

COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS

**FINANCIAL STATEMENTS
AND
ADDITIONAL INFORMATION
WITH
INDEPENDENT AUDITORS' REPORTS**

YEAR ENDED JUNE 30, 2004

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**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

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**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

REPORT SUMMARY

AUTHORITY, PURPOSE AND SCOPE

The Office of the State Auditor, State of Colorado, engaged McPherson, Breyfogle, Daveline & Goodrich, PC (MBDG) to conduct certain audits of the Colorado State Veterans Nursing Home at Fitzsimons (the Nursing Home) for its year ended June 30, 2004. MBDG, PC performed these audits in accordance with auditing standards generally accepted in the United States of America; *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. We conducted the related field work in August 2004.

The purpose and scope of our audits was to:

- Express our opinion on the financial statements of the Nursing Home as of and for the year ended June 30, 2004. This included a review of internal control in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*.
- Evaluate compliance with laws, regulations, contracts and grants governing the expenditure of federal funds.
- Express an opinion on the Nursing Home's compliance with requirements applicable to each of its major programs along with reporting on internal control over compliance.
- Evaluate progress in implementing prior audit findings and recommendations.

SUMMARY OF MAJOR AUDIT FINDINGS AND RECOMMENDATIONS

We expressed a qualified opinion on the Nursing Home's financial statements as of and for the year ended June 30, 2004. Our report included an explanatory paragraph stating that, in accordance with the terms of our engagement, we did not apply audit procedures necessary to satisfy ourselves about the classifications and amounts comprising the statement of net assets at June 30, 2003.

We issued a report on the Nursing Home's internal control over financial reporting and compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*. We did not note any material weakness in the internal control over financial reporting or any material instances of noncompliance with legal or regulatory requirements based on our audit of the financial statements. We noted certain matters that we reported to the members of the Legislative Audit Committee and management of the State Veterans Nursing Home at Fitzsimons that are included in the findings and recommendations section of this report and titled "Exhibit K Preparation" and "Accounting for Capital Assets, Anticipation Warrants, and Accounts Receivable."

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
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First, we found that the Fitzsimons Home's continued operating losses of \$5.4 million in Fiscal Year 2003 and \$5.0 million in Fiscal Year 2004 and need for general fund appropriations raise concerns about the Home's ability to continue as a going concern. The Office of the State Auditor previously noted in the *Colorado Department of Human Services, State and Veterans Nursing Homes Performance Audit* dated October 2003 that the Home should establish monthly comparison of actual to projected performance and assess the feasibility of the facility to reach break-even status. We recommend that the Department of Human Services continue to assess the Nursing Home's operations and ability to reach break-even status, including updating its revenue and expense projections for the next five-years through the development of a formal business plan. The plan should be designed to bring the Nursing Home's operations to a break-even point without state subsidization as soon as possible. The second recommendation relates to the Nursing Home's preparation of the Exhibit K. At the end of each fiscal year, the State Controller's Office requires all agencies to prepare and submit reports, or "exhibits," for use in compiling the statewide financial statements and required footnote disclosures. Within each department, each agency is responsible for preparing its own exhibits. As a result of our audit procedures, we noted that the Exhibit K was prepared and revised four times for Fiscal Year 2004 due to errors and omissions we identified through our audit. Further, an Exhibit K was not prepared by the Nursing Home for Fiscal Year 2003. We recommend that the Department improve controls over the Nursing Home's preparation of the Exhibit K to ensure information is accurately reported to the State Controller's Office. The third recommendation is derived from the Nursing Home's lack of adequate accounting controls over capital assets, anticipation warrants, and federal accounts receivable. We recommend that the Department improve controls over accounting functions at the Nursing Home by following generally accepted accounting principles to record capital assets, anticipation warrants, and federal revenue.

SUMMARY OF PROGRESS IN IMPLEMENTING PRIOR AUDIT RECOMMENDATIONS

Following is the one outstanding prior audit recommendation to the State Veterans Nursing Home at Fitzsimons contained in the Office of the State Auditor's *Colorado Department of Human Services, State and Veterans Nursing Home Performance Audit*, dated October 2003.

Recommendation No. 1 (Recommendation No. 2 in the October 2003 report):

The Department of Human Services should ensure that the State Veterans Nursing Home at Fitzsimons achieves self-sufficiency as soon as possible by:

- a. Establishing and implementing a formal, documented monthly comparison of actual to projected performance and a process for assessing the ability of the facility to reach break-even status and meet scheduled payments on the anticipation warrants.
- b. Using the review to identify significant variances in revenues and expenses and taking timely action to improve performance.

Disposition:

Partially implemented. See current year Recommendation No. 1.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	7	Continue to assess operations and ability to reach break-even status.	Colorado Department of Human Services	Agree	a.1/10/05 b.Ongoing c.3/1/06
2	8	Improve controls over Exhibit K preparation to ensure information is accurately reported to the State Controller's Office.	Colorado Department of Human Services	Agree	a.and b. 6/30/05 c.1/31/05
3	10	Follow generally accepted accounting principles to record capital assets and anticipation warrants and ensure revenue is properly classified	Colorado Department of Human Services	Agree	6/30/05

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

DESCRIPTION OF THE NURSING HOME

The Colorado State Veterans Nursing Home at Fitzsimons (the “Nursing Home”) is a skilled-care nursing facility created under Title 26, Article 12 of the Colorado Revised Statutes. It provides health services (including physician care, physical, speech, and occupational therapy, dietician consultation, dental care, and 24-hour licensed nursing care) and related social care to patients who are severely limited in their ability to care for themselves due to severe illness and/or disability. The Nursing Home also has an Alzheimer’s unit which provides, in addition to the care mentioned above, a safe and secure environment for patients with Alzheimer’s or related disorders.

The Nursing Home held its grand opening on July 4, 2002 and admitted its first resident on October 21, 2002.

The Nursing Home, by statute, serves all veterans of service in the armed forces of the United States, their spouses, their widow(er)s, and their dependent mothers and/or “gold star” parents. A gold star parent is a parent whose child died in combat or as a result of injuries received in combat. Preference for admission is given to Colorado veterans. The Nursing Home must maintain a 75 percent veterans occupancy based on the number of residents. The Nursing Home serves veterans without regard to sex, race, color, or national origin.

The Nursing Home is one of a very limited number of facilities which meet U.S. Department of Veterans Affairs (VA) requirements to provide care to veterans. In turn, the Nursing Home receives certain funding from VA on the basis of the number of veterans served. The Nursing Home is overseen by the Division of State and Veterans Nursing Homes within the Colorado Department of Human Services.

WORKLOAD AND STATISTICAL FACTORS

Authorized capacity	180
Average daily census for the year ended June 30, 2004	125
Average occupancy percentage for the year ended June 30, 2004	69%
Patient days for the year ended June 30, 2004	45,785

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

FINDINGS AND RECOMMENDATIONS

We have audited the financial statements of the Colorado State Veterans Nursing Home at Fitzsimons (the "Nursing Home") for the year ended June 30, 2004 and have issued our report thereon dated August 20, 2004. In planning and performing our audit of the financial statements, we considered the Nursing Home's internal control solely to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. In addition, in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, we have also issued our report dated August 20, 2004 on our consideration of the Nursing Home's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grants, and other matters. We have not considered internal control since August 20, 2004.

Our procedures were designed primarily to enable us to form an opinion on the financial statements and on management's assertion regarding compliance and the effectiveness of internal control over financial reporting and, therefore, may not identify all weaknesses in policies or procedures that may exist.

During our engagement, we noted certain matters involving internal control that are presented for the Nursing Home's consideration. These comments and recommendations, which have been discussed with appropriate members of the Nursing Home's management, are intended to improve internal control and are detailed in the following section.

* * * * *

CONTINUED ASSESSMENT OF PERFORMANCE AND PLANNING

The Fitzsimons Nursing Home has incurred substantial operating losses since admitting its first patient in October 2002. Specifically, the Nursing Home incurred a net operating loss of about \$5.4 million in Fiscal Year 2003 and over \$5.0 million in Fiscal Year 2004. As noted in Note 12 of this report, in September 2004, the Joint Budget Committee, under HB04-1421, appropriated approximately \$4.0 million in general funds to cover the Nursing Home's Fiscal Year 2005 projected operating deficit. The Home also received an operating grant from the Tax Relief Governor's Discretionary Fund for approximately \$820,000 in July 2004. Finally, the Department of Human Services issued \$6.0 million in anticipation warrants for the Nursing Home on November 1, 2002, about \$5.0 million of which has been used to fund operating shortfalls.

One of the criteria in determining if a fund should be treated as an enterprise fund under Governmental Accounting Standards Board Statement No. 34 (GASB 34), *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, is that "the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service)." Accordingly, generally accepted governmental accounting standards presume that enterprise funds will at some point reach break-even or better operationally and that subsidization of activities conducted by the enterprise will be the exception rather than the norm.

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Section 26-12-201.5(6), C.R.S., specifically prohibits the State from providing general funds to cover any operational shortfall incurred by the Fitzsimons Nursing Home after its construction and before it begins to “generate revenues sufficient to cover its operational expenses.” Further, per Section 26-12-108(1)(a), C.R.S., operations and resources of the five nursing homes operated by the Department of Human Services are pooled and accounted for within one central fund. This structure allows the Department of Human Services to use other homes’ monies to cover Fitzsimons’ operating shortfalls. Consequently, the timing and capacity of the Fitzsimons Home to reach break-even status could impact the financial and operating status of the other state-operated state and veterans nursing homes.

The Office of the State Auditor’s *Colorado Department of Human Services, State and Veterans Nursing Home Performance Audit* (dated October 2003) recommended that the Fitzsimons Nursing Home establish and implement a formal, documented monthly comparison of actual to projected performance and a process for assessing the feasibility of the facility to reach break-even status and meet scheduled payments on the Department’s anticipation warrants issued for the Fitzsimons Home. The report further recommended that the Nursing Home use the review to identify significant variances in revenues and expenses and take timely action to improve performance. The Department agreed with the recommendations and reported that it had implemented a streamlined chart of accounts to use in a budget-to-actual monitoring process. The Department also indicated that the implemented budgetary tools would be used to monitor the Home’s performance and to make necessary adjustments to performance projections. The Department indicated at that time that the Nursing Home was expected to achieve consistent break-even status by January 1, 2004.

While the Nursing Home has taken steps to implement ongoing comparisons of actual to projected performance and to assess the potential timeframe of the Home to reach break-even status, the Nursing Home’s continued Fiscal Year 2004 operating loss and need for general fund appropriations for ongoing operations causes concerns about the Home’s ability to continue as a going concern. As noted in the October 2003 report, it is critical that the Fitzsimons Home’s operations are continually assessed and appropriate actions are taken to ensure that the facility reaches self-sufficiency as soon as possible. Therefore, the Home should continue to conduct monthly comparisons of actual to projected performance and assessments of ability to reach break-even status and to take timely action to improve performance. The Home should also revise and update its projections to include a five-year business plan designed to bring the Home’s operations to a break-even point, without State subsidization, as soon as possible.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

Recommendation No. 1:

The Department of Human Services should ensure that the State Veterans Nursing Home at Fitzsimons achieves self-sufficiency as soon as possible by:

- a. Continuing to perform a formal, documented monthly comparison of actual to projected performance and to assess the ability of the facility to reach break-even status.
- b. Identifying and investigating significant variances in revenues and expenses and taking timely action to improve performance.
- c. Updating its revenue and expense projections to include a five-year business plan designed to bring the Home's operations to a break-even point, without State subsidization, within the five-year period covered by the plan.

Department of Human Services Response:

a. Agree. We will continue to perform a formal, documented monthly comparison of actual to projected performance and to assess the ability of the facility to reach break-even status. We have hired a contractor to build an automated reporting process to compare actual to projected revenues and expenditures. We hired a full-time Fitzsimons Business Office Manager on January 10, 2005 and on this date we also have a full time Accountant overseeing the Division of State and Veterans Nursing Homes.

Implementation date: January 10, 2005.

b. Agree. We will continue to identify and investigate significant variances in revenues and expenses and take timely action to improve performance. Please see above responses.

Implementation date: Ongoing.

c. Agree. The home is striving to break even as soon as possible. A five-year plan will be developed to sustain operational profitability and plan for capital requirements, debt service, and other cash requirements by the end of September 2005.

Implementation date: September 30, 2005.

EXHIBIT K PREPARATION

At the end of each fiscal year, the State Controller's Office requires all agencies to prepare and submit reports, or "exhibits," for use in compiling the statewide financial statements and required footnote disclosures. Within each department, each agency is responsible for preparing its own exhibits.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

We performed audit procedures with respect to the Nursing Home's preparation of Exhibit K, Schedule of Federal Assistance for the Fiscal Year ended June 30, 2004. This exhibit is used to report federal receipts and expenditures for the Nursing Home's administration of grant programs, and it is the basis for the State's Schedule of Expenditures of Federal Awards (SEFA) submitted to the federal government each year. As a result of our audit procedures, we noted that:

- Exhibit K required four separate revisions for Fiscal Year 2004 due to errors and omissions we identified through our audit. We requested that Nursing Home staff correct expenditures, beginning balances, ending balances, and grants included on the Exhibit K, respectively, on the original and revised exhibits submitted by the Nursing Home. For example, Nursing Home staff erroneously included receipts totaling \$322,000 and expenditures totaling \$24,300 on the Exhibit K for a federal non-grant program. Also, Nursing Home staff used beginning balance information from its accounts receivable system that had not been reconciled to COFRS. During Fiscal Year 2004 Nursing Home staff had made adjustments to the information in the system and amounts recorded on COFRS but staff did not incorporate the adjustments while preparing the Exhibit K. As a result, Exhibit K beginning balances were initially overstated by a total of \$132,000.
- Exhibit K was not prepared by the Nursing Home for the year ended June 30, 2003. Therefore, no beginning accounts receivable balances were available for the Fiscal Year 2004 exhibit. Further, the State's Schedule of Expenditures of Federal Awards for Fiscal Year 2003 was understated by \$465,000.

The Nursing Home should improve controls over the preparation of the Exhibit K in order to ensure the State's SEFA is accurate and that time required to correct and revise exhibits is minimized. This should include providing adequate training to staff preparing the exhibit and instituting a supervisory review process over the Exhibit K prior to its submission.

Recommendation No. 2:

The Department of Human Services should improve controls over the preparation of the Exhibit K at the State Veterans Nursing Home at Fitzsimons by:

- a. Ensuring staff preparing the exhibit are adequately trained.
- b. Instituting a secondary review process over the Exhibit K to ensure its accuracy prior to submission.
- c. Ensuring that information used to prepare the Exhibit K is accurate. Periodic reconciliations between federal accounts receivable information in the accounts receivable system and COFRS should be performed during the fiscal year and a supervisory review should be performed on the reconciliations.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

Department of Human Services Response:

a. Agree. The Division of State and Veterans Nursing Homes' accountant will adequately train Fitzsimons' business office staff in preparing the Exhibit K.

Implementation date: June 30, 2005.

b. Agree. We will have the Division of State and Veterans Nursing Homes' Accountant review the Exhibit K for accuracy prior to submission and have a secondary review from the CDHS Central Accounting Office.

Implementation date: June 30, 2005.

c. Agree. We will have periodic reconciliations between federal accounts receivable information in the accounts receivable system and COFRS. These reconciliations will be performed during the fiscal year and the Division of State and Veterans Nursing Homes' Accountant will review the reconciliations.

Implementation date: January 31, 2005.

ACCOUNTING FOR CAPITAL ASSETS, ANTICIPATION WARRANTS, AND ACCOUNTS RECEIVABLE

During our Fiscal Year 2004 audit, we identified several problems with the Nursing Home's accounting for capital assets, anticipation warrants, and federal accounts receivable. Specifically, we found the following:

- The Nursing Home did not properly capitalize equipment totaling \$52,800 that was purchased in Fiscal Year 2003 but recorded as an asset in Fiscal Year 2004. During the Office of the State Auditor's Fiscal Year 2003 financial audit of the Department of Human Services, auditors determined Nursing Home staff inappropriately expensed rather than capitalized a van. Nursing Home staff subsequently capitalized the van during Fiscal Year 2004. However, the Nursing Home inappropriately recorded the offsetting revenue as a gain on disposal of equipment rather than an offset to prior-year expense. An adjusting entry to reclassify revenue from gain on disposal of equipment to reimbursement of prior year expense was made to the Fiscal Year 2004 financial statements.
- The Nursing Home did not record another van donated in Fiscal Year 2004 with an assessed value of about \$46,000 on its financial statements. Under generally accepted accounting principles, donated equipment should be recorded as an asset on the financial statements in an amount equal to its assessed value. A correcting entry was not posted to the Fiscal Year 2004 financial statements for this error.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
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- The Nursing Home did not correctly account for accrued interest revenue totaling \$24,000 received on proceeds from the sale of anticipation warrants. The accrued interest should have offset the interest expense for Fiscal Year 2003. The improper accounting resulted in a \$24,000 overstatement of interest expense and an offsetting \$24,000 understatement of deferred anticipation warrants issue costs. A correcting entry was not made to the Fiscal Year 2004 financial statements. Also, \$39,000 of the Nursing Home's amortization expense was incorrectly posted to a purchased services-office moving general ledger account instead of interest expense. A correcting entry to decrease purchased services -office moving and to increase interest expense was recorded on the Fiscal Year 2004 financial statements.
- Federal revenue totaling \$88,600 was incorrectly recorded by Nursing Home staff as non-federal patient revenue. As a result, federal revenue was understated and patient revenue was overstated by \$88,600. A correcting entry to increase federal revenue and decrease patient revenue was recorded on the Fiscal Year 2004 financial statements.

The problems identified demonstrate a lack of adequate accounting controls to ensure that capital assets and anticipation warrants are accurately reported and that revenue is accurately recorded on COFRS. The Nursing Home should adopt appropriate control procedures to ensure that amounts are accurate and complete and in accordance with generally accepted accounting principles.

Recommendation No. 3:

The Department of Human Services should improve controls over accounting functions at the State Veterans Nursing Home at Fitzsimons by following generally accepted accounting principles to record capital assets and anticipation warrants and by ensuring that revenue is properly classified.

Department of Human Services Response:

Agree. The Division of State and Veterans Nursing Homes' Accountant is holding quarterly meetings with all six State and Veterans Nursing Homes' Business Managers for training on these and other accounting issues.

Implementation date: June 30, 2005.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED JUNE 30, 2004**

DISPOSITION OF PRIOR AUDIT RECOMMENDATIONS

The Nursing Home has one outstanding prior audit recommendation from the Office of the State Auditor's *Colorado Department of Human Services, State and Veterans Nursing Home Performance Audit*, dated October 2003.

Recommendation No. 1 (Recommendation No. 2 in the original report):

The Department of Human Services should ensure that the State Veterans Nursing Home at Fitzsimons achieves self-sufficiency as soon as possibly by:

- a. Establishing and implementing a formal, documented monthly comparison of actual to projected performance and a process for assessing the ability of the facility to reach break-even status and meet scheduled payments on the anticipation warrants.
- b. Using the review to identify significant variances in revenues and expenses and taking timely action to improve performance.

Implementation Status:

Partially implemented. See current year Recommendation No. 1

FINANCIAL AUDIT REPORT SECTION



McPherson,
Breyfogle,
Daveline &
Goodrich, PC
Certified Public Accountants

740 Thatcher Building
Pueblo, CO 81003
Phone (719) 543-0516
Fax (719) 544-2849

INDEPENDENT AUDITORS' REPORT

Members of the Legislative Audit Committee

We have audited the accompanying financial statements of Colorado State Veterans Nursing Home at Fitzsimons (“the Nursing Home”), an enterprise fund of the State of Colorado, as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Nursing Home’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In accordance with the terms of our engagement, we have not applied audit procedures necessary to satisfy ourselves about the classifications and amounts comprising the statement of net assets at June 30, 2003.

The financial statements present only the Colorado State Veterans Nursing Home at Fitzsimons, an enterprise fund of the State of Colorado, and do not purport to, and do not, present fairly the financial position of the State of Colorado as of June 30, 2004, and the changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been necessary had we been able to satisfy ourselves about amounts comprising the statement of net assets at June 30, 2003, the financial statements referred to above present fairly, in all material respects, the financial position of Colorado State Veterans Nursing Home at Fitzsimons as of June 30, 2004, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 20, 2004, on our consideration of Colorado State Veterans Nursing Home at Fitzsimons' 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 to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

August 20, 2004, except for Note 12
as to which date is November 5, 2004

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents management's analysis of the financial performance of the Colorado State Veterans Home at Fitzsimons (the "Nursing Home") for the fiscal year ended June 30, 2004. The Nursing Home is an enterprise fund of the State of Colorado.

The accompanying financial statements are an integral part of this analysis, and figures reported on these statements are incorporated and referred to throughout this discussion. Please read this section in conjunction with these statements.

SUMMARY OF OPERATIONAL POLICIES AND PROCEDURES

The Colorado State Veterans Home at Fitzsimons is owned and operated by the State of Colorado, Department of Human Services, Office of Adult Disability and Rehabilitation, Division of State and Veterans Nursing Homes. The Division of State and Veterans Nursing Homes consists of six facilities accounted for as one *Enterprise Fund* within the State's financial system managed individually by Nursing Home administrators and collectively by Division staff.

The mission of the Colorado Department of Human Services, Division of State and Veterans Nursing Homes is to provide superior nursing care in an environment that enhances the quality of life of each resident.

The Nursing Home accepts residents whose care is funded by the State of Colorado Medicaid program, the United States Department of Veterans Affairs (VA) and private sources. The Nursing Home also received Medicare certification on March 1, 2003 enabling it to accept residents who qualify for Medicare funding.

FINANCIAL HIGHLIGHTS

Resident Population

One of the single most significant economic factors underlying a skilled nursing facility's financial performance is resident occupancy. The Nursing Home sponsored a grand opening on July 4, 2002, and admitted its first resident on October 21, 2002.

As expected of a start-up facility, the resident population gradually increased during the first year, Fiscal Year 2003, climbing from zero to 108. The first Medicare resident was admitted in March 2003. The resident population expanded to approximately 145 residents in October 2003.

However, on September 30, 2003, the Colorado Department of Health and Environment (CDH&E) responded to a health care complaint at the Nursing Home. The resulting survey set in motion a six-month time frame for the Nursing Home to correct noted deficiencies, and in October 2003, the State and the Centers for Medicare and Medicaid Services placed a freeze on new admissions. Additionally, in November 2003, the VA performed a separate health care survey with similar but different standards from the CDH&E. The VA health care survey also noted deficiencies which lead to a separate VA freeze on admissions.

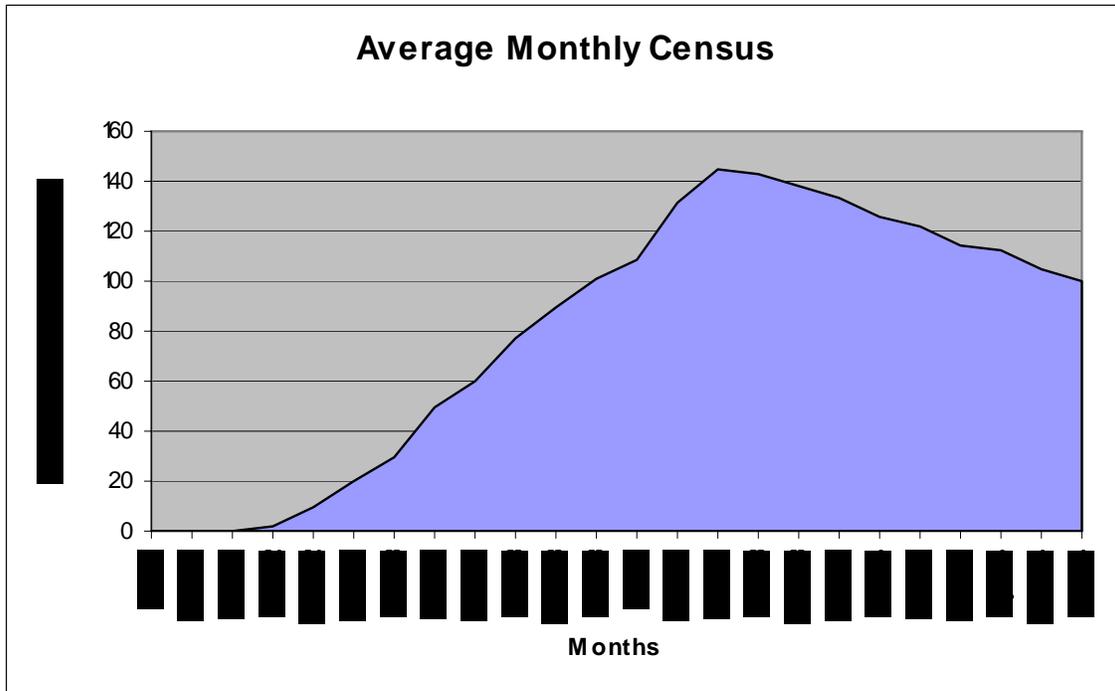
In response to the survey issues, the Governor of Colorado initiated a special task force to oversee the Nursing Home's compliance issues, and on December 20, 2003, a six-month contract was executed with a private

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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

management company to bring the Nursing Home into regulatory compliance. This management contract contains the option for three more renewals of six-month periods.

The Nursing Home succeeded in regaining regulatory compliance with the CDH&E standards on March 13, 2004, within the six-month time frame. The Nursing Home also worked diligently with the VA to correct its deficiencies. The VA freeze ended on August 15, 2004 at which time the Nursing Home started admitting new residents. As a result of the above-mentioned factors, the 180-bed Nursing Home ran at approximately 60% occupancy for a substantial portion of fiscal year 2004.

The average monthly census since inception, inclusive of all revenue sources, is as follows:



Net Assets and Revenues and Expenses at June 30, 2004 and for the Year Then Ended:

- Current assets of \$1.7 million are comprised primarily of restricted cash, resident receivables and amounts due from government agencies.
- Non-current assets of \$25 million are comprised primarily of land and improvements of approximately \$8 million, buildings of \$17 million, furniture and equipment of \$1 million and related accumulated depreciation of approximately \$1 million.
- Current liabilities of \$5 million are comprised primarily of a \$2.5 million operating cash overdraft. The remaining \$2.5 million are comprised of various vendor payables, employee compensation, amounts due to other governments and the current portion of anticipation warrants payable. The operating cash overdrafts are part of pooled funds that are held by the State Treasury for all of the State-operated Nursing Homes.
- Non-current liabilities of \$5.5 million are comprised primarily of the long-term portion of net anticipation warrants payable.
- Net assets of \$16 million are comprised primarily of \$19 million invested in capital assets, net of related debt, and a negative \$3 million unrestricted net assets.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

OVERVIEW OF THE FINANCIAL STATEMENTS

Nursing Home Funds

The Nursing Home maintains three accounting funds, an operating fund classified as an *enterprise fund*, a restricted donations fund, maintained for the benefit of the Nursing Home and/or residents, classified as a *special revenue fund*, and a personal needs resident trust fund classified as a *fiduciary fund*.

The operating fund is controlled by management. A committee comprised of Nursing Home staff, community volunteers and residents approves disbursements from the donations fund. Residents or their personal representatives control the individual accounts comprising the personal needs fund.

	Fund 505 Enterprise (Operating)	Fund 813 Special Revenue (Donations)	Fund 900 Fiduciary (Resident Trust)	Total Nursing Home
Assets	\$ 26,950,828	\$ 21,609	\$ 9,785	\$ 26,982,222
Liabilities	10,640,116	-	9,785	10,649,901
Net Assets	\$ 16,310,712	\$ 21,609	\$ -0-	\$ 16,332,321

These three funds are combined on the accompanying statement of net assets.

Fund Financial Statements

Statement of Net Assets

The Statement of Net Assets reports the nature and amounts of the Nursing Home's assets and liabilities. This statement provides the basis for determining the overall financial health of the Nursing Home, including its liquidity and financial flexibility.

Statement of Revenue, Expenses and Changes in Net Assets

The Statement of Revenue, Expenses and Changes in Net Assets includes revenues and expenses of the Nursing Home reported on the accrual basis of accounting. This Statement measures the efficiency of the Nursing Home's overall operations and can be used to help determine if the Nursing Home's rates and census volume are adequate to recover expenses related to providing skilled nursing care.

Statement of Cash Flows

The Statement of Cash Flows presents information concerning the Nursing Home's cash receipts and cash disbursements during the year, along with net changes in cash from operating activities, non-capital financing, capital and related financing, and investing activities.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

FINANCIAL ANALYSIS

Statement of Net Assets

The following chart presents an overview of the Nursing Home's assets and liabilities as of June 30, 2004 and 2003.

*Condensed Statement of Net Assets (Rounded in thousands)
As of June 30*

	2004	2003 (Unaudited)	Dollar Change Inc (Dec)	Percent Change
Current assets	\$ 1,702	\$ 2,121	\$ (419)	(20%)
Non-current assets	25,280	26,040	(760)	(3%)
Total assets	\$ 26,982	\$ 28,161	\$ (1,179)	(4%)
Current liabilities	\$ 5,079	\$ 1,064	\$ 4,015	377%
Non-current liabilities	5,571	6,250	(679)	(11%)
Total liabilities	\$ 10,650	\$ 7,314	\$ 3,336	46%
Net assets invested in capital assets, net of related debt	\$ 19,578	\$ 25,474	\$(5,896)	(23%)
Restricted for resident purposes	22	-0-	22	--
Unrestricted	(3,268)	(4,627)	\$1,359	(29%)
Total net assets	\$ 16,332	\$ 20,847	\$ (4,515)	(22%)
Total liabilities and net assets	\$ 26,982	\$ 28,161	\$ (1,179)	(4%)

- The decrease in net assets of \$4,515,000 or 22% as of June 30, 2004 is due primarily to a loss of revenue from the hold on admissions for the period October 2003 through June 2004.
- Non-current assets include approximately \$566,000 debt issuance costs.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

Statement of Revenues, Expenses and Changes in Net Assets

The following chart presents an overview of the Nursing Home's revenues, expenses and changes in net assets for the year ended June 30, 2004 and for the eight months ended June 30, 2003.

The comparability of the two periods is impacted by the different number of months in each reporting period. Amounts for 2003 have not been annualized for purposes of this presentation. Likewise, the start-up nature of the Nursing Home in 2003 and early 2004 and the admissions hold discussed above have significantly affected results of operations in both years.

Condensed Statement of Revenue, Expenses, and Changes in Net Assets (Rounded in thousands)

	Year Ended June 30, 2004	Eight Months Ended June 30, 2003 (Unaudited)	Dollar Change Inc (Dec)	Percent Change
Medicare, Medicaid, VA per diem & patient revenue	\$ 9,127	\$ 3,331	\$ 5,796	174%
Economic Recovery funds from the Governor's Office	754	-0-	754	---
Other revenue	106	15	91	607%
Total revenue	\$ 9,987	\$ 3,346	\$ 6,641	198%
Personal services & employee benefits	\$ 8,565	\$ 6,167	\$ 2,398	39%
Other expenses	5,653	1,917	3,736	195%
Interest expense	337	145	192	(132)%
Total expenses	\$ 14,555	\$8,229	\$6,326	77%
Net Income (loss) before Capital Contributions	\$ (4,568)	\$ (4,883)	\$ 315	6%
Capital Contributions	53	-0-	53	---
Change in Net Assets	\$ (4,515)	\$ (4,883)	\$ 368	7%

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

- For comparison purposes between the two years, the above chart does not include state and federal capital contributions of approximately \$26 million in 2003 for the Nursing Home's land and building.
- For Fiscal Year 2003, the Nursing Home budgeted revenues at \$6.2 million as compared to actual revenue of \$3.3 million and expenses were budgeted for \$7.6 million as compared to actual expenses of \$8.2 million with an anticipated loss from the start up of the operations of \$1.4 million.
- Total revenue increased \$6.6 million from Fiscal Year 2003 to Fiscal Year 2004 primarily due to a full year's operations and increased census in Fiscal Year 2004 versus eight months of activity in Fiscal Year 2003.
- Operating expenses increased \$6 million from Fiscal Year 2003 to Fiscal Year 2004 due primarily to additional services required to care for the larger census during a full year of operations.
- The Nursing Home lost \$4.9 million during the first eight months it operated in Fiscal Year 2003, in general as a result of inefficiencies incurred from being fully staffed but only gradually admitting residents. The Nursing Home lost \$4.6 million during Fiscal Year 2004 mainly due to low census from not admitting residents for nine months while the delivery of health care was being brought in line with the standards of the federal Centers for Medicare and Medicaid, the Colorado Department of Health and Environment and the federal Department of Veterans Affairs, as discussed above.

BUDGETARY HIGHLIGHTS

Fiscal Year 2004

The Nursing Home operating and capital budgets are established by the Nursing Home administrator and are approved by the Department of Human Services, Nursing Home Division. The Nursing Home revenues and expenditures are solely part of the Nursing Home enterprise fund.

The Nursing Home opened in the fall of 2002 with a budget that contained significant normal start-up costs and a projected loss of \$1.4 million for the eight months ended June 30, 2003.

The budget for the Fiscal Year ending June 30, 2004 was more optimistic, projecting a census of 166 residents and an operating profit. However, as discussed above, the significant health care issues that emerged in the fall of 2003 and the resulting hold on new admissions kept the census below the breakeven level of approximately 150 residents for this 180-bed Nursing Home. As of the end of Fiscal Year 2004, the Nursing Home had incurred an operating loss of \$4.6 million as compared to a budgeted net income of \$1.5 million.

Revenue

Operating revenue was under budget by approximately \$3 million with a budget of \$13.1 million as a result of significantly lower census for the last nine months of the Fiscal Year. The census at June 30, 2004 was 108 as compared to a budget of 166 or a total of 45,787 actual days compared to a budget of 50,726 days.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

Medicaid rates were also lower than budgeted by approximately \$46 per day, or a rate of \$141.38 as compared to a budgeted rate of \$187.54. This rate difference resulted from a misinterpretation of the State's Medicaid start-up reimbursement rules, whereby the State reimburses new facilities the statewide average rate as compared to a rate based on the actual costs of the Nursing Home. The higher rate of \$187.54 was paid to the Nursing Home until May 2004, at which time a liability was established to pay back the Medicaid Agency the \$1 million overpayment. However, effective May 1, 2004, the Medicaid rate increased to approximately \$172 per day based upon the submitted 2002-2003 Medicaid cost report; this rate has been audited but not yet finalized.

Expenses

Operating expenses were \$2.6 million over budget with the total budget of \$11.6 million for Fiscal Year 2004. Personnel services and employee benefits of nearly \$8.6 million comprised 60% of the total operating expenses of \$14.6 million in Fiscal Year 2004.

Nursing costs were a significant component of personnel costs and were high for several reasons. One such reason is fundamental supply and demand. Consistent with state-wide and national trends, the demand for nursing personnel remains high while the supply remains low. To address this need, it is typical for a Nursing Home to purchase health care services from an outside agency or pool of nurses. Consequently, during the first half of the year, the Nursing Home incurred significant cost overruns due to extensive use of contract nursing agency staff needed to fill vacant nursing positions. In addition, to help mitigate the scarcity of qualified nursing personnel, the Nursing Home offered sign-on bonuses of \$4,500 for registered nurses and licensed practical nurses, and \$2,000 for certified nurse assistants during the last six months of Fiscal Year 2004. These efforts were successful. All nursing positions were consequently filled with in-house staff, and the use of temporary nursing agency was eliminated April 2004, thereby saving several thousands of dollars monthly. With significant help from the management company, a solid team of nurse managers has now been recruited and retained to oversee clinical care twenty-four hours a day, seven days a week.

Other departments also incurred high costs. During the early part of the year prior to the admission hold, several departments were staffing up in preparation for the expected census growth. Consequently, in October 2003, when the Nursing Home was put on an admission hold, many of the departments were already overstaffed. In November 2003, 23 employees were laid off or re-assigned to other State positions outside the Nursing Home. These layoffs saved approximately one million dollars in annualized salaries. Also, significant nursing, social services, medical, administrative and other costs were incurred to address the serious state and federal regulatory survey deficiencies.

Costs incurred through June 30, 2004 for the private management company retained by the State to direct correction of the deficiencies of the Nursing Home's previous operations and to bring the Nursing Home back into regulatory compliance were approximately \$753,000.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

CAPITAL ASSETS AND DEBT ACTIVITIES

**Capital Assets, Net of Depreciation (In thousands)
At June 30**

Capital Assets	2004	2003	Change
Land	\$ 3,312	\$ 3,312	\$ 0
Land Improvements	4,255	4,485	(230)
Building	16,381	16,799	(418)
Equipment	784	878	(94)
Construction in Progress	21	0	21
Total	\$24,753	\$25,474	\$(721)

The \$24.9 million cost of the Nursing Home's construction was funded in part (about 62 percent) through a federal Veterans Administration (VA) grant (CFDA No. 64.105) and through State general funds appropriated for capital construction (about 38 percent).

Land valued at \$3.3 million was donated by the Fitzsimons Redevelopment Committee. The Fitzsimons campus was formerly the grounds for the Fitzsimons Army Medical Center and is currently being redeveloped as an extensive, diversified medical campus which includes the University of Colorado Health Sciences Center, Children's Hospital and other prominent medical research and health providers.

Pursuant to Section 26-12-113, C.R.S., the Department of Human Services also issued anticipation warrants (bonds) in the amount of \$6,045,000 on November 1, 2002, for the Nursing Home.

There were only minor additions to the Buildings and Equipment in Fiscal Year 2004. Net decreases are primarily due to depreciation.

**Debt (In thousands) -
At June 30**

Outstanding Debt	2004	2003
Anticipation Warrants	\$ 5,765	\$ 6,045

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

The anticipation warrants discussed in the table on the previous page have a payback period of 15 years and are guaranteed by the revenues of the facilities operated by the State of Colorado.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

Concentration of Funding Risk

Approximately 75% of the Nursing Home's residents are covered by Medicaid. Each year the funding of Medicaid is at risk if the economy suffers and hence the federal government is unable to maintain the appropriate level of reimbursement of health care costs.

Census Factors

The budget for Fiscal Year 2005 projects a net loss of \$3.1 million. As a result of the regulatory survey deficiencies, the Nursing Home continued to be on census hold through the middle of August 2004. Beginning in August 2004 the budgeted census is planned to grow by 4.3 residents per month through the remainder of the year to reach a census of 152 residents at the end of June 2005. Thus, the budgeted loss is the result of the Nursing Home's starting with a low census at the beginning of the year combined with certain substantial fixed costs. The budget projects that the Nursing Home will break even in the last quarter of Fiscal Year 2005.

Revenue

Revenues for Fiscal Year 2005 are budgeted at \$11.5 million. The three primary room and board rates for the Nursing Home were increased in October 2004. The all-inclusive private room rate increased to \$279.00; the Medicaid rate is budgeted at \$185.08, and the veterans' daily per diem rate was budgeted at \$59.50.

In September 2004, pursuant to the provisions of Section 24-75-111(1)(c)(I)(C), C.R.S., as specified in H.B. 98-1331, the Joint Budget Committee authorized the State Controller's Office to release \$4.1 million in additional funding to the Department of Human Services to cover the Nursing Home's Fiscal Year 2005 projected operating deficit.

Expenses

Operating expenses for Fiscal Year 2005 are budgeted at \$14.6 million including non-cash depreciation expense of \$870,000. The most significant budgeted expense line items are personal service costs of \$9.9 million and contract services of \$1.7 million.

Management

A strong department manager team has been put into place to provide daily operational oversight under the direction of the licensed nursing home administrator. The management team meets daily to review Nursing Home operations and review and respond to emergent issues.

Fiscal Year 2006

A 2006 budget has been prepared which shows the Nursing Home will make a profit given today's assumptions.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004**

CONTACTING FITZSIMONS NURSING HOME FINANCIAL MANAGEMENT

This financial report is designed to provide citizens, taxpayers, customers, investors, and creditors with a general overview of the Colorado State Veterans Nursing Home at Fitzsimons' finances and to demonstrate accountability for the money it receives. If you have questions about this report or need additional information, contact the Controller of the Colorado Department of Human Services at 1575 Sherman Street, Denver, CO 80203 or phone 303-866-2732.

COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
STATEMENT OF NET ASSETS
JUNE 30, 2004

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$ 40,002
Restricted cash, debt service reserve	564,755
Restricted cash, resident funds	30,565
Accounts receivable (net of allowance for uncollectibles of \$403,079)	583,634
Due from other governments	479,117
Accounts receivable, resident funds	829
Prepaid expenses	<u>2,753</u>
TOTAL CURRENT ASSETS	<u>1,701,655</u>

NONCURRENT ASSETS

Deferred anticipation warrants issue costs	526,669
Capital assets -	
Land and improvements	7,910,962
Buildings	17,018,960
Furniture and equipment	963,810
Vehicles	52,785
Construction in progress	21,178
Accumulated depreciation	<u>(1,213,797)</u>
TOTAL CAPITAL ASSETS (NET OF ACCUMULATED DEPRECIATION)	<u>24,753,898</u>
TOTAL NON CURRENT ASSETS	<u>25,280,567</u>

TOTAL ASSETS \$ 26,982,222

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accounts and vouchers payable	\$ 584,910
Due to other governments	869,896
Operating cash overdraft	2,514,937
Accrued salaries payable	670,407
Current portion of liability for compensated absences	108,639
Current portion of anticipation warrants payable	320,000
Deposits held in trust for residents	<u>9,785</u>
TOTAL CURRENT LIABILITIES	<u>5,078,574</u>

NONCURRENT LIABILITIES

Anticipation warrants payable (net of unamortized discount of \$62,830)	5,382,170
Liability for compensated absences	<u>189,157</u>
TOTAL NONCURRENT LIABILITIES	<u>5,571,327</u>

TOTAL LIABILITIES 10,649,901

NET ASSETS

Invested in capital assets, net of related debt	19,578,397
Restricted for resident purposes	21,609
Unrestricted	<u>(3,267,685)</u>

TOTAL NET ASSETS 16,332,321

TOTAL LIABILITIES AND NET ASSETS \$ 26,982,222

The accompanying notes are an integral part of this statement.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2004**

OPERATING REVENUE	
Patient charges for services	\$ 7,093,351
VA per diem reimbursement	2,034,060
Miscellaneous revenue	<u>5,147</u>
TOTAL OPERATING REVENUE	<u>9,132,558</u>
OPERATING EXPENSES	
Personal services and employee benefits	8,565,310
Advertising	88,346
Building, laundry and recreational supplies	235,886
Claims paid	20,241
Food and food service supplies	372,138
Insurance	191,066
Inter-departmental charges for services	120,671
Medical and laboratory supplies	1,087,507
Office	41,686
Other operating expenses	63,557
Professional services	1,312,413
Repairs and maintenance	165,516
Small equipment	95,708
Telephones	116,321
Utilities	229,773
Vehicles and travel	45,697
Depreciation	815,116
Bad debt expense	<u>631,721</u>
TOTAL OPERATING EXPENSES	<u>14,198,673</u>
OPERATING INCOME (LOSS)	<u>(5,066,115)</u>
NONOPERATING REVENUE AND EXPENSES	
Federal grant	753,682
Other grant - Tobacco	53,890
Interest income	6,028
Donations - resident funds	41,025
Interest income - resident funds	10
Interest expense	(336,599)
Recreation - resident funds	<u>(19,426)</u>
TOTAL NONOPERATING REVENUE	<u>498,610</u>
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS	<u>(4,567,505)</u>
CAPITAL CONTRIBUTION	<u>52,785</u>
CHANGE IN NET ASSETS	(4,514,720)
NET ASSETS, beginning of year	<u>20,847,041</u>
NET ASSETS, end of year	<u>\$ 16,332,321</u>

The accompanying notes are an integral part of this statement.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2004**

CASH FLOWS FROM OPERATING ACTIVITIES

Cash received from patients and third-party payors	\$ 7,543,536
Cash received from federal government	2,356,994
Cash payments to employees for services	(7,526,484)
Cash payments to suppliers for goods and services	<u>(4,946,849)</u>
NET CASH USED BY OPERATING ACTIVITIES	<u>(2,572,803)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Short-term borrowings from state cash pool	907,509
Operating grant	<u>753,682</u>
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	<u>1,661,191</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Acquisition of capital assets	(41,803)
Principal payment on anticipation warrants	(280,000)
Interest payment on anticipation warrants	(248,412)
Other interest paid	(44,520)
Other grant	<u>53,890</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(560,845)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Interest income	<u>4,185</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>4,185</u>

NET DECREASE IN CASH AND CASH EQUIVALENTS

(1,468,272)

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR

1,508,274

CASH AND CASH EQUIVALENTS AT END OF YEAR

\$ 40,002

RECONCILIATION OF OPERATING INCOME TO NET CASH USED BY OPERATING ACTIVITIES

Operating loss	\$ (5,066,115)
Adjustments to reconcile operating income to net cash used by operating activities -	
Depreciation	815,116
Bad debt expense	631,721
Changes in assets and liabilities -	
Accounts receivable	(36,874)
Prepaid expenses	(2,753)
Accounts payable and accrued expenses	1,147,592
Deferred revenue	(65,052)
Liability for compensated absences	<u>3,562</u>
NET CASH USED BY OPERATING ACTIVITIES	<u>\$ (2,572,803)</u>

The accompanying notes are an integral part of this statement.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Colorado State Veterans Nursing Home at Fitzsimons (the "Nursing Home") is part of the State of Colorado (the "State"), Department of Human Services.

The financial statements of the Nursing Home have been prepared in accordance with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Nursing Home applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB statements prevail. The more significant of the Nursing Home's accounting policies are described below.

The Financial Reporting Entity

The State is the primary reporting entity for state financial reporting purposes. As an enterprise fund of the State, the Nursing Home's financial statements are generally presented in a manner consistent with those of the State. However, the financial statements of the Nursing Home are not intended to report financial information of the State in conformity with generally accepted accounting principles.

The accounting policies of the Nursing Home conform to accounting principles generally accepted in the United States of America, applicable to governmental units.

Fund Accounting

The Nursing Home uses an enterprise fund to report its financial position, changes in financial position, and cash flows. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. Enterprise funds are used to report activities for which a fee is charged to external users for goods or services.

Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. All assets and liabilities are included on the Statement of Net Assets. Revenues are recorded when earned and expenses when a liability is incurred, regardless of the timing of cash flows.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

GASB 34

At the beginning of Fiscal Year 2003, the Nursing Home adopted the provisions of GASB Statement No. 34 entitled *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. This statement established standards for external financial reporting for all state and local governmental entities which includes a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows, where applicable.

The statement requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This caption consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted – This caption consists of constraints placed on net asset use through external restrictions imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted – Consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt”.

Budget and Budgetary Accounting

Appropriations for the nursing homes owned by the State are not included in the annual Long Bill (appropriations bill) passed by the General Assembly. Therefore, no budgetary comparison statement is required to be presented.

The Nursing Home’s administrator submits a budget at least 60 days prior to the beginning of the fiscal year to the Department of Human Services for approval. The budget includes proposed expenditures and the means of financing them.

During the year, the budget may be modified; however, a supplemental budget request must be submitted for approval at the Department level if a change in requirements dictates that the originally approved budget is to be exceeded.

COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

Accounts Receivable

The Nursing Home's accounts receivable consist primarily of open accounts with residents for services, subsidized Medicaid and Medicare reimbursements, and VA per diem reimbursements. Portions of accounts receivable relating to non-subsidized charges for services are subject to credit risk. Consequently, an allowance for doubtful accounts has been established based on management's estimate.

Capital Assets

Any individual item of property and equipment with a cost of \$5,000 or more and whose estimated life exceeds two years is recorded at cost. Expenses for normal maintenance and repairs are recognized currently as incurred, while renewals and betterments are capitalized.

Depreciation of all exhaustible capital assets is charged as an expense against operations. Accumulated depreciation is reported on the statement of net assets. Depreciation has been provided over the estimated useful lives by class using the straight-line method, as follows:

Land improvements	20 years
Buildings	15-40 years
Furniture and equipment	3-15 years
Vehicles	10 years

Compensated Absences

It is the Nursing Home's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. Employees are allowed to accumulate vacation benefits up to predetermined maximums and are compensated for these accumulated vacation benefits either through paid time off or at termination or retirement. Employees are also allowed to accumulate sick pay benefits up to predetermined maximums; however, payment of these sick pay benefits is limited to 25% of the balance upon retirement only.

Vacation and related payroll benefits are accrued as an expense and fund liability when incurred up to the predetermined maximums. Sick pay and related payroll benefits are recognized as an expense and a fund liability and are measured using an estimate of current employees that will eventually retire.

Statement of Cash Flows

For purposes of the statement of cash flows, the Nursing Home considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents except that the Nursing Home has elected not to include restricted cash as part of cash equivalents.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

Long-Term Obligations and Bond Discount and Issue Costs

Long-term liabilities financed from the enterprise proprietary fund are accounted for in that fund. Warrant discounts and issue costs are deferred and amortized over the term of the warrants using a method that approximates the interest method. Warrant discounts are presented as a reduction of the face amount of the anticipation warrants payable, whereas issue costs are recorded as deferred charges.

NOTE 2 – FINANCIAL STATEMENT PRESENTATION

The Nursing Home has a Patient Benefit fund and a Resident Trust fund that have been included with the enterprise proprietary fund for financial reporting purposes. The Patient Benefit fund is funded by donations from the public and is controlled by a committee consisting of resident representatives and other interested outside parties. The funds are used for various resident needs and activities. The Resident Trust fund consists of personal funds belonging to the individual residents. The assets, liabilities, fund balance, revenue, and expenditures of these funds are included in the Statement of Net Assets and the Statement of Revenue, Expenses, and Changes in Net Assets. Below are the amounts from these funds included in the financial statements:

Statement of Net Assets

	June 30, 2004	
	Patient Benefit Fund	Resident Trust Fund
<u>Assets</u>		
Cash and cash equivalents	\$ 20,780	\$ 9,785
Accounts receivable	829	-
Total Assets	\$ 21,609	\$ 9,785
<u>Liabilities and Net Assets</u>		
Deposits held in trust for residents	\$ -	\$ 9,785
Net Assets		
Restricted for resident purposes	21,609	\$ -
Total Liabilities and Net Assets	\$ 21,609	\$ 9,785

COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004

NOTE 2 – FINANCIAL STATEMENT PRESENTATION (Cont'd.)

Statement of Revenue, Expenses, and Changes in Net Assets

	<u>Year ended June 30, 2004</u>
	<u>Patient Benefit Fund</u>
Nonoperating revenue	
Donations	\$ 41,025
Interest income	<u>10</u>
Total nonoperating revenue	<u>41,035</u>
Expenses	
Recreation	<u>19,426</u>
Change in net assets	21,609
Net assets, beginning of year	<u>-</u>
Net assets, end of year	<u>\$ 21,609</u>

NOTE 3 - CASH AND CASH EQUIVALENTS

Cash and cash equivalents are summarized as follows:

<u>Proprietary Fund</u>	
Cash on hand	\$ 1,000
Demand deposits	<u>39,002</u>
	<u>\$ 40,002</u>
 <u>Resident Funds</u>	
Cash on hand	\$ 500
Demand deposits	<u>30,065</u>
	<u>\$ 30,565</u>

At June 30, 2004, the carrying amount of the Nursing Home's demand deposits was \$69,067 and the bank balance was \$70,026. All of the bank balance was covered by federal depository insurance.

The Nursing Home also had restricted cash required for the debt service reserve. As of June 30, 2004, the carrying amount and the bank balance was \$564,755. These funds are maintained in a treasury money market fund and are collateralized with U.S. treasury securities whose fair value approximates the carrying value.

The Nursing Home's cash with state treasurer was overdrawn in the amount of \$2,514,937 at June 30, 2004, and is not subject to risk categorization. Detailed information on the state treasurer's cash and investments is available from that office.

COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004

NOTE 4 - RECEIVABLES

Receivables at June 30, 2004 consist of the following:

Patient fees, net of allowance for doubtful accounts of \$403,079	<u>\$ 583,634</u>
Medicaid reimbursements	\$ 336,747
VA per diem reimbursements	<u>142,370</u>
Total due from other governments	<u>\$ 479,117</u>

NOTE 5 – CAPITAL ASSETS

Following is a summary of capital assets:

	<u>Balance July 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2004</u>
Nondepreciable assets –				
Land	\$ 3,312,000	\$ -	\$ -	\$ 3,312,000
Construction in progress	<u>-</u>	<u>21,178</u>	<u>-</u>	<u>21,178</u>
Total capital assets not being depreciated	<u>3,312,000</u>	<u>21,178</u>	<u>-</u>	<u>3,333,178</u>
Depreciable assets –				
Land improvements	4,598,962	-	-	4,598,962
Building	17,010,225	8,735	-	17,018,960
Furniture and equipment	951,920	11,890	-	963,810
Vehicles	<u>-</u>	<u>52,785</u>	<u>-</u>	<u>52,785</u>
Total capital assets being depreciated	<u>22,561,107</u>	<u>73,410</u>	<u>-</u>	<u>22,634,517</u>
Less: accumulated depreciation for –				
Land improvements	114,029	230,578	-	344,607
Building	210,880	426,711	-	637,591
Furniture and equipment	73,772	149,916	-	223,688
Vehicles	<u>-</u>	<u>7,911</u>	<u>-</u>	<u>7,911</u>
Total accumulated depreciation	<u>398,681</u>	<u>815,116</u>	<u>-</u>	<u>1,213,797</u>
Net capital assets	<u>\$ 25,474,426</u>	<u>\$ (720,528)</u>	<u>\$ -</u>	<u>\$ 24,753,898</u>

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004**

NOTE 6 – LONG-TERM DEBT

Following is a summary of long-term debt:

	<u>Balance July 1, 2003</u>	<u>Issued</u>	<u>Retired</u>	<u>Balance June 30, 2004</u>	<u>Due within One Year</u>
Revenue – Anticipation warrants, series 2002A	<u>\$ 6,045,000</u>	<u>\$ -</u>	<u>\$ 280,000</u>	<u>\$ 5,765,000</u>	<u>\$ 320,000</u>

The issue is described as follows:

\$6,045,000 series 2002A Colorado Department of Human Services, Division of State and Veterans Nursing Homes, Enterprise System Revenue Anticipation Warrants; interest rate ranges from 4.20% to 4.75%; due in annual installments ranging from \$547,525 to \$558,013 including interest through December 2017.

The warrants were issued with an original issue discount of \$69,811. As of June 30, 2004, the unamortized original issue discount was \$62,830, which is netted against the warrant payable on the Statement of Net Assets.

Presented below is a summary of the debt service requirements to maturity, including interest:

<u>Year ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 320,000	\$ 238,013	\$ 558,013
2006	325,000	226,712	551,712
2007	340,000	213,413	553,413
2008	355,000	200,400	555,400
2009	365,000	186,887	551,887
2010 – 2014	2,060,000	696,369	2,756,369
2015 – 2019	<u>2,000,000</u>	<u>195,462</u>	<u>2,195,462</u>
	<u>\$ 5,765,000</u>	<u>\$ 1,957,256</u>	<u>\$ 7,722,256</u>

NOTE 7 - RISK MANAGEMENT

The Nursing Home is exposed to various risks of loss related to torts; theft, damage, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Nursing Home's risks related to general liability, motor vehicle liability, worker's compensation and medical claims are covered under the self-insurance fund managed by the Department of Personnel/General Support Services for the State of Colorado. Property claims are covered by commercial insurance and claims settled have not exceeded coverage limits for the last three years. A further description of the state's risks is contained in the state's Comprehensive Annual Financial Report.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004**

NOTE 8 – PENSION PLANS

A. PLAN DESCRIPTION

Virtually all of the Nursing Home's employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost sharing multiple employer plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the plan is placed with the Board of Trustees of PERA. Changes to the plan require legislation by the General Assembly. The state plan and other divisions' plans are included in PERA's financial statements which may be obtained by writing PERA at 1300 Logan Street, Denver, Colorado, 80203, by calling PERA at 303-832-9550 or 1-800-729-PERA (7372), or by visiting www.copera.org.

Plan members vest after five years of service and most are eligible for retirement benefits at age 50 with 30 years of service, age 60 with 20 years of service, or at age 65 with 5 years of service. Members are also eligible for retirement benefits without a reduction for early retirement if they are at least 55 and have a minimum of 5 years of service credit, and their age plus years of service equals 80 or more. Monthly benefits are calculated as a percentage of highest average salary (HAS). HAS is one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit.

Members disabled, who have five or more years of service credit, six months of which has been earned since the most recent period of membership, may receive retirement benefits if determined to be permanently disabled. If a member dies before retirement, their spouse or their eligible children under the age of 18 (23 if a full time student) are entitled to monthly benefit payments. If there is no eligible spouse, financially dependent parents will receive a survivor's benefit.

B. FUNDING POLICY

Employees contribute 8.0 percent of their gross covered wages to an individual account in the plan. During the fiscal year ended June 30, 2004, the Nursing Home contributed 10.15 percent of the employee's gross covered wages. Effective January 1, 2003, 1.1 percent of the total contribution was allocated to the Health Care Trust Fund. Through May 31, 2004, the amount needed to meet the match requirement established by the PERA Board was allocated to the Matchmaker Program (See Note 9). The balance remaining after allocations to the Matchmaker program and the Health Care Trust Fund was allocated to the defined benefit plan.

The annual gross covered wages subject to PERA is the gross earnings less any reduction in pay to offset employer contributions to the state-sponsored IRC 125 plan established under Section 125 of the Internal Revenue Code. The contribution requirements of plan members and their employers are established, and may be amended, by the General Assembly.

The Nursing Home's contributions to the three programs described above for the fiscal years ended June 30, 2004, 2003 and 2002 were \$720,935, \$487,235 and \$0, respectively. These contributions met the contribution requirement for each year.

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004**

NOTE 9 – VOLUNTARY TAX-DEFERRED RETIREMENT PLAN

Beginning on January 1, 2001, the Matchmaker Program established a state match for PERA member's voluntary contributions to tax-deferred retirement plans. For Calendar Year 2002, the match was 100 percent of up to 3 percent of employee's gross covered wages paid during the month. For Calendar Year 2003, the matching amount was set at 100 percent of up to 2 percent of employee's gross covered wages paid during the month. For Calendar Year 2004 through May 31, 2004, the match was 100 percent of up to 1 percent of employee's gross covered wages paid during the month. The PERA board sets the level of the match with two percent of gross salary plus fifty percent of any reduction in the overall contribution rate due to over funding of the pension plan that was available for the match. While the plan was not overfunded in the current year, the maximum one-year change in the match rate is statutorily limited to 1 percent and, therefore, the match changed from 2 percent to 1 percent on January 1, 2004. Legislation passed in the 2004 session of the General Assembly terminated the match for pay periods ending May 31, 2004. The match will resume when the actuarial value of the defined benefit plan assets are one hundred ten percent of actuarially accrued plan liabilities.

PERA offers a voluntary 401(k) plan entirely separate from the defined benefit pension plan. The state offers a Section 457 deferred compensation plan. Members who contribute to these plans also receive the state match.

NOTE 10 – POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

Health Care Program

PERACare (formerly known as the PERA Health Care Program) began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the Program and the Health Care Fund. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefits. During the year ended June 30, 2004, the premium subsidy was \$115 for those with 20 years of service credit (\$230 for members under 65 and not eligible for Medicare) and it was reduced by 5 percent for each year of service fewer than 20.

The Health Care Trust Fund is maintained by an employer's contribution as discussed above in Note 8 B.

Monthly premium costs for participants depend on the health care plan selected, the number of persons covered, Medicare eligibility, and the number of years of service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured medical and prescription benefits plans, and with several health maintenance organizations providing services within Colorado. As of December 31, 2003, there were 37,067 enrollees in the plan.

Life Insurance Program

PERA provides its members access to two group life insurance plans offered by Prudential Insurance Company and Anthem Life (formerly known as Rocky Mountain Life Insurance Company). Members may join one or both plans, and they may continue coverage into retirement. Premiums are collected monthly by payroll deduction or other means.

COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004

NOTE 11 - CONTINGENCIES AND COMMITMENTS

Grant Programs – The Nursing Home participates in state and federal grant programs which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the Nursing Home has not complied with the rules and regulations governing the grant, refunds of any money received may be required.

As part of a performance audit of the nursing homes throughout the state, it was discovered that the Division of State and Veterans Nursing Homes implemented a policy change regarding how VA per diem payments are treated with respect to the Medicaid program. This policy change was initiated in December 2001 and continues to date. The performance audit reported that this policy change may not be in compliance with federal requirements. The policy change represented additional revenue recognized and for the Colorado State Veterans Nursing Home at Fitzsimons totaled approximately \$1,297,716 for the period July 1, 2002 to June 30, 2004. The amount of additional revenue recognized since July 1, 2004 has not been determined. As such, some or all of this additional revenue may be subject to repayment depending upon the ultimate disposition of this policy change.

Taxpayer Bill of Rights – Colorado voters passed an amendment to the state constitution in November 1992 which contains several limitations, including revenue raising, spending and other specific requirements affecting state and local governments. The amendment, commonly known as the TABOR Amendment, is complex and subject to judicial interpretation; however, the management of the Nursing Home believes it is in compliance with the requirements of the amendment.

NOTE 12 - OTHER

As shown in the accompanying financial statements, the Nursing Home incurred an operating loss of \$5,066,115 for the Fiscal Year ended June 30, 2004 and incurred a substantial operating loss in Fiscal Year 2003. At June 30, 2004, current liabilities exceed current assets by \$3,373,919. These factors raise substantial doubt about the Nursing Home's ability to continue as a going concern. In October 2003 the Colorado Department of Public Health and Environment performed a survey review at the Nursing Home and found deficiencies in the quality of care provided to residents by the Nursing Home as well as the general administration of the facility. As a result, CDPHE and the federal Centers for Medicare and Medicaid Services placed a freeze on new admissions at the Nursing Home at that time. In November 2003, the United States Department of Veterans Affairs performed a separate health care survey of the Nursing Home. Based on deficiencies noted in that review, the VA placed a separate freeze on admissions at that time. In December 2003, the Nursing Home hired a management company to oversee the Nursing Home's operations and facilitate the replacement of the prior management. CDPHE and the federal Centers for Medicare and Medicaid Services lifted their freeze on admissions in March 2004. The VA lifted its freeze on admissions in August 2004. The Nursing Home has been admitting new residents since that time. Management believes these factors will contribute toward achieving profitability. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the Nursing Home cannot continue in existence.

COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2004

NOTE 12 – OTHER (Cont'd)

In September 2004, pursuant to the provisions of Section 24-75-111(1)(c)(I)(C), C.R.S., as specified in H.B. 98-1331, the Joint Budget Committee authorized the State Controller's Office to release additional funding to the Department of Human Services to cover the Fitzsimons Nursing Home's Fiscal Year 2005 projected operating deficit. In July 2004, the Nursing Home also received an operating grant from the Tax Relief Governor's Discretionary Fund in the amount of \$821,318.

GOVERNMENT AUDITING STANDARDS

AND

OMB CIRCULAR A-133 REPORTS

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2004**

SUMMARY OF INDEPENDENT AUDITORS' RESULTS

FINANCIAL STATEMENTS

A qualified opinion was rendered on the financial statements of Colorado State Veterans Nursing Home at Fitzsimons as of and for the year ended June 30, 2004.

Internal control over financial reporting:

- Material weakness(es) identified? _____ Yes X No
- Reportable condition(s) identified that are not considered to be material weaknesses? _____ Yes X None Reported

Noncompliance material to financial statements noted? _____ Yes X No

FEDERAL AWARDS

Internal control over major programs:

- Material weakness(es) identified? _____ Yes X No
- Reportable condition(s) identified that are not considered to be material weaknesses? _____ Yes X None Reported

An unqualified opinion was issued on compliance for major programs.

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? _____ Yes X No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
64.015	Veterans State Nursing Home Care
21.999	Tax Relief Governor's Discretionary Fund

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee: _____ Yes X No

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Cont'd.)
YEAR ENDED JUNE 30, 2004**

FINANCIAL STATEMENT FINDINGS

No financial statement findings were noted.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No findings or questioned costs for federal awards were noted.



McPherson,
Breyfogle,
Daveline &
Goodrich, PC
Certified Public Accountants

740 Thatcher Building
Pueblo, CO 81003
Phone (719) 543-0516
Fax (719) 544-2849

INDEPENDENT AUDITORS' REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Members of the Legislative Audit Committee:

We have audited the financial statements of Colorado State Veterans Nursing Home at Fitzsimons (“the Nursing Home”), an enterprise fund of the State of Colorado as of and for the year ended June 30, 2004, and have issued our report thereon dated August 20, 2004. These financial statements are the responsibility of the Nursing Home’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In accordance with the terms of our engagement, we have not applied audit procedures necessary to satisfy ourselves about the classifications and amounts comprising the statement of net assets at June 30, 2003.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Colorado State Veterans Nursing Home at Fitzsimons’ financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

August 20, 2004

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2004**

<u>FEDERAL GRANTOR/PASS-THROUGH GRANTOR/PROGRAM TITLE</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity's Identifying Number</u>	<u>Federal Expenditures</u>
U.S. DEPARTMENT OF VETERANS AFFAIRS			
Direct assistance -			
Veterans State Nursing Home Care	64.015	-	\$ 1,995,424
Veterans Nursing Home Care	64.010	-	<u>38,636</u>
TOTAL U.S. DEPARTMENT OF VETERANS AFFAIRS			<u>2,034,060</u>
U.S. DEPARTMENT OF TREASURY			
Passed through the State of Colorado Governor's Office			
Tax Relief Governors Discretionary Fund	21.999	-	<u>\$ 753,682</u>
TOTAL FEDERAL EXPENDITURES			<u><u>\$ 2,787,742</u></u>

**COLORADO STATE VETERANS NURSING HOME AT FITZSIMONS
NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2004**

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Colorado State Veterans Nursing Home at Fitzsimons and is presented on the accrual basis of accounting wherein expenses are recognized when the liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organization*. Therefore, some amounts presented in this schedule may differ from amounts presented in or used in the preparation of the financial statements.



McPherson,
Breyfogle,
Daveline &
Goodrich, PC
Certified Public Accountants

740 Thatcher Building
Pueblo, CO 81003
Phone (719) 543-0516
Fax (719) 544-2849

**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Members of the Legislative Audit Committee:

We have audited the financial statements of Colorado State Veterans Nursing Home at Fitzsimons as of and for the year ended June 30, 2004, and have issued our report thereon dated August 20, 2004. Our report was qualified for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves about amounts comprising the statement of net assets at June 30, 2003. Except as described in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

In accordance with the terms of our engagement, we did not apply audit procedures necessary to satisfy ourselves about the classifications and amounts comprising the statement of net assets at June 30, 2003.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Colorado State Veterans Nursing Home at Fitzsimons' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Colorado State Veterans Nursing Home at Fitzsimons' 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to the members of the legislative audit committee and management of the State Veterans Nursing Home at Fitzsimons that are included in the findings and recommendations section and titled "Exhibit K preparation" and "accounting for capital assets, anticipation warrants, and accounts receivable".

This report is intended solely for the information and use of the Legislative Audit Committee, the Nursing Home's management, 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.

August 20, 2004



McPherson,
Breyfogle,
Daveline &
Goodrich, PC
Certified Public Accountants

740 Thatcher Building
Pueblo, CO 81003
Phone (719) 543-0516
Fax (719) 544-2849

**INDEPENDENT AUDITORS' REPORT ON
COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH
OMB CIRCULAR A-133**

Members of the Legislative Audit Committee:

Compliance

We have audited the compliance of Colorado State Veterans Nursing Home at Fitzsimons with the types of compliance requirements described in *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal programs for the year ended June 30, 2004. Colorado State Veterans Nursing Home at Fitzsimons' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Colorado State Veterans Nursing Home at Fitzsimons' management. Our responsibility is to express an opinion on Colorado State Veterans Nursing Home at Fitzsimons' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Colorado State Veterans Nursing Home at Fitzsimons' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Colorado State Veterans Nursing Home at Fitzsimons' compliance with those requirements.

In our opinion, Colorado State Veterans Nursing Home at Fitzsimons complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended June 30, 2004.

Internal Control Over Compliance

The management of Colorado State Veterans Nursing Home at Fitzsimons is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Colorado State Veterans Nursing Home at Fitzsimons' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Legislative Audit Committee, the Nursing Home's management, federal awarding agencies, and pass-through entities and is not intended to be or should not be used by anyone other than these specified parties.

August 20, 2004



McPherson,
Breyfogle,
Daveline &
Goodrich, PC
Certified Public Accountants

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Pueblo, CO 81003
Phone (719) 543-0516
Fax (719) 544-2849

REQUIRED AUDITOR COMMUNICATION TO THE LEGISLATIVE AUDIT COMMITTEE

Members of the Legislative Audit Committee:

We have audited the financial statements of Colorado State Veterans Nursing Home at Fitzsimons (the "Nursing Home") as of and for the year ended June 30, 2004, and have issued our report thereon dated August 20, 2004. Professional standards require that we provide you with the following information related to our audit.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND *GOVERNMENT AUDITING STANDARDS*

Our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free from material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Nursing Home. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Nursing Home's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

SIGNIFICANT ACCOUNTING POLICIES

Management has the responsibility for selection and use of appropriate accounting policies. The significant accounting policies used by the Nursing Home are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during Fiscal Year 2004.

We noted no transactions entered into by the Nursing Home during the Fiscal Year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

ACCOUNTING ESTIMATES

Accounting estimates are an integral part of financial statement preparation by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. Management's use of estimates is disclosed in the notes to the financial statements. We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable taken in relation to the financial statements as a whole.

AUDIT ADJUSTMENTS

For the purposes of this letter, professional standards define an audit adjustment as a proposed correction to the financial statements that, in our judgment, may not have been detected except through audit procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Nursing Home's financial reporting process (that is, cause future financial statements to be materially misstated.)

We had three passed audit adjustments to the financial statements.

- The first passed adjustment was to post revenue received in the prior year for a donated vehicle and to record the associated depreciation expense. The adjustment would have increased contributed capital by \$46,231 and increased depreciation expense by \$6,935 with a corresponding net increase in capital assets of \$39,296.
- The second passed adjustment was to correct the posting of accrued interest received on the sale of anticipation warrants and record additional amortization of deferred issue costs. The adjustment would have increased deferred anticipation warrants issue costs by a net amount of \$24,131 with a corresponding decrease to interest expense.
- The third passed adjustment was to record accrued interest payable on the anticipation warrants. The adjustment would have charged one month's interest expense of \$20,234 with a corresponding increase to anticipation warrants interest payable.

We had three posted audit adjustments.

- The first adjustment was to reclassify patient revenue to federal revenue. This adjustment relates to patient fees paid from federal funds for a resident transferring to the Nursing Home from Ft. Lyons which is a closed Nursing Home and for VA per diem payments. The adjustment increased federal revenue from \$1,945,159 to \$2,034,060 with a corresponding decrease to patient revenue.
- The second adjustment was to reclassify revenue from gain on disposal of equipment to reimbursement of prior year expense. This adjustment relates to a vehicle purchased and expensed in the prior year but capitalized in the current year. The adjustment increased capital contributions by \$52,785 with a corresponding decrease to gain on disposal.
- The third adjustment was to reclassify amortization expense associated with deferred anticipation warrants issue costs that was expensed as purchased services – office moving. This adjustment increased interest expense by \$39,012 with a corresponding decrease to professional services.

The uncorrected misstatements pertaining to Fiscal Year 2004 was determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

Pursuant to professional standards, the auditors' responsibility for other information in documents containing the Nursing Home's audited financial statements does not extend beyond the financial information identified in the audit report, and the auditor is not required to perform procedures to corroborate such other information. However, in accordance with such standards, we are required to read the information in such documents and consider whether such information, or the manner of its presentation, is materially inconsistent with its presentation in the financial statements. Our responsibility also includes calling to management's attention any information which we believe is a material misstatement of fact. No such inconsistencies or misstatements came to our attention.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Nursing Home's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

ISSUES DISCUSSED PRIOR TO RETENTION OF INDEPENDENT AUDITORS

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Nursing Home's auditors. However, these discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our retention.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no significant difficulties in dealing with management in performing and completing our audit.

This information is intended solely for the information and use of the Legislative Audit Committee, the Nursing Home's management, and others within the Department of Human Services 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 upon release by the Legislative Audit Committee.

August 20, 2004

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