

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract

Annual Financial Report

September 30, 2023



A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General





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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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

Angie Rodgers, Executive Deputy Director and Cabinet Executive Officer
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, 2023, 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, 2023, 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, 2023, 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 opinions. 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 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 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 an opinion on the financial statements that collectively comprise the ALTCS Contract's financial statements. The accompanying schedule of related-party transactions is presented for the purpose 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 April 24, 2024, 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

Lindsey A. Perry, CPA, CFE
Auditor General

April 24, 2024

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Balance sheet—special revenue fund
September 30, 2023

Assets

Cash and investments held by the State Treasurer	\$ 274,173,196
Due from other state funds	2,253,967
Investment income receivable	5,477,481
Due from providers	<u>63,284,074</u>

Total assets 345,188,718

Liabilities and fund balance

Accrued administrative and payroll costs	\$ 9,173,222
Accrued medical and healthcare claims	177,819,601
Due to other state funds	<u>57,621,343</u>

Total liabilities 244,614,166

Fund balance:

Restricted for health and welfare	<u>100,574,552</u>
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Total liabilities and fund balance \$ 345,188,718

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, 2023

Revenues:	
Capitation	\$ 2,906,406,294
Tiered reconciliation settlement	12,670,886
Investment earnings	11,493,602
Miscellaneous	<u>60,821,064</u>
Total revenues	<u>2,991,391,846</u>
Expenditures:	
Health and welfare:	
Aid to individuals	2,588,750,234
Allocated administrative expenditures	103,370,270
Case management	88,030,858
Professional and outside services	15,306,555
Sub-capitation block administrative	28,073,010
Premium tax	<u>59,347,653</u>
Total expenditures	<u>2,882,878,580</u>
Excess of revenues over expenditures	108,513,266
Other financing uses:	
Transfers to other state funds	<u>(137,526,208)</u>
Net change in fund balance	(29,012,942)
Fund balance, October 1, 2022	<u>129,587,494</u>
Fund balance, September 30, 2023	<u>\$ 100,574,552</u>

See accompanying notes to financial statements.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to financial statements
September 30, 2023

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's (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 Division's 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.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to financial statements
September 30, 2023

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.

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.

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 is allocated monthly based on the average daily balance. Participant shares in the pool are purchased and sold based

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to financial statements
September 30, 2023

on the net position value of the shares. The net position value is determined by dividing the fair value of the portfolio 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 be registered and are not registered with the Securities and Exchange Commission 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, 2023, the ALTCS Contract's deposits with the State Treasurer were as follows:

	Amount
State Treasurer's investment pool 3	\$193,200,509
State Treasurer's investment pool 500	<u>80,972,687</u>
	<u>\$274,173,196</u>

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 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, 2023, the State Treasurer's weighted average to maturity of its internal pool 3 investments is 1.19 years and its external investment pool 500 is 2.15 years.

Note 3 – Due from other state funds

Amounts due from other state funds totaling \$2,253,967 at September 30, 2023, include capitation revenue.

Note 4 – Due from providers

Due from providers totaling \$63,284,074 at September 30, 2023, include:

- \$792,419 as a result of post-payment reviews of long-term care home- and community-based service providers.
- \$79,459 as a result of a provider's portion for long-term care services.
- \$62,412,196 as a result of provider contract settlements.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to financial statements
September 30, 2023

Note 5 – Due to other State funds

Due to Other State Funds totaling \$57,621,343 at September 30, 2023, include:

- \$273,015 of premium tax payable to the Arizona Department of Insurance.
- \$5,766,196 payable to Department of Economic Security for provider payments.
- \$49,741,310 of provider contract settlements payable to AHCCCS.
- \$1,840,822 of American Rescue Plan Act (ARPA) funds received and payable to AHCCCS.

Note 6 – Accrued medical and healthcare claims

Accrued medical and healthcare claims totaling \$177,819,601 at September 30, 2023, include IBNR medical claims.

Note 7 – Miscellaneous revenues

Miscellaneous revenues totaling \$60,821,064 during the period ended September 30, 2023, include:

- \$5,763,484 of revenue for professional and dental provider cost increases as a result of the Access to the Professional Services Initiative.
- \$22,759,656 of revenue for pediatric services provider cost increases as a result of the Pediatric Services Initiative.
- \$31,653,183 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.
- \$613,028 of reinsurance revenue premium tax.
- \$31,713 of other revenue.

Note 8 – Physical and behavioral health reinsurance

During the year ended September 30, 2023, the Division received reimbursements totaling \$30,038,383 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 \$30,125,591 to the health plans during the year ended September 30, 2023.

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to financial statements
September 30, 2023

Note 9 – 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)	\$ 31,129,706
Total institutional care	<u>31,129,706</u>
Home- and community-based services (HCBS):	
State-operated group home	8,032,820
Vendor-operated group home	685,645,235
Adult developmental home	104,665,019
Child developmental home	11,115,435
Home-based services	1,226,804,833
Value-based purchasing arrangements	<u>4,560,778</u>
Total HCBS	<u>2,040,824,120</u>
Physical and behavioral health	
Physical and behavioral health care	\$ 516,709,200
Reinsurance	30,125,591
Reinsurance reimbursement	<u>(30,038,383)</u>
Total physical and behavioral health	<u>516,796,408</u>
Total aid to individuals expenditures	<u>\$2,588,750,234</u>

During the year ended September 30, 2023, the ALTCS Contract recorded allocated charges of \$33,134,602 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 10 – Allocated administrative expenditures

During the year ended September 30, 2023, the ALTCS Contract recorded allocated administrative charges of \$103,370,269 as expenditures for its share of the administrative and fiscal services the Department provided.

Note 11 – Sub-capitation block administrative expenditures

During the year ended September 30, 2023, the ALTCS Contract recorded sub-capitation block administrative expenses of \$28,073,010 as expenditures for its share of the administrative payments to the Mercy Care and United Healthcare plans.

Note 12 – Premium tax

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

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Notes to financial statements
September 30, 2023

Note 13 – Transfers

Transfers to other state funds totaling \$137,526,208 during the year ended September 30, 2023, include:

- \$129,587,494 to the State's general fund as a result of A.R.S. §36-2953(H).
- \$7,938,714 of interest to the state-funded long-term care fund, as authorized by AHCCCS.

Note 14 – Commitments and contingencies

The State has the ultimate fiscal responsibility for the Division's ALTCS Contract. Accordingly, any claims requiring additional resources require the Legislature's approval. Although there is a possibility that claims could be asserted that would require additional resources for the ALTCS Contract, in the Division management's opinion, the possibility is low that valid claims will be asserted and claim amounts cannot reasonably be estimated.

Note 15 – Risk management

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

Note 16 – Related-party transactions

During the year ended September 30, 2023, the ALTCS Contract reimbursed the Division for \$33,134,602 of health and rehabilitative services provided to enrollees, including administrative costs. The ALTCS Contract also reimbursed the Division as well as other Department of Economic Security divisions for \$103,370,269 of administrative and fiscal services and the Arizona Department of Insurance and Financial Institutions for \$59,347,653 of premium taxes due.

Supplementary schedule

Department of Economic Security
Division of Developmental Disabilities ALTCS Contract
Related-party transactions
September 30, 2023

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	\$18,748,751
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	14,385,851
Department of Economic Security, Division of Developmental Disabilities and all other divisions	Administrative and fiscal services	Allocated departmental overhead costs	103,370,269
Department of Insurance	Compliance with A.R.S. §§36-2905 and 36-2944.01	Premium tax payments	59,347,653

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

Angie Rodgers, Executive Deputy Director and Cabinet Executive Officer
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, 2023, and the related notes to the financial statements, which collectively comprise the ALTCS Contract's financial statements, and have issued our report thereon dated April 24, 2024.

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 deficiencies described in the accompanying schedule of findings and recommendations as items 2023-01 and 2023-02 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 2023-03 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 matter that is required to be reported under *Government Auditing Standards* and that is described in the accompanying schedule of findings and recommendations as item 2023-01.

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

April 24, 2024



SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Financial statement findings

2023-01

Division of Developmental Disabilities failed to provide key financial information timely, resulting in delayed information for AHCCCS, State legislators, federal grantors, and other stakeholders

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 supporting schedules to us by established deadlines agreed upon at the beginning of the audit. Specifically, the Division failed to submit key financial information for audit by December 31, 2023, as agreed upon, and did not provide some key information until February 5, 2024. Additionally, we found that the draft financial statements the Division initially provided did not agree with its underlying schedules and accounting records. Consequently, those draft financial statements had to be revised and corrected by the Division before they could be audited.

Effect—The Division providing the financial information for audit late delayed by 2 months the issuance of the ALTCS contract's Annual Financial Report for the fiscal year ended September 30, 2023, which included its financial statements. As a result, the Division did not provide timely financial information to AHCCCS, State legislators, federal grantors, and other stakeholders who rely on it to make important decisions about ALTCS' operations and financial position.

Cause—The Division reported the delays were due to turnover in the position responsible for compiling the financial information. Further, the Division did not have written policies and procedures for it to reconcile the financial statements to the underlying accounting records and to ensure they were accurate, complete, and adequately supported before providing the financial statements for audit, resulting in additional delays.

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, 2024. Developing and implementing policies and procedures for preparing financial information for the ALTCS contract 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 integral to ensuring the County's financial reporting and related compliance objectives are achieved.¹

Recommendations—The Division should:

1. Provide key financial information to auditors by the agreed-upon deadlines established at the beginning of the audit to ensure timely issuance of its audited financial statements.
2. Develop and implement written policies and procedures to require its personnel to reconcile the financial statements to the underlying accounting records and to ensure they were accurate, complete, and adequately supported before providing the financial statements 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 2022-03 and was initially reported in fiscal year 2022.

¹ U.S. Government Accountability Office (GAO). (2014). *Standards for internal control in the federal government*. Retrieved 1/19/24 from <https://www.gao.gov/assets/670/665712.pdf>.

2023-02

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 annual risk assessment should consider IT risks. For each identified risk, the Department should analyze the identified risk and develop a plan to respond 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 2022-01 and was initially reported in fiscal year 2015.

2023-03

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 developed, 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.
- **Managing system configurations and changes**—Procedures did not ensure configuration settings were securely maintained and all IT system changes were adequately managed.
- **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 its policies and procedures were incomplete, and some developed policies and procedures 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.
- **Manage system configurations and changes through well-defined, documented configuration management process**—Ensures the Department's IT system configurations are documented and that changes to the systems are identified, documented, evaluated for security implications, tested, and approved prior to implementation. This helps limit the possibility of an adverse impact on the system's security or operation.
- **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 develop and 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 the 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.

Manage system configurations and changes—To configure IT systems securely and manage system changes, develop, document, and implement processes to:

9. Maintain configurations for all system services, assets, and infrastructure; manage configuration changes; and monitor the system for unauthorized or unintended configuration changes.

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

10. Perform proactive key user and system activity logging and log monitoring, particularly for users with administrative access privileges.

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

11. 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 2022-02 and was initially reported in fiscal year 2015.

DEPARTMENT/DIVISION RESPONSE



DEPARTMENT OF ECONOMIC SECURITY

Your Partner For A Stronger Arizona

Katie Hobbs
Governor

Vacant
Director

April 17, 2024

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,

Katherine Goldcamp
Division of Developmental Disabilities
Business Operations Administration

cc: Zane Garcia-Ramadan, DDD Assistant Director
Nicolette Fidel, DDD Chief Operating Officer
Patrick Hays, DDD Chief Financial Officer
Sherri Wince, DDD Chief Strategy Officer
Trya Oliver, DDD Corporate Compliance
Stefanie Schwartz-Jacobs, DDD Deputy Assistant Director

Financial Statement findings

2023-01

Division of Developmental Disabilities failed to provide key financial information timely, resulting in delayed information for AHCCCS, State legislators, federal grantors, and other stakeholders

Name of contact person and title: Katherine Goldcamp, DDD Business Administrator

Anticipated completion date: July 2024

Agency's Response: Concur

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

1. Provide key financial information to auditors by the agreed-upon deadlines established at the beginning of the audit to ensure timely issuance of its audited financial statements.

The Division of Developmental Disabilities (Division/DDD) strives to ensure its financial reports are completed accurately, thoroughly, and submitted timely. Over the past few years, DDD identified that internal resources were insufficient to consistently accomplish these goals. Due to the amount of work and its cyclical nature, the Division determined that contracting with a CPA firm to complete the financial statements was the best long-term solution.

The Division onboarded a CPA firm in July 2023. The new process using the CPA firm caused unforeseen delays. Because the working papers will be consistent in future years, the delay should not recur, resulting in timely submission of critical information to the auditors.

2. Develop and implement written policies and procedures to require its personnel to reconcile the financial statements to the underlying accounting records and to ensure they were accurate, complete, and adequately supported before providing the financial statements for audit.

The Division is in the process of updating its written policies and procedures to include the reconciliation of financial statement information to the underlying accounting records. In addition, the Division is working with the CPA firm referenced in the first recommendation to ensure accuracy.

2023-02

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: December 2024

Agency's Response: Concur

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

Financial Statement findings

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 have taken place since September 2023 and are currently demonstrated through various management tools including Trello. DES is also on track to implement additional risk oversight software by June 2024.

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.

DTS will continue efforts to obtain input from DES' Division of Technology Services, 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. DES is on target to acquire the additional resources and develop the assessment by the end of June 2024. DES is planning for the first annual Department-wide IT risk assessment to be performed in December 2024.

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.

Financial Statement findings

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.

2023-03

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: December 2024
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 develop and 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 has been brought on board. The estimated completion of these policy reviews is December 2024.

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 the 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.

Financial Statement findings

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. The estimated completion date for this is November 2024

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. DES is on track to have the general plan developed by June 2024 and successful implementation of the recommendation completed by December 2024.

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. DES is on track to have the additional resources acquired by June 2024. DES is expecting to have fully implemented this recommendation by December 2024.

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 2024. DES will continue improvements as needed to comply with associated policies and procedures.

Manage system configurations and changes

9. Maintain configurations for all system services, assets, and infrastructure; manage configuration changes; and monitor the system for unauthorized or unintended configuration changes.

The Department has partially implemented this recommendation and will continue to improve its processes and protocols around configuration management. DES has a mature process for managing change, that includes a Change Advisory Board. Changes are thoroughly documented and managed. These efforts are supported by a series of policies and procedures.

Secure systems and data

Financial Statement findings

10. Perform proactive key user and system activity logging and log monitoring, particularly for users with administrative access privileges.

The Department has implemented associated policies and procedures and has begun performing regular audits on administrative user access accounts beginning in June 2023. All logs are sent to the SIEM for automated review. Additionally, flags are manually reviewed by appropriate personnel.

Ensure operations continue

11. Test the contingency plan.

The Disaster Recovery and Contingency plans are in place and approved. The Department plans to begin testing the contingency plan in July 2024.

