Office of the State Auditor

Colorado Department of Human Services
State and Veterans Nursing Homes

Performance Audit
October 2003

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This report includes the results of the performance audit, conducted by Clifton Gunderson LLP in accordance with a contract with the Office of the State Auditor, of the Colorado Department of Human Services' Division of State and Veterans Nursing Homes,. The audit was performed pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our findings, conclusions, and recommendations, and the responses of the Department of Human Services and the Department of Health Care Policy and Financing.

Denver, Colorado
October 2, 2003

Table of Contents

REPORT SUMMARY

State and Veterans Nursing Homes
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Authority, Purpose, and Scope

This audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the Office of the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The audit work, performed from April through July 2003, was conducted by Clifton Gunderson LLP in accordance with an agreement with the Office of the State Auditor.

To evaluate the financial stability of the six state and veterans nursing homes and their ability to be self-sustaining, we gathered information through interviews, data analysis, and document review. In addition, we conducted on-site visits of the Walsenburg and Fitzsimons homes.

We gratefully acknowledge the assistance and cooperation extended by management and staff at the Department of Human Services, the Department of Health Care Policy and Financing, and the homes.

Overview

The Division of State and Veterans Nursing Homes is located within the Department of Human Services. The Division's role is to oversee state-owned nursing homes, which provide skilled nursing and domiciliary care primarily to honorably discharged veterans and their spouses, widows, and, in some instances, parents of deceased veterans. The Division currently oversees six facilities that provide skilled nursing care (Fitzsimons, Florence, Homelake, Rifle, Trinidad, and Walsenburg) and one domiciliary or assisted living unit (at Homelake). Five of these facilities (excluding Trinidad) currently participate in the U.S. Department of Veterans Affairs (VA) state home program to provide skilled nursing care to eligible veterans. In Fiscal Year 2003, the six homes reported operating revenue of $28 million.

Key Findings

Financial Condition of the State and Veterans Nursing Homes

One of the Division's primary goals is to establish the financial independence and self-sufficiency of the state and veterans homes. We reviewed the homes' financial data and found the following:

? **Processes to ensure that service rates for each home are set at a full cost-recovery level are lacking.** We found that rates for private pay patients have not been set at a high enough level to ensure full cost recovery. In Fiscal Year 2000, two of the homes (Rifle and Florence) had established semi-private rates that exceeded their costs, while the other homes (Homelake,

Trinidad, and Walsenburg) were not recovering their costs. By Fiscal Year 2002, all five homes had semi-private rates that were established at levels below their cost per day (the sixth home, Fitzsimons, did not begin operations until Fiscal Year 2003). Thus, even if the homes had full occupancy, they would be unable to break even. We believe that the Department should develop and implement a formal, documented, long-term business plan for improving the financial condition of the nursing homes.

? **Original financial projections for the State Veterans Nursing Home at Fitzsimons have not been revised on the basis of actual performance.** The Fitzsimons Home opened in October 2002. Although the Division projected 15,494 patient days for the first eight months of the Home's operation, the Home actually realized 13,311 patient days during this period, which was 14 percent lower than anticipated. However, the Division did not revise the original financial projections for the facility on the basis of actual performance, including determining a break-even point on operations. The lack of accurate, timely, and complete financial management information makes it difficult to assess the facility's ability to reach break-even status and to continue principal and interest payments on anticipation warrants that began June 1, 2003.

? **A long-term strategy for the financial stability of the State Veterans Nursing Home at Walsenburg has not been developed.** Prior audits conducted by the Office of the State Auditor have discussed problems with the Walsenburg Home's financial condition and State oversight. We found that the Walsenburg Home lost money again in Fiscal Year 2002 and, as of June 30, 2003, was continuing to operate at a deficit. It is imperative that the Department address the financial viability of the Home and determine what additional steps must be taken to increase net income to a level above costs.

Operational Issues

Our review of other areas of the homes operations including federal funding sources and cost allocations resulted in the following:

? **The Division's recent policy change regarding Medicaid billings and VA per diem reimbursements may not be in compliance with federal regulations.** Effective December 1, 2001, the Division's policy instructed the state veterans homes to bill for the full amount allowable for Medicaid patients regardless of whether the Department received a VA reimbursement on behalf of the patient. Court cases in other states indicate that the Division's policy change may not be consistent with federal law and regulations. Federal law requires that Medicaid be the payor of last resort, and that all third party payments (e.g. insurance, private pay, etc.) offset the amount billed to Medicaid. We estimate that potential Medicaid overpayments, or questioned costs, could total approximately $4.1 million for Fiscal Years 2002 and 2003 ($2.05 million each in state general funds and federal funds). Further, as a result of this change it appears that in some cases, the homes may have received more than their published daily semi-private room rate for veterans who are also Medicaid-eligible. We believe the Department should work with the federal Centers for Medicare and Medicaid Services to determine if its current Medicaid billing policy in relation to VA per diem payments is appropriate and allowable.

- **The Division has no process in place to periodically review bases used for the allocation of Division costs to the homes or the allocation of indirect costs from the Spanish Peaks Regional Health Center to the State Veterans Nursing Home at Walsenburg.** Total Division costs allocated to the facilities increased significantly from about $167,000 in Fiscal Year 1998 to $412,000 in Fiscal Year 2002, or about 147 percent. The Division should analyze these costs and determine if they can be reduced. In addition, in Fiscal Year 2003, the Division changed its basis for allocating non-departmental costs to the homes other than Fitzsimons from actual patient days to projected patient days. We are concerned that the Division's use of forecasted patient days as opposed to actual patient days could result in unwarranted discrepancies of allocated costs among the homes. Finally, in Fiscal Year 2002 approximately $1.7 million of the Walsenburg Home's total expenses of $5.5 million were based upon allocations from the Spanish Peaks Regional Health Center. Because the cost allocations account for a significant portion of the Walsenburg Home's operating costs, it is important for the Home and the Department to institute a periodic review of the allocation of Health Center costs to the Home.

Our recommendations and the Department's responses can be found in the Recommendation Locator on pages 5 through 7 of this report.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	20	Establish a formal, documented plan for the long-term operational stability of the state and veterans nursing homes.	Department of Human Services	Agree	May 2004
2	25	Ensure the State Veterans Nursing Home at Fitzsimons achieves self-sufficiency as soon as possible by performing monthly comparisons of actual to projected performance and using the review to identify significant variances in revenues and expenses.	Department of Human Services	Agree	October 2003
3	25	Work with the Department of the Treasury when issuing revenue-related debt for future projects to ensure bids received, costs incurred, and repayment terms are appropriate and reasonable.	Department of Human Services	Agree	October 2003
4	28	Work with the Huerfano County Hospital District to prepare a formal, documented long-term plan to address future operations at the State and Veterans Nursing Home at Walsenburg to ensure the financial stability of the Home.	Department of Human Services	Agree	July 2004
5	31	Work with each facility's administrator to establish specific marketing and outreach goals and objectives.	Department of Human Services	Agree	December 2003

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
6	35	Work with the federal Centers for Medicare and Medicaid Services to determine if the current Medicaid billing policy in relation to VA per diem payments is appropriate and allowable.	Department of Human Services	Agree	June 2004
7	36	Review and revise the budgets for the five VA-certified state homes to reflect the reduction in Medicaid revenues and to anticipate the funding necessary to repay Medicaid overpayments if the current Medicaid billing policy in relation to VA per diem payments is determined inappropriate by the federal Medicaid agency.	Department of Human Services	Agree	Upon implementation of Recommendation 6
8	36	Implement a formal procedure for consulting with and receiving approval from the Department of Health Care Policy and Financing for policy changes that affect billings to the Medicaid program.	Department of Human Services	Agree	December 2003
			Department of Health Care Policy and Financing	Agree	December 2003
9	37	Review the effect of the current VA per diem policy on Medicaid residents and non-Medicaid, private-pay residents and ensure that any inconsistencies caused by policy changes are eliminated.	Department of Human Services	Agree	Upon implementation of Recommendation 6

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
10	38	Address gaps in current nursing facility audit practices by developing analytical tools and procedures to identify significant changes in reimbursements received by providers and investigate these instances as appropriate.	Department of Health Care Policy and Financing	Agree	March 2004
11	39	Perform an assessment of the costs and benefits of Medicare certification to the state and veterans nursing homes and establish and implement a plan for obtaining certification as deemed beneficial.	Department of Human Services	Agree	May 2004
12	42	Ensure costs allocated to the nursing homes are appropriate by performing an analysis of Division costs to identify areas where costs can be reduced, reviewing the methodology for allocating Division-level costs to the homes, completing periodic studies to determine the actual time spent on individual facilities, and reviewing the basis for adjusting cost allocations to the Walsenburg and Fitzsimons homes and the Homelake domiciliary to determine accuracy.	Department of Human Services	Agree	December 2003
13	46	Improve oversight of State Veterans Nursing Home at Walsenburg operations by: (a) periodically reviewing allocated costs; (b) ensuring that Walsenburg staff submit a corrected December 31, 2002, Medicaid cost report; (c) developing a usable format for quarterly reporting; and (d) implementing procedures at the Home and Department levels for the review and approval of contractual arrangements under which costs are allocated to the nursing facility.	Department of Human Services	Agree	a. December 2003 b. October 2003 c. January 2004 d. January 2004

Overview of State and Veterans Nursing Homes in Colorado

The Division of State and Veterans Nursing Homes (Division) in the Department of Human Services was established in the mid-1980's. The Division's role, as outlined in Section 26-12-101, et. seq., C.R.S., is to oversee state-owned nursing homes, which provide skilled nursing and domiciliary care primarily to honorably discharged veterans and their spouses, widows, and, in some instances, parents of deceased veterans. The Division currently oversees six facilities that provide skilled nursing care and one domiciliary or assisted living unit. These facilities are located at the Fitzsimons site in Denver and in Florence, Homelake (nursing home and domiciliary), Rifle, Trinidad, and Walsenburg. Five of these facilities – Fitzsimons, Florence, Homelake, Rifle, and Walsenburg – currently participate in the U.S. Department of Veterans Affairs (VA) state home program to provide skilled nursing care to eligible veterans. In the case of the Trinidad Home, the Division has not sought VA certification and the home has always been open to all qualifying residents of Colorado. Under statutes, the Division is responsible for overseeing all six facilities. Five of the homes are operated directly by the Division; the Walsenburg Home is operated by the Huerfano County Hospital District under contract with the Department of Human Services. In Fiscal Year 2003, the homes reported operating revenue of $28 million.

The Homes

The six homes overseen by the Division encompass a total of 738 skilled nursing beds and 46 domiciliary beds:

State Veterans Nursing Home at Fitzsimons: 180-bed nursing home facility in the eastern metropolitan Denver area certified by the U.S. Department of Veterans Affairs. Construction on the home was completed in August 2002, and the first resident was admitted on October 21, 2002. It is the only home that currently is Medicare-certified.

State Veterans Nursing Home at Florence: 120-bed skilled facility certified by the U.S. Department of Veterans Affairs. The Florence Home was built in 1976 and is located along the Front Range near Pueblo.

State Veterans Center at Homelake: Includes a 60-bed skilled nursing facility constructed in 1990 and certified by the U.S. Department of Veterans Affairs, as well as a 46-bed domiciliary or assisted living program. The domiciliary at Homelake is the only facility that regularly receives state general funds. The Home is located near Monte Vista in Colorado's San Luis Valley. Several of the Home's original buildings were constructed in the 1890's when a group of local citizens, together with the General Assembly, established Homelake as a place for Colorado's Civil War veterans.

State Veterans Home at Rifle: 100-bed skilled facility certified by the U.S. Department of Veterans Affairs. The facility, which opened in 1987, is located on Colorado's Western Slope in the Colorado River Valley.

Trinidad State Nursing Home: 158-bed skilled nursing facility open to all eligible Colorado residents. The facility, which opened in 1957, is located in Trinidad, Colorado.

State Veterans Nursing Home at Walsenburg: 120-bed skilled nursing facility certified by the U.S. Department of Veterans Affairs. The facility opened in 1993 and, as noted earlier, is operated for the Division on an intergovernmental contractual basis by the Huerfano County Hospital District. The nursing facility is located in the same building as Spanish Peaks Regional Health Center in Walsenburg, Colorado.

All six homes are Medicaid-certified and licensed by the Colorado Department of Public Health and Environment.

Nursing Home Billing Rates

The six state and veterans nursing homes recoup their costs through payments received from four primary sources. These sources are Medicaid, Veterans Administration per diem payments received on behalf of eligible veterans, individual patient payments or "self pay" amounts, and various pension payments. The homes have two basic billing rate structures that are used to charge patients: (1) the rates set by the homes for private pay residents, which are based on either semi-private or private/special care rooms, if available at the facility, and (2) the rates for Medicaid-eligible patients. Semi-private rates represent the cost for a private-pay resident in a semi-private room (two residents per room). Some facilities, as shown in the following table, have separate rates for private rooms with 24-hour nursing care. Medicaid patients accounted for approximately 54 percent of the homes' residents during Fiscal Years 2000 through 2002. A summary of the homes' daily rates for Fiscal Year 2003 is included in Table 1.

Table 1. State and Veterans Nursing Homes
Summary of Daily Patient Rates
Fiscal Year 2003

	Semi-Private Rate[1]	Private/ Special Care Rate[1]	Medicaid Reimbursement Rate[2]
Fitzsimons	$219.00	N/A	$130.98
Florence	$162.00	N/A	$132.91
Homelake	$146.00	$150.00	$135.46
Rifle	$175.00	$187.00	$158.50
Trinidad	$142.00	N/A	$140.51
Walsenburg	$151.20	$156.60	$132.18

Source: Rate notification letters provided by state and veterans nursing home admissions staff and/or facility administrators; Medicaid payment rate notification letters.

Notes:
[1]Rates are for semi-private or private rooms with 24-hour nursing care. The rate for the Trinidad facility (the non-VA-certified facility) includes only room and board; all ancillary costs are billed separately. For the other homes (VA-certified facilities), rates include medications, oxygen, in-house physician visits, laboratory services, and some diagnostic services.
[2]Medicaid reimbursement rates in Colorado are set by the Department of Health Care Policy and Financing, the state agency responsible for administering the Medicaid program. Rates are based on historical cost figures and program policies and regulations and can vary during the year. Rates shown for Fiscal Year 2003 above represent those in place for the state and veterans nursing homes from September 2002 through March 2003.

Status of the Homes Under TABOR

In general, the homes' operations are funded through patient revenues, third-party payments, and Medicaid, as opposed to state general funds. In most years the state nursing homes qualify under Colorado law as an enterprise for purposes of Article X, Section 20 of the State Constitution (TABOR). An enterprise is defined as a government-owned business having the power to issue revenue bonds in its own name and deriving less than 10 percent of its annual revenue in the form of grants and subsidies from the State or other Colorado governments. TABOR imposes substantial restrictions on the taxation, revenue generation, borrowing, and spending authority of state and local governments in Colorado. As an enterprise, the homes are exempt from the revenue growth limitations under TABOR. Section 26-12-110, C.R.S., provides that any state nursing home or group of homes shall constitute an enterprise under TABOR as long as the conditions defining an enterprise are met. For TABOR purposes, the five homes directly operated by the Division have been treated as one enterprise, and the Walsenburg home has been treated as part of the Huerfano County Hospital District enterprise.

In Fiscal Year 2003 the construction of the Fitzsimons home was funded by a combination of approximately $15.5 million in federal funds (62 percent) and $9.4 million in state general funds (38 percent). As a result, the group of Division-operated homes exceeded the 10 percent limitation on state- and/or local-funding subsidies, thereby disqualifying the group as a TABOR

enterprise. Consequently, these five homes will be reported as part of the state district for TABOR in Fiscal Year 2003. This means that the homes' Fiscal Year 2003 revenue will count toward the State's overall TABOR revenue, which is subject to the growth limitations established under state law. With the construction of Fitzsimons now completed, the five homes are expected to qualify as an enterprise under TABOR for Fiscal Year 2004.

Audit Purpose and Scope

The purpose of this audit was to review the financial condition of the state and veterans nursing homes and their ability to operate self-sufficiently. We interviewed staff at both the Division and nursing homes and reviewed and analyzed documentation regarding the financial solvency and self-sufficiency of each of the six homes, including information on funding mechanisms and staffing patterns, daily patient rates, census trends, and cost allocation methodologies. We conducted onsite visits at the Walsenburg and Fitzsimons homes.

Financial Condition of the State and Veterans Nursing Homes

Chapter 1

Facility Financial Performance

As stated in its annual report, one of the Division's primary goals is to establish the financial independence and self-sufficiency of the state and veterans homes. Historically, the homes have not typically received general funds to support ongoing operations. Therefore, it is important that the homes be operated in a manner that enables them to generate enough revenue from patients, pension payments, and other sources such as Medicaid and other federal programs, to cover their costs. As mentioned previously, the domiciliary at Homelake is the only part of the program that has received general fund appropriations on an annual basis. For Fiscal Year 2004, the domiciliary received general fund appropriations of approximately $194,000. Periodically the General Assembly has appropriated general funds to help address major maintenance or construction projects, such as the recent construction of the Fitzsimons facility in Denver.

Overall, our audit found that the Division lacks sufficient controls and procedures to ensure that the homes are operated in a self-sufficient and cost-effective manner. Our review of the homes' financial data indicates the homes are not able to operate self-sufficiently on a consistent basis. For the five homes in operation prior to Fiscal Year 2003, four homes had a net operating loss in Fiscal Year 2001 and three homes had a net operating loss in Fiscal Year 2002 (the Fitzsimons Home was opened in Fiscal Year 2003). For Fiscal Year 2003, three of the six homes had operating losses. Net operating results for the homes for Fiscal Years 2000 through 2003 are shown in Table 2. In total, over the four-year period, the homes experienced net operating losses of about $6.6 million; Fitzsimons contributed $5.4 million to the loss. During this period it appears that Homelake generally subsidized the other homes. As noted above, the Homelake domiciliary has received general fund appropriations on an annual basis; for Fiscal Year 2003, general funds provided to the domiciliary represent about $194,000 of Homelake's $321,000 net income, or 60%.

Table 2. State and Veterans Nursing Homes
Net Operating Results
Fiscal Years 2000 through 2003
(Brackets indicate a net loss for the year)

Facility	2000	2001	2002	2003[1]	Total
Florence	$119,686	($147,431)	($287,813)	($10,269)	($325,827)
Homelake	$334,227	($52,722)	$249,260	$321,119	$851,884
Rifle	($5,150)	($406,861)	$63,574	$56,624	($291,813)
Trinidad	($73,492)	$120,548	($287,027)	($63,657)	($303,628)
Fitzsimons[2]	N/A	N/A	N/A	($5,441,738)	($5,441,738)
Subtotal	$375,271	($486,466)	($262,006)	($5,137,921)	($5,511,122)
Walsenburg[3]	($488,051)	($273,363)	($37,047)	($310,816)	($1,109,277)
Total	($112,780)	($759,829)	($299,053)	($5,448,737)	($6,620,399)

Source: Colorado Financial Reporting System (COFRS).
Notes:
[1]Financial information presented for 2003 for all homes is unaudited through 6/30/03.
[2]Construction of the Fitzsimons Home was completed in August 2002 and the Home opened during Fiscal Year 2003 on October 21, 2002.
[3]Walsenburg is shown separately in the lower section of the table because the Huerfano County Hospital District is responsible for covering operational shortages at this facility and also has the rights to any excess revenues. Walsenburg has a December 31 fiscal year end, unlike the other five homes which have a June 30 fiscal year end. Thus, information shown above for Walsenburg for 2000 through 2002 is for the periods ending 12/31/00 through 12/31/02; Fiscal Year 2003 information is for the first six months of the Home's fiscal year (1/1/03 through 6/30/03).

We identified several weaknesses in the Division's oversight of home operations that appear to have contributed to the homes' operating losses and lack of financial stability. First, we found that the Division lacks processes to ensure that patient rates for each home are set at a full cost-recovery level. As a result, some of the homes will be unable to break even under the best scenario. Second, the Division lacks adequate systems and controls to ensure that budgets are monitored and compared with actual financial performance. Thus, the Division cannot adequately plan for revenue shortages and implement appropriate cost-cutting measures. We also noted problems with the homes' ability to maintain adequate occupancy, or census, rates. These issues are discussed in more detail in this report.

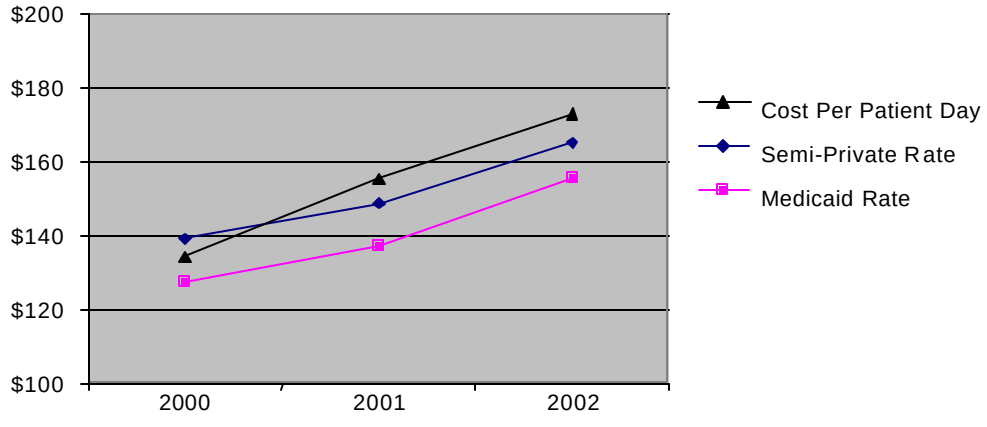
Nursing Home Rate-Setting

We reviewed the homes' policies and procedures for setting daily patient, or service, rates. With the exception of Walsenburg, each facility sets its own daily private pay rate based upon its budget, subject to negotiation with and approval by the Division's Director. Walsenburg sets its private pay rate independently of Division guidance or oversight. Final determination of the private pay rate at Walsenburg is subject to the approval of the Huerfano County Hospital District Board. The daily Medicaid rates, or rates used by the state agency that administers the Medicaid program to reimburse a facility for serving Medicaid-eligible residents, are based on

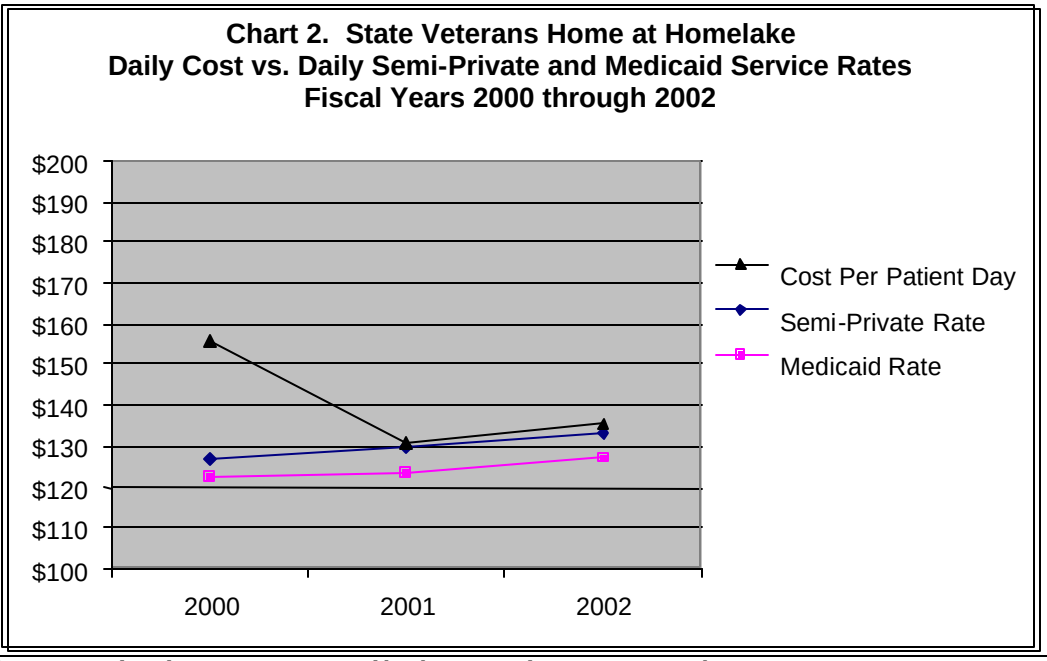
historical cost figures and program policies and regulations. In Colorado, Medicaid rates are established by the Department of Health Care Policy and Financing upon review of each facility's cost data.

Our review indicates that rates for private pay patients have not been set at a high enough level to ensure full cost recovery. We reviewed financial information for Fiscal Years 2000 through 2002 on all of the homes except Fitzsimons (which did not open until Fiscal Year 2003) to determine if private pay rates were sufficient to cover the actual operating costs of the homes on a per patient basis. Per patient day cost is calculated by dividing total costs by the number of patient days. We reviewed data through Fiscal Year 2002 as it was the most recent year for which the applicable data were available. As shown in the five charts that follow, in Fiscal Year 2000, only two of the homes (Rifle and Florence) had established semi-private rates that exceeded their costs, meaning that these homes at least had the opportunity to break even or make a profit, if their occupancy rates were high enough. By Fiscal Year 2002, all five homes had semi-private rates that were established at levels below their cost per day. In other words, even if the homes had full occupancy, they would be unable to break even. In terms of Medicaid rates, in Fiscal Years 2000 through 2002, Medicaid reimbursement rates received by four of the five homes were less than the homes' daily costs for all three years. For Trinidad, the daily cost equaled the Medicaid reimbursement rate in Fiscal Year 2001, but daily costs exceeded the Medicaid reimbursement rate in Fiscal Years 2000 and 2002.

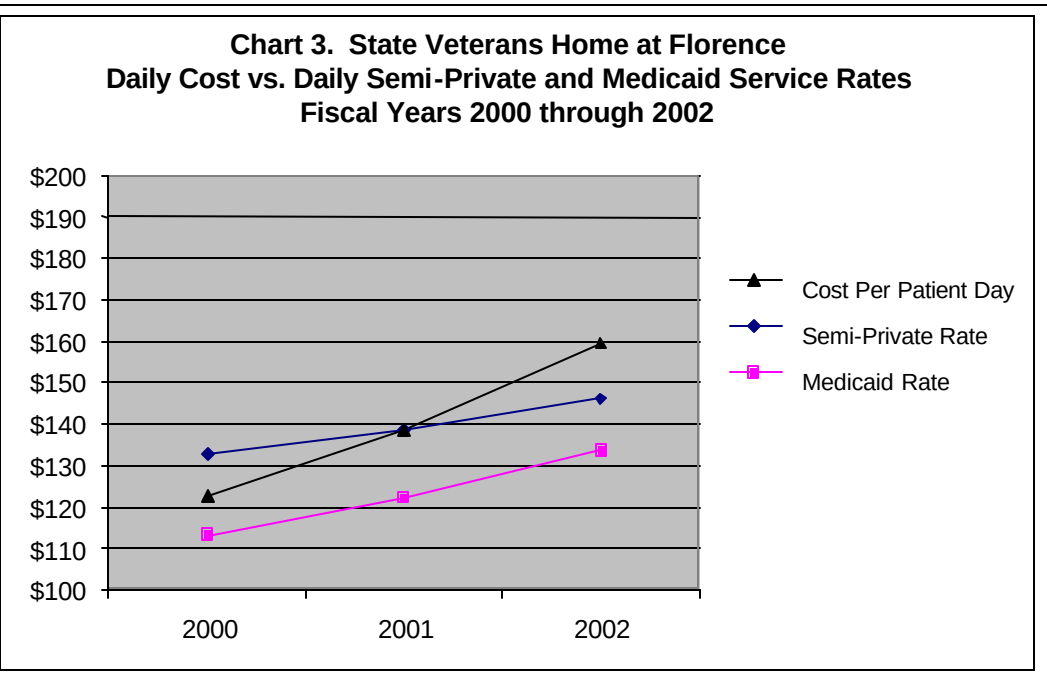
Chart 1. State Veterans Home at Rifle
Daily Cost vs. Daily Semi-Private and Medicaid Service Rates
Fiscal Years 2000 through 2002



Source: Medicaid cost reports prepared by the state and veterans nursing homes.

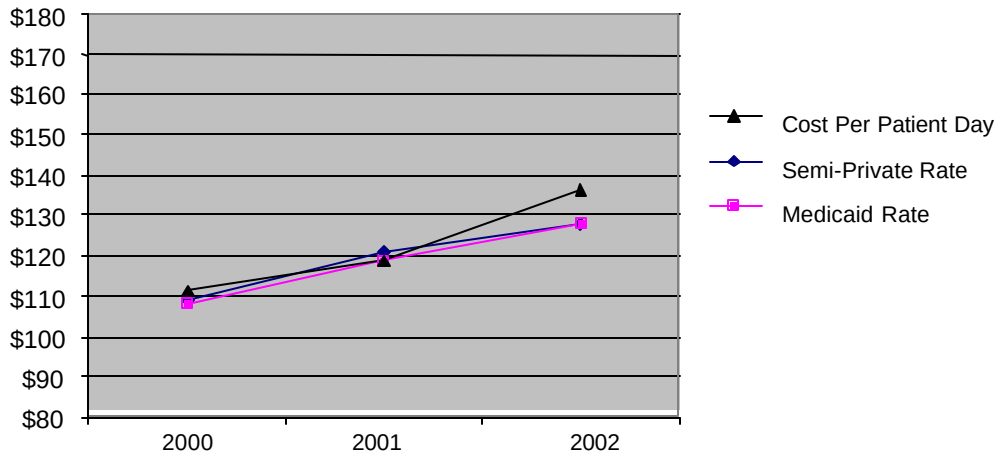


Source: Medicaid cost reports prepared by the state and veterans nursing homes.



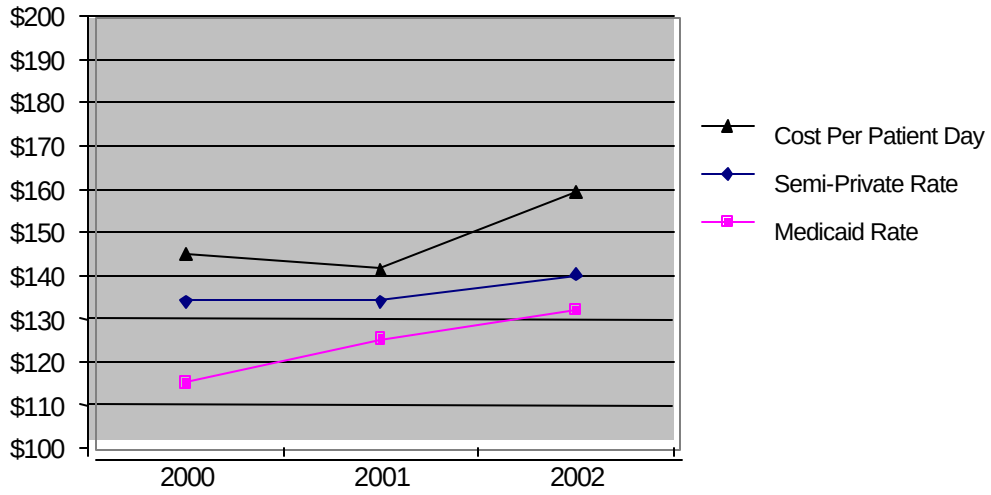
Source: Medicaid cost reports prepared by the state and veterans nursing homes.

Chart 4. State Nursing Home at Trinidad
Daily Cost vs. Daily Semi-Private and Medicaid Service Rates
Fiscal Years 2000 through 2002



Source: Medicaid cost reports prepared by the state and veterans nursing homes

Chart 5. State Veterans Home at Walsenburg
Daily Cost vs. Daily Semi-Private and Medicaid Service Rates
Fiscal Years 2000 through 2002



Source: Medicaid cost reports prepared by the state and veterans nursing homes.

In total for the five homes, costs per patient day exceeded semi-private room rates per patient day for Fiscal Years 2000 through 2002 by about $28, $10, and $52, respectively. Likewise, total costs per patient day for the five homes exceeded Medicaid rates per patient day for the same time period by approximately $74, $43, and $89, respectively.

We also compared actual revenue received from all funding sources and cost on a per patient day basis for the five homes during Fiscal Years 2000 through 2002. Although revenue per patient day increased from year to year between Fiscal Year 2000 and Fiscal Year 2002 for all homes with the exception of Homelake, the corresponding increase in cost per patient day eclipsed the revenue increase for all homes except Rifle and Walsenburg. The significant increase in revenue for Fiscal Year 2002 is primarily related to a change in the Division's policy related to the treatment of VA per diems which is discussed in Chapter 2. If not for this policy change, the increase in cost over revenue per patient day would have been even greater. A comparison of cost per patient day to revenue per patient day for each of the five homes is shown in Table 3. Overall, while revenues exceeded costs on a per patient day basis by almost $11 in Fiscal Year 2000, in Fiscal Years 2001 and 2002 costs exceeded revenues on a per patient day basis by about $18 and $2, respectively.

Table 3. State and Veterans Nursing Homes
Comparison of Increase in Revenue Per Patient Day to
Increase in Cost Per Patient Day
Fiscal Year 2000 through 2002

	2000			2001			2002		
	Per Patient Day			Per Patient Day			Per Patient Day		
	Revenue[1]	Cost	Difference	Revenue[1]	Cost	Difference	Revenue[1]	Cost	Difference
Florence	$126.52	$122.51	$4.01	$134.84	$138.91	($4.07)	$151.53	$159.44	($7.91)
Homelake	$178.13	$155.89	$22.24	$130.99	$128.91	$2.08	$122.00	$135.64	($13.64)
Rifle	$134.05	$134.19	($0.14)	$143.59	$155.26	($11.67)	$174.46	$172.99	$1.47
Trinidad	$109.96	$111.48	($1.52)	$121.15	$118.70	$2.45	$130.04	$136.24	($6.20)
Walsenburg	$131.36	$145.07	($13.71)	$134.27	$141.27	($7.00)	$183.36	$159.45	$23.91
TOTALS	**$680.02**	**$669.14**	**$10.88**	**$664.84**	**$683.05**	**($18.21)**	**$761.39**	**$763.76**	**($2.37)**

Source: Colorado Financial Reporting System (COFRS) and Medicaid cost reports filed by each state and veterans nursing home.
Note:
[1]Amounts represent actual revenue received from all funding sources.

The Division does not have a formal rate review process to ensure that the facilities are setting rates at full cost-recovery and competitive levels. Rate-setting requires thorough analyses because of its significant impact on the bottom line. For example, setting private pay rates below the actual cost of operations results in an ongoing operating deficit and poor financial performance. However, setting private pay rates at a level that is not competitive with market rates may result in low or declining census and, ultimately, poor financial performance.

Additionally, we reviewed the timeliness of the homes' collection of outstanding accounts receivable. Over the period from Fiscal Year 2000 through Fiscal Year 2002, we found that the homes' timeliness in collecting accounts receivable improved significantly. For example, we noted that total accounts receivable for the five homes (excluding Fitzsimons) decreased from 3 percent of patient revenues in 2000 to 1.1 percent in 2002. This indicates that the homes were collecting their receivables relatively quickly in relation to the revenue being generated.

The Division indicated that efforts were made over the past two to three years to analyze facility accounts receivable balances, to identify collection problems, and to improve facility collections wherever possible. The reduction in accounts receivable as a percentage of patient revenues from Fiscal Years 2000 to 2002 is attributable to the Division's efforts. We commend the Department for its attention to and improvements in this area.

Budget Review and Financial Accountability

Our findings also indicate the need to improve Division oversight related to the homes' budgeting processes. For the fiscal years we reviewed, budgets were set at the beginning of the year and were not reviewed to adjust for each facility's actual census and other operating data. Expense budgets were not considered to be "census sensitive" and were not revised if an actual census was below targeted figures. In addition, budgets were not established or reviewed on a per patient day basis. The Division reports that it plans to implement a revised budgeting and monitoring process beginning in Fiscal Year 2004.

We also found that the homes' administrators have not been held accountable for financial performance of the homes they oversee or adequately educated on the importance of operating in a cost-effective manner. For fiscal years prior to Fiscal Year 2003, facility administrators were not given measurable budget goals for which they were responsible. For Fiscal Year 2003, the Division instituted measurable budget goals for the facilities; however, the same goals were established for all facilities, without consideration to each individual facility's circumstances. For example, all facilities were given a budget goal of 91 percent occupancy and a financial performance goal of net income after cash and non-cash expense equal to at least 1 percent of net revenue, regardless of the facility's past census and financial performance history. Further, the overall financial operation of the nursing homes has not been included within the performance evaluation process for the Director of the Division of State and Veterans Nursing Homes.

The Department is currently transitioning all state and veterans nursing homes to new financial and clinical software, the Achieve Healthcare Pathlinks Information (Achieve) System. The Department cites several technological reasons for the switch to the Achieve System and the need to implement patient privacy and technology requirements promulgated by the federal Health Insurance Portability and Accountability Act of 1996 (HIPAA). The Achieve System is reportedly fully compliant with all HIPAA requirements. The Department indicates that financial recordkeeping and tracking will be greatly improved through the implementation of the Achieve System. However, the increased capabilities of the new system will not result in improved management of the homes unless the Division and homes change the manner in which business is conducted. In conjunction with the implementation of the Achieve System, the Department should improve its current budgeting process for the homes and educate facility

administrators and staff on the importance of operating in a cost-effective manner. This will enable the Department to more closely monitor nursing home performance.

The Department should also develop and implement a formal, documented, long-term business plan for improving the operational stability of the nursing homes. This should include conducting a market analysis to determine if state home rates are competitive with area homes and whether rate increases are feasible, and identifying areas where costs can be reduced or eliminated. For the state veterans homes (excludes Trinidad), rate comparisons should include consideration of the daily per diem reimbursement paid by the federal Veterans Administration for veteran residents. The Department should also establish a more effective review process over rates set each year by the five homes operated by the Division. For the Walsenburg Home, the Department should work with the Huerfano County Hospital District Board to ensure rates are appropriate and meet or exceed operational costs.

Recommendation No. 1:

The Department of Human Services should establish a formal, documented plan for the long-term operational stability of the state and veterans nursing homes. This should include, but not be limited to:

a. Performing a market analysis to determine if the state homes' rates are competitive and whether rate increases are feasible, necessary, and appropriate.
b. Implementing a process for reviewing private and semi-private room rates and special care rates set annually by each facility and the Huerfano County Hospital District Board to ensure the rates are set at a full cost-recovery level.
c. Evaluating expenditures at each of the six homes to identify possible cost reductions.
d. Reviewing each facility's budget-to-actual information periodically during the fiscal year and comparing costs between years to identify outliers and problem areas and address concerns identified.
e. Educating facility administrators on the importance of operating in a cost-effective manner.
f. Implementing measurable budget goals into the evaluation process for nursing home administrators specific to their facility and for the Director of the Division of State and Veterans Nursing Homes.

Department of Human Services Response:

Agree. Implementation date: May 2004

a. The Division will perform a market analysis.
b. The Division will establish a plan to review rates annually and ascertain that rates are set at a full-cost recovery level.
c. The Division will evaluate expenditures at all nursing homes using Achieve Pathlinks financial information reports generated from COFRs data. In addition, each facility

administrator will have an individual performance objective included in their performance plans addressing maximizing revenues and monitoring/evaluating expenditures on a regular schedule.

d. The Division is in the process of creating a consolidated template whose purpose is to compare each facility's budget-to-actual data and monitor monthly expenditures for reasonableness. Historical expenditures will be compared annually to determine adequacy and effectiveness of facility budgets. The Division will meet with the facility administrators and business managers monthly to identify and address areas of concern.
e. The Division meets monthly with the administrators and business office managers at each facility. Each meeting will include a training session focused on the importance of managing operations in a cost-effective manner. In addition, each facility administrator will have an individual performance objective included in their performance plan addressing efficient/cost-effective business and operations management.
f. Measurable budget goals will be included as part of the performance evaluation for each nursing home administrator as it pertains to their corresponding facility. Consequently, the Division Director and Business Manager will be evaluated similarly on a Division scale.

State Veterans Nursing Home at Fitzsimons

Section 26-12-201.5, C.R.S., authorized the establishment and construction of a state veterans nursing home on the site of the former Fitzsimons Army Medical Center in Aurora, Colorado. The Fitzsimons Home accepted its first resident on October 21, 2002. The U.S. Department of Veterans Affairs (VA) provided funding for about $15.5 million of the Home's total $24.9 million construction costs, or about 62 percent. State general fund appropriations for the Home totaled $9.4 million, or 38 percent. The VA provides grant funding for up to 65 percent of the construction costs for a state veterans nursing home. In this case, the VA provided 62 percent of the funding because the Home's construction costs totaled about $1 million more than originally estimated when the Department applied for the grant. Pursuant to VA guidelines, construction funding is subject to certain operating requirements. Among these requirements are: (1) a minimum of 75 percent of the facility's residents must be veterans and the remaining 25 percent of the facility population must include spouses of veterans or "Gold Star" parents (i.e., parents with children who died while serving in the U.S. Armed Forces); (2) the facility must operate as a veterans home for a minimum of 20 years; and (3) the facility must maintain VA certification. A VA-certified facility must allow VA to regularly review and audit, or survey, all facility records that have a bearing on compliance with VA requirements and, upon request, must submit documentation related to the VA per diem payments. If any of these requirements are not met, the State will be required to repay the VA construction funding.

The Fitzsimons Home includes a licensed bed capacity of 180 beds arranged in four nursing units that include two 42-bed units and two 48-bed units. One 42-bed unit is a secured area dedicated to residents with Alzheimer's and related dementias. The facility includes space

available for use as an Adult Day Health Program (ADHP). This ADHP is physically separate from the nursing facility. The total area of the facility, including ADHP, is approximately 123,000 square feet, representing 680 square feet per licensed bed. The average square feet per licensed bed for other state and veterans nursing homes in Colorado ranges from 330 at Florence to approximately 500 at Walsenburg. Services offered by the facility include 24-hour skilled nursing; onsite physician visits; physical, speech, and occupational therapy; and social services, in addition to several other amenities, including a barbershop, gardens, and a library.

For Fiscal Year 2003, Fitzsimons reported $3.4 million in revenue and $8.8 million in expenses, for a net operating loss of about $5.4 million. Patient days provided for June 2003 indicate an average census of 104 residents for the month compared to the home's capacity of 180 residents, or 58 percent of capacity.

Anticipation Warrants

Pursuant to Section 26-12-113, C.R.S., the Department issued anticipation warrants (bonds) in the amount of $6,045,000 on November 1, 2002, for the Fitzsimons Home. The proceeds of the sale of these warrants were to fund: (1) Fitzsimons start-up expenditures, (2) the Debt Service Reserve Fund as security for the payment of principal and interest, (3) certain amounts for working capital, and (4) the cost of bond issuance. The repayment sources of the warrants are the pledged revenues of all the homes.

Actual sources and uses of funds as presented in closing documents for the anticipation warrant issuance are as follows:

Sources	
Principal Amount of Series 2002 Warrants	$ 6,045,000
Accrued Interest	26,812
Total Sources	$ 6,071,812
Uses	
Project Fund	$ 4,803,824
Debt Service Reserve Fund	562,913
Original Issue Discount	69,811
Cost of Issuance	608,452
Estimated Accrued Interest	26,812
Total Uses	$ 6,071,812

Through May 2003, Division representatives indicated that cumulative draws on the anticipation warrants were approximately $3.3 million. An initial draw of $1 million included reimbursement for capital construction and start-up costs incurred prior to the facility's opening date on October 21, 2002. The remaining draws of $2.3 million include $1.3 million for operations, predominantly for personal service expenses (salaries and benefits), and $1 million drawn in May 2003 for use beginning in July 2003. Based upon approximately $4.8 million in the project fund, nearly $1.5 million remains for future draws. Division representatives indicate

that they intend to make additional draws through August 2003 to support day-to-day operations at Fitzsimons.

The Division reports that the first interest payment of $121,000 for the Fitzsimons warrants which was due June 1, 2003, was made on a timely basis. Future payments of principal and interest are approximately $550,000 per fiscal year and are scheduled to continue through June 1, 2018. The total amount of payments on the $6,045,000 in anticipation warrant principal is scheduled to be $8,398,842, including interest of $2,353,842. Interest rates range between 3.0 and 4.75 percent depending upon the maturity date.

The warrant issuance costs incurred by the Department appear high in relation to the amount of the anticipation warrants issued. Specifically, the $608,452 in issuance costs equate to approximately 10 percent of the $6,045,000 in anticipation warrants. The Department provided supporting documentation for $548,230, or 90 percent, of the warrant issuance costs; these costs included bond insurance premiums, the underwriter's discount, and related contract costs. However, the Department has not provided detailed documentation supporting the remaining $60,222 in issuance costs incurred. Further, the Department has not provided documentation for the process it followed to ensure that only reasonable and necessary issuance costs were incurred. Because the Department does not issue anticipation warrants during its normal course of business, it does not have the level of expertise in this area that some state agencies have. For example, staff in the Department of the Treasury could provide valuable assistance with determining reasonable financing terms for issuing anticipation warrants. However, the Department did not consult with the Department of the Treasury at the beginning of the process for guidance on how to structure the offering of the Fitzsimons warrants or assistance in obtaining optimal financial terms for the issuance. Although the Department contacted the Department of the Treasury to obtain standard proposal request forms for acquiring bond counsel, the Department did not consult with the Department of Treasury as to the amount of anticipation warrants that could feasibly be issued, repayment terms, or issuance costs. It would benefit the Department to consult with Department of the Treasury staff at the beginning of the process to obtain this input when issuing revenue-related debt in the future.

Financial Management

Division management acknowledged certain characteristics inherent in the design of the Fitzsimons Home that will result in higher costs per patient and therefore, it will be particularly challenging for this home to achieve financial self-sufficiency. Chief among these characteristics are the nurse staffing patterns resulting from the design of two 42-bed and two 48-bed units. Typically, VA requires one Licensed Practical Nurse (LPN) for each 30 residents; accordingly, from a design standpoint, units of 30 or 60 beds are typically the most cost-efficient to staff. However, to ensure sufficient LPN coverage, the Fitzsimons facility is required to staff two LPNs for each of its four units. This results in staffing ratios of 21 patients or 24 patients per LPN for the 42 and 48-bed units, respectively. Consequently, these LPNs will be underutilized, as each LPN could normally oversee 30 residents. The structure, in effect, results in LPN costs that are approximately 33 percent higher than a facility with the same number of beds arranged in 30-bed units. The Division Director estimates that total nurse staffing costs (including all levels of nursing) will be 10 to 15 percent higher than a facility where each LPN

oversees 30 residents. The Division reports that it considered input from the veterans community and worked with an architectural firm in designing the facility.

Division representatives noted that the original financial projections for the Fitzsimons Home prepared in Fiscal Year 2000 addressed various financial and census scenarios during the facility's start-up stage. During our review, however, we found that the Division had not formally revisited the assumptions and projections to ensure that the projected operating targets remain feasible. We made several requests to obtain revised budgeting models. We received information demonstrating that staff had prepared various cash flow scenarios to ensure revenues were sufficient to meet daily operational requirements. However, it appears that staff had not revised the original financial projections for the facility on the basis of actual performance, including determining a break-even point on operations.

We found that the original projections have not been updated. First, although revenue projections included a daily Medicaid rate of $142.91, our analysis revealed that the Medicaid rate received by the Home is actually $130.98. Second, although the Division projected 15,494 patient days for the first eight months of operation, the Home actually realized 13,311 patient days during this period, which was 14 percent lower than anticipated. Facility census and payment rates are two major drivers of operating results.

Financial information should be utilized to assess the Home's financial performance on a periodic basis by comparing it with initial projections. The Department, in its Fitzsimons' pro forma financial statements, indicated the primary goal of the nursing home is to be "self-sustaining, where revenues exceed expenditures." However, the lack of accurate, timely, and complete financial management information makes it difficult to assess the facility's ability to reach break-even status and to continue principal and interest payments on anticipation warrants that began June 1, 2003.

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. We noted earlier in this chapter that the General Assembly has historically not appropriated general funds for ongoing operations of the state and veterans nursing homes. With respect to Fitzsimons' start-up period, Senate Bill 98-186, which authorized the establishment and construction of the home, states specifically that, "The State Department shall not be authorized to use any general funds to cover any operational shortfall incurred by the facility after its construction and before it begins to generate revenues sufficient to cover its operation expenses."

Per Section 26-12-108, C.R.S., operations and resources of the five homes operated by the Division are pooled and accounted for within one central fund. This structure allows the Department to use other homes' monies to cover Fitzsimons' operating shortfalls. Consequently, the timing and capacity of Fitzsimons to reach break-even status and to contribute to the repayment of the anticipation warrants could impact the financial and operating status of all five state-operated state and veterans nursing homes. Thus, it is essential for the Division to implement a formal process for routinely reviewing operations at Fitzsimons, identifying opportunities to improve performance, and ensuring that the facility reaches break-even status as soon as possible.

Recommendation No. 2:

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 schedule payments on the anticipation warrants
b. Using the review to identify significant variances in revenues and expenses and taking timely action to improve performance.

Department of Human Services Response:

Agree. Implementation date: October 2003

a. The Division implemented a streamlined chart of accounts as of July 1, 2003 that will address the concerns surrounding achieving a formal budget-to-actual monitoring process. As stated in the response to Recommendation Number 1, the Division is in the process of creating consolidated reporting and comparison tools to assist in this practice and in meeting scheduled payments on the anticipation warrants. Census stabilization is a key factor in achieving self-sufficiency at any nursing facility. Currently, census at the State Veterans Home at Fitzsimons has reached 147 occupancy, or 81.6%. As census stabilizes, costs stabilize resulting in the facility's ability to achieve financial viability. The budget factors for Fitzsimons will establish breakeven at no more than 86% occupancy. At current admission trends and cost reductions, consistent breakeven is expected to be achieved by January 1, 2004.
b. The facility will review the newly generated consolidated budgetary tools weekly. These tools will be used to monitor performance and make adjustments to revenues and expenditures on a case-by-case basis as required.

Recommendation No. 3:

The Department of Human Services should work with the Department of the Treasury when issuing revenue-related debt for future projects to ensure bids received, costs incurred, and repayment terms are appropriate and reasonable.

Department of Human Services Response:

Agree. Implementation date: October 2003. The Department of Human Services requested input and instructions from the Department of Treasury throughout the warrant process.

The type of debt issued was secured solely by the net revenues from operation of the homes themselves. There was no tax pledge, nor any backing from the State of Colorado. This makes the risk of the credit relatively high, particularly when a substantial portion of the net revenues available for debt service are only to be realized by the fill up of the Fitzsimons property. The borrowing structure and protocol was essentially created for the first time since the last debt issued by the Division was in 1988. The largest single issuance cost was for bond insurance, without which the warrants could not have been sold at a reasonable interest rate, if at all.

The Department of Human Services will continue to seek assistance with the Department of the Treasury when issuing revenue-related debt to ascertain appropriateness and reasonableness.

State Veterans Nursing Home at Walsenburg

The State Veterans Nursing Home at Walsenburg (Walsenburg) is a 120-bed facility located in a separate wing on the second floor of the Spanish Peaks Regional Health Center in southern Colorado. The nursing home opened in 1993 and is operated by the Huerfano County Hospital District (District) under a contract with the Department of Human Services. The District is composed of an elected five-member Board of Directors which oversees the operation of the county's hospital – the Spanish Peaks Regional Health Center – and the Walsenburg Home.

Contract terms are addressed in the Joint Operating Contract between the State and the Huerfano County Hospital District dated November 30, 1993, and subsequent modifications. The Hospital District Board of Directors oversees the management and control of the facility and assures that the stipulations in the contract with the State are met.

Financial Position and State Oversight

Past audits conducted by the Office of the State Auditor have identified issues related to the Walsenburg Nursing Home. Specifically, the *State and Veterans Nursing Homes Compliance Audit* dated September 1997 and the follow-up report dated February 1999 discussed problems with the Home's financial condition and State oversight. The reports specifically noted that the Home had experienced financial losses since its opening in April 1993 and recommended that the Department work with the District to establish a long-term strategy for increasing net income and reducing the Home's outstanding working-capital loan balance from the District's hospital. Both reports further noted that Department oversight and monitoring procedures are especially important in the case of the Walsenburg Home because, as discussed above, the facility, although owned by the State, is operated by the District.

Our audit found that the problems noted in previous audits continue and that a long-term strategy for the Home has not been developed. As shown in Table 4, the Home lost money again in Fiscal Year 2002 and, as of June 30, 2003, was continuing to operate at a deficit. Historically,

the Hospital District has financed the Home's deficits through the Spanish Peaks Hospital which, until Fiscal Year 2000, operated at a profit. Operating information for the Home and the Hospital are shown in the following two tables.

Table 4. Walsenburg State and Veterans Nursing Home
Selected Financial Data
Fiscal Year 1998 – 2003[1]

	1998	1999	2000	2001	2002	2003[2]
Revenue	$ 4,136,893	$ 4,201,646	$ 4,676,425	$ 5,240,239	$ 5,514,039	$ 2,461,517
Net Gain (Loss)	$ (458,553)	$ (473,373)	$ (488,051)	$ (273,363)	$ (37,047)	$ (310,816)
Owed to Hospital at Year End	$ 2,884,667	$ 2,409,501	$ 3,321,266	$ 3,582,365	$ 2,842,860	$ 2,698,696

Source: Auditor analysis of Huerfano County Hospital District audited financial statements for 1998 through 2002 and unaudited interim statements for 2003.

Notes:
[1] The Home operates on a calendar fiscal year.
[2] 2003 data represents unaudited data through June 30, 2003, as prepared by the District.

Table 5. Spanish Peaks Hospital
Selected Financial Data
Fiscal Year 1998 – 2003[1]

	1998	1999	2000	2001	2002	2003[2]
Revenue	$ 7,717,482	$ 7,822,056	$ 6,604,840	$ 6,611,286	$ 8,273,745	$ 4,414,200
Net Gain (Loss)	$ 233,477	$ 234,648	$ (1,166,029)	$ (1,763,416)	$ (498,386)	$ (151,833)

Source: Auditor analysis of Huerfano County Hospital District audited financial statements for 1998 through 2002 and unaudited interim statements for 2003.

Notes:
[1] The Hospital operates on a calendar fiscal year.
[2] 2003 data represents unaudited data through June 30, 2003, as prepared by the District.

The Home also is experiencing high staff turnover. Turnover in the administrator and director of nursing positions has been a recurring problem at the facility since it opened in 1993. In its most recent Annual Survey Report for Walsenburg in September 2002, the VA noted that the facility has employed 11 administrators and 11 directors of nursing over the past 10 years. In addition, discussions with VA staff indicate that the Hospital has had seven different presidents over that same time period. Further, two management personnel resigned from the facility during our audit. Continuity in these positions is critical for a facility to manage day-to-day operations effectively and maintain a consistent quality of care for residents.

In addition to these problems with financial and management stability, we found that the Department and the Walsenburg Home lack processes for reviewing the allocation of indirect costs from the Spanish Peaks Hospital to the Home. Further, contractual arrangements between the Hospital and the Home are problematic. These issues are discussed in more detail in Chapter 2.

Although the State's contract with the District does not legally obligate the State to fund operating deficits for the Walsenburg Home, the State bears the ultimate financial risk for the facility because the Home is state-owned. In particular, if the Home were to lose its VA recognition due to substandard patient care, under the terms of the federal VA grant received by the State to build the home, the State could be obligated to repay approximately $5.4 million to the federal government for funds originally paid to the State for the construction of the Home.

Although both the Department and District have undertaken additional efforts in the last year to establish better operating measurements for the Home and the Hospital, both the Home and the Hospital, as we have noted, are continuing to experience operating losses. These continued losses raise concerns about the financial condition of both facilities. Thus, it is imperative that the Department further address the financial viability of the Home and determine what additional steps must be taken to increase net revenue to a level above costs and continue to reduce the Home's outstanding loan balance to the Hospital.

Recommendation No. 4:

The Department of Human Services should work with the Huerfano County Hospital District to prepare a formal, documented long-term plan to address future operations at the State and Veterans Nursing Home at Walsenburg to ensure the financial stability of the Home. This document should address immediate steps that will be taken to reduce costs and/or increase revenue at the Home.

Department of Human Services Response:

Agree. Implementation date: July 2004. As of Fall 2001, Walsenburg has been providing quarterly reports to the Office of the State Auditor. Although the State has an ongoing presence at the home, the Division lacks direct control over the operations of the home and has limited ability to influence policies and practices. In order for the Division to obtain formal contractual authority over the home to reduce costs or increase revenues, a change in statute would be required. At present, a legislative initiative is on the table for necessary legislative changes to fully implement this recommendation.

Operational Issues

Chapter 2

Improving Census: Resident Occupancy

The Department of Public Health and Environment (CDPHE), which is responsible for licensing all nursing homes operating in the State, recently published 2002 occupancy data for all Colorado nursing facilities. Below we have compared the occupancy of each state and veterans home with the average for all other nursing facilities in surrounding counties. The Fitzsimons home is excluded from this analysis, as it had a census of only 12 residents on December 31, 2002.

Table 6. State and Veterans Nursing Homes
Comparison of Occupancy Rates for State and Veterans Nursing Homes with Area Calendar Year Averages Through December 31, 2002

	State and Veteran Homes		Other Area Homes	
	Licensed Beds	Occupancy %	Area Licensed Beds	Average Occupancy %
Florence	120	78.3%	80	82.8%
Homelake	60	90.0%	50	92.4%
Rifle	100	89.0%	69	77.8%
Trinidad	158	82.9%	85	86.3%
Walsenburg	120	70.8%	85	86.3%

Source: Colorado Department of Public Health and Environment nursing home 2002 occupancy data; Medicaid cost reports filed by each state and veterans nursing home.

As shown in Table 6, occupancy percentages for all homes, with the exception of the Rifle facility, were below the average occupancy in their respective areas during Calendar Year 2002. In addition, four of the five state and veterans nursing homes have experienced a decrease in occupancy since Fiscal Year 2000. While overall the decline in average occupancy rates is about 1 percent, individually homes have experienced declines of up to 6 percent. Homelake had an increase of 25 percent in average occupancy. See Table 7 for Fiscal Years 2000 through 2002 occupancy trends for each of the homes.

Table 7. State and Veterans Nursing Homes
Occupancy Trends for Colorado State and Veterans Nursing Homes
Average Rates for Fiscal Year 2000 through Fiscal Year 2002

	Fiscal Year 2000	Fiscal Year 2001	Fiscal Year 2002	Total Percentage Change
Florence	86%	83%	83%	(3%)
Homelake	68%	88%	93%	25%
Rifle	96%	95%	90%	(6%)
Trinidad	73%	84%	70%	(3%)
Walsenburg	81%	89%	79%	(2%)
Overall	81%	84%	80%	(1%)

Source: Auditor analysis of Medicaid cost reports filed by each state and veterans nursing home.

Decreases in occupancy are problematic because they mean the homes are caring for fewer patients and consequently, receiving less revenue. This also means that a facility's fixed operating costs are spread over fewer patients, and therefore the average cost per patient increases. Division and facility personnel cite two primary reasons for occupancy decreases: (1) an increasing number of resident deaths within an aging facility population accompanied by decreases in facility admissions; and (2) a poor economy, evidenced by many adult children caring for their elderly parents in the community. Caring for elderly parents at home allows children to utilize the elderly parent's pension and/or social security checks for day-to-day expenses.

As part of our audit, we reviewed the state and veterans nursing homes' marketing and outreach efforts. Through discussions with the Division Director, we noted that the Fitzsimons and Walsenburg facilities each currently employ a full-time marketing director. However, for a period of nearly two years between 2000 and 2002, the Walsenburg facility did not have a marketing director. Marketing responsibilities for the remaining facilities are included in a "shared" position at each Home that encompasses facility admissions, marketing, and community relations. In periods of declining occupancy, the effectiveness of a facility's marketing and outreach efforts increases in importance as raising census numbers becomes vital to financial performance.

The Department currently serves in an advisory role related to marketing and outreach and does not set formal policies or objectives for facility marketing personnel. The Department informally encourages its facilities to network with additional referral sources, e.g., veterans organizations, Alzheimer's organizations, community social workers, and health system discharge planners. However, because four of the five homes have experienced declines in occupancy since Fiscal Year 2000, it is essential for the Department to ensure each facility has sufficient resources and clear objectives for its marketing and outreach efforts. Further, without leadership in the

marketing and outreach arenas, facility admissions will not be able to keep pace with facility discharges and deaths, negatively impacting financial performance. Thus, the Department should ensure each of the homes has an organized, central outreach and marketing program to ensure census and market share remain at optimal levels.

Recommendation No. 5:

The Department of Human Services should work directly with each facility's administrator to establish specific marketing and outreach goals and objectives. These goals should be reviewed periodically to ensure that each facility is meeting the Department's expectations.

Department of Human Services Response:

Agree. Implementation date: December 2003. The established facility census goals are significantly more thorough in Fiscal Year 2004. Steps and methods with specific goals and objectives will also be established, allowing facilities movement in the direction of increased measurable performance. Goals and objectives will be monitored to ensure that facilities are meeting the marketing and outreach targets. The Division anticipates full compliance with the improved marketing techniques at each facility by calendar year-end.

Federal Reimbursement

During our review, we determined 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 change and its impact are discussed below. While this change has resulted in increased revenue to the five state veteran homes, we are concerned that it may not be in compliance with federal requirements.

Revenue for the state and veterans nursing homes is generated primarily through payments received from private pay patients, Medicaid, the VA per diem program, and various pensions received by patients. Overall Medicaid occupancy averaged 54 percent of the patient population for Fiscal Years 2000 through 2002 for all of the homes. For the four homes certified by VA during that period, the overall Medicaid occupancy averaged 44 percent and veteran occupancy averaged 89 percent of patient population over this three-year period.

As of Fiscal Year 2003, five of the homes (Rifle, Florence, Homelake, Fitzsimons, and Walsenburg) are VA-certified. According to federal regulations, in order to be certified by the VA, the nursing home must: (a) send a request for recognition and certification to the VA Undersecretary of Health; (b) allow VA to survey the facility; and (c) upon request from the director of the VA medical center of jurisdiction, submit documentation related to the payment

of the VA per diem. The survey, as necessary, covers all parts of the facility and includes a review and audit of all records of the facility that have a bearing on compliance with VA requirements.

VA-certified facilities are eligible to receive a daily per diem for eligible veterans in accordance with federal law. VA per diem rates for the past three federal fiscal years are documented in Table 8.

Table 8. State and Veterans Nursing Homes
VA Per Diem Rates
Federal Fiscal Years 2001 through 2003

Federal Fiscal Year	Effective Dates	VA Daily Per Diem
2001	10/1/00 – 9/30/01	$51.58
2002	10/1/01 – 9/30/02	$53.17
2003	10/1/02 – 9/30/03	$56.24

Source: U.S. Department of Veterans Affairs.

Prior to December 2001 the State's VA-certified facilities subtracted the VA per diem from monthly billings to the Medicaid program on behalf of qualifying patients. Thus, the VA per diem rate was treated as a third-party payment and reduced the amount paid by the Medicaid program to the homes. As of December 1, 2001, a change in the Medicaid billing process related to the VA per diem was implemented by the homes at the Division's direction. Specifically, the Division's documented policy instructed the homes not to subtract the VA per diem from Medicaid billings. Effectively, the change resulted in the homes receiving reimbursement of the full Medicaid daily rate in addition to the daily VA per diem. Additionally, as a result of this change it appears that in some cases, the Department may have received more than its published daily semi-private room rate for Medicaid-eligible, veteran patients. For example, during Fiscal Year 2003, the Rifle Home would have received $175 from a private-pay resident in a semi-private room, but the Home would have received $214.74 for a Medicaid-eligible veteran during the same time period ($158.50 Medicaid rate plus $56.24 VA per diem), or almost $40 more. Table 9 shows the semi-private room rate charged to self-pay residents by each VA-certified home during Fiscal Year 2003 compared with amounts received from Medicaid and VA per diem payments for Medicaid-eligible, veteran patients on a per patient day basis under the homes' revised billing process. As shown, for all homes except Fitzsimons, Medicaid and VA payments received on behalf of each qualifying patient exceeded the semi-private room rate charged by the homes.

Table 9. State and Veterans Nursing Homes[1]
Daily Semi-Private Room Rate vs. Daily Rate for Medicaid-Eligible Veteran Patients
Fiscal Year 2003

Nursing Home	Semi-Private Room Rate	Medicaid Room Rate Plus VA Per Diem[2]	Medicaid and VA Over /(Under) Semi-Private Rate
Fitzsimons	$219.00	$187.22	($31.78)
Florence	$162.00	$189.15	$27.15
Homelake	$146.00	$191.70	$45.70
Rifle	$175.00	$214.74	$39.74
Walsenburg	$151.20	$188.42	$37.22

Source: Auditor analysis of rate information provided by the Department of Human Services and federal Department of Veterans Affairs.
Note:
[1]The Trinidad Home is not included in this analysis because it is not a VA-certified facility.
[2]This analysis reflects the VA per diem rate of $56.24 per day in place for Federal Fiscal Year 2003 and the specific Medicaid rate for Fiscal Year 2003 for each facility. The Medicaid rates ranged from $130.98 to $158.50 per day.

As part of our audit, we contacted several sources to determine whether the Division's handling of the VA per diem was allowable under federal Medicaid regulations. The Department of Health Care Policy and Financing, the state agency charged with administering the Colorado Medicaid program, and the federal Centers for Medicare and Medicaid Services Regional Office verbally indicated that the Division's decision to no longer treat VA per diem payments as third party payments under the Medicaid program is not consistent with federal regulations. In addition, a state supreme court decision in the State of Montana (June 2002) and a state appeals process in Virginia (October 2002) have affirmed that the VA per diem should be considered as a third-party payment and offset against the Medicaid liability. Federal law states that state Medicaid agencies are required to "take all reasonable measures to ascertain the legal liability of third parties…to pay for care and services available under the [state's Medicaid] plan." Federal regulations define a third party as "any individual, entity or program that is or may be liable to pay all or part of the expenditure for medical assistance furnished under a State plan."

The Department of Human Services has represented in the past that Medicaid billings would continue to be offset by VA per diem payments. For example, planning documents prepared for the Fitzsimons' facility indicate that the State would benefit from the introduction of a VA-certified state veterans nursing home because Medicaid billings, which include a 50 percent general fund match, would be partially offset by funding received through the VA per diem, which is entirely funded by federal monies.

To support its policy change, the Division reports that it determined that the VA per diem under the federal state home program is a daily operating grant to the homes and, therefore, is considered to be a contribution toward the operation of the facility and its mission. The Department of Human Services appears to have relied, in part, on a 1994 administrative decision from the State of California for its policy change. This settlement decision made by the California Department of Health Services found that VA per diem payments constituted aid provided by the federal government to state veterans homes which provide care for veterans and therefore, should not be categorized as third-party resources available to veteran beneficiaries. As such, the Division believes that the per diem should not be considered a benefit payable on behalf of an individual veteran. However, for private pay veterans – in other words, those patients not eligible for Medicaid – we noted that the Division continues to instruct its facilities to deduct the VA per diem from the home's daily billing rate and bill these residents for only the net amount. Thus, Medicaid-eligible veterans and private pay veterans are treated differently in how the VA per diem payment is applied.

The Division's change in policy for the handling of the VA per diem payments resulted in potential Medicaid overpayments equal to all VA per diem payments received for Medicaid-eligible veterans since the change was implemented. We have not analyzed individual Medicaid billings or VA reimbursements for each patient. However, based on our review of Medicaid and veteran census data for each of the VA-certified homes, we estimate that Medicaid potential overpayments, or questioned costs, could total approximately $1.3 million and $2.8 million for Fiscal Years 2002 and 2003, respectively, or a total of $4.1 million for both years ($2.05 million each in state general funds and federal funds). On the basis of our estimate, we have shown the split of the potential impact between state general funds and federal funds in Table 10.

Table 10. State and Veterans Nursing Homes
Estimated General Fund and Federal Fund Impact of Billing Change
Related to VA Per Diem Payments
Fiscal Years 2002 and 2003[1]

	General Fund Impact	Federal Fund Impact	Total Impact
Fiscal Year 2002	$650,000	$650,000	$1,300,000
Fiscal Year 2003	$1,400,000	$1,400,000	$2,800,000
Total	$2,050,000	$2,050,000	$4,100,000

Source: Census information provided by each state and veterans nursing home; VA per diems per Federal Register.

Notes:
[1]Fiscal Year 2002 and Fiscal Year 2003 amounts were calculated using Medicaid, veteran patient days multiplied by the VA per diem rate in effect at the time.

The homes have always received Medicaid payments because they have served Medicaid-eligible veterans. However, the Division's new treatment of VA payments is likely the primary reason for the significant increase in Medicaid payments to these homes during Fiscal Years 2002 and 2003 compared to prior years. Overall, Medicaid revenue to the VA-certified homes increased from $6.2 million in Fiscal Year 2001 to $7.5 million and $9.6 million in Fiscal Years

2002 and 2003, respectively, or 55 percent over the time period. The increase in Medicaid payments also means that there has been a substantial increase in general funds provided to the homes, since the State shares the cost of the Colorado Medicaid program equally with the federal government. Although the Department anticipated that the policy change would result in significant increased Medicaid revenue to the homes, the Department did not provide any documentation to us that the new policy was approved by either the state or federal Medicaid agency.

We believe the Department should work with the federal Centers for Medicare and Medicaid Services to determine if its current policy of not offsetting Medicaid billings with the VA per diem is appropriate and allowable. Under the existing practice, the amount of questioned costs owed to the federal government continues to accumulate on a daily basis. If it is determined that the Department's current Medicaid billing practice is unallowable under the federal Medicaid program, the Department should also work with the Department of Health Care Policy and Financing (HCPF) to determine the appropriate steps for identifying and reporting the amount of Medicaid program overpayments. Reverting to the previous practice of offsetting Medicaid billings with VA per diem payments will cause the homes to realize less Medicaid revenue than anticipated under the current policy; thus, the Division must review and make appropriate revisions to its current and future budgets to reflect the expected reduction in Medicaid revenue and to anticipate funding necessary to repay the Medicaid overpayments.

The Department must also review the effect of the current VA per diem policy on Medicaid residents and non-Medicaid, private-pay residents and ensure that inconsistencies are eliminated through policy changes. Specifically, the Department should not collect a higher payment from a Medicaid veteran than from a non-Medicaid veteran. Further, the Department should implement a formal procedure for conferring with HCPF on any Medicaid billing changes to determine whether the change is in accordance with state and federal Medicaid laws and regulations. The Department should submit proposed changes in writing to HCPF for its review and approval prior to implementing the change.

Recommendation No. 6:

The Department of Human Services should work with the federal Centers for Medicare and Medicaid Services to determine if its current Medicaid billing policy in relation to VA per diem payments is appropriate and allowable. If determined unallowable, the Department should work with the Department of Health Care Policy and Financing to determine the appropriate steps for identifying and reporting all resulting Medicaid program overpayments since the inception of the revised policy as of December 2001.

Department of Human Services Response:

Agree. Implementation date: June 2004. The Division will communicate with the federal Centers for Medicare and Medicaid, along with the federal Department of

Veterans Affairs to determine if its current Medicaid billing policy in relation to VA per diem operating grant payments is appropriate and allowable. The Department of Human Services will work with the Department of Health Care Policy and Financing and the Office of the State Auditor on an on-going basis as well, and will identify steps to reconcile any disallowances.

Currently a number of states are operating with different scenarios, many similar to Colorado's. As this is a national issue affecting many states throughout the country, it will require national clarification and is an anticipated lengthy process.

Recommendation No. 7:

The Department of Human Services should review and revise the budgets for the five VA-certified facilities overseen by the Division of State and Veterans Nursing Homes to reflect the reduction in Medicaid revenues and to anticipate the funding necessary to repay Medicaid overpayments if its current Medicaid billing policy in relation to VA per diem payments is determined inappropriate by federal Medicaid agency.

Department of Human Services Response:

Agree. Implementation date: Upon implementation of Recommendation 6. The Department will implement policy changes once determination is made at the federal level.

Recommendation No. 8:

The Department of Human Services should implement a formal procedure for consulting with and receiving approval from the Department of Health Care Policy and Financing for policy changes that affect billings to the Medicaid program. This should include submitting proposed changes in writing to the Department of Health Care Policy and Financing for review and approval prior to implementation.

Department of Human Services Response:

Agree. Implementation date: December 2003. The Department will implement a formal procedure for conferring with the Department of Health Care Policy and Financing on any future Medicaid billing changes to determine whether the change is in accordance with state and federal Medicaid laws and regulations. The Department will submit proposals in writing to the Department of Health Care Policy and Financing for its review and approval.

Department of Health Care Policy and Financing Response:

Agree. Implementation date: December 2003. The Department will develop and implement a protocol with the Department of Human Services to ensure that proposed billing policy changes are cleared and transmitted in writing by the Executive Director of the Department of Human Services, or an appropriately delegated representative, to the Executive Director of the Department of Health Care Policy and Financing, or an appropriately delegated representative. The Executive Director of the Department of Health Care Policy and Financing, or an appropriately delegated representative, will approve or reject such changes, and send written notice of the approval or rejection of the proposal to the Executive Director of the Department of Human Services.

Recommendation No. 9:

The Department of Human Services should review the effect of the current VA per diem policy on Medicaid residents and non-Medicaid, private-pay residents and ensure that any inconsistencies caused by policy changes are eliminated.

Department of Human Services Response:

Agree. Implementation date: Upon implementation of Recommendation 6. The Department will review the effect of current VA per diem operating grant policy on Medicaid and non-Medicaid residents and ensure that inconsistencies are eliminated through policy changes.

Oversight of Nursing Home Billings

Our audit found that the Department of Health Care Policy and Financing did not have adequate procedures in place to identify the significant Medicaid payment increases experienced by the state and veterans nursing homes as the result of the change in policy described above. This indicates a need for increased oversight of nursing home billing practices by the Department of Health Care Policy and Financing. A 1999 OSA performance audit, *Medicaid Fraud and Abuse Programs*, indicated a need for that Department to address gaps in current nursing facility audit practices to more quickly identify anomalies in billing practices. The report specifically identified a problem with overpayments made to nursing homes due to overlapping billing periods. Our current finding regarding the change in billing practices related to the VA per diem reimbursement in this report again indicates a need for improved oversight and monitoring of nursing facility billing practices.

Recommendation No. 10:

The Department of Health Care Policy and Financing should address gaps in current nursing facility audit practices by developing analytical tools and procedures to identify significant changes in reimbursements received by providers and investigate these instances as appropriate.

Department of Health Care Policy and Financing Response:

Agree. Implementation date: March 2004. The findings of the OSA audit demonstrate a clear need for better controls over Medicaid nursing home billing practices. The failure of providers to appropriately offset resources can substantially impact general fund expenditures. Like many other state Medicaid agencies, the Department relies upon a post-payment audit process, and associated sentinel effect, to ensure program integrity in this area. The Department recently expanded the scope of its post-pay review activities through implementation of a contract with an external audit firm. However, the existence of a post-payment review process cannot *prevent* a participating nursing home from failing to offset resources against charges appropriately when it bills for Medicaid services. The only way to do so is to develop claims system controls that will automate the offset of income and other resources at the point of claim adjudication. The development of such claims system controls would likely be costly, and would have to be justified in terms of improved cash flow and reduced administrative burden. In the interim, the Department will develop statistical reports to reduce the likelihood that inappropriate changes in nursing home billing practices go unnoticed for an extended period of time.

Medicare Reimbursement and Certification

Some patients served by the state and veterans nursing homes are Medicare-eligible. Medicare is administered directly by the federal government. Among other things, the Medicare program furnishes coverage for beneficiaries that require skilled nursing facility services for a limited period of time following a hospital stay. Currently, only the Fitzsimons Home is Medicare-certified. The Medicare program may represent an opportunity for other homes to increase their revenues.

Prior to July 1998, the Medicare program reimbursed nursing facilities through a retrospective, reasonable cost basis. Thus, reimbursement for services was a function of the actual costs incurred by a facility as submitted on Medicare cost reports. The federal Balanced Budget Act of 1997 modified the payment system for Medicare-certified facilities. Effective with cost

reporting periods beginning on or after July 1, 1998, facilities are no longer paid on a reasonable cost basis, but rather on the basis of a prospective payment system (PPS). The PPS is adjusted for resident acuity, or severity of care requirements, through case mix indices and for geographic wage variations. The PPS rate is intended to cover all costs of furnishing covered skilled nursing facility services (i.e., routine, ancillary, and capital-related costs).

Division staff indicate that they are considering the possibility of acquiring Medicare certification for the Florence facility. However, we found that the Division has not conducted an analysis of the potential costs and benefits of obtaining Medicare certification for the remaining four homes. For example, Medicare certification could result in additional costs because of the stringent reporting requirements and documentation standards tied to program participation. However, since the homes have been experiencing declining census, ensuring that all potential revenue pools are identified is important to the financial performance of the homes. If a facility is certified to receive Medicare funds to offset the initial costs of a resident's care, this could make the state homes financially more attractive to prospective occupants. Thus, the Division should consider the costs and benefits of obtaining Medicare certification and establish a plan for obtaining the certification if deemed beneficial.

Recommendation No. 11:

The Department of Human Services should perform an assessment of the costs and benefits of Medicare certification to the state and veterans nursing homes and establish and implement a plan for obtaining certification as deemed beneficial.

Department of Human Services Response:

Agree. Implementation date: May 2004. The Department will assess costs and benefits of Medicare certification to the state and veterans nursing homes and will implement a plan as deemed beneficial.

Allocation of Indirect Costs

Under state and federal requirements, applicable overhead costs are allocated to the state and veterans nursing homes from both the Department and Division. Department overhead, or "indirect," costs are allocated to each agency within the Department in accordance with federal Office of Management and Budget (OMB) principles and standards outlined in OMB Circular A-87. A portion of these indirect costs is allocated to each of the state nursing homes. The allocation to the nursing homes is limited in the annual legislative appropriation and has remained constant over the past five fiscal years (Fiscal Years 1998 through 2002) at about $95,800 annually.

The Division's personnel and operating costs are not included in the Department's indirect allocation to the homes. Instead, Division costs are allocated to the homes on a monthly basis. The primary basis for the Division's allocation is patient days. Each home's allocation is based on its number of patient days, and in general, the higher the facility's number of patient days in a given month, the more indirect costs will be allocated to that facility. Total Division costs allocated to the facilities increased significantly over the past five fiscal years from about $167,000 in Fiscal Year 1998 to $412,000 in Fiscal Year 2002, or about 147 percent. The amount allocated to the homes, excluding the allocation from the Department, and the split of the allocation between personal services costs and other costs is detailed in Table 11 for Fiscal Years 1998 through 2002.

Table 11. State and Veterans Nursing Homes
Indirect Costs Allocated to State and Veterans Nursing Homes
Fiscal Years 1998 through 2002
(Excludes department-level allocations[1])

	1998	1999	2000	2001	2002
Salaries and Benefits	$140,785	$277,853	$384,390	$351,293	$360,742
Other Costs	$26,252	$37,317	$33,754	$60,398	$51,208
Total	$167,037	$315,170	$418,144	$411,691	$411,950

Source: Colorado Financial Reporting System (COFRS).

Note:
[1]The Department allocation to the State and Veterans Nursing Homes has been approximately $95,800 per year over the past five Fiscal Years (1998 through 2002).

As shown in the table above, the majority of costs allocated from the Division to the homes relates to salaries and benefits. Currently, these costs are for the following five positions:

?? Division Director
?? Deputy Director of Administrative Support
?? Manager of Direct Services Management
?? Director of Quality Assurance
?? Operations Manager

In addition, based on a November 1998 agreement between the Department and the Division, the homes are allocated costs related to facilities management support provided by the Department. Given the 147 percent increase in Division costs allocated to the facilities from Fiscal Year 1998 to Fiscal Year 2002, the Department needs to analyze Division costs to determine if costs can be reduced.

Our audit found that the basis used for the allocation of Division costs to the homes needs to be reviewed. The current allocations do not appear to be reflective of the value of actual services being rendered to the facilities and are not based on adequate supporting documentation. For example, there is currently no process in place for Division staff to track time spent at each

facility. Tracking time at each facility is necessary to ensure that Division costs are being equitably allocated to the homes. Per discussion with Division staff, the Division recognizes the need to implement a time study to determine the actual amount of time being devoted to each facility and plans to implement a process in the future.

Further, while the Division has made some adjustments to allocations in recognition that patient days may not adequately reflect actual services rendered to each facility, Division staff indicate that some of these adjusted allocation percentages have been in use for many years, and no re-evaluation of their appropriateness has been conducted. We identified three instances in which the Division has made adjustments to the policy of allocating Division costs on the basis of patient days.

- First, the Division has chosen to allocate costs to the Homelake domiciliary based on 33 percent of the program's patient days. Division staff state they use this allocation method because, due to the lower acuity level of patients serviced by the Homelake domiciliary, the program experiences lower expenses and revenue per patient day than standard nursing facilities.

- Second, Division staff reduce patient days for Walsenburg by 50 percent to determine the facility's allocation. This reduction is required by the Department's contract with the Huerfano County Hospital District. Division staff explain this reduction is made because the Walsenburg facility is operated by the Huerfano County Hospital District and, therefore, the facility should not require the same time commitment from the Division as the state-operated facilities.

- Third, for Fiscal Year 2003, with the new Fitzsimons facility becoming operational, the Division has decided to allocate 29 percent of the total allocation of Division expenses, regardless of Fitzsimons' patient days. However, the Division Director and Operations Manager report that they have spent a large amount of their time on-site at Fitzsimons during the facility's construction and start-up phases. In fact, the Division Director has been the acting administrator for the facility since December 2002. Therefore, we question whether the method used to allocate indirect costs to the Fitzsimons facility is reflective of the actual time spent by Division staff on behalf of this facility.

In Fiscal Year 2003, the Division changed its basis for allocating non-departmental costs to the homes other than Fitzsimons from actual patient days to projected patient days. This change could also affect whether the homes receive equitable cost allocations. We are concerned that the Division's use of forecasted patient days as opposed to actual patient days could result in unwarranted discrepancies among the homes. All homes were budgeted at 91 percent occupancy for Fiscal Year 2003, however, the homes have experienced varying levels of actual performance in relation to that forecast. Through June 30, 2003, the homes had experienced the following actual occupancy levels: Rifle – 90 percent, Homelake – 83 percent, Florence – 84 percent, Trinidad – 81 percent, and Walsenburg – 73 percent.

In order to ensure costs allocated to the nursing homes are appropriate, the Department and Division should review Division-level costs to identify areas for cost-reduction and review the current methodology used by the Division to allocate indirect costs to the homes. This should include completing studies to determine the actual time spent by staff for each facility and making changes to the allocation process as determined appropriate. In addition, the Department should analyze the differences between projected and actual patient days by facility and perform periodic adjustments during the fiscal year to correct these allocations.

Recommendation No. 12:

The Department of Human Services should ensure costs allocated to the nursing homes are appropriate by:

a. Performing an analysis of Division costs to identify areas where costs can be reduced.
b. Reviewing the methodology for allocating Division-level costs to the state and veterans nursing homes to determine if patient days are reflective of the actual services rendered by the Division and make adjustments as deemed appropriate.
c. Completing periodic studies to determine the actual time spent on individual facilities and analyzing differences between each facility's projected and actual patient days and revising allocations as appropriate.
d. Reviewing the basis for adjusting cost allocations to the Walsenburg and Fitzsimons homes and the Homelake domiciliary program to determine if historical bases are an accurate reflection of services rendered by the Division.

Department of Human Services Response:

Agree. Implementation date: December 2003.

a. Analysis and review of Division central costs will be performed and necessary steps taken to implement cost reductions where possible.
b. The Division has moved from a methodology of Division cost allocation by projected budgeted census to a methodology of actual census as of July 1, 2003.
   The Division will review the methodology for allocating Division level costs and determine the appropriate method that correlates to actual services rendered.
c. The Division will utilize the federal Office of Management and Budget Circular No. A-87 titled "Cost Principles for State, Local, and Indian Tribal Governments," as specified within VA regulations as the federal guide to determine cost allocation methods to be used for review of the operating grant funding. This publication establishes the principles and standards for determining costs for federal awards carried out through grants, cost reimbursement contracts, and other agreements with state and local governments and federally recognized Indian tribal governments (governmental units).

d. The Division will review the current methodologies for adjusting cost allocations and use corresponding state and federal regulations and guidelines to determine if historical basis adjustments are an accurate reflection of services rendered to Walsenburg, Fitzsimons, and the Homelake domiciliary.

Walsenburg Nursing Home Operations

As noted earlier in the report, the Walsenburg Home is operated by the Huerfano County Hospital District under a contract with the Department of Human Services. Because of this Home's unique operating circumstances, we reviewed several issues specific to this Home. Through our review, we identified several areas of concern. In addition to the financial problems we noted in Chapter 1, we also identified problems related to the allocation of costs to the Home from the Spanish Peaks Regional Health Center (Hospital) and concerns relating to the Department's relationship with the Huerfano County Hospital District. These areas are discussed in more detail below.

Allocation of Spanish Peaks Hospital Costs

As discussed in Chapter 1, the Walsenburg Home is also charged an allocation of overhead costs by the Spanish Peaks Regional Health Center for services provided by hospital departments, in addition to its allocation of Department and Division costs. A summary of the hospital departments involved and the basis used to allocate costs to these departments is shown in Table 12.

Table 12. State Veterans Nursing Home at Walsenburg
Spanish Peaks Regional Health Center Bases for Allocating Costs

Department	Allocation Basis
Central Supply	Quarterly Time Studies
Medical Records	Quarterly Time Studies
Dietary	Meals Served
Maintenance	Square Footage
Housekeeping	Direct Hours
Laundry	Pounds of Laundry
Employee Benefits	Gross Salaries
Cable	Number of Televisions
Telephone	Number of Telephone Lines
Liability Insurance	Square Footage

Source: Medicare cost reports filed by Spanish Peaks Regional Health Center and the State Veterans Nursing Home at Walsenburg.

All allocation bases are designed to be in compliance with the bases approved by the Medicare program. Although the Walsenburg Home does not participate in the Medicare program, the Hospital is Medicare-certified. Therefore, the overhead cost allocations of the Hospital are required to be in compliance with Medicare regulations. Medicaid regulations defer to federal Medicare regulations in this situation.

As part of our audit, we reviewed the allocation statistics maintained by the Hospital for costs charged to the Home for Fiscal Year 2002, the most recent year for which a completed Medicaid cost report was available, as well as the allocation bases compared with those stipulated by the Medicare program. Our review did not identify problems with the allocation statistics and determined that the allocation bases were consistent with Medicare regulations. However, we found that there is no process in place at either the Department or within the Walsenburg nursing facility to periodically review the allocation of indirect hospital costs to the Home.

We also reviewed and found problems with the Hospital's allocation of costs to the Home for a consulting service contract. In the fall of 2001, the Hospital entered into a contract with Quorum Health Resources LLC to provide various consulting services, including a nursing wage assessment for both the Hospital and the Walsenburg Home. This contract's cost is being split between the Hospital and the Home on the basis of each entity's budgeted expenses. Total costs related to the contract were approximately $188,000 for Fiscal Year 2001 and $205,000 for Fiscal Year 2002. Amounts allocated to the Walsenburg Home for the contract totaled $81,000 and $96,000, respectively, for those years. The nursing wage assessment included a survey of nursing salaries in surrounding areas and in similar medical settings to bring nursing salaries at the Hospital and the Home in line with the competition. The Home, specifically, was having trouble recruiting and retaining qualified staff due in part to inequitable pay rates.

We identified three concerns related to the contract. First, Hospital management was unable to provide adequate documentation for the related contract costs allocated to the Walsenburg Home. Although the Home was charged 43 percent of the contract costs in Fiscal Year 2001 and 47 percent of the contract costs in Fiscal Year 2002, Hospital management could not provide substantive documentation supporting the cost benefit to the nursing facility from the contract or detailed support for the actual services rendered and hours spent by Quorum on various consulting projects for the Home. Thus, we were unable to determine what portion of costs, if any, should be allocated to the Home. Further, while the nursing wage assessment may have benefited the Home, the majority of services identified in the contract are hospital specific and do not appear to directly benefit the nursing facility. For example, services to be rendered included: a business office review, a medical information review including a coding audit and chargemaster review, an assessment of the Hospital's current marketing activities, review of the Hospital's productivity management program, and the implementation of Quorum's productivity management program at the Hospital. Thus, the current allocation of costs to the Home appears to be disproportionately high compared to the benefit received by the Home.

Second, our discussions with Division management indicated that it was unaware of the Quorum contract or that a portion of the contract costs had been allocated to the Home. This indicates that there is no process in place for the Division or the Home to review and/or approve contractual arrangements with the Hospital in advance that affect the Home. As a result, there

was no Division involvement in the original contracting process and the involvement of Walsenburg facility personnel was limited.

Third, during our audit Hospital staff determined that the costs reported by the Home for the Quorum contract for Calendar Year 2002 on its Medicaid cost report were overstated by $47,000. The overstatement was caused by a clerical error that resulted in a portion of the costs being inadvertently charged to the incorrect account. The error was detected during the year-end financial audit, and an adjusting journal entry was made to correct the overstatement. The financial audit occurred subsequent to the submission of the Medicaid cost report; thus, costs were incorrectly stated on the Medicaid cost report. As of the end of our audit, the Home's management had not resubmitted the Medicaid cost report to correct this overstatement. The Department should ensure that Walsenburg Home staff prepare and submit a corrected December 31, 2002, Medicaid cost report to the appropriate approving agency.

It is important for the Home and the Department to institute a periodic review of the allocation of Hospital costs to the Home because these cost allocations account for a significant portion of the Home's operating costs. For example, in Fiscal Year 2002 approximately $1.7 million of the Home's total expenses of $5.5 million were based upon allocations from the hospital. Further, since the Home uses these costs as part of its request for reimbursement from the Medicaid program, the Home should obtain assurance that the costs are appropriate. By instituting a review process over costs allocated to the Home, the Department and the District can gain assurance that allocations remain equitable and are consistent with Medicare requirements.

Also, implementation of an approval process by the Division and Home related to District contractual arrangements that affect the Home would assure the Division's active participation in decisions that impact the Home's financial operations. If a contractual arrangement resulting in the allocation of expenses to the Walsenburg facility is to be entered into, the nursing facility, in cooperation with the Division, should analyze the appropriateness of the proposed cost allocation methodology prior to approving the arrangement.

Recommendation No. 13:

The Department should improve its oversight of State Veterans Nursing Home at Walsenburg operations by:

a. Implementing a process for the periodic review of the allocation of costs from the Spanish Peaks Regional Health Center to the State Veterans Home at Walsenburg to ensure the allocations are appropriate and equitable.
b. Ensuring that Walsenburg Home staff prepare and submit a corrected December 31, 2002, Medicaid cost report to the appropriate reporting agency to accurately report Quorum contract costs allocated to the Home during Calendar Year 2002.
c. Developing a usable format for quarterly reports to be submitted by the Walsenburg Home. Specific responsibility for reviewing the reports and monitoring the Walsenburg Home's

operations should be assigned and this responsibility should be incorporated in the assigned personnel's performance plan.

d. Implementing procedures at the Home and Department levels for the review and approval of contractual arrangements under which costs are allocated to the nursing facility.

Department of Human Services Response:

Agree.

a. As stated in Recommendation Number 4, the Division can and will review cost allocations but does not have contractual authority to ensure Walsenburg allocations are appropriate and reasonable. Implementation date: December 2003.
b. The Division will request that a revised cost report be submitted to Medicaid for Calendar Year 2002. Implementation date: October 2003.
c. The Division will work with Walsenburg to develop a usable format for the submitted quarterly reports. The Division will review and monitor Walsenburg's operations and make recommendations for adjustments. Again, due to contractual restrictions, the Division can make recommendations to the facility only. Implementation date: January 2004.
d. The Division can and will recommend procedures that should be implemented regarding contractual arrangements, however, the Division does not have the ability to withhold contract approval. The Division intends that the State's contract with the District be reevaluated and necessary steps taken to support a legislative initiative for the Division to directly renegotiate the contract with the Huerfano County Hospital District. Implementation date: January 2004.

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