

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

Annual Financial Report

September 30, 2020



A Report to the Arizona Legislature

Lindsey A. Perry  
Auditor General





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# ANNUAL FINANCIAL REPORT



LINDSEY A. PERRY  
AUDITOR GENERAL

ARIZONA  
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 financial statements

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, 2020, and the related notes to the financial statements, which collectively comprise the Division's ALTCS Contract's financial statements as listed in the table of contents.

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

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

#### *Auditors' responsibility*

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

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

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

## **Opinion**

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, 2020, and the respective changes in financial position thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

## **Emphasis of matter**

As discussed in Note 1 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 governmental activities and major fund of the State of Arizona that is attributable to the 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, 2020, 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.

## **Other matters**

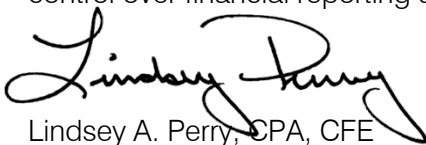
### *Supplementary information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the ALTCS Contract's financial statements. The 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 31, 2021, 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 A. Perry, CPA, CFE  
Auditor General

March 31, 2021

**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Balance sheet—special revenue fund**  
**September 30, 2020**

**Assets**

Investments held by the State Treasurer	\$ 169,126,850
Due from other state funds	1,550,702
Due from providers	<u>3,192,658</u>

Total assets \$ 173,870,210

**Liabilities and fund balance**

Liabilities:

Accrued administrative and payroll costs	\$ 7,453,634
Accrued medical and healthcare claims	105,515,655
Due to other state funds	<u>11,130,129</u>

Total liabilities 124,099,418

Fund balance:

Restricted for health and welfare	<u>49,770,792</u>
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Total liabilities and fund balance \$ 173,870,210

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**  
**September 30, 2020**

Revenues:	
Capitation	\$ 2,067,145,209
Investment earnings	4,592,444
Miscellaneous	<u>26,424,033</u>
Total revenues	<u>2,098,161,686</u>
Expenditures:	
Health and welfare:	
Aid to individuals	1,814,677,569
Allocated administrative expenditures	78,861,761
Case management	66,779,233
Professional and outside services	17,587,064
Sub-capitation block administrative	22,835,531
Premium tax	<u>42,902,732</u>
Total expenditures	<u>2,043,643,890</u>
Excess of revenues over expenditures	54,517,796
Other financing uses:	
Transfers to other state funds	<u>(49,334,275)</u>
Net change in fund balance	5,183,521
Fund balance, October 1, 2019	<u>44,587,271</u>
Fund balance, September 30, 2020	<u><u>\$ 49,770,792</u></u>

See accompanying notes to financial statements.



**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Notes to financial statements**  
**September 30, 2020**

**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 U.S. 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 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'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.

**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Notes to financial statements**  
**September 30, 2020**

**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 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 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 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, 2020, the ALTCS Contract's investments with the State Treasurer were as follows:

	Amount
State Treasurer's investment pool 3	\$169,126,850

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.

**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Notes to financial statements**  
**September 30, 2020**

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, 2020, the State Treasurer's weighted average to maturity of its internal pool 3 investments is .84 years.

**Note 3 – Due to other state funds**

Amounts due to other state funds at September 30, 2020 include:

- \$10,863,318 of premium tax payable to the Arizona Department of Insurance, and
- \$266,811 of assessments payable to the State's General Fund.

**Note 4 - Accrued medical and healthcare claims**

Accrued medical and healthcare claims totaling \$105,515,655 include IBNR medical claims.

**Note 5 - Miscellaneous revenues**

Miscellaneous revenues during the period ended September 30, 2020, include:

- \$8,419,899 of revenue for professional and dental provider cost increases as a result of the Access to Professional Services Initiative,
- \$17,362,911 of revenue for pediatric services provider cost increases as a result of the Pediatric Services Initiative, and
- \$641,223 of reinsurance revenue premium tax.

**Note 6 - Acute care reinsurance**

During the year ended September 30, 2020, the Division received reimbursements totaling \$31,419,899 from AHCCCS for acute care reinsurance 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 \$31,571,045 to the health plans during the year ended September 30, 2020.

**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Notes to financial statements**  
**September 30, 2020**

**Note 7 - 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	\$ 218,449
Intermediate (intellectually or developmentally disabled)	24,739,580
Institutional care IBNR	<u>818,252</u>
Total institutional care	<u>25,776,281</u>
Home- and community-based services (HCBS):	
State-operated group home	\$ 7,104,755
Vendor-operated group home	456,753,249
Adult developmental home	66,866,014
Home-based services	773,825,803
HCBS IBNR	<u>103,807,466</u>
Total HCBS	<u>1,408,357,287</u>
Acute care:	
Acute care	379,520,887
Acute care IBNR	889,937
Reinsurance	31,571,045
Reinsurance reimbursement	(31,419,899)
Third party liability	<u>(17,969)</u>
Total acute care	<u>380,544,001</u>
Total aid to individuals expenditures	<u>\$1,814,677,569</u>

During the year ended September 30, 2020, the ALTCS Contract recorded allocated charges of \$35,840,698 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 8 - Allocated administrative expenditures**

During the year ended September 30, 2020, the ALTCS Contract recorded allocated administrative charges of \$78,861,761 as expenditures for its share of the administrative and fiscal services the Department provided.

**Note 9 – Sub-capitation block administrative expenditures**

During the year ended September 30, 2020, the ALTCS Contract recorded sub-capitation block administrative expenditures of \$22,835,531 for its share of the administrative payments to the health plans. In prior contract years, this expenditure was reported in the acute care expenditures of aid to individuals.

**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Notes to financial statements**  
**September 30, 2020**

**Note 10 - 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 11 - Transfers**

Transfers to other state funds during the year ended September 30, 2020, consisted of \$44,587,271 to the State's General Fund as a result of A.R.S. §36-2953(H); and \$4,747,004 of interest to the state-funded long-term care fund, as authorized by AHCCCS.

**Note 12 - 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 13 - 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 14 – Related-party transactions**

During the year ended September 30, 2020, the ALTCS Contract reimbursed the Division for \$35,840,698 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 \$78,861,761 of administrative and fiscal services and the Arizona Department of Insurance for \$42,902,732 of premium taxes due.

## Supplementary schedules

**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Lag report for institutional care payments**  
**Year ended September 30, 2020**

Quarter in which service was provided

Quarter of payment	Current	1 <sup>st</sup> Prior	2 <sup>nd</sup> Prior	3 <sup>rd</sup> Prior	4 <sup>th</sup> Prior	5 <sup>th</sup> Prior	6 <sup>th</sup> Prior	Total
Current	\$ 1,573,162	\$ 794,322	\$ 1,286					\$ 2,368,770
1 <sup>st</sup> Prior		1,642,114	921,498	\$ 21,988	\$ 2,468	\$ 197		2,588,265
2 <sup>nd</sup> Prior			1,688,992	904,412	77,205	32,438		2,703,047
3 <sup>rd</sup> Prior				1,826,608	1,251,544	17,272	\$ 164	3,095,588
4 <sup>th</sup> Prior					5,946,869	1,410,243	54,616	7,411,728
5 <sup>th</sup> Prior						5,688,500	1,589,584	7,278,084
6 <sup>th</sup> Prior							2,469,118	2,469,118
Total	<u>1,573,162</u>	<u>2,436,436</u>	<u>2,611,776</u>	<u>2,753,008</u>	<u>7,278,086</u>	<u>7,148,650</u>	<u>4,113,482</u>	<u>27,914,600</u>
Expenses reported	3,624,707	2,210,077	2,458,246	2,705,882	6,700,835	6,903,163	6,826,825	31,429,735
Adjustment (1)	<u>(1,268,988)</u>	<u>255,080</u>	<u>160,460</u>	<u>47,170</u>	<u>577,251</u>	<u>245,487</u>	<u>(2,713,343)</u>	<u>(2,696,883)</u>
Remaining liability	<u>\$ 782,557</u>	<u>\$ 28,721</u>	<u>\$ 6,930</u>	<u>\$ 44</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 818,252</u>

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

Department of Economic Security  
 Division of Developmental Disabilities ALTCS Contract  
 Lag report for home- and community-based services payments  
 Year ended September 30, 2020

Quarter in which service was provided

Quarter of payment	Current	1 <sup>st</sup> Prior	2 <sup>nd</sup> Prior	3 <sup>rd</sup> Prior	4 <sup>th</sup> Prior	5 <sup>th</sup> Prior	6 <sup>th</sup> Prior	Total
Current	\$ 268,236,352	\$ 120,158,666	\$ 1,600,165	\$ 82,504	\$ (1,396)			\$ 390,076,291
1 <sup>st</sup> Prior		239,421,747	96,095,419	1,369,321	204,957	\$ 57,326	\$ (43,272)	337,105,498
2 <sup>nd</sup> Prior			221,366,170	98,930,330	1,374,024	149,386	64,059	321,883,969
3 <sup>rd</sup> Prior				216,360,996	113,535,382	1,090,966	73,997	331,061,341
4 <sup>th</sup> Prior					205,332,275	95,155,284	1,485,406	301,972,965
5 <sup>th</sup> Prior						195,925,055	92,187,162	288,112,217
6 <sup>th</sup> Prior							183,941,910	183,941,910
Total	<u>268,236,352</u>	<u>359,580,413</u>	<u>319,061,754</u>	<u>316,743,151</u>	<u>320,445,242</u>	<u>292,378,017</u>	<u>277,709,262</u>	<u>2,154,154,191</u>
Expenses reported	370,411,583	361,500,824	321,943,190	315,199,998	320,983,833	296,042,452	277,233,319	2,263,315,199
Adjustment (1)	<u>(3,695,736)</u>	<u>349,808</u>	<u>(1,181,998)</u>	<u>2,937,421</u>	<u>(574,545)</u>	<u>(3,664,435)</u>	<u>475,943</u>	<u>(5,353,542)</u>
Remaining liability	<u>\$ 98,479,495</u>	<u>\$ 2,270,219</u>	<u>\$ 1,699,438</u>	<u>\$ 1,394,268</u>	<u>\$ (35,954)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 103,807,466</u>

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



**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Lag report for acute care payments**  
**Year ended September 30, 2020**

Quarter in which service was provided

<u>Quarter of payment</u>	<u>Current</u>	<u>1<sup>st</sup> Prior</u>	<u>2<sup>nd</sup> Prior</u>	<u>3<sup>rd</sup> Prior</u>	<u>4<sup>th</sup> Prior</u>	<u>5<sup>th</sup> Prior</u>	<u>6<sup>th</sup> Prior</u>	<u>Total</u>
Current	\$ 749,485	\$ 247,785	\$ 198,876	\$ 98,261	\$ (34,085)	\$ 145,297	\$ (30,055)	\$ 1,375,564
1 <sup>st</sup> Prior		188,574	338,548	137,313	244,799	94,135	98	1,003,467
2 <sup>nd</sup> Prior			121,568	467,231	314,350	21,319	21,423	945,891
3 <sup>rd</sup> Prior				301,024	946,517	170,497	101,241	1,519,279
4 <sup>th</sup> Prior					61,017,642	3,600,677	343,003	64,961,322
5 <sup>th</sup> Prior						69,693,963	103,323	69,797,286
6 <sup>th</sup> Prior							79,662,119	79,662,119
Total	<u>749,485</u>	<u>436,359</u>	<u>658,992</u>	<u>1,003,829</u>	<u>62,489,223</u>	<u>73,725,888</u>	<u>80,201,152</u>	<u>219,264,928</u>
Expenses reported (2)	1,391,653	988,585	968,575	1,600,415	77,020,933	77,231,658	79,605,264	238,807,083
Adjustment (1)	<u>(747,521)</u>	<u>(601,742)</u>	<u>(325,426)</u>	<u>(594,367)</u>	<u>(14,047,009)</u>	<u>(2,932,041)</u>	<u>595,888</u>	<u>(18,652,218)</u>
Remaining liability	<u>\$ (105,353)</u>	<u>\$ (49,516)</u>	<u>\$ (15,843)</u>	<u>\$ 2,219</u>	<u>\$ 484,701</u>	<u>\$ 573,729</u>	<u>\$ -</u>	<u>\$ 889,937</u>

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

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

**Department of Economic Security**  
**Division of Developmental Disabilities ALTCS Contract**  
**Related-party transactions**  
**September 30, 2020**

<b>Related party and relationship</b>	<b>Service provided</b>	<b>Description of transactions or payment terms agreement</b>	<b>Amount</b>
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	\$24,739,580
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	11,101,118
Department of Economic Security, Division of Developmental Disabilities and all other divisions	Administrative and fiscal services	Allocated departmental overhead costs	78,861,761
Department of Insurance	Compliance with A.R.S. §§36-2905 and 36-2944.01	Premium tax payments	42,902,732