrative costs | Allocated by Title XIX case management time reporting, member days count, and modified total direct costs | 7,888,927 |
| Department of Economic Security, Division of Developmental Disabilities and all other divisions | Administrative and fiscal services | Allocated departmental overhead costs | 109,327,876 |
| Department of Insurance and Financial Institutions | Compliance with A.R.S. §§36-2905 and 36-2944.01 | Premium tax payments | 65,190,882 |

# INTERNAL CONTROL/COMPLIANCE REPORT

LINDSEY A. PERRY
AUDITOR GENERAL

ARIZONA
AUDITOR GENERAL

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

Michael Wisehart, Director,
Department of Economic Security

We have audited, in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the U.S. Comptroller General, the financial statements of the State of Arizona, Department of Economic Security (Department), Division of Developmental Disabilities (Division), Arizona Long Term Care System Contract (ALTCS Contract), as of and for the year ended September 30, 2024, and the related notes to the financial statements, which collectively comprise the ALTCS Contract's financial statements, and have issued our report thereon dated June 13, 2025.

### Report on internal control over financial reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and recommendations, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the ALTCS Contract's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in the accompanying schedule of findings and recommendations as items 2024-02 and 2024-04 to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and recommendations as item 2024-01 to be a significant deficiency.

## Report on compliance and other matters

As part of obtaining reasonable assurance about whether the 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 financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and that is described in the accompanying schedule of findings and recommendations as item 2024-03.

## Division response to findings

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

## Purpose of this report

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

*Lindsey A. Perry*

Lindsey A. Perry, CPA, CFE
Auditor General

June 13, 2025

## Financial statement findings

### 2024-01

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

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

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

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

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

**Recommendations—**The Department's administration and IT management should:

1. Identify, analyze, and reduce risks to help prevent undesirable incidents and outcomes that could impact business functions and IT systems and data.
2. Plan for where to allocate resources and where to implement critical controls.

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

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

This finding is similar to prior-year finding 2023-02 and was initially reported in fiscal year 2015.

## 2024-02

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

**Condition—**The Department of Economic Security's (Department) control procedures were not sufficiently documented and implemented to respond to risks associated with its IT systems and data. The Department lacked sufficient procedures over the following:

- **Restricting access—**Procedures did not consistently help prevent or detect unauthorized or inappropriate access to its IT systems and data.
- **Securing systems and data—**IT security policies and procedures lacked controls to prevent unauthorized or inappropriate access or use, manipulation, damage, or loss.
- **Ensuring operations continue—**Contingency plan lacked key elements related to restoring operations in the event of a disaster or other system interruption.

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

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

**Criteria—**Implementing effective internal controls that follow a credible industry source, such as the National Institute of Standards and Technology, help the Department to protect its IT systems and ensure the integrity and accuracy of the data it maintains as it seeks to achieve its financial reporting, compliance, and operational objectives. The Department is required to follow the State's IT policies the Arizona Strategic Enterprise Technology Office (ASET) established to implement effective internal controls that protect its IT systems and ensure the integrity and accuracy of the data it maintains, as follows:

- **Restrict access through logical controls—**Help to ensure systems and data are accessed by users who have a need, systems and data access granted is appropriate, and key systems and data access is monitored and reviewed.
- **Secure systems and data through IT security internal control policies and procedures—**Help prevent, detect, and respond to instances of unauthorized or inappropriate access or use, manipulation, damage, or loss to its IT systems and data.
- **Ensure operations continue through a comprehensive, documented, and tested contingency plan—**Provides the preparation necessary to place the plan in operation and helps to ensure business operations continue and systems and data can be recovered in the event of a disaster, system or equipment failure, or other interruption.

**Recommendations—**The Department should:

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

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

4. Assign and periodically review employee user access ensuring appropriateness and compatibility with job responsibilities.
5. Remove terminated employees' access to IT systems and data.
6. Review all other account access to ensure it remains appropriate and necessary.
7. Evaluate the use and appropriateness of accounts shared by 2 or more users and manage the credentials for such accounts.
8. Enhance authentication requirements for IT systems.

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

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

**Ensure operations continue—**To ensure operations continue, implement processes to:

10. Test the contingency plan.

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

This finding is similar to prior-year finding 2023-03 and was initially reported in fiscal year 2015.

# 2023-03

## Division of Developmental Disabilities inappropriately transferred $5.5 million of Arizona Long Term Care System (ALTCS) fund monies to the State General Fund, resulting in an increased ALTCS fund deficit and less monies available to spend on medical and healthcare services

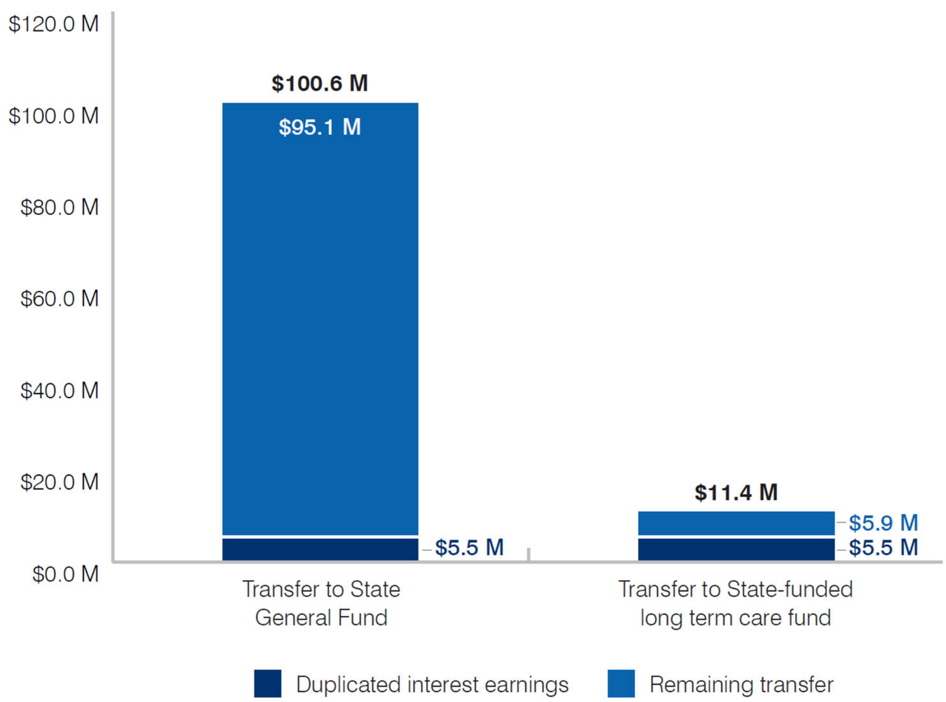
**Condition—**Contrary to State law, the Department of Economic Security (Department), Division of Developmental Disabilities (Division) inappropriately transferred $5.5 million of ALTCS fund monies to the State General Fund. Specifically, the Division transferred $5.5 million that was not unexpended or unencumbered capitated payments at the prior fiscal year end (September 30, 2023), which are the only ALTCS Fund monies allowed to be transferred to the State General Fund.

In accordance with its contract with the Arizona Healthcare Cost Containment System (AHCCCS), the Division requested and received approval from AHCCCS on June 28, 2024, to make 2 cash transfers totaling $112 million from the ALTCS fund, which the Division made on June 30, 2024, as follows:

- $100.6 million transfer of its fiscal year 2023 fund balance to the State General Fund.
- $11.4 million transfer of its interest earnings for the period of April 1, 2023 through March 31, 2024, to the Department's State-funded long-term care fund.

However, the Division incorrectly calculated the $100.6 million transfer to the State General Fund by including $5.5 million of interest earnings, which are not unexpended or unencumbered capitated payments required to be transferred to the State General Fund. Further, as approved by AHCCCS, the Division included this same $5.5 million in the $11.4 million transfer of its interest earnings.[1] In other words, the Department included the same $5.5 million in 2 transfers—one inappropriately and one as allowed, as shown in the figure below.

**Figure 1**
**ALTCS fund transfers**
**Fiscal year 2024**



**Effect—**The Division's inappropriate $5.5 million transfer to the State General Fund coupled with the allowable transfer of $5.5 million to the State-funded long-term care fund caused the Department to erroneously reduce the ALTCS Fund balance twice by the same $5.5 million rather than once, resulting in $5.5 million less monies available to pay for medical and healthcare services to eligible enrollees of the ALTCS program for the developmentally disabled. In addition, it contributed to the ALTCS Fund deficit of $94.1 million as of September 30, 2024.

**Cause—**The Division lacked written policies and procedures to ensure transfer amounts were calculated properly, including procedures to review its prior fiscal year's financial statements for interest receivable amounts included in the fund balance and to require a review and approval of transfer amount calculations by the appropriate level of Division management prior to submitting to AHCCCS for final approval.

**Criteria—**State law requires the Division to transfer all monies from capitated payments in the ALTCS Fund that are unexpended and unencumbered at the end of the fiscal year to the State General Fund on or before June 30 of the following fiscal year (Arizona Revised Statutes §36-2953[H]). Further, the ALTCS contract with AHCCCS requires the Division to obtain AHCCCS approval prior to making equity distributions, which would include interest earnings (AHCCCS Contract YH6-0014, Section D. Program Requirements, Paragraph 45).

## Recommendations to the Division—

1. Comply with State law by only transferring capitated payments in the ALTCS fund that are unexpended and unencumbered at the end of the fiscal year on or before June 30 of the following fiscal year to the State General Fund.

Develop and implement policies and procedures for calculating transfer amounts to include a:

2. Review of the prior year's financial statements for interest receivables amounts included in the fund balance to ensure interest amounts are correctly included or excluded from the transfer calculations.

3. Review and approval of transfer calculations by the appropriate level of Division management prior to submitting to AHCCCS for final approval.

4. Work with AHCCCS, the Arizona Department of Administration, and the Legislature, as necessary, to restore the ALTCS fund's fund balance for any inappropriate transfers identified.

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

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[1] We found that the Division included $5.5 million of interest receivable at June 30, 2023, in the $100.6 million amount transferred to the State General Fund, which is not unexpended or unencumbered capitated payments. The Division recognized the same $5.5 million of interest receivable as interest earnings revenue received during the period of April 1, 2023, through March 31, 2024, which was allowed by the ALTCS contract.

## 2024-04

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

**Condition—**The Department of Economic Security—Division of Developmental Disabilities (Division) failed to provide key financial information in time to meet its contractually required audit deadlines for the Arizona Long Term Care System (ALTCS) contract's financial statements. Specifically, the Division did not provide key financial information, such as accurate and complete financial statements, associated note disclosures, and information supporting the accrued medical healthcare claims balance to us by established deadlines agreed upon at the beginning of the audit. The Division failed to submit key financial information for audit by December 30, 2024, as agreed upon, and did not provide some key information until April 7, 2025.[1]

Further, contrary to U.S. generally accepted accounting principles (GAAP), the Division's initial and subsequent draft financial statements, which were provided on December 30, 2024 and April 28, 2025, respectively, contained errors we identified and recommended the Division correct so that the ALTCS contract financial statements and note disclosures would contain accurate information. The initial and subsequent draft financial statements included the following significant misstatements:

- $3.4 million in investment earnings and investment income receivable that were incorrectly omitted from the financial statements.
- $5.5 million in due to other State funds and transfers out that were understated as the Division incorrectly reversed a portion of a transfer to the State General Fund.[2] See finding 2024-03 for more information.

The Division subsequently corrected these errors and provided revised, final financial statements on May 7, 2025.

**Effect—**The Division's providing the financial information for audit late delayed by 3 months the issuance of the ALTCS contract's Annual Financial Report for the fiscal year ended September 30, 2024, which included its financial statements. As a result, the Division did not provide timely financial information to the Arizona Health Care Cost Containment System (AHCCCS), State legislators, federal grantors, and other stakeholders who rely on it to make important decisions about ALTCS' operations and financial position.

Further, although the Division corrected the errors we identified and recommended it correct before issuing the ALTCS contract's final financial statements, without the Division implementing corrective action to improve its financial reporting process, there is an increased risk that the ALTCS contract's financial statements could contain significant errors and misinform those who are relying on the information.

**Cause—**The Division outsourced the preparation of the ALTCS contract's financial statements to a CPA firm in May 2023 without developing and implementing processes to require management or an independent knowledgeable individual to oversee and review the financial statement preparation process, including the information provided to the CPA firm by the Division, and to monitor the CPA firm's progress to ensure established deliverable deadlines for key financial information were met. Specifically, the Division did not review accounting records prior to providing them to the CPA firm to ensure the financial statements were accurate, complete, and adequately supported. In fact, the Division did not provide complete accounting records for investment earnings and investment income receivable to the CPA firm for inclusion in the financial statements. Further, the Division did not review the financial statements, including the post-closing adjusting journal entries prepared by Division staff related to transfers.

**Criteria—**The Division's ALTCS contract with AHCCCS requires it to issue its audited Annual Financial Report within 150 days of the ALTCS contract's fiscal year-end of September 30, or by February 27, 2025. Also, the Governmental Accounting Standards Board sets the accounting and financial reporting standards that require the Division to prepare the ALTCS contract's financial statements in accordance with GAAP. Accurate financial statements provide valuable information to those charged with the Division's governance and management, and others who rely on the reported financial information to make important decisions about the Division's financial operations.

Developing and implementing policies and procedures for preparing financial information for the ALTCS contract's financial statements, including providing key information for audit by agreed-upon dates after reconciling financial statement information to the underlying accounting records, is an essential part of internal control standards, such as the *Standards for Internal Control in Federal Government issued* by the Comptroller General of the United States, and is integral to ensuring the County's financial reporting and related compliance objectives are achieved.[3]

## Recommendations to the Division—

1. Provide accurate and key financial information to auditors by the agreed-upon deadlines established at the beginning of the audit to ensure timely issuance of the audited ALTCS contract's financial statements.
2. Prepare the ALTCS contract's financial statements and associated note disclosures accurately and in accordance with GAAP.

Develop and implement written policies and procedures to:

3. Monitor the CPA firm's progress to ensure established deadlines for key financial information are met.
4. Require management or an independent knowledgeable individual to review the accounting records prior to providing them to the CPA firm to ensure the financial statements are accurate, complete, and adequately supported.
5. Require management or an independent knowledgeable individual to review the ALTCS contract's financial statements, including the post-closing adjusting journal entries prepared by the Division. This review should ensure that the financial statements are accurate and complete, properly supported, and presented in accordance with GAAP and to detect and correct misstatements in the financial statements before providing them for audit.

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

This finding is similar to prior-year finding 2023-01 and was initially reported in fiscal year 2022.

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[1] In May 2023, the Division outsourced the preparation of the ALTCS contract's financial statements and the statement of actuarial opinion of the unpaid claim liability as of September 30, 2024. This actuarial opinion supports the accrued medical healthcare claims balance in the ALTCS contract's financial statements. The Division's task order number TO23-000163 with the CPA firm outlined the due date of February 17, 2025.

[2] As noted in finding 2024-03, the Division inappropriately transferred $5.5 million of ALTCS fund monies to the State General Fund. Once the Division became aware of this transfer error because of our audit, they incorrectly reversed a portion of the journal entry that initially recorded the transfer of ALTCS fund monies to the State General Fund. However, GAAP requires the Division to report transfers in the accounting period in which the interfund receivable and payable arise, and as such, a transfer out should not be reversed outside the accounting period. Therefore, the Division will need to work with the AHCCCS, the Arizona Department of Administration, and the Legislature to determine the appropriate action to restore the ALTCS fund's fund balance, such as transferring monies from the State General Fund to the ALTCS fund. See finding 2024-03 for related recommendation.

[3] U.S. Government Accountability Office (GAO). (2014). Standards for internal control in the federal government. Retrieved 5/13/25 from https://www.gao.gov/assets/670/665712.pdf

# DEPARTMENT/DIVISION RESPONSE

Katie Hobbs
Governor

ARIZONA
DEPARTMENT OF
ECONOMIC SECURITY

Michael Wisehart
Director

June 9, 2025

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

Mrs. Perry:

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

Sincerely,

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

## 2023-01

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

Name of contact person and title: Robert Parker, SR Information Security Manager
Anticipated completion date: July 2026
Agency's Response: Concur

The Department of Economic Security (Department/DES) will continue to address the audit recommendations as follows:

1. Identify, analyze, and reduce risks to help prevent undesirable incidents and outcomes that could impact business functions and IT systems and data.

DES has developed a risk management process that identifies risks, their impact, and creates Plans of Action and Milestones (POA&M) to monitor resolution activities. This includes ongoing operational exposures, new solution requests, end of life impacts, and remediation activities derived from audits. These activities are currently demonstrated through various management tools including Audit Board Risk management. DES is also on track to implement additional risk oversight software as available.

2. Plan for where to allocate resources and where to implement critical controls.

The Department will continue efforts to implement this recommendation, through its Information Security Program Plan (ISPP) and associated policies and procedures, which are being updated to be compliant with the National Institute of Standards and Technology (NIST), Special Publication, 800-53, Revision 5. These activities are being facilitated and directed by the DES/DTS Chief Information Officer (CIO) and Chief Information Security Officer (CISO), who are responsible for planning, implementing, and executing the requirements of these guiding resources and controls. Acquisition of additional resources to assist with risk management activities are currently in process.

3. Ask responsible administrative officials and management over finance, IT, and other entity functions for input in the Department's process for managing risk.

DES will continue efforts to obtain input from DES' Division of Technology Services (DTS), Office of Inspector General, and Division of Financial Operations to identify operational risks (end of life devices), resolution strategies (increased solutions analysis), organizational ownership (NIST security management), and ongoing solutions management processes (TRB).

4. Perform an annual Department-wide IT risk assessment process that includes evaluating and documenting risks and safeguards. Such risks may include inappropriate access that would affect financial data, system changes that could adversely impact or disrupt system operations, and inadequate or outdated system security.

DES recognizes the need for an annual Department-wide Risk assessment. DES is planning to remediate this recommendation by first acquiring additional resources. These resources will assist in planning a comprehensive analysis of DES' numerous divisions for the purpose of developing an annual Department-wide risk assessment. After performing the analysis, the additional resources will continue assisting by performing the annual risk assessments.

5. Evaluate and manage the risks of holding sensitive information by identifying, classifying, and inventorying the information the Department holds to assess where stronger access and security controls may be needed to protect data in accordance with State statutes and federal regulations.

DES aligns with and tightly follows National Institute of Standards and Technology (NIST) 800-53 Rev 5 as required by government agencies (Internal Revenue Service and Social Security Administration) which helps ensure adequate cybersecurity supply chain risk management, privacy controls, security controls, and security programs. DES will continue to strengthen, manage, and evaluate discovered risks and enhance risk management activities to bolster its security footprint and protect data in accordance with State statutes and federal regulations.

## 2023-02

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

Name of contact person and title: Robert Parker, Sr. Information Security Manager
Anticipated completion date: July 2026
Agency's Response: Concur

The Department of Economic Security (Department/DES) will continue to address the audit recommendations as follows:

General

*1. Make it a priority to document comprehensive IT policies and procedures and develop a process to ensure the procedures are being consistently followed.*

All DES, Division of Technology Services (DTS) Policies are currently under review and are being modified and updated to ensure compliance. To assist in this, additional staffing is being sourced.

*2. Monitor Department employees' adherence to the IT policies and procedures on a periodic basis to ensure they are consistently followed and inform employees of updates to the policies and procedures throughout the year.*

The policy reviews currently underway include updating identified deficiencies and revising the language to ensure NIST 800-53 Rev 5 compliance. As policy and procedure documents are completed and approved they are placed on the DTS IT Policy internal web page.

*3. Work with ASET on ways to implement audit recommendations.*

DES IT Policies, Standards and Procedures meet or exceed the guidelines and requirements as set forth by the ASET Library of Policies and Procedures. The DES Chief Information Officer (CIO) and Chief Information Security Officer (CISO) maintain a relationship with the ASET Team and are advised of critical and non-critical issues that DES must address. The Department will continue to work with ASET as necessary on updates or recommendations of IT issues.

Restrict Access

*4. Assign and periodically review employee user access ensuring appropriateness and compatibility with job responsibilities.*

New hire IDs are created and uniquely tailored to an individual user's requirements. There is a project underway to revamp personnel access management that will help ensure individual permissions are continually reevaluated for appropriateness.

*5. Remove terminated employees' access to IT systems and data.*

DES recognizes the need for removing terminated employee access. Resolving this recommendation will require the acquisition of additional resources. These resources will assist in the planning and analysis of DES' numerous divisions to determine the full scope and cost of implementation.

*6. Review all other account access to ensure it remains appropriate and necessary.*

The Department will continue efforts to review all other account access in conjunction with efforts to address recommendations 4 and 5.

*7. Evaluate the use and appropriateness of accounts shared by 2 or more users and manage the credentials for such accounts.*

DES recognizes the need to evaluate the use and appropriateness of shared accounts such as administrative and services accounts. Resolution of this recommendation will require the acquisition of additional resources. In addition, DES is implementing a new privileged access management tool that will assist in managing shared accounts. By using these additional resources and management tools, DES will perform an analysis of DES' divisions and associated Policies to determine the full scope of implementing this recommendation.

*8. Enhance authentication requirements for IT systems.*

The Department has made significant improvements as it currently uses multi-factor authentication for critical applications. Privileged Accounts are also on track to require multi-factor authentication by July 2026. DES will continue improvements as needed to comply with associated policies and procedures.

Secure systems and data

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

There was a transition from Tracorp to InfosecIQ that started in May 2024. Employees are sent multiple reminders to take the Training if not completed.

Ensure operations continue

*10. Test the contingency plan.*

The Disaster Recovery and Contingency plans are in place and approved. The Contingency Policy is in process of being updated.

## 2024-03

Division of Developmental Disabilities inappropriately transferred $5.5 million of Arizona Long Term Care System (ALTCS) fund monies to the State General Fund, resulting in an increased ALTCS fund deficit and less monies available to spend on medical and healthcare services

Name of contact person and title: Katherine Goldcamp, Business Administrator and Patrick Hays, Deputy Assistant Director of Business Operations
Anticipated completion date: September 2025
Agency's Response: Concur

The Department of Economic Security (Department/DES) will continue to address the audit recommendations as follows:

1. Comply with State law by transferring only capitated payments in the ALTCS fund that are unexpended and unencumbered at the end of the fiscal year on or before June 30 of the following fiscal year to the State General Fund.

Develop and implement policies and procedures for calculating transfer amounts to include a:

> 2. Review of the prior year's financial statements for interest receivables amounts included in the fund balance to ensure interest amounts are correctly included or excluded from the transfer calculations.
>
> 3. Review and approval of transfer calculations by the appropriate level of Division management prior to submitting to AHCCCS for final approval.

4. Work with AHCCCS, the Arizona Department of Administration, and the Legislature, as necessary, to restore the ALTCS fund's fund balance for any inappropriate transfers identified.

The Department has updated procedures related to tracking and transferring interest earnings to avoid similar issues in the current contract period. The updated procedures include changing the transfer of interest earnings to the end of the contract period from June to September. The financial statements in the future will delineate the net amounts of capitation revenue separately from the net amount of interest earnings to avoid incorrect transfers.

## 2024-04

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

Name of contact person and title: Brandon Senior, Deputy Business Administrator and Patrick Hays, Deputy Assistant Director of Business Operations
Anticipated completion date: December 2025
Agency's Response: Concur

The Department of Economic Security (Department/DES) will continue to address the audit recommendations as follows:

1. Provide accurate and key financial information to auditors by the agreed-upon deadlines established at the beginning of the audit to ensure timely issuance of the audited ALTCS contract's financial statements.

2. Prepare the ALTCS contract's financial statements and associated note disclosures accurately and in accordance with GAAP.

Develop and implement written policies and procedures to:

> 3. Monitor the CPA firm's progress to ensure established deadlines for key financial information are met.
>
> 4. Require management or an independent knowledgeable individual to review the accounting records prior to providing them to the CPA firm to ensure the financial statements are accurate, complete, and adequately supported.
>
> 5. Require management or an independent knowledgeable individual to review the ALTCS contract's financial statements, including the post-closing adjusting journal entries prepared by the Division. This review should ensure that the financial statements are accurate and complete, properly supported, and presented in accordance with GAAP and to detect and correct misstatements in the financial statements before providing them for audit.

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

The Division is updating its policies and procedures with respect to the identified items interest earnings and transfers. The audit this year identified opportunities to improve the historical process of interest transfers from the ALTCS program. The Division has been working closely with the external CPA firm in reviewing the draft financial statements produced by the CPA firm. The interest earnings and transfer procedures were an internal Department procedure which is being updated.

This contract year was unique in working with an external CPA firm where there were some challenges in the procurement process to maintain a consistent contract. This issue is being resolved for the current contract year. In addition, the Division has expanded the financial team with more staff to assist in the process of producing financial statements. These two items are being done to mitigate any timeliness issues and assist with the oversight of the post-closing entry process with the annual financial statements.

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