



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Pima County

Year Ended June 30, 2010



Debra K. Davenport
Auditor General

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Pima County
Report on Internal Control and Compliance
Year Ended June 30, 2010

Table of Contents	Page
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Basic Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	1
Schedule of Findings and Recommendations	3
County Response	
Report Issued Separately	
Comprehensive Annual Financial Report	



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
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 Basic Financial
Statements Performed in Accordance with *Government Auditing Standards***

Members of the Arizona State Legislature

The Board of Supervisors of
Pima County, Arizona

We have audited the financial statements of the governmental activities, business-type activities, aggregate discretely presented component units, each major fund, and aggregate remaining fund information of Pima County as of and for the year ended June 30, 2010, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 17, 2010. Our report was modified to include a reference to our reliance on other auditors and as to consistency because of the implementation of Governmental Accounting Standards Board Statement No. 54. 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. Other auditors audited the financial statements of the Stadium District, School Reserve Fund, Self-Insurance Trust, Regional Wastewater Reclamation Department, Development Services, Sports & Tourism Authority, and Southwestern Fair Commission, as described in our report on the County's financial statements. This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting and compliance and other matters that are reported on separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the County's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

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 County's basic financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We and the other auditors did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we and the other auditors identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Recommendations as items 10-01 and 10-02 that we consider to be significant deficiencies in internal control over financial reporting. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the County's basic financial statements are free of 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 determination of financial statement amounts. 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 that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Recommendations as item 10-01.

Pima County's responses to the findings identified in our audit are presented on pages 6 through 7. We did not audit the County's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Board of Supervisors, management, others within the County, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited.

Jay Zsorey, CPA
Financial Audit Director

December 17, 2010

Pima County
Schedule of Findings and Recommendations
Year Ended June 30, 2010

10-01

The County's Pima Health System and Services Enterprise Fund should improve its internal controls over claims processing

Criteria: Pima County's management over the Fund is responsible for ensuring that medical claims are timely and accurately processed, paid, and submitted to the Arizona Health Care Cost Containment System (AHCCCS). Also, medical claims submitted to AHCCCS must include the appropriate pay rates, medical service and procedure codes, and other information AHCCCS requires or AHCCCS will pend rather than accept those claims as valid.

Condition and context: During fiscal year 2010, the County processed approximately 49,000 medical claims each month averaging approximately \$13 million. While testing a sample of the County's medical and healthcare claims, auditors noted claims that had not been submitted to AHCCCS and claims that were submitted with missing information or other errors that the County had not corrected. Based on data provided by AHCCCS, at June 30, 2010, the County had almost 15,000 claims totaling an estimated \$3.4 million that were in pended status for more than 4 months, including over 3,500 for more than a year.

Effect: Because of these deficiencies, AHCCCS has assessed the County a potential sanction of \$564,130 as of June 30, 2010. However, AHCCCS acknowledges it may waive this sanction if the County shows continued improvement in submitting complete and accurate claims within the contractual timelines. In addition, until complete and accurate claims information is submitted to AHCCCS, the County cannot reasonably estimate the amount of reinsurance revenues to report in its financial statements. Further, AHCCCS evaluates the County's profit margins by comparing capitation revenues to medical claims expenses submitted to AHCCCS. If the profit margins exceed specified contractual thresholds, AHCCCS requires the County to pay back the excess profits. This analysis is based on the total dollar value of only those claims accurately submitted to AHCCCS. A high number of pended claims could result in larger perceived profits and thus, larger amounts to be paid back to AHCCCS. This finding is a significant deficiency in the County's internal control over financial reporting and noncompliance with AHCCCS contractual requirements.

Cause: The County stated that it did not have sufficient resources to fully implement procedures over the claims-processing systems to ensure that all medical and healthcare claims were submitted to AHCCCS in a timely manner and that the claims information submitted was accurate and complete. Software purchased and implemented in the prior fiscal year to help correct deficiencies did not always properly interface with AHCCCS' system resulting in discrepancies.

Recommendation: To help ensure that the County submits accurate and complete medical and healthcare claims to AHCCCS in a timely manner and thereby minimizes sanctions and repayments, the County should continue to strengthen its internal control policies and procedures over its claims-processing systems by continuing to implement the following:

- Assign experienced employees to identify all pended claims as well as claims never submitted and submit these claims to AHCCCS as soon as possible to reduce or avoid possible sanctions and liabilities.

Pima County
Schedule of Findings and Recommendations
Year Ended June 30, 2010

- Have experienced employees analyze pended claims to determine the causes so that the County can make software or procedural changes to prevent future errors.
- Require appropriate supervisors to document, monitor, and review all software configuration changes and have independent users approve the changes.
- Assign employees to monitor claims held in AHCCCS' Transaction Insight software system and make the necessary corrections within 90 days after submission to help ensure that those claims are successfully submitted and not pended.
- Implement the claim reference number write-back program to identify in the County's QNXT claims-processing system those claims that were successfully processed by AHCCCS. This will help the County's employees better analyze which claims were pended and help them to more easily prepare required financial reports.

This finding is similar to a prior-year finding.

Other auditors' finding:

The other auditors who audited the Self-Insurance Trust reported the following significant deficiency:

10-02

The County's Self-Insurance Trust Fund should improve internal controls over claims processing

The County's Self-Insurance Trust Fund uses third-party administrators (TPAs) for processing workers' compensation and dental claims. As a result, the County places reliance on the TPA's internal controls over the claims-processing cycle. During our testing of this cycle, we performed tests of internal controls applicable to the review, approval, and disbursement of claims. This includes obtaining, when available, reports on internal control for audits performed in accordance with Statement on Auditing Standard Number 70, *Service Organizations*, (SAS 70) issued by the Auditing Standards Board.

In reviewing the SAS 70 report prepared for the County's workers' compensation TPA, we noted the TPA's independent service auditor reported certain deficiencies related to the lack of segregation of duties over the establishment of claims and the initiation and printing of claims checks. This deficiency resulted in a modified independent service auditor's opinion in which the stated internal control objectives applicable to the TPA's segregation of duties over the cash disbursement process were not met.

During fiscal year 2010, county management was unaware that the workers' compensation TPA had control deficiencies related to claims processing that were significant to warrant a modified service auditor's report. Also, county management was unaware that the dental claims TPA did not have an audit performed in accordance with SAS 70.

Pima County
Schedule of Findings and Recommendations
Year Ended June 30, 2010

In both instances, the County's internal controls over claims processing were not designed or operated in a manner that considered the TPA's internal control structure. However, for workers' compensation claims, the County had internal controls in place to review the claims processed by the TPA, which reduces the risk of undetected errors. Such internal controls were not in place for dental claims.

We recommend that the County's policies and procedures consider whether the TPA has placed in operation relevant internal controls and their operating effectiveness.



**PIMA COUNTY
DEPARTMENT OF FINANCE AND RISK MANAGEMENT**

Thomas E. Burke, Director

December 17, 2010

Ms. Debbie Davenport
Auditor General
2910 N. 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Davenport,

The following corrective action plan has been prepared as recommended by Government Auditing Standards. Specifically, we are providing you with the name of the contact person responsible for corrective action, the corrective action planned, and the anticipated completion date.

Sincerely,

Thomas E. Burke
Director

10-01

Pima Health System and Services Enterprise Fund should improve its internal controls over claims processing.

Contact Person — Mary Fellows, Chief Financial Officer, Pima Health Systems and Services

Anticipated completion Date – July 31, 2011

Pima County has made significant progress over the past year in reducing the volume of pended encounters and the financial risks associated with improper encountering. The County developed and implemented internal control procedures which addressed all of the findings from the prior year and assigned significant resources to address the volume of pended encounters. Pended encounters decreased by over 106,000 from June 30, 2009 to June 30, 2010. The County agrees with the finding that there are still some deficiencies and has taken steps to address the issues raised. The County has taken the following corrective actions to address this finding:

- An Encounter Coordinator position was created and filled in the Claims division to coordinate staff and resources in the successful encountering of paid claims and the research and remediation of pended encounters.
- Experienced Claims Examiners have been trained to assist the Coordinator in the research and remediation of pended encounters and emphasis has been placed on identification of software and procedural modifications needed to avoid continued duplication of errors.
- The County initiated and put into place change management processes and has continued to enhance and monitor these processes during the fiscal year.
- The Encounter Coordinator is receiving additional training from AHCCCS on the use of the Transaction Insight portal and additional procedures are being written to ensure that the claims held in the portal are corrected within 90 days of submittal.
- The Claim Reference Number (CRN) write-back program will be fully implemented within the next 120 days.

10-02

The County's Self Insurance Trust Fund should improve internal controls over claims processing

Contact Person — Lauren Eib, Risk Manager, Finance and Risk Management

Anticipated completion Date – March 1, 2011

The County agrees the Fund's policies and procedures should include language that requires knowledge of the internal control structure of each third party administrator (TPA). The County believes the internal control structure of the selected TPAs were adequate when initially contracted; however, subsequent reviews are warranted.

