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THE FINANCIAL COLLAPSE OF HEALTHSOUTH
Part 1

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON ENERGY AND
COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

OCTOBER 16, 2003

Serial No. 108–53

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THE FINANCIAL COLLAPSE OF HEALTHSOUTH

THURSDAY, OCTOBER 16, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2123, Rayburn House Office Building, James C. Greenwood (chairman) presiding.

Members present: Representatives Greenwood, Bilirakis, Stearns, Burr, Bass, Walden, Ferguson, Rogers, Tauzin (ex officio), and DeGette.

Staff present: Casey Hemard, majority counsel; Kelli Andrews, majority counsel; Ann Washington, majority counsel; Yong Choe, legislative clerk; Edith Holleman, minority counsel; and Voncille Hines, research assistant.

Mr. GREENWOOD. The hearing of the Committee on Energy and Commerce Subcommittee on Oversight and Investigations will come to order, and the Chair recognizes himself for the purpose of making an opening statement.

This morning we hold the first day of our hearing to examine allegations of accounting fraud and poor corporate governance policies at HealthSouth, the largest provider of outpatient rehabilitation services in the United States. This committee has a well recognized history of bringing important matters of corporate governance and accounting fraud to the forefront of public awareness in a timely and thorough fashion.

In the last Congress, this Committee took the lead in examining the corporate governance practices and accounting fraud allegations associated with the financial collapse of several companies, all of which were in industries that fell within with the Energy and Commerce Committee's broad jurisdictional ground. For example, the Enron investigation focused on corporate governance practices and accounting matters associated with the energy industry. Questionable accounting practices at telecommunication companies were brought to light during our hearings last year on Qwest and Global Crossing.

We now turn to another area that falls within this committee's jurisdiction, the health care industry. The HealthSouth hearings will provide this committee the opportunity to examine various corporate governance and accounting issues as they apply to and as they may impact the health care industry specifically.

The importance of having congressional hearings on matters effecting the investing public cannot be over emphasized. Due in large to the work of this committee, last year Congress passed and President Bush signed into law historic corporate reform legislation, legislation that addressed many corporate governance and accounting matters that were first brought to the public's attention by our hearings.

While investigations by other branches of the government can last months, even years, timely congressional hearings can result in changes that benefit the public sooner rather than later.

With respect to the HealthSouth investigation, on March 19 of this year the first of 15 former HealthSouth officers plead guilty to a variety of Federal charges including conspiracy to commit wire fraud, securities fraud, falsifying books and records, falsification of financial information filed with the SEC, bank fraud and conspiracy to make false statements to auditors. Incredibly, all five of the company's chief financial officer spanning a period of over 15 years have plead guilty to a variety of these Federal offense. Guilty pleas also have been obtained from several controllers and treasurers of the company.

The essence of the fraud was similar to those we have witnessed in the past. It involved the use of inappropriate accounting practices to hide expenses and inflate revenues. All in an attempt to meet Wall Street's earnings expectations.

What is unique in this case is how the company's senior officers crafted an elaborate ruse to come clean with Wall Street about true projected earnings once it became obvious that they would need to do so by blaming a Medicare billing policy clarification on group therapy reimbursement, known as Transmittal 1753, for an immediate and ongoing $175 million annual hit to its books.

The reality, as we will hear today, is that this policy clarification would have little immediate impact and questionable long term impact on HealthSouth's finances. The last man standing after this wave of admissions and guilty pleas is the founder and former chairman and CEO of the company Richard Scrushy. Notably, every CFO as well as other senior officer of HealthSouth have stated under oath that Mr. Scrushy directed them to falsify HealthSouth's public financial statements.

Mr. Scrushy appears before this committee today voluntarily, but has advised us that he will not testify and plans to assert his Fifth Amendment right not to incriminate himself. This committee, as always, respects this assertion. However, I am deeply troubled by this decision given that just 4 days before this hearing Mr. Scrushy granted a no holes barred interview to "60 Minutes" without his attorney present. To agreed to answer the questions put to him by a reporter, but now refuses to answer questions put to him by the representatives of the investing public who lost so much money in the almost total dissemination of HealthSouth's stock last year.

This begs the question why is Mr. Scrushy unwilling to answer here today under oath some of the same exact same questions asked of him by a reporter? I also wanted to know why it is that in the 3 months leading up to the company's announcement of the purported $175 million impact of Transmittal 1753, an announcement that sent HealthSouth's stock plummeting and the company

to the brink of bankruptcy, Mr. Scrushy disposed of 75 percent of his HealthSouth stock worth nearly $100 million? This fact is even more suspicious given that Mr. Scrushy had not engaged in any stock sales for the 5 preceding years.

Although we likely will not hear answers from Mr. Scrushy today to these and other questions, we will hear from other witnesses about the intimidating nature of the corporate environment and its domineering chairman and how he made employees feel that if they ever told him something he did not want to hear or pointed out any internal problems, they would lose their jobs.

We will hear how Mr. Scrushy installed hidden cameras to keep watch over his empire and had himself accompanied by an armed bodyguard even while in his own company's corporate office.

Several employees will tell us that one reason they did not use the fraud hotline set up by HealthSouth and touted by Mr. Scrushy as a way to report fraud allegations within the company, was that they feared that the hotline was, in fact, monitored by HealthSouth's security and their identity could be uncovered.

We also will hear testimony from a witness who reported her suspicion about fraud occurring at the company by senior management 3 years before the HealthSouth case broke. However, as the committee has learned, the corporate compliance officer who took charge of the investigation directed that the case be closed and no paperwork substantiating any investigation that he did exists today.

All of these matters raise distributing questions about the corporate culture established by Mr. Scrushy and the extent to which the company under Mr. Scrushy's leadership allowed its internal controls and compliance efforts to be weak or nonexistent. They also raise serious questions about the adequacy of efforts by HealthSouth's Board, it's outside auditors and other extensible independent actors to properly oversee this company and protect the interests of investors, a subject for our next day of hearing into this matter.

Following our hearing into the Enron scandal, this Congress passed historic legislation to reform some of these corporate abuses. To some degree we are already seeing the benefit of that legislation in this case as the personal certifications of company books now required by senior officers reported led one or more of HealthSouth's CFOs to think twice and go to the Justice Department instead. However, I cannot help but be amazed that even in the post Enron environment HealthSouth's corporate chiefs, board members and outside experts would either participate in or fail to properly undercover and stop such blatant accounting scams. How could this have occurred? Certainly Mr. Scrushy had it at least partially right when he said on "60 Minutes" the other night that there are incredible financial and other incentives for corporate chiefs to cook the book because of promotions, raises, bonuses, stock options and just plain old greed. If that is true, then we must question whether any legislation will ever be sufficient to deter such behavior.

Perhaps it comes down to the ethical and cultural climate fostered by those at the top of these companies, which is why it is so appropriate to start this hearing with Mr. Scrushy himself.

I want to thank all of the witnesses for attending.

I now recognize the lady from Colorado, Ms. DeGette, for an opening statement.

Ms. DEGETTE. Thank you, Mr. Chairman, for holding this very important hearing on the fraud that nearly brought down the $4 billion HealthSouth Corporation.

This committee has developed an enviable record in exposing and investigating fraud as some of the largest companies in this country, including Enron and WorldCom. In response to the scandals at Enron and WorldCom, Congress passed the Sarbanes Oxley Act which you referred to, which took a critical step in increasing accountability and cracking down on corporate malfeasance throughout corporate America. However, the revolutions of the culture of deceit that pervaded HealthSouth and the countless measures members of the management team took in order to create and to protect their own fortunes reminds us that corporate reform is, nevertheless, an issue that requires our immediate attention.

Simply, the deception that permeated HealthSouth from the management team to the board of directors to the internal and external auditing teams is an absolute outrage. It is yet another sobering instance of the triumph of creed and arrogance over a company's fiduciary duty to its shareholders. Accordingly, it's incumbent upon us as a legislative body to send an unequivocal message that such crookedness should not and will not be tolerated.

Unlike other cases that we've investigated in this subcommittee, like Enron and WorldCom, the case of HealthSouth has some unique characteristics. It's often difficult to prove that a company's chairman and chief executive officer had personal knowledge of a fraud. In this case however, as the chairman mentioned, 5 chief financial officers covering the period of HealthSouth's creation in 1984 to March 2003 have plead guilty, and all of them have said that Richard Scrushy, the company's chief executive officer directed them to make changes in the company's financial books when the company couldn't meet Wall Street's expectations; changes that allegedly amounted to nearly $3 billion.

Meanwhile, Mr. Scrushy claims he's innocent but refuses to tell this committee what he knows and what he doesn't know, preferring I guess to go on national TV to say so. He claims that these officers committed fraud, or at least he said on Sunday the officers committed fraud to benefit themselves. But, of course, he neglected to mention the biggest beneficiary of the fraud and other questionable practices of HealthSouth was Mr. Scrushy himself.

Our investigation has revealed a company with a breathtaking lack of internal controls and one of the most negligent boards that we've observed. The company was under the total control of Mr. Scrushy with no countervailing corporate governance system in place. By all accounts Mr. Scrushy ran HealthSouth by intimidation and manipulation. He refused to listen to top staff who told him what he didn't want to hear and punished them by taking away responsibilities or playing staff members against each other.

One of the board members has said that no employee could stand up against Mr. Scrushy without expecting pay back. As a result, the compliance officer who could have stopped this fraud in 1999

failed to investigate credible allegations backed up by documentary evidence which were actually admitted by the controller.

The chief financial officer instructed him to placate the complainant and the traditional internal controls were also missing. The internal auditors who reported directly to Mr. Scrushy by his orders could not look at the corporate books. Ernst & Young, the external auditor, which should have picked up on some of these weaknesses never once found a single concern with the company's accounting practices or internal controls. I understand they're coming in a few weeks, and I'm looking forward to hearing them.

The HealthSouth board, stacked with personal friends of Mr. Scrushy, was awash in conflicts of interests that benefits them financially and functioned as a rubber stamp for Mr. Scrushy.

For example, the board agreed to reprice stock options after they were granted to benefit Mr. Scrushy and the officers.

The audit committee never met with the internal or external auditor except to get perfunctory annual reports. The current internal auditor did not meet with the audit committee for the first 18 months of his tenure. The audit committee only met once in 2001.

These weaknesses allows Mr. Scrushy and others to use corporate funds to their own advantage. Mr. Scrushy had 7 corporate planes. He wanted to be a music entrepreneur, so he spent a million dollars of HealthSouth's money on Third Phase, a girl band that he hoped would be the next Destiny's Child.

The board approved a grant of 250,000 stock options to Tony Mottola, then head of Sony Records, which subsequently signed Third Phase to a record contract. But the board can't even remember why they did it. And it goes on and on.

HealthSouth's so called code of ethics requires that all potential conflicts of interests be approved. According to the minutes provided to us, none of the conflicts were approved by the board. Some of them, the board was not even aware of.

In every sense of the word HealthSouth failed the investing public in its employees. And, frankly, they are the ones who have paid the highest price; the shareholders and the employees.

Mr. Chairman, thanks again for holding this hearing. I hope we cannot only find out the corporate abuses with HealthSouth, but also delve more into what we can do with accounting and auditing firms, and the role of boards. Because I think those are two areas ripe for legislation.

Mr. GREENWOOD. The Chair thanks the gentlelady and recognizes for purposes of an opening statement, the Chairman of the full Committee, the gentleman from Louisiana, Mr. Tauzin.

Chairman TAUZIN. Thank you, Chairman Greenwood.

And let me first begin by saying how much the whole Committee appreciates the hard work you and ranking Democrat Ms. DeGette and the staff on both sides of the aisles have done on behalf of the committee with respect to these corporate governance and accounting fraud cases.

This morning we begin our examination of the financial collapse of HealthSouth. At its peak this company, reporting its operations in 50 States and worldwide, was producing about $4 billion a year in revenues. Today we know that figure was grossly inflated. And we know these numbers were made up by cooking the HealthSouth

books over a multiple year period. In fact, currently the companies forensic accountants indicate approximately $3 billion in fraudulent accounting entries. That puts this fraud in the class of the WorldCom fraud we looked at earlier.

Today we know, as the Chairman pointed out, the 15 former employees of the company, most of them senior management people, have plead guilty to a range of criminal charges arising out of this fraud.

We also know that, like some other cases we examined, the committee has learned that there was shredding of documents responsive to the SEC inquiry in this case, and to the Fulbright review attempt in 2002 to examine one of the aspects of the case.

And we know that shredding occurred in a restricted area, a restricted access area in which the chairman, Mr. Scrushy and 4 other executive officers were located. We obviously don't know yet who did the shredding, but we know where it occurred in this restricted area and we know the shredding was, obviously, of documents responsive to these investigations and examinations.

So we have to ask once again how did such a vast conspiracy, how could that have occurred in a Fortune 500 company which is publicly trade and in which millions of Americans, many pension holders, invest?

When people in this country make decisions about where to invest their hard dollars, when pension funds and others place their sacred trust dollars into these businesses, everyone should be able to rely upon established safeguards to ensure that the numbers they are looking at are real. Those safeguards include internal controls, financial disclosures, corporate compliance programs, board independence and external auditing. All to ensure that investors can trust the numbers they are looking at. In the case of HealthSouth and some of the other cases we have examined, these safeguards resoundingly failed and Congress and the American public have a right to know why.

It will be interesting, Mr. Chairman, to examine as we learn all the fact in this case how the new statute that was passed by Congress would have changed, if it would have changed the results in this case if this fraud would have been discovered early, if this fraud could have been prevented. And from this examination we may learn whether the act we passed can and will work as well as we hope it will.

This examination is also relevant because we are in the middle of a Medicare conference. We are examining a health care company, a health care company that made claims against CMS, the agency that expends funds for Medicare and Medicaid, a system that is hard pressed to satisfy the needs of Americans in terms of maintaining and taking care of health problems in this country, particularly for our seniors. And so this examination has relevance on a number of different levels.

As a pointed out, we call the chairman of the board, Mr. Scrushy. Our job is not to prosecute people here. Our job is to learn what went wrong. To learn from it, and to establish policy to prevent it in the future. But we are not going to learn a lot from Mr. Scrushy today, other than what we have learned on "60 Minutes" while he was willing to talk to "60 Minutes" reporters without the benefit

of an attorney, my understanding he will take the Fifth this morning. And while we certainly respect the rights afford to him under the Constitution to refuse to incriminate himself, we really question why he felt it was appropriate to discuss this story to a television journalist when he is unwilling to do so before Congress today.

We look forward to hearing the testimony of current and former employees of the company who, in fact, raised concerns about irregularities that they observed during the period of the fraud, only to be punished or berated for bringing it to the attention of officers of the company. Have we heard that before in some of these investigations?

Let me also thank you all for coming to testify today. If management had listened to your concerns when you brought them up several years ago, maybe HealthSouth would not have been forced to the brink of bankruptcy. An important company that delivers important health care services to Americans would not have been put in such an awful position.

We will hear from former members of the management team and employees who were integrally involved in the company's internal control and compliance activities. Perhaps they can shed some light on why these processes failed so dramatically and whether or not the new Sarbanes Oxley Bill will help cure those problems.

This committee has been examining these HealthSouth issues for 6 months. And, again, I want to thank you all for the extraordinary hard work you have done, Mr. Chairman and Ms. DeGette, and the members of your staff. But as you know, we have been looking at these kind of problems in various sectors of the economy that fall under this Committee's jurisdiction. Enron in the energy sector, WorldCom, Global Crossing, Qwest in the telecom sector. ImClone and now HealthSouth in the health care sector. In each of these cases we have pursued these investigations because of the transparency, the accuracy, the credibility of financial statements are simply essential to the smooth functioning of competitive markets. And they're absolutely critical to instill the requisite confidence in the investing public necessary to support our capital system. Thankfully, perhaps as a result of the hearings we have held, perhaps as a result of the Sarbanes Oxley Bill, perhaps as a result of the extraordinary changes that are occurring in board rooms across America, Americans are beginning to feel some confidence again in the marketplace.

Today we take one more step in ensuring the problems that occurred at HealthSouth and the damage done to the investing public, to the workers who tried to build a great company only to find that their leadership in the company let them down; we take one more step in establishing and reestablishing confidence of Americans and investors in this marketplace.

We have got a lot of ground to cover, so Mr. Chairman, I will yield back the balance of my time.

Mr. GREENWOOD. The Chair thanks the gentleman and recognizes for the purposes of an opening statement the vice chairman of the subcommittee, the gentleman from Oregon, Mr. Walden.

Mr. WALDEN. Thank you very much, Mr. Chairman. And thank you for convening this hearing, the first in a series that examines the collapse of HealthSouth.

A year and a half ago Congress passed laws in the wake of the frauds and tumultuous bankruptcies of Enron and Global Crossing to protect workers and investors in publicly traded corporations by improving the accuracy of corporate financial disclosures and increasing supervision of accountants that audit public companies. As a result, the Securities and Exchange Commission has set standards to ensure that corporate financial disclosures are complete, transparent and provide an accurate picture of a company's financial health. I question if HealthSouth heeded any of the methodologies that Congress established to check and balance the financial underpinnings of publicly trade corporations.

I am troubled by charges included in the complaint filed in the U.S. District Court of the Northern Alabama by the SEC that claims that between 1999 and 2002 when HealthSouth's earnings fell short of Wall Street's earnings estimates, Mr. Scrushy, CEO of HealthSouth, directed accounting personnel to "fix it" by artificially inflating the company's earnings to match Wall Street's expectations. This type of alleged fraud is exactly what Congress is attempting to root out when we passed the landmark Sarbanes Oxley Corporate Accountability Act. Was anyone accountable at HealthSouth under Mr. Scrushy's leadership?

As long as corporate executives feel they are above the law and not accountable to each and every shareholder, Congress will hold them accountable for their actions or inactions. Reforming accounting oversight and enhancing corporate disclosure are critical to increasing and maintaining investor confidence in our Nation's corporations. Without this confidence, private investment will plummet and our economy will suffer.

The "60 Minutes" piece that aired on Sunday night told a story of a night that had a vision and worked tirelessly to make his vision a reality. He built a health care empire that provided rehabilitative care to patients coast to coast and employed tens of thousands. That company, HealthSouth, would still be a struggling small business scraping capital together if it were not for the confidence that investors and shareholders afford Richard Scrushy in the mid 1980's when HealthSouth began to be publicly traded.

Each time an Enron, WorldCom, Global Crossing or HealthSouth scandal surfaces investor confidence is severely eroded. Without investor confidence, the free enterprise system falters. This sets of a domino effect throughout our economy.

It is extraordinary to me that this company paid more to Ernst & Young to check its trash cans and toilets than it paid to audit its books and its revenues and expenditures. It is absolutely outrages.

One of my colleagues mentioned that there was a breathtaking lacking of internal control. And, indeed, from a normal sense of business practice that is true. But it begins to look like there was an extraordinary system of internal control right at the top that prevented internal auditors from accessing the books and records they needed to access. There is a total failure here in how this com-

pany was reviewed, audited and the information that flowed out to investors.

I spent 5 years on a community bank board and served on an audit committee. I am outraged at the practices that I read about that took place here. It's unexcusable, it's unacceptable, it will not be tolerated.

Mr. Chairman, I yield back the balance of my time.

Mr. GREENWOOD. The Chair thanks the gentleman and recognizes for an opening statement the gentleman from North Carolina, Mr. Burr.

Mr. BURR. Thank you, Mr. Chairman.

Mr. Chairman, this has become too much of a commonplace thing for this Committee that we have a piece of corporate America in front of the Oversight Committee. Because of the fact that they let down the trust of their investors, their employees, that there potentially was fraud. I would remind everybody, we are not a court. We have a very important role to play, and it is why I think this hearing is going on.

We have a policy mission as it relates to Medicare and Medicaid that a lot of times people do not believe that our eyes are on the right thing. To understand it in total it means that you have to look at everything that has an effect on it. Fraud within that system has a huge effect. It is very appropriate for this Committee to look at this issue, and to look at it in whatever detail helps us to understand what happened, why it happened. Because our challenge is to make sure that we design a system that does not allow it to happen, whether it is this company or another company, or another entity in the future.

Clearly there is a legal process that those that need to go through will go through. But I hope that those that are here today understand that this committee through this subcommittee are focused on the changes, if any, that we need to make to make sure that in the future this cannot happen. Not that it does not. We understand that individual creed maybe does drive people to do things that they know are wrong. It does not mean that we have to create a system or allow one to stay in place that makes it easy for them to make that decision.

So I do appreciate the Chairman's willingness to do this, and I know this will not be the last time that we are forced to have a hearing in Oversight that does this, but I do thank the Chairman.

Mr. GREENWOOD. The Chair thanks the gentleman and recognizes for an opening statement the gentleman from New Jersey, Mr. Ferguson.

Mr. FERGUSON. Thank you, Mr. Chairman. Thank you for holding this important hearing on the massive and comprehensive fraud perpetrated by executives at HealthSouth.

First of all, we have to remember and think of the people at the FBI and the SEC, and the Department of Justice. They should be commended for their diligence in pursuing this matter and helping uncover the deceptive and illegal scheme that is simply business as usual for the executive team at HealthSouth.

Listen to the words that the FBI and the U.S. Attorney have used to describe the criminal HealthSouth's activities. "Securities fraud, tax fraud, bank fraud, accounting fraud, wire fraud, criminal

conspiracy." Clearly the authorities must continue their hard work until justice is served for all those who are guilty of deceptive and unlawful business practices.

Mr. Chairman, as you have noted, 15 people have already plead guilty in this case. These are 15 seemingly everyday people who have been branded as felons and will spend time in jail, possibly, for their criminal actions. At HealthSouth it was the culture from top to bottom to carry out this fraudulent scheme with the executive team.

As a U.S. Attorney said in a recent press release, "HealthSouth does not represent a mere accounting fraud, but rather a business scheme to fraudulent boost HealthSouth's reported earnings." The U.S. Attorney continued "HealthSouth executives concealed the scheme to fraudulently inflate earnings from the investing public, the auditors and government regulators and willfully and knowingly made false and misleading statements to auditors and omitted material facts in order to mislead their accountants"—even misleading their accountants—"in connection with an audit of HealthSouth's financial statement."

I am interested to hear how such a massive and comprehensive fraud could have been orchestrated. Unfortunately, we will not be hearing, seemingly, from the captain of the ship at HealthSouth. Many have suggested that Mr. Scrushy, founder and former CEO of the company, initiated and masterminded this fraud. We may not get any answers from Mr. Scrushy today, but we will learn a great deal about the fraud at HealthSouth.

But if there is one thing that I hope that we will learn from this hearing, and all America will learn from this hearing, is that those who run America's companies will continue to get the message; that if you are committing fraud, you will be caught and there will be a dear price to pay.

Thank you, Mr. Chairman. I look forward to hearing from our witnesses, and I yield back.

Mr. GREENWOOD. The Chair thanks gentleman and recognizes for his opening statement the gentleman from Florida, Mr. Stearns.

Mr. STEARNS. Good morning. And thank you, Mr. Chairman, for holding this subcommittee hearing.

Now here we go again. We have been through this with other companies, and obviously it's disheartening to see that this committee has to continue to investigate corporate malfeasance and whether this financial fraud is committed by accounting firms, like Arther Anderson, or energy companies or conglomerates, it is all disappointing again this morning to be here.

There is a branch of HealthSouth chain in my hometown of Ocala, Florida. My constituents have used it for years and families in Ocala and throughout central Florida depend upon the jobs there.

HealthSouth had its executives come into my office here in Washington to lobby me and my staff. One of the concerns they had were they want a more lucrative classification dealing with Medicare reimbursement for therapy, the 75 percent rule so called. And they wanted to make themselves more available for this. And one of their arguments was they needed it for their bottom line.

It is not wrong to lobby me, obviously. But myself and my staff trust that when they come in and to make their arguments in their presentation about their finances for their firm that they are accurate. Issues like the senior Transmittal 1753, which deals with it. And then to see to Mr. Scrushy's mysterious stock option sale, you know, 3 days prior to that memo casts doubt on that trust.

Mr. Chairman, the Department of Defense put up the 52 most wanted people in Iraq. My colleagues, there are now two websites that have come up with the most wanted executives. One of them is called Shareholders Most Wanted The Original Greedy Executive Card Deck. And they show a royal flush here including Ken Lay and others.

Mr. Scrushy, I would think that you will be added to this Shareholders Most Wanted list, The Original Greedy Executive so we can see here a royal flush. You will probably replace even some of the people on this list.

There is another, Stacked Deck, Corporate America's Least Wanted, the original scandal list. It's a parody. It's a good card set. It includes companies as well as individuals.

So, Mr. Chairman, we can see that the public is starting to perceive, and that is why we are here.

Let me follow up a little bit on what my colleague from North Carolina, Mr. Burr, indicated.

I was asked, well, why is this Committee investing? Why do you not just send all this information to the Justice Department or the FTC, or the SEC, why are you spending your time here?

Well, we write the laws, and we write the laws on Medicare reimbursement and security trading, and therefore we need to be informed when these events do not proceed according to the law that we passed. And that is why we are here today. We have a fiduciary responsibility to taxpayers to understand it so we can write the laws better.

So once again the committee will again examine the issues of falsified accounting records, inflated share prices, the role of executive compensation and the protection of corporate and courageous whistleblowers. Besides jeopardizing patients and employees, shady executives' practices lead to damaging effects that ripple through this economy. Do not give the shareholders the confidence they need to invest.

My colleagues, Mr. Chairman, integrity is the elixir that attracts capital, bottom line. It leads to lifesaving treatment. While deceit is a poison that erodes investor confidence and hurts employees and possible patients.

So I look forward to the testimony, Mr. Chairman, this morning. And I, again, compliment you on this hearing.

Mr. GREENWOOD. The Chair thanks the gentleman.

If there are no additional opening statements, at this time the Chair will call forward our first witness, Mr. Richard Scrushy, former Chairman and CEO of HealthSouth.

Mr. Scrushy, please come forward and be seated at the table.

Good morning, sir.

Given that you have indicated through your counsel that you will not answer the subcommittee's questions today, I want to show you and the subcommittee members some excerpts from your appear-

ance on "60 Minutes" last Sunday night, an interview that your own lawyers have said in a letter to this subcommittee should "serve any immediate public need for information from you."

So will the staff please start the video.

Mr. WALLACE. You are supposed to be a crook. The SEC in effect says you are. Your former financial officers, chief financial officers say you are, that Richard Scrushy inflated earnings and betrayed his stockholders, betrayed his employees.

Mr. SCRUSHY. There is no evidence of any of that. And mainly what the people have said is not true.

Mr. WALLACE. He told us his top financial officers committed the fraud without his knowledge.

Mr. SCRUSHY. You have to rely, you have to trust people. You have to believe—you have to delegate. I mean, you hire you them, you pay them good salaries, you expect them to do the right thing. And I signed off on the information based on what was provided to me and what I was told.

Mr. WALLACE. You say you did not keep track of the accounting?

Mr. SCRUSHY. CEO's do not do that. CFOs do that.

Mr. WALLACE. Who is that?

Mr. SCRUSHY. Chief financial officer means he is the chief financial officer.

Mr. WALLACE. Here is how the SEC describes what it calls the scheme, your scheme. Each quarter HealthSouth senior officers would present Scrushy with the company's actual earnings and he would compare them to Wall Street expectations. If the actual results fell short of expectations, Scrushy would tell his management to "fix it" by recording false earnings to make up for the shortfall.

Mr. SCRUSHY. That is not true.

Mr. WALLACE. Scrushy's world first began to become apart last March when one of his chief financial officers went to Federal prosecutors and confessed that HealthSouth at Scrushy's expressed direction had been overstating its profits hugely for years. So far, 15 former HealthSouth employees have plead guilty.

Michael Martin, Chief Financial Officer. Let me read from the court transcript when he plead guilty. The judge asked Michael Martin "Did you Mr. Scrushy discuss in fact the numbers contained in the filings were false?" "Yes, sir."

"Did Mr. Scrushy direct you to do something with the number?" "Yes, sir. He told me to inflate the numbers. To fix the numbers so that they met Wall Street's expectations."

Mr. SCRUSHY. So is Mike Martin just a dummy? Just some guy says go do something to commit a fraud or a crime that would put you in jail, and Mike Martin just does it? You don't believe that, Mike.

I would never have done that. He is not telling the truth.

Mr. WALLACE. Tad McVay, CFO until early this year, 2003, plead guilty told the judge Richard Scrushy was aware that the financial statement contained numbers that were incorrect.

Mr. SCRUSHY. This is—again, it is not true.

I have an—I have——

Mr. WALLACE. All these guys are liars and you are a knight in shining armor?

Mr. SCRUSHY. Mike, there are 50,000 people; there are 5—you know, 5 people that have made these claims out of 50,000. Let me make a comment.

Mr. WALLACE. But you are in charge. Come on, you are——

Mr. SCRUSHY. It does not mean—it does not mean I am a—no, I did not—I did not—no. This—you are not right.

Mr. WALLACE. McVay told the judge you tried to justify it by saying "all companies play games with accounting."

Mr. SCRUSHY. I never said that to him, and he knows that.

Mr. WALLACE. Why would these chief financial officers, what you are saying is they committed the fraud? For what reason?

Mr. SCRUSHY. I did not—I certainly did not commit the fraud. People know me. They know I would not instruct somebody to do that.

Mr. WALLACE. What would be the motive of your CFOs to commit a fraud?

Mr. SCRUSHY. I really do not want to get into it with you. But every one of them has a motive.

Mr. WALLACE. But then he did tell us what he believes motivated his CFOs to falsely inflate earnings.

Mr. SCRUSHY. Promotions, bonuses, stock, stock options, an opportunity to make a lot of money. There is incentives in it. Tremendous incentives: Power, greed. There is a lot of reasons for what they did. There is no motive for me to destroy a great company that I built, a company that I loved, my fourth child. There is no reason for me to do that.

Mr. JONES. He benefited more than anybody from this fraud. There is no question about it, 100 times fold.

Mr. WALLACE. Doug Jones, a former U.S. Attorney in Birmingham has filed a class action suit against Scrushy on behalf of stockholders who lost billions while Scrushy made hundreds of millions dollars from the fraud. How?

Mr. JONES. In his stock options, his salaries and his bonuses. And he has for years cultivated an image that this is my company. I am the one that brought this company up. I had my finger on the pulse. I know everything that is going on in this company. I know the numbers. I know all that, I know all that he told me, but I am not an accountant. He does not have to be an accountant to direct this fraud. Other people may be the ones sitting up there late at night crunching the numbers and cooking the books. But that does not mean when he says fix it, if that is true that he's not as much responsible for engineering that train wreck as anybody else.

Mr. WALLACE. When the public sees a report in The Wall Street Journal and HealthSouth says hey, things look very, very good for the next quarter or the next year or whatever, and then people would be buying the stock and conceivably driving up the price of the stock, right?

Mr. SCRUSHY. That is right.

Mr. WALLACE. It's suggested that that was the motive for you to inflate these figures because you were living high, you wanted to that stock to be high and that is, apparently, what people are saying is the motive for you to phony up the figures.

Mr. SCRUSHY. Well, I didn't phony—first of all, I did not phony up the figures.

Second of all, you got to look at my—my buying and selling, okay?

Mr. WALLACE. Yes.

Mr. SCRUSHY. I did not sell the stock at a high.

Mr. WALLACE. The stock is now $3.

Mr. SCRUSHY. Yes.

Mr. WALLACE. You sold $99 million worth of that stock between $10 and $14.

Mr. SCRUSHY. When you build something from nothing, you should have the right at some point to have some liquidity. That is what every young MBA in America is working toward.

So what I did was, you know, the American dream.

Mr. WALLACE. But you get out?

Mr. SCRUSHY. I did not—no, I didn't—I just got some of it out. I did not—I just——

Mr. WALLACE. You got a lot of it out, $99 million worth.

Mr. SCRUSHY. Yes. But I am saying——

Mr. WALLACE. $99 million worth between $10 and $14, and all of these other poor people, what are they doing?

Mr. SCRUSHY. Right. Right.

Mr. WALLACE. They are sitting there waiting because they do not know what you know.

Mr. SCRUSHY. Mike? Mike? Mike, I had stock options that were going to go away, $99 million worth going away. It was going away. It was done.

Mr. WALLACE. Right.

Mr. SCRUSHY. I was going to lose it. What would you have done? What would anybody have done?

Mr. WALLACE. What he did was sell high, and to help keep it high he regularly gave bullish profit predictions to Wall Street analysts and interviewers.

Here is what he said on CNBC last year when the stock was selling at $15.

Mr. SCRUSHY. Well, I think the companies should be offering $20 a share right now. Certainly we should be higher than we are now, but I would expect to see the company in the $20's, and that is where we are headed, we believed.

Mr. WALLACE. But just 12 days later Scrushy sold more than 5 million shares of his stock. Now HealthSouth board is barred him from even entering any offices of the company he built and HealthSouth now admits that none of his past profit numbers can be trusted. The company is struggling to stay out of bankruptcy and Scrushy is struggling to stay out of prison.

You would expect, I would imagine, the U.S. Attorney here in Birmingham within what? Weeks to bring criminal charges against you?

Mr. SCRUSHY. I do not expect that at all. I think an objective review of the evidence will show that Richard Scrushy was not involved in any of these alleged crimes. And they will see that I was not part of that scheme.

Mr. WALLACE. Scrushy still lives an over-the-top millionaire's life, though now that his fate will probably be decided by a jury in Birmingham, he wants to downplay his wealth. He would not let

us videotape his 4 mansions, nor his antique car collection, nor his wine cellar.

I have seldom been in this position before, to talk to a man of great accomplishments who maybe or maybe not went wrong and who sits here and says the SEC is wrong, the prosecutors are wrong, the chief financial officers are wrong, the world is against me. They are all wrong and I am right. I am an honorable man and they are just damn wrong.

Mr. SCRUSHY. Why do we not take the testimony of people who are not felons, who are admitted liars and see what they have to say. Let us get their testimony. They will not say the same thing.

Mr. WALLACE. You are not going to jail?

Mr. SCRUSHY. No. No, I am not going to jail. I am an innocent man. I am not going to jail.

Mr. GREENWOOD. Mr. Scrushy, here is your opportunity to say under oath what you said on "60 Minutes". Here is your opportunity to answer questions and tell this Committee of Congress what we need to know about HealthSouth under oath.

As you know, when we conduct an investigative hearing this Committee has the practice of taking testimony under oath. Do you have any objection to doing so?

You have to put your microphone on, Mr. Scrushy. There is a little button there.

Mr. SCRUSHY. Is that one?

Mr. GREENWOOD. It is on.

Mr. SCRUSHY. Mr. Chairman, I would like to state my position if it is——

Mr. GREENWOOD. Well, first, then in that case do you object to giving your testimony under oath? We take testimony under oath here.

Mr. SCRUSHY. Mr. Chairman, I am—I am going to state my—I mean I am going to invoke the Fifth, but I would like to state my position on that.

Mr. GREENWOOD. In that case, would you stand and raise your right hand? You have to be sworn in before you say you state your position. You can say anything you want for as long as you want this morning, and we would love it if you would, but the first thing you need to do is stand and raise your right hand so I can place you under oath.

In case your lawyers are not making this clear for you, I will.

If you wish to take the Fifth, assert your Fifth Amendment rights, you may do so. But the first thing you do, even before you assert those rights——

Mr. SCRUSHY. Yes, sir.

Mr. GREENWOOD. [continuing] is you need to be sworn in.

Mr. SCRUSHY. I understand.

Mr. GREENWOOD. Do you have any objections to——

Mr. SCRUSHY. No, sir.

Mr. GREENWOOD. Okay. Then would you please stand and raise your right hand?

[Witness sworn.]

Mr. GREENWOOD. Okay. You are now under oath. And under the rules of the House you are also advised that you have the right to be advised by counsel as to your constitutional rights. Could you

please state for the record the names of the counsel who are here today to advise you with respect to such matters?

Mr. SCRUSHY. Donald Watkins and Jonathan Wills.

Mr. GREENWOOD. Okay. The Chair now recognizes you for the purpose of making an opening statement, if you so desire. Do you desire to make an opening statement, sir?

Mr. SCRUSHY. Yes, sir, I do.

Mr. GREENWOOD. You may proceed.

TESTIMONY OF RICHARD SCRUSHY, FORMER CHAIRMAN AND CEO HEALTHSOUTH

Mr. SCRUSHY. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, thank you for the opportunity to appear here today.

Since the committee first wrote me, I asked my counsel to try to arrange for a fair hearing where I could tell the truth about the charges which have been made concerning me and HealthSouth. "60 Minutes" gave me such an opportunity in the media. I had hoped that the committee today at this hearing would ask my accusers to make their charges against me under oath, then I could answer them under oath. But the committee has not called any of my accusers to testify today.

The committee wants me to answer charges without facing my accusers. I do not believe this is fair. I am, therefore, by advice of my counsel forced to take the Fifth Amendment today until I can get a venue where I can face my accusers.

I hope the committee will let me come back someday under more appropriate circumstances to testify fully about the HealthSouth success story. By then, it will know more of the true facts. It will also know that there is not, and has never been any financial collapse of HealthSouth.

The only collapse has been the temporary one in the HealthSouth stock price caused by the manner in which this matter was investigated last March and the excess media publicity generated.

Thank you, Mr. Chairman.

Mr. GREENWOOD. Thank you, Mr. Scrushy.

The Chair would note, Mr. Scrushy, that during your "60 Minutes", which I watched with my mother and father in their home Sunday evening, your accusers were not there. You faced a series of questions from a reporter and you openly—apparently openly asked those questions. So the only difference that we can see between then and now is that you are now under oath.

So I am going to ask you one of the questions that Mr. Wallace asked you about former HealthSouth CFO Mike Martin's guilty plea transcript in which Martin says that he discussed with you the fact that the numbers contained in the HealthSouth filing were false and that you told him to inflate the numbers, to fix the numbers so that they met Wall Street's expectations. Your response Sunday night was "I would never have done that. He is not telling the truth." Mr. Scrushy, why do you not tell us the truth?

Mr. SCRUSHY. Under the advice of counsel, Mr. Chairman, I invoke the Fifth Amendment.

Mr. GREENWOOD. Did you discuss with Mr. Martin the fact that the numbers contained in HealthSouth's filings were false and did you direct Martin to inflate the numbers or fix them to meet Wall Street's expectations?

Mr. SCRUSHY. I invoke the Fifth, Mr. Chairman.

Mr. GREENWOOD. Well I am a little confused, Mr. Scrushy. If what you told the American public Sunday night was in fact the truth, why don't you simply repeat those denials here today under oath?

Mr. SCRUSHY. Mr. Chairman, I have stated my position and my reason for invoking the Fifth.

Mr. GREENWOOD. Let us try another one. Mike Wallace asked you about former CFO McVay's plea transcript in which he said that you were aware that the financial statement contained numbers that were incorrect. Your response on Sunday night was "It is not true." That sounds definitive, emphatic. So let me ask you the same question here today under oath, Mr. Scrushy. Were you aware that the financial statement contained numbers that were incorrect?

Mr. SCRUSHY. As previously stated, Mr. Chairman, I invoke the Fifth.

Mr. GREENWOOD. Mr. McVay told the judge you tried to justify it by saying "all companies play games with accounting." When Mike Wallace asked you about this on Sunday night you said "I never said that to him, and he knows that."

Mr. Scrushy, did you tell Mr. McVay that "all companies play games with accounting"?

Mr. SCRUSHY. Again, Mr. Chairman, I invoke the Fifth Amendment.

Mr. GREENWOOD. Well, since you do not seem to want to answer Mike Wallace's questions here today under oath, let me ask a few of my own.

You told "60 Minutes" that your CFOs who have plead guilty had plenty of incentive to falsify the numbers because of bonuses and stock options, yet is it not true, Mr. Scrushy, that you were one of the only employees at HealthSouth, if not the only employee, to have an employment agreement with large financial bonuses directly tied to monthly and annual revenue targets? And if you would like to, you could turn to Tab 22 in the binder in front of you if you would like to refer to that agreement.

Mr. SCRUSHY. On advice of counsel, Mr. Chairman, I invoke my Fifth Amendment rights.

Mr. GREENWOOD. All right. Well, let us try one last question. Mike Wallace asked you about your sale of $99 million worth of HealthSouth stock just before the bad news hit and the bottom dropped out. Comparing your position to those of average investors who got taken to the cleaners, he said to you "But you got out." Your response was "I did not get—no, I did not get—I just got some of it out." Mr. Wallace replied "You got a lot of it out." To which you replied "No."

Mr. Scrushy, the committee found a copy of an analysis by HealthSouth's own attorneys showing that you sold off 75 percent of your HealthSouth stock at that time. Was it not just a bit dis-

ingenuous when you told Mike Wallace that you just got some of it out?

Mr. SCRUSHY. On advice of counsel, Mr. Chairman, I invoke the Fifth Amendment rights.

Mr. GREENWOOD. The Chair yields to Mr. Stearns for the purpose of questioning.

Mr. STEARNS. Thank you, Mr. Chairman.

You have gone, based upon Mike Wallace's interview, you went and indicated to Mr. Scrushy you want an answer to two or three of those questions that Mike Wallace posed.

I have a question for you, Mr. Scrushy. Did everything that you said in that "60 Minute" interview with Mike Wallace represent the whole truth and nothing but the truth?

Mr. SCRUSHY. Sir, as I said earlier, on advice of counsel I am going to have to take the Fifth Amendment.

Mr. STEARNS. Okay. The last thing you said in that interview, you said I am an innocent man. I am asking you today are you an innocent man? Can you say yes without taking the Fifth?

The question is very simple. Are you an innocent man, yes or no?

Mr. SCRUSHY. Mr. Chair—I mean, sir, based on as I said earlier in my statement and advice of counsel, I stand on my statement.

Mr. STEARNS. I respect that. But I am just saying that you made a statement you're an innocent man. You have an opportunity just to answer that question. You do not need to take the Fifth just to say by gosh I am an innocent man. You are saying it to yourself, your family and everybody. You are standing by what you said in your opening statement. So it seems like you could say yes, I am an innocent man.

Mr. SCRUSHY. As you know, sir, I—I would love to answer all of these questions——

Mr. STEARNS. It is just——

Mr. SCRUSHY. And I look forward to the day that I get that chance. But on advice of counsel during this session I will take the Fifth Amendment on every question. I will stand on my statement.

Mr. STEARNS. Mr. Chairman, thank you.

Mr. GREENWOOD. The Chair yields to the gentlelady from Colorado, Ms. DeGette.

Ms. DEGETTE. Thank you, Mr. Chairman.

Mr. Scrushy, with all due respect, it seems to me that you want it both ways. You want to be able to go in front of a national TV audience and give your story without having to answer questions under oath. Then you want to come into today and make a statement, a self-serving statement in my view, and then when we ask you questions you want to take the Fifth Amendment when we ask you questions under oath.

And, Mr. Chairman, it seems to me that Mr. Scrushy may well have waived his right to take the Fifth in front of this Committee by coming in under oath and making an opening statement that deals with the substance of the investigation before answering questions. And so I would respectfully request the committee to refer this issue to the House General Counsel for a legal opinion as to whether he has indeed waived his Fifth Amendment right. And if he has, Mr. Chairman, I would ask that the committee re-

serve the right to recall Mr. Scrushy to answer this committee's questions under oath.

Mr. GREENWOOD. The Chair will take the gentlelady's request under consideration.

Mr. Scrushy, let me be clear, are you refusing, as it seems that you are, to answer all of the questions on the right against self-incrimination to you under the Fifth Amendment of the U.S. Constitution?

Mr. SCRUSHY. Yes, I am.

Mr. GREENWOOD. Okay. Given that there are no further—and is it your intention to assert such right in response to all further questions from the subcommittee today?

Mr. SCRUSHY. Yes, sir.

Mr. GREENWOOD. Okay. Given that, if there are no further questions from the members, I will dismiss you at this time subject to the right of the subcommittee to recall if necessary.

Mr. Scrushy, when the day comes that you're prepared to come to this Committee and testify under oath, have your lawyers call our lawyers. We would love nothing more than to give you that opportunity. But, for the moment, sir, you are excused.

Mr. SCRUSHY. Yes, sir. We will be happy to do that. Thank you.

Mr. GREENWOOD. At this time the Chair will call forward our second witness, Ms. Susan Jones-Smith, former Senior Vice President of Finance and Reimbursement of HealthSouth.

Ms. Jones-Smith, please come forward and be seated at the table. Good morning.

TESTIMONY OF SUSAN JONES-SMITH, FORMER VICE PRESIDENT OF FINANCE AND REIMBURSEMENT OF HEALTHSOUTH

Ms. JONES-SMITH. Hello.

Mr. GREENWOOD. As you know, when conducting an investigative hearing, this Committee has the practice of taking testimony under oath. Do you have any objection to doing so?

Ms. JONES-SMITH. No.

Mr. GREENWOOD. Okay. In that case, would you stand and raise your right hand.

[Witness sworn.]

Mr. GREENWOOD. You can be seated.

Under the rules of the House and this Committee you have the right to be advised by counsel as to your constitutional rights. Can you please state for the record the name of the counsel is here today to advise you with respect to such matters?

Ms. JONES-SMITH. David McKnight.

Mr. GREENWOOD. That is the gentleman to your right?

Ms. JONES-SMITH. Yes.

Mr. GREENWOOD. Thank you.

The Chair recognizes the witness for purposes of making an opening statement, if you so desire. Do you desire to make an opening statement this morning?

Ms. JONES-SMITH. I have no opening statement.

Mr. GREENWOOD. Okay. In that case, the Chair now recognizes himself for 10 minutes for purposes of questioning the witness, and I yield 5 minutes to Mr. Walden from Oregon.

Mr. WALDEN. Thank you, Mr. Chairman.

Ms. Jones-Smith, the SEC has alleged that every quarter for a period of at least 5 years senior officers at HealthSouth would meet to discuss how to "fill the gap" between HealthSouth's actual revenues and Wall Street's expected earnings of the company. My question is did you participate in or have knowledge about these meetings in which HealthSouth officers determined how they were going to falsify HealthSouth's earnings?

Ms. JONES-SMITH. Upon advice of counsel, I respectfully decline to answer based on my Fifth Amendment privilege.

Mr. WALDEN. Ms. Jones-Smith, let me be clear. Are you refusing to answer the question on the right against self-incrimination afforded to you under the Fifth Amendment of the U.S. Constitution?

Ms. JONES-SMITH. Upon advice of counsel, I respectfully decline to answer based upon my Fifth Amendment rights.

Mr. WALDEN. And is it your intention to assert such right in response to all further questions from the subcommittee today?

Ms. JONES-SMITH. Yes, sir.

Mr. WALDEN. Given that, Mr. Chairman, I would recommend that this subcommittee dismiss this witness at this time.

Mr. GREENWOOD. If there are no further questions from the members, I will dismiss you at this time subject to the right of the subcommittee to recall you if necessary. And we thank you for being with us this morning.

You are excused.

The Chair calls forward our next panel of witnesses. And they are, Ms. Diana Henze, Assistant Controller, HealthSouth Corporation; Ms. Teresa Sanders, former Group Vice President and Chief Auditing Officer of HealthSouth Corporation; Mr. Steve Schlatter, former HealthSouth Physical Therapist; Mr. Michael Vines, former HealthSouth employee in Corporate Fixed Assets Department; Mr. Martin Cohen, Senior Managing Director, FTI Consulting; Ms. Kelly Cullison, former Vice President of Compliance HealthSouth Corporation; Mr. Greg Smith, Chief Auditing Officer of HealthSouth Corporation.

Good morning, ladies and gentlemen, and we thank you very much for volunteering to come and testify at our hearing this morning.

As you heard me say to the previous witnesses, it is the practice of this subcommittee to take testimony under oath. And so I need to ask you if any of you object to giving your testimony under oath? Okay.

And I also should advise you that pursuant to the rules of the House and this Committee you are entitled to be represented by counsel. Do any of you wish to be represented by counsel this morning?

Yes, sir, Mr. Cohen? You need to bring the microphone up to you and make sure that it is on. Push the button. There you go.

Mr. COHEN. Represented by Phillip Evans.

Mr. GREENWOOD. Okay. And he's the gentleman directly behind you?

Mr. COHEN. Yes, sir.

Mr. GREENWOOD. Anyone else chose to be represented by counsel? Ms. Cullison?

Ms. CULLISON. Yes. John Robbins is seated behind me.

Mr. GREENWOOD. Yes. Thank you.

Mr. Smith?

Mr. SMITH. Mr. Michael Dyer.

Mr. GREENWOOD. Okay. Very well.

Ms. Henze? You have got to push the button.

Ms. HENZE. Mr. John Robbins sitting behind me.

Mr. GREENWOOD. Very well. Thank you.

Ms. Sanders?

Ms. SANDERS. Mr. John Robbins sitting behind me.

Mr. GREENWOOD. Okay. And where is Mr. John Robbins. Oh. You have a busy day today.

All right. In that case, I am going to ask you if you would please rise and raise your right hand.

[Witnesses sworn.]

Mr. GREENWOOD. Okay. So saying you are all under oath.

And the Chair would now recognize Ms. Henze first for your opening statement. And so if you will pull the microphone over so you can speak directly into it.

Mr. GREENWOOD. Good morning, ma'am.

Ms. HENZE. Good morning.

Mr. GREENWOOD. Thank you for being with us. And you are free to make your statement.

TESTIMONY OF DIANA HENZE, ASSISTANT CONTROLLER, HEALTHSOUTH CORPORATION; TERESA SANDERS, FORMER GROUP VICE PRESIDENT AND CHIEF AUDITING OFFICER, HEALTHSOUTH CORPORATION; STEVE SCHLATTER, FORMER HEALTHSOUTH PHYSICAL THERAPIST; MICHAEL VINES, FORMER HEALTHSOUTH EMPLOYEE IN CORPORATE FIXED ASSETS DEPARTMENT; MARTIN COHEN, SENIOR MANAGING DIRECTOR, FTI CONSULTING; KELLY CULLISON, FORMER VICE PRESIDENT OF COMPLIANCE HEALTHSOUTH CORPORATION; AND GREG SMITH, CHIEF AUDITING OFFICER, HEALTHSOUTH CORPORATION

Ms. HENZE. My name is Diana Henze, and I live in Birmingham, Alabama.

I am 39 years old, married with two children. I graduated from the University of Montevallo in 1985 with a B.S. degree in accounting.

After a few accounting positions, I began working for a Birmingham-based healthcare company, ReLife, in 1994. In December of that year, ReLife was acquired by HealthSouth, and I began working in HealthSouth's accounting department. In 1995 and 1996, I helped install a standardized accounting software package for the accounting department. In 1997, I was promoted to Assistant Vice President of Finance, and in 1998, I was promoted to Vice President of Finance.

My responsibilities were somewhat ad hoc, but included running the accounting computer system, preparing quarterly consolidations and assisting in the SEC filings.

Sometime in 1998, after re-running several consolidation processes for one quarter end, I noticed that earnings and earnings per share jumped up. The amount and timing of those changes seemed

odd to me so I approached my supervisor, Ken Livesay, who was the Assistant Controller. Ken told me that the increase in earnings was the result of the reversal of some over-reserves and over-accruals. At the time, Ken's explanation appeared to be reasonable and I did not pursue the matter further. I did notice a jump in earnings the next quarter, but I did not question Ken about it.

In January 1999, I went on maternity leave to have my second son, Douglas, and did not work on the year-end consolidation or the 10-K preparation for 1998. Shortly after returning to work in March, I assisted in preparing the first quarter consolidation and 10Q preparation for 1999. During that process, I noticed the numbers changing again, and I approached Ken Livesay a second time. I told him, "You can't tell me that we have enough reserves to reverse that would justify this type of swing in the numbers." When he told me that I was right, I informed him that I did not understand what was going on, but would have no part in any wrongdoing.

Ken apparently went to Bill Owens, the Controller, with my suspicions because Bill called me in an attempt to justify what they were doing. Bill said that HealthSouth had to make its numbers or innocent people would lose their jobs and the company would suffer. I told Bill that I believed that whatever was going on to be fraudulent, and I would not participate in it and wanted no part of it. I also asked him to stop whatever it was they were doing and told him that I was going to keep an eye on it.

The numbers continued to change in the second and third quarter of 1999. After the third quarter, I went to Ken and said "enough is enough," because the numbers still appeared to be moving with irregularities. I told him I was to going to report these suspicions to our Compliance Department because I suspected that fraud was being committed within the accounting department. Ken said to do what I needed to do.

In October or November 1999, I went to our Corporate Compliance Department and made an official complaint to Kelly Cullison, who was Vice President of Corporate Compliance. I gave her information on my suspicions and where I thought some of the "entries" were being made. I also gave her information on how to write specific types of queries against the transactional tables within our system, which helped her look at the fluctuations that were being made and of which I was suspicious. I did not have access to the supporting documentation of the suspect journal entries, and therefore, could not give her that information. As it turns out, Kelly did not have access to the information necessary to investigate my complaint of suspected fraud.

Ken Livesay called me to ask if I had gone to the Corporate Compliance Department with my complaint because he had been called to Mike Martin's, who was the Chief Financial Officer office about it. I confirmed that I had gone to the Compliance department and filed a complaint. In a follow-up discussion with Kelly Cullison, I told her that I stood by my complaint and would not withdraw it. I do not mean to imply in any way that Kelly tried to get me to withdraw my complaint because she did not do that.

Shortly after I filed the complaint, Ken Livesay was moved to the position of Chief Information Officer, and two others were pro-

moted to his previous position of Assistant Controller. I felt that I had been overlooked for this position and I confronted Bill Owens about this. I was told by Bill that he could not put me in that position, because I would not do what "they wanted me to do." Within a few days, possibly weeks, I requested a transfer from the accounting department and was transferred immediately to our Information Technology Group. Soon after joining ITG, I began working on an Internet project and ultimately moved to that department under the supervision of Scott Stone in January 2001. Under HealthSouth's new leadership, in May 2003, I was promoted to Assistant Controller of the Corporate Division. I enjoy my work now, and believe HealthSouth is a good company which can be a profitable business if run properly.

[The prepared statement of Diana Henze follows:]

PREPARED STATEMENT OF DIANA HENZE, ASSISTANT CONTROLLER, HEALTHSOUTH CORPORATION

My name is Diana Henze, and I live in Birmingham, Alabama. I am 39 years old, married with two children. I graduated from the University of Montevallo in 1985 with a B.S. degree in accounting. After a few accounting positions, I began working for a Birmingham-based healthcare company, ReLife, in 1994. In December of that year, ReLife was acquired by HealthSouth, and I began working in HealthSouth's accounting department. In 1995 and 1996, I helped install a standardized accounting software package for the accounting department. In 1997, I was promoted to Assistant Vice President of Finance, and in 1998, I was promoted to Vice President of Finance. My responsibilities were somewhat ad hoc, but included running the accounting computer system, preparing quarterly consolidations and assisting in the SEC filings.

Sometime in 1998, after re-running several consolidation processes for one quarter end, I noticed that earnings and earnings per share jumped up. The amount and timing of those changes seemed odd to me so I approached my supervisor, Ken Livesay, who was the Assistant Controller. Ken told me that the increase in earnings was the result of the reversal of some over-reserves and over-accruals. At the time, Ken's explanation appeared to be reasonable and I did not pursue the matter further. I did notice a jump in earnings the next quarter, but I did not question Ken about it.

In January of 1999, I went on maternity leave to have my second son, Douglas, and did not work on the year-end consolidation or the 10-K preparation for 1998. Shortly after returning to work in March, I assisted in preparing the first quarter consolidation and 10Q preparation for 1999. During that process, I noticed the numbers changing again, and I approached Ken Livesay a second time. I told him, "You can't tell me that we have enough reserves to reverse that would justify this type of swing in the numbers." When he told me that I was right, I informed him that I did not understand what was going on, but would have no part in any wrongdoing.

Ken apparently went to Bill Owens, the Controller, with my suspicions because Bill called me in an attempt to justify what they were doing. Bill said that HealthSouth had to make its numbers or innocent people would lose their jobs and the company would suffer. I told Bill that I believed that whatever was going on to be fraudulent, and I would not participate in it and wanted no part of it. I also asked him to stop whatever it was they were doing and told him that I was going to keep an eye on it.

The numbers continued to change in the second and third quarter of 1999. After the third quarter, I went to Ken and said "enough is enough," because the numbers still appeared to be moving with irregularities. I told him I was to going to report these suspicions to our Compliance Department because I suspected that fraud was being committed within the accounting department. Ken said to do what I needed to do.

In October or November of 1999, I went to our Corporate Compliance Department and made an official complaint to Kelly Cullison, who was Vice President of Corporate Compliance. I gave her information on my suspicions and where I thought some of the "entries" were being made. I also gave her information on how to write specific types of queries against the transactional tables within our system, which helped her look at the fluctuations that were being made and of which I was sus-

picious. I did not have access to the supporting documentation of the suspect journal entries, and therefore, could not give her that information. As it turns out, Kelly did not have access to the information necessary to investigate my complaint of suspected fraud.

Ken Livesay called me to ask if I had gone to the Compliance Department with my complaint because he had been called to Mike Martin's (Chief Financial Officer) office about it. I confirmed that I had gone to the Compliance department and filed a complaint. In a follow-up discussion with Kelly Cullison, I told her that I stood by my complaint and would not withdraw it. I do not mean to imply in any way that Kelly tried to get me to withdraw my complaint because she did not do that.

Shortly after I filed the complaint, Ken Livesay was moved to the position of Chief Information Officer (CIO), and two others were promoted to his previous position of Assistant controller. I felt that I had been overlooked for this position and I confronted Bill Owens about this. I was told by Bill that he could not put me in that position, because I would not do what "they wanted me to do."

Within a few days or weeks I requested a transfer from the accounting department and was transferred immediately to our ITG (Information Technology Group) Department. Soon after joining ITG, I began working on an internet project and ultimately moved to that department under the supervision of Scott Stone in January 2001. Under HealthSouth's new leadership, in May of 2003, I was promoted to Assistant Controller of the Corporate Division. I enjoy my work now, and believe HealthSouth is a good company which can be a profitable business if run properly.

Mr. GREENWOOD. Thank you, Ms. Henze, and that is a point that is important for us to understand, that there is new management at the company and, frankly, wish the new management well in reestablishing the company.

Ms. Sanders, you are recognized for your opening statement. Good morning.

Ms. SANDERS. Good morning.

TESTIMONY OF TERESA SANDERS

Ms. SANDERS. My name is Teresa Sanders, and I currently live in Birmingham, Alabama. I am 39 years old and I am married.

In 1986, I graduated from the University of Alabama with a degree in accounting and also received my master's degree in accounting in 1988.

I began working with Ernst & Young in August 1988 as a staff auditor, and I was laid off in February 1990. In March 1990, I was hired by HealthSouth as the Internal Auditor. During my employment I received three promotions, and when I left my title was Group Vice President and Chief Auditing Officer. My immediate supervisor was Richard Scrushy, and I reported directly to him for over 9 years. I left HealthSouth in November 1999.

I was hired by HealthSouth to audit our field operations. When I started at HealthSouth, the company had 35 facilities, and by the time I left that number had grown to approximately 2000. I had complete access to the financial books of the field operations in order to do my audits. However, I did not have access to the corporate financial books. I did not need access to the corporate books to perform field audits. Ernst & Young performed the audit on the corporate books and any reports to the SEC.

As part of my duties as the Chief Auditing Officer, I had to make reports to the audit committee of the Board of Directors. All meetings that I had with the audit committee were before the full Board except for one time in the years between 1997 and 1998, when I met separately with that audit committee. However, that meeting was attended by Tony Tanner, who is an Executive Vice President and Corporate Compliance Officer.

In 1996, Richard Scrushy approached me about establishing a 50 point checklist which became known as the "Pristine Audit." After Mr. Scrushy asked me to develop the checklist, I sent him a memo expressing my opinion about the checklist. I have attached a copy of that memo. Mr. Scrushy did not appreciate my opinion on the matter and again instructed me to develop the checklist for his approval. Mr Scrushy informed me the Pristine Audit was to be handled by Ernst & Young.

I developed the 50 point checklist which Mr. Scrushy approved. I am attaching a copy of that checklist as well. As you can see, the Pristine Checklist has nothing to do with the auditing of the financial books of a field facility. The Pristine Audit was nothing more than a cosmetic, white glove, walk through of a facility. It was in the nature of quality control and had nothing to do with the financial viability of a particular facility.

By the time I left HealthSouth, I was having problems with Mike Martin, who was then CEFO. He turned off my computer access to the general ledgers of the field operations. I needed access to those ledgers to do my audits. I had to manually retrieve hard copies of those ledgers, if needed, which was very time consuming.

I also did not like the way that HealthSouth handled an internal sexual harassment investigation. It was my opinion that the offending employee should have been terminated.

Although I heard rumors that "they were playing with the books," I had no knowledge that anyone at HealthSouth was committing fraud.

I ultimately left HealthSouth because I received a better job offer with Eastern Health Systems in the compliance department as the Compliance Officer. I was tired of traveling and my new job did not require any travel.

[The prepared statement of Teresa Sanders follows:]

PREPARED STATEMENT OF TERESA SANDERS, FORMER GROUP VICE PRESIDENT AND CHIEF AUDITING OFFICER, HEALTHSOUTH CORPORATION

My name is Teresa Sanders, and I currently live in Birmingham, Alabama. I am 39 years old. In 1986, I graduated from the University of Alabama with a degree in accounting. I received my masters degree in accounting in 1988.

I began working with Ernst & Young in August of 1988 as a staff auditor, and I was laid off in February of 1990. In March of that year (1990), I was hired by HealthSouth as the Internal Auditor. During my employment I received three promotions, and when I left my title became Group Vice President and Chief Auditing Officer. My immediate supervisor was Richard Scrushy, and I reported directly to him for over nine years. I left HealthSouth in November of 1999.

I was hired by HealthSouth to audit our field operations. When I started at HealthSouth, the company had thirty-five (35) field facilities, and by the time I left the number had grown to approximately two thousand (2000). I had complete access to the financial books of the field operations in order to do my audits. However, I did not have access to the corporate financial books. I did not need access to the corporate books to perform field audits. Ernst & Young performed the audit on the corporate books and any reports to the SEC.

As part of my duties as the Chief Auditing Officer, I had to make reports to the audit committee of the Board of Directors. All the meetings that I had with the audit committee were before the full Board except one time in either 1997 or 1998, when I met separately with the audit committee. However, that meeting was attended by Tony Tanner.

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Mr. GREENWOOD. Thank you, Ms. Sanders. Thank you for being here.

Mr. Schlatter, your opening statement, please?

TESTIMONY OF STEVE SCHLATTER

Mr. SCHLATTER. My name is Steve Schlatter. I am a physical therapist from Muncie, Indiana. I come before this Committee to present concerns that arose during my employment as an Administrator of a HealthSouth outpatient clinic from July 1995 to December 2001.

In April 2001, I became aware of an HCFA Transmittal 1828 which discussed the use of the CPT code 97150 group therapy. The Transmittal states that this code must be used when a therapist performs "procedures with two or more individuals concurrently or during the same time period." My concerns about this were twofold as this was a common practice within the HealthSouth system and the fact that HealthSouth's HCAP system (an automated documentation system) did not make this billing code available for the clinicians to use. Out of concerns for my professional staff and myself, I felt a corporate explanation regarding this issue would assure us that we were in compliance with all regulations and we were in fact treating ethically and within the accepted standards of our profession.

My initial effort was a simple request from HealthSouth for a written policy. My quest for this information proved to be long, frustrating, and unsuccessful. I did discuss this issue with the American Physical Therapy Association Department of Government Affairs and received the same interpretation of the Transmittal. I also discussed this issue with a colleague who had hired an independent firm to perform a Medicare compliance audit on his private physical therapy practice. He claimed his auditors were adamant that group therapy charges must be used when treating more than one patient at a time. I communicated this information to HealthSouth management and saved all communication to use as proof that I was attempting to comply with regulations in the event of an unexpected Medicare audit.

After nearly 2 months, I was told by several colleagues that HealthSouth personnel in the Columbus, Ohio business office were

irritated with my persistence in this matter. At that time I simply made appropriate internal adjustments within my own clinic to make sure that we were not treating patients concurrently, which I felt to be the most ethical and professionally accepted standard of practice.

In August 2002, I read that HealthSouth was claiming to miss earnings expectations by $175 million due to unexpected changes in Medicare reimbursements from group therapy. At that time I felt compelled to share my information with the appropriate authorities, thus bringing me before your Committee today.

I would like to thank you for the opportunity to appear before this subcommittee, and I am willing to answer any questions.

[The prepared statement of Steve Schlatter follows:]

PREPARED STATEMENT OF STEVE SCHLATTER

Mr. Chairman and Members of the Subcommittee: My name is Steve Schlatter. I am a physical therapist from Muncie, Indiana. I come before this Committee to present concerns that arose during my employment as an Administrator of a Healthsouth outpatient clinic from July 1995 to December 2001. In April of 2001, I became aware of an HCFA transmittal 1828 which discussed the use of CPT code 97150 group therapy. The transmittal states that this code must be used when a therapist performs "procedures with two or more individuals concurrently or during the same time period." My concerns about this were twofold as this was a common practice within the Healthsouth system and the fact that Healthsouth's HCAP system (an automated documentation system) did not make this billing code available for clinicians to use. Out of concerns for my professional staff and myself, I felt a corporate explanation regarding this issue would assure us that we were in compliance with all regulations and we were in fact treating ethically and within the accepted standards of our profession.

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I would like to thank you for the opportunity to appear before this Subcommittee. I am willing to answer any questions regarding my statement and testimony.

Mr. GREENWOOD. We thank you, Mr. Schlatter. Thank you so much.

Mr. Vines, an opening statement, please?

Mr. VINES. Good morning.

Mr. GREENWOOD. Good morning, sir.

TESTIMONY OF MICHAEL VINES

Mr. VINES. My name is Michael Vines. I live in Birmingham, Alabama. I was employed at HealthSouth from April 1997 to May 2002 working in the Fixed Asset Management Department, and would answer any questions about that time.

Thank you.

Mr. GREENWOOD. Okay. And we will have plenty of them. Thank you for being with us.

Mr. Cohen, do you have an opening statement?

TESTIMONY OF MARTIN COHEN

Mr. COHEN. Yes. Mr. Chairman and members of the subcommittee, good morning. My name is Martin Cohen. I am currently a Senior Managing Director with FTI Consulting focusing on financial restructuring of troubled companies.

I have been invited to testify this morning about an analysis that FTI conducted in the fall of 2002 for HealthSouth.

In mid-September 2002, FTI was hired by the law firm of Fulbright & Jaworski to conduct an analysis of the impact of Medicare Transmittal 1753 on the revenues of HealthSouth. It is my understanding that Fulbright had been engaged by the Board of Directors of HealthSouth to examine a number of issues, and Fulbright hired FTI to examine the impact of Transmittal 1753 on HealthSouth's outpatient rehabilitation revenues and assess the reasonableness of the HealthSouth's assertion that the reduction in revenue could, on an annual basis, approximate $175 million.

While typically FTI considers itself bound by attorney/client privilege and attorney work product doctrine when it undertakes investigations at the direction of counsel, it is my understanding that current counsel for HealthSouth has waived any such claim of privilege as to the investigation conducted by FTI, thus allowing me to testify before you today.

After being retained by Fulbright, I led a team of FTI employees in analyzing the potential impact of Transmittal 1753 on HealthSouth's outpatient rehabilitation revenues. FTI collected detailed coding and billing information from HealthSouth's billing files for a limited number of health care facilities for a 2-week period during the months of May and June, 2002.

FTI then created a billing model based upon various assumptions as to how Medicare outpatient rehabilitation coding guidelines should be applied in the field. FTI further assessed the potential impact of Transmittal 1753 on commercial and worker's compensation insurance revenues.

Applying the data provided by HealthSouth to the billing model developed by FTI, we next applied those conclusions to HealthSouth's outpatient rehabilitation patient population for the first 6 months of 2002. Using this methodology, we came up with a series of estimates of the potential impact of Transmittal 1753 on HealthSouth's revenues.

FTI presented a draft report to Fulbright on November 5, 2002, which preliminarily indicated that the potential annualized impact of Transmittal 1753 on HealthSouth's outpatient rehabilitation revenues from Medicare, commercial and worker's compensation could range from a low of $101 million to a high of $227 million. The range of impact was largely dependent on the fact that it was unclear how the commercial and workers compensation insurers would respond to the Medicare changes, either through a change in billing practice or subsequent reduction in rates. However, during the course of drafting the report FTI staff listened to the

HealthSouth third quarter investor call held on November 5, 2002, and noted significant discrepancies between management's representations as to the impact of Transmittal 1753 on third quarter financial results and FTI's preliminary findings.

Concerned that the HealthSouth management's representations during the third quarter investor call, if correct, could indicate a problem with FTI's draft analysis, FTI immediately notified Fulbright & Jaworski of the discrepancies.

Further, on November 6, 2002, I wrote to Bill Owens, HealthSouth's President and Chief Executive Officer, and requested that HealthSouth provide FTI with certain specific financial information, which could be used to check the discrepancies between FTI's draft findings and the statements made during the earnings announcement. Neither Mr. Owens, nor anyone else from HealthSouth, ever responded to my November 6, 2002 request for further information, and FTI never finalized its report.

I will be happy to answer any questions the members of the subcommittee may have regarding the draft report.

[The prepared statement of Martin Cohen follows:]

PREPARED STATEMENT OF MARTIN L. COHEN, FTI CONSULTING, INC.

Mr. Chairman and members of the Subcommittee, good morning. My name is Martin Cohen. I am currently a Senior Managing Director with FTI Consulting, Inc. ("FTI"), focusing on financial restructuring of troubled companies. I have been invited to testify this morning about an analysis that FTI conducted in the Fall of 2002 for HealthSouth Corporation ("HealthSouth").

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I will be happy to answer any questions the members of the Subcommittee may have as to the draft analysis performed by FTI.

Mr. GREENWOOD. Thank you very much, Mr. Cohen.

Ms. Cullison, do you have an opening statement.

Ms. CULLISON. Yes.

Mr. GREENWOOD. Good morning.

TESTIMONY OF KELLY CULLISON

Ms. CULLISON. Good morning.

My name is Kelly Cullison, and I live in Birmingham, Alabama. I am 32 years old. I graduated from the University of Alabama at Birmingham with a degree in accounting in December 1992.

In August 1994, I was hired by HealthSouth to work in the Internal Audit Department. I held the title of Staff Auditor, Senior Auditor and Assistant Vice President of Internal Audit. In June 1997, I was transferred to the compliance department and was given the title of Compliance Director.

The Compliance Department provided an internal mechanism for the employees to report problems. We ran a day-to-day hotline and most of the complaints that we received involved personnel problems. Those complaints were routed to the Human Resource Department.

My immediate supervisor was Tony Tanner who was Executive Vice President of Administration. Mr. Tanner retired in December 1999, and he was replaced by Brad Hale who was my immediate supervisor until I resigned in January 2001.

Around November 1999, Diana Henze came to me with a complaint about some accounting transactions. This was a face-to-face meeting with Diana, and she gave specific information about journal entries being posted on a quarterly basis. She gave me specific queries to run on the computer system to find the journal entries. In short, Diana's complaint had to do with possible fraud being committed. I ran the queries and found large dollar amounts being entered. However, I did not have access to the supporting documents to determine whether or not the journal entries were legitimate. Therefore, I did not have the means or authority to properly investigate Diana's complaint.

I took Diana's complaint to my supervisor Tony Tanner. He expressed concern and said that he would look into the matter. I believe that I had a follow-up conversation with Diana about her complaint, but I do not recall the specifics of what was said. However, Diana was clear that she stood by her complaint and would not withdraw it. Mr. Tanner told me that Diana's complaint had been resolved and that the case was closed. I had no reason to doubt him because I could not investigate her complaint on my own. Because of the way HealthSouth was structured a complaint

such as Diana's had to go up the chain of command to be properly investigated.

I left HealthSouth in January 2001 to begin working for myself. I started my own business doing internal audits for healthcare companies on an independent contract basis.

At HealthSouth, the Compliance Department was defined too broadly. It dealt not only with State and Federal laws and regulations but also with internal policy as well. The department was bogged down with complaints concerning internal policy and personnel decisions, and it simply became a clearinghouse of complaints. As I stated earlier, most complaints were sent to Human Resources. We did not have the authority or resources to investigate complaints such as the one brought by Diana. What we should learn from this is that the compliance departments should have the appropriate resources and authority, such as complete access to corporate books to investigate complaints involving fraud in financial accounting.

Moreover, compliance departments should consider the merits of focusing solely on State and Federal laws and regulations rather than broadly addressing regulatory and personnel issues.

Thank you.

[The prepared statement of Kelly Cullison follows:]

PREPARED STATEMENT OF KELLY CULLISON, COMPLIANCE DIRECTOR, HEALTHSOUTH CORPORATION

My name is Kelly Cullison, and I live in Birmingham, Alabama. I am thirty-two years old. I graduated from the University of Alabama at Birmingham with a degree in accounting in December of 1992.

In August of 1994, I was hired by HealthSouth to work in the Internal Audit Department. I held the title of Staff Auditor, Senior Auditor and Assistant Vice President of Internal Audit. In June of 1997, I was transferred to the compliance department and was given the title of Compliance Director.

The Compliance Department provided an internal mechanism for the employees to report problems. We ran a day-to-day hotline and most of the complaints that we received involved personnel problems. Those complaints were routed to the Human Resource Department.

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I left HealthSouth in January of 2001 to begin working for myself. I started my own business doing internal audits for healthcare companies on an independent contract basis.

At HealthSouth, the Compliance Department was defined too broadly. It dealt not only with State and federal laws and regulations but also with internal policy as

well. The department was bogged down with complaints concerning internal policy and personnel decisions, and it simply became a clearinghouse of complaints. As I stated earlier, most complaints were sent to Human Resources. We did not have the authority or resources to investigate complaints such as one brought by Diana. What we should learn from this is that compliance departments should have the appropriate resources and authority, i.e. complete access to corporate books to investigate complaints involving fraud in financial accounting. Moreover, compliance departments should consider the merits of focusing solely on State and federal laws and regulations rather than broadly addressing regulatory and personnel issues.

Mr. GREENWOOD. Thank you, Ms. Cullison.

Mr. Smith, for your opening statement.

TESTIMONY OF GREG SMITH

Mr. SMITH. I do not wish to make a statement at this time, but I will answer your questions.

Mr. GREENWOOD. Very well. Thank you very much.

The Chair recognizes himself for 10 minutes for purposes of inquiry, and we will begin with you, Ms. Henze.

Ms. Henze, you told us in your opening statement that in 1998 you began to notice earnings and earnings per share, as you said, jump up over a period of a few days during the quarter end consolidation process. Could you explain to us what you were asked to do that caused you to notice the changes in the numbers?

Ms. HENZE. Yes. One of my sole responsibilities or one of my responsibilities was to run the consolidation process, which is to pull the numbers together after general accounting was through.

So when general accounting came to me and said they were through, I pulled—you know, I ran a consolidation process, which is a totally audited process on the computer, handed it up to my supervisor, which was Ken Livesay.

Shortly there afterwards, they asked me to rerun it. Open up the periods—well, actually, I'm sorry. They asked me to open up the accounting periods so that more entries could be entered into the system.

Mr. GREENWOOD. And was that in itself unusual?

Ms. HENZE. Not in and of itself. I mean, usually you can run a consolidation and then be asked to rerun.

Mr. GREENWOOD. Okay.

Ms. HENZE. But this was probably like the third, maybe the fourth time. I mean, it was continuing to do that. And at this time of the quarter end it was very unusual that your amounts should jump dramatically or drastically.

So it was just in this process that after a few times of running the consolidation that the numbers—that the numbers jumped.

Mr. GREENWOOD. Okay. You told our staff that you also witnessed accounting meetings occurring behind closed doors. Could you tell us who you recall in those meetings and what appeared to be happened or what happened after those meetings?

Ms. HENZE. Yes. Usually during the quarter end prior to earnings releases during—after I had run the consolidations, one, twice, there would be a meeting in a conference room right outside of Mr. Owens' office. And——

Mr. GREENWOOD. And just identify who Mr. Owens is.

Ms. HENZE. I'm sorry. Mr. Owens was the Controller at that time.

Mr. GREENWOOD. Okay.

Ms. HENZE. Shortly after this meeting after they would adjourn, I would get a phone call to open up the accounting periods that they needed to make some additional entries, which in my previous answer I would go through that whole process again.

Mr. GREENWOOD. Right. Okay. And was Mr. Livesay there?

Ms. HENZE. Yes.

Mr. GREENWOOD. And Weston Smith?

Ms. HENZE. I believe I recall seeing Mr. Smith.

Mr. GREENWOOD. Susan Jones?

Ms. HENZE. Yes.

Mr. GREENWOOD. Sharon Faulkner?

Ms. HENZE. Yes.

Mr. GREENWOOD. Emery Harris?

Ms. HENZE. Yes, sir.

Mr. GREENWOOD. Kay Morgan?

Ms. HENZE. Yes, sir.

Mr. GREENWOOD. Okay. These are pretty senior level officers that are meeting, and then soon after you are told to reopen the consolidation process and, lo and behold, the numbers are changing. Is that what you are testifying to?

Ms. HENZE. That is—that is correct.

Mr. GREENWOOD. Okay. You mentioned that in 1999 you were called into Bill Owens' office after you complained to your boss about your suspensions of fraud. Did Mr. Owens or Mr. Livesay, your boss, ever deny that the fraud was being committed?

Ms. HENZE. They neither denied nor acknowledged.

Mr. GREENWOOD. They didn't admit it, they didn't deny it, they just sort of nodded their heads, is that what they did? Okay.

You told our staff in an interview that when you were called into Bill Owens' office in 1999 after you told your boss Ken Livesay's your suspicions about fraud, that Mr. Owens said "If we do not meet our earnings, people start losing jobs." Is that what the Controller of HealthSouth told you?

Ms. HENZE. Yes, sir.

Mr. GREENWOOD. Were you shocked?

Ms. HENZE. Pretty much.

Mr. GREENWOOD. Did you take that as an admission that they were doing something funny with the numbers?

Ms. HENZE. He did not deny it, so it was kind of I really did not know whether to really believe that they were or that somebody——

Mr. GREENWOOD. How did you feel emotionally about that?

Ms. HENZE. I was pretty upset.

Mr. GREENWOOD. You also Committee staff that you spoke to Mike Martin, who was then the CFO of HealthSouth about your concerns. Could you tell us what you told Mr. Martin and what his response was?

Ms. HENZE. I went to Mike Martin, it was mainly about being passed over for a promotion. And——

Mr. GREENWOOD. Did you believe that you were being passed over because you had brought these concerns?

Ms. HENZE. I did not know what to believe at first.

Mr. GREENWOOD. Okay.

Ms. HENZE. But I was told that I did not get the promotion because I did not—would not participate. But in our conversation I brought up the—what had been occurring within the accounting department. Mike seemed very upset, but restated some similar to Bill's conversation that——

Mr. GREENWOOD. Was he yelling?

Ms. HENZE. He was yelling, not necessarily at me. More of just that he was approached with an uncomfortable situation.

Mr. GREENWOOD. Did he say the company will go down, we have to do it?

Ms. HENZE. I believe he—he said something that we have to do this. I am not sure if he actually said the company will go down.

Mr. GREENWOOD. Okay. And then Mr. Scrushy walked into Mr. Martin's office?

Ms. HENZE. Yes, right near the end of our conversation.

Mr. GREENWOOD. Okay. Did Ken Livesay ever relay to you that he had been told by upper management to "passive you".

Ms. HENZE. Mr. Livesay had called me into his office shortly after I had gone to the Corporate Compliance. And had asked me if I actually did go in and file a complaint. He apparently—he had told me that he got called to Bill—I mean, to Mike Martin's office and that eventually they wanted Compliance to come back to the person who had filed the complaint and instruct them to go back to Mr. Livesay so that he could smooth things over.

Mr. GREENWOOD. When you spoke with Kelly Cullison about your suspensions of accounting fraud, did you also mention to her who you believed might be involved?

Ms. HENZE. Yes, sir.

Mr. GREENWOOD. Did you mention Ken Livesay, Mike Martin, Bill Owens?

Ms. HENZE. Yes, sir.

Mr. GREENWOOD. Okay. The people that you believed were committing accounting fraud as far back as 1998, have these people plead guilty to similar charges?

Ms. HENZE. Yes, sir.

Mr. GREENWOOD. Okay. What did you believe would happen when you made your formal complaint with HealthSouth Compliance Department?

Ms. HENZE. I believed that it—that it would go up to senior—the most senior level and that appropriate action would take place, and that the—if it was fraud, which is what I suspected, that it would be addressed and taken care of.

Mr. GREENWOOD. And do you in fact think now looking back that it was taken seriously and it was investigated?

Ms. HENZE. I think when I made—I believe when I made my complaint to the—to Kelly in Corporate Compliance that it was taken seriously. I do not think that it was taken seriously or handled appropriately beyond that.

Mr. GREENWOOD. What made you decide to go to log a formal complaint with the Compliance Department?

Ms. HENZE. What made me?

Mr. GREENWOOD. When did you decide it was time to file a formal complaint?

Ms. HENZE. When it became apparent that it was going to continue even after my first address to Mr. Owens and Mr. Livesay.

Mr. GREENWOOD. It is a pretty bold thing to do. Were you not worried about losing your job?

Ms. HENZE. I was not really worried about losing my job.

Mr. GREENWOOD. Because you did not think you would lose it or because you could survive without it?

Ms. HENZE. Well, I could not really—it would have been tough to survive without it. You know, technically they could not fired me for going to Compliance, even though I know that they could have made it very hard for me.

Mr. GREENWOOD. Yes. Or pass——

Ms. HENZE. But it was not right. So——

Mr. GREENWOOD. Well, good for you.

Ms. HENZE. Thank you.

Mr. GREENWOOD. Let me quickly try to ask a question or two of Ms. Sanders.

Now you told us you worked for HealthSouth from 1993 to 2000 and you were the Chief Internal Auditor for the company throughout many of those years. To whom did you report to in that capacity?

Ms. SANDERS. Actually, I worked for the company 1990 to 1999.

Mr. GREENWOOD. Okay.

Ms. SANDERS. And I reported to Richard Scrushy, the CEO. And when I started, he was also the President of the company as well.

Mr. GREENWOOD. Okay. Did the internal audit department have any direct reporting relationship with the audit committee of the board of directors?

Ms. SANDERS. In the charter, I believe there was a statement that they would have a reporting—maybe not a direct reporting relationship, but a reporting relationship to the audit committee.

Mr. GREENWOOD. That is the way it was supposed to work?

Ms. SANDERS. That was the way it was supposed to work. But in reality I did not have separate meetings with the audit committee except for that one that was in 1990—somewhere between——

Mr. GREENWOOD. And why was that? You know at the time that the charter said that there was supposed to be this reporting relationship?

Ms. SANDERS. Correct.

Mr. GREENWOOD. You did not take it upon yourself to make that happen or you tried and were not given the opportunity, or what?

Ms. SANDERS. It was really—I mean, it was a very difficult thing to try to push that with Mr. Scrushy. He was—he did not like surprises. He wanted to be in those meetings. So those why those meetings were usually held always with the——

Mr. GREENWOOD. So did you ever ask Mr. Scrushy if it would be okay if you reported directly to the——

Ms. SANDERS. I do not recall ever asking him for that specifically, no.

Mr. GREENWOOD. In the 10 years that you were Chief Internal Auditor for HealthSouth how many times did you meet with the audit committee?

Ms. SANDERS. One time, and that—I mean, as far as like one time separately. Whenever we had audit committee meetings, they were always the full board. They—that meeting was the one that was attended by Tony Tanner, who was the Executive Vice President and Compliance Officer.

Mr. GREENWOOD. Were you scared that Mr. Scrushy would find out that you made—I'm sorry.

Let me go back to you, Ms. Henze. And one final question for you because my time has expired. Were you scared that Mr. Scrushy would find out that you made the allegations?

Ms. SANDERS. That I made——

Mr. GREENWOOD. No. This is Ms. Henze, I'm sorry. I'm sorry.

Ms. HENZE. I'm sorry, what was your question?

Mr. GREENWOOD. I asked you earlier if you were worried about losing your job. Were you particularly worried that Mr. Scrushy would find out about this?

Ms. HENZE. Yes, sir.

Mr. GREENWOOD. Okay. Why were you worried that he would find out about this?

Ms. HENZE. I was worried about retaliation.

Mr. GREENWOOD. What made you worried about retaliation? Was there reason?

Ms. HENZE. Just the atmosphere and rumors that circulate within the corporation.

Mr. GREENWOOD. Such as?

Ms. HENZE. That he did not like bad news. That, you know, just bad things happened. And, you know, one of the examples is definitely you would lose your job, but is it more than just intimidation? I did not know, you know, financially, personally there would be a retaliation toward me.

Mr. GREENWOOD. Okay. Thank you.

My time has expired. The gentlelady from Colorado.

Ms. DEGETTE. Thank you, Mr. Chairman.

Ms. Henze, were you worried as well as your job about your husband's job?

Ms. HENZE. Yes, ma'am.

Ms. DEGETTE. And why was that?

Ms. HENZE. My husband works for the University of Alabama in Birmingham, and Mr. Scrushy has a lot of contact there with the University.

Ms. DEGETTE. And were you worried that he would have the influence to effect your husband's job if he was upset with you?

Ms. HENZE. Yes, ma'am. Yes, ma'am.

Ms. DEGETTE. Why is it that you thought that Mr. Scrushy would go that far in retaliation? What gave you that level of fear?

Ms. HENZE. I cannot really give you a specific. It was more of just the general atmosphere within the corporate office that you are not to do anything to cross Mr. Scrushy.

Ms. DEGETTE. Did you get the sense with your position that Mr. Scrushy kept an eye on the books and knew what was going on in terms of the financial affairs of the company?

Ms. HENZE. Did I think that he knew what was going on or——

Ms. DEGETTE. Yes.

Ms. HENZE. Yes, ma'am.

Ms. DEGETTE. Why?

Ms. HENZE. Well, in the Monday morning meetings that we would have, he talked about just the numbers of the books and that he made comments "I know what's going on, I am keeping an eye on everybody's performance." I mean, you know, mainly talking about the operational, facility operations. So he—he—he stressed it within our Monday morning meetings.

Ms. DEGETTE. Now, you were here in the hearing room when we played the snippets from the "60 Minutes" interview with Mr. Scrushy, were you not?

Ms. HENZE. Yes, ma'am.

Ms. DEGETTE. I thought I saw you. And I do not know if you heard Mike Wallace say you don't keep track of the accounting. Mr. Scrushy said "CEOs do not do that. CFOs do that." Do you remember seeing that?

Ms. HENZE. Yes, ma'am.

Ms. DEGETTE. In your experience in your position do you think that that is true that Mr. Scrushy didn't keep track of the accounting?

Ms. HENZE. I—I believe that kept an eye on the performance of the company, maybe not down to the total details of the accounting. But he kept an eye on what our earnings were, what our performance was.

Ms. DEGETTE. And I think that is the job of the CEO, do you?

Ms. HENZE. Yes, ma'am.

Ms. DEGETTE. Ms. Sanders, I wanted to ask you because you reported directly to Mr. Scrushy what you thought about that statement. Was it your sense that Mr. Scrushy kept track of the accounting, at least on a general basis?

Ms. SANDERS. On a general basis, yes. He—during those Monday morning meetings that Ms. Henze's referring to, yes, he would make those—those comments.

Ms. DEGETTE. Talk if you can a little bit your perception of those Monday morning meetings?

Ms. SANDERS. They were usually very large, especially toward the end when I was there because there several hundred—or several hundred people within the room. You were basically to report on the top five things that you did the previous week and the top five things that you were going to be reporting on this on the upcoming week.

Usually he followed up with ending comments and would talk about, you know, he usually had a stack that he would throw up on the table and say that I have got all the numbers for the—for every one of the facilities and I am watching, and I know what is going on in this facilities.

Ms. DEGETTE. So, as the internal auditor you—was that your title, internal auditor?

Ms. SANDERS. That was my title when I started with the company in 1990, yes.

Ms. DEGETTE. Okay. And, I'm sorry, when you left it was Group Vice President and Chief Auditing Officer.

Ms. SANDERS. Yes.

Ms. DEGETTE. So it was your job in the Monday morning meetings or the Monday meetings to talk about the auditing, right?

Ms. SANDERS. It basically the facilities that we were visiting and that we had been at last—at the previous week and then the facilities that we were visiting for the coming week. We did not necessarily report on the results of those audits.

Ms. DEGETTE. Now, you did not actually have access to the corporate books when you were doing field audits, did you?

Ms. SANDERS. No, I did not.

Ms. DEGETTE. Did you ever have access to the corporate books?

Ms. SANDERS. No, I did not.

Ms. DEGETTE. How is it as the Group Vice President and Chief Auditing Officer you would be able to achieve field audits if you could not compare it back to the corporate books?

Ms. SANDERS. That was not part of our audits. We were to audit the information that was coming in from the individual facilities, and to just make sure it had been posted correctly to the general ledgers. But it was not our responsibility to make sure that it got pulled into the corporate books or into the consolidation.

Ms. DEGETTE. And whose job was that?

Ms. SANDERS. That would have been left to Ernst & Young to audit that.

Ms. DEGETTE. The outside auditors?

Ms. SANDERS. The outside—the outside auditors, yes.

Ms. DEGETTE. And you said in your testimony that you had some concerns, I think it was in 1996, and so you wrote a memo to Mr. Scrushy about the facility auditing. That is Tab 40 in the notebook in front of you there.

Ms. SANDERS. Is this the Pristine, referring to the memo about the Pristine Audit?

Ms. DEGETTE. Right.

Ms. SANDERS. Yes, ma'am.

Ms. DEGETTE. Why did you write that memo to Mr. Scrushy?

Ms. SANDERS. I do not have a copy of it, but I believe I remember it.

Ms. DEGETTE. It is the one that you said was attached to your testimony.

Ms. SANDERS. Thank you.

Ms. DEGETTE. It says to Richard M. Scrushy from——

Ms. SANDERS. Yes. Uh-huh.

I wrote it for two reasons. No. 1 was I felt it—not that it was a waste of money. I agreed with the idea that we needed to do these types of audits, but I did not necessarily agree that we needed to have a CPA firm performing those audits.

Ms. DEGETTE. So the word "audit" is being thrown around kind of loosely here.

Ms. SANDERS. Right.

Ms. DEGETTE. Because, I mean, with you you are an accountant, right?

Ms. SANDERS. Correct. Yes.

Ms. DEGETTE. So when you do an audit, you are talking about reconciling the books, correct?

Ms. SANDERS. Right. Financially.

Ms. DEGETTE. But that's not financial information. But that is not the kind of audit that Mr. Scrushy was talking about, was it?

Ms. SANDERS. No. This was more of a quality standards, quality control.

Ms. DEGETTE. And, in fact, the 50 point—the Pristine factor audit form?

Ms. SANDERS. Yes.

Ms. DEGETTE. That's attached to Tab 41, and that was also attached to your testimony.

Ms. SANDERS. Right.

Ms. DEGETTE. That was what you were talking about, that was the kind of audit that Mr. Scrushy wanted of the facilities, correct?

Ms. SANDERS. Correct, yes.

Ms. DEGETTE. And the kinds of audit is things like: Overall appearances, organized and neat; music is at an acceptable level, etc, right?

Ms. SANDERS. Correct.

Ms. DEGETTE. Now none of those are financial things?

Ms. SANDERS. No, ma'am.

Ms. DEGETTE. Now, after you sent this memo to Mr. Scrushy, did you take that concern to anybody else that they were asking you to do a facilities type audit but not a financial audit? What did you do about that?

Ms. SANDERS. I—I had cc'd this memo to Jim Bennett, Gerald Brown, Aaron Beam and Bill Owens. I did not necessarily hear any responses back from them about this, but that would have been—this would have been an internal memo and I would not have gone outside of the company with my concerns about it.

Ms. DEGETTE. But did anybody ever get back to you and tell you—let me ask you this——

Ms. SANDERS. Which it did, yes.

Ms. DEGETTE. Did you ever do any financial audits of the outside facilities, of the facilities?

Ms. SANDERS. Yes. That was what we were responsible for, was doing the financial audits of the field locations, the information that they were sending in to the corporate office.

Ms. DEGETTE. Did you ever visit the field locations?

Ms. SANDERS. Yes.

Ms. DEGETTE. How many of the field locations?

Ms. SANDERS. When I started, I probably did about 20 of the 35. And then when we left, we usually budgeted for about 100 facilities to be audited in a year.

Ms. DEGETTE. Now, I think you said that while you were there—did you want to correct and answer, ma'am?

Ms. SANDERS. I'm sorry. I'm sorry. No, ma'am.

Ms. DEGETTE. After consulting with counsel?

Ms. SANDERS. Okay. It was—yes. It was my responsible to do the financial audits on the field locations.

Ms. DEGETTE. Right.

Ms. SANDERS. Yes. Okay.

Ms. DEGETTE. Now, you said there were 35 facilities and one auditor when you started.

Ms. SANDERS. Right.

Ms. DEGETTE. And then when you left there were 1800 facilities, correct?

Ms. SANDERS. Correct.

Ms. DEGETTE. So were there 50 auditors then when you left?

Ms. SANDERS. No. There were approximately 10 auditors.

Ms. DEGETTE. Ten auditors for 1800 facilities?

Ms. SANDERS. Correct.

Ms. DEGETTE. So were you able to then do the same kind of level of auditing at the end as you were at the beginning?

Ms. SANDERS. No.

Ms. DEGETTE. Obviously.

Ms. SANDERS. No.

Ms. DEGETTE. Did Ernst & Young ever tell you that your internal audit operation was weak?

Ms. SANDERS. No, they did not make that direct statement to me, no.

Ms. DEGETTE. Did Ernst & Young ever recommend that you have access to the corporate books so that you could compare the audits?

Ms. SANDERS. No, ma'am. They did not make that direct statement.

Ms. DEGETTE. And did Ernst & Young ever recommend that you get additional staff to complete these audits?

Ms. SANDERS. We talked about adding staff and they tried to make—they made those recommendations, to my knowledge, to management. They would make that recommendation, and I am not sure if it was in the management letter or not, but those would make those recommendations to management.

Ms. DEGETTE. And did you ever discuss that with Mr. Scrushy, your immediate supervisor?

Ms. SANDERS. I did talk to him one time about adding more staff. We did end up adding one or two more people at that point in time. That was probably the 1996 to 1998 timeframe is what I am thinking.

Ms. DEGETTE. And was that sufficient, was that one additional staff member sufficient to complete these audits?

Ms. SANDERS. No. No it was nowhere near. No.

Ms. DEGETTE. Now, security at HealthSouth was always very tight. Were there hidden cameras in the hallways?

Ms. SANDERS. Yes.

Ms. DEGETTE. And where were they, do you know?

Ms. SANDERS. I know of one in particular. It was outside of Bill Owens' and Weston Smith's office.

Ms. DEGETTE. Do you know what those hidden cameras were for?

Ms. SANDERS. To keep an eye on who was going in and out of the offices, is all I know.

Ms. DEGETTE. When did you discover that?

Ms. SANDERS. During an investigation that I conducted. A contract employee had falsified and had gotten—falsified documents and had gotten a check written. And during that investigation working with the security department they showed me tapes from those cameras and I realized that there wasn't a camera that you could see up there. And they said, well, there is some that are hidden. And they showed me where.

Ms. DEGETTE. How did that make you feel then?

Ms. SANDERS. Oh, a little nervous.

Ms. DEGETTE. Thank you.

Mr. GREENWOOD. The time of the gentlelady has expired. The Chair recognizes the gentleman from Oregon, Mr. Walden for 10 minutes.

Mr. WALDEN. Thank you, Mr. Chairman.

Ms. Henze, you have testified about the reopening of the books and the adjustments that occurred I think going into the end of each quarter, is that correct?

Ms. HENZE. Yes, sir.

Mr. WALDEN. Did the numbers ever get adjusted negatively?

Ms. HENZE. Not that I recall. No, sir.

Mr. WALDEN. So to the best of your recollection the numbers were always enhanced, which would make it seem like the company was doing better than perhaps it was?

Ms. HENZE. Yes, sir. They were always enhanced to meet the earnings per share that was estimated on the street.

Mr. WALDEN. I want to hear that again. They were always enhanced to meet the earnings per share estimate——

Ms. HENZE. The earnings per share.

Mr. WALDEN. [continuing] that was on the street?

Ms. HENZE. Yes.

Mr. WALDEN. And that is part of why you filed your objection?

Ms. HENZE. Yes, sir.

Mr. WALDEN. Okay. Ms. Sanders, were minutes ever kept of the Monday morning meetings?

Ms. SANDERS. I am not aware of any minutes that were kept. I do know that they kept copies of our reports that we submitted for those meetings.

Mr. WALDEN. Do you know based on what you know about the security system, were they tapped?

Ms. SANDERS. Not to my knowledge. I do not know. There were cameras in the conference center, then it would have been taped. But I am not sure if there are cameras in that conference center. I do not remember.

Mr. WALDEN. It would be most interesting to find out.

The memo, Ms. Sanders, that you sent to Mr. Scrushy, could you describe for us to the best of your recollection his specific reaction to that memo? Did he ever talk to you about that?

Ms. SANDERS. Oh, yes. Yes, sir, he did. He was very upset with me. I felt like I was disagreeing with what he was wanting to do and the program that he was wanting to do. And I was told to get—I needed to pull the wagon and get with the program and go out and make it happen. And that is basically what I did.

Mr. WALDEN. Is that all he said to you?

Ms. SANDERS. He was very vocal in how he said it, specific language that he used I do not recall. But I just know that he was very forceful in telling me that I needed to put this memo aside, he wanted this done and we were going to go forward with this.

Mr. WALDEN. Did he say that you were lucky to have a job?

Ms. SANDERS. Yes, he did. He did tell me that. He said I needed to remember that I was lucky to have a job. That I had been laid off from Ernst & Young and that I had not—and I did not have a job when I had started to work with HealthSouth, yes.

Mr. WALDEN. Did he ever call you an idiot?

Ms. SANDERS. He did not use that specific terminology, no. But he—he certainly made me feel that way once I walked out of there.

Mr. WALDEN. All right. Who chaired the board's audit committee?

Ms. SANDERS. During the time that I was there it had been Dr. Philip Watkins.

Mr. WALDEN. And did you ever meet just individually with Dr. Watkins?

Ms. SANDERS. No, sir. No.

Mr. WALDEN. Did he ever ask to meet with you individually?

Ms. SANDERS. No, sir, he did not.

Mr. WALDEN. Did he ever schedule board meetings, audit committee meetings to meet with you?

Ms. SANDERS. No, sir, he did not.

Mr. WALDEN. Was there ever a discussion about why the internal auditor reported to senior management and not to the audit committee independently?

Ms. SANDERS. Not with me there was not.

Mr. WALDEN. Did you ever raise that as an issue that maybe that's not the way it should work?

Ms. SANDERS. Not with him, no.

Mr. WALDEN. Who did you raise it with?

Ms. SANDERS. The only person that I would have raised that with would have been when we were writing the charter when I first started, and that would have been with Tony Tanner and with Mr. Scrushy at that time.

Mr. WALDEN. So Mr. Tanner and Mr. Scrushy? And you raised it with them, and what again did the charter say?

Ms. SANDERS. The charter, when it—one it had been revised said that I reported directly to the CEO and in his absence the CFO of the company with I believe, it was either administrative or functional responsibility to the audit committee of the board of directors.

Mr. WALDEN. So we get back to this issue of lack of internal control. Would you say based on your auditing experience that there was extraordinary internal control in the sense that anything you found went directly to the CEO/President or the CFO, I believe all 5 of whom have now admitted to fraud?

Ms. SANDERS. Yes.

Mr. WALDEN. Is that not a huge gap in internal controls?

Ms. SANDERS. Yes, but our responsibility was only to audit the field locations. So that information would have gone to the operations personnel as well as in a general report to Mr. Scrushy and then to whoever, like the president of the company which would have been Jim Bennett at that point in time.

So, yes, there would be a gap.

Mr. WALDEN. Would you work for a company that set it up that way again?

Ms. SANDERS. No, sir, I would not.

Mr. WALDEN. All right. Thank you.

Mr. Cohen, why did the alleged $175 million hit that HealthSouth claimed it took in the third quarter of 2002 not make sense to you?

Mr. COHEN. Actually, they did not claim to have taken a $175 million in the third quarter. Their representation that they made, if I remember correctly, was that revenues were decreased third quarter over second quarter by $23 million related to Transmittal 1753.

The 175 was their estimate of an annualized effect including both Medicare and non-Medicare.

The reason it did not make sense is as part of our analysis we also sampled a period of time the last 2 weeks of September for the purpose of seeing if indeed they were—the billing practice had changed and just how far adrift they were from the guidelines that we felt were appropriate.

When we did that at the time you did the analysis for that 2 week period, the most had they been following those billing practices throughout that quarter, the most that could have been effected by Transmittal 1753 we felt were somewhere in the $7, $7.5 million range.

Mr. WALDEN. $7 to $7.5 million range?

Mr. COHEN. Right. That would be the most.

We also were aware that for the most part guidance had not been given throughout the quarter as to changing billing. So our view was that really the changes in billing were only taking place starting to take effect the last part of September. So our initial feeling was that perhaps $2 to $4 million may have been effected during that quarter. Not 23.

Mr. WALDEN. So did you proceed to find out what accounted for the other amount of money?

Mr. COHEN. As soon as we saw that, we had just—we heard this as we were drafting the report. And as soon as we saw it, we let Fulbright and Jawarksi know that we had some concerns about it, and that we needed to resolve those before we could ever make the report final. And then on November 6 I sent a note to Bill Owens detailing all the representations that were being made and asked for additional information, and never did get a response. Contacted him——

Mr. WALDEN. So——

Mr. COHEN. Tried to contact him about three times and never did get a response.

Mr. WALDEN. Never did get a response?

Mr. COHEN. No.

Mr. WALDEN. So is it your opinion then, was it then and is now that 1753 would not have had an incredible impact on the company?

Mr. COHEN. My opinion is that I feel very comfortable very with the analyses that we did. I cannot tell you, I mean, there may—we did sampling. You could not go out to all the thousands of facilities and do this.

Mr. WALDEN. Sure.

Mr. COHEN. So there is always a potential for error. But I felt very comfortable with our analyses. And so based on that, I would—there was virtually no impact on the commercial insurance during that quarter and the most, as I said, the Medicare could have possibly been 6, 6.5 and probably was closer to 2 or 3.

Mr. WALDEN. Do you think then that Mr. Scrushy was using Transmittal 1753 as a ruse to cover up other accounting misstatements that had been made prior to that so you wrap it all up and blame it on Transmittal 1753, wipe it out, point over here when really the fraud is over there?

Mr. COHEN. Obviously, at the time we had no knowledge as to the depths of the fraud that was taking place there. So we were concerned that perhaps adjustments were being made to contractual allowances for prior periods that might account for the difference. In hindsight knowing what I know today, it certainly would have been methodology of covering up some of those earnings.

Mr. WALDEN. Mr. Vines, I read a little bit about your comments on this issue. And I understand the allegation is something in the order of more than a billion dollars was shifted from expenses over into capital costs, right?

Mr. VINES. That is correct.

Mr. WALDEN. I guess the question that I cannot answer and maybe you can, is why the auditors did not more closely question that much capital asset showing up on the books? Now, I know from what we have read there is this allegation of manipulation of the data so that anything from up to $4,999, you know, that Ernst & Young did not look at anything below $5,000. So those are what, I guess, got picked up and pulled over and put into assets and amortized over a longer period of time. Is that accurate?

Mr. VINES. That's correct.

Mr. WALDEN. I am not an account. So help me out here.

But still there should be some paper trail behind that to identify a billion plus showing up there. What broke down there? How was that not identified?

Mr. VINES. I do not know, really. I mean it just moved from the expense accounts to the capital accounts.

Mr. WALDEN. But would you not agree that—I mean somebody in the accounting side of things, the auditing side of things should have noticed a billion dollars showing up over there, or is it just——

Mr. VINES. Well, if it is within a dollar range, the auditors do not look at it. So if it is under $5,000, they are not going to pay attention to it.

Mr. WALDEN. Right. But in accumulative when you get a get to a billion showing up on the balance sheet, do that not change——

Mr. VINES. Because if they are looking individual, looking at individual costs instead of overall costs.

Mr. WALDEN. So there is nobody looking at that? It is amazing.

Did you ever have contact with the auditors?

Mr. VINES. Not directly. Any contact I had with the auditors was through Kathy Edwards, my former supervisor.

Mr. WALDEN. And she has now plead guilty for the fraud?

Mr. VINES. Yes.

Mr. WALDEN. You raised some of these issues, the allegation is, on Yahoo?

Mr. VINES. Yes.

Mr. WALDEN. Are you Junior?

Mr. VINES. Yes.

Mr. WALDEN. And what were you trying to accomplish there you could not accomplish inside the company?

Mr. VINES. Well, I started posting messages after I left HealthSouth. I mean, I just wanted the truth out there of what was going on at HealthSouth in the accounting department and how expenses were being shifted and, you know, bogus assets added to the books each quarter.

Mr. WALDEN. Let me ask you this, because part of what we are trying to do is not just investigate what happened to HealthSouth, but look at are there changes in accounting rules, laws, things we do here in the Congress would catch these sorts of problems and save shareholders extraordinary losses. Is there something we need to change or was this just criminal behavior already in violation of law?

Mr. VINES. It is already in law. I mean, I am sorry it is happening. This is you need a tougher compliance department at the corporations, you know, a monitoring and stronger auditor department, you know, auditing every entry.

Mr. WALDEN. What did Kathy Edwards ask you to do with respect to the capitalization?

Mr. VINES. She had ran some queries on some expense accounts and she wanted me to move out certain expenses from $500 to right under $5,000, move those out of the expense accounts to the capital accounts.

Mr. WALDEN. And did you object to that?

Mr. VINES. Not really. The only thing I asked for, is I asked for her signature on the entries after the entries were prepared.

Mr. WALDEN. And you did that for what purpose?

Mr. VINES. I was not comfortable with the entries.

Mr. WALDEN. So you knew this was not a right thing to do?

Mr. VINES. Yes.

Mr. WALDEN. But you did not—basically the signature gives you CYA?

Mr. VINES. Yes.

Mr. WALDEN. That is what you were after. And you—why did you not come forward like Ms. Henze came forward and file a complaint within the internal workings? Is it fear, is it——

Mr. VINES. Fear. I was afraid I would lose my job.

Mr. WALDEN. Thank you, Mr. Chairman. That is all the questions I have at this time.

Mr. GREENWOOD. The Chair thanks the gentleman, and recognizes the gentleman from New Jersey, Mr. Ferguson for 10 minutes.

Mr. FERGUSON. Thank you, Mr. Chairman.

I just want to begin by thanking all the witnesses for being here today. I really believe that you are acting in the best way that you know how to try and account for this situation and to try and prevent this kind of a tragedy from happening again.

I want to begin with Mr. Vines, if I might. Mr. Vines, you knew people at HealthSouth were making accounting entries that you were not comfortable with, is that correct?

Mr. VINES. Yes.

Mr. FERGUSON. While you were employed at HealthSouth did you ever personally witness a falsification of a document that were

being given to your auditors, to Ernst & Young? And if you did, tell us about that.

Mr. VINES. Yes, I did. It was for the 2001 audit, I believe, at HealthSouth. The auditor while they were questioning an asset addition, which was an AP summary on a general ledger, well Kathy Edwards had scanned the accounts payable system to find a dollar amount close to that amount that she needed. She then ordered me to get that copy of the invoice for her. And then she scanned the invoice into her computer system and made the changes she needed on the invoice to give to the auditors.

Mr. FERGUSON. You had testified in court about a fake asset in Kansas?

Mr. VINES. Yes.

Mr. FERGUSON. Being supported by alerted documentation for an asset from Massachusetts. And as you were just saying and as I understand it, people were using scanners and computers to create false documents and using them to lie to the auditors?

Mr. VINES. That is correct.

Mr. FERGUSON. That is correct?

You seem to have discussed these uncomfortable entries with some of your colleagues. In April you testified that you discussed this with asset manager supervisors for the other two regions. Who were those people in the east and in the west?

Mr. VINES. The west was Wendy Walker and the east was on Amy Watts.

Mr. FERGUSON. And you had testified that between the three of you that you covered all 1800 HealthSouth facilities and that Amy Watts and Wendy Walker the same kind of thing was happening in their offices that was happening in yours, is that right?

Mr. VINES. I believe so.

Mr. FERGUSON. And I have got your testimony from a Federal court here, and I want to ask you some of the questions that were posed to you then.

There was this fraud hotline within HealthSouth, the 1-800 hotline program with cards that had been passed out to all the employees to report anything that you were not comfortable with. Is that right? You are familiar with that?

Mr. VINES. Yes, I am.

Mr. FERGUSON. Did you ever call that hotline to report these frauds, these falsification of documents that were being given to your auditors?

Mr. VINES. No, I did not.

Mr. FERGUSON. Okay. After you talked to Amy Watts and Wendy Walker about what was going on, did either one of them indicate that they were going to call the hotline or had called the hotline?

Mr. VINES. No, they did not. Not to me they did not.

Mr. FERGUSON. Did you have any conversations amongst yourselves suggesting that one another may be—someone call the hotline?

Mr. VINES. No.

Mr. FERGUSON. Did you talk amongst the three of you about possibly informing your auditors about what was going on, about going right to Ernst & Young to tell them some of these things that you were uncomfortable with?

Mr. VINES. No. No, we did not.

Mr. FERGUSON. Okay. Thank you.

Mr. VINES. Thank you.

Mr. FERGUSON. I want to move on to Ms. Henze.

Ms. Henze, you have testified in Federal court that you knew that fraud was being perpetrated by some of your superiors at HealthSouth, is that correct?

Ms. HENZE. I suspected fraud was being——

Mr. FERGUSON. You suspected so, okay.

And you had said, and you have made clear today that you did not want to sit idly by while this was going on?

Ms. HENZE. Right.

Mr. FERGUSON. It was obviously making you uncomfortable and you have talked about kind of a culture of fear and intimidation.

I do not have any question. And it is clear from your testimony today that you were trying to do the right thing, and I do not question that at all. But looking back, do you ever wish that you had gone directly to the outside auditors to talk about what was going on within the company? I mean, you had—your superiors who you believed or you suspected that they were committing fraudulent acts and you obviously were involved in this or a victim of, in many ways, this culture of fear, this culture of possible retaliation not only against you, but as you said against your husband. Did you ever think or consider going to the outside auditors to talk to them about what was going on?

Ms. HENZE. I just used internal purposes.

Mr. FERGUSON. Okay. Why? Any idea why? Was it because of this fear or——

Ms. HENZE. Can you repeat the question?

Mr. FERGUSON. Sure. We talked about your suspicions of fraudulent activities that were being done or perpetrated by your superiors, by the executives. I mean, we have 15 people who have plead guilty to various sundry things, so I think some of your fears have been substantiated or your suspicions have been confirmed. But my question was about going to outside auditors, your outside auditors Ernst & Young. You know, there were documents that were being fraudulently constructed and used to perpetrate this fraud and to mislead your outside auditors Ernst & Young. And my question was did you ever, because of your suspicions of what your supervisors were doing, did you ever think to go to or consider going directly to the outside auditors to tell them about your suspicions or your concerns?

Ms. HENZE. First of all, I did not know there was the documentation thing that was going on.

Mr. FERGUSON. Okay.

Ms. HENZE. No, I—I personally felt that it should—I should go through the channels that were made available to me, which was our corporate compliance.

Mr. FERGUSON. So you never considered telling someone outside the company, the external auditors?

Ms. HENZE. Yes, I had thought about it. But I chose not to.

Mr. FERGUSON. And why is that?

Ms. HENZE. Because I felt that it needed to be handled internally first and then let compliance, which was my avenue to take this

kind of suspicion to and let them handle it with the appropriate authorities at that time.

Mr. FERGUSON. Okay. Thank you very much.

I just have a couple of questions for Ms. Sanders.

You were at HealthSouth from 1990 to 1999, is that right?

Ms. SANDERS. Correct.

Mr. FERGUSON. Okay. And you were the director of internal audit?

Ms. SANDERS. I started out as the internal auditor. Was promoted to assistant VP and then to Vice President, and then Group Vice President.

Mr. FERGUSON. Depending on the company, the role of internal auditor varies, is that right?

Ms. SANDERS. Correct.

Mr. FERGUSON. And according to your testimony in Federal court your job description differed from what many would consider a typical internal auditor, is that correct?

Ms. SANDERS. If you—if you were hiring an internal auditor to be for an entire corporation, then yes my job description differed.

Mr. FERGUSON. Your role it seems based on your testimony in the past, your role as internal auditor tended to be more focused on the field operations?

Ms. SANDERS. Correct.

Mr. FERGUSON. And not on auditing the books at the corporate level?

Ms. SANDERS. Correct.

Mr. FERGUSON. Is that correct?

Ms. SANDERS. Yes.

Mr. FERGUSON. All right. And you suspected fraud?

Ms. SANDERS. I didn't suspect fraud. I had heard rumors about it, but I never had anyone bring me information saying this is what's happening, let me show you what's going on.

Mr. FERGUSON. But you requested access to the books, the corporate books, is that right?

Ms. SANDERS. To the corporate books, yes. It was not because I suspected fraud, no.

Mr. FERGUSON. But your request was denied, is that correct?

Ms. SANDERS. Correct.

Mr. FERGUSON. How did that make you feel? Was that common? Did you—was that the response you expected?

Ms. SANDERS. Not necessarily that I expected, but I was told that I was hired to audit the field locations and that is what Richard wanted me to do. So I didn't——

Mr. FERGUSON. Based on the rumors that you had heard and then being denied an opportunity to review the corporate books, did you have any suspicions yourself of fraudulent activities? Did you think there was any merit to these rumors of possible fraudulent activity?

Ms. SANDERS. Since I did not have any documentation to prove that it was going on, it was strictly a rumor and I could not necessarily go running up to the executive level with saying oh, I am hearing all these rumors that are going on. I needed something more substantial to be able to start an investigation and to be able to pursue it.

Mr. FERGUSON. But you did not have an opportunity to get anything more substantial because your superiors were denying you that information?

Ms. SANDERS. Correct.

Mr. FERGUSON. So did that give you any suspicion, a hunch, anything at all?

Ms. SANDERS. It did not give me the warm fuzzy, if you want to put it that way.

Mr. FERGUSON. Okay. Did you ever share that with your external auditors?

Ms. SANDERS. With the external auditors, no, I did not share that I did not have access to that. They did understand, though, that I only audited the field locations just because they saw what our audits, the list of audits that we did and then the list of audits that we were either planning to do over the next year or that we had completed. Because they reviewed our work at the year end.

Mr. FERGUSON. Okay. Thank you.

My time is up. I just want to thank the witnesses for being here. I want to thank you. I know you are—I really believe that you were operating on good faith and appreciate your cooperation here this morning. Appreciate it.

Mr. GREENWOOD. The Chair thanks the gentleman, and Mr. Rogers is recognized for 10 minutes.

Mr. ROGERS. Thank you, Mr. Chairman.

I appreciate the opportunity to be here, and I appreciate the witnesses here today. As a former FBI agent, I can tell you your work and honest testimony is incredibly important to get to the bottom of this particular set of pretty bad circumstances. And we thank you for having the courage to do that.

I have just a few questions, Mr. Chairman.

Mr. Cullison, you were the head of Corporate Compliance, as I understand it. Is that correct?

Ms. CULLISON. I was the Compliance Director. I reported to the Corporate Compliance officer.

Mr. ROGERS. Right. And how would you define your job responsibilities?

Ms. CULLISON. I ran the day-to-day operations of the compliance department, which included running our employee hotline, coordinating training for our employees, day-to-day types of things.

Mr. ROGERS. And explain the employee hotline to me, if you would?

Ms. CULLISON. Certainly. The employee hotline was a mechanism that we put into place for employees to report any wrongdoing, any questions that they had, concerns that they had about violations of our internal policies or State or Federal regulations or laws. And the hotline, it was just that. And when a case came in, we either routed it to the appropriate department and if it was not a matter for us to investigate or we handled the investigation within our department.

Mr. ROGERS. So it could be an equal opportunity complaint, it could be an audit?

Ms. CULLISON. Right. It ran the gambit. Everything from personnel issues, which really amounted to about 75 to 80 percent of

our calls, any kind of financial issues. Really anything that an employee had a question about.

Mr. ROGERS. So you would take that information, and how would you handle it? What would you do with that information that came off of that employee hotline?

Ms. CULLISON. We would log it into a computer system. We kept track of the date the call was received, if we knew any information about the general location, the facility or the state, we would keep track of that information. We lodged the details of the call and any kind of resolution that was done as well.

Mr. ROGERS. Now you know a person named Diana Henze, correct?

Ms. CULLISON. Yes.

Mr. ROGERS. She also worked with HealthSouth as well?

Ms. CULLISON. Correct.

Mr. ROGERS. That is correct. Is it true that Ms. Henze reported to you that there was fraud at the company in relation to inflated earnings?

Ms. CULLISON. She reported that she had some suspicions about accounting transactions that she had seen.

Mr. ROGERS. And how did you dispose of that information?

Ms. CULLISON. When she came and talked to me, she gave me tips on what types of queries to run on our accounting system, what types of journal entries to look for. So I ran those queries and was able to confirm the types of journal entries that she had concerns about did exist.

From that point forward I did not have the authority or the means to investigate it any further. I did not have access to the supporting documentation for those journal entries, so I took it to my supervisor, Tony Tanner, and he told me that he was concerned about it and that he would look into it.

Mr. ROGERS. Did you tell anyone else in the company about this report?

Ms. CULLISON. Not that I recall.

Mr. ROGERS. Were you ever told not to talk to your external auditing company?

Ms. CULLISON. No.

Mr. ROGERS. Okay. Did you ever have any feeling that that might be something you should do?

Ms. CULLISON. No. I felt like I had taken it through the proper channels by taking it to my supervisor.

Mr. ROGERS. Did you ever hear through your supervisor or did you ever directly talk to Mr. Scrushy that this report had been made and that he had acknowledged the receipt of it either by your supervisor; ever have that conversation anytime in your employment?

Ms. CULLISON. Did I have knowledge that Mr. Scrushy was aware of it?

Mr. ROGERS. Yes.

Ms. CULLISON. No.

Mr. ROGERS. What did you your supervisor tell you he had done with that information?

Ms. CULLISON. He did not give me details of his investigation. He merely told me that he had looked into it and that the allegations were unsubstantiated.

Mr. ROGERS. Did you believe that to be true at the time?

Ms. CULLISON. I had no reason not to believe that.

Mr. ROGERS. Did you ever go to the audit committee of the board of directors?

Ms. CULLISON. No, I did not have reporting authority to them.

Mr. ROGERS. Did you ever directly have communication with Ernst & Young about either the complaint or the inconsistencies that you saw, or your report to your supervisor?

Ms. CULLISON. No.

Mr. ROGERS. None of those things happened?

Ms. CULLISON. No.

Mr. ROGERS. Now, did you at anytime subsequently to this have a conversation with Ms. Henze as to what happened with that information?

Ms. CULLISON. We had a follow up conversation or two after her initial report to me. I do not remember the details of that. She continued to make it clear that that she stood by her complaint.

Mr. ROGERS. Did you give her any advice that she may want to seek someone else's advice at that particular time, by any chance?

Ms. CULLISON. I do not recall giving her that type of advice.

Mr. ROGERS. Okay. Do you have any idea what kind of direction you may have offered her at that time?

Ms. CULLISON. I do not recall. I am sorry.

Mr. ROGERS. Did you see after that time any increase in the number of calls to the hotline about audit irregularities?

Ms. CULLISON. No.

Mr. ROGERS. Nothing?

Ms. CULLISON. No.

Mr. ROGERS. Again, I appreciate your honesty in being here. And I have to tell you how important it is that you are here so that we make sure this does not happen in the future.

And, Mr. Chairman, I am going to yield back the balance of my time.

Mr. GREENWOOD. The Chair thanks the gentleman, and would make two notes. Oh, we will go to Mr. Stearns next.

We anticipate votes within the next 15 minutes, but we also intend to do a second round of this panel.

The gentleman from Florida, Mr. Stearns, is recognized for 10 minutes.

Mr. STEARNS. Thank you, Mr. Chairman.

In the time I have I thought I would talk to Mr. Schlatter. He, from what we have heard in the witnesses and the panel this morning, Mr. Chairman, seems like he was a person with a conscience, an individual that was asking questions and sort of like in our past hearings here we have had people which we call whistleblower, but he might not be a strict sense a whistleblower, but he was an individual that had conscience and was asking some questions. And I understand you are a physical therapist who used to work in HealthSouth facility?

Mr. SCHLATTER. Yes, sir.

Mr. STEARNS. From July 1995 through December 2001. And, as I understand it from your opening statement, you started questioning some of the billing practice for group therapy.

Now, under Medicare reimbursement, if you are reimbursed for group therapy, that is less than for one-on-one, is that correct?

Mr. SCHLATTER. Way less, yes.

Mr. STEARNS. Way less.

And you attempt a corporate policy on this issue. And what was the reaction to your corporate policy?

Mr. SCHLATTER. I never received one. My initial email was to a gentleman who was involved with the HCAP system, and he responded that there was a policy. But over the next——

Mr. STEARNS. So you asked him? Can I see the——

Mr. SCHLATTER. Yes. Yes.

Mr. STEARNS. Okay.

Mr. SCHLATTER. Yes. However, over the next 2 months this policy was never able to be produced.

Mr. STEARNS. And this policy was to include whether it is group therapy for reimbursement versus one-on-one?

Mr. SCHLATTER. I understood that, yes, there was just no way for us document in our HCAP system that we were doing group therapy. And in essence, we were doing that. We just could not document that we were doing that. We were continuing to bill as one-on-one.

Mr. STEARNS. So you did a lot of group therapy?

Mr. SCHLATTER. Yes, sir.

Mr. STEARNS. And you were billing it, you were told to bill it as one-on-one?

Mr. SCHLATTER. That is the only way we could.

Mr. STEARNS. Okay. And how long did this go on?

Mr. SCHLATTER. This—the Transmittal was actually dated 1996. Our profession as a whole was unaware of this transmittal. I myself was made aware of it in April 2001 from a weekly publication of the ELI Rehab Report. Upon receiving that report, I sought information in put from HealthSouth and I also called our American Physical Therapy Association for their interpretation. And I spoke with a personal friend, colleague, who had just recently gone through an voluntary Medicare audit of his own private practice to discuss these issues.

Mr. STEARNS. How many physical therapists like yourself do you think approximately were working for HealthSouth doing the same type of thing that you were doing; that is billing for individual therapy when you were doing group therapy?

Mr. SCHLATTER. Hundreds.

Mr. STEARNS. Hundreds? And so this went from 1996 to the year 2001?

Mr. SCHLATTER. Correct.

Mr. STEARNS. So we compound what you were very disturbed about by hundreds of employees, two or three hundred maybe, maybe a thousand? Do you think we are talking about——

Mr. SCHLATTER. Oh, thousands, yes.

Mr. STEARNS. Thousands. So let us move from the word "hundreds" to thousands of employees doing physical therapy and

they're doing it in group and they are billing it as one-on-one because there is no corporate policy, is that correct?

Mr. SCHLATTER. There was no way in our billing system to bill for group therapy.

Mr. STEARNS. Okay. So there must be at some point, based upon you emailing and asking for corporate policy and reading in the literature that it was wrong and knowing innately that this is wrong, this must have troubled our conscience?

Mr. SCHLATTER. Very much. That is why I was persistent in trying to get some resolution.

Mr. STEARNS. And did you ever get a resolution to your concern?

Mr. SCHLATTER. No, sir.

Mr. STEARNS. Okay. So in the roughly 6 years you were there you never got any support from above saying look, we will give you a corporate policy on this?

Mr. SCHLATTER. We—I did not actually start asking about the policy until I was made aware of it in April 2001.

Mr. STEARNS. 2001?

Mr. SCHLATTER. Yes.

Mr. STEARNS. Okay. Did you ever go to anybody else, for example to the Corporate Compliance Department?

Mr. SCHLATTER. No, I did not.

Mr. STEARNS. Okay. Did you never know there was a Corporate Compliance Department?

Mr. SCHLATTER. I was aware of it. I had a supervisor quite candidly tell me that I did not want to go there, they would make my life miserable.

Mr. STEARNS. So you got threatened? You got intimidated?

Mr. SCHLATTER. Yes.

Mr. STEARNS. And were you intimidated or intimidated maybe is a lighter word than threatened, intimidated over the whole period or was this just sporadically or was this consistent, or how would you say that pressure was put on you? Over what period of time and how often? Monthly, weekly, yearly?

Mr. SCHLATTER. No, I would not say intimidated. I mean——

Mr. STEARNS. Harassed? Harassed not the right word either.

Mr. SCHLATTER. Pressured.

Mr. STEARNS. Pressured. Pressured. Yes. Okay.

So with this letter pressure you thought well, who am I? I am a physical therapist. I am working in the chain of command here and the people at HealthSouth said there is no corporate policy, because they have not answered my question and there is thousands of my colleagues billing improperly. Is there a check off box that you had to actually say whether it was group therapy or individual?

Mr. SCHLATTER. No. No.

Mr. STEARNS. Okay. So you just submit the hours and the costs to HealthSouth and they would submit it to Medicare?

Mr. SCHLATTER. No. We did all of our documentation, our clinical procedures on a laptop, okay. And the—the program—it was programmed, okay. And it was programmed to base our billing based on what we entered in that we had done. What procedures we had done. What exercises we had done. We therapy modalities we had

done. And our billing statement was just generated from what we had entered.

Mr. STEARNS. Okay. So this would be then given to? To whom was it given?

Mr. SCHLATTER. It went via computer to Birmingham.

Mr. STEARNS. To Birmingham. And in Birmingham just run through my mind, what do you think happened there? I mean, did they just take your hours and then submit to to Medicare as individual therapy?

Mr. SCHLATTER. Yes.

Mr. STEARNS. And how did you know they were doing that?

Mr. SCHLATTER. Well, I mean, I knew it was being billed one-on-one because the group therapy was not—again, it was not on the billing statement.

Mr. STEARNS. Oh. So you only had one box?

Mr. SCHLATTER. Again, that was all taken right off the software of the computer.

Mr. STEARNS. Okay. I see.

Mr. SCHLATTER. I did not, per se, check group, one-on-one.

Mr. STEARNS. Did HealthSouth develop that software?

Mr. SCHLATTER. Yes.

Mr. STEARNS. Okay. And it was not done by an outside source?

Mr. SCHLATTER. No.

Mr. STEARNS. So that did HealthSouth say we had no culpability because we did not develop that software? It was done in house?

Mr. SCHLATTER. Right.

Mr. STEARNS. And did they update this on a regular basis? Did you get any revisions to that software?

Mr. SCHLATTER. I had just started working with the HCAP system a couple of months prior to my realization that this was a problem. We—I mean, I think—I think the HCAP was just rolled out in my facility in February 2001.

Mr. STEARNS. I got you.

Now, you said in your opening statement that you tried to make internal adjustments at your clinic when you could not get resolution to this corporate issue of group therapy.

Mr. SCHLATTER. Yes.

Mr. STEARNS. Maybe just give us briefly what sort of adjustments you are talking about?

Mr. SCHLATTER. I just simply altered the schedule books so that we would never see two patients at one time. We would not double book like we had done in the past. And, I mean, that pretty much took care of it for my clinic. You know, I faced some ramifications from decreased revenues, but——

Mr. STEARNS. Did you share your protocol that you developed at your facility with other physical therapists?

Mr. SCHLATTER. Yes.

Mr. STEARNS. And what was the response of these other people?

Mr. SCHLATTER. Actually, I shared it with some of the management people via conference call and I was told that I would face the repercussions of decreased earnings.

Mr. STEARNS. So they reduce your salary?

Mr. SCHLATTER. No. No. That was not threatened.

Mr. STEARNS. What was the threat when you say "decreased earnings?" Is that universally or——

Mr. SCHLATTER. When I did not meet my budget. You know, the budget was the thing, you know, that administrators had to be concerned about.

Mr. STEARNS. But you talked about a group therapy reimbursement versus individual.

Mr. SCHLATTER. My bottom would have been effected.

Mr. STEARNS. Bottom line. So what would that mean, what were they saying to you if you did not meet your figures?

Mr. SCHLATTER. That I would just have to face the consequences.

Mr. STEARNS. And what were the consequences in your mind? Were they going to fire you?

Mr. SCHLATTER. There were other circumstances involved, but my facility was closed.

Mr. STEARNS. They would close your facility?

Mr. SCHLATTER. Yes, it was closed.

Mr. STEARNS. It was eventually closed?

Mr. SCHLATTER. Yes.

Mr. STEARNS. Okay.

Mr. SCHLATTER. And I should add, there were other circumstances involved.

Mr. STEARNS. You do not want to share those with us? Are they too intimate? You do not have to, now. You have done a great job.

Mr. SCHLATTER. No, I will. The majority of my business was based on workman's compensation.

Mr. STEARNS. Okay.

Mr. SCHLATTER. We had two HealthSouth industrial medicine clinics within my hometown. That was the majority of my referrals. HealthSouth sold those facilities to U.S. Healthworks, who brought their own therapists in and, thus, that took away my referral base area.

Mr. STEARNS. Okay.

Mr. Chairman, I yield back the 1 second I have.

Mr. GREENWOOD. Sure you do not want to use that, Mr. Stearns?

Mr. STEARNS. No, thank you.

Mr. GREENWOOD. The Chair notes that, you know, we have just begun a series of votes on the House floor. So that will consume probably a half an hour by the time we get to them. So I am going to recess until 1 o'clock so members will have an opportunity and the witnesses and the audience, as well, have an opportunity to get some lunch. And perhaps some of the staff members might inform the witnesses where they can find lunch over the course of the hour.

So we will reconvene at 1 o'clock.

[Whereupon, at 11:58 a.m., the subcommittee recessed, to reconvene at 1:09 p.m., the same day.]

Mr. GREENWOOD. The committee will come to order.

We thank the patience of the witnesses. We hope that they found a place to have a sandwich and are refreshed.

The Chair recognizes himself for 10 minutes for inquiry, and Mr. Vines, I would like to begin with you.

Under questioning from Mr. Ferguson, he asked you a series a questions about why you did not report what you were suspicious

of to the company sooner. Do you believe that the hotline could have been bugged and is that why you did not report what was going wrong with the accounting?

Mr. VINES. I was afraid I would lose my job if I went to the Compliance Department.

Mr. GREENWOOD. Okay. But I thought you may have told staff that you were not sure that the hotline was monitored, that somehow you would not have anonymity if you used the hotline? Is that the case?

Mr. VINES. That is true. That is true.

Mr. GREENWOOD. Did you have any reason to believe that? Were there rumors to that effect in the company?

Mr. VINES. Just rumors and just a feeling.

Mr. GREENWOOD. Okay. All right.

Let me to go to Ms. Cullison. Okay. I am sorry. I am not going to Ms. Cullison. I am going to Ms. Sanders.

Okay. If you turn to Tab 67 in your notebook there, you will find what's popularly will be called the "Fleeced Shareholder Email." Do you recall being provided this document by Bill Horton or anyone else at HealthSouth around November 1998? This was, apparently, a memo or an email that was sent anonymously from someone who had called himself or herself a fleeced shareholder. Went to a long list of folks at Ernst & Young and at HCFA and at the SEC, and it relayed concerns about the bookkeeping at HealthSouth. Have you seen this in that timeframe?

Ms. SANDERS. I do not recall seeing this memo. I do recall having a discussion with Bill Owens to generate a response to one of the things in the memo.

Mr. GREENWOOD. And that was what timeframe? Back around late 1998?

Ms. SANDERS. Yes.

Mr. GREENWOOD. So you were aware of this? Did he——

Ms. SANDERS. I do not recall him going into detail as to why I needed to write the memo and the response.

Mr. GREENWOOD. Okay.

Ms. SANDERS. I do not remember seeing this.

Mr. GREENWOOD. Okay. Is it fair to say you probably would have remembered a memo that said from a "fleeced shareholder"?

Ms. SANDERS. Yes. Yes. I believe I would.

Mr. GREENWOOD. Have you previously had a chance to review the allegations contained in the memo?

Ms. SANDERS. Just a few moments ago I was glancing through here, and then when I met with your staff, yes.

Mr. GREENWOOD. Okay. As chief internal auditor of the company were these the kinds of allegations that you should have been made aware of?

Ms. SANDERS. Anything to do with the field operations, yes, especially the comment made about how come the HealthSouth outpatient clinics treat patients without recertification, both the revenue and carry it after being denied payment. Yes, I should have been made aware of that.

Mr. GREENWOOD. All right. So you would expect that if someone in the company was aware that these allegations were being made, the appropriate thing to do would have been to bring that to your

attention so that you could have used your capacities and resources to ascertain its veracity, is that fair to say?

Ms. SANDERS. Correct, yes.

Mr. GREENWOOD. Okay. Did Mr. Horton or Mr. Owens ever advise you that they were undertaking an internal investigation in the allegations of accounting fraud at the company?

Ms. SANDERS. No, sir. They did not.

Mr. GREENWOOD. Okay. Would you turn to Tab 38 now, please?

Ms. SANDERS. Yes.

Mr. GREENWOOD. Okay. This is a memo that apparently you sent to Bill Horton on December 9, 1998, having to do with outpatient audits between 1996 and 1998. Is that right?

Ms. SANDERS. Correct.

Mr. GREENWOOD. Okay. Do you recall writing this memo?

Ms. SANDERS. Yes, I do.

Mr. GREENWOOD. Okay. And what was your understanding of the request for this information?

Ms. SANDERS. That would have been, and in reading it, it says: "Per your request below is the summary of the insurance verification portion." They were asking me are we doing—that would deal with the recertification. Did we verify that there was insurance on a patient before we treated them.

Mr. GREENWOOD. And what was the answer to that?

Ms. SANDERS. The answer was yes, we did go through that process in our facility.

Mr. GREENWOOD. Okay. Let me turn to Mr. Smith, to whom I think no questions have been addressed yet. I do not want you to feel left out, Mr. Smith.

How long have you been with the internal audit department at HealthSouth?

Mr. SMITH. Going on 9 years.

Mr. GREENWOOD. Okay. And how long have you been Vice President of Internal Audit?

Mr. SMITH. Since 1999.

Mr. GREENWOOD. Okay. And during the course of your tenure as head of internal audit how often have you met with the audit committee of the board of directors?

Mr. SMITH. Say that again, please.

Mr. GREENWOOD. Okay. How long and during the course of your tenure as head of internal audit, how often have you met with the audit committee of the board of directors?

Mr. SMITH. I have met with the audit committee twice on an individual basis, but I met with them at our board meetings as well.

Mr. GREENWOOD. Okay. So you mean when you attended the board meetings?

Mr. SMITH. Yes.

Mr. GREENWOOD. Okay. So the other time other than at official board meetings, the one time that you met with them, was that per their request?

Mr. SMITH. Yes.

Mr. GREENWOOD. Okay. And so they only ever asked to meet with you once in 9 years?

Mr. SMITH. Twice. Twice.

Mr. GREENWOOD. Twice in 9 years?

Mr. SMITH. Yes.

Mr. GREENWOOD. Okay. To whom have you been reporting?

Mr. SMITH. I have been reporting—currently or at that time?

Mr. GREENWOOD. Over the course of the 9 years.

Mr. SMITH. I was reporting to Teresa Sanders when she was at HealthSouth.

Mr. GREENWOOD. Okay.

Mr. SMITH. And then when she left, then I took over the department, I reported to Richard Scrushy.

Mr. GREENWOOD. Okay. Did you ever question the fact that as head of internal audit you never met with the audit committee other than once or twice?

Mr. SMITH. No, I just—you know, in an off-the-wall conversation, I think I had asked Teresa at one time did she ever meet with them. And she said she was having the same type problems.

Mr. GREENWOOD. Yes. Have you held similar capacity in other companies prior to——

Mr. SMITH. No.

Mr. GREENWOOD. Okay. So did you have a sense of what—you must have thought that something was amiss if you—that they were not asking to meet with you if you brought it to Ms. Sanders' attention and said have you—because you just said have you had the same problem?

Mr. SMITH. Well, yes. I asked were we supposed to meet with the audit committee on an individual basis. And I asked her had she been meeting with them as well.

Mr. GREENWOOD. Okay. And in the course of your tenure there, I do not know if you belonged to associations or you had opportunities to interact with other individuals in other companies in your position. Did you, in fact, did you have occasions in the course of those 9 years to talk to other people from other companies who did the kind of work that you did or held the kind of positions that you did?

Mr. SMITH. Yes. By attending seminars.

Mr. GREENWOOD. You went to seminars?

Mr. SMITH. Yes.

Mr. GREENWOOD. Did you ever at any of those seminars say to your colleagues, you know, it is kind of weird at HealthSouth the audit committee has only ever asked to meet with me once or twice, is that the way it is at your company? Or did you have seminars where they said you should expect to meet with your auditors X number of times a year? I mean, was there a standard that you were aware of that would have seem to have been the right kind of communications with the board?

Mr. SMITH. No. It was never addressed in any of our seminars and I did not have any contact with——

Mr. GREENWOOD. So what made you think that it was a problem?

Mr. SMITH. Well, I just felt like that I probably should be meeting with the audit committee as well.

Mr. GREENWOOD. Why did you feel that?

Mr. SMITH. If I had anything to share with them, you know, the audit committee should know that.

Mr. GREENWOOD. And did you have things that you would have liked to have shared with them?

Mr. SMITH. No. It would have just been my report.

Mr. GREENWOOD. Okay. But you thought that you should on a routine basis share your reports with the auditing committee of the board of directors?

Mr. SMITH. That's correct.

Mr. GREENWOOD. Okay. Let me go back to Mr. Vines in the time that I have.

If you would turn to Tab 46, please, in your notebook. Okay. And could you identify that document for us?

Mr. VINES. That is an email that I sent to HealthSouth's auditor.

Mr. GREENWOOD. Which was whom?

Mr. VINES. Ernst & Young.

Mr. GREENWOOD. And when did you send that?

Mr. VINES. In June or July 2002.

Mr. GREENWOOD. Okay. So you sent that to Ernst & Young in 2002. Were you with the company at that point?

Mr. VINES. No. I left in May 2002.

Mr. GREENWOOD. In when?

Mr. VINES. In May.

Mr. GREENWOOD. So this is about a month after you left?

Mr. VINES. Yes.

Mr. GREENWOOD. You decided to send an email to Ernst & Young. And give us the gist of what that email says?

Mr. VINES. Basically that HealthSouth was moving expenses out of the expense accounts to capital accounts.

Mr. GREENWOOD. Okay. And why did you do that?

Mr. VINES. Because the expenses that were being moved weren't legitimate expenses that should be capitalized.

Mr. GREENWOOD. Yes, but you were not with the company anymore, so what do you care?

Mr. VINES. Just I thought the problem should be addressed. It should have been reported to the auditor.

Mr. GREENWOOD. So I do not want to put words in your mouth, but you had said earlier that you were afraid that if you blew the whistle on this, that you might get fired. Now that you left the company, you felt there was nothing to lose, so you let——

Mr. VINES. Correct.

Mr. GREENWOOD. Okay. And did Ernst & Young ever respond to your memo?

Mr. VINES. Not to me, they did not, not.

Mr. GREENWOOD. And you gave them an email address so that they could respond?

Mr. VINES. Yes.

Mr. GREENWOOD. But they did not? You never heard a word from them again?

Mr. VINES. No.

Mr. GREENWOOD. Did you try to contact them anymore after that?

Mr. VINES. No.

Mr. GREENWOOD. It just went into a black hole, and that was the end of it? You never heard of them?

Mr. VINES. Yes.

Mr. GREENWOOD. Okay. My time has expired. The gentlelady from Colorado is recognized for 10 minutes.

Ms. DEGETTE. Thank you, Mr. Chairman.

Mr. Smith, you succeeded Ms. Sanders in your position, correct?

Mr. SMITH. Correct.

Ms. DEGETTE. Thank you.

And how many facilities does HealthSouth have now, right now?

Mr. SMITH. I do not have the exact figures, because they've closed some. But I would say around, maybe, 1700 roughly.

Ms. DEGETTE. And so that would be around the same as when Ms. Sanders left, maybe more?

Mr. SMITH. Yes, could be.

Ms. DEGETTE. Okay. How many auditors do you have right now?

Mr. SMITH. Currently I have including myself, there's 5.

Ms. DEGETTE. So you have gone down from 10 when she was there to now 5, correct?

Mr. SMITH. Correct.

Ms. DEGETTE. And in August 2002 that is when the budget cuts came through, right?

Mr. SMITH. That is correct.

Ms. DEGETTE. Did you tell the audit committee of the board about the fact that all of these 1700, or however many facilities, that you were now being cut back to 5 auditors?

Mr. SMITH. I did and——

Ms. DEGETTE. And what was the response?

Mr. SMITH. I mean, they listened to me. They did not really comment on it. They just thanked me for sharing that with them, and if I had any——

Ms. DEGETTE. When was that?

Mr. SMITH. That was in August 2002.

Ms. DEGETTE. So over a year ago, right?

Mr. SMITH. Yes.

Ms. DEGETTE. Have you gotten any more auditors since then?

Mr. SMITH. I have not. I am in the process of hiring more now.

Ms. DEGETTE. So you are going to be all the way up to 6?

Mr. SMITH. Six, correct.

Ms. DEGETTE. Do you think that's enough to really conduct full audits of all these facilities?

Mr. SMITH. No, I do not.

Ms. DEGETTE. How many do you think you should have on staff?

Mr. SMITH. You know, I would have to study numbers and do some planning to see. But, I mean, I am not—I could not answer that right now.

Ms. DEGETTE. Okay. But certainly more than 6?

Mr. SMITH. Oh, yes.

Ms. DEGETTE. Probably a lot more than 10?

Mr. SMITH. Yes.

Ms. DEGETTE. Do you currently have access to the corporate books?

Mr. SMITH. No, I do not.

Ms. DEGETTE. So you are in the same position that Ms. Sanders was in, correct?

Mr. SMITH. That is correct.

Ms. DEGETTE. And who are you reporting to right now?

Mr. SMITH. I am reporting to Bob May.

Ms. DEGETTE. Okay. And do you think you need to have all that access knowing what you know now to all the corporate books to be able to conduct internal audits?

Mr. SMITH. I think it would be helpful to have access to that information.

Ms. DEGETTE. So do I. So what do you intend to do about that?

Mr. SMITH. I would like to meet with the board and specifically the audit committee to address that issue with them.

Ms. DEGETTE. Okay. Have you met with the board to talk about these audit issues since all this has transpired?

Mr. SMITH. I have not.

Ms. DEGETTE. Have they requested to meet with you?

Mr. SMITH. They have not.

Ms. DEGETTE. Ms. Sanders, I wanted to ask you there was a period in 1997 you said you did not have access to the corporate ledgers, but you had access to the facility ledgers, correct?

Ms. SANDERS. Correct.

Ms. DEGETTE. But at some point in 1997 your access to those ledgers was cutoff, too, was it not?

Ms. SANDERS. Correct. It was the computer access to it. I still had access to the hard copies.

Ms. DEGETTE. And why was that?

Ms. SANDERS. I do not know why. I just know that when we went in to access that information I was told by our ITG department that Mike Martin, who was the CFO, had turned that access of.

Ms. DEGETTE. Did you talk to Mike Martin about that?

Ms. SANDERS. I attempted to talk to him, yes.

Ms. DEGETTE. And what happened?

Ms. SANDERS. He told me that I did not need that access to do my job. We got into a short confrontation about that, and then I left, and left the meeting with we could go to Mr. Scrushy with this.

Ms. DEGETTE. And why did you feel it was important for you to get computer access versus just access to the hard copy?

Ms. SANDERS. Well, with close to 2,000 facilities it made it a little bit easier to do planning if you could do it through computer than having to go actually pull a hard copy.

Ms. DEGETTE. It is hard to do that to the hard copy, is it not?

Ms. SANDERS. Correct. Yes. There are times——

Ms. DEGETTE. A job I once actually did it recently, and it is hard. Did you ever get your computer access back?

Ms. SANDERS. Yes, I did.

Ms. DEGETTE. How long were you without that access?

Ms. SANDERS. I was probably without it for about 2 or 3 months. I know that I finally went and talked to Tony Tanner about it and he said that he would help me with talking to Mike about it. And we did get that access turned on.

Ms. DEGETTE. And Mike never gave you or Tony an explanation as to why that access was revoked?

Ms. SANDERS. I do not know if he gave it to Tony or not. I know he did not give it to me.

Ms. DEGETTE. Did you ever tell Mr. Scrushy about that, about the denial of the access?

Ms. SANDERS. No, I did not. No. No.

Ms. DEGETTE. Mr. Cullison, I wanted to ask you some questions. You set up the Compliance Department at HealthSouth, did you not?

Ms. CULLISON. Yes.

Ms. DEGETTE. Had you ever done that before?

Ms. CULLISON. No.

Ms. DEGETTE. Okay. And who asked you to do that?

Ms. CULLISON. I was approached by Teresa Sanders, who was my supervisor in the internal audit department. And she told me that they were looking at developing this program and asked if I would be interested.

Ms. DEGETTE. Okay. And the company hired Strategic Management Systems to assist you in developing compliance policy and procedures, is that right?

Ms. CULLISON. Correct.

Ms. DEGETTE. And that company is headed by Richard Kusserow, a former Inspector General of the Department of HHS, as far as I know, is that right?

Ms. CULLISON. Correct.

Ms. DEGETTE. Now, if you will look at Tab 98 in the notebook there. He sent a letter to you on December 3, 1997 and do you recognize that?

Ms. CULLISON. Yes.

Ms. DEGETTE. Did you receive that?

Ms. CULLISON. Yes.

Ms. DEGETTE. Now in that letter it says that there are occasions that would arise when the legal counsel needed to direct the issue resolution process and that HealthSouth needed a policy on when to do that. Is that correct?

Ms. CULLISON. Correct.

Ms. DEGETTE. And Mr. Kusserow provided that kind of protocol, right?

Ms. CULLISON. Yes.

Ms. DEGETTE. What it said is when there are allegations of criminal law violations the legal counsel should be notified immediately and that the legal counsel should conduct the investigation, evaluate the facts and evidence and to determine whether a criminal violation may have occurred and determine how to handle the issue. Is that right?

Ms. CULLISON. Correct.

Ms. DEGETTE. And do you know did the compliance office adopt those protocols?

Ms. CULLISON. I remember that we went through the process of reviewing the draft policies that SMS presented to us. I do not, on the other hand, remember which ones wee adopted. I do not recall which ones were adopted.

Ms. DEGETTE. Who was in charge of adopting the protocols?

Ms. CULLISON. Ultimately it would have been the compliance officer, Tony Tanner.

Ms. DEGETTE. And is it your belief that the protocol between the compliance office and legal counsel was adopted, that specific one?

Ms. CULLISON. I do not recall if that specific one was adopted or not.

Ms. DEGETTE. Did you ever utilize those procedures?

Ms. CULLISON. The procedures that were adopted we had in our office and we had access to——

Ms. DEGETTE. But you do not remember which ones they were?

Ms. CULLISON. I do not recall which ones specifically were, yes.

Ms. DEGETTE. But did you ever refer anything to legal counsel?

Ms. CULLISON. I did on an informal basis, yes.

Ms. DEGETTE. Okay. And that would be, I suppose, contemplated by the protocol on the compliance office?

Ms. CULLISON. Right.

Ms. DEGETTE. Now, Ms. Henze alleged fraud, which is a criminal violation. Did you alert the legal counsel?

Ms. CULLISON. I did not alert them at that time.

Ms. DEGETTE. Okay. Did you suggest to Mr. Tanner that he call in legal counsel about these allegations?

Ms. CULLISON. I do not recall doing that.

Ms. DEGETTE. Okay. And why not?

Ms. CULLISON. Probably at the time I felt that that would have been a call better made by him.

Ms. DEGETTE. So you thought that he would do it?

Ms. CULLISON. Right.

Ms. DEGETTE. Now, Ms. Henze suggested that you do some computer queries to see if what she said was accurate. Did you do those queries?

Ms. CULLISON. Yes.

Ms. DEGETTE. And what did you find?

Ms. CULLISON. I found after running those queries, I found some large dollar amount journal entries that were consistent with what she had brought to me.

Ms. DEGETTE. And did you give those, the results of those queries to Mr. Tanner?

Ms. CULLISON. Yes.

Ms. DEGETTE. What happened then?

Ms. CULLISON. At that point, that was when he informed me that he was going to look into it.

Ms. DEGETTE. And did you ever follow up with him to see what he had done?

Ms. CULLISON. I did not get the details of his investigation. The only response I received or the only response that I was given was that the matter had been looked into.

Ms. DEGETTE. So you never knew anything more than that?

Ms. CULLISON. No.

Ms. DEGETTE. Was this the standard way that you operated? Was this unusual?

Ms. CULLISON. This was an unusual type of case. Generally he would not have been involved in an investigation. But due to the high level of management that was involved in the allegations, it was not unusual that it would have gone to him.

Ms. DEGETTE. And also the credibility of Ms. Henze, which I think you have said was impacted?

Ms. CULLISON. Exactly. Right.

Ms. DEGETTE. Now, so how many times do you think you took situations like this to Mr. Tanner?

After consulting with counsel, your answer?

Ms. CULLISON. Right. We only had the one allegation of fraud, of a fraud nature from Diana, and that was the only one that went to Mr. Tanner. The only one that we received.

Ms. DEGETTE. Were there any other issues that you thought were big enough to take to Mr. Tanner?

Ms. CULLISON. For example, I remember a sexual harassment situation that went to Mr. Tanner because of the high level of management that it involved as well.

Ms. DEGETTE. So it was very unusual?

Ms. CULLISON. Right.

Ms. DEGETTE. Yes. And the sexual harassment situation, Mr. Tanner also found that the allegations were unsubstantiated, is that not correct? That was his initial finding?

Ms. CULLISON. I think through the course of his investigation that case was put to rest as well.

Ms. DEGETTE. Now, do you know if the board of directors was ever made aware of this high level complaint against the senior officials of the company?

Ms. CULLISON. I do not know that they were made aware of it.

Ms. DEGETTE. And what happened to the records in this case?

Ms. CULLISON. We had a policy within the compliance department that once a case had been closed, it would remain in our system for 90 days and then it would be purged from our system. And the only thing that would remain as a record of that case was general information like the date of the call, whether—you know, what type of call it was but not specific information.

Ms. DEGETTE. And so do you know if those records still exist anymore?

Ms. CULLISON. Yes, they do.

Ms. DEGETTE. I do not have anymore questions, Mr. Chairman.

I just—I want to add my thanks to all the witnesses for coming forward. But I also want to add I have been here for all of these corporate responsibility hearings. And I think that if there is any one thing that the testimony today and the testimony we have been hearing for a couple of years should teach is is that when employees of a company see something wrong, they really need to find a way to take it to places other than their immediate supervisors, who are often the ones that are guilty of the wrongdoing.

And I was thinking about this over the lunch break. In so many of these cases what we have had is a very charismatic powerful leader of a company. Enron, Qwest, ImClone. And the employees, even if they see wrongdoing are afraid to take it outside the normal channels. So I think probably all of you have learned a good lesson, and I know we certainly have. And I would hope that throughout corporate America employees would be sitting there saying today, you know, if I am seeing some wrongdoing, I have some kind of duty to bring this up and not just to the people who are committing the wrongdoing.

So, those are just my thoughts.

And, again, I want to thank everybody here. Because I know everybody here has tried to work the best that they could within the system. And I do appreciate your testimony.

Mr. GREENWOOD. The Chair thanks the gentlelady.

The gentleman from Oregon, Mr. Walden is recognized for 10 minutes.

Mr. WALDEN. Thank you, Mr. Chairman.

Ms. Sanders, I have a question for you and it relates to the audits by Ernst & Young. Do you think it was appropriate to classify the Pristine Audits as audit related services?

Ms. SANDERS. As audit related services?

Mr. WALDEN. Yes.

Ms. SANDERS. Like financial audit related services?

Mr. WALDEN. Right.

Ms. SANDERS. No, I do not.

Mr. WALDEN. And yet it was done that way, right?

Ms. SANDERS. To my knowledge, that is what I have heard.

Mr. WALDEN. Yes. It does not seem right to me. It is sort of a white glove test to see whether the trash is—what all did they do? Trash taken out, rooms clean?

Ms. SANDERS. Right. The reception is friendly.

Mr. WALDEN. I mean, that's a function.

Ms. SANDERS. Right. Business license posted. I mean, it was very generic. Things that someone could walk in the door and be able to do and check yes or no on.

Mr. WALDEN. Why would they have classified them as audit related?

Ms. SANDERS. I do not know. That was my——

Mr. WALDEN. Does anyone on the panel know that? The answer to that?

Does anyone on the panel know if the board meetings were taped, given the hidden cameras and microphones and the fact, I understand Mr. Scrushy even had a tape recorder going in his pick-up, I understand? His folks here were handing out copies of those tapes gratuitously out here in the lobby earlier. Do you know if the board—we do not have minutes from the board meetings. They could not keep track of that, but they could, you know, wire his pick-up. Do you know, were any of these board meetings taped?

Ms. SANDERS. No.

Mr. WALDEN. All right. Mr. Cohen, can you refer to Tab 27, please sir, in the document binder? This was taken from the transcript of HealthSouth's conference call to discuss third quarter results. You will see beginning on line 4 Mr. Scrushy states: "I would like to begin by saying the third quarter was a challenging quarter for the company. The introduction of Transmittal 1753 certainly had an impact on the company."

In your opinion was the estimated impact of Transmittal 1753 going to have an immediate revenue impact on the company, and if not, why? And I know we have touched on this earlier, but I would like to go back to it?

Mr. COHEN. Based on what we found while we were there, there had not appeared to be any guidance given to the field as to how to code. We did find one memo that had gone out telling everybody to begin using group codes.

Mr. WALDEN. Right.

Mr. COHEN. However, when we talked to people in the field, people fairly well admitted they disregarded that memo. Because they thought it was inappropriate advice.

On about September 13 CMS did hold an open forum where they discussed more about the different scenarios and how the coding could take place. And after that we would have expected to see some impact. And, indeed, when we did look at the end of September, we saw some impact. But, as I said before——

Mr. WALDEN. But as of that conference call?

Mr. COHEN. We did not study earlier in the third quarter. Based on our conversations we would not have expected to see a significant amount of change in the way coding was done and certainly through that period of time we found a dominus amount of impact in how people coded commercial, and that was mainly out of the hospital division.

Mr. WALDEN. And the commercial was the biggest part of the book of business, was it not?

Mr. COHEN. Yes, and that was—it was also the toughest part to figure out what would happen long term as to how they would respond to a change in Medicare.

Mr. WALDEN. Okay. How much was FTI paid to perform the analysis of the impact of Transmittal 1753 on HealthSouth's revenue, and for that amount of money did HealthSouth board of directors receive a final product with the analysis FTI had performed?

Mr. COHEN. We received, I believe, around $1.4 million.

Mr. WALDEN. All right.

Mr. COHEN. To prepare to the analysis.

Mr. WALDEN. Did the board ever see a final product?

Mr. COHEN. They never saw a final product. They never saw—they were never given a report from us because we told the counsel, we were working for counsel, a report went to Fulbright.

Mr. WALDEN. Right.

Mr. COHEN. I do not know if they then subsequently shared the draft that we gave Fulbright with the board.

Mr. WALDEN. Right.

Mr. COHEN. But we did indicate to Fulbright as well as we indicated to the company that unless we resolve—until we were able to resolve the discrepancies we saw, we were not going to take that report to final.

Mr. WALDEN. And those discrepancies required additional information which you sought?

Mr. COHEN. Yes.

Mr. WALDEN. And you sought that from Mr. Scrushy?

Mr. COHEN. No. We sought—I sent—we worked entirely through Bill Owens while we were there in terms of coordinating data.

Mr. WALDEN. And who did he report to?

Mr. COHEN. Mr. Scrushy.

Mr. WALDEN. Thank you.

Mr. COHEN. And we sent a—I sent a note to him, an email on November 6.

Mr. WALDEN. Right.

Mr. COHEN. Listing out the discrepancies and then also requesting of him certain information and indicated the information that we needed in order to complete that.

Mr. WALDEN. And Mr. Owens never got back to you?

Mr. COHEN. He never got back. Counsel was also notified of the information that there was a discrepancy and we needed further information.

Mr. WALDEN. Okay. And did the counsel ever pursue it that you are aware of?

Mr. COHEN. There were two groups of counsel that we were dealing with at the time. We were engaged by Fulbright & Jaworski. I do not know what Fulbright & Jaworski did with that information. I am not aware of what conversations they may have had.

Mr. WALDEN. How much would it have cost you to finish the report?

Mr. COHEN. The second counsel that we talked to was Lanny Davis with Patton Boggs. He had asked us for a memo detailing remaining cost to finish the report.

Mr. WALDEN. Right.

Mr. COHEN. That he said he wanted to discuss with Mr. Scrushy.

The whole report including reporting to the board, etcetera, was somewhere around $100,000 to just do the work that we needed to confirm that number——

Mr. WALDEN. About 116, I think.

Mr. COHEN. Right. Somewhere in that neighborhood. Just to do the work that we need to confirm the numbers in the report was probably somewhere in the 40,000 or 50,000 range.

Mr. WALDEN. So you could have completed your report for that amount, is that correct?

Mr. COHEN. Yes.

Mr. WALDEN. And they had already spent a million dollars on you?

Mr. COHEN. A million four.

Mr. WALDEN. A million four? And for another, no more than 40,000 confirm another 116 altogether including the 40 you could have wrapped it up?

Mr. COHEN. That is correct.

Mr. WALDEN. Do you think that asking for this additional information it may have caused some—to suggest it might be not in their benefit to have you finish that report?

Mr. COHEN. At the time, since it was an insider—insider trading investigation, we figured they were going to want that report finished.

Mr. WALDEN. But who asked for the report to begin with through the law firm?

Mr. COHEN. Well, the law firm at the behest of—they were engaged by the board.

Mr. WALDEN. By the board or Mr. Scrushy?

Mr. COHEN. I believe they were engaged by the board. I might be incorrect, but I believe it is by the board.

Mr. WALDEN. Okay.

Mr. COHEN. And the law firm engaged us then to do one component of their overall assessment, and that was to test the validity of the $175 million assertion.

Mr. WALDEN. And so you go through all this process, the board—let me understand this. The board asks the law firm to do this study and you never end up finishing the study and the board never sees it?

Mr. COHEN. I do not know if the board ever saw the draft or not, but I never did complete the study.

Mr. WALDEN. Who was Lanny Davis retained by?

Mr. COHEN. I do not know. At some point we had conversations with Lanny. Lanny had indicated that he retained by the company. And I am telling you what I recollect, and that is I had heard he was retained as a crises manager. Do not ask me what that is.

Mr. WALDEN. So they thought they might have a crises on their hands. What a concept.

Mr. Smith, I want to go to you because you're still there, right?

Mr. SMITH. Yes.

Mr. WALDEN. The auditing officer. And the auditing committee at the board doesn't talk to you?

Mr. SMITH. I talk directly—I talk weekly with Mr. May, CEO of the company. But I have not talked with the audit committee.

Mr. WALDEN. That's phenomenal.

Mr. SMITH. They get reports from me on audits, but I have not had a one-on-one——

Mr. WALDEN. They do not call you in, you do not sit down, you do not make your report to them independent——

Mr. SMITH. No.

Mr. WALDEN. [continuing] of the CEO?

Mr. SMITH. I have not met them, no.

Mr. WALDEN. They did not do that the last time either, right, under Mr. Scrushy? Did they meet independently with their own auditors?

Ms. SANDERS. No, sir, they did not.

Mr. WALDEN. What kind of board is this? This is outrageous.

Ms. Sanders, going back to the amount of money charged by Ernst & Young, Tab 44, are you surprised the amount charged for the Pristine Audit was so much higher than the amount charged for the annual audit?

Ms. SANDERS. After seeing this document, yes sir, I am. I've not seen——

Mr. WALDEN. I'll let you get to Tab 44. You'll see in the year 2000 the annual audit cost $939,400 plus the quarterly reviews of 87, so a million 27,000 let us say in 2000; a million 165,000 in 2001 for the audit. And then for the Pristine Audits it is a million and a quarter for 2000 and a million 330,000. So they basically were spending more to check the trash cans than to check the books?

Ms. SANDERS. That—that would appear so, yes, sir. I was not there, though, during these years.

Mr. WALDEN. You were not there during these years?

Ms. SANDERS. I had—no, sir. I had left in 1999.

Mr. WALDEN. On, that is right. I'm sorry. So you do not know who prepared these figures?

Ms. SANDERS. No, sir. I do not.

Mr. WALDEN. All right. Let us see, let us go back to Mr. Cohen.

Would you please refer to Tab 35 in our binder? Attached to this email is a document entitled "Fee Estimate for Remaining Tasks". On the line total remaining fees and expenses you have 116,756. So that was the estimate we were just talking about.

Mr. COHEN. That is correct.

Mr. WALDEN. Okay. Was there some push back from HealthSouth on the additional cost involved?

Mr. COHEN. They had pushed back on the overall bill. On the additional cost, we never got—we never got any response.

Mr. WALDEN. Did they pay the million dollar bill? The million and a half?

Mr. COHEN. Yes, they did. Yes.

Mr. WALDEN. So they had already invested $1.4 million to find out if there was some problem internally, but they did not want to see the final result? Well, they did not want to pay you to finish your work?

Mr. COHEN. They certainly for whatever reason did not provide us the information we needed to complete a final report.

Mr. WALDEN. Have you subsequent to that ever seen the information?

Mr. COHEN. No.

Mr. WALDEN. Okay. All right. Did anyone at HealthSouth, either employee or board member, request to see FTI's analyses before it was completed?

Mr. COHEN. The only contact we had with the board was a very early meeting where we met with, I believe it was Bob May just wanted to know what we were doing. Never had any contact after that.

We anticipated we would be—when we completed it, we would be making a presentation to the board. But since we never completed the report that never happened.

As a normal course we had planned on going down to Birmingham——

Mr. WALDEN. Right.

Mr. COHEN. [continuing] to meet with Bill Owens and the remaining senior staff that we had worked with to go through the report with them and make sure there were not any glaring mistakes——

Mr. WALDEN. Sure.

Mr. COHEN. [continuing] or things that we had missed. That never occurred because they did not respond to us to the November 16——

Mr. WALDEN. For the additional information?

Mr. COHEN. [continuing] for the additional information.

Mr. WALDEN. And that is pretty standard procedure, is it not? You do other audits for other companies?

Mr. COHEN. Sure.

Mr. WALDEN. Is that correct? And is it not normal that an audit committee you meet with them?

Mr. COHEN. You talking about the audit committee now?

Mr. WALDEN. Yes. I mean, I know there are several——

Mr. COHEN. Not related to this.

Mr. WALDEN. No, no, no. But just in general in the kinds of audits you do?

Mr. COHEN. Well, I am not an auditor, but I am certainly aware of that, yes. Typically, we would be meeting with the audit committee.

Mr. WALDEN. Would that not be a standard corporate practice?

Mr. COHEN. Oh, yes.

Mr. WALDEN. In a well run company?

Mr. COHEN. Certainly.

Mr. WALDEN. The audit committee would have some independence from its management and you would report to that audit committee sometimes with management not there?

Mr. COHEN. Absolutely.

Mr. WALDEN. Especially if you saw a problem?

Mr. COHEN. It certainly has evolved over the years. I mean, if you went back 10 years, what you are hearing today was probably fairly normal course. But it has evolved over time to where it is pretty much an independent practice where whoever is in charge of internal audit will report directly to the audit committee of the board.

Mr. WALDEN. Ms. Sanders, is that not what you do now? Report independently?

Ms. SANDERS. I report—or reported when I worked with Eastern Health System, yes. I reported directly to the CEO and also directly to the audit committee.

Mr. WALDEN. And you could meet with either separately and not fear for your job?

Ms. SANDERS. Correct. I met on a quarterly basis alone with the audit committee, yes.

Mr. WALDEN. But at HealthSouth you did not have that opportunity?

Ms. SANDERS. No, sir, I did not.

Mr. WALDEN. And at the other health company, I am sorry, Eastern——

Ms. SANDERS. Eastern Health System.

Mr. WALDEN. Eastern Health. Did you have access to the corporate books as well as anything else you wanted to look at?

Ms. SANDERS. Yes, sir, I did.

Mr. WALDEN. But at HealthSouth you did not?

Ms. SANDERS. I did not, no.

Mr. WALDEN. So, I mean, maybe I am—well, it just strikes me that there were firewalls put up to make sure that the people doing the audits could never see everything they needed to see to get a clear picture of whether or not these books were being manipulated. Is that an accurate picture from those of you were there who are not there now?

Ms. SANDERS. We were hired to audit the field, and that is what we audited. And, so that is—I mean——

Mr. WALDEN. Okay. I understand. Thank you very much.

Mr. GREENWOOD. The time of the gentleman has expired.

The gentleman from Michigan, Mr. Rogers is recognized for 10 minutes for inquiry.

Mr. ROGERS. Thank you, Mr. Chairman.

Ms. Sanders, I am just trying to understand this a little better. Just for my own edification. When you were hired in 1990 were you hired for internal audit functions or operational audit functions?

Ms. SANDERS. I was hired as the internal auditor, but it was very well defined by Mr. Scrushy that I was hired to audit the field and it was the financial audit of the field, the financial information that they would be submitting to the corporate office to post to their general ledgers which would generate the financial statement.

Mr. ROGERS. So you were more in the facilities? You were not for the corporate finances, if you will?

Ms. SANDERS. Correct. Yes.

Mr. ROGERS. Okay. And it is my understanding there is no law or was not a law at the time that set any parameters for what an internal auditors could or should or would do according to the specifics of the law, is that correct?

Ms. SANDERS. Correct.

Mr. ROGERS. Okay. So they could define by law any type of system that they wanted to do, including one where you were excluded from the finances of the corporation and only did operational auditing, is that correct?

Ms. SANDERS. Correct, yes.

Mr. ROGERS. You testified earlier that rumors were circulating as to fraud that raised some concern for you. Now you did not see anything within your audit purview in the facilities that indicated to you that there would be fraud, is that correct?

Ms. SANDERS. That is correct.

Mr. ROGERS. But you heard a rumor that there may be some fraudulent activity?

Ms. SANDERS. I heard that they—they heard the rumor that they were playing with the numbers.

Mr. ROGERS. Can I ask, how did you hear that rumor? I mean, how would you come about that kind of information?

Ms. SANDERS. I heard it once from a controller at one of the hospital. She did not elaborate on how they were playing with the numbers or exactly what she was talking about. It was a just comment that was made.

And then I also heard it from a senior person at the corporate office.

Mr. ROGERS. And I am at a point in your testimony here from the asset freeze hearing. And the question was posed "So you have got rumors circulating of some notions about fraud going on. You are the in-house auditor of the company and you did nothing about it?" End of question.

Answer: "You could look at it that way, yes sir." So what you were saying then is that you did not feel that there was anywhere that you could go to talk about that information, is that correct?

Ms. SANDERS. I did not really have any documented information to take to be able to investigate and see if the rumors were valid.

Mr. ROGERS. So you had no direct knowledge?

Ms. SANDERS. Correct.

Mr. ROGERS. Okay. And you also said that you heard even apparently these Pristine Audits, but you had no direct knowledge of the operation of Pristine Audits, did you?

Ms. SANDERS. No. I had—I had the direct knowledge of the Pristine Audits. I did not have direct knowledge of where they were classifying the expenses on the financial statements. That was not part of my function. It was always intended to be a quality standards program; that was what the original proposal was.

Mr. ROGERS. Now, was the scope of your responsibility known both to the senior officers and those below you in the different functions of the compliance department and other places? They

knew that your function was separate from the financial auditors, or did they?

Ms. SANDERS. I do not know that they really knew that there was a separation between the two of us. I do know that they knew that I was responsible for doing the field audits, yes.

Mr. ROGERS. At anytime did you talk to the external auditors about your concerns about these rumors that you were hearing?

Ms. SANDERS. No, I did not. And the main reason that I did not is there was not anything to substantiate that the rumor was even valid, and I would not have felt comfortable going either up the chain to senior level management to the external auditors without something to back up the rumors. I have heard these rumors, I have got documentation to prove it exists.

Mr. ROGERS. To some degree you were a victim as well by the numbers that you were getting in your operational audits as well?

Ms. SANDERS. Correct. Yes.

Mr. ROGERS. Okay. So, and I would assume you are a consummate professional and you take your job very seriously. Obviously, you have had the courage to testify today. It can happen in these companies, can it not? If there is that much fraud and that much conspiracy, that widespread and throughout a corporation culture, these internal audit operations can be fooled as well, cannot they?

Ms. SANDERS. Yes, they can. They teach us that in our initial auditing courses and any of our certified fraud training, and any of that. If there is collusion in a company, there is not anything that you can do to detect that.

Mr. ROGERS. This is just more of a gee wiz question for me. The SEC has just come out to require listed companies to have an internal audit function. And prior to that the language is "an effective internal control." Big difference there, do you not think, in your role as a professional?

Ms. SANDERS. Yes.

Mr. ROGERS. And do you think it would help in the future for these companies, make it a little bit more difficult for professionals like you if you can be fooled to have an internal audit function as opposed to an open ended effective internal control? Do you think that would be effective?

Ms. SANDERS. Yes, it would.

Mr. ROGERS. I mean, that is something that we will be looking at as a result of these hearings.

And I hope you all understand, I am just understanding it myself to make sure that any action that we take here, make sure that we go after the bad guys, the folks who are causing these problems.

And I just, again for the record, there is no time that you went to either internal operations or external operations to say hey there is a—we have a fraud problem here? And mainly because you did not know, accordingly to your testimony?

Ms. SANDERS. I did not know. No, sir. The only—only comments that I made were to Mr. Scrushy during my exit conference that there were—I was having issues with Mike Martin, that he had turned off my access. We had gotten that turned back on. And he asked me why I felt like Mike had done that. And we got into a discussion about Mike and the CFO. So——

Mr. ROGERS. Okay. In your history as an auditor in other places, was it unusual that you would do this operational audit only or is that something that a company that might——

Ms. SANDERS. It is not unusual.

Mr. ROGERS. Not unusual?

Ms. SANDERS. No.

Mr. ROGERS. I am going to open it up to the panel. I am still trying to understand the culture of fear that we have heard from many of the employees, or at least from testimony that we have gleaned from the past. And I am wondering if anybody can tell me other than something that we have talked about earlier today, that might help me understand completely this culture of fear that would even when you got to the point where you really understood that this—you were participating, quite frankly, in a fraudulent act that maybe this is not my place or my time to relay that information to either a superior or an external operation either through the hotline compliance, Ernst & Young or others. And I am going to open end that question to anybody.

Ms. DEGETTE. Will the gentleman yield?

Mr. ROGERS. Yes.

Ms. DEGETTE. I would assume you are not trying to get any of the panel members to admit to participating in a fraudulent act?

Mr. ROGERS. No, absolutely not.

Ms. DEGETTE. That makes me be nervous when you say that.

Mr. ROGERS. No. I mean, other than some of these folks were, obviously, participating in acts and why they are cooperating witnesses at this point because they had firsthand knowledge of those activities. And, obviously, something in them said, hey, I am going to do my best. But what was that culture? I am more the culture of fear than your activity. I am not really interested in you telling me what you did other than what was that fear factor that said I am not going to take the extra step to go? That was—I am just curious. I want to understand the culture of fear in this company that got to us to where we are today. It existed.

Nobody wants to step up to that one?

Thank you, Mr. Chairman. I have no further questions.

Mr. GREENWOOD. The Chair thanks the gentleman.

Before I excuse this panel, just two more questions.

Ms. Henze, you are the assistant controller of HealthSouth today. Do you see a difference between the company, the way the company was run when Mr. Scrushy was there versus the way it is operating now under new management?

Ms. HENZE. Yes, sir.

Mr. GREENWOOD. Could you describe that difference?

Ms. HENZE. Just the general atmosphere is a lot more relaxed. It seems to be a lot more open door. Mr. Bob May is the acting CEO and, you know, I have—there is many occasion. I have seen him in the cafeteria, walked up to him, gone to his office just said "hey, something that never occurred."

I mean, the little things. Like there was a private entrance that only Mr. Scrushy could come into the company campus. As soon the new leadership came, they opened it up to everybody so all employees could use any entrance that was available.

They allowed us now to go out on the back deck. Just a nice little deck where you can stand by the waterfall. We were not really—we were—I do not know if hinder is the right word, but discouraged from going out there and standing. We are allowed to go out there now.

There is picnic tables.

I mean, it is just a lot nicer atmosphere and——

Mr. GREENWOOD. And how about the financial?

Ms. HENZE. Oh, I am sorry.

Mr. GREENWOOD. That is quite all right. That is all very interesting. But how about the financial position of the company? Do you feel confident that it is going to be able to survive this?

Ms. HENZE. Yes, I do.

Mr. GREENWOOD. Okay.

You all have long been involved with this company, and you all, I think, were here when Mr. Scrushy was here. My guess is you have all seen the "60 Minutes" tape in which Mr. Scrushy says that he is perfectly innocent, he did not know about any of these shenanigans, did not know that the books were being falsified. He had the terrible bad luck to hire 5 corrupt CFOs in a row and 10 other company executives who hide all of this behind his innocent back.

Do any one of you based on Mr. Scrushy's management style as you have known it, does anyone of you believe him? Okay.

Thank you for coming. And thank you for your time and for you openness, and for your willingness to try to do the right thing.

You are excused.

Okay. We now call forward our third and final panel of witnesses consisting of: Mr. William Horton, Former Executive Vice President and Corporate Counsel of HealthSouth Corporation; Mr. Brandon Hale, Former Executive Vice President of Administration, Corporate Security and Compliance Officer from HealthSouth Corporation; Mr. James Goodreau, Former Chief of Security, HealthSouth Corporation, and; Mr. Anthony Tanner, Founder and Former Corporate Secretary and Compliance Officer at HealthSouth Corporation.

Gentleman, we welcome you.

Okay. Again, we welcome you. I think you have observed from the other panels that it is the practice of this subcommittee to take testimony under oath. Do any of you object to giving your testimony under oath this afternoon? Okay.

Seeing no such objection, I need to let you know that pursuant to the rules of this Committee and the House, you are entitled to be represented by counsel. Do any of you wish to be represented by counsel today?

Mr. Horton? You need to pull your microphone over and turn the button on. Try now. There you go.

Mr. HORTON. Thank you, Mr. Chairman.

My counsel William Baker and Tamara Smith are behind me.

Mr. GREENWOOD. Okay. Would you gentlemen raise your hands. Thank you.

Mr. Hale?

Mr. HALE. Mr. Chairman, my attorney is David Burn and Paige Jackson are behind me.

Mr. GREENWOOD. Okay. Welcome.

Mr. Goodreau?

Mr. GOODREAU. Mr. Chairman, my attorney Fred Sinclair is behind me, sir.

Mr. GREENWOOD. Very well, sir.

Mr. Tanner?

Mr. TANNER. Mr. Chairman, my attorney Jack Sharman is behind me.

Mr. GREENWOOD. Okay. Mr. Tanner, I need to ask you, do you have any difficulty rising to——

Mr. TANNER. It would be easier——

Mr. GREENWOOD. All right. I am going to ask Mr. Horton, Mr. Hale, Mr. Goodreau to stand and Mr. Tanner to just raise your right hand as they do.

[Witnesses sworn.]

Mr. GREENWOOD. Okay. You are under oath.

And, Mr. Horton, do you have an opening statement?

TESTIMONY OF WILLIAM HORTON, FORMER EXECUTIVE VICE PRESIDENT AND CORPORATE COUNSEL, HEALTHSOUTH CORPORATION; BRANDON HALE, FORMER EXECUTIVE VICE PRESIDENT OF ADMINISTRATION, CORPORATE SECURITY AND COMPLIANCE OFFICER, HEALTHSOUTH CORPORATION; JAMES GOODREAU, FORMER CHIEF OF SECURITY, HEALTHSOUTH CORPORATION; AND ANTHONY TANNER, FOUNDER AND FORMER CORPORATE SECRETARY AND COMPLIANCE OFFICER, HEALTHSOUTH CORPORATION

Mr. HORTON. Mr. Chairman, I am Bill Horton from Birmingham, Alabama. I was formerly Executive Vice President and Corporate Counsel of HealthSouth. Pleased to be here today and try to answer any questions the subcommittee may have.

Mr. GREENWOOD. Mr. Hale, do you have an opening statement?

TESTIMONY OF BRANDON HALE

Mr. HALE. Mr. Chairman, I do not have an opening statement prepared. I am the former Executive Vice President of Administration, and I am here to answer questions today.

Mr. GREENWOOD. Yes, sir.

Mr. Goodreau?

TESTIMONY OF JIM GOODREAU

Mr. GOODREAU. Mr. Chairman, I am Jim Goodreau, and I was the former Chief of Security for HealthSouth. And I am here to answer any questions you have to ask.

Mr. GREENWOOD. Okay.

And Mr. Tanner?

TESTIMONY OF ANTHONY TANNER

Mr. TANNER. Mr. Chairman, I am a founder and a retired Executive Vice President of the company, and I have no formal statement.

Mr. GREENWOOD. Okay. The Chair recognizes himself for 10 minutes for inquiry. And let me start with Mr. Hale.

Mr. Hale, as Corporate Secretary were you responsible for keeping the minutes at board meetings?

Mr. HALE. That is right.

Mr. GREENWOOD. Okay. And once a board meeting was over, what was your process for organizing the minutes?

Mr. HALE. The minutes would be prepared. I would take my notes for the minutes, handwrite a draft of those minutes. Send those to Mr. Horton's office. Those would be typed and prepared by his assistant. Would come back to me. I would review and send back to Mr. Horton for his review. And then they would be sent—signed by me and sent to Mr. Scrushy for his approval and distributed to the board.

Mr. GREENWOOD. Before I asked this next question, one of the panel members asked if the board meetings were videotaped or audiotaped. To your knowledge, were they, Mr. Hale?

Mr. HALE. To my knowledge, no.

Mr. GREENWOOD. Okay. Mr. Tanner, do you know if the board meetings were video or audiotaped?

Mr. TANNER. Not to my knowledge, sir.

Mr. GREENWOOD. Okay. Anyone else have any knowledge with regard to that? Okay.

Back to you, Mr. Hale. Was Mr. Scrushy given the opportunity to review the minutes before they were provided to board members?

Mr. HALE. He was given the opportunity to review the minutes, yes.

Mr. GREENWOOD. Before they were given to the board members?

Mr. HALE. Before they were given——

Mr. GREENWOOD. And why was that?

Mr. HALE. For his signature before they went to the board.

Mr. GREENWOOD. Did Mr. Scrushy ever make alternations to the minutes before you provided them to board members?

I do not think your button is on.

Mr. HALE. It was very rare that he would make any changes or suggestions to the minutes. I remember a couple of occasions, but that is all.

Mr. GREENWOOD. Do you remember the substance of those changes?

Just leave it on.

Mr. HALE. Okay. Sorry. That is a lot easier. Thank you.

Mr. GREENWOOD. Yes.

Mr. HALE. It was in the August—I think the August 30 meeting of 2000 he added a little clarity with regard to the Transmittal 1753 statement or the addressing the timeframe of that. I think the comments, I would need to refer to it to be certain, but added in there comments that he was advised by Mr. Owens of Transmittal 1753 on August 6 and referenced the potential impact initially estimated at $15 to $20 million. It is not exact words, but something to that effect.

Mr. GREENWOOD. Did you find it inappropriate that Mr. Scrushy could edit the minutes at will?

Mr. HALE. He could not edit at will. I mean, that was something that was stated in the meeting, and I agreed to it. I mean, if it was not done in the meeting, I would not agree to adding it. No, sir.

Mr. GREENWOOD. Okay. So it is your testimony that Mr. Scrushy never added anything to the minutes that, in fact, did not reflect what happened at the board meeting?

Mr. HALE. Not the minutes that I prepared, no.

Mr. GREENWOOD. Nor did he delete anything from minutes that in fact did occur, words that were spoken?

Mr. HALE. Not to my knowledge.

Mr. GREENWOOD. Okay. Were you present at the executive sessions?

Mr. HALE. I was—occasionally I would be asked to stay in the executive session. Normally I would not be.

Mr. GREENWOOD. Okay. And were there separate minutes for the executive sessions?

Mr. HALE. Any—any notations in the minutes from executive sessions would have been given to me from Mr. Scrushy to add to the minutes.

Mr. GREENWOOD. And how would you know if they were, in fact, accurate?

Mr. HALE. Well, they would be distributed to the board.

Mr. GREENWOOD. But is it not true that frequently there were minutes that the board never saw and never reviewed? Never approved?

Mr. HALE. The minutes were distributed to the board.

Mr. GREENWOOD. In every instance?

Mr. HALE. The ones I did were distributed, yes.

Mr. GREENWOOD. Okay.

Mr. HALE. Now there were some toward the final period that I was taking minutes that were in various stages of drafts and production. And those certainly might be in question.

Mr. GREENWOOD. Okay. Would you turn to Tabs 9 and 10 in the binder on the table? And turn to pages 2, which carries over to page 3 on Tab 9.

Did you prepare these minutes?

Mr. HALE. Yes, sir. I did.

Mr. GREENWOOD. Okay. I would like to read a few lines that begin at the bottom of page 2 and carry over to page 3. "Mr. Owens stated that he had believed the Transmittal—" I believe that refers to the CMF transmittal about the 1753—"might apply to the corporation's outpatient services and freestanding outpatient centers. He informed Mr. Scrushy on August 6 that it might apply to such services in freestanding outpatient centers and the impact could be $15 to $20 million." Behind these typed minutes are your handwritten minutes, and that is in Tab 10. Do you see those?

Mr. HALE. Yes, sir.

Mr. GREENWOOD. Okay. And I note that there are two versions of the handwritten notes. It looks like an earlier version and then a more formalized version. Looking at both versions of your handwritten notes of the meeting on which you base these minutes, I presume there was no mention of this $15 to $20 million figure? Is that correct?

Mr. HALE. Sir, I remember that figure being mentioned in the minutes. It is not in my notes. But it was a figure that was discussed.

Mr. GREENWOOD. Okay. So it is not in your draft notes?

Mr. HALE. Correct.

Mr. GREENWOOD. Not in the draft minutes?

Mr. HALE. That's correct.

Mr. GREENWOOD. But then it appears in the final minutes?

Mr. HALE. That's correct.

Mr. GREENWOOD. And that was as a result of Mr. Scrushy's addition?

Mr. HALE. That is correct.

Mr. GREENWOOD. Okay. Did Mr. Scrushy ask you to put the figure into the minutes?

Mr. HALE. Yes. The figure was in his addition to the minutes.

Mr. GREENWOOD. Okay. So he said to—he reviewed your draft minutes and then he asked you to add this language about the $15 to $20 million impact?

Mr. HALE. That is correct.

Mr. GREENWOOD. And you said I would do that, and you went back and altered the minutes? Is that correct.

Mr. HALE. The minutes were still in the stage of being put together, and I made that adjustment because that—I did recall that being statement in the meeting. Yes.

Mr. GREENWOOD. Because what?

Mr. HALE. I did recall that being stated——

Mr. GREENWOOD. You did not?

Mr. HALE. You did recall that being stated.

Mr. GREENWOOD. Oh, you did recall? So you have an independent recollection of Mr. Owens stating during this meeting that he told Mr. Scrushy on August 6 that the impact could be $15 to $20 million?

Mr. HALE. That is correct.

Mr. GREENWOOD. Okay. Would you turn to Tab X. I am sorry. Go back to Tab 10. Okay.

Tab 10 you will find the August 8 board meeting minutes.

Mr. HALE. Tab 10 shows August 26 in my book. It is a different tab.

Mr. GREENWOOD. All right. So stay on Tab 10 and go to pages entitled "HHEC293-0469".

Mr. HALE. Okay.

Mr. GREENWOOD. And do you see about three quarters of the way down your notes "Get with WTO and RMS to see what needs to be added to board minutes."

Mr. HALE. Yes.

Mr. GREENWOOD. Okay. Could you tell us what that means to you?

Mr. HALE. That was after I left, and you see above that you see that all including me left the board. So that was to go with them to find out if anything needed to be added to the minutes.

Mr. GREENWOOD. So it was your decision to do that or was it Mr. Scrushy's decision to do that?

Mr. HALE. I asked if there was anything else in executive session that needed to be incorporated into the minutes.

Mr. GREENWOOD. Okay. Go to Tab 52, please.

Mr. HALE. Could I add one other thing? If you will see my note below that where it states continue—discussion continued and then motion approved with no votes against the motion. That is what I

was advised that actually what occurred after they went into executive session.

Mr. GREENWOOD. And you were advised that by whom?

Mr. HALE. By Mr. Scrushy.

Mr. GREENWOOD. Mr. Scrushy told you that that was what happened at the executive meeting and so you should put that in the minutes?

Mr. HALE. That should be included in the minutes. Yes, that is correct.

Mr. GREENWOOD. Okay. Is that in your view consistent the way a secretary should conduct himself to just take the word of the CEO that something happened at a meeting that you did not attend and drop it into the notes?

Mr. HALE. If it is noted in executive session that I was not in, I thought that was appropriate. Yes, sir.

Mr. GREENWOOD. Okay. Did you ever have any question in your mind as to whether you should just assume that anything that Mr. Scrushy told you happened in the executive meeting actually happened in the executive meeting?

Mr. HALE. I did not question it at that time.

Mr. GREENWOOD. You did not question that?

Mr. HALE. I certainly would not have.

Mr. GREENWOOD. All right. Let us go to Tab 52. And do you see that memorandum?

Mr. HALE. Yes, I do.

Mr. GREENWOOD. Okay. Why do you not tell us what this memo indicates?

Mr. HALE. This is a memo——

Mr. GREENWOOD. This is a memo that you sent, right?

Mr. HALE. Yes. This is a memo, dated March 3, 2003 to Joe Gordon. It says "Enclosed please find board minutes for January 31, 2003, February 6, 2003, February 7, 2003, February 21, 2003. Please review and we will discuss and finalize at the board meeting in Orlando.

Mr. GREENWOOD. Okay. So what you did is you sent him the board minutes for 5 separate meetings and you asked him to review them and then have discussion with you and finalize at the board meeting in Orlando, is that right?

Mr. HALE. That is correct.

Mr. GREENWOOD. Now, is that common practice for you to send the minutes off to—describe what Mr. Gordon's role was?

Mr. HALE. Mr. Gordon was a director. This memo went to all the directors. This is just a copy of the one that went to Mr. Gordon.

Mr. GREENWOOD. Okay. And why did you feel that it was appropriate to ask Mr. Gordon specifically to review those minutes and decide whether they need to be altered or not?

Mr. HALE. Sir, these minutes went to all directors. This same memo went to each director. This is just a copy of the memo that went to Mr. Gordon.

Mr. GREENWOOD. So what was the normal procedure by which the board would approve minutes?

Mr. HALE. The normal procedure for approval when I was secretary would be the minutes would be distributed to the board members and they would sign their—the statement, the waiver on

the back, and that was acknowledgement that they received. Never was it practice during—from December 1999 while I was the secretary to approve the minutes prior to the start of the next board meeting. That was not a practice.

Mr. GREENWOOD. So most meetings have an early on in their agenda approved the minutes from the last meeting. That was not the standard practice at HealthSouth?

Mr. HALE. That was not the standard practice. No, sir.

Mr. GREENWOOD. Okay. We have been informed by board members from HealthSouth that there are still outstanding minutes from board meetings that have still never been approved. Is that so?

Mr. HALE. The—in March 2003 I ceased to take minutes for board meetings. The attorneys from Skadden Arps took over that responsibility. There were some minutes in stages of drafts and review with Mr. Horton that were never finalized.

Mr. GREENWOOD. But I am talking about minutes that were taken at board meetings when you were still in your role as secretary and we are told by board members that there were minutes from meetings that they have never approved that you took?

Mr. HALE. Yes, sir that is what I said. There were minutes that were in stages of either my draft form or review of Mr. Horton that were not finalized prior to that time and still have not been addressed.

Mr. GREENWOOD. And what is the normal turn around time for you? There is a board meeting, you take the minutes, you draft—you do a draft of the minutes. How long does it take to get that through the process and approved?

Mr. HALE. That process should not take that long, but that process was taken away from my hands in March 2003.

Mr. GREENWOOD. But were there periods of time when before that, before the date to which you just referred, that minutes went 5 months without being approved?

Mr. HALE. That sounds long. We were not quick in getting them back, I will admit that. But I do not know of any that would be missing.

Mr. GREENWOOD. Did you ever hear from the board members complaining that they were unhappy with the fact that minutes had not been provided to them for approval?

Mr. HALE. Not until after August 2002.

Mr. GREENWOOD. Okay. My time has expired. The gentlelady from Colorado is recognized for 10 minutes.

Ms. DEGETTE. Well, Mr. Hale, before August 2002 how long was it taking you to get the minutes out to the board members?

Mr. HALE. I do not recall exactly.

Ms. DEGETTE. At sometimes it was up to almost a year, was it not?

Mr. HALE. I do not think so, no.

Ms. DEGETTE. And when you got the draft minutes out to the board members, like the example here in Tab 52, did you ever get comments back from executive committee members about things that were in the minutes that you were not there and——

Mr. HALE. I do not recall any comments.

Ms. DEGETTE. So you never had anyone say no that was not right or something else happened, right?

Mr. HALE. Not in the time period prior to that. And the examples that I remember after August 2003 there was one comment from Mr. May on clarification of some events in a meeting that were addressed.

Ms. DEGETTE. When was that?

Mr. HALE. That was in probably October 2002.

Ms. DEGETTE. And what was Mr. May talking about?

Mr. HALE. I do not recall specifically. I know there some confusion in—there was a meeting on October 22 with Fulbright & Jaworski that I was not in that some Fulbright attorneys were taking the minutes for that meeting. I do not think those have ever been completed or seen. I was not in that meeting. It was strictly executive session. And there was some confusion over what was presented at the meeting prior to that by Fulbright in that meeting.

Ms. DEGETTE. And the subject of that was the auditing, the financial reporting?

Mr. HALE. The Fulbright report and investigation.

Ms. DEGETTE. The report. Okay. Thank you.

Mr. Horton, I wanted to ask you some questions. If you can take a look at Tab 98. That's the compliance policies and procedures that I was talking to Ms. Cullison about in the last panel. And I wanted to ask you if you have ever seen these compliance policies before?

Mr. HORTON. I do not recall seeing them before, ma'am.

Ms. DEGETTE. Now, were you familiar with the protocols of the Compliance Department for investigating allegations of fraud?

Mr. HORTON. I am not sure—I am not sure what you mean by the protocols.

Ms. DEGETTE. Well, did they have a protocol if there was an allegation of fraud.

Mr. HORTON. They had, I think, procedures that they followed. I am not sure if by protocols you mean a written set of protocols.

Ms. DEGETTE. Okay. Well, what were their procedures?

Mr. HORTON. My understanding was, I think essentially as Ms. Cullison said on the previous panel, if they got a call in on the hotline or any other sort of inquiry, they would sort of assess the nature of the problem whether it was in fact a compliance problem or human resources problem, or something else. Route it down the appropriate path.

Ms. DEGETTE. Okay. Now, as legal counsel was it your understanding that you should be contacted immediately if there were allegations of criminal activity?

Mr. HORTON. I would have expected that we would have been. I do not know that there was a formal policy to that effect. But the Compliance Department would not infrequently contact someone in my department, you know, if in view of the Compliance Department they had an issue come in that——

Ms. DEGETTE. Let me ask you, was your department—was the legal counsel's office ever contacted by the Compliance Department to notify you of an allegation of criminal activity?

Mr. HORTON. I do not recall any allegations of criminal activity.

Ms. DEGETTE. So, but you were never notified of that.

Now, fraud is potential criminal conduct, is it not?

Mr. HORTON. Certainly certain kinds of fraud. Yes, ma'am.

Ms. DEGETTE. Yes. In fact, you know, as it turns out 15 people have plead guilty to criminal fraud in this resulting from this company, right?

Mr. HORTON. There are 15 people who have plead guilty. Yes, ma'am.

Ms. DEGETTE. And that was to a crime, right?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. Okay. Now, in 1999 as we heard on the last panel, Ms. Henze made a compliant to the Compliance Department that there was fraud going on at the highest levels of HealthSouth. She said, and she had some credible evidence to back it up as we heard, that the financial chiefs at HealthSouth were making improper entries to the books at the end of each quarter to increase earnings. This is a pretty serious allegation of criminal activity at a publicly held company, is it not?

Mr. HORTON. Yes, ma'am. It is.

Ms. DEGETTE. And Ms. Cullison testified that she gave the complaint to Mr. Tanner, the Compliance Officer, to investigate. Mr. Tanner has no experience in criminal investigations and under HealthSouth's protocol I would assume that he would be required to bring that type of allegation to you. Would you assume that as well?

Mr. HORTON. I am not aware of the protocol that she describes some of.

Ms. DEGETTE. Well, would you think that Mr.—that if an employee came in and said there are serious fraud going on here and I have the evidence to back it up, would you suspect someone might have called you?

Mr. HORTON. That would certainly be a reasonable thing to do. Yes, ma'am.

Ms. DEGETTE. I would think so. Did he bring it to you? Did he call you and tell you about it?

Mr. HORTON. No, ma'am. Not that I recall.

Ms. DEGETTE. Until Ms. Henze testified in the SEC asset hearing earlier this year, had you ever heard of this allegation?

Mr. HORTON. No, ma'am. I had not.

Ms. DEGETTE. Did you hear about these rumors that some of the witnesses on the second panel talked about that someone was cooking the books at HealthSouth? Did anyone ever bring that to your attention?

Mr. HORTON. I do not recall any particular rumors that were brought to my attention. No, ma'am.

Ms. DEGETTE. Okay. What would you have done if you heard about those rumors as the legal counsel for the company?

Mr. HORTON. Certainly if—you know, if they were rumors that appeared to have any substance or, you know, provided any information that would enable them to—enable someone to pursue them, you know, I would have wanted to find out what was behind them.

Ms. DEGETTE. What would have happened if someone would have brought Ms. Henze's complaint to you?

Mr. HORTON. Specifically, I had not thought out a plan of action. But certainly that would be something we would want to follow up on and try to get to the bottom of.

Ms. DEGETTE. Because it is a serious allegation, right?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. Now if you will take a look at Tab 67. This is the Fleeced Shareholder fax that we were talking about in the last panel. That did come to your attention, as I recall?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. Is that correct? And you were asked to look into it, right?

Mr. HORTON. That is correct.

Ms. DEGETTE. And you had internal audit Mr. Owens write memos which provided plausible rebuttals, as you described them to our staff, to these allegations. Is that right?

Mr. HORTON. Yes, ma'am. I asked Mr. Owens to look into it and receive the memos that I think the staff is saying, and I believe you are saying, from Mr. Owens and from Ms. Sanders that tended to rebut the allegations.

Ms. DEGETTE. Did you ever bring this to the attention of the board or the audit committee?

Mr. HORTON. No, ma'am.

Ms. DEGETTE. Why not?

Mr. HORTON. The information that Mr. Owens and Ms. Sanders provided appeared to me to be credible and to be responsive to the concerns of—you know, I was not aware of any reason to take it further than it was taken at the time.

Ms. DEGETTE. What about Mr. Scrushy? Was he aware of it? Did you tell him about it?

Mr. HORTON. I believe—I am going back in my memory. I believe he was aware of this communication and—that—and Mr. Owens and Ms. Sanders were to be looking at the data. But I did not make a specific report to him.

Ms. DEGETTE. How do you know that he knew about it then?

Mr. HORTON. I am going—and I apologize, because my memory may not be exact on this. But I have—I have some recollection of his having been involved at least some of the original discussion when this came to our attention.

Ms. DEGETTE. About the——

Mr. HORTON. When the original memo came up.

Ms. DEGETTE. About the allegations that are made in this email?

Mr. HORTON. Yes, ma'am. Again, that—that is the best of my recollection now. I could not guarantee that he was involved, but I think he was.

Ms. DEGETTE. Do you know if Ernst & Young was ever provided a copy of the memos, the plausible rebuttals?

Mr. HORTON. I am not sure.

Ms. DEGETTE. Now, do you go to the board meetings as legal counsel?

Mr. HORTON. Only when I have been invited to.

Ms. DEGETTE. How often are you invited?

Mr. HORTON. There is really no particular pattern to it. It would depend on, you know, what was under discussion and whether Mr.

Scrushy, who is chairman and CEO of the board up until March, you know, wanted me there for some reason.

Ms. DEGETTE. And would that be for some specific report or something of that nature?

Mr. HORTON. Occasionally during—I mean during the period I would say 1994 through 1998 or 1999 when the company was in a heavy acquisition mode, I would normally be at the board meetings where acquisitions were being approved. Occasionally there would be some other topic that Mr. Scrushy would want me to report on, whether it was a piece of litigation or something. It just really depended on the circumstances.

Ms. DEGETTE. So there was no requirement, as with many corporate boards, that legal counsel be present at—that corporate legal counsel be present at the board meetings, right?

Mr. HORTON. That is correct.

Ms. DEGETTE. And is that true to this day, do you know?

Mr. HORTON. I am not sure that there is any policy requirement as a practical matter in the meetings of the board and the special committee of the board of directors that have occurred since the end of March, there have invariably, as far as I know——

Ms. DEGETTE. They have had lawyers there all the time lately.

Mr. HORTON. There are a lot of lawyers.

Ms. DEGETTE. Lots of lawyers. Yes. I noticed that.

Thanks.

Mr. WALDEN [presiding]. Thank you. Mr. Horton, I just want to go back to explain about the Fleeced Shareholder fax so that I understand it. Ernst & Young received this, right?

Mr. HORTON. Yes, sir. That is my understanding.

Mr. WALDEN. And it raises a whole list of issues from somebody who obviously had inside information about the company, or at least it would appear they did. And they came to you, Ernst & Young came to you and said what should we do about this. And is it accurate to say then you said we will take care of it, we will look at it?

Mr. HORTON. I am not sure. I do not believe Ernst & Young originally came to me. I think they originally came to Bill Owens and Mike Martin, who called me in and we—you know, we did undertake to look into it.

Mr. WALDEN. All right. And what was your response back to Ernst & Young?

Mr. HORTON. That we would look into it.

Mr. WALDEN. So that was it?

Mr. HORTON. Subsequently we got the information that we have discussed from Mr. Owens and Ms. Sanders, and——

Mr. WALDEN. But are they not the auditors, Ernst & Young, would you not share that information back to them so they can do their job?

Mr. HORTON. I believe that it was shared with them ultimately. I mean, in any event, there was no—as far as I know, no subsequent follow up after that information had been gathered from Ernst & Young. I never—never heard anything from them or never had any follow up——

Mr. WALDEN. Can I clarify. Did you or the others involved, do you know whether or not that they provided the information, the

answers to these questions from the Fleece Shareholder to Ernst & Young?

Mr. HORTON. It is my impression at this point that the information was discussed with Ernst & Young. At this point I just don't recall the details of how that——

Mr. WALDEN. You do not remember when or how much, or any of that?

Mr. HORTON. No, sir. I apologize. I just do not.

Mr. WALDEN. All right.

Mr. Goodreau, in the summer of 2002 did Bill Owens, the CFO of the company, tell you that there were "big problems with the numbers, not Enron big, but significant"?

Mr. GOODREAU. Sir, it was not in that terminology. What he said was that—and I believe if you will look at my testimony, it says that he told me that there was some accounting problems at the office. And then he said it is not an Enron, but the number is significant.

Mr. WALDEN. Okay. Similar to what I have recounted here, but there are big problems with the numbers, not Enron big but significant? Is that not what I heard you sort of say?

Mr. GOODREAU. Sir, what I just said is exactly what I remember him saying.

Mr. WALDEN. All right. When you heard his comments by the CFO about the numbers of the company, a company you owned stock in and were an employee of, did you use the compliance hotline to report what Bill Owens had told you?

Mr. GOODREAU. No, sir, because I had no reason or any documentation to prove that what he was saying was criminal.

Mr. WALDEN. So even though he told you there are numbers and problems and raises the word "Enron", and he is the CFO, that did not cause concern enough to do anything about it?

Mr. GOODREAU. For all I knew, sir, he was talking about problems in accounting in a certain division. I had no idea that he was talking about anything other than that.

Mr. WALDEN. But you did have a hotline card like other employees had?

Mr. GOODREAU. Yes, sir. I had a hotline card.

Mr. WALDEN. Okay. But you did not use it? You did not think that what he said was enough to trigger that?

Mr. GOODREAU. No, sir.

Mr. WALDEN. Okay. Did you witness Mr. Scrushy use a computer at his Merrian offices located on the premises of his home in Birmingham prior to March 2003?

Mr. GOODREAU. I do not remember him ever using a computer there.

Mr. WALDEN. Did you not tell our staff, our investigators, that he had a laptop computer there?

Mr. GOODREAU. He had a laptop computer there, but I do not recall him every using it. I remember it sitting on the counter, but I never saw him use it.

Mr. WALDEN. Okay. Did you ever investigate or hire an outside firm to investigate any HealthSouth board members?

Mr. GOODREAU. No, sir. I did not.

Mr. WALDEN. Did Mr. Scrushy ever ask you to investigate or hire a third party to investigate board members?

Mr. GOODREAU. I did not hire any outside person to investigate a board member.

Ms. DEGETTE. Did you ever investigate a board member?

Mr. GOODREAU. I did.

Mr. WALDEN. Okay. That was part of my question. Who was it? Can you tell us about it?

Mr. GOODREAU. Mr. May.

Mr. WALDEN. And what was the issue and who asked you to investigate?

Mr. GOODREAU. I do not remember exactly that I was asked to investigate Mr. May. I looked into Mr. May because I thought that he had been dishonest.

Mr. WALDEN. In what respect?

Mr. GOODREAU. Mr. May had been involved in the bankruptcy of a couple of companies, and I did not remember ever hearing that from Mr. Scrushy.

Mr. WALDEN. Were these——

Mr. GOODREAU. I asked him about it, and he did not know about it.

Mr. WALDEN. Mr. Scrushy did not know about it?

Mr. GOODREAU. No, sir.

Mr. WALDEN. And were these companies with some relationship with HealthSouth?

Mr. GOODREAU. I do not think they had any relationship with HealthSouth.

Mr. WALDEN. Okay. Did you report to Mr. Scrushy about the investigation or what you found out?

Mr. GOODREAU. Yes, sir. I told him that—that—actually what I did, was I asked him if he knew about that. And he said no, he did not know about that. And then I think he confronted Mr. May about it.

Mr. WALDEN. Could you turn to Tab 58? And can you tell us who is Joel that Mr. Scrushy is referring to? I will let you get to that tab, sir. Do you know is he referring to Joel Gordon, a long time board member?

Mr. GOODREAU. Yes, sir. He is.

Mr. WALDEN. And why is he asking you to follow Mr. Gordon? It says: "Subject: Re: Come to the first floor. Hang out with Mary and follow Joel as he goes in and out. See what he is doing. RS." From Richard Scrushy. And you responded. "Okay. Jim Goodreau."

Mr. GOODREAU. Yes, sir.

Mr. WALDEN. Do you know why he was asking you to follow Mr. Gordon?

Mr. GOODREAU. I do not know why he was asking me to follow him.

Mr. WALDEN. You never asked him that?

Mr. GOODREAU. No, sir. I never——

Mr. WALDEN. You just did whatever he told you to do and—what did you find out after following Mr. Gordon?

Mr. GOODREAU. He was just coming out of the—I think they were in a board meeting or something, and he—Mr. Gordon came out of

the board meeting. But, I mean, he stayed on the 5th floor. He did not go anywhere.

Mr. WALDEN. Is that—I mean, I—I have been on a couple of boards. And I have never run into where the CEO has a security person follow us in and out of the bathroom, or wherever they go as board members. Is that pretty typical at HealthSouth?

Mr. GOODREAU. No, sir. That was the only time I believe I was ever asked.

Mr. WALDEN. And you never inquired as to why?

Mr. GOODREAU. No, sir.

Mr. WALDEN. Did you report? Did Mr. Gordon know he was being followed? Did he ask you about that?

Mr. GOODREAU. I have no idea if he knew or not. It was not like I was following him around the—following him around the room.

Mr. WALDEN. All right. Did you ever hire an investigation company by Les Moore and investigate any board members?

Mr. GOODREAU. I hired an investigative company, yes. But as to whether to investigate any board members, I have—I have no idea.

Mr. WALDEN. Did Mr. Scrushy authorize you to hire outside investigators?

Mr. GOODREAU. I did not ask Mr. Scrushy about hiring outside investigators.

Mr. WALDEN. Who was paying the bills for the outside investigators?

Mr. GOODREAU. The company.

Mr. WALDEN. Okay. But Mr. Scrushy did not—you are telling me under oath Mr. Scrushy never asked you to hire these investigators? You did them on your own?

Mr. GOODREAU. Yes, sir.

Mr. WALDEN. But sent the bill back, obviously, or it came out of your department?

Mr. GOODREAU. Actually, Bill Owens signed off on the bills.

Mr. WALDEN. Bill Owens. And Bill Owens worked for Mr. Scrushy, right?

Mr. GOODREAU. That is correct.

Mr. WALDEN. Okay. And what were they investigating, this company you hired, Les Moore?

Mr. GOODREAU. The company would investigate whatever it was that needed to be investigated by the corporation——

Mr. WALDEN. All right. But specifically in this case why did you hire them?

Mr. GOODREAU. With the board?

Mr. WALDEN. Yes.

Mr. GOODREAU. Is that what you are asking me?

Mr. WALDEN. Yes.

Mr. GOODREAU. Again, I would have to look and see. Because I am not exactly clear on what specifically you are asking about.

Mr. WALDEN. Okay. Let us get specific. Les Moore. That is a security guard, right, that works for you?

Mr. GOODREAU. He has a company.

Mr. WALDEN. He has a company?

Mr. GOODREAU. Yes.

Mr. WALDEN. And you hired him and that company?

Mr. GOODREAU. I had hired that company prior to him becoming an employee.

Mr. WALDEN. Okay. And why did you hire that company? What was their mission? What did you ask them to look at?

Mr. GOODREAU. Whenever we had any type of investigative needs within HealthSouth that required the use of outside investigators——

Mr. WALDEN. So, would that be to investigate people inside HealthSouth?

Mr. GOODREAU. Not specifically. No, sir. It might be to investigate——

Mr. WALDEN. But you are not going to tell me specifically why you hired these people and what you asked them to look at?

Mr. GOODREAU. Excuse me, sir?

Mr. WALDEN. Are you going to tell me specifically why you hired this company and what you asked them to look at? I mean, that is what I am asking is specifically why did you hire them and what did you ask them to look at? What other kinds of needs were there at HealthSouth, investigative needs?

Mr. GOODREAU. We had investigative needs for looking into whatever. We have 50,000 employees, we see 100,000——

Mr. WALDEN. So you were looking at different employees and what they were doing?

Mr. GOODREAU. No, sir. I was not looking at different employees and what they were doing.

Mr. WALDEN. Okay.

Mr. GOODREAU. There was an allegation that came up about a situation where an employee had a problem with someone or had a confrontation with someone, or someone came into a facility to—made some threat, or if we received a letter from someone stating a threat, that we were to investigate that to see what merit it would hold.

Mr. WALDEN. So how many investigations did you undertake?

Mr. GOODREAU. I cannot recall exactly.

Mr. WALDEN. Can you give me a range? Ten, 100, 5,000?

Mr. GOODREAU. Over a 7 year period, 50 maybe. I do not know.

Mr. WALDEN. And did any of those involve board members?

Mr. GOODREAU. Only the one that I can recall with Mr. May.

Ms. DEGETTE. Will the gentleman yield?

Mr. WALDEN. Certainly.

Ms. DEGETTE. Did you keep records of those investigations, Mr. Goodreau?

Mr. GOODREAU. Not specifically. If we had records of anything, it would be retained until the investigation was over and then we would get rid of it. We had no reason to keep it.

Ms. DEGETTE. So as far as you know, any of the investigations as you described if someone came into a facility or if there was some other issue, you would have no record of that if that was closed at this point?

Mr. GOODREAU. There may be a record of that if it was on our—we had a reporting system inside the corporate security that kept with the majority of that. It may or may not be on that system.

Ms. DEGETTE. And what you are saying is not every investigation would have had a record?

Mr. GOODREAU. No, ma'am.

Ms. DEGETTE. Thank you.

Thank you, Mr. Chair.

Mr. WALDEN. Did your investigators or yourself, were you armed running around HealthSouth?

Mr. GOODREAU. There were only probably four guys that were armed at—or allowed to carry a side arm. They were all trained. And not everyone would be armed at the same time.

Mr. WALDEN. Okay. And were you one of those four?

Mr. GOODREAU. I was.

Mr. WALDEN. Okay. Did you carry a side arm at all times?

Mr. GOODREAU. I carried a side arm.

Mr. WALDEN. Yes.

I am curious about how extensive this video system was, because it seemed some of our witnesses were sort of shocked and intimidated to find out it existed. Was it throughout the 5th floor?

Mr. GOODREAU. The camera system?

Mr. WALDEN. Yes.

Mr. GOODREAU. No, sir. The camera system is mainly in the traffic hallways and high traffic areas of the——

Mr. WALDEN. Is it in the conference room sort of places?

Mr. GOODREAU. In—no, sir. It is not in any conference room.

Mr. WALDEN. Okay.

Mr. GOODREAU. There may be some cameras in the back hallway of the conference center, but there is not any in the conference room.

Mr. WALDEN. In those—did this system record what transpired? Would you keep tapes?

Mr. GOODREAU. It did not record audio. It only recorded video. And we kept the tapes for a specific period of time. I cannot remember if it was 30 days or 60 days exactly. And then the tapes would just be simply rotated back through.

Mr. WALDEN. And after the company came under various investigations, were those tapes then preserved as part of potential evidence or were they required to be preserved?

Mr. GOODREAU. There was no directive to me to preserve any tapes. However, there was no change in the normal way we operated. We continued to do what we normally do.

Mr. WALDEN. Okay.

At this point we are going to recess the committee for about 5 minutes. And then we will return. So if you could stay, we would appreciate it.

And the committee is in recess.

[Brief recess.]

Mr. GREENWOOD. The meeting will come to order. And I thank the witnesses for their patience.

And the Chair recognizes for 10 minutes the gentleman from Florida, Mr. Stearns for inquiry.

Mr. STEARNS. Thank you, Mr. Chairman.

And I appreciate your patience here as we recessed and we return here.

Mr. Tanner, I guess you were involved with the founding of this corporation?

Mr. TANNER. Yes, sir.

Mr. STEARNS. And how big was the company when you started it?

Mr. TANNER. We had one office with just 5 men when we started the company in 1984.

Mr. STEARNS. Not too long ago. And now how many employees does HealthSouth have?

Mr. TANNER. I do not know what they have now. I left the company in 1999.

Mr. STEARNS. Okay. Okay. And tell me again why you left the company.

Mr. TANNER. I retired. My health was getting to the point where I did not want to take a chance on where I would be in the future. And I decided to let me retire now and see the world.

Mr. STEARNS. Were you involved with the Compliance Department at HealthSouth?

Mr. TANNER. Yes, sir.

Mr. STEARNS. Okay. And what was your position in that department?

Mr. TANNER. The board made me Corporate Compliance Officer.

Mr. STEARNS. And your responsibilities included what?

Mr. TANNER. I was the Corporate Compliance Officer. The Compliance Department reported up to me to the board committee on corporate compliance.

Mr. STEARNS. And why did HealthSouth start a Compliance Department? Because they felt it was needed, right?

Mr. TANNER. It was started as a response to a presentation that Mr. Kusserow and Ernst & Young made following the National Medical Enterprise——

Mr. STEARNS. So Ms. Cullison claimed that she brought a very serious charge, potential accounting fraud, to your attention as head of the Compliance Department in 1999, and that is the year you retired?

Mr. TANNER. Yes, sir.

Mr. STEARNS. Okay. She brought to your attention a serious charge. She also claimed that you advised her that you would take care of the investigation yourself. Do you recall that?

Mr. TANNER. No, sir, I do not. I have no recollection of that.

Mr. STEARNS. So you have no recollection of her bringing a very serious charge, a potential accounting fraud to your attention, to the Compliance Department in 1999?

Mr. TANNER. I do not remember a lot of 1999, sir. And that is one reason why I also retired.

Mr. STEARNS. So you do not recall the information, so obviously you do not know what she did with it?

Mr. TANNER. That is correct, sir.

Mr. STEARNS. Have you heard anything about what she claimed?

Mr. TANNER. Just in what she said here earlier and what was said——

Mr. STEARNS. Was that a total surprise to you?

Mr. TANNER. No. It had been reported to me when I was subpoenaed at the SEC hearing.

Mr. STEARNS. Okay. And you heard about this information after you retired, not before? Is that what your sworn testimony is, that

you did not hear about this information while you were an employee of HealthSouth Corporation?

Mr. TANNER. I do not recollect——

Mr. STEARNS. "Recollect" is a sort of vague term. Do you or do you not remember——

Mr. TANNER. I do not remember, sir, what she said she told me.

Mr. STEARNS. Do you remember her coming in and talking to you?

Mr. TANNER. I do not remember that, sir. No.

Mr. STEARNS. Do you remember her ever showing up in your office or calling you on the phone? I mean, if I go back and look at telephone records, will I find that she called you ever?

Mr. TANNER. I am sure since she reported to me, we spoke. I am sure that we had conversations. I cannot say what the substance of those conversations were. I do not remember things.

Mr. STEARNS. So you talked to her because she is one of your employees, but you never remember her talking specifically about this serious charge potential accounting fraud? That is your——

Mr. TANNER. No, sir. I do not remember.

Mr. STEARNS. Okay. Okay. But you talked to her regularly on the phone and in person about other things?

Mr. TANNER. I am—I am sure we spoke. I am sure we have had conversations. How many, what they were, I cannot tell you, sir, because I do not remember.

Mr. STEARNS. Okay. Do you perform when people come to you with complaints, do you perform actual investigations on these allegations? Have you ever done that in your position as Compliance Department head? Had you ever taken initiative to investigate any actual allegations?

Mr. TANNER. The way the Compliance Department was established, she would do the work. She would do the investigations and using the resources that the Compliance Department had, either a audit or——

Mr. STEARNS. So she—Cullison did the research for you? And did she ever tell you that she was investigating any serious charges of potential problems? Forget accounting fraud. But had she done any investigation into anything as your employee which would involve an investigation of allegations?

Mr. TANNER. I received the statistics of activities that the compliance report did that I passed on to the board.

Mr. STEARNS. Okay.

Mr. TANNER. I do not remember——

Mr. STEARNS. You never physically talked to her about any allegations that she was investigating?

Mr. TANNER. I do not remember——

Mr. STEARNS. Just yes or no.

Mr. TANNER. No, sir. I do not.

Mr. STEARNS. Okay. Does the Compliance Department have a contact in the legal department of HealthSouth?

Mr. TANNER. I think——

Mr. STEARNS. Just yes or no.

Mr. TANNER. I do not remember.

Mr. STEARNS. Well, this is procedural. This is a policy position. You are in charge of something. This is not something that you re-

member or not. This is actual procedure. Did you have a procedure in the Compliance Department where you had contact with the legal department. I think the obvious answer you must have. I mean, if you are going to have a Compliance Department, you have got to be able to—just like Congressmen, we have an ethics. So we know we can go to the Ethnics Committee anytime we have a problem to find out whether we are doing something wrong. So I assume that the Compliance Department would have some contact with the legal department at HealthSouth. And you are saying you do not recollect or you do not know. It seemed to me you had to. That would be part of the police procedure. Am I wrong?

Mr. TANNER. I do not——

Mr. STEARNS. Because you understand, you got to operate in a legal framework——

Mr. TANNER. Sir——

Mr. STEARNS. You have to have contact with legal.

Mr. TANNER. [continuing] The compliance program was established in response to a presentation. I recall attorneys from legal department present at that initial meeting.

Mr. STEARNS. So if I go back to the Compliance Department today and ask them, the new head, do you have any contact with the legal department, he will say yes? He or she will say yes, do you not think? Just off——

Mr. TANNER. I do not know.

Mr. STEARNS. Okay.

Mr. TANNER. I am not there, sir.

Mr. STEARNS. Okay. Let me continue to ask——

Mr. TANNER. I retired in 1999.

Mr. STEARNS. How would a Compliance Department employee know that a complaint was serious enough to be forwarded to the legal department or even outside authorities? Under your scenario, you do not even have any contact with the legal department. So answer me this: How you as head of the Compliance Department would know if your complying with the legal department? Is that not of the Compliance Department's responsibility to comply with legalities? I mean, you are telling me that you have no recollection if you had any contact with the legal department, yet at the same time do you not want to comply with the law or even outside authorities? There is something not ticking here.

Mr. TANNER. Sir, if I could remember, I would be happy to tell you. I do not remember.

Mr. STEARNS. You draw a blank?

Mr. TANNER. Yes, sir. That is one reason why I am no longer working and I have no activity in terms of everyday work because my cognitive functions have been impaired.

Mr. STEARNS. Okay. I respect that. I respect that. I understand. Understand.

But you understand my question?

Mr. TANNER. Yes, sir. I understand your question.

Mr. STEARNS. Okay. And you understand, just take off your hat and you and I just talking in the lobby out here, we would say, you are head of the Compliance Department. You should have contact with the legal department to know what you are doing is correct. Does that not seem to make sense? We are not talking about back

in 1999. We are just talking in general straight common sense that if you are head of the Compliance Department, you want to be in touch with the legal department to make sure you obey the law. Does that not make sense? I am just trying to get you to commit common sense here what we are talking about. Not asking you to go back in your memory. Just to say—sir?

Mr. TANNER. Yes.

Mr. STEARNS. Okay. That is all I want. Okay.

You know, I am not making any judgments here. I am just talking. So, I mean, you are certainly entitled. And so I do not mean to imply you are not entitled here. Because, God bless, you know, everybody goes through his ups and down here.

So it is our understanding that the Compliance Department policy was to purge all closed complaint materials after 90 days. Is this a policy that you understood when you were head of it?

Mr. TANNER. When I was interviewed by the counsel, they showed me the—they made a reference to the purging. And I was surprised, because I did not——

Mr. STEARNS. You do not remember that policy?

Mr. TANNER. I do not remember that and I was shocked that it was—said that it was—they were shredded, and I did not have any knowledge.

Mr. STEARNS. And you do not have any idea when—they actually then showed you this policy, right, to purge it, in 90 days, they showed you the policy, right? And you were surprised?

Mr. TANNER. They showed me a spreadsheet, I think it was.

Mr. STEARNS. Right. Yes.

Mr. TANNER. And it said it was a category purged. And it was——

Mr. STEARNS. Okay. Okay. Do you have any idea who wrote that policy to purge in 90 days?

Mr. TANNER. No, sir.

Mr. STEARNS. Okay. Okay. Well, thank you for answering my questions.

And, Mr. Chairman, I yield back my time.

Mr. WALDEN. Thank you.

The Chair recognizes the gentle woman from Colorado.

Ms. DEGETTE. I just have—thank you.

Mr. Tanner, if you can take a look at Tab 98. This is the now infamous compliance policies that I have been talking about.

Mr. TANNER. Yes, ma'am.

Ms. DEGETTE. It was sent to Ms. Cullison, but there is a cc to you. Do you remember receiving these compliance policies?

Mr. TANNER. I do not remember. I probably did because my name is cc'd on it. Yes, ma'am.

Ms. DEGETTE. Do you recall whether these or any compliance policies were adopted?

Mr. TANNER. I do not recall.

Ms. DEGETTE. Did the company have any compliance policies when you were the Compliance Officer?

Mr. TANNER. We had the compliance program and the structure laid out. There was a book, a training program and that type of thing that laid out what was to be done.

Ms. DEGETTE. So there was a procedure in place, you are just not sure if it is this one?

Mr. TANNER. Yes, I can't—I do not say it is this format or not.

Ms. DEGETTE. Would it be your recollection as the former Compliance Officer of the company that when there were allegations of violations of criminal law that legal counsel would be consulted?

Mr. TANNER. I would assume that it would happen, okay. I cannot say it did or did not. But I would assume that would happen.

Ms. DEGETTE. That would be a logical inference to make?

Mr. TANNER. Yes, ma'am.

Ms. DEGETTE. And if that were the policy, you would not be surprised, right?

Mr. TANNER. Yes, ma'am.

Ms. DEGETTE. Do you recall ever contacting legal counsel about allegations of violations of criminal law yourself when you were Compliance Officer?

Mr. TANNER. No, ma'am. I do not.

Ms. DEGETTE. Okay. Thank you.

I wanted to ask you, Mr. Goodreau, if you—yesterday the "The Wall Street Journal" had an article, and it talked about Mr. Scrushy having wired his truck and taping a woman without her knowledge considering allegations of various sundry extra marital affairs that were made while she was in the truck. And I was wondering if you had any knowledge of the truck and its taping system?

Mr. GOODREAU. Other than he used a tape recorder.

Ms. DEGETTE. Did you have a knowledge of that at the time?

Mr. GOODREAU. I know that he used a tape recorder.

Ms. DEGETTE. In his truck?

Mr. GOODREAU. Yes, ma'am.

Ms. DEGETTE. How do you know that?

Mr. GOODREAU. Because he told me.

Ms. DEGETTE. At the time?

Mr. GOODREAU. That—of the taping.

Ms. DEGETTE. Now, of what taping?

Mr. GOODREAU. Of this conversation that you are speaking of.

Ms. DEGETTE. Did he tell you he taped any other conversations in the truck?

Mr. GOODREAU. No, ma'am.

Ms. DEGETTE. Did he tell you why he taped the conversation?

Mr. GOODREAU. No, ma'am.

Ms. DEGETTE. He just said I taped a conversation in the truck, and that was it?

Mr. GOODREAU. No, ma'am. He said he taped the conversation with Amy Krumpton.

Ms. DEGETTE. Did he say why he did that?

Mr. GOODREAU. No, ma'am.

Ms. DEGETTE. He just walked up to you and said I taped this conversation? That was the end of your conversation with him?

Mr. GOODREAU. No, ma'am. That she had information that was going to shed some light on his particular situation and the situation that involved Hope Lanius and Bill Massy.

Ms. DEGETTE. I am sorry. The situation that involved what?

Mr. GOODREAU. Hope Lanius and Bill Massy.

Ms. DEGETTE. Thank you.

Did Mr. Scrushy often talk to you about taping conversations?

Mr. GOODREAU. No, ma'am.

Ms. DEGETTE. How many times did he?

Mr. GOODREAU. That's the only—that's the only conversation I ever had with him about it.

Ms. DEGETTE. Did you ever wire or arrange to have wired any of Mr. Scrushy's homes, offices, vehicles or any other location he might be?

Mr. GOODREAU. When you mean—when you say "wire"?

Ms. DEGETTE. Yes. Taping systems.

Mr. GOODREAU. Maybe a surveillance system at this house or something of that nature, but not anything in any car or anything like that.

Ms. DEGETTE. Now, the surveillance system at his home, when was that installed?

Mr. GOODREAU. There has been a few modifications to that surveillance system throughout the time I have been there.

Ms. DEGETTE. And when have you been there? I am sorry?

Mr. GOODREAU. In the last 7 years, ma'am.

Ms. DEGETTE. And were you in charge of making those modifications?

Mr. GOODREAU. Usually. Yes, ma'am.

Ms. DEGETTE. And what were those modifications?

Mr. GOODREAU. Typically it might be an upgrade to a system or an upgrade to a camera or something.

Ms. DEGETTE. Does he have cameras throughout his properties?

Mr. GOODREAU. No, ma'am. Just at his home in Birmingham.

Ms. DEGETTE. At his home in Birmingham.

Mr. GOODREAU. Yes, ma'am.

Ms. DEGETTE. So that is where you are saying you made modifications, it was to the system to his home in Birmingham?

Mr. GOODREAU. Yes, ma'am.

Ms. DEGETTE. Did that involve cameras throughout the property?

Mr. GOODREAU. Sometimes it might, and sometimes it would not. It just——

Ms. DEGETTE. Did it involve audiotaping?

Mr. GOODREAU. No audiotaping.

Ms. DEGETTE. Okay. Now, we heard about Mr. Watkins. Were there any other times that Mr. Scrushy had you investigate members of the board of HealthSouth?

Mr. GOODREAU. About Mr. Watkins?

Ms. DEGETTE. I'm sorry. It was Mr. May.

Mr. GOODREAU. Yes, ma'am.

Ms. DEGETTE. Were there any others?

Mr. GOODREAU. No, ma'am. Not that I remember.

Ms. DEGETTE. And you testified earlier this year in district court that Bill Owens told you in the fall of 2002 about fraud that was going on at HealthSouth. Did you tell Mr. Scrushy about this?

Mr. GOODREAU. No, ma'am.

Ms. DEGETTE. Why not?

Mr. GOODREAU. Well, first of all, Mr. Owens did not tell me about fraud that was going on at HealthSouth.

Ms. DEGETTE. What did he tell you?

Mr. GOODREAU. He told me that there were some accounting problems at the office. But I did not know if he was talking about a particular division or not. I was close to him, he was my friend. And he was confiding in me.

Ms. DEGETTE. And so you did not tell Mr. Scrushy?

Mr. GOODREAU. I did not think there was a need to tell Mr. Scrushy. I told Mr. Owens he needed to talk to Mr. Scrushy. I was a security guy. I thought maybe that was something that ought to be handled on that level of management. Certainly not from my perspective.

Ms. DEGETTE. Did Mr. Owens tell you the extent of the accounting problems?

Mr. GOODREAU. No, ma'am. What he told me was just what I said.

Ms. DEGETTE. That there were——

Mr. GOODREAU. There were some accounting problems, that is all he said.

Ms. DEGETTE. Okay. Did you know that the board wanted to fire Mr. Owens in late 2002? Did Mr. Owens confide that in you?

Mr. GOODREAU. I do not know that Mr. Owens confided that in me. I want to say I believe I heard Mr. Scrushy say that, but I am not positive. I know that it was—I know that I have heard that, but I just honestly cannot remember.

Ms. DEGETTE. Do you know that Mr. Scrushy actually persuaded the board not to fire Mr. Owens?

Mr. GOODREAU. I have heard that, too. I do not——

Ms. DEGETTE. Who did——

Mr. GOODREAU. I cannot remember specific conversations. It seems that I heard—I cannot remember exactly who I heard it from. But I did hear that he went to bat for Bill to keep his job.

Ms. DEGETTE. But it is your testimony today that you never told Mr. Scrushy about what Mr. Owens had told you about the accounting problems?

Mr. GOODREAU. Yes, ma'am. That is absolutely correct.

Ms. DEGETTE. Okay.

Mr. WALDEN. Would the gentle woman yield?

Ms. DEGETTE. Sure. Be happy to yield.

Mr. WALDEN. Because I would like to follow up on that point. Because there is something here that just does not add up. Because Mr. Owens tells you that there is a problem with the accounting. I think you told me the words were something like we got some problems in accounting, not as big as Enron, but something to that effect. We could go back and get your exact words.

But you did not ask any questions of Mr. Owens after that? I am amazed these people come and just spill their heart to you in little bits and you do not ask the next question. Did you ask Mr. Owens any questions about the accounting? Not one word, not one question? If we brought him up here under oath——

Mr. GOODREAU. I asked—I asked him did he—did Mr. Scrushy know about it. And he said no. And I said you need to tell him, Bill. This is exactly what I said.

Mr. WALDEN. Okay. And you never said anything to Mr. Scrushy?

Mr. GOODREAU. No, sir. I never did.

Mr. WALDEN. In a given day, how much time did you spend with Mr. Scrushy?

Mr. GOODREAU. A great portion of the day.

Mr. WALDEN. And this is a man who will tell you he secretly tape recorded somebody in his pick-up. And you are the security person that investigates whatever is going on in the company. And you are the security person who has been tasked to watch board members coming in and out of a board meeting or a board member coming and out of a board meeting, you are the security person who hires third party security firms to look at different things. Security is on your mind and yet you do not ever say anything to a guy you are with virtually all the time every day that there is some sort of accounting problems and did Owens ever tell you about it? You never said anything to Mr. Scrushy about it?

Mr. GOODREAU. I never said anything to him, sir, no.

Mr. WALDEN. Did you say it to anybody in the company?

Mr. GOODREAU. I said it to Les Moore that works with me.

Mr. WALDEN. I'm sorry, to whom?

Mr. GOODREAU. I said to the gentleman that works with me.

Mr. WALDEN. Another security person?

Mr. GOODREAU. Yes, sir. And—and——

Mr. WALDEN. What did you tell him?

Mr. GOODREAU. Sir?

Mr. WALDEN. What did you tell him?

Mr. GOODREAU. The same thing I just told you. That—that I met with Bill Owens last night and Bill said there was some accounting problems at the office. And I told him to—I asked him did he talk to Richard, and he—or did Richard know, and he said no. And I said well you need to tell him.

Mr. WALDEN. What prompted your meeting with Mr. Owens?

Mr. GOODREAU. He called me to talk to me.

Mr. WALDEN. About what subjects?

Mr. GOODREAU. I do not know. Bill and I were friends. But he called and wanted me to—to——

Mr. WALDEN. Would you say this is the principal subject?

Mr. GOODREAU. Excuse me, sir?

Mr. WALDEN. Would you say that this revolution of accounting problems at HealthSouth was the principal topic of your conversation? Was it a day or night or——

Mr. GOODREAU. It was in the evening. Probably, I do not know, 7, 8. But I do not know that that——

Mr. WALDEN. Were you usually there that late at night?

Mr. GOODREAU. Where?

Mr. WALDEN. Wherever you had—where did this meeting take place?

Mr. GOODREAU. It was a Mexican restaurant, On The Border, in Birmingham.

Mr. WALDEN. Okay. So he called you to come to a Mexican restaurant?

Mr. GOODREAU. I do not remember exactly what he said, but it was something to the effect of meet at On The Border. You know, go and meet at On The Border.

Mr. WALDEN. Okay. And so he calls, says meet me On The Border. You do not remember anything else you talked about, but you did talk about——

Mr. GOODREAU. I am sure we probably talked about his—his family situation and things like that that he and I would typically talk about.

Mr. WALDEN. Okay. But in the course of that conversation he said there were some accounting problems?

Mr. GOODREAU. Well, I could tell he had something on his mind, but I did not know what it was.

Mr. WALDEN. Okay. Did you think there were any problems with the approval process for board minutes?

Mr. Horton, let us go to you. I am sorry.

Ms. DEGETTE. Excuse me.

Mr. WALDEN. Oh, I am sorry.

Ms. DEGETTE. I yield back all the time I have left.

Mr. GREENWOOD. The gentlelady's time has expired.

Mr. WALDEN. I would yield her some if——

Ms. DEGETTE. That is okay.

Mr. GREENWOOD. That is quite all right. Neither of you have anything to yield at this point.

The Chair recognizes himself for 10 minutes.

Mr. WALDEN. Oh, okay.

Mr. GREENWOOD. And, Mr. Hale, I want to go back to a line of questioning that I had with you earlier. And I want to put this thing in its entire consequence. Okay.

The reason that this congressional committee is holding this hearing is because in my district and every State in the union retirees, among others, invested in HealthSouth because they were led to believe that HealthSouth was a vibrant growing company, it was meeting its Wall Street expectations. People all over the country put their hard earned earnings into this company to help pay for—to put money away and let it grow for their children's education. Investors believed in this company.

What we know is that at some point, for a number of reasons, the stock dropped and it dropped precipitously. We also know that Mr. Scrushy sold 75 percent of his stock by, I think, July 31, 2002. Okay.

What we are interested in, what the SEC is interested in, what the Justice Department is interested in is whether or not Mr. Scrushy, among other things, sold his stock when he did because he understood that there was going to be a major financial impact to this company because in essence it had gotten the word from the Medicare program, from CMS, that it was wildly overbilling Medicare and charging individual rates for group rates for group therapy.

So it is important for us to understand when it was that Mr. Scrushy, what did Mr. Scrushy know about that impact and when he knew it.

The logical thing for us to do is to go to the board meetings to find out when at those board meetings there was a discussion about this so you can put that into a chronology. Okay.

Now, having put that in context, and I would like you to go again back to Tab 9 and Tab 10 from your notebook. Now in Tab 9, which

are the minutes from the August 26, 2002 board meeting—you with me?

Mr. HALE. Yes, sir.

Mr. GREENWOOD. Okay. And you included in those—you are the secretary, you are in charge of the minutes. And you wrote in those minutes the sentence that says "He informed Mr. Scrushy on August 6 that it might apply"—this is in reference to this new directive out of CMS about billing—"that it might apply to such services in freestanding outpatient centers and the impact could be $15 million to $20 million. Mr. Scrushy stated that he had advised Mr. McVay and subsequently Mr. Owens to go back to CMS for better clarification." All right?

Now, are those the words that in fact were not in your draft minutes that you added at Mr. Scrushy's direction?

Mr. HALE. I believe so. Yes, sir.

Mr. GREENWOOD. Pardon me?

Mr. HALE. I believe so. Yes, sir.

Mr. GREENWOOD. Okay. So you took notes at the meeting. They're in Tab 10. None of those words are in your notes. But you added them into the minutes after Mr. Scrushy told you to? Right?

Mr. HALE. Let me check with my notes and make sure that—what that—if I could, sir, refer back to the notes on the August 8 meeting.

Mr. GREENWOOD. Sure. Yes.

Mr. HALE. Do you know which tab? Could you lead me to those, please?

Mr. GREENWOOD. Oh, you want to know where they are? If you look in Tab 10 and you look at the page—let's see here. That's a board of director's minutes in your handwriting, 8/26/02. And I think the relevant language is on the page that is labeled 293-0467 having to do with timeline of CMS transmittal.

Mr. HALE. Yes. I am trying to find the notes on the August 8 meeting.

Mr. GREENWOOD. Oh. That is on Tab 9. It is on the third page of that document at the very top. It says "He informed Mr. Scrushy," and this is—are you with me now?

Mr. HALE. I am with you on the August 26 minutes. Yes, sir. I am looking for the notes——

Mr. GREENWOOD. All right. Let's start at page——

Mr. HALE. [continuing] of the August 8 meeting.

Mr. GREENWOOD. Okay. Go to Tab 8. Are you looking for the words that I quoted in the official?

Mr. HALE. Yes. I wanted to reference my notes on the August 8 meeting.

Mr. GREENWOOD. Okay. That is Tab 8. Okay. And it says "discussion of CMS transmittal"—this is on the fourth page of that document at the very bottom.

Mr. HALE. Okay. The—I believe what referenced back to the August 26, what was added by Mr. Scrushy was the sentence "He informed Mr. Scrushy," and this was Mr. Owens going, again, through the timeline. And the timeline it stated "He informed Mr. Scrushy on August 6 that it might apply to such services and freestanding outpatient centers, and the impact could be $15 to $20

million." The—if you reference back the August 8 board minutes, my notes, which is 388-0445.

Mr. GREENWOOD. Yes.

Mr. HALE. Actually I make a notation here that with the discussion of the timeline of the transmittal letter, that the—they advised and the board concurred that management should meet again with CMS to assess—to get additional clarification. So that was in that part of it as far as the reference to go back, that is where that came from.

Mr. GREENWOOD. Okay. Now, you did add that sentence, "He informed Mr. Scrushy" all the way up to $15 to $20 million, you added that line at Mr. Scrushy's request, correct?

Mr. HALE. Yes, sir.

Mr. GREENWOOD. Okay.

Mr. HALE. He wanted additional clarification on the timeline.

Mr. GREENWOOD. Got it.

Mr. HALE. That was included in the timeline.

Mr. GREENWOOD. Okay. Now, you testified earlier that there were at least two kinds of occurrences that would cause you to amend minutes. One is someone, for instance Mr. Scrushy, would say Mr. Hale you forgot that we said this. You forgot to incorporate this in your minutes. And if you had what you called an independent recollection of that being said, you said, oh yes—you would say, oh, yes, I did—yes, I remember that but I did not put it in the minutes so I will put it in now. Okay. That is one way you would amend the minutes?

Mr. HALE. Yes, sir.

Mr. GREENWOOD. Okay. The other way you said you would amend the minutes is if Mr. Scrushy told you that certain things happened in executive sessions which you did not attend, correct?

Mr. HALE. Well, that would be an addition, not necessarily an amendment to something that was in there.

Mr. GREENWOOD. Okay. So the question I have is which of those occurrences caused that sentence to be added to the minutes? Is that because Mr. Scrushy reminded you of that and you independently recollected all of that language, including that there was a $15 to $20 million impact?

Mr. HALE. Yes, sir. I remember that being presented. Yes.

Mr. GREENWOOD. You remember it being discussed at that board meeting?

Mr. HALE. The board meeting on August 6, not August 26. But this is referencing back to the timeline of events.

Mr. GREENWOOD. Is it August 8 you mean?

Mr. HALE. August 8, yes.

Mr. GREENWOOD. Okay. Then why was it not put in the minutes from the August 8 meeting? Why was it put in the minutes from the August 26 meeting?

Mr. HALE. The—what is in the August 26 meeting is, it states Mr. Scrushy asks Mr. Owens to review with the board the timeline of events. So, Mr. Owens was going back through with the board the timeline on when these—with 1753. So this was referencing back the timeline of events.

Mr. GREENWOOD. All right. Well then go to Tab 7. And those are the official minutes of the August 8 meeting.

Mr. HALE. Okay.

Mr. GREENWOOD. All right. Where in those minutes was a reflection of this conversation?

Mr. HALE. It is not in there, sir.

Mr. GREENWOOD. Why not?

Mr. HALE. Well, everything is—I mean, I do not put every detail in the minutes.

Mr. GREENWOOD. But on—you thought it was important to amend the August 2 notes to say that on August 8 something occurred, but you did not think it was important to amend the August 8 notes minutes to actually reflect that? Is that right?

Mr. HALE. I was not requested to consider an amendment to the August 8 notes.

Mr. GREENWOOD. No red lights went off in your mind that it would seem funny that Mr. Scrushy thought it was critical to have the August 26 minutes reflect this conversation?

Mr. HALE. He was requesting more detail than had been put in the minutes. In looking—you know, in looking back at that date when Mr. Owens said he communicated with Mr. Scrushy and the amount that they were talking about was critical in that time period. So I felt it was important.

Mr. GREENWOOD. So give us your independent recall now? What do you remember, how do you remember that conversation occurring? At the board meeting on August 8 what do you remember—August 26, was there in fact that discussion and can you recall it for us?

Mr. HALE. I recall Mr. Owens going through a very detailed timeline of those events and the sequence of those events. And including, you know, when he told Mr. Scrushy, what they initially thought the range of impact would be. You know, the meetings with CMS and, you know, when that changed after that meeting when they were—it was indicated that it would apply to more of the outpatient centers than they initially thought. That was—it what was presented. That is what I recall. Yes, sir.

Mr. GREENWOOD. My time has expired.

We are going to wait a moment for Mr. Walden to return.

Before I give time to Mr. Walden, Mr. Horton, you were at that August 16 board meeting, is that correct?

Mr. HORTON. Yes, sir, it is.

Mr. GREENWOOD. Do you recall the conversation, do you recall the discussion in the same way that Mr. Hale recalls the discussion?

Mr. HORTON. My recollection, I got a little confused there. But my recollection is consistent with what's in the minutes. Yes, sir.

Mr. GREENWOOD. The gentleman from Oregon for 10 minutes.

Mr. WALDEN. Mr. Horton, I want to go back to how the board minutes were handled. Are you—do you think there were any problems with the approval process for the board minutes?

Mr. HORTON. The question that has come up in this process, I know in several meetings with the staff, was the approval of the minutes. And typically as I think—as I think one of—I apologize, I can't remember which of you alluded to before, it was not the common practice to actually formally approve the minutes at each

subsequent meeting from previous meetings. And, yes sir. I think that is a weakness in the system, and that——

Mr. WALDEN. Let me make sure I understand your role in this, too. You are the corporate counsel?

Mr. HORTON. I was. Yes, sir.

Mr. WALDEN. You were. And you were during for how long? What period of time gain?

Mr. HORTON. From July 1994 until September 2003.

Mr. WALDEN. And did you ever advise them to handle the minutes in a different manner?

Mr. HORTON. No, sir. I do not believe I did.

Mr. WALDEN. Yes. Were you aware of any of these investigation of a board member?

Mr. HORTON. I do not know that I was particularly aware of an investigation. I had heard at some point that Mr. Scrushy—I had understood that Mr. Scrushy had asked someone to look into Mr. May's background and whether—sort of the employment history that was on his résumé, if you will was—was accurate and complete. And I later heard that it was. But I was not particularly aware of details of that.

Mr. WALDEN. Yes. Now, I thought we heard from Mr. Goodreau that there was something in Mr. May's background that was not know beforehand. Some bankruptcies or something?

Mr. GOODREAU. I believe Mr. May was involved in some companies with some bankruptcy troubles, and I did not know that about it and I did not think Mr. Scrushy did. That was what I was saying, that I made him aware of that.

Mr. WALDEN. You made Mr. Scrushy aware of that?

Mr. GOODREAU. Yes.

Mr. WALDEN. I still do not understand why you would not have made Mr. Scrushy aware of the comment about an accounting problem, Enron—not Enron like but all of that.

Mr. Horton, were you ever made aware of any accounting problems?

Mr. HORTON. No, sir. I was not.

Mr. WALDEN. So nobody stepped up and told you. And the board was never made aware. Is that accurate?

Mr. HORTON. As far as I know that is correct, sir.

Mr. WALDEN. Okay. Mr. Horton, if you could turn to Tab 87. That is where you will find an email that you wrote to Mr. Hale and Weston Smith on September 29, 2002, and you write, "I am finding no record that I was ever given drafts of audit committee minutes for 2001 after March 27 or 2002. Do either of you know the status of audit committee minutes?" And the email is Tab 87. It shows it is from you.

Mr. HORTON. That's——

Mr. WALDEN. I'm sorry. It is apparently Tab 86.

Mr. HORTON. Okay.

Mr. WALDEN. Okay.

Mr. HORTON. I have it now. Yes, sir. I'm sorry. What was the question?

Mr. WALDEN. The question is—well then if you will turn to Tab—is that probably 87 then? 87 there are two emails between you and Weston Smith dated October 7, 2002. After you again request the

audit minutes. Mr. Smith writes "Bill, copies of the minutes were sent to George Strong last week. He had requested them in response to Fulbright. We have 2002 minutes. None were prepared in 2001." So my first question is why did not you as corporate counsel have copies of the audit committee minutes?

Mr. HORTON. Well——

Mr. WALDEN. Would you normally have had copies in prior years?

Mr. HORTON. In the normal course the minute books were maintained, physically maintained in my department. So ordinarily they would have come to us. Yes, sir.

Mr. WALDEN. Okay. Why did it take nearly a year and a half to ask for the audit committee meeting minutes?

Mr. HORTON. I do not think I had become aware that we did not have the minutes until that point.

Mr. WALDEN. So who was responsible for maintaining the minutes for committee meetings? Somebody in your department?

Mr. HORTON. No, sir. Normally the—the corporate secretary normally maintains the minutes. If it is a circumstance where there were, you know, multiple committee meetings going on at more or less the same time, then the corporate secretary, Mr. Tanner or Mr. Hale as the case may be, might ask me or one of the other assistant secretaries to take minutes for one committee meeting while he covered another one.

Mr. WALDEN. Sure. Yes.

Mr. HORTON. And as far as a I know, in these particular audit committee meetings for whatever reason, nobody was ever requested to take minutes.

Mr. WALDEN. You know, I hope you understand. Again, having spent 5 years on a relatively small bank board, we had somebody taking minutes at every committee meeting. And they came up to the board—we met every month, the board did. And the committees did not always meet every month. But the minutes came forward. We had presentations to the board. We reviewed the minutes. We reviewed the minutes of the board meeting. We acted on them. There was an agenda. If we went into executive session, it was spelled out.

How in the devil does a Fortune 500 company not have a board that meets, you know, once or twice a year and you do not keep minutes? Can you explain that to me?

Mr. HORTON. To have a committee that meets once or twice a year or——

Mr. WALDEN. How often did the board meet?

Mr. HORTON. It would vary from year to year. In a typical year, I would say 10 or 12 times.

Mr. WALDEN. Ten or 12 times a year the board met? I was under the impression they only met like once or twice a year. How often did the committee met? The audit committee? Quarterly? Monthly?

Mr. HORTON. The audit committee in recent years, as I understood it, met quarterly. But I am not—going back further, I do not think they did.

Mr. WALDEN. Did the proxy statements reflect that?

Mr. HORTON. Yes, sir. The proxy statements reflected the total number of meetings for each committee. Yes. For the preceding year, and the total number of board meetings.

Mr. WALDEN. I am told the proxy statements for 2001 indicate that the audit committee met one time.

Mr. HORTON. That's—that is what the proxy statement reflects. I understand that the audit committee members have records of other meetings which were not in the corporate minutes at the time the proxy statement was prepared.

Mr. WALDEN. Whose job was it to keep track of the minutes of the committee meetings? If the committees were meeting and no minutes were taken or if members had minutes of committee meetings and they were not provided, I mean who is running the ship here?

Mr. HORTON. I cannot answer that question, sir.

Mr. WALDEN. Were you ever asked to—if the minutes were kept in your books in your office, was it your responsibility to ask where they are? I mean, you did ask in this one email, and I commend you for that. But——

Mr. HORTON. Sir, in circumstance as in this case where it came to my attention that we were missing minutes, I would try to find out about them. If—if it did not come to my attention, you know, I would not necessarily ask.

Mr. WALDEN. So you had members of the board who met as committees to review various things and you are telling me that the board met basically every month, 10 to 12 times a year, right?

Mr. HORTON. In a typical year. Yes.

Mr. WALDEN. Typical year. And are there agendas indicating that the chairs of the various committees of the board discussed what they had met and talked about as committees? Was that on an agenda?

Mr. HORTON. In the ordinary course I did not see board agendas, sir. So I really am not in a position to answer that question.

Mr. WALDEN. Did you sit in on the board meetings?

Mr. HORTON. Again, as I said earlier, I sat in if I was invited to sit in. I did not sit in as a routine matter.

Mr. WALDEN. How many board meetings a year would you have sat in on?

Mr. HORTON. Again, as I testified earlier, it would have depended on the subject matter and whether Mr. Scrushy, who was the chairman and CEO for all the time that I had been there until the end of March, invited me.

Mr. WALDEN. Oh, if he invited you? Oh, I see. All right.

Did Mr. Scrushy tell you that the 175—okay. Let me go to a document. Mr. Scrushy sent an email to Larry Doc Leemack at sourcemed.net on August 27. And we will provide you with that.

In this email he says "Thanks. The genius in all this will be seen later. We will take some heat only in the shortrun. Swad told me he had talked to you and I appreciate you" that's the type "support and understanding. I will call you soon to go over everything. RS."

Did Mr. Scrushy tell you the $175 million announcement was a genius plan?

Mr. HORTON. No, sir.

Mr. WALDEN. Do you know what he's referring to?

Mr. HORTON. No, sir, I do not.

Mr. WALDEN. Do you know anything about whatever this plan is he references? Did he ever talk to you about his strategy on the announcement of the $175 million?

Mr. HORTON. I discussed with him the substance of the press release in which that was announced. But I—I do not know of any particular strategy. No, sir.

Mr. WALDEN. Do any of the rest of you? Are any of the rest of you aware of what this might mean, the genius of all this will be seen later?

I will ask you individually. Mr. Hale?

Mr. HALE. No.

Mr. WALDEN. Mr. Goodreau?

Mr. GOODREAU. No, sir.

Mr. WALDEN. Mr. Tanner?

Mr. TANNER. No, sir.

Mr. WALDEN. You all say no?

Who is Larry Doc Leemack?

Mr. HORTON. Dr. Leemack is a physician in Birmingham.

Mr. WALDEN. Was a he stockholder in the company?

Mr. HORTON. I believe he is a stockholder. Yes, sir.

Mr. WALDEN. Okay. All right.

I do not have any other questions. Thank you, Mr. Chairman.

Mr. GREENWOOD. The Chair thanks the gentleman and recognizes himself for 10 minute.

Mr. Horton, let me ask you a series of questions. When were you first made aware of Transmittal 753?

Mr. HORTON. 1753? I was made aware of it on June 6 of last year.

Mr. GREENWOOD. Okay. Was this the first time that you were made aware of issues with regard how HealthSouth was billing Medicare for group therapy?

Mr. HORTON. We had issues that had arisen in a case filed under the False Claims Act in which the Department of Justice intervened. It was actually four cases in which the Department of Justice intervened in December 2001, January 2002.

Mr. GREENWOOD. Okay. So you knew way back then that this was at least a potentially serious liability for the company? That other companies in a similar business, the same business as HealthSouth, was being subjected to lawsuits over its billing practices? Is that correct?

Mr. HORTON. That other companies were being subjected to law—I was aware of lawsuit directed against HealthSouth.

Mr. GREENWOOD. Against HealthSouth. Okay. So you knew there was a suit out there?

Mr. HORTON. Yes, sir.

Mr. GREENWOOD. And when did you first know that?

Mr. HORTON. The original lawsuit, I guess before the government intervened, we were made aware by the Department of Justice in sometime in 2000, I believe.

Mr. GREENWOOD. Okay. And did you share that information with Mr. Scrushy?

Mr. HORTON. Yes, sir.

Mr. GREENWOOD. Okay. When you became aware of Transmittal 1753 what other officers of the company did you discuss this with?

Mr. HORTON. Discussed Transmittal 1753 with Bill Owens who was then the President and CEO, with Weston Smith who was then the CFO, with Susan Smith who was the Senior Vice President of Reimbursement, with Larry Taylor who was at the time the President of our Ambulatory Services Division and at various times with other lower level officers.

Mr. GREENWOOD. And never with Mr. Scrushy?

Mr. HORTON. I do not recall having any discussions with Mr. Scrushy about it until sometime in August 2002.

Mr. GREENWOOD. How did you advise the company to address the Medicare billing for group therapy while the company was sorting through the issues?

Mr. HORTON. My advice was to take a conservative position and assume, while there were questions about what Transmittal 1753 meant, that we needed to assume that it applied to our outpatient operations and take what I would characterize as a conservative position on the issue.

Mr. GREENWOOD. And did the company act on your advice?

Mr. HORTON. The company, ultimately the decision was to seek clarification from the Centers for Medicare and Medicaid Services, CMS. And it was my understanding that the operations personnel were directed not to bill Medicare for outpatient therapy services during a period beginning July 1, 2002 until that clarification had been obtained.

Mr. GREENWOOD. Okay. I want you to turn to Tab 29, if you would. You will find an email, dated July 7, 2002 with an attachment which you forwarded to Bill Owens, Weston Smith and Susan Jones-Smith. And attached to that is a memo from Tom Fox of Reed Smith on the status of group therapy issues.

On page 7 of the memo——

Mr. HORTON. Mr. Chairman, that is not Tab 29 in my book.

Mr. GREENWOOD. All right. I will clarify that for you then. 79. I am sorry. Somebody's sevens look like a two. Okay.

On page 7 of the memo in the first full paragraph, "HealthSouth outside counsel advises "However if HealthSouth were to continue to utilize the clinical standards followed in the past which essentially limited billing under the group therapy code only when two or more patients were treated at the same time with the same modality as opposed to billing for concurrent therapy, if the patients were treated with different modalities, the risk of liability for claims submitted by HealthSouth for services provided after July 1, 2002 is greatly increased and could implicate its rehab hospitals." You see that?

Mr. HORTON. Yes, sir.

Mr. GREENWOOD. All right. In your email you state that you agree with this advice and that you want to get clarification to the field right away. What was Mr. Owens' response when you discussed this with him?

Mr. HORTON. I did not—I do not recall discussing this particular email and memorandum with him. I have discussed the issue with him on a number of occasions and his response was to schedule a meeting with appropriate officials at CMS to attempt to get clarity

on the issue. And a meeting was ultimately scheduled with Tom Grissom, who was then the relative person at CMS.

Mr. GREENWOOD. Okay. Then I am going to ask you to turn now to Tab 80 in the binder. And there you will find another email from Tom Fox of Reed Smith, dated July 24, 2002.

Mr. HORTON. Yes, sir.

Mr. GREENWOOD. It reads: "This is what I would say to Bill Owens and Richard if I had the opportunity, unless and until Transmittal 1753 is withdraw, outside counsel is telling the company that it faces substantial risk of false claims liability by not following that coding and billing policy for therapy effective July 1, 2002." And my question to you is what did you do with this advice from HealthSouth's outside counsel? Who did you tell about it?

Mr. HORTON. Throughout this process I was conveying this advice to Mr. Owens, to Weston Smith, to Susan Smith through the operations and reimbursement chains.

Mr. GREENWOOD. As the general counsel of this company, would not you have wanted to make sure that the CEO himself understood that there was significant and serious jeopardy, financial jeopardy, perhaps worse if they did not change their billing practices?

Mr. HORTON. Sir, as I have discussed with the staff when we originally addressed this, my belief was that unless I could get Mr. Owens and the senior operations personnel to form a unified position on this issue, that if I took it to Mr. Scrushy without that, that Mr. Scrushy would disregard it.

Mr. GREENWOOD. Now, you knew he was engaged in a stock sale, Mr. Scrushy, right? You were aware that he was—of his preparations and his ultimate sales of ultimately $99 million worth of stock?

Mr. HORTON. Beginning in early to mid-July. Yes, sir.

Mr. GREENWOOD. All right. Okay. Now, you are a smart lawyer. Did it occur to you that Mr. Scrushy's knowledge or lack of knowledge, relative knowledge of this change in billing practices might have some legal implications with regard to the timing of the sale of the stock?

Mr. HORTON. No, sir. At this point I had no basis to evaluate the materiality of this information. So I did not really take that into account.

Mr. GREENWOOD. Materiality as it regards what?

Mr. HORTON. Materiality as regards financial impact of——

Mr. GREENWOOD. Well, you know it was—you had been advised by outside counsel that it was a serious issue that would have significant impact on the company, were you not?

Mr. HORTON. I do not think outside counsel had provided us with any information. And, indeed, I do not think they could have provided us with any information.

Mr. GREENWOOD. Okay. So in other words, they did not tell you this magnitude of the impact on the company of changing? They just suggested that change needed to be made?

Mr. HORTON. That is correct.

Mr. GREENWOOD. Okay. Was Mr. Scrushy aware in 2001 that the Department of Justice was planning to intervene in a false claim

suit that alleged HealthSouth was improperly billing individual therapy when they should have been billing for group?

Mr. HORTON. He was aware that we were in communication with DOJ throughout 2001 about their possible intervention in the False Claims Act litigation. And then when we received confirmation that DOJ was going to intervene in late December 2001, he was aware of that. Yes, sir.

Mr. GREENWOOD. Did Mr. Scrushy have an understanding about what the government's allegations were with respect to group therapy charges?

Mr. HORTON. I discussed it with him, sir. I assumed he had an understanding from that.

Mr. GREENWOOD. Did you engage in discussions with Mr. Scrushy about the potential damages facing the company in a False Claims suit?

Mr. HORTON. Not at that time. No, sir. We did not have any basis on which to quantify damages.

Mr. GREENWOOD. Were you present in any meeting prior to Transmittal 1753 where Mr. Scrushy discussed what HealthSouth's strategy should be with respect to the group therapy claims alleged in the False Claims lawsuit?

Mr. HORTON. There was a meeting that occurred, I believe, in March 2002 at which Mr. Scrushy was present where we discussed strategies to get legislative clarification of the group therapy issue from this House. Yes, sir.

Mr. GREENWOOD. Is it fair to say that Mr. Scrushy was well aware prior to Transmittal 1753 of HealthSouth's billing practices concerning group versus individual therapy claims and the potential claims against the company asserted by various False Claims suits?

Mr. HORTON. He was certainly aware of the False Claims Act litigation and the nature of the claims therein. Yes, sir.

Mr. GREENWOOD. As general counsel did you feel that you had the access to Mr. Scrushy that you needed, the ability to advise him of what you know, to make recommendations to him? Because it sounds like you needed to go—that between you as general counsel and Mr. Scrushy as CEO, there were other officers that you had to either convince them—you had to convince them before you dared to take this information to Mr. Scrushy?

Mr. HORTON. In general, I do not think I would characterize it as a problem of access, sir. But I would characterize it as a question of what was going to be needed to get his attention, particularly in the last couple of years. Mr. Scrushy was never—was never an easy man to discuss things with that were bad news or that would make him unhappy. And in particular it was my belief that if—if I raised an issue that involved operational matters and did not have a consensus among the operations people, that in all likelihood my advise would be—would be discounted or perhaps disregarded.

Mr. GREENWOOD. Would you be uncomfortable having to operate under that circumstances?

Mr. HORTON. Yes, sir. I did.

Mr. GREENWOOD. Okay. Is it your recollection that Bill Owens shared with Mr. Scrushy in February 2002 an estimate of the potential impact of changing HealthSouth's billing practices?

Mr. HORTON. In February 2002?

Mr. GREENWOOD. Yes.

Mr. HORTON. I do not believe I am aware of that, sir.

Mr. GREENWOOD. Okay. I have no further questions.

I would——

Ms. DEGETTE. I have a couple.

Mr. GREENWOOD. We will get to you in a second, Ms. DeGette.

I would move that we enter the documents into the record. And without objection, that will be the case.

Ms. DeGette, do you have additional inquiry?

Ms. DEGETTE. Yes, I do. Thank you.

Mr. Horton, as I sit here and review all of your correspondence in July 2002 regarding Transmittal 1753 and going back and forth, and as I listen to your answers to the Chairman's questions it occurs me that there was quite a bit of concern on the part of the legal department as to what people should be doing about the group billing code for the physical therapy sessions. Would that be a fair statement on my part?

Mr. HORTON. There was certainly a lot of concern. In general, I was the only person in the legal department who was actively involved in this issue.

Ms. DEGETTE. Okay. So you were concerned?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. And that is because HealthSouth was doing a lot of physical therapy sessions and how that was billed would be important to the company, right?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. And as general counsel you wanted to make sure that the company was billing correctly because of liability issues, right? I think you said that?

Mr. HORTON. That is correct.

Ms. DEGETTE. Did you ever ask anybody from the financial management of the company about what the financial impact would be of a changing code?

Mr. HORTON. I do not think I specifically asked that. I certainly tried to get the financial—the CFO and the head of reimbursement to focus on this issue.

Ms. DEGETTE. Did they ever tell you what the impact would be?

Mr. HORTON. I did not receive any information on the financial impact until—until after August 15, I guess, of last year which——

Ms. DEGETTE. Of 2002?

Mr. HORTON. Of 2002, which was the $175 million estimate.

Ms. DEGETTE. And even before the $175 million, in fairness, you knew that it would be a large number, right?

Mr. HORTON. I really did not—did not have information to make an estimate of the number. I mean, large——

Ms. DEGETTE. Well, I mean in that case, if you look at Tab 79 where you are sending—it looks like an email to Bill Owens from you with the memo from Tom Fox on the status of group therapy issues, and you say "importance high", right?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. And then there is the memo. And you say "In particular I point out that Reed Smith's strong advice is the recent group therapy transmittal should be read to apply to all non-PPE PT or OT services. I agree with this position." And you go on. So you thought this was important enough to send it to Bill Owens with high importance, right?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. And then there are some follow up emails. An email from Tom Fox to you on July 24.

During that period of July 2002 you were really—you thought this was important to get resolved, right?

Mr. HORTON. Yes, I did.

Ms. DEGETTE. And did you get it resolved?

Mr. HORTON. I thought I had ultimately in August.

Ms. DEGETTE. All right. Now, I have a memo I would like to show you, and it is not in your notebook. If we can have this given to—you have it?

Mr. HORTON. I believe so. Yes, ma'am.

Ms. DEGETTE. Okay. Because I believe you said earlier in response to a question by the Chairman that you were not particularly—or you had not heard any allegations of accounting problems. Is that correct?

Mr. HORTON. That is correct.

Ms. DEGETTE. Now, I have shown you a memo. It is dated September 29, 1999. And it is from you to Michael D. Martin and William T. Owens, the CFO and controller at that time, right?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. Do you recognize this memo?

Mr. HORTON. I do.

Ms. DEGETTE. Okay. I find this curious, because you said you did not know of any accounting problems. But in 1999 you are sending this memo to Martin and Owens and it says "I thought you might find interesting the enclosed press release put out by the SEC indicating its recent filing of 30 enforcement actions against 68 individuals and companies for allegedly engaging in various types of financial reporting fraud." And then it goes on to say "In any event, I thought that you might be interested in seeing the sorts of practices that the SEC has been focusing its attention on."

And then the attached memo from the SEC says: "Together", and it is talking about these enforcement actions, "these actions allege a variable cookbook of recipes for fraudulent accounting and reporting, including" and then it lists a whole bunch of things including as some of the things that we now know happened with HealthSouth. Things like creation of fictitious invoices, back dating of agreement, reporting of expenses as capital assets, over valuations of inventory.

So I guess my question to you is if you had not heard of any allegations of accounting abuses before then, why on earth did you send the CFO and the controller this memo?

Mr. HORTON. I think, you know, if you look back at my correspondence over the years that I was at HealthSouth, you will find that not infrequently if the SEC announced something that it regarded as a significant development, I would circulate it to people that I thought would be interested in it.

Ms. DEGETTE. Oh, okay. So this was just part of your routine correspondence with the senior management of the company?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. How many times would you say you sent memos like this out?

Mr. HORTON. I could no give you an accurate number. If you go back in—certainly in the period 2001/2002 when the SEC was doing a significant amount of pronouncing, if you will, on financial reporting and management discussion and analyses and filings and that sort of thing, I think you will find several things that I provided to people in connection with regulation——

Ms. DEGETTE. Well, what about in 19—I think you said you started in 1994?

Mr. HORTON. Yes, ma'am.

Ms. DEGETTE. What about the period 1994 to 2001?

Mr. HORTON. Again, I mean there is no magic to the number. But you will go back and I think you will find—you will find these sorts of things going back pretty much the whole period of time that I was with the company. It is one of the things that I did.

Ms. DEGETTE. Thank you.

Mr. GREENWOOD. The Chair thanks the gentlelady.

The chair thanks the witnesses for your willingness to come here today and for your testimony. I know it has been a long day.

As far as I can tell, this the tragic case, another tragic case where a company that had lots of potential filled with thousands of honest, good employees had a leadership at the top that was corrupt. And it is evidenced at least by the five CFOs that have already plead guilty, 10 other senior executives having plead guilty. Mr. Scrushy still maintains his innocence. And we will be watchful of how that turns out.

This will play itself out in the courts. And we wish the company well. We think the company has new management that is going to do its level best to bring this company into a new and brighter era, in that the company will be vital and that the employees will continue to provide the services that they do out in those little clinics to people who are in pain, which is what a company like this should have been focused on.

I imagine some of the witnesses, including probably all of you, will wind up giving your testimony in a court of law before this over. I wish you well on that.

And I enter into the record a "Wall Street Journal" article from yesterday, entitled "Scrushy Claims FBI Agent is Close to Witness" and it talks about what we have talked about here with regard to the taped conversations. But it also says this: "Earlier this month Mr. Scrushy's attorney, Richard Dean, Jr. a well respected U.S. attorney who works in the Atlantic office of Jones Day, became more involved in Mr. Scrushy's defense. Donald V. Watkins, a Birmingham attorney who directs Mr. Scrushy's defense says the legal team has held focus groups to test how a jury might react to any dirt they may have on the 15 former HealthSouth executives who have agreed to plead guilty in connection with the case and others who might testify against Mr. Scrushy. Mr. Watkins, the lead attorney for Mr. Scrushy, says such details are fair game for public disclosure. "Human beings make mistakes in life. Some as a result

of negligence, other as a result of lifestyles, intentional acts of deception. It is our job to find out who these people really are" Mr. Watkins said. This case has everything in it. It has mystery. It has got sex. It has got death. And it is high stakes. It is a real life drama being played out on a daily basis before a national audience."

So those are the tactics to which Mr. Scrushy is prepared to go in his defense. And I wish you well in dealing with those kinds of tactics when this matter goes to court.

Thank you again.

And the subcommittee is adjourned.

[Whereupon, at 4:08 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

Tab	Document Description	Date
	Board of Directors Documents	
1	Unanimous Written Consent in Lieu of Meeting of Board of Directors	2/4/2002
2	Corporate Compensation Committee Minutes	4/29/2002
3	Corporate Compensation Committee Minutes	7/25/2002
4	Corporate Compensation Committee Minutes	7/31/2002
5	Corporate Compensation Committee Minutes	9/2/2002
6	Corporate Compliance Committee Minutes (includes handwritten notes)	3/15/2002
7	Board of Directors Meeting Minutes	8/8/2002
8	Board of Directors Handwritten Meeting Minutes	8/8/2002
9	Board of Directors Meeting Minutes	8/26/2002
10	Board of Directors Handwritten Meeting Minutes	8/26/2002
11	Board of Directors Meeting Minutes	8/30/2002
12	Board of Directors Meeting Minutes	9/17/2002
13	Board of Directors Meeting Minutes	10/1/2002
14	Fulbright & Jaworski Memo to Bill Horton Re: Recollection of Proceedings of October 22, 2002 Board of Directors Meeting	3/6/2003
15	Lanny Davis Letter to Richard Scrushy Re: Board of Directors Minutes of October 22, 2002 Executive Session Meeting	2/14/2003
	Richard Scrushy Documents	
16	Richard Scrushy Stock Sales	no date
17	Fulbright & Jaworski Documents Relating to Stock Sales by Richard Scrushy	no date
18	Malcom McVay Plea before US District Court of Northern District of Alabama	5/1/2003
19	Michael Martin Plea before US District Court of Northern District of Alabama	5/1/2003
20	Wiliam Owens Guilty Plea before US District Court of Nortern District of Alabama	no date
21	2001 HealthSouth Executive Compensation (Proxy Statement)	4/14/2000
22	Employment Agreement	4/1/1998
23	Owens E-mail to Scrushy with attachment of DOJ Powerpoint Slides	2/1/2002
24	Richard Scrushy E-mail to Daut Re: Current Stock Action	10/14/03
25	Hal Hirsch E-mail Re: Release of Fulbright Report on October 23, 2002	10/21/2002
26	Jones Day Letter to Energy and Commerce with Richard Scrushy's REesponse	10/7/2003
27	HealthSouth Teleconference - Third Quarter 2002 Financial Results	11/5/2002
	Steve Schlatter Documents	
28	Steve Schlatter E-mail Exchange with Jon Santini Re: HCAP-HCFA Group Therapy	4/23-26/2001
29	Steve Schlatter E-mail to Walt Jimenez Re: HCAP-HCFA Group Therapy	4/30/2001
30	Steve Schlatter E-mail to Bill Schmidt Re: APTA Discussion	5/2/2001
31	Steve Schlatter E-mail Exchange Re: Stonewalled on Group Therapy	5/10-17/01
	Martin Cohen Documents	
32	Martin Cohen Memo to Bill Owens Re: Fulbright & Jaworski Report- Open Items and Follow-up Questions From Earnings Announcement	11/6/2002
33	Weston Smith's Projected Effect of Outpatient Reimbursement Changes on Net Revenue	8/26/2002
34	FTI Memo to Weston Smith Re: Difference in Company's Analysis on Revenue and FTI's Numbers	10/31/2002
35	FTI E-mail to Lanny Davis Re: FTI's Fee Estimate for Remaining Tasks	11/12/2002

36	FTI Consulting Memo to Fulbright & Jaworski Re: HealthSouth Draft Report	11/5/2002
	Teresa Sanders Documents	
37	Series of Ernst & Young Correspondence to Aaron Beam & Teresa Sanders Re: "The Program"	2/14/1996
38	Teresa Sanders E-mail to Bill Horton Re: Outpatient Audits 1996-1998	12/9/1998
39	2001 and 2002 Proxy Statements: Excerpts RE: Audit Fee Disclosures	2001/2002
40	Teresa Rubio Memo to Richard Scrushy Re: Ernst & Young Evaluation Program	1/4/1996
41	HealthSouth Pristine Factor Surveys	3/29/1996
42	"Why the HealthSouth Pristine Audits should not be considered Internal Audit Services"	no date
43	2001 and 2002 HealthSouth Audit Fees to Ernst & Young	no date
44	2000 and 2001 HealthSouth Audit Fees	no date
	Michael Vines Documents	
45	Vines Posting in Investor Chat Room	no date
46	Ernst & Young Review of Michael Vines' Allegation	no date
47	Rebecca Kay Morgan before US District Court of Northern District of Alabama	4/3/2003
48	Wall Street Journal Article Titled "Accountant Tried In Vain To Expose HealthSouth Fraud"	5/20/2003
	Brandon Hale Documents	
49	Employee Bonuses for 2001 and 2002	no date
50	Scrushy E-mail to Hale Re: Signing Board of Directors Minutes	12/19/2002
51	Appointment Re: Make sure RMS signs Mottola Stock	4/18/2002
52	Joel Gordon Fax Transmittal to Bradon Hale Re: Board Minutes	3/12/2003
53	Bob May Memo to George Strong Re: 10 K Signature(s) 2003	3/12/2003
54	Bob May Memo to Brad Hale & Bill Horton Re: Minutes	3/12/2002
55	Bob May E-mail to Jason Hervey Re: Minutes	12/20/2002
	James Goodreau Documents	
56	Jim Goodreau E-mail to File Re: Shredder Documents in Fifth Floor File Room	10/3/2002
57	William Horton E-mail to Chuck Stark Re: Security Cameras in Elevators	12/6/2002
58	Jim Goodreau Email to Richard Scrushy Re: Come to 5th floor. Hang out with Mary and follow joel as he goes in and out. See what he is doing. Rs	12/12/2002
59	Les Moore Memo to Jim Goodreau Re: Jean Davis Files	3/25/2003
60	Jim Goodreau E-mail to Richard Scrushy Re: Document Shredding	10/4/2002
	Fulbright & Jaworski Documents	
61	Fulbright & Jaworski Letter to Board of Directors: Updating Board on Their Work	10/1/2002
62	Fulbright & Jaworski Letter to Board of Directors Re: Updating Board on Their Work	10/21/2002
63	Fulbright & Jaworski Letter to Board of Directors Re: Destruction of Documents	10/29/2002
64	Fulbright & Jaworski Letter to Board of Directors Re: Disclosing they found nothing that established Scrushy was aware of Transmittal 1753 at the time of his sale of HealthSouth common stock	10/29/2002

	Pristine Audits Documents	
65	HealthSouth Corporation Fees / WSJ Article Titled "What Ernst Did For HealthSouth?"	6/11/2003
	William Horton Documents	
66	Reed Smith Presentation to DOJ Re: Outpatient Physical Therapy	Dec-01
67	Memo from Fleeced Shareholder Re: HealthSouth / Ernst & Young	11/12/1998
68	Eli's Rehab Report	5/28/2001
69	William Horton Activity Report	6/17/2002
70	William Horton Email to Larry Taylor Re: Group Code	6/18/2002
71	Reed Smith Email to William Horton Re: Group Therapy	6/24/2002
72	Zurek E-mail to Nantz Re: Group Code Roll Out	6/25/2002
73	E-mail Re: Group Therapy / Rick Schmitt	6/26/2002
74	William Horton E-mail to Susan Jones Re: Group Code	6/26/2002
75	William Horton E-mail to Jones et al. Re: Transmittal 1753	6/28/2002
76	William Horton Memo Re: Group Therapy	6/28/2002
77	Zurek E-mail to Nantz Re: Group Code Update	6/28/2002
78	Jones E-mail to IP Market Leaders Re: Meeting with CMS for Group Therapy Clarification	7/2/2002
79	William Horton E-mail to William Owens Re: Tom Fox/Scott Hasselman	7/7/2002
80	Thomas Fox E-mail to William Horton Re: HealthSouth Congressional Strategy on Group Therapy	7/24/2002
81	William Horton E-mail to Compensation Committee Re: Info for Meeting	7/24/2002
82	William Horton E-mail to William Owens Re: Draft Chronology	8/27/2002
83	William Horton E-mail to Scrushy Re: Questions for Mr. Scrushy	9/5/2002
84	William Horton E-mail to Lanny Davis Re: Thursday Conference Call	9/14/2002
85	Hicks E-mail to William Horton Re: MCD	9/20/2002
86	William Horton E-mail to Brandon Hale & Weston Re: Audit Committee	9/29/2002
87	Weston E-mail to William Horton Re: Audit Committee	10/7/2002
88	William Horton E-mail to Scrushy Re: Board Meeting	12/11/2002
89	William Horton E-mail to Scrushy Re: Board Meeting	3/5/2003
90	William Horton E-mail to Esclavon Re: Drafts of Governance Documents	1/6/2003
91	Watkins E-mail to William Horton Re: Insider Trading Policy from Corporate Governance Committee	1/17/2003
92	William Horton E-mail to Tadd McVay Re: Source Call	2/13/2003
93	Memo from Bill to Bill Re: Personal and Confidential	no date
94	Glen Banks Memo to David Barrack Re: Class Action and Derivative Complaints	9/23/2002
95	Susan Smith E-mail to OPS - IP Market Leaders Re: CMS Meetings to Discuss Group Therapy Definitions	7/2/2002
96	Bill Horton E-mail Re: Transmittal on Group Therapy	6/6/2002
	Kelly Cullison Documents	
97	Compliance Log	4/4/2000
98	Richard Kusserow Letter to Kelly Cullison Re: Compliance Policies and Procedures for Roles and Responsibilities for the Compliance Officer, Employee Issue Resolution Process, and Protocols between the Compliance Office and Legal Counsel	12/3/1997

99	Richard Kusserow Letter to Kelly Cullison Re: Policies and Procedures for the HealthSouth Coroporation Compliance Office	11/21/1997
100	HealthSouth Compliance Program	no date
	Miscellaneous Documents	
101	Teresa Rubio Memo To Ken Livesay and Jack Hawkins Re: Fixed Assets	11/14/1995
102	Kelly Coleman Testimony from SEC Asset Hearings	4/24/2003

UNANIMOUS WRITTEN CONSENT IN LIEU OF MEETING OF THE BOARD OF DIRECTORS OF HEALTHSOUTH Corporation

Tab 1

FEBRUARY 4, 2002

Pursuant to Section 141(f) of the General Corporation Law of the State of Delaware, the undersigned, being all of the members of the Board of Directors of HEALTHSOUTH Corporation, a Delaware corporation (the "Corporation"), do hereby (i) consent to and adopt the following resolutions as of the date hereof, which resolutions shall have the same force and effect as if adopted by an affirmative vote at a meeting of the Board of Directors duly called and held; (ii) waive all requirements of notice; and (iii) direct that this written consent be filed with the minutes of the proceedings of the Corporation:

RESOLVED, that the following persons are hereby awarded options under the Corporation's 1993 Consultants' Stock Option Plan to purchase that number of shares set forth following their names below, such options to have an exercise price of $10.90 per share, being the fair market value of the Corporation's Common Stock on the date of grant:

Name	Number of Shares
Thomas D. Mottola	250,000
Eric R. Hanson	20,000
Joel Katz	10,000
Swaid N. Swaid, M.D.	50,000

RESOLVED, that the options granted to Thomas D. Mottola are immediately vested and exercisable as of the date of grant.

RESOLVED, that the options granted to all other persons indicated above shall vest at the rate of 25% per year, commencing on February 4, 2003.

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HEALTHSOUTH Corporation **Tab 2**

Meeting of the Corporate Compensation Committee

April 29, 2002

Minutes

A Meeting of the Compensation Committee of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held at the Corporation's offices in Birmingham, Alabama on April 29, 2002.

The following members were present: Larry D.Striplin, Jr., Phillip C. Watkins, M.D., and John S. Chamberlin. The following guests were also present: William T. Owens, President and Chief Operating Officer of the Corporation and Brandon O. Hale, Senior Vice President, Administration and Secretary of the Corporation. Messrs. Owens and Hale were present at the Corporation's offices and all others participated via a telephonic connection.

Mr. Striplin acted as Chairman and Mr. Hale acted as Secretary. The Meeting was called to order by Mr. Striplin at 11:00 AM CDT.

Members of the Committee had been provided with Management's recommendation for bonuses to be awarded to the Corporation's Executive Officers. (Copy attached to these minutes) Mr. Striplin asked if Committee Members had reviewed the list and asked for discussion. Mr. Chamberlin made a Motion to approve as submitted and Dr. Watkins seconded the Motion. The Motion was approved unanimously by the Committee.

Mr. Owens advised the Committee that the Company had exhausted its efforts to find a way to extend Mr. Scrushy's options which expire in May 2002. Mr. Owens stated that there were no good choices to consider and Mr. Scrushy may have to sell shares in the market.

There being no further business to transact, the Meeting was adjourned.

Brandon O. Hale
Senior Vice President, Administration
and Secretary

Larry D. Striplin, Jr.
Chairman, Compensation Committee
of the Board of Directors

Name	Social Security Number	Title	Department Psoft	Previous Pay	Current Pay	Merit Increase	%	2001 Bonus	2002 Bonus
Scrushy, Richard M.								$6,500,000.00	10,000,000.00
Owens,William T.	421-92-9618	President & COO HSC & Dir	9000000C	500,000.00	800,000.00	300,000.00	60.00%	$1,500,000.00	2,000,000.00
Taylor,Larry D.	135-56-3483	President & COO	9410010C	450,000.00	490,000.00	40,000.00	8.89%	$500,000.00	600,000.00
Foster,Patrick	419-60-4702	President & COO	9430010C	450,000.00	490,000.00	40,000.00	8.89%	$500,000.00	600,000.00
Carman,Thomas W	056-38-6771	EVP Corp Development	9100000C	360,000.00	390,000.00	30,000.00	8.33%	$75,000.00	250,000.00
Smith,Weston L	416-64-8836	EVP CFO	9000000C	300,000.00	325,000.00	25,000.00	8.33%	$100,000.00	400,000.00
McVay,Malcolm E.	423-82-7827	EVP & Treasurer	9020000C	260,000.00	280,000.00	20,000.00	7.69%	$100,000.00	175,000.00
Hale,Brandon O.	422-66-9495	SVP Administration	9050000C	290,000.00	320,000.00	30,000.00	10.34%	$75,000.00	100,000.00
Jones,Susan M.	420-08-1211	SVP Finance - Reimbursement	9640000C	200,000.00	215,000.00	15,000.00	7.50%	$60,000.00	125,000.00
Horton,William W.	419-74-5437	EVP & Corporate Counsel	9200000C	300,000.00	330,000.00	30,000.00	10.00%	$100,000.00	150,000.00

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HHEC 18-01838

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HEALTHSOUTH Corporation

Meeting of the Corporate Compensation Committee

July 25, 2002

Tab 3

Minutes

A Meeting of the Compensation Committee of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held at the Corporation's offices in Birmingham, Alabama on July 25, 2002.

The following members were present: Larry D. Striplin, Jr., Phillip C. Watkins, M.D., and John S. Chamberlin. The following guests were also present: Brandon O. Hale, Executive Vice President, Administration and Secretary of the Corporation and William W. Horton, Executive Vice President and Corporate Counsel of the Corporation. Messrs. Hale and Horton were present in the Corporate office and all others participated via a telephonic connection.

Mr. Striplin acted as Chairman of the Meeting and Mr. Hale acted as Secretary.

Mr. Striplin called the meeting to order at 9:03 AM CDT.

The purpose of the Meeting was for the Compensation Committee of the Board of Directors to consider Mr. Scrushy's request to repay the principal amount of his loan under the 1999 Executive Equity Loan Plan by transferring to the Company HEALTHSOUTH shares with a value equal to the principal amount. The accrued interest on the loan was paid in cash by Mr. Scrushy in June 2002.

Mr. Horton advised the Compensation Committee that Mr. Scrushy's request to repay the principal amount of his loan with this transaction would require the Committee's ratification. Mr. Horton further advised the Committee that the transaction would accomplish three significant things. It would satisfy Mr. Scrushy's loan and eliminate the last significant loan under the 1999 Plan to an executive officer, it would allow the Company to acquire over two million shares as a part of the buyback effort without any additional cash outlay and it would likely reduce the depressive effect that would result if Mr. Scrushy sold shares for cash in a down market.

The Committee members agreed that the repayment of Mr. Scrushy's loan would be a positive event and that they should consider approval to repay the loan by transfer of stock back to the Company in an amount equal to the principal amount. After discussion among the Committee Members and Mr. Horton regarding the effective date of the transfer of shares back

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to the Company and the method for determining the share price for the transfer the Committee decided not to act upon the request until Mr. Striplin had an opportunity to discuss these issues with Mr. Scrushy. The Committee agreed to reconvene at a later date.

Brandon O. Hale
Executive Vice President, Administration
and Secretary

Larry D. Striplin, Jr.
Chairman, Compensation Committee
of the Board of Directors

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HEALTHSOUTH Corporation

Meeting of the Corporate Compensation Committee

July 31, 2002

Tab 4

Minutes

A Meeting of the Compensation Committee of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held at the Corporation's offices in Birmingham, Alabama on July 31, 2002.

The following members were present: Larry D. Striplin, Jr., Phillip C. Watkins, M.D., and John S. Chamberlin. The following guests were also present: Brandon O. Hale, Executive Vice President, Administration and Secretary of the Corporation and William W. Horton, Executive Vice President and Corporate Counsel. Messrs. Hale and Horton were present in the Corporate office and all others participated via a telephonic connection.

Mr. Striplin served as Chairman of the Meeting and Mr. Hale served as Secretary.

Mr. Striplin called the Meeting to order at 2:00 PM CDT.

The purpose of this Meeting was to further consider Mr. Scrushy's request to repay the principal amount of his loan under the 1999 Executive Loan Plan by transferring to the Company HEALTHSOUTH shares with a value equal to the principal amount.

After reviewing the discussion at the July 25 meeting and having further discussion, Committee members agreed to approve the repurchase of shares from Mr. Scrushy to repay the principal of his loan effective July 31, 2002 at a share price established by using an average between the high and low trade price on July 31, 2002.

Brandon O. Hale
Executive Vice President, Administration
and Secretary

Larry D. Striplin, Jr.
Chairman, Compensation Committee
of the Board of Directors

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HEALTHSOUTH Corporation

Meeting of the Corporate Compensation Committee

September 2, 2002

Tab 5

Minutes

A Meeting of the Compensation Committee of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held at the Corporation's offices in Birmingham, Alabama on September 2, 2002.

The following members were present: Larry D. Striplin, Jr., Phillip C. Watkins, M.D., and John S. Chamberlin. The following guest was present: Brandon O. Hale, Executive Vice President, Administration and Secretary of the Corporation.

Mr. Hale was advised by Mr. Striplin that he discussed via telephone the following salary changes for Mr. Scrushy and Mr. Owens. Mr. Striplin stated that the changes were approved unanimously by the Committee to be effective September 2, 2002.

Richard M. Scrushy, Chairman of the Board
Salary $1,200,000/year
Target Bonus $1,200,000/year

William T. Owens, Chief Executive Officer
Salary $1,200,000/year
Target Bonus $ 600,000/year

Brandon O. Hale
Executive Vice President, Administration
and Secretary

Larry D. Striplin, Jr.
Chairman, Compensation Committee
of the Board of Directors

Tab 6

Compliance Committee 3/15/02

HEALTHSOUTH Corporation

Meeting of the Corporate Compliance Committee

March 15, 2002

Minutes

A Meeting of the Corporate Compliance Committee of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held at the Disney Coronado Springs Resort in Orlando, Florida on March 15, 2002.

The following members were present: Joel C. Gordon, Phillip C. Watkins, M.D., Charles W. Newhall, III and Brandon O. Hale, Senior Vice President and Corporate Compliance Officer of the Corporation. The following guests were also present: Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of the Corporation, William T. Owens, President and Chief Operating Officer and Director of the Corporation, William W. Horton, Executive Vice President and Corporate Counsel of the Corporation and Thomas C. Fox with the law firm of Reed, Smith, Shaw and McClay. Mr. Fox participated in the Meeting via a telephonic connection.

Mr. Gordon acted as Chairman of the Meeting and Mr. Hale acted as Secretary. The Meeting was called to order by Mr. Gordon at 8:23 AM EST.

DOJ CASE UPDATE

Mr. Gordon opened the Meeting and Mr. Horton introduced Mr. Fox with Reed, Smith, Shaw and McClay to the group and asked him to give the Committee an update on the Manning v. HEALTHSOUTH whistleblower case. Mr. Fox provided the Committee with a summary of the facts and an overview of the procedural issues involved in the case. Mr. Fox advised the Committee that after two and one half years of study and research on the case he feels that there is no basis for the claim being made against HEALTHSOUTH. Additionally, Mr. Fox felt that the Corporation's position is very strong and stated that the HEALTHSOUTH model on physical therapy is the business model of the world on physical therapy. The Committee was given an opportunity to question Mr. Fox regarding all issues in the case.

COMPLIANCE REPORT

Mr. Hale presented to the Committee an update on Compliance Program activities. He reviewed a summary of the Compliance Hotline, Compliance Department initiatives for the first quarter 2002 and outlined the schedule for the 2002 HCAR Program and provided results of the HCAR audits for 2001. Mr. Hale also updated the

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Confidential Treatment
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Committee on the audit requirements of the Corporate Integrity Agreement which are being conducted by KPMG.

OTHER BUSINESS

Mr. Hale proposed one change to Policy #302 in the Corporate Compliance Policy and Procedure manual changing the requirement for refresher training from a two year required refresher training to an annual required refresher training (Copy Attached). Mr. Hale also proposed the addition of Policy #203 Sanction Policy (Copy Attached). Both the change to Policy #302 and the addition of Policy #203 of the Corporate Compliance Policy and Procedure manual were unanimously approved by the Committee.

There being no further business to transact, the Meeting was adjourned at 8:58 AM EST.

Brandon O. Hale, Secretary

Joel C. Gordon, Chairman

Phillip C. Watkins, M.D.

Charles W. Newhall, III

HEALTHSOUTH Corporation

Meeting of the Corporate Compliance Committee

March 15, 2002

Minutes

A Meeting of the Corporate Compliance Committee of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held at the Disney Coronado Springs Resort in Orlando, Florida on March 15, 2002.

The following members were present: Joel C. Gordon, Phillip C. Watkins, M.D., Charles W. Newhall, III and Brandon O. Hale, Senior Vice President and Corporate Compliance Officer of the Corporation. The following guests were also present: Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of the Corporation, William T. Owens, President and Chief Operating Officer and Director of the Corporation, William W. Horton, Executive Vice President and Corporate Counsel of the Corporation and Thomas C. Fox with the law firm of Reed, Smith, Shaw and McClay. Mr. Fox participated in the Meeting via a telephonic connection.

Mr. Gordon acted as Chairman of the Meeting and Mr. Hale acted as Secretary. The Meeting was called to order by Mr. Gordon at 8:23 AM EST.

DOJ case update

Mr. Gordon opened the Meeting and Mr. Horton introduced Mr. Fox with Reed, Smith, Shaw and McClay to the group and asked him to give the Committee an update on the Manning v. HEALTHSOUTH whistleblower's case. Mr. Fox provided the Committee with a summary of the ~~case~~ facts and an overview of the procedural issues involved in the case. Mr. Fox advised the Committee that after two and one half years of study and ~~research on the case~~ he feels that there is no basis for the claim being made against HEALTHSOUTH. Mr. Fox felt that the Corporation ~~has a very strong position and~~ position is very strong and ~~concurred~~ stated that the HEALTHSOUTH model on physical therapy is the business model of the world on physical therapy. The Committee was given an opportunity to question Mr. Fox regarding all issues in the case.

Additionally

COMPLIANCE REPORT

Mr. Hale presented to the Committee an update on Compliance Program activities. He ~~discussed the activity~~ reviewed summary of the Compliance Hotline, Compliance Department initiatives for the first quarter 2002 and outlined the schedule for the 2002 HCAR Program and provided results of the HCAR audits for 2001. Mr. Hale also updated the Committee on the audit requirements of the Corporate Integrity Agreement which are being conducted by KPMG.

OTHER BUSINESS

Mr. Hale proposed one change to Policy #302 in the Compliance ~~Office~~ Policy and Procedure~~s~~ manual changing the requirement for refresher training from a two year required refresher training to a ~~required~~ annual refresher training (Copy Attached). Mr. Hale also proposed the addition of Policy #203 Sanction Policy (Copy Attached). Both the change to Policy #302 and the addition of Policy #203 of the Corporate Compliance Policy and Procedure~~s~~ manual were unanimously approved by the Committee.

There being no further business to transact, the Meeting was adjourned at 8:58 AM EST.

Brandon O. Hale, Secretary

Joel C. Gordon, Chairman

Phillip C. Watkins, M.D.

Charles W. Newhall, III

HealthSouth Corporation
Meeting of the Corporate Compliance Committee
March 15, 2002
Minutes

A meeting of the Corporate Compliance Committee of the Board of Directors of HealthSouth Corporation (the "Corporation") was held at the Disney Coronado Springs Resort in Orlando, Florida on March 15, 2002.

The following members were present: Joel C. Gordon, Phillip C. Watkins, M.D. Charles W. Newhall III and Brandon O. Hale, Senior Vice President and Corporate Compliance Officer of the Corporation. The following guest were also present: Richard M. Scrushy Chairman of the Board and Chief Executive Officer of the Corporation, William T. Owens President, ~~and~~ Chief Operating Officer and Director of the Corporation, William W. Horton Executive Vice President and Corporate Counsel of the Corporation and Thomas C. Fox with the law firm of Reed, Smith, Shaw and McClay. Mr. Fox participated in the meeting via a telephonic connection.

Mr. Gordon acted as Chairman of the meeting and Mr. Hale acted as Secretary. The meeting was called to order by Mr. Gordon at 8:23 AM EST.

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DOJ Case Update

Mr. Gordon opened the meeting and Mr. Horton introduced Mr. Fox with Reed, Smith, Shaw and McClay to the group and asked him to give the Committee an update on the Manning v. HealthSouth whistleblower case. Mr. Fox provided the Committee with a summary ~~of~~ of the case and an overview of the procedural issues involved in the case. Mr. Fox ~~stated that~~ ~~after~~ advised the Committee that after 2½ years of study and research on this case he feels that there is no basis for the claim being made against HealthSouth. Mr. Fox felt that the Company has a very strong position and concurred that the HealthSouth model on physical therapy is the business model of the world on physical therapy. The Committee was given an opportunity to question Mr. Fox regarding all issues in the case.

Compliance Report

Mr. Hale presented to the Committee an update on Compliance program activities. He discussed the activity ~~of~~ of the Compliance Hotline, Compliance Department initiatives for the 1st Quarter 2002 and outlined the schedule for the 2002 HCAR program and provided results of the HCAR audits for 2001

HHEC 388-0696
Confidential Treatment
Requested by HealthSouth Corp.

Mr Hale also updated the Committee on the audit requirements of the Corporate Integrity Agreement which are being conducted by KPMG

Other Business

Mr. Hale ~~proposed a changes in~~ Policy # 302 in the one change to ~~the Current~~ Compliance Office Policy and Procedures manual ~~and~~ changing the requirement for refresher training from a two year required refresher ~~o~~ training to a required annual refresher training. Mr. Hale also proposed the addition of Policy # 203 Sanction Policy (Copy attached). (Copy Attached) Both the change to Policy # 302 and the addition of Policy # 203 of the Corporate Compliance Policy and Procedures manual were unanimously approved by the Committee

There being no further business to transact, the meeting was adjourned at 8:58 AM EST

Scott Scantz

Joel C Gordon, Chairman
Phillip C. Watkins MD
Charles W. Newhall III

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Confidential Treatment
Requested by HealthSouth Corp.

Compliance Committee
March 15, 2002

JCG, PCW, CHN
BOH
Guest: Bill Horton
RMS
WTO

Opn
8:23 EST

- Conference Call - Tom Fox

- Manning Wickelhaus case
Manning brought case against HS
Govt joined in
8-count complaint
- use of extensive or unlicensed personnel

Procedurally
120 day period to amend claim
+ begin to prosecute

HS filed for Judge to reconsider order on
120 day >ext - "Claim should
be unsealed + made available to HS

Tom - "After 2½ years of study + research we
feel there is no basis for this claim"

HHEC 388-0698
Confidential Treatment
Requested by HealthSouth Corp.

Significant Federal Regulation → July 2001
rules on payment for skilled nursing care
with clear recognition of concurrent
therapy

— we feel Company has a very strong position

Tom — Concerns that this is business added if
the model on physical therapy

Govt must prove false claim which
the facts would be very difficult

Both Review

→ Policy + Procedures change approved

8:58 — closed

HHEC 388-0699
Confidential Treatment
Requested by HealthSouth Corp.

Tab 7

HEALTHSOUTH Corporation

MEETING OF THE BOARD OF DIRECTORS

AUGUST 8, 2002

MINUTES

A meeting of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held in the Board Room at the Corporation's offices in Birmingham, Alabama pursuant to a Waiver of Notice dated August 8, 2002, a copy of which is attached to these Minutes.

The following Directors were present, constituting a quorum: Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of the Corporation, William T. Owens, President and Chief Operating Officer of the Corporation, John S, Chamberlin, C. Sage Givens, Joel C. Gordon, Charles W. Newhall III, Larry D. Striplin, Jr., George H. Strong and Phillip C. Watkins, M.D. The following guests were also present: Brandon O. Hale, Executive Vice President – Administration and Secretary, Malcolm E. McVay, Executive Vice President and Treasurer of the Corporation, Weston L. Smith, Executive Vice President and Chief Financial Officer of the Corporation, W. Greg Smith, Vice President – Internal Audit of the Corporation, and William C. McGahan, Roderick O'Neill, Scott Wollard and Hugh O'Hare of UBS Warburg LLC. With the exception of Dr. Watkins, everyone was physically present in the Corporation's Board Room. Dr. Watkins participated via a telephonic connection whereby everyone could freely hear and speak to one another.

Richard M. Scrushy acted as Chairman of the Meeting and Brandon O. Hale acted as Secretary.

The Meeting was called to order by Mr. Scrushy at 11:05 a.m. C.D.T.

Internal Audit Report

Mr. Scrushy asked Mr. Greg Smith to give the Board an update on the Corporation's internal audit program. Mr. Smith reviewed with the Board the number and type of audits which had been conducted year-to-date. Mr. Smith also discussed the results of the billing review required by the

Corporate Integrity Agreement, reviewed the Internal Audit Department's involvement with the HCAR program and responded to questions from the Board.

Compliance Report

Mr. Gordon and Mr. Hale presented to the Board an update on the Corporate Compliance Program. Mr. Hale presented statistics from the Compliance Hotline, reviewed the Corporation's compliance training activities and announced to the Board that KPMG had completed its audit of year one under the Corporate Integrity Agreement and that HEALTHSOUTH had met all requirements of the Corporate Integrity Agreement.

Mr. Gordon advised the Board that the Corporate Compliance Committee was reviewing the gift policy provisions in the Standards of Business Conduct manual and would make a recommendation on revised language at a subsequent meeting.

Treasury Review

Mr. McVay presented to the Board a review of Treasury activities. He highlighted the new $1,250,000,000 bank facility and the refinancing of $207,000,000 in synthetic leases. He discussed the Corporation's strong liquidity position, indicating that the Corporation had no off-balance sheet financing issues and no significant maturities until 2007. Mr. McVay stated that the Corporation's refinance plan goals had been met. He completed his review with an overview of investor relations issues, including the top ten holders of HRC, current analyst coverage and target list for new coverage.

Financial Review

Mr. Smith led the Board through a review of the Corporation's financial performance for the second quarter of 2002. He presented overall results from the income statements and highlighted key financial indicators by operating division.

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PW 0000141

Chairman's Review

Mr. Scrushy began his presentation with a brief history of HEALTHSOUTH and its competitors. He then led the Board through an evaluation of the surgery center business and discussed a possible strategy for spinning out or splitting off the surgery division. At that time Mr. Scrushy invited Mr. McGahan and his associates to join the meeting and to present to the Board a detailed analysis of a strategic plan to spin or split the surgery division (Project Crimson). In addition to the analysis provided by UBS Warburg, Mr. Scrushy presented to the Board a proposed management structure for the surgery company and identified individuals for all key executive positions. Mr. Scrushy also stated his desire to move into the Chairman of the Board position of both HEALTHSOUTH and the new surgery company, and recommended William T. Owens be promoted to Chief Executive Officer of HEALTHSOUTH, such promotion to be effective at such time as the Board approved a plan with respect to the surgery division. Mr. Scrushy also recommended that Malcolm E. McVay be promoted to Chief Financial Officer in order to allow Weston L. Smith to focus all of his attention on the proposed surgery center transaction.

Upon motion duly made by Mr. Striplin and seconded by Mr. Chamberlin, the following resolution was unanimously adopted:

> RESOLVED, that the following persons are hereby appointed to the offices set forth following their names below, to serve until the next Annual Meeting of the Board of Directors of this Corporation and until their successors are duly elected and qualified, or until their earlier death, resignation or removal, such appointment to be effective at such time as the Board of Directors give preliminary approval to a strategic transaction involving the Corporation's surgery center division, or as otherwise directed by the Board of Directors:

Name	Title
William T. Owens	President and Chief Executive Officer
Malcolm E. McVay	Executive Vice President and Chief Financial Officer

Mr. Scrushy then advised the Board that the Corporation had obtained a copy of a CMS transmittal which appeared to change regulations for payment of group and concurrent therapy for outpatient medicare reimbursement. Mr. Scrushy stated that the Corporation's reimbursement

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department was initially advised by Blue Cross/Blue Shield of Alabama, the Corporation's Medicare intermediary, that the transmittal did not apply to HEALTHSOUTH's outpatient therapy business. Mr. Owens then joined the discussion and advised the Board that in seeking additional clarification to the transmittal, HEALTHSOUTH reimbursement officials scheduled a meeting with CMS in Washington in July, and after that meeting reimbursement officials left Washington with more questions than answers and were still unclear of the intent and possible impact of the transmittal.

Mr. Scrushy advised the Board that the Corporation was still seeking answers and clarification so as to assess the impact on revenue and announce it if necessary. Mr. Scrushy recommended, and the Board concurred, that management should again meet with CMS in Washington as soon as possible to obtain further clarification and assess the impact on the Corporation.

Mr. Scrushy then advised the Board that he had repaid his loan under the 1999 Executive Loan Plan by transferring to the Company HEALTHSOUTH shares with a value equal to the principal amount of the loan and paying interest owed in cash.

There being no further business to transact, the Meeting was adjourned.

Brandon O. Hale
Executive Vice President – Administration
and Secretary

Richard M. Scrushy
Chairman of the Board
and Chief Executive Officer

HS-71306.1

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HEALTHSOUTH Corporation

WAIVER OF NOTICE

We, the undersigned, constituting all the members of the Board of Directors of HEALTHSOUTH Corporation, a Delaware corporation, do hereby waive notice of the time, place and purpose of the Meeting of the Board of Directors of HEALTHSOUTH Corporation to be held on August 8, 2002, at 11:00 a.m. C.D.T., and we consent to the transaction of such business as may properly become before said Meeting.

DATED the 8th day of August, 2002.

Richard M. Scrushy	Phillip C. Watkins
C. Sage Givens	Joel C. Gordon
Charles W. Newhall, III	Larry D. Striplin, Jr.
John S. Chamberlin	William T. Owens
George H. Strong	

HS-71306.1

Tab 8

BOD 8/8/02

HHEC 388-0441
Confidential Treatment
Requested by HealthSouth Corp.

BOD
8/8/02

RMS SSC CSG JCG CWW
LDS WTO GHS PCW Telephone

Grenda Hale, Smith, McVay

Audit Report
Greg Smith
Audits
Type Audits
Asst Eng
Billing Review for CIA
Error rate ↓ 2%

HCAR

Questions

Compliance Report

Joel Grenda – Cont

Bott – Review

Treasury Review
Todd McVay
– Comments on Conference Call – All parties
– with earnings release

HHEC 388-0442
Confidential Treatment
Requested by HealthSouth Corp.

Recent Events
- $1B 10 year Sr. Notes
- New $1.25B Bank Facility
- Refinanced $207 mm in Synthetic Leases

Strong Liquidity Position
- 1.2B available under new bank facility
- New facility provides ample availability to fund cost savings
- Reactivated Stock repurchase program 2003 refinancing
- No off balance sheet financing issues
- No significant maturities until 2007

Liquidity Summary

→ Refinance Plan Goals met

- Completed Transactions
- Review of financial ratios

Investor Relations issues
- HHC trades at discount to peers
- Top 10 Holders of HHC
- Current analyst coverage
- Target list for new coverage

Treasury Summary

HHEC 388-0443
Confidential Treatment
Requested by HealthSouth Corp.

Financial Review — Weston Smith

Income Statement Highlights
- Revenues
- EBITDA
- Net Income
- Earnings per Share 2Q4
- Discontinued Net Revenue
- Outpatient Visits
- OP Revenue
- Surgery Cases
- Surgery Revenue
- Diagnostic Scans
- Inp. Discharges up 5% vs. prior year
- Inp. Revenue
- Medical Center Days
- Medical Center Revenues

RMS
Overview of history of HealthSouth + competitors
- Evaluation of surgery business + strategy for spinning out surgery division +
- Div

- Discussion of CMS Transitional Staffing regulation of Group Therapy / Concurrent Therapy in Outpatient Medicare reimbursement

HHEC 388-0444
Confidential Treatment
Requested by HealthSouth Corp.

We need to get the input on version
☆ + arrange it to the street.

→ Rick asked Bill McGuire to join us
to present plan / 3 others / Rod O'Neal Mark
1 Via telephone / Hugh O'Hare

Project Crimson
Break for Lunch – Discussion continued during lunch

↳ Continued discussion after lunch on
Project Crimson

* Discussion of Mgt Structure.

~~Project Crimson~~ ☒ ~~Motion~~ Strip
2nd
~~approved~~

☆ Add Discussion by Rms. + WTO of CMS Transmittal letter
+ what is about – Board concerned that mgt
should meet with CMS to clarify letter and
assess impact on HHC

Approved Promotions

Taylor COO
Vanlandingham CFO
R. Dunn Tony
Mark Controller

WTO – CEO
Todd – CFO

move Stapel
2nd Williams

HHEC 388-0445
Confidential Treatment
Requested by HealthSouth Corp.

RMS

Discussion of Executive Loan repayments

RMS report with exchange of stock

Adjourn 2:55 PM

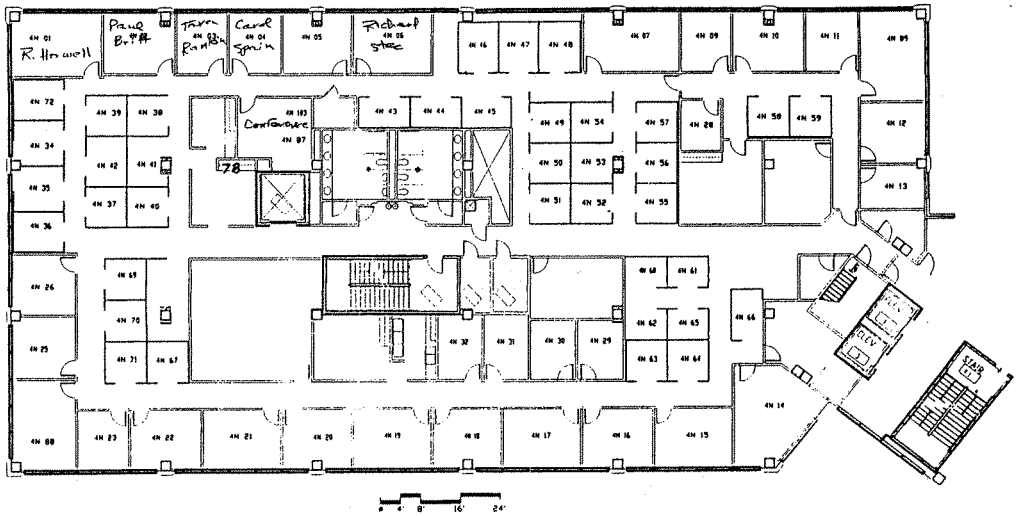
HHEC 388-0446
Confidential Treatment
Requested by HealthSouth Corp.

Brad,

1) Floor plan 4 North
2) PAF for Paul

HHEC 388-0447
Confidential Treatment
Requested by HealthSouth Corp.

Four North



FOURTH FLOOR PLAN NORTH – CORPORATE OFFICES

HHEC 388-0448
Confidential Treatment
Requested by HealthSouth Corp.

Tab 9

HEALTHSOUTH Corporation

MEETING OF THE BOARD OF DIRECTORS

AUGUST 26, 2002

MINUTES

A meeting of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held in the Board Room at the Corporation's offices in Birmingham, Alabama pursuant to a Waiver of Notice dated August 26, 2002, a copy of which is attached to these Minutes.

The following Directors were present, constituting a quorum: Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of the Corporation, William T. Owens, President and Chief Operating Officer of the Corporation, Joel C. Gordon, Phillip C. Watkins, M.D., Larry D. Striplin, Jr., George H. Strong, John S, Chamberlin and C. Sage Givens. The following guests were also present: Brandon O. Hale, Executive Vice President – Administration and Secretary, Malcolm E. McVay, Executive Vice President and Treasurer of the Corporation, Weston L. Smith, Executive Vice President and Chief Financial Officer of the Corporation, William W. Horton, Executive Vice President and Corporate Counsel of the Corporation, and Larry D. Taylor, President and Chief Operating Officer – Ambulatory Services of the Corporation, William McGahan, Rod O'Neill, Hugh O'Hare, Scott Wollard, John Wagner and Rick Leaman of UBS Warburg, LLC, and Samuel H. McGarr and Tom Avent of KPMG. With the exception of Mr. Leaman, everyone was physically present in the Corporation's Board Room. Mr. Leaman participated via a telephonic connection whereby everyone could freely hear and speak to one another.

Richard M. Scrushy acted as Chairman of the Meeting and Brandon O. Hale acted as Secretary.

The Meeting was called to order by Mr. Scrushy at 4:00 p.m. C.D.T.

Project Crimson Strategic Alternatives Discussion

UBS Warburg Presentation

Mr. Scrushy asked Mr. McGahan and his associates to lead the Board through a strategic alternative discussion on Project Crimson. UBS Warburg began with a review of a segment valuation and a discussion of ways to improve business focus by considering several alternatives, including the sale of the diagnostic facilities combined with the split off of the surgery centers, the sale of the surgery centers, the spin-off or split-off of the surgery centers (with or without IPO) and the sale of the diagnostic facilities. UBS Warburg then presented to the Board a debt analysis and discussed how the current debt profile impacted the alternatives being considered. In closing, Mr. McGahan and the UBS Warburg team presented a summary of the timeline of events to take place and led a discussion of the key separation decisions that needed to be made by the Corporation.

KPMG Opinion

Mr. Scrushy requested Mr. McGarr and Mr. Avent give their opinion on whether there is a justifiable business reason for either the spin off or split-off of the surgery division, thus allowing a tax-free transaction. Mr. Avent responded that he is very comfortable that there are several justifiable business reasons for the spin-off or split-off transaction which would allow a tax-free transaction to be effected.

CMS Transmittal 1753

Mr. Scrushy asked Mr. Owens to review with the Board the timeline of events resulting from CMS Transmittal 1753. Mr. Owens stated that CMS Transmittal 1753 was posted to Part B carriers only on May 17, 2002 and the Corporation received a copy of the Transmittal from a third party in early June. The Corporation forwarded a copy to Blue Cross of Alabama (the Corporation's fiscal intermediary), who advised the Corporation that the Transmittal did not apply to HEALTHSOUTH. The Corporation requested a formal letter from Blue Cross of Alabama. After not having received one, a meeting was scheduled for July 18, 2002 with CMS and reimbursement representatives from HEALTHSOUTH. That meeting generated more questions than answers. Mr. Owens stated that he had believed the Transmittal might apply to the Corporation's outpatient services in freestanding

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outpatient centers. He informed Mr. Scrushy on August 6 that it might apply to such services in freestanding outpatient centers and the impact could be $15,000,000 - $20,000,000. Mr. Scrushy stated that he had advised Mr. McVay and subsequently Mr. Owens to go back to CMS for better clarification. The meeting on August 15 did not answer all questions regarding Transmittal 1753, but answered enough questions to allow the Corporation to prepare an analysis of the potential impact.

Mr. Owens advised the Board that he was comfortable with the chronology of events and that the Corporation had been working diligently since the August 15 meeting to assess the impact of the Medicare changes.

Mr. Scrushy and Mr. Owens advised the Board that the estimated impact on revenue of CMS Transmittal 1753 would be $175,000,000 per year, and that the Corporation would be putting out a press release disclosing this on Tuesday, August 27.

SCA Update

Mr. Taylor thanked Messrs. Scrushy and Owens and the Board for their support and made comments regarding SCA's management team and updated the Board on current initiatives and development activities.

All guests left the room at this time for the Board to continue discussions regarding Project Crimson and CMS Transmittal 1753. After discussions, the Board, upon motion duly made and seconded, gave preliminary approval to management to proceed with development of a plan for a separation transaction involving the surgery center division. There were no votes cast against the motion. It was noted that the promotions and responsibility changes involving Mr. Owens, Mr. Smith and Mr. McVay that were approved at the August 8 meeting would become effective as of this meeting.

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There being no further business to transact, the Meeting was adjourned.

Brandon O. Hale
Executive Vice President – Administration
and Secretary

Richard M. Scrushy
Chairman of the Board

HS-71307.1

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TREATMENT REQUESTED

HEALTHSOUTH Corporation

WAIVER OF NOTICE

We, the undersigned, constituting all the members of the Board of Directors of HEALTHSOUTH Corporation, a Delaware corporation, do hereby waive notice of the time, place and purpose of the Meeting of the Board of Directors of HEALTHSOUTH Corporation to be held on August 26, 2002, at 4:00 p.m. C.D.T., and we consent to the transaction of such business as may properly become before said Meeting.

DATED the 26th day of August, 2002.

Richard M. Scrushy	Phillip C. Watkins
C. Sage Givens	Joel C. Gordon
Charles W. Newhall, III	Larry D. Striplin, Jr.
John S. Chamberlin	William T. Owens
George H. Strong	

HS-71307.1

Tab 10

800 8/24/02

HHEC 293-0465
Confidential Treatment
Requested by HealthSouth Corp.

BOD
8/26/02

RMS WTO JEG PCW
LDS, GS, JC, SG

Guest: W. Smith B. Hale T McVay
B. Horton L. Taylor

KPMG - Sam McGann & Tom
UBS - ~~(4)~~ B. McGann S Mathis

4:00 PM CDST

UBS Presentation - Bill McGann Rick Layman
Strategic Alternatives Discussion

① Segment Valuation Rod O'Neal UBS

1) Discussed CMS Transmittal letter and impact on business
2) Also discussed positive impact of Transmittal letter on our DOJ case.

KPMG ~~H~~ Feels there is ~~[illegible]~~ business ~~[illegible]~~ for the Spin-off/Split off

⇒ Analysis of All options

HHEC 293-0466
Confidential Treatment
Requested by HealthSouth Corp.

Debt Analysis

- Debt Capital Structure
- Financing Considerations

Time line

Discuss

Executing Strategic Alternatives

1) Spin-off or split off
2) Can tax free status be achieved
3) What are the appropriate capital structures & dividend policies
4) Pursue IPO before Full Separation?

☆ RMS → WTO — Timeline of CMS Transaction

HHEC 293-0467
Confidential Treatment
Requested by HealthSouth Corp.

WTO → 1) Data May 19
2) We received early June
3) We spoke to HCA (independently) — Michael Brown & they said it did not apply to us — would not put in waiting
4) Schedule meeting with CMS July 18

nearly generated more questions than answers
- Back to CMS Aug 16 - Once again we don't have all questions answered but enough to begin our analysis of impact
- We have clarity of events that we are comfortable with
- We did not bill Medicare for 1st 45 days of stay until we got clarification

Bill Horton →

2

Guest leave room except T. McVay, L. Taylor, W. Smith, B. Hale, D. Horton

Discussion

HHEC 293-0468
Confidential Treatment
Requested by HealthSouth Corp.

Thanks board, Richard + Bill for their support

Larry Taylor — Commends our Mgt Team + investors for Surgery Company
- Development activities

Bill Owens — Comments on Storm to weather in rehab company - but good cash flow + good Mgt Team to carry out very strong & positive -

Motion Watkins
Stephen 2nd

All Guest including BOH left the room for Board to continue discussion.

Get with WTO + RMS to see what needs to be add'l to Board minutes.

"Discussion continued then motion approved with no votes against the motion"

6:28 PM

HHEC 293-0469
Confidential Treatment
Requested by HealthSouth Corp.

Draft

HealthSouth Corporation
Meeting of the Board of Directors
August 26, 2002
Minutes

A Meeting of the Board of Directors of HealthSouth Corporation (the "Corporation") was held in the Board Room at the Corporation's offices in Birmingham, Alabama pursuant to a Waiver of Notice dated August 26, 2002, a copy of which is attached to these minutes.

Board Members Present: RMS WTD JCG PCW
LDS GAS JSC, CSG

Guests: W. Smith, B. Hale, T. McVay,
B. Horton, L. Taylor

KPMG - Sam McFann
Tom Adcock

Adcock

HBS Working - Bill McFadden
~~Gordon Johnson~~

Red O'Neill, Hugh O'Hare, Scott Wollard, John Wayne
and Rick Lemon (Rick Lemon via telephone)

Richard M. Scrushy acted as Chairman of the Meeting and Brandon O. Hale acted as Secretary.

HHEC 293-0470
Confidential Treatment
Requested by HealthSouth Corp.

The meeting was called to order at 4:00 PM CDT

~~UBS Warburg~~

Project Crimson Strategic Alternatives Discussion

Mr. Scrudy asked Mr McGahan and his associates with UBS Warburg to lead the Board through a Strategic Alternative Discussion on Project Crimson. UBS Warburg began with a review of a segment valuation and a discussion of ways to improve business focus ~~the~~ by considering several alternatives including the sale of Diagnostics ~~and~~ combined with a split-off of Surgery Centers, the sale of Surgery Centers, the spin-off or split off of Surgery Centers (with or without IPO) and the sale of Diagnostics. UBS Warburg then presented to the Board a debt analysis and discussed how the current debt profile impacted the alternatives being considered. ~~The timeline for execution and~~ a summary of the timeline of events and a discussion of key separation decisions to be made by the Company. In closing Mr McGahan and the UBS Warburg team presented a summary of the timeline of events to take place and lead a discussion of the key separation decisions that would to be made by the Corporation.

HHEC 293-0471
Confidential Treatment
Requested by HealthSouth Corp.

KPMG

~~At the~~ Mr. Scrasby requested ~~Mr.~~ Mr. McGrew and Mr. Adent with KPMG to give their opinion whether ~~they felt~~ there is a justifiable business reason for either the spin off or split off of the Surgery Division thus allowing a tax free transaction. Mr. Adent responded ~~to the good~~ that he ~~was~~ is very comfortable that there are several justifiable business reasons for the spin or split off transaction which would allow a tax-free status to be achieved.

HHEC 293-0472
Confidential Treatment
Requested by HealthSouth Corp.

CMS Transmittal 1753

Mr. Scrasby advised ~~the Board that Company representatives had again met with CMS and based on~~ asked Mr. Owens to review with the Board the timeline of events resulting from CMS Transmittal 1753. Mr. Owens stated that CMS Transmittal 1753 to Carriers on May 17, 2002 and the Company a copy of the transmittal from a third party in early June. The Company forwarded a copy to Blue Cross of Alabama (our fiscal intermediary)

and they advised us that it did not apply to us. The Company requested a formal letter from Blue Cross of Alabama but did not ~~recei~~ get one so a meeting was scheduled on July 18, 2002 with CMS and Reimbursement Representatives from HealthSouth. The meeting on July 18 generated more questions than answers therefore a subsequent meeting was scheduled for August 16, 2002. The meeting on August 16 did not answer all questions regarding Transmittal 1253 but answered enough questions to begin HealthSouth's analysis of impact.

Mr. Owens advised the Board that he was comfortable with the chronology of events and ~~that~~ the Company had been working diligently since the August 16 2002 meeting to the access impact of the Medicare changes. ~~Owens also advised the Board that the~~

Mr. Scrivly and Mr Owens advised the Board that the estimated impact on Revenue of CMS Transmittal 1253 would be $175 million per year.

HHEC 293-0473
Confidential Treatment
Requested by HealthSouth Corp.

SCA Update

Mr. Taylor thanked Messrs Scrivly and Owens and the Board for their support and updated the Board on ~~the Board on~~ made comments regarding SCA's management team and updated the Board on current initiatives and development activities.

All guests left the room at this time for the Board to continue discussions regarding Project Crimson and CMS Transmittal 1753. After discussions a motion was made ~~to~~ and approved to either spin the Surgery Division ~~to~~ There were no votes cast against the motion.

There being no further business to discuss, the meeting was adjourned.

HHEC 293-0474
Confidential Treatment
Requested by HealthSouth Corp.

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HEALTHSOUTH Corporation

MEETING OF THE BOARD OF DIRECTORS

AUGUST 30, 2002

MINUTES **Tab 11**

A meeting of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held in the Board Room at the Corporation's offices in Birmingham, Alabama pursuant to a Waiver of Notice dated August 30, 2002, a copy of which is attached to these Minutes.

The following Directors were present, constituting a quorum: Richard M. Scrushy, Chairman of the Board of the Corporation, William T. Owens, President and Chief Executive Officer of the Corporation, John S. Chamberlin, Phillip C. Watkins, M.D., George H. Strong, Larry D. Striplin, Jr. and Joel C. Gordon. The following guests were also present: Brandon O. Hale, Executive Vice President – Administration and Secretary, Malcolm E. McVay, Executive Vice President and Chief Financial Officer of the Corporation, Weston L. Smith, Executive Vice President of the Corporation, William W. Horton, Executive Vice President and Corporate Counsel of the Corporation, Larry D. Taylor, President and Chief Operating Officer – Ambulatory Services of the Corporation, and Eric R. Hanson of U.S. Strategies. Joining Mr. Scrushy in the Board Room were Messrs. Owens, Striplin, Smith, McVay, Hale, Taylor and Horton. The other members participated via a telephonic connection whereby everyone could freely hear and speak to one another.

Richard M. Scrushy acted as Chairman of the Meeting and Brandon O. Hale acted as Secretary.

The Meeting was called to order by Mr. Scrushy at 10:00 a.m. C.S.T.

The purpose of the meeting was to provide the Board with an update of recent events.

Transmittal 1753

Mr. Scrushy advised the Board that he was working with various U.S. Senators and Congressmen regarding the impact of CMS Transmittal 1753. Mr. Scrushy also advised the Board

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TREATMENT REQUESTED

that he had spoken with Tom Scully at CMS and there was a possibility that Mr. Scully might issue a press release indicating that CMS rules on group therapy were ambiguous. The Board was updated by Mr. Scrushy on the four shareholder lawsuits that had been filed.

Mr. Scrushy reviewed with the Board the financial impact of the revised revenue after the impact of CMS changes and reviewed financial projections after the split/spin.

SCA Update

Mr. Taylor updated the Board on the status of SCA's organizational structure and other activities with regard to the split/spin of the surgery division.

Investor Issues

Mr. Owens updated the Board on investor issues and made comments on the dedicated efforts by the Company to make outpatient physical therapy work under the new CMS regulations. He also stated that inpatient rehabilitation under PPS rules continues to do well and the divestiture process of diagnostic facilities was beginning to heat up.

Sale of Aircraft

Mr. Scrushy advised the Board that the Company had sold one airplane and had two others up for sale.

There being no further business to transact, the Meeting was adjourned.

Brandon O. Hale
Executive Vice President – Administration
and Secretary

Richard M. Scrushy
Chairman of the Board

HS-71308.1

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TREATMENT REQUESTED

HEALTHSOUTH Corporation

MEETING OF THE BOARD OF DIRECTORS

SEPTEMBER 17, 2002

MINUTES **Tab 12**

A meeting of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held in the Board Room at the Corporation's offices in Birmingham, Alabama pursuant to a Waiver of Notice dated September 17, 2002, a copy of which is attached to these Minutes.

The following Directors were present, constituting a quorum: Richard M. Scrushy, Chairman of the Board of the Corporation, William T. Owens, President and Chief Executive Officer of the Corporation, John S. Chamberlin, Phillip C. Watkins, M.D., C. Sage Givens, Charles W. Newhall III, Larry D. Striplin, Jr. and Joel C. Gordon. The following guests were also present: Larry D. Taylor, President and Chief Operating Officer — Surgery Center Operations of the Corporation, Patrick A. Foster, President and Chief Operating Officer — Inpatient Services of the Corporation, Brandon O. Hale, Executive Vice President — Administration and Secretary of the Corporation, Malcolm E. McVay, Executive Vice President and Chief Financial Officer of the Corporation, William W. Horton, Executive Vice President and Corporate Counsel of the Corporation, Weston L. Smith, Executive Vice President of the Corporation, Daniel J. Riviere, President — Ambulatory Services of the Corporation, Jason Hervey, Senior Vice President — Media and Communications of the Corporation, Susan Smith, Senior Vice President — Reimbursement of the Corporation, Jean Davis, Vice President — Operations of the Corporation, Eric R. Hanson of U.S. Strategies, William C. McGahan and Benjamin D. Lorello of UBS Warburg LLC, J. Michael Rediker and Thomas L. Krebs of Haskell Slaughter Young & Rediker, Lanny J. Davis, Debra M. Laboschin and Raphael Larson of Patton Boggs, LLP, Michael Deaver of The Edelman Group. and Thomas C. Fox and Scot T. Hasselman of Reed Smith LLP. With the exception of Messrs. Hanson, Davis and Deaver, all Directors and guests were physically present in the Board Room. Messrs. Hanson, Davis and Deaver participated via a telephonic connection whereby everyone could freely hear and speak to one another.

Richard M. Scrushy acted as Chairman of the Meeting and Brandon O. Hale acted as Secretary.

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The Meeting was called to order by Mr. Scrushy at 2:35 p.m. C.D.T.

SCA Update

Mr. Taylor provided the Board with an update on surgery center separation activities. He reviewed the new SCA logo, the Mission Statement and the organizational structure. He also outlined several other key initiatives critical for success.

CMS Regulations Review

Mr. Owens introduced Ms. Smith and Ms. Davis and asked them to present a history of CMS activity from 1998 to the present with regard to reimbursement for concurrent or group therapy provided by physical therapists. Ms. Smith and Ms. Davis presented a detailed history using correspondence from CMS and documentation from HEALTHSOUTH and HEALTHSOUTH's reimbursement counsel regarding outpatient therapy reimbursement issues.

Mr. Owens also introduced Matt Zurek, Regional Vice President — Operations, and Rob Tillman, Vice President — Clinical Development, both physical therapists. Messrs. Zurek and Tillman discussed with the Board how physical therapists within the industry treat patients with regard to concurrent and group therapy. Both felt that HEALTHSOUTH's practices were consistent with the industry and what is taught in the physical therapy schools.

At this point Mr. Lanny Davis of Patton Boggs joined the meeting via telephonic connection. Mr. Davis and his firm were hired by the Corporation to consult on legal and media relations matters facing the Corporation. Mr. Davis spent several minutes discussing strategy and the scope of his firm's involvement.

Mr. Rediker and Mr. Krebs discussed with the Board the strategy for defending the shareholder and derivative lawsuits. Mr. Rediker stated that the cases were winnable and the Corporation should be aggressive with a proactive strategy which could produce newsworthy developments.

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Corporate Compliance

Mr. Gordon advised the Board that he and Messrs. Watkins and Newhall had a telephone conference on September 13, 2002 to discuss the need for an independent investigation of allegations of insider trading and improper disclosure. Mr. Gordon recommended the firm of Wilmer, Cutler & Pickering and Mr. Newhall recommended the firm of Fulbright & Jaworski, L.L.P. to conduct the independent investigation on behalf of the Board.

Mr. Scrushy asked Mr. Rediker to comment on the independent investigation and to give the Board recommendations on other matters to consider. Mr. Rediker recommended the Board establish a special litigation committee of the Board of Directors, comprised of independent directors to investigate the derivative lawsuits. This committee would conduct their investigation concurrent with the independent investigation conducted by an outside law firm. To establish a special litigation committee, Mr. Rediker advised the Board that it would need to add an additional outside director who met the test of independence.

After discussion, upon motion duly made by Mr. Chamberlin and seconded by Dr. Watkins, the following resolution was unanimously adopted:

> RESOLVED, that the number of Directors constituting the whole Board of Directors shall be ten.

There after, upon motion duly made by Dr. Watkins and seconded by Mr. Chamberlin, the following resolution was unanimously adopted:

> RESOLVED, that Jon F. Hanson is hereby appointed to serve as a Director of this Corporation until the next Annual Meeting of Stockholders of this Corporation and until his successor is duly elected and qualified, or until his earlier death, resignation or removal.

After discussion of the special litigation committee and the independent investigation, Mr. Davis stated that he felt Fulbright & Jaworski would be the better choice to conduct the independent investigation.

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After further discussion, upon motion duly made by Dr. Watkins and seconded by Ms. Givens, the following resolutions were unanimously adopted:

RESOLVED, that having considered the claims made by Wade Tucker, purporting to be a shareholder, against the Company, Richard M. Scrushy, an officer and director of the Company, Gerald P. Scrushy, MedCenterDirect.com, Source Medical Solutions, Inc., Capstone Capital Corporation, and G.G. Enterprises, Case No. CV02-5212, Circuit Court of Jefferson County, Alabama, filed August 28, 2002 without prior demand on the Company's Board of Directors, in the form of a derivative action (the "Tucker Action"), and taking into consideration the Company's plans to move to dismiss or stay the Tucker Action, and desiring to preserve to the Company and the Board to pursue such motions to dismiss or stay while otherwise delegating to an appropriate committee the powers and discretions to conduct the review of the Tucker Action and any related matters and issues as set forth below, the Board of Directors hereby constitutes and appoints a Special Litigation Committee (the "Committee"), which will consist initially of existing director Larry D. Striplin, Jr. and new director Jon Hanson (and, subsequently, of such additional independent directors, if any, as the Board of Directors may appoint from time to time), to investigate, review and analyze: (1) the facts, transactions, events and circumstances surrounding the claims made in such Tucker Action and any other actions or proceedings which may be filed which relate or are allege to relate to any event or transaction which is a subject in or of the Tucker Action; and (2) to the extent the Business Judgment Rule may be determined to be applicable thereto or to the extent claims of a derivative nature may be asserted in respect thereto, any events or transactions which are or may become the subject of any of the pending federal court class actions which have been filed against the Company since August 27, 2002 in the United States District Court for the Northern District of Alabama.

FURTHER RESOLVED, that such Committee shall consider and determine whether or not prosecution or continuation of such claims and actions is in the best interests of the Company and its shareholders, and what action the Company should take with respect thereto;

FURTHER RESOLVED, that such Committee is hereby authorized and directed to continue in existence until such time as the Committee shall recommend its dissolution to the Board of Directors, and to engage such experts and advisers, including independent legal counsel, as the Committee shall deem necessary or desirable in order to assist it in the discharge of its responsibilities;

FURTHER RESOLVED, that the Committee shall have and may exercise in connection with its investigation and determination all the powers and authority of the Board of Directors, which is hereby delegated to the Committee, and such other powers as are accorded to such a committee under applicable law;

FURTHER RESOLVED, that nothing herein is intended to moot or waive the Company's planned motions to dismiss or stay the Tucker Action for lack of standing

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and/or failure to state a claim upon which relief may be granted and failure to comply with the requirements of Rules 12(b)(6) and 23.1, Alabama Rules of Civil Procedure; provided, however, that the Committee shall have have full power and discretion to recommend that any Company motion or pleading be changed, withdrawn, or supplemented by additional or substituted pleadings or motions of the Committee or the Company, or both, as shall be deemed appropriate;

FURTHER RESOLVED; that the determinations made by the Committee shall be final, shall not be subject to review by the Board of Directors and shall in all respects be binding upon the Company;

FURTHER RESOLVED, that the officers, agents, and employees of the Company, and each of them, are hereby authorized and directed to assist the Committee and to provide it with all information and documents that it shall request with respect to the subject matter of the Tucker Action and any actions or proceedings related to the subject matter of the Tucker Action, having due regard for any applicable privileges.

After further discussion, upon motion duly made by Dr. Watkins and seconded by Ms. Givens, the following resolutions were unanimously adopted:

RESOLVED, that this Corporation is authorized to engage the services of Fulbright & Jaworski, LLP to conduct a review of such matters relating to pending litigation and investigations regarding this Corporation as may be directed by the Board of Directors and encompassed in one or more engagement letters executed between this Corporation and Fulbright & Jaworski, LLP.

RESOLVED, that any reports or other work product created by or at the direction of Fulbright & Jaworski, LLP pursuant to the foregoing resolution shall be made available to the Special Litigation Committee as it may request.

Mr. Striplin then affirmed that he has no financial relationship with Mr. Scrushy and was not an investor in MedCenterDirect, Source Medical or Capstone Capital.

CEO Report

Mr. Owens updated the Board on operational and financial results to date for the current quarter. He also discussed with the Board the Corporation's decision to suspend guidance at the present time.

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UBS Warburg Comments on Surgery Center Transaction

Messrs. McGahan and Lorello reviewed in detail with the Board current issues surrounding the spin or split of the surgery division.

Confidentiality Statement

Mr. Rediker stated to the Board and to agents of the Board participating in the meeting the importance of confidentiality and the nature of insider information being shared and discussed.

Review of Investor Conference Call

Messrs. Scrushy and Davis reviewed with the Board the key components of the investor conference call scheduled for September 19, 2002.

Other Matters

At the close of the Meeting, Hal Hirsch of Fulbright & Jaworski joined the meeting via telephonic connection to accept the assignment to conduct the independent investigation and confirmed that Fulbright & Jaworski had no prior involvement with the Corporation.

Mr. Gordon discussed with the Board his views on the role of the Compliance Committee in regard to the investigation by Fulbright & Jaworski and his desire that the Compliance Committee and the full Board be kept informed of all relevant information on a current basis.

There being no further business to transact, the Meeting was adjourned.

Brandon O. Hale
Executive Vice President – Administration
and Secretary

Richard M. Scrushy
Chairman of the Board

HS-71515.1

Tab 13

HEALTHSOUTH Corporation

MEETING OF THE BOARD OF DIRECTORS

OCTOBER 1, 2002

MINUTES

A meeting of the Board of Directors of HEALTHSOUTH Corporation (the "Corporation") was held in the Board Room at the Corporation's offices in Birmingham, Alabama pursuant to a Waiver of Notice dated October 1, 2002, a copy of which is attached to these Minutes.

The following Directors were present, constituting a quorum: Richard M. Scrushy, Chairman of the Board of the Corporation, William T. Owens, President and Chief Executive Officer of the Corporation, John S. Chamberlin, Phillip C. Watkins, M.D., George H. Strong, C. Sage Givens, Charles W. Newhall III, Larry D. Striplin, Jr., Joel C. Gordon, Robert P. May and Jon F. Hanson. The following guests were also present: Brandon O. Hale, Executive Vice President — Administration and Secretary of the Corporation, Malcolm E. McVay, Executive Vice President and Chief Financial Officer of the Corporation, William W. Horton, Executive Vice President and Corporate Counsel of the Corporation, Jason Hervey, Senior Vice President — Media and Communications of the Corporation, Eric R. Hanson of U.S. Strategies, Michael Rediker of Haskell Slaughter Young & Rediker, Hal M. Hirsch of Fulbright & Jaworski, L.L.P., and Lanny J. Davis of Patton Boggs, LLP.

Richard M. Scrushy acted as Chairman of the Meeting and Brandon O. Hale acted as Secretary.

The Meeting was called to order by Mr. Scrushy at 12:25 p.m. C.D.T.

Surgery Divestiture Update

Mr. Owens advised the Board that management gave a high-level presentation to a group of interested buyers in New York in a meeting arranged by the bankers. The Corporation is gauging the level of interest and will provide additional information to serious buyers. Mr. Owens stated that

the Corporation had not abandoned the split/spin strategy of the surgery division, but that it should evaluate other options if any develop.

Lawsuit Update

Mr. Rediker provided the Board with an update on the various shareholder lawsuits. He advised that the Corporation filed answers in 14 cases on September 30.

Fulbright & Jaworski Update

Mr. Hirsch presented to the Board a preliminary report of Fulbright & Jaworski's review of the Corporation's disclosures and related events surrounding CMS Transmittal 1753. Mr. Hirsch read a proposed letter to the Board, a copy of which is incorporated into these minutes. Mr. Hirsch then entertained questions from the Board.

Mr. Davis at that point added that he had agreed to undertake the assignment with HEALTHSOUTH only with the understanding that he must have complete transparency. Mr. Davis stated that he felt the Corporation had been completely open and transparent and at this point in time Fulbright & Jaworski had found nothing to indicate that Mr. Scrushy knew anything about the impact of CMS Transmittal 1753 at the time of his stock transactions in May and July 2002.

Appointment of Corporate Governance Committee

Mr. Scrushy proposed that the Board establish a Corporate Governance Committee to be made up of three outside Directors plus a minimum of two reputable independent advisors who are not members of the Board. The Directors serving on the Committee would make recommendations for such independent advisors, to be submitted to the full Board for approval. After discussion, upon motion duly made by Dr. Watkins and seconded by Mr. Striplin, the following resolutions were unanimously adopted:

> RESOLVED, that the following persons are hereby appointed to the Corporate Governance Committee of the Board of Directors, each to serve until the next Annual Meeting of the Board of Directors of this Corporation and until his

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successor is duly appointed and qualified, or until his earlier death, resignation or removal:

Robert P. May
Jon F. Hanson
John S. Chamberlin

RESOLVED, that the foregoing members of the Corporate Governance Committee shall consider and recommend to the Board of Directors of the Corporation for approval at least two independent persons who are not Directors, officers or employees of the Corporation to serve on the Corporate Governance Committee as special advisors.

Special Litigation Committee

Mr. Striplin advised the Board that he had resigned as Chairman of the Special Litigation Committee and that Mr. May had been elected to replace him. Mr. May then reported to the Board that the Special Litigation Committee had engaged Balch & Bingham LLP to serve as its counsel, would meet with counsel, and would keep the Board informed through routine reports to the Board.

Compensation Committee

Mr. Striplin advised the Board that the Compensation Committee recommended the following compensation for the Special Litigation Committee: $25,000 per year retainer, $2,500 for in-person Committee meetings and $1,000 for telephone Committee meetings.

Upon motion duly made by Mr. Striplin and seconded by Mr. Newhall, the following resolution was unanimously adopted:

RESOLVED, that compensation for the Special Litigation Committee of the Board of Directors is hereby set at a retainer of $25,000 per year, plus a fee of $2,500 for in-person meetings of the Special Litigation Committee and $1,000 for telephonic meetings of the Special Litigation Committee.

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Investor Relations Update

Mr. McVay advised the Board that the Corporation was in the process of reviewing its investor relations function with the objective of improving effectiveness, particularly with the major 100 investors. Mr. McVay stated that he would provide the board with more information at a subsequent Board meeting.

There being no further business to transact, the Meeting was adjourned.

Brandon O. Hale
Executive Vice President – Administration
and Secretary

Richard M. Scrushy
Chairman of the Board

HS-71662.1

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PW 0000165

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Fulbright & Jaworski L.L.p.
A Registered Limited Liability Partnership
666 Fifth Avenue, 31st Floor
New York, New York 10103-3198
www.fulbright.com

MEMORANDUM

Tab 14

ATTORNEY-CLIENT PRIVILEGED MATERIAL
ATTORNEY WORK PRODUCT DOCTRINE APPLIES

TO: William W. Horton

FROM: Hal M. Hirsch
Richard W. Beckler

DATE: March 6, 2003

RE: Recollection of Proceedings of October 22, 2002 Board of Directors Meeting of HealthSouth Corporation

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You have requested that we provide you with a memorandum containing our recollections of the proceedings of the meeting of the Board of Directors of HealthSouth that was held on October 22, 2002 (the "Meeting"). Mr. Hirsch attended the Meeting in person and Mr. Beckler attended the Meeting by conference telephone.

We remind you that we were not requested to take minutes of the Meeting and, therefore, did not undertake to prepare any minutes of the Meeting. Please also note that our recollection of the Meeting's proceedings may not accurately reflect the full content of the matters discussed at the Meeting and may omit some of the discussions held during the course of the Meeting. This memo should not be considered to be the minutes of the Meeting and the recollection of the proceedings provided in this memo is not intended to constitute advice as to the appropriate content of the minutes of the Meeting.

Our recollection is that the board members who attended the Meeting were Jack Chamberlin, Sage Givens, George Strong, Charles Newhall, John Hanson, Robert May, Larry Striplin, Richard Scrushy, and Phillip Watkins. Lanny Davis, of Patton Boggs LLP, also was a guest at the Meeting and was present by conference telephone. We cannot assure you, however, that this is a full and accurate list of the persons who attended the Meeting.

Set forth below is a synopsis of our recollection of the proceedings of the Meeting:

At the beginning of the Meeting, Mr. Scrushy stated that the Fulbright & Jaworski L.L.P. report would take up most of the Meeting.

Mr. Scrushy then reported that a national survey conducted by a corporate governance firm which graded public companies gave HealthSouth a grade of 75%; it

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gave The Walt Disney Company a grade of 5%. According to this survey, HealthSouth's grade put HealthSouth in the top 90% of companies surveyed.

Mr. Scrushy reported that he met with Herb Denton in New York, and that they had a good exchange. He stated to Mr. Denton that HealthSouth is cooperating with the SEC. Mr. Denton would propose individuals to sit on HealthSouth's Board of Directors and/or the corporate governance committee. Mr. Denton told Mr. Scrushy that he wanted to work with HealthSouth, although Mr. Scrushy mentioned to the Board that in the past Mr. Denton had gone hostile with other companies.

Mr. Scrushy informed the Board that he had met with Stephens, an Arkansas investment banking firm.

Mr. Scrushy reported that he had discussions with AIG, and at that point in time, they had only exchanged documents. AIG has a product which would relieve a company of potential litigation liability for a set price. Mr. Scrushy said that senior management of AIG discussed with Mr. Scrushy the possibility of HealthSouth buying out its potential litigation liability and AIG taking the risk of a judgment in the litigation. AIG indicated that they would be willing to review HealthSouth's litigation.

Mr. Hirsch then stated that Fulbright & Jaworski L.L.P. had prepared a report based on the firm's review of certain matters for the time period December 2001 through September 2002. Mr. Hirsch read the report of Fulbright & Jaworski L.L.P. to the Board. Following his reading of the report, in response to an inquiry, Mr. Hirsch stated that, as requested, there are no restrictions on the Board with respect to the use of Fulbright & Jaworski L.L.P.'s report, but he advised that because the report contains attorney-client privileged and attorney work product material, releasing the report or a summary thereof could result in a waiver of such privileges as to the matters contained in the report.

Joel Gordon's letter to Richard Scrushy was also discussed and Mr. Davis read a proposed response to Mr. Gordon. The Board felt that it was best not to respond in writing to Mr. Gordon's letter, though no decision was made.

Thereafter, a discussion ensued concerning additional data the Board sought concerning the Fulbright & Jaworski L.L.P. report. Mr. Scrushy suggested that, until this follow-up is completed, a press release should not be issued relating to the report of Fulbright & Jaworski L.L.P.

Mr. May inquired as to the contents of a possible press release on the matters contained in the Fulbright & Jaworski L.L.P. report. Mr. Davis discussed options for a press release.

Mr. May suggested that the chronology section of the report should not be released at that time because the Company's investigation was on-going and because there was a reference in the report to document destruction by Company personnel. Mr. Scrushy requested that Robert May, John Hanson and Fulbright & Jaworski L.L.P. investigate the document destruction matter further and report back to the Board in the next two weeks on the matter. Mr. Scrushy stated that it is important to understand what

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was destroyed and that he wanted clarification on the issue. He indicated that employees had been told not to destroy any documents. It was also discussed that it was possible that the document destruction was purely routine, because of HealthSouth's obligations under federal law to destroy patient information. Mr. Scrushy stated that he ordered the removal of all shredders from HealthSouth's corporate offices, and that such shredders were removed upon his request.

Mr. Scrushy requested that Fulbright & Jaworski L.L.P. also investigate further as to whether Transmittal 1753 or the group therapy policy addressed therein was discussed at the July 8, 2002 Monday Morning Meeting.

Mr. Hirsch stated that an accounting firm had been engaged to review the financial impact of Transmittal 1753.

The Board agreed, without adopting a resolution, that the Fulbright & Jaworski L.L.P. report would not be released to the press or sent to the SEC at that time, but that this should be done sooner rather than later.

The Board was reminded that the earnings release call was scheduled for November 5, and that every effort should be made to get the answers and report them prior to that date.

The Board then discussed the scheduling of its next meeting and decided it should be held on Tuesday, October 29, 2002.

HMH
RWB

PATTON BOGGS LLP
ATTORNEYS AT LAW

Tab 15

February 14, 2003

VIA FEDERAL EXPRESS

Mr. Richard M. Scrushy
Chairman of the Board
HealthSouth Corporation
One HealthSouth Parkway
Birmingham, AL 35243

Dear Richard:

Enclosed is a copy of minutes that Adam Goldberg took of the October 22, 2002 executive session of the Board of Directors. I wanted to ensure that you had a copy of the enclosed for two reasons: (1) it reflects the seriousness and appropriateness with which you and the Board of Directors have approached the applicable issues; and (2) in case it is responsive to any document requests in the civil litigation or government inquiries. I am sending it to you rather than Bill Horton because the minutes are of an executive session in which Bill did not participate.

Please call me if you have any questions.

Best regards,

Lanny Davis

Lanny J. Davis

Enclosure

Doc. 683777

HEALTHSOUTH CORPORATION
Minutes of Executive Session Board Meeting: October 22, 2002

This Board meeting was held in executive session – no officers of the company attended the meeting. The meeting was held by conference call, with certain Board members present at HealthSouth headquarters in Birmingham. The following Board members attended the meeting and were present at the Birmingham headquarters: Richard Scrushy (Chairman); Robert May; Larry Striplin, Jr.; and Phil Watkins. The following Board members participated in the meeting by telephone: Jon Hanson; C. Sage Givens; Jack Chamberlain; Joel Gordon; and George Strong. C. Sage Givens missed portions of the meeting. Also participating in the meeting were the following outside counsel: Lanny Davis (Patton Boggs); Dick Beckler (Fulbright & Jaworski); Hal Hirsch (Fulbright & Jaworski); and Adam Goldberg (Patton Boggs).

The Chairman called the meeting to order and described certain corporate matters. The Chairman informed the Board about the Chairman's meeting with Bert Denton and described it as positive. The Chairman also informed the Board about his meeting with AIG about the possibility of AIG assuming the liability risk from outstanding litigation for a set fee. The Chairman explained to the Board that he will be continuing discussions with AIG on that matter.

The Chairman then asked Lanny Davis, outside counsel, to provide additional information on the Denton and AIG meetings. Mr. Davis provided additional details on the meeting and on subsequent conversations that Mr. Davis had with Mr. Denton. Mr. Davis also provided additional information on the Chairman's meeting with AIG.

The Chairman then asked Hal Hirsch, outside counsel, to present findings of Fulbright & Jaworski to the Board related to the timing of the Chairman's stock transactions in May and July. Mr. Hirsch described his law firm's inquired, cautioned the Board about privilege issues related to dissemination of Fulbright's findings, and read a Fulbright & Jaworski report to the Board. A copy of the report read to the Board is attached to these minutes.

Following Mr. Hirsch's reading of the report, the Chairman then asked the Board if it had questions for outside counsel. Mr. Strong asked a question about a potential news release and Mr. Davis responded. The Chairman then asked Mr. Hirsch why no one got a copy of the report prior to the meeting and Mr. Hirsch explained that he wanted to avoid any appearance that his law firm's findings were influenced.

The Chairman then proposed that Robert May and Jon Hanson review the report and back-up materials collected by Fulbright & Jaworski, take comments from Board members, and report to the Board at a meeting to be held on October 29, 2002 on matters such as whether disciplinary action should be taken.

The Chairman also stated that the document destruction issues raised in the report must be pursued quickly. Mr. Hirsch explained that it is important for the Board to note that the company destroys certain documents in the normal course and practice to prevent competitors from getting information. Mr. Hirsh cautioned the Board that no one should jump to rash

conclusions. The Board then discussed related issues and Mr. Hirsch stated that Fulbright & Jaworski would supplement the report with respect to the document destruction issue. Mr. Hirsh reported to the Board that on the day that Mr. Hirsch informed the Chairman about document destruction, the Chairman ordered that the company's security office disconnect all shredders and lock them up in a room monitored by security.

Mr. Stripland then asked certain questions regarding the company's estimates of the financial impact of the May 2002 CMS rule change and the Chairman responded. The Chairman explained that FTI and Fulbright & Jaworski were examining the accuracy of the company's $175 million EBITDA estimate and that the Board should receive a report on such matters in the next week or two.

Robert May then informed the Board about certain matters relating to the Corporate Governance Committee chaired by Mr. May. Mr. May explained that he was working out matters with Barbara Franklin, Jack Kemp, and Connie Mack regarding their potential service as advisers to the Corporate Governance Committee. Mr. May also explained that the Committee was holding discussions with search firms to identify potential independent Board members.

Mr. May then asked Hal Hirsch a series of questions regarding Fulbright and Jaworski's findings as to when the Chairman, the Board, and members of the Compensation Committee were informed about certain matters. Mr. Hirsch responded.

The Chairman then ended the meeting.

HHEC 247-1857
Confidential Treatment
Requested by HealthSouth Corp.

Thomson Insider Activity

Tab 16

Highlights | Breaking News | Insider Ideas | Insider Reports by Symbol

SCRUSHY RICHARD M

HEALTHSOUTH CORP (HLSH)

	AVG RETURN 3 MO.	AVG RETURN 6 MO.	# OF DECISIONS 3 MO.	# OF DECISIONS 6 MO.	
BUY	**29.79%**	**27.10%**	**12**	**12**	**The stock was higher after 6 months for 8 out of the 12 buys.**
SELL	**2.16%**	**3.34%**	**28**	**28**	**The stock was lower after 6 months for 10 out of the 28 sells.**

Note: Number of decisions may exceed filings since a "decision" spans a seven day period.

CSFB Direct Page 1 o

TRANS TYPE	TRANS DATE(S)	SHARES	D/I OWN	PRICE RANGE(S)	MKT VALUE(S)	TOTAL HOLDINGS
X	09/11/02-09/11/02	1.08M	D	$3.78-$3.78	$4.10M	3.76M
X	05/14/02-05/14/02	5.28M	D	$3.78-$3.78	$19.95M	5.18M
S	05/14/02-05/14/02	5.28M	D	$14.05-$14.05	$74.12M	5.18M
B	02/28/00-02/28/00	10,000	D	$4.94-$4.94	$49,375	9,000
B	12/20/99-12/20/99	10,000	D	$4.94-$4.94	$49,375	5.17M
B	09/10/99-09/10/99	4.36M	D	$5.73-$5.73	$25.00M	5.16M
B	04/08/99-04/08/99	35,000	D/I	$9.06-$9.16	$318,126	700,134
B	10/01/98-10/08/98	61,000	D/I	$7.88-$10.25	$534,630	665,134
S	11/06/97-11/06/97	4,000	D	$27.00-$27.00	$108,000	604,134
X	11/06/97-11/06/97	2.20M	D	$2.89-$3.78	$7.81M	604,134
S	11/01/96-11/12/96	400,000	D	$37.38-$38.94	$15.26M	302,067
X	11/01/96-11/07/96	400,000	D	$5.04-$5.78	$2.29M	302,067
X	10/31/96-10/31/96	100,000	D	$5.04-$5.04	$504,000	302,067
S	10/31/96-10/31/96	100,000	D	$37.78-$37.78	$3.78M	302,067
S	10/31/96-10/31/96	100,000		$37.78-$37.78	$3.78M	302,067
B	08/31/93-08/31/93	10,000		$13.25-$13.25	$132,500	57,551
S	11/30/92-11/30/92	416,666		$24.00-$24.00	$10.00M	47,551
X	11/30/92-11/30/92	833,334	D	$0.00-$7.30	$3.04M	0
X	08/20/91-08/20/91	240,862	D	$7.42-$7.42	$1.79M	0
S	08/20/91-08/20/91	240,862		$36.25-$36.25	$8.73M	31,700
S	03/19/90-03/20/90	35,000		$17.88-$18.25	$635,050	275,000
S	01/03/90-01/03/90	3,000		$18.18-$18.18	$54,540	310,000
S	12/26/89-12/26/89	2,000		$17.00-$17.00	$34,000	310,000
S	06/19/89-06/19/89	35,000		$14.00-$14.00	$490,000	315,000
S	03/31/89-03/31/89	25,000		$11.25-$11.25	$281,250	350,000
S	11/06/87-04/07/88	35,000		$11.63-$12.63	$415,750	375,000

* = Amended Transactions

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✓ Sale of stock options in July also ($25 M)

✓ Send Kelly new ##

Tab 17

Documents Relating to Stock Sales By Richard Scrushy

Fulbright & Jaworski L.L.P.
Attorney Work Product

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

Documents Relating to Stock Sales By Richard Scrushy

May 2002 Option Transactions

A 1. Copies of the Company's 1991 and 1992 Stock Option Plan pursuant to which options were granted to Mr. Scrushy.

Attached hereto.

B 1. Stock option agreements relating to the options Mr. Scrushy exercised in May 2002:

(a) Option Agreement #1 – Dated Feb. 26, 1993, covering 3,900,000 shares at $4.1875 per share and expiring May 14, 2002.

The original agreement is attached hereto. As explained below, this agreement was superceded by a "Re-Price" Agreement, a copy of which we have not yet been provided. 1,624,640 shares were exercised and sold on 11/6/97. 2,275,360 shares were exercised and sold on 5/14/02.

(b) Option Agreement #2 -- Dated Feb. 26, 1993, covering 3,000,000 shares at $4.1875 per share and expiring June 16, 2002.

The original agreement is attached hereto. As explained below, this agreement is superceded by the "Re-Price" Agreement referred to in (c), below

(c) "Re-Price" Option Agreement, dated April 20, 1993, covering the 3,000,000 shares referred to in (b), above, at $3.7825 per share and expiring June 16, 2002.

This was exercised in full and Mr. Scrushy immediately sold on May 14, 2002. A copy of the agreement is attached hereto.

NOTE: The Company confirmed that agreements referenced in (a) and (b) above were superceded by the "Re-Price" Agreements; however, these new agreements were dated the same date and did not reference the original stock option agreements. We were told that the original option agreements in (a) and (b) are no longer in force. The Form 4 for Mr. Scrushy indicates an exercise at $3.7825. If there was merely a re-price -- the option agreement setting forth the price change for option agreement (a) as the Form 4 provides that the exercise thereof was at $3.7825 as well. We have not seen a new Form 4 or 5 representing the new option grant at the lower prices.

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

C 7. All minutes/consents/other correspondence of the board of directors AND the Compensation Committee of the Board relating to the approval of the exercise and sale of the 5,275,360 shares on May 14, 2002 by Richard Scrushy, including all attachments to the minutes and consents used by the board/compensation committee to make their decision to approve.

We have not yet received any minutes/consents or other correspondence relating to the approval of the exercise/sale.

D 8. All emails/memos/documents to or from HealthSouth personnel describing the proposed exercise/sale by Mr. Scrushy of the 5,275,360 shares.

We do not have documents responsive to this item.

E 9. All correspondence from HealthSouth to the Company's transfer agent regarding the exercise/sale of the 5,275,360 shares, and a copy of all opinions of counsel to the transfer agent regarding the issuance of share certificates without a legend upon such exercise and sale.

We have a letter to Mellon Investor Services, dated May 15, 2002, which is attached hereto.

F 10. A copy of the Form S-8 registration statement filed by HealthSouth with the SEC regarding the sale of shares exercised and sold pursuant to the Scrushy Option Agreements.

We have not received the appropriate S-8. We have received many S-8s, but the S-8 relating to the 1991 Stock Option Plan was not provided. Also, this S-8 was not on the EDGAR database because it most likely was not filed with the SEC electronically.

<u>July 2002 Stock Surrender to HealthSouth to Satisfy Loan</u>

G 11. 1999 Equity Loan Plan

A draft copy of the plan is attached hereto.

H 12. The Proxy Statement relating to the 1999 Annual Meeting of the Stockholders of HealthSouth, and the Certificate of Tabulation of the Inspector of Elections for the 1999 Annual Meeting indicating approval of the plan by the Stockholders.

A copy of the proxy statement was provided and is attached hereto. We have not been provided with the certificate of tabulation evidencing the approval

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

by the stockholders of the plan. In addition, a copy of the 2002 proxy statement is attached hereto.

I 9. Loan agreement between HealthSouth and Richard Scrushy pursuant to which Mr. Scrushy borrowed the principal amount of $25,218,114.87, plus interest and all documents entered in connection with this loan, including, but not limited to, a pledge agreement, security agreement and the related UCC-1.

The Promissory Note was provided and is attached hereto. Please note: The note provides that payment may only be made in "legal currency of the United States." This indicates that surrender of stock in lieu of cash would require approval of the board and a written waiver by HealthSouth. This has not been provided. We have also received a copy of the Security Agreement covering the shares. A copy is attached.

J 10. All minutes/consents of the board of directors AND the Compensation Committee of the Board relating to the approval of the surrender of the 2,506,770 shares on July 31, 2002 by Richard Scrushy, including all attachments to the minutes and consents used by the board/compensation committee to make their decision to approve.

We have not received any minutes or consents approving the surrender. The "Chronology" provided that the board and comp committee approved this transaction, but we have not yet been provided evidence.

K 11. All emails/memos/documents to or from HealthSouth personnel describing the proposed surrender by Mr. Scrushy of the 2,506,770 shares.

Other than July 24, 2002 email from Horton to Comp Committee for approval of surrender, we have not received any emails/memos/correspondence, except for an email, dated August 1, 2002, from Horton to Scrushy regarding imputed interest. The July 24 email recommends approval, but does not refer to any 1753 issues or potential lower earnings.

L 12. A copy of the canceled certificate representing the 2,506,770 shares surrendered to HealthSouth and a copy of the certificate held by Mr. Scrushy representing the remaining 1,855,527 shares (purchased pursuant to the Loan) that Mr. Scrushy did not surrender.

We have a copy of a statement from Salomon Smith Barney evidencing the sale and transfer of HealthSouth shares. We do not have any stock certificates.

M 13. A copy of all documents relating to the repayment of the $25,218,114.87 loan, including acknowledgment of payment of interest and release of the remaining

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

1,855,527 shares from all liens provided in the Security Agreement and Pledge Agreement.

Attached is: (a) a memo to McVay, etc. asking them to provide for the transfer of 2,506,770 shares to the Company's treasury account, (b) a letter from Horton to Salomon Smith Barney asking them to transfer 2,506,770 shares to the HealthSouth treasury account, providing that the surrender of such shares was approved by HealthSouth and instructing SSB to release all liens and transfer restrictions with respect to the remaining 1,855,527 shares held by Mr. Scrushy, and (c) a letter dated 8/24/01 to SSB providing that HealthSouth WOULD have not objection to a SALE of stock and use of those proceeds to pay back the loan – This letter does not provide that surrender of the stock itself is approved.

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

0001
1 UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
2 SOUTHERN DIVISION

Tab 18

3
UNITED STATES OF AMERICA,) CR-03-C-195-S
4)
Plaintiff,) Birmingham, Alabama
5)
vs.) May 1, 2003
6)
MALCOLM E. McVAY,) 2:35 P.M.
7)
Defendant.)
8 ----------)

9

TRANSCRIPT OF PLEA
10 BEFORE HON. U. W. CLEMON
CHIEF UNITED STATES DISTRICT JUDGE
11

12 APPEARANCES:

13 FOR THE PLAINTIFF: HON. GEORGE A. MARTIN, JR.
Assistant U.S. Attorney
14 1801 Fourth Avenue North
Birmingham, AL 35203
15

16

17 FOR THE DEFENDANT: HON. WILLIAM A. KIMBROUGH, JR.
Attorney at Law
18 1359 Dauphin Street
Mobile, AL 36604
19

20

21 COURT REPORTER: Penny L. Enoch
325 Federal Courthouse

to do so, yes.

THE COURT: All right.

Q. Now, Mr. McVay, if you will tell me what you did which

resulted in your being charged with these crimes.

A. Your Honor, I signed a financial statement for the third

quarter of 2002 in November last year after someone had told me

that in prior periods, prior to that third quarter, there had

been irregularities in the numbers. And I knew that and signed

the document anyway.

Q. Who told you to sign the document?

A. I -- I signed it myself.

0014

1 Q. No one told you? You signed the document knowing that it

2 contained false entries?

3 A. Yes, Your Honor.

4 Q. All right. But someone told you that that had been done in

5 the past?

6 A. Yes, Your Honor.

7 Q. Who told you that?

15 to do so, yes.

16 THE COURT: All right.

17 Q. Now, Mr. McVay, if you will tell me what you did which

18 resulted in your being charged with these crimes.

19 A. Your Honor, I signed a financial statement for the third

20 quarter of 2002 in November last year after someone had told me

21 that in prior periods, prior to that third quarter, there had

22 been irregularities in the numbers. And I knew that and signed

23 the document anyway.

24 Q. Who told you to sign the document?

25 A. I -- I signed it myself.

0014

1 Q. No one told you? You signed the document knowing that it

2 contained false entries?

3 A. Yes, Your Honor.

4 Q. All right. But someone told you that that had been done in

5 the past?

6 A. Yes, Your Honor.

7 Q. Who told you that?

8 A. A representative -- a person from the Accounting Department

9 at HealthSouth named Emery Harris.

10 Q. Emery Harris told you that. Did Richard Scrushy tell you to

11 sign a false document?

12 A. Your Honor, I'm -- just hesitating -- he -- he and I did

13 have discussions prior to my signing that document. He was

14 aware that I was signing the document with knowledge that prior

15 numbers were incorrect.

16 Q. All right. Tell me about that.

17 You say you and Mr. Scrushy had discussions. What did you

18 say to him and he say to you?

19 A. The discussions centered around the fact that the cash on

20 the balance sheet -- that the balance sheet showed was higher

21 than what in actuality was the amount of cash.

22 Q. All right. And you told him that?

23 A. Yes, sir, on -- we had those discussions on -- on numerous

24 occasions.

25 Q. But, yes, you told him that the -- that the figures did not

reflect the true amount of cash on hand?

A. With the -- the conversation was such, Your Honor, that -- I

mean, he -- he was already aware of that situation.

Q. How do you know he was already aware of it?

A. Based on the -- the nature of the conversation itself.

Q. Well, tell me what he said, and then maybe I can get a

better understanding of it.

A. His comment was something -- paraphrase, he said that he had

bought numerous companies and all companies had accounting --

play games with the accounting.

And that was prior to my leaving his office with the

expectation that I would be signing that document.

Q. All right. So what he said was that he had bought previous

companies and that all companies play games with the accounting?

A. That's correct.

Q. So did he tell you that HealthSouth had done so in the past?

A. Just prior to -- to that comment when I left the office --

18 Q. Yes, sir.

19 A. -- I -- we discussed the fact that the cash on the balance

20 sheet was -- was greater than what it actually was, I -- I

21 don't remember whether I bought up the subject or he brought up

22 the subject, but we had the conversation.

23 And that was followed by his -- his consolation to me that,

24 you know, in essence -- the way I took it anyway, Your Honor --

25 was that it was okay to sign the document, because he knew from

0016

1 experience that that was commonplace, that companies that he had

2 bought had irregularities in numbers.

3 Q. All right. Now, how great was the disparity between the

4 fact and the fiction, in terms of numbers?

5 A. At that time, Your Honor, I -- I wouldn't know the -- I did

6 not know the answer to that question.

7 I did know from my prior experience at the company that the

8 cash shown on the balance sheet, you know, seemed larger than

9 what actually felt like we had to operate the company. But I

10 didn't know an exact discrepancy amount at that time.

11 Q. So you didn't know what the true figures were?

12 A. Not precisely, Your Honor. I knew that it was --

13 Q. Did you have a general feeling of what the true figures

14 were?

15 A. Yes, sir. I mean, we -- we were showing on the balance

16 sheet at that time approximately $400 million in cash, and it

17 was a struggle at quarter end to -- to pay down debt; which

18 indicated to me, you know, that the disparity should be in the

19 several hundred million dollar range.

20 Q. All right. So, the disparity may have been as high as $200

21 million?

22 A. I -- I would -- at that time, I would think that was within

23 the realm of possibility.

24 Q. And is that a high figure or a low figure?

25 A. For a company like HealthSouth?

0017

1 Q. No. In estimating the disparity, is $200 million a high

2 figure or a low figure?

3 A. I would say that at that time, given my feeling that we had

4 very little cash to operate, I did understand that certain cash

5 you cannot use to operate, it's in deposit or on account or --

6 you know, for some reason you can't use.

7 But my feeling would be that it would be -- that would be

8 low, that it would be probably 2 -- you know, somewhere greater

9 than 200, but less than 400.

10 Q. All right. And whose job -- as between you and Mr. Scrushy,

11 who would be in a better position to know what the actual cash

12 on hand was?

13 A. You know, that's -- that's difficult, because I assumed the

14 title of CFO on August 27th, 2002; and that discussion would

15 have been -- and I was informed of the discrepancy from prior

16 periods, I believe, to the best of my knowledge, in

17 mid-September.

18 And then this --

19 Q. Who gave you that information?

20 A. Mr. Harris.

Q. All right.

A. And so I had not been on the job very long to -- that's the

reason, I guess, I didn't have a good feeling for what that

level of disparity was.

Q. All right. Do you have any reason to believe that

18 Mr. Scrushy knew the range of the disparity, the seriousness of

it?

A. I do, Your Honor. Based again on the nature -- I know for a

4 fact he did from subsequent conversations that I had with him

5 after I signed the document.

6 Q. And what were those conversations?

7 A. There -- there were conversations where the amount of the

8 disparity in the cash was discussed openly with Mr. Scrushy

9 present; and discussions centered around ways that that

10 discrepancy could be corrected, with Mr. Scrushy fully

11 understanding the level of the discrepancy.

12 Now, again, that occurred after -- after the conversation

13 that I alluded to earlier in his office.

quarter financial results that I signed were correct, they

were correct -- they were real -- the income statement the

third quarter.

But by signing the 10-Q, it had as accompanying financial

information the old income statement numbers that I knew were

wrong, and it had a balance sheet that was wrong.

So, I understood -- I mean, to the best of my knowledge to

you -- I mean, to answer that question -- I was fixated on my

third quarter results as CFO. The one quarter I signed off on

was -- what I was told later, the only quarter that was clean in

the history of the company. I don't know whether that's true or

not, but that was what I sort of hung my hat on at that time.

But, Your Honor, I did know that there was accompanying

information from prior periods that had been told to me was

incorrect. I didn't have the ability or time at that point to

determine for myself exactly what anything was. But I had been

14 Q. When did that occur?

15 A. One -- the one example I'm alluding to occurred on -- on or

16 around January 2nd, 2003, the date that I was -- I removed from

17 the CFO title that I had been given on August 27th.

18 Q. All right. And who was present for that conversation?

19 A. Mr. Scrushy and Mr. Owens.

20 Q. All right. Did at all material times you know what you were

21 doing?

22 A. The material -- I would -- by interpretation of the material

23 time is when I signed that document --

24 Q. Yes, sir.

25 A. -- and yes, sir, I understood that prior numbers had been

0019

1 messed with, and I signed the document.

2 Q. So you knew that you were committing a crime when you signed

3 the document?

4 A. Yes, Your Honor.

5 Q. And you willfully did so?

6 A. Your Honor, I was fixated at that point that the third

7 quarter financial results that I signed were correct, and they

8 were correct -- they were real -- the income statement on the

9 third quarter.

10 But by signing the 10-Q, it had as accompanying financial

11 information the old income statement numbers that I knew were

12 wrong, and it had a balance sheet that was wrong.

13 So, I understood -- I mean, to the best of my knowledge to

14 you -- I mean, to answer that question -- I was fixated on my

15 third quarter results as CFO. The one quarter I signed off on

16 was -- what I was told later, the only quarter that was clean in

17 the history of the company. I don't know whether that's true or

18 not, but that was what I sort of hung my hat on at that time.

19 But, Your Honor, I did know that there was accompanying

20 information from prior periods that had been told to me was

21 incorrect. I didn't have the ability or time at that point to

22 determine for myself exactly what anything was. But I had been

23 told that, and I signed the document.

24 Q. Well, was your signing of this document the extent of your

25 participation in this conspiracy?

0020

1 A. Yes, Your Honor.

2 Q. All right. But you willfully signed the document, knowing

3 that it was not true?

4 A. Yes, Your Honor.

5 Q. All right. And this happened here in the Northern District

6 of Alabama?

7 A. Yes, Your Honor. Birmingham.

8 Q. All right.

9 THE COURT: Anything else that the government would

10 show as a factual basis?

11 MR. MARTIN: Judge, I would just add in support of the

12 wire fraud part of the conspiracy that the document he signed

13 was wired to Washington, D.C. --

14 THE COURT: All right.

15 MR. MARTIN: -- and filed with the SEC.

16 Q. Do you disagree with that, Mr. McVay?

001

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

Tab 19

UNITED STATES OF AMERICA,	)	CR-03-C-191-S
	)	
Plaintiff,	)	Birmingham, Alabama
	)	
vs.	)	May 1, 2003
	)	
MICHAEL MARTIN,	)	2:00 P.M.
	)	
Defendant.	)	
----------	)	

TRANSCRIPT OF PLEA
BEFORE HON. U. W. CLEMON
CHIEF UNITED STATES DISTRICT JUDGE

APPEARANCES:

FOR THE PLAINTIFF: HON. GEORGE A. MARTIN, JR.
Assistant U.S. Attorney
1801 Fourth Avenue North
Birmingham, AL 35203

FOR THE DEFENDANT: HON. MARK HULKOWER
Attorney at Law
1330 Connecticut Avenue NW
Washington, DC 20036
1-202-429-6221

COURT REPORTER: Penny L. Enoch
325 Federal Courthouse
1729 Fifth Avenue North
Birmingham, AL 35203

7 follow?

8 A. I am.

9 THE COURT: Mr. Hulkower, are you satisfied that your

10 client has a sufficient understanding of the guidelines to make

11 his plea a knowing plea?

12 MR. HULKOWER: I am, Your Honor. Mr. Martin and I have

13 discussed this extensively, and he's exhibited a good command of

14 the guidelines based on those discussions, and he understands

15 the proceedings today.

16 THE COURT: All right.

17 Q. Now, Mr. Martin, tell me what you did which resulted in your

18 being charged with these crimes.

19 A. Your Honor, I was CFO at HealthSouth from late 1997 to early

20 2000. During that time, at the direction of the HealthSouth

21 CEO, I signed the company's 10-K and 10-Qs filed with the SEC --

22 Q. Now, you are reading to me a statement?

23 A. Yes, sir.

24 Q. Do you have a copy of it so that I can read along with you?

15 MR. HULKOWER: May I approach, Your Honor?
0011
1 THE COURT: Yes.

2 (Approaching bench and handing document to the Court.)

3 THE COURT: Thank you.

4 A. As I said, Your Honor, I was CFO at HealthSouth from 1997 to

5 early 2000. During that time, at the direction of the

6 HealthSouth CEO --

7 Q. That's Richard Scrushy?

8 A. Yes, sir.

9 Q. All right.

10 A. -- I signed the company's 10-Ks and 10-Qs filed with the SEC

11 knowing that a number -- that the numbers contained in the

12 filings were false. These numbers were fabricated in order to

13 give the appearance that HealthSouth (sic) meeting expectations

14 regarding earnings.

15 I ultimately became unwilling to engage in any such further

16 activity as required by the CEO and resigned as CFO in February

17 2000. I deeply regret my conduct in this matter, sir.

18 Q. All right. Mr. Martin, did you at Mr. -- did you and

19 Mr. Scrushy discuss the fact that the numbers contained in the

20 filings were false?

21 A. Yes, sir.

22 Q. Beginning at what point?

23 A. The first time was in 1993.

24 Q. All right. And what happened in 1993?

25 A. We were going to list earnings, and we had to make an

0012

1 acquisition to -- to make up the difference in earnings.

2 Q. And what happened?

3 A. We made an acquisition and were able to make the earnings

4 up.

5 Q. All right. Did he direct you to do something -- did

6 Mr. Scrushy direct you to do something with the numbers?

7 A. Yes, sir.

8 Q. What did he direct you to do?

9 A. To inflate the numbers.

10 Q. He told you specifically to inflate the numbers?

11 A. Yes, to fix the numbers so that they met the Street's

12 expectations.

13 Q. So that was basically his -- his statement to you, fix the

14 numbers so that they meet the expectations?

15 A. Yes, sir.

16 Q. All right. And at that time, you know that he knew that the

17 numbers to which he had asked -- numbers about which he had

18 asked you to fix, he knew that those numbers represented the

19 true condition?

20 A. I'm sorry --

21 Q. Let me rephrase it.

22 Mr. Scrushy knew that the numbers that you initially

23 presented to him in 1993 presented a true condition of the

24 company's finances?

25 A. Yes, sir.

0013

1 Q. All right. And then when he looked at those numbers, he

2 then told you to fix them?

3 A. He not only told me, told a number of senior executives.

4 Q. In your presence?

5 A. Yes, sir.

6 Q. All right. And this was in 1993?

7 A. No, sir. Later -- I became CFO in 1997 --

8 Q. All right.

9 A. -- and that is when, you know, I saw the real numbers -- I

10 was treasurer before that -- but that's when I saw the real

11 numbers. And I'd have monthly meetings with him and other

12 senior executives relating to the shortfall in the numbers.

13 Q. All right. And what did he say beginning in 1997 when you

14 became the CFO?

15 A. He said, "you guys figure it out."

16 Q. All right. Did he tell you again as explicitly as he had

17 done in 1993 to fix the numbers?

18 A. Yes, Your Honor, he did.

19 Q. When did he tell you, after you became CFO, to fix the

20 numbers?

21 A. Virtually every month.

22 Q. Every month?

23 A. Yes, sir. We weren't making the numbers.

Q. All right. All right. And you say that sometimes gave

you those directions in the presence of other persons?

014

1 A. Yes, sir.

2 Q. And who were they?

3 A. William T. Owens, the controller at that time.

4 Q. All right. Anyone else?

5 A. In particular, Bill Owens and I would meet with Richard

6 every month to go over those numbers. And if we weren't making

7 the numbers, you know, he'd say, "go figure it out."

8 Q. Pardon me?

9 A. He would say, "go figure it out."

10 Q. Did he say that before you presented the numbers to him or

11 afterward?

12 A. After.

13 Q. I see. All right. And then after he would tell you to "go

14 figure it out," then you and Mr. Owens would meet with other --

15 meet with personnel in the financial departments, auditing,

16 whatever, and have them inflate the numbers?

17 A. Yes, sir.

18 Q. All right.

19 MR. HULKOWER: Your Honor?

20 THE COURT: Yes, sir.

21 MR. HULKOWER: If I may, so the record is clear, from

22 time to time there were others present. Some of the others are

23 not mentioned in court documents at this point and have not

24 entered pleas.

25 THE COURT: All right. Who were the others?

0015

1 MR. HULKOWER: Out of an abundance of caution, I have

2 asked Mr. Martin, since their names haven't been made public,

3 not to volunteer them.

4 THE COURT: Yes, sir. But I'm now directing him to

5 answer.

6 MR. HULKOWER: Okay.

7 THE WITNESS: Weston Smith, Leif Murphy --

8 Q. And who was Weston Smith?

9 A. He was head of Reimbursement.

10 Q. All right.

11 A. Leif Murphy was the Assistant Treasurer.

12 Q. All right.

13 A. And I'm sorry, in terms of the question, I'm --

14 Q. Yes. What other persons were present at the time when

15 Mr. Scrushy directed you to fix the numbers?

16 A. Bill Owens and Leif Murphy.

17 Q. All right. And Mr. Weston?

18 A. I believe Weston was at some point.

19 Q. All right. Anyone else?

20 A. No, sir.

21 Q. All right. And would these directions have been given at

22 some point since 1999?

23 A. Well, I left at the end of -- the very beginning of 2000.

24 Q. All right. So the directions were given from the time that

25 you became the Chief Financial Officer until the time that you

0016

1 resigned?

2 A. I can only speak for the time I was there, Your Honor.

3 Q. Yes, sir, that's what I'm asking you about.

4 A. Up until I resigned.

5 Q. Yes. All right. And the numbers that you eventually

6 provided were false numbers?

7 A. Yes, sir.

8 Q. And you knew it, Mr. Owens knew it, Mr. Weston knew it, and

9 Mr. Scrushy knew it?

10 A. Yes, sir.

11 Q. All right. So you knew that you were committing not just a

12 crime, but several crimes, over a period of time?

13 A. Yes, sir.

14 Q. And you willfully did it?

15 A. Yes, sir.

16 Q. All right. Now, there is a factual basis -- let me ask you

17 this -- give me your best judgment as to the number of times

18 that Mr. Scrushy directed you to fix the numbers.

19 A. It was virtually every month while I was CFO. So that would

20 have been, what, 24 months or so.

21 Q. All right.

22 THE COURT: Well, that's a sufficient factual basis for

23 me.

24 Does the government have anything else that it wishes to add

25 as a factual basis?

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF ALABAMA

SOUTHERN DIVISION

ITED STATES OF AMERICA	)	
	)	
v.	)	**Tab 20**
	)	
LLIAM T. OWENS,	)	
fendant	)	

RULE 11(f) FACTUAL BASIS FOR GUILTY PLEA

COMES NOW the United States of America through its undersigned counsel, for the pose of satisfying the requirements of Federal Rule of Criminal Procedure 11(f), submits the llowing Factual Basis in support of the guilty plea of **WILLIAM T. OWENS**:

1. Defendant **WILLIAM T. OWENS** was employed at HealthSouth Corporation. *HealthSouth*") since 1986 in various capacities, including Chief Financial Officer from ebruary 2000 to August 2001, President and Chief Operating Officer from August 2001 to ugust 2002, President and Chief Executive Officer from August 2002 to January 2003 and xecutive Vice President and Chief Financial Officer from January 2003 until the present. Defendant **OWENS** is licensed as a certified public accountant.

2. *HealthSouth* was formed around 1984. Since in or about 1986, when it made its nitial Public Offering (IPO), *HealthSouth* has been an issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934, required to file reports under said Act. *HealthSouth*'s common stock was listed on the New York Stock Exchange. *HealthSouth* claims o be the nation's largest provider of outpatient surgery, diagnostic imaging and rehabilitative health care services with approximately 1,800 locations in all 50 states, Puerto Rico, the United

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Kingdom, Australia, and Canada. Millions of its shares have been traded since it made its offering.

3. Beginning at least in or about 1996, defendant **OWENS** and *HealthSouth's* current Chief Executive Officer (the "CEO"), other *HealthSouth* senior executives and others recognized that *HealthSouth's* financial results were failing to produce sufficient earnings per share to meet or exceed Wall Street "earning expectations" or "analyst expectations." The difference between *HealthSouth's* true and correct earnings per share and the Wall Street expectations was referred to internally at *HealthSouth* as the "gap" or the "hole." The CEO, defendant **OWENS**, and others recognized that the earnings shortfall created a substantial risk that unless *HealthSouth's* earnings per share were artificially improved, *HealthSouth's* earnings would fail to meet analyst expectations and the market price of *HealthSouth's* securities would therefore decline. The value of stock options owned by, and bonuses paid to certain *HealthSouth* senior officials, including the CEO, depended, in part, on *HealthSouth* meeting earnings projections.

4. The CEO, defendant **OWENS**, and others agreed to engage in an illegal scheme to inflate artificially *HealthSouth's* publicly reported earnings and earnings per share and to falsify reports of *HealthSouth's* financial condition. Defendant **OWENS** presented the CEO with financial information, which would ordinarily be reflected in monthly and quarterly reports that were to be made available to the public through the SEC filings. When those reports showed that the company did not or would not meet market ("Wall Street") expectations, the CEO demanded that the reports be changed to meet or exceed those expectations.

5. The CEO and defendant **OWENS** issued instructions as to the desired earnings hare number and *HealthSouth's* accounting staff met to discuss ways to inflate artificially *thSouth's* earnings in order to meet the Wall Street earnings expectations. These meetings known as "family" meetings and the attendees were known as the "family." At the dings the "family" members discussed how members of the accounting staff would falsify *lthSouth's* books to fill the "gap" or "hole" and meet the desired earnings.

6. Defendant **OWENS** and others made and caused to be made false and fraudulent ries in *HealthSouth's* books and records for the purpose of inflating artificially *HealthSouth's* nings and earnings per share. Methods used for artificially inflating *HealthSouth's* earnings d earnings per share included falsifying the "contractual adjustment" account and decreasing her expenses. After manipulating the "contractual adjustment" and other expense accounts to ficially inflate revenue on the Income Statement, corresponding fraudulent adjustments were ade to increase assets and decrease in liabilities on *HealthSouth's* Balance Sheet. Thus, false nd fraudulent entries were made to accounts in *HealthSouth's* books and records including, but ot limited to, the: (1) Property, Plant and Equipment ("PP&E") account; (2) cash account; (3) nventory account; and (4) intangible asset (goodwill) accounts. Each of these accounts were eported in *HealthSouth's* Balance Sheets. As defendant **OWENS** and his co-conspirators well knew, there was no justification in fact, or under GAAP, for these entries.

7. Defendant **OWENS** became aware that *HealthSouth's* accounting personnel designed the fictitious accounting entries to avoid their detection. For example, if the accounting staff decided to increase inventories, it would increase inventory accounts at various *HealthSouth* facilities by different false amounts because they knew that if amounts were increased uniformly,

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suspicions of the auditors might be raised. In addition, since the *HealthSouth* accounting staff knew that auditors questioned additions to the PP&E account that exceeded a certain threshold, the bogus additions to PP&E at a particular facility were kept below the threshold.

8. Defendant **OWENS** and others made and caused to be made false and fraudulent journal entries in *HealthSouth's* books and records knowing and intending (1) that such journal entries would ultimately be reflected in *HealthSouth's* financial statements and public filings with the SEC; (2) that *HealthSouth's* financial statements and public filings would falsely overstate *HealthSouth's* revenue, earnings and earnings per share; and (3) that the investing public would rely upon such overstated earnings.

9. Defendant **OWENS**, the CEO and others caused *HealthSouth* to file publicly with the SEC annual reports and quarterly reports that materially misstated, among other things, *HealthSouth's* net income, revenue, earnings per share, assets, and liabilities from at least 1999 until the present. As a result of the scheme, *HealthSouth's* revenue and earnings were inflated by hundreds of millions of dollars on publicly filed reports. For example, the Balance Sheet included in *HealthSouth's* 10-Q for the second quarter of 2002 overstated gross PP&E by approximately $1 billion, or approximately 33% of the total PP&E reported. The amount of cash on the same 10-Q was overstated by more than $300 million and *HealthSouth's* total gross assets were overstated by more than $1.5 billion.

10. In or about August 2002, in order to cover up and conceal the materially false and misleading financial information which *HealthSouth* had provided to the SEC and the public in the past, the CEO, defendant **OWENS**, and the Chief Financial Officer (the "CFO") at that time, met and discussed the need for the CFO to sign and file with the SEC a statement which would

ertify that *HealthSouth's* financial statements fairly presented, in all material respects, ncial condition and results of *HealthSouth.*

11. The CEO, defendant **OWENS,** and the CFO also agreed that the CFO would sign use to be filed with the SEC a statement certifying that *HealthSouth's* 10-Q for the second r of 2002 fairly presented, in all material respects, the financial condition and results of *hSouth*, when in truth and fact, they knew that the 10-Q contained materially false and ding information.

12. On or about August 14, 2002, defendant **OWENS** wilfully caused to be mitted by wire from Birmingham, Alabama to the SEC, in Washington, D.C., the 1350 ment certifying that *HealthSouth's* 10-Q for the second quarter of 2002 fairly presented, in aterial respects, the financial condition and results, when in truth and fact, he knew that the Q contained materially false and misleading information. This document was signed by the O and the CFO who also knew that the periodic report attached to the 1350 statement, *lthSouth's* second quarter 10-Q, contained materially false information.

13. Defendant **OWENS** wilfully and knowingly caused to be signed and transmitted wire from Birmingham, Alabama to Washington, D.C. for delivery to the SEC other reports *HealthSouth's* financial results and financial condition which he knew to contain materially lse information or which omitted material information. These included the above- referenced 0-Q for the second quarter of 2002 and *HealthSouth's*10-Q for the third quarter of 2001 which vas filed on or about November 13, 2001.

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14. This document does not set forth the complete and full extent of defendant **OWENS'** knowledge about criminal activity at HealthSouth, but is intended only to provide a factual basis for his plea of guilty to an Information filed against him by the government.

ALICE H. MARTIN
United States Attorney
Northern District of Alabama

GEORGE A. MARTIN
Assistant United States Attorney
Northern District of Alabama

MIKE RASMUSSEN
Assistant United States Attorney
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Deputy Chief, Fraud Section
Criminal Division
United States Department of Justice

RICHARD N. WIEDIS
Senior Trial Attorney, Fraud Section
Criminal Division
United States Department of Justice

EXECUTIVE COMPENSATION -- GENERAL **Tab 21**

The following table sets forth compensation paid or awarded to our Chief Executive Officer and each of our other four most highly compensated executive officers (the "Named Executive Officers") for all services rendered to HEALTHSOUTH and our subsidiaries in 1997, 1998 and 1999.

SUMMARY COMPENSATION TABLE DOES NOT include stock sales

<TABLE>
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NAME AND CURRENT POSITION	YEAR	ANNUAL COMPENSATION SALARY	BONUS/ANNUAL INCENTIVE AWARD	L STOCK OPTIO AWARD
<S>	<C>	<C>	<C>	<C>
Richard M. Scrushy	1997	$ 3,398,999	$ 10,000,000	1,300,00
Chairman of the Board	1998	2,777,829	--	1,500,00
and Chief Executive Officer(2)	1999	1,634,031	--	1,050,00
James P. Bennett	1997	639,161	1,500,000	700,000
President and Chief	1998	670,000	--	300,000
Operating Officer	1999	589,058	--	275,000
Michael D. Martin	1997	359,672	2,000,000	450,000
Executive Vice President --	1998	415,826	--	260,000
Investments	1999	362,810	--	200,000
P. Daryl Brown	1997	370,673	450,000	250,000
President -- Ambulatory	1998	386,212	--	75,000
Services -- East	1999	336,920	--	125,000
Robert E. Thomson	1997	305,376	500,000	250,000
President - Inpatient Operations	1998	327,928	--	150,000
	1999	402,987	--	125,000

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(1) Includes car allowances of $500 per month for Mr. Scrushy and $350 per month for the other Named Executive Officers in 1997, use of a company-owned automobile by Mr. Scrushy in 1998, and car allowances of $500 per month for Mr. Scrushy and $450 per month for the other Named Executive Officers through September 1998. All such car allowances were discontinued in October 1998. Also includes (a) matching contributions under HEALTHSOUTH's Retirement Investment Plan for 1997, 1998 and 1999, respectively, of: $791, $1,450 and $745 to Mr. Scrushy; $1,425, $1,499 and $1,500 to Mr. Bennett; $1,324, $1,395 and $1,212 to Mr. Martin; $1,319, $1,415 and $1,212 to Mr. Brown; and $1,001, $1,070 and $736 to Mr. Thomson; (b) awards under HEALTHSOUTH's Employee Stock Benefit Plan for 1997, 1998 and 1999, respectively, of $2,889, $2,882 and $1,292 to Mr. Scrushy; $2,889, $2,882 and $1,292 to Mr. Bennett; $2,889, $2,882 and $1,292 to Mr. Martin; $2,889, $2,882 and $1,292 to Mr. Brown; and $2,889, $2,882 and $1,292 to Mr. Thomson; and (c) split-dollar life insurance premiums paid in 1997, 1998 and 1999 of $11,750, $45,187 and $52,108 with respect to Mr. Scrushy; $1,644, $1,661, and $1,558 with respect to Mr. Bennett; $1,287, $1,338 and $1,271

<S>	<C>	<C>	<C>	<C>
Richard M. Scrushy	1999	$1,634,031	--	1,050,000
Chairman of the Board	2000	3,654,849	--	800,000
and Chief Executive Officer(2)	2001	3,961,169	$6,500,000	1,200,000
William T. Owens	1999	$ 272,944	--	55,000
President	2000	386,510	--	75,000
and Chief Operating Officer	2001	502,115	$1,500,000	400,000
Larry D. Taylor	1999	$ 183,298	--	113,166
President - Ambulatory Services	2000	278,796	$ 75,000	30,000
	2001	452,076	500,000	150,000
Patrick A. Foster	1999	$ 275,977	--	125,000
President -- Inpatient	2000	356,043	--	60,000
Operations	2001	337,922	$ 500,000	150,000
Robert E. Thomson	1999	$ 402,987	--	125,000
Formerly President -- Inpatient	2000	396,162	--	60,000
Operations	2001	85,556	$ 500,000	100,000
Thomas W. Carman	1999	$ 295,167	--	65,000
Executive Vice President --	2000	326,300	$ 50,000	20,000
Corporate Development	2001	361,651	75,000	80,000

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(1) For the year ending December 31, 2001, this category includes (a) matching contributions under the HEALTHSOUTH Retirement Investment Plan of $1,020 for Mr. Scrushy, $0 for Mr. Owens, $1,393 for Mr. Taylor, $1,400 for Mr. Foster, $719 for Mr. Thomson and $1,059 for Mr. Carman; (b) awards under our Employee Stock Benefit Plan of $3,263 for Mr. Scrushy, $3,263 for Mr. Owens, $3,263 for Mr. Taylor, $3,263 for Mr. Foster, $3,263 for Mr. Thomson and $3,263 for Mr. Carman; and (c) split-dollar life insurance premiums paid of $54,039 with respect to Mr. Scrushy, $1,492 with respect to Mr. Owens, $1,492 with respect to Mr. Taylor, $1,492 with respect to Mr. Foster, $1,492 with respect to Mr. Thomson and $1,492 with respect to Mr. Carman. See "Executive Compensation and Other Information -- Retirement Investment Plan" and "Executive Compensation and Other Information -- Employee Stock Benefit Plan".

(2) Salary amounts for Mr. Scrushy include monthly incentive compensation amounts payable upon achievement of certain budget targets. Effective November 1, 1998, Mr. Scrushy voluntarily suspended receipt of his base salary and monthly incentive compensation through March 31, 1999, and voluntarily took reduced compensation through January 2, 2000. See "Executive Compensation and Other Information -- Compensation Committee Report on Executive Compensation -- Chief Executive Officer Compensation".

(3) The value of restricted stock awards in 1999 reflects the closing price of HEALTHSOUTH common stock at the date of the award. The value of these awards measured at December 31, 2001 was $1,482,000 for the award to Mr. Scrushy (100,000 shares) and $1,111,500 for the awards to each of Messrs. Owens, Carman and Foster (75,000 shares each). The award to Mr. Thomson lapsed in 2001. The awards vest five years from the date of grant, except as otherwise provided in our 1998 Restricted Stock Plan. See "Executive Compensation and Other Information - 1998 Restricted Stock Plan".

Richard M. Scrushy	$ 25,218,114.87
James P. Bennett	5,043,622.97
Michael D. Martin	1,513,086.89
P. Daryl Brown	1,008,506.87
Robert E. Thomson	1,008,506.87
Patrick A. Foster	1,008,506.87
Malcolm E. McVay	100,850.69
William W. Horton	88,914.00

</TABLE>

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The loans made to Mr. Bennett and Mr. Martin were repaid in full in 2000. The loans made to Mr. McVay, Mr. Foster, Mr. Horton and Mr. Thomson were repaid in 2001. In addition, loans made to six persons who were not executive officers had been repaid in full by December 31, 2001.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

General

The establishment and review of HEALTHSOUTH's compensation plans have been delegated to the Compensation Committee of HEALTHSOUTH's Board of Directors, all of whom are outside Directors. John S. Chamberlin, Phillip C. Watkins, M.D. and Larry D. Striplin, Jr., who serves as Chairman, are the current members of the Committee. The Committee is charged by the Board of Directors with establishing a compensation plan which will enable HEALTHSOUTH to compete effectively for the services of qualified officers and key employees, to give those employees appropriate incentive to pursue the maximization of long-term stockholder value, and to recognize those employees' success in achieving both qualitative and quantitative goals for the benefit of HEALTHSOUTH. The Committee makes recommendations to the full Board of Directors as to appropriate levels of compensation for specific individuals, as well as compensation and benefit programs for the company as a whole.

The following sections discuss the Committee's general philosophy and policies concerning compensation for executive officers of HEALTHSOUTH, as well as providing information concerning the specific implementation of such policies.

Compensation Philosophy and Policies for Executive Officers

As its first principle, the Committee believes that HEALTHSOUTH executives should be rewarded based upon their success in meeting the company's operational goals, improving its earnings, maintaining its leadership role in the healthcare services field, and generating value for its stockholders, and the Committee strives to establish levels of compensation that take such factors into account and provide appropriate recognition for past achievement and incentive for future success. The Committee recognizes that the demand for executives with expertise and experience in the healthcare services field is intense. In order to attract and retain qualified persons, the Committee believes that HEALTHSOUTH must offer current compensation at levels consistent with those of other publicly traded healthcare companies. In addition, the Committee believes that it is in the best interests of HEALTHSOUTH's stockholders to offer its executives meaningful equity participation in HEALTHSOUTH, in order that those executives' interests will be aligned with those of the company's stockholders. The Committee feels that the historic mix of cash compensation and equity

EMPLOYMENT AGREEMENT **Tab 22**

EMPLOYMENT AGREEMENT, dated as of April 1, 1998 (this "Agreement"), between HEALTHSOUTH Corporation, a Delaware corporation (the "Company"), and RICHARD M. SCRUSHY, a resident of Birmingham, Alabama (the "Executive").

WITNESSETH:

WHEREAS, the Company provides comprehensive rehabilitative, clinical, diagnostic and surgical healthcare services;

WHEREAS, the Executive is a founder of the Company and serves as Chief Executive Officer of the Company and as Chairman of its Board of Directors; and

WHEREAS, the Company wishes to assure itself of the continued services of the Executive so that it will have the continued benefit of his ability, experience and services, and the Executive is willing to enter into an agreement to that end, upon the terms and conditions hereinafter set forth.

NOW, THEREFORE, in consideration of good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereby covenant and agree as follows:

1. Employment

The Company hereby agrees to continue to employ the Executive, and the Executive hereby agrees to remain in the employ of the Company, on and subject to the terms and conditions of this Agreement.

2. Term

(a) The period of this Agreement (the "Agreement Term") shall commence as of the date hereof (the "Effective Date") and shall expire on the fifth anniversary of the Effective Date. The Agreement Term shall be automatically extended for an additional year on each anniversary of the Effective Date, unless written notice of non-extension is provided by either party to the other party at least 90 days prior to such anniversary.

(b) The period of the Executive's employment under this Agreement (the "Employment Period") shall commence as of the Effective Date and shall expire at the end of the

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Agreement Term, unless sooner terminated in accordance with the terms and conditions of this Agreement.

3. Position, Duties and Responsibilities

(a) The Executive shall serve as, and with the title, office and authority of, the Chief Executive Officer of the Company and the Chairman of the Board of Directors of the Company (the "Board") and shall report directly to the Board. The Company shall use its best efforts to cause the Executive to be nominated and elected (or renominated and reelected, as the case may be) during the Employment Period as a director of the Company.

(b) The Executive shall have effective supervision and control over, and responsibility for, the strategic direction and general and active day-to-day leadership and management of the business and affairs of the Company and the direct and indirect subsidiaries of the Company, subject only to the authority of the Board, and shall have all of the powers, authority, duties and responsibilities usually incident to the positions and offices of Chief Executive Officer and Chairman of the Board of the Company.

(c) The Executive agrees to devote substantially all of his business time, efforts and skills to the performance of his duties and responsibilities under this Agreement; provided, however, that nothing in this Agreement shall preclude the Executive from devoting reasonable periods required for (i) participating in professional, educational, philanthropic, public interest, charitable, social or community activities, (ii) serving as a director or member of an advisory committee of any corporation or other entity that the Executive is serving on as of the Effective Date or any other corporation or entity that is not in direct competition with the Company or (iii) managing his personal investments, provided that such activities do not materially interfere with the Executive's regular performance of his duties and responsibilities hereunder.

(d) The foregoing provisions of this Section 3 shall be subject to the Executive's right to elect to serve the Company solely as the Chairman of the Board, as provided in Section 22 hereof.

4. Place of Performance

The Executive shall perform his duties at the principal offices of the Company located at One HealthSouth Parkway, Birmingham, Alabama, but from time to time the Executive may be required to travel to other locations in the proper conduct of his responsibilities under this Agreement.

5. Compensation and Benefits

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In consideration of the services rendered by the Executive during the Employment Period, the Company shall pay or provide to the Executive the amounts and benefits set forth below.

(a) Salary. The Company shall pay the Executive an annual base salary (the "Base Salary") of at least $1,200,000. The Executive's Base Salary shall be paid in arrears in substantially equal installments at monthly or more frequent intervals, in accordance with the normal payroll practices of the Company. The Executive's Base Salary shall be reviewed at least annually by the Compensation Committee of the Board (the "Compensation Committee") for consideration of appropriate merit increases and, once established, the Base Salary shall not be decreased during the Employment Period, except as otherwise contemplated by Section 22 hereof.

(b) Annual Target Bonus. The Company shall provide the Executive with the opportunity to earn an annual target bonus (the "Annual Target Bonus") equal to at least $2,400.000. The amount of the Annual Target Bonus will be reviewed at least annually by the Compensation Committee for consideration of appropriate merit increases and, once established at a specified amount, the Annual Target Bonus shall not be decreased during the Employment Period, except as otherwise contemplated by Section 22 hereof. The Annual Target Bonus will be payable in the event that the Company's operations meet the annual performance standard set forth in the Company's business plan, as approved by the Compensation Committee in each year of the Employment Period (the "Business Plan"). In the event that the Company's operations meet the monthly performance standard set forth in the Business Plan, an amount equal to one-twelfth (1/12) of the Annual Target Bonus (a "Monthly Target Bonus") shall be payable within five days following the date the Company's internal monthly financial statements have been completed. In the event that any Monthly Target Bonus shall not be paid during the course of such calendar year because the relevant monthly performance standard was not met, such Monthly Target Bonus shall again become available for payment if the Company attains its annual performance standard for such calendar year. In the event that the annual performance standards are not met, Executive shall nevertheless be entitled to retain all amounts theretofore received in respect of any Monthly Target Bonuses paid during the course of such calendar year. For the remainder of the 1998 calendar year following the Effective Date, the Executive will be paid $200,000 within five days following the date the Company's internal monthly financial statements have been completed for each calendar month ending following the Effective Date in which the relevant monthly performance standard is met and, in the event the Company attains its annual performance standard for 1998, the Executive shall be paid $200,000 of any month, dating back to January, 1998, in which the Executive was not paid the Monthly Target Bonus due to the relevant monthly performance standard not having been met.

(c) Other Incentive Plans. The Executive shall participate in all other bonus or incentive plans or arrangements in which other senior executives of the Company are eligible to participate from time to time, including, without limitation, any management bonus pool arrangement. The Executive's incentive compensation opportunities under such plans and

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arrangements shall be determined from time to time by the Compensation Committee upon consultation with the Executive.

(d) Equity Incentives. The Executive shall be given consideration, at least annually, by the Compensation Committee for the grant of options to purchase shares of the common stock of the Company. In addition, the Executive shall be entitled to receive awards under any stock option, stock purchase or equity-based incentive compensation plan or arrangement adopted by the Company from time to time for which senior executives of the Company are eligible to participate. The Executive's awards under such plans and arrangements shall be determined from time to time by the Compensation Committee upon consultation with the Executive.

(e) Employee Benefits. The Executive shall be entitled to participate in all employee benefit plans, programs, practices or arrangements of the Company in which other senior executives of the Company are eligible to participate from time to time, including, without limitation, any qualified or non-qualified pension, profit sharing and savings plans, any death benefit and disability benefit plans, and any medical, dental, health and welfare plans. Without limiting the generality of the foregoing, the Company shall provide the Executive with the following:

(i) provision of long-term disability insurance coverage paying benefits equal to at least 100% of the Executive's Base Salary and Annual Target Bonus for the duration of any permanent and total disability of the Executive, either through an individual disability insurance policy or otherwise;

(ii) continued provision of split-dollar life insurance coverage and payment of premiums pursuant to that certain Split-Dollar Agreement between the Executive and the Company, dated February 1, 1992, as amended; and

(iii) provision of the pension benefits provided under a non-qualified retirement plan for the Executive, a summary of the terms of which is attached hereto as Exhibit A.

(f) Fringe Benefits and Perquisites. The Executive shall be entitled to continuation of all fringe benefits and perquisites provided to the Executive on the Effective Date, and to all fringe benefits and perquisites which are generally made available to senior executives of the Company from time to time. Without limiting the generality of the foregoing, the Company shall provide the Executive with the following:

(i) provision of executive offices and secretarial staff;

(ii) six weeks paid vacation during each calendar year;

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(iii) provision of an automobile of the Executive's choice (which may be traded in for a new automobile each year), plus payment of all related automobile expenses, including gas, maintenance expenses and automobile insurance;

(iv) payment of initiation fees and annual dues for two country clubs of the Executive's choice, and payment of dues for any professional societies and associations of which the Executive is a member in furtherance of his duties hereunder;

(v) in order to ensure the accessibility and security of the Executive, use of the Company's aircraft and related facilities for both business and personal travel and provision of appropriate personal residence security services, a 24-hour bodyguard service, a security-trained driver/bodyguard and any other measures prescribed from time to time by the Company's corporate security advisor and approved by the Board; and

(vi) reimbursement of all reasonable travel and other business expenses and disbursements incurred by the Executive in the performance of his duties under this Agreement, upon proper accounting in accordance with the Company's normal practices and procedures for reimbursement of business expenses.

6. Termination of Employment

The Employment Period will be terminated upon the happening of any of the following events:

(a) Resignation for Good Reason. The Executive may voluntarily terminate his employment hereunder for Good Reason. For purposes of this Agreement, "Good Reason" shall mean:

(i) the assignment to the Executive of any duties inconsistent with the Executive's position (including status, offices, titles or reporting relationships), authority, duties or responsibilities as contemplated by Section 3 hereof, or any action by the Company that results in a diminution in such position, authority, duties or responsibilities, but excluding for these purposes any isolated and insubstantial action not taken in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by the Executive;

(ii) any material change in the Executive's reporting responsibilities;

(iii) any material failure by the Company to honor its obligations under this Agreement;

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(iv) a notice of non-extension of the Agreement Term provided by the Company to the Executive as set froth in Section 2 hereof;

(v) the relocation of the Company's principal executive offices to a location more than 40 miles from its current location in Birmingham, Alabama, or the location of the Executive's own office to other than the Company's principal executive offices;

(vi) any failure by the Company to obtain an assumption of this Agreement by a successor corporation as required under Section 14(a) hereof;

(vii) the failure of the Company to renominate the Executive to the Board or the failure of the Company's stockholders to reelect the Executive to the Board; or

(viii) any purported termination by the Company of the Executive's employment otherwise than as expressly permitted by this Agreement.

However, in no event shall the Executive be considered to have terminated his employment for "Good Reason" unless and until the Company receives written notice from the Executive identifying in reasonable detail the acts or omissions constituting "Good Reason" and the provision of this Agreement relied upon, and such acts or omissions are not cured by the Company to the reasonable satisfaction of the Executive within 30 days of the Company's receipt of such notice.

(b) Resignation other than for Good Reason. The Executive may voluntarily terminate his employment hereunder for any reason other than Good Reason.

(c) Termination for Cause. The Company may terminate the Executive's employment hereunder for Cause. For purposes of this Agreement, the Executive shall be considered to be terminated for "Cause" only if (i) the Executive is found, by a non-appealable order of a court or competent jurisdiction, to be guilty of a felony under the laws of the United States or any state thereof or (ii) the Executive is found, by a non-appealable order of a court of competent jurisdiction, to have committed a fraud, which has a material adverse effect on the Company. However, in no event shall the Executive's employment be considered to have been terminated for "Cause" unless and until the Executive receives a copy of a resolution duly adopted by the affirmative vote of a majority of the Board at a meeting called and held for such purpose (after reasonable written notice is provided to the Executive setting forth in reasonable detail the facts and circumstances claimed to provide a basis of termination for Cause and the Executive is given an opportunity, together with counsel, to be heard before the Board) finding that the Executive is guilty of acts or omissions constituting Cause.

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(d) Termination other than for Cause. The Board shall have the right to terminate the Executive's employment hereunder for any reason at any time, including for any reason that does not constitute Cause, subject to the consequences of such termination as set forth in this Agreement.

(e) Disability. The Executive's employment hereunder shall terminate upon his Disability. For purposes of this Agreement, "Disability" shall mean the inability of the Executive to perform his duties to the Company on account of physical or mental illness for a period of six consecutive full months, or for a period of eight full months during any 12-month period. The Executive's employment shall terminate in such a case on the last day of the applicable period; provided, however, in no event shall the Executive be terminated by reason of Disability unless (i) the Executive is eligible for the long-term disability benefits set forth in Section 5(e)(i) hereof and (ii) the Executive receives written notice from the Company, at least 30 days in advance of such termination, stating its intention to terminate the Executive for reason of Disability and setting forth in reasonable detail the facts and circumstances claimed to provide a basis for such termination.

(f) Death. The Executive's employment hereunder shall terminate upon his death.

7. Compensation Upon Termination of Employment

In the event the Executive's employment by the Company is terminated during the Agreement Term, the Executive shall be entitled to the severance benefits set forth below:

(a) Resignation for Good Reason. In the event the Executive voluntarily terminates his employment hereunder for Good Reason, the Company shall pay the Executive and provide him with the following:

(i) Accrued Rights. The Company shall pay the Executive a lump-sum amount equal to the sum of (A) his earned but unpaid Base Salary through the date of termination, (B) any earned but unpaid Annual Target Bonus for any completed calendar year, (C) any earned but unpaid Monthly Target Bonus for any completed month in the calendar year of the Executive's termination and (D) any unreimbursed business expenses or other amounts due to the Executive from the Company as of the date of termination. In addition, the Company shall provide to the Executive all payments, rights and benefits due as of the date of termination under the terms of the Company's employee and fringe benefit plans, practices, programs and arrangements referred to in Sections 5(e) and 5(f) hereof (including, but not limited to, any retirement benefits set forth on Exhibit A to which Executive is entitled) (together with the lump-sum payment, the "Accrued Rights").

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(ii) Severance Payment. The Company shall pay the Executive a lump-sum amount equal to the sum of the Executive's then-current Base Salary and Annual Target Bonus at the time of the Executive's termination, for each year remaining in the Agreement Term (with pro-rated amounts of such Base Salary and Annual Target Bonus, on a daily basis, for any partial calendar years during such remaining Agreement Term), with such lump-sum payment discounted to present value using an interest rate equal to 100% of the monthly compounded applicable federal rate (the "Applicable Rate"), as in effect under Section 1274(d) of the Internal Revenue Code of 1986, as amended (the "Code"), for the month in which payment is required to be made. For purposes of determining the portion of the severance payment based on the Annual Target Bonus to be payable hereunder, the relevant performance standards for the Company shall be deemed to have been achieved.

(iii) Continued Benefits. The Company shall pay or provide the Executive with all employee and fringe benefits referred to in Sections 5(e) and 5(f) hereof for the balance of the Agreement Term; provided, however, that if and to the extent the Company determines that any such benefits cannot be paid or provided under the plans in question due to Code or other restrictions, the Company shall provide payments, coverages or benefits, which are at least as favorable to the Executive on an after-tax basis, through other means reasonably satisfactory to the Executive.

(iv) Equity Rights. All stock options and other equity-based rights held by the Executive at the date of termination shall become immediately and fully vested and exercisable, and the Executive shall retain the right to exercise all outstanding stock options for the duration of their original full term (without regard to termination of employment) in accordance with the Founder Retirement Benefit Program attached hereto as Exhibit B (the "Founders' Program"). The Company shall forthwith take all necessary steps to amend any relevant stock option plans of the Company and stock option agreements to the extent necessary to allow for the foregoing vesting and term of exercise.

(b) Resignation other than for Good Reason. In the event the Executive voluntarily terminates his employment hereunder other than for Good Reason, the Company shall pay the Executive and provide him with the following:

(i) Accrued Rights. The Company shall pay and provide to the Executive any Accrued Rights.

(ii) Severance Payment. The Company shall pay the Executive a lump-sum amount equal to two times the sum of the Executive's then-current Base Salary

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and Annual Target Bonus at the time of the Executive's termination, with such lump-sum payment discounted to present value using the Applicable Rate for the month in which payment is required to be made. For purposes of determining the portion of the severance payment based on the Annual Target Bonus to be payable hereunder, the relevant performance standards for the Company shall be deemed to have been achieved.

(c) Termination for Cause. In the event the Executive's employment hereunder is terminated by the Company for Cause, the Company shall pay and provide to the Executive any Accrued Rights.

(d) Termination other than for Cause, Disability or Death. In the event the Executive's employment hereunder is terminated by the Company for any reason other than for Cause, Disability or death, the Company shall pay the Executive and provide him with all severance benefits set forth in Section 7(a) hereof.

(e) Disability. In the event the Executive's employment hereunder is terminated by reason of the Executive's Disability, the Company shall pay the Executive and provide him with the following:

(i) Accrued Rights. The Company shall pay and provide to the Executive any Accrued Rights, including all disability insurance coverage.

(ii) Severance Payment. The Company shall provide the Executive with continued payment of the Executive's Base Salary and Annual Target Bonus, as in effect on the date of termination, for a period of three years following the Executive's termination, payable at the times and in the manner such Base Salary and Annual Target Bonus would have been paid if the Executive had continued in the employment of the Company and as if all relevant performance standards had been achieved during such periods.

(f) Death.

In the event the Executive's employment hereunder is terminated by reason of the Executive's death, the Company shall pay the Executive's representatives or estate the following:

(i) Accrued Rights. The Company shall pay and provide to the Executive's representatives or estate any Accrued Rights, including all life insurance coverage.

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(ii) Severance Payment. The Company shall pay the Executive's representatives or estate a lump-sum amount equal to the sum of the Executive's then-current Base Salary and Annual Target Bonus at the time of the Executive's death, with such lump-sum payment discounted to present value using the Applicable Rate for the month in which payment is required to be made. For purposes of determining the portion of the severance payment based on the Annual Target Bonus to be payable hereunder, the relevant performance standards for the Company shall be deemed to have been achieved.

8. Founders' Benefits

Upon the Executive's termination of employment hereunder for any reason, and in addition to any severance benefits payable to him under Section 7 hereof, the Company shall treat such termination as a "retirement" for purposes of the Founder's Program, and shall provide the Executive with the benefits outlined in the Founders' Program in recognition of his status as a founder of the Company.

9. Change in Control

(a) Supplemental termination Rights. In the event of Executive's termination other than for Cause, Disability or death or in the event a voluntary termination of employment by the Executive pursuant to [either Section 6(a) or] Section 6(b) hereof, in either case occurring within two years following a Change in Control, the Company shall pay to the Executive, in addition to the severance benefits payable under Section 7(b) hereof, an additional lump-sum amount equal to the Executive's then-current Base Salary and Annual Target Bonus at the time of the Executive's termination, with such lump-sum payment discounted to present value using the Applicable Rate for the month in which payment is required to be made.

(b) Definition. For purposes of this Agreement, a "Change in Control" shall be deemed to have occurred by reason of:

(i) the acquisition (other than from the Company) by any person, entity or "group" (within the meaning of Sections 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, but excluding, for this purpose, the Company or its subsidiaries, or any employee benefit plan of the Company or its subsidiaries which acquires beneficial ownership of voting securities of the Company) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Securities Exchange Act of 1934) of 25% or more of either the then-outstanding shares of the common stock of the Company or the combined voting power of the Company's then-outstanding voting securities entitled to vote generally in the election of directors; or

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(ii) individuals who, as of the date hereof, constitute the Board (as of such date, the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any person becoming a director subsequent to such date whose election, or nomination for election, was approved by a vote of at least a majority of the directors then constituting the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of directors of the Company) shall be, for purposes of this Section 9(b)(ii), considered as though such person were a member of the Incumbent Board; or

(iii) approval by the stockholders of the Company of a reorganization, merger, consolidation or share exchange, in each case with respect to which persons who were the stockholders of the Company immediately prior to such reorganization, merger, consolidation or share exchange do not, immediately thereafter, own more than 75% of the combined voting power entitled to vote generally in the election of directors of the reorganized, merged, consolidated or other surviving entity's then-outstanding voting securities, or a liquidation or dissolution of the Company or the sale of all or substantially all of the assets of the Company.

10. Parachute Tax Indemnity

(a) If it shall be determined that any amount paid, distributed or treated as paid or distributed by the Company to or for the Executive's benefit (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise, but determined without regard to any additional payments required under this Section 10) (a "Payment") would be subject to the excise tax imposed by Section 4999 of the Code or any interest or penalties are incurred by the Executive with respect to such excise tax (such excise tax, together with any such interest and penalties, being hereinafter collectively referred to as the "Excise Tax"), then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that after payment by the Executive of all federal, state and local taxes (including any interest or penalties imposed with respect to such taxes), including without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Tax imposed upon the Gross-Up Payment, the Executive retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments.

(b) All determinations required to be made under this Section 10, including whether and when a Gross-Up Payment is required and the amount of such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by a nationally recognized accounting firm as may be designated by the Executive (the "Accounting Firm") which shall provide detailed supporting calculations both to the Company and the Executive within 15

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business days of the receipt of notice from the Executive that there has been a Payment, or such earlier time as is requested by the Company. In the event that the Accounting Firm is serving as accountant or auditor for the individual, entity or group effecting the Change in Control, the Executive shall appoint another nationally recognized accounting firm to make the determinations required hereunder (which accounting firm shall then be referred to as the Accounting Firm hereunder). All fees and expenses of the Accounting Firm shall be borne by the Company. Any Gross-Up Payment, as determined pursuant to this Section 10, shall be paid by the Company to the Executive within five days of the receipt of the Accounting Firm's determination. Any determination by the Accounting Firm shall be binding upon the Company and the Executive. As a result of the uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Gross-Up Payments which will not have been made by the Company should have been made ("Underpayment"), consistent with the calculations required to be made hereunder. In the event that the Company exhausts its remedies pursuant to this Section 10 and the Executive thereafter is required to make a payment of any Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to or for the Executive's benefit.

(c) The Executive shall notify the Company in writing of any claim by the Internal Revenue Service that, if successful, would require the payment by the Company of the Gross-Up Payment. Such notification shall be given as soon as practicable but no later than ten business days after the Executive is informed in writing of such claim and shall apprise the Company of the nature of such claim and the date on which such claim is requested to be paid. The Executive shall not pay such claim prior to the expiration of the 30-day period following the date on which it gives such notice to the Company (or such shorter period ending on the date that any payment of taxes with respect to such claim is due). If the Company notifies the Executive in writing prior to the expiration of such period that it desires to contest such claim, the Executive shall:

(i) give the Company any information reasonably requested by the Company relating to such claim;

(ii) take such action in connection with contesting such claim as the Company shall reasonably request in writing from time to time, including, without limitation, accepting legal representation with respect to such claim by an attorney reasonably selected by the Company;

(iii) cooperate with the Company in good faith in order to effectively contest such claim; and

(iv) permit the Company to participate in any proceeding relating to such claim;

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provided, however, that the Company shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in connection with such contest and shall indemnify and hold the Executive harmless, on an after-tax basis, from any Excise Tax or income tax (including interest and penalties with respect thereto) imposed as a result of such representation and payment of costs and expense. Without limitation on the foregoing provisions of this Section 10, the Company shall control all proceedings taken in connection with such contest and, at its sole option, may pursue or forego any and all administrative appeals, proceedings, hearings and conferences with the taxing authority in respect of such claim and may at its sole option, either direct the Executive to pay the tax claimed and sue for a refund or contest the claim in any permissible manner, and the Executive agrees to prosecute such contest to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts as the Company shall determine; provided, however, that if the Company directs the Executive to pay such claim and sue for a refund, the Company shall advance the amount of such payment to the Executive, on an interest-free basis, and shall indemnify and hold the Executive harmless, on an after-tax basis, from any Excise Tax or income tax (including interest or penalties with respect thereto) imposed with respect to such advance or with respect to any imputed income with respect to such advance; and further provided that any extension of the statute of limitations relating to payment of taxes for the Executive's taxable year with respect to which such contested amount is claimed to be due is limited solely to such contested amount. Furthermore, the Company's control of the contest shall be limited to issues with respect to which a Gross-Up Payment would be payable hereunder and the Executive shall be entitled to settle or contest, as the case may be, any other issue raised by the Internal Revenue Service or any other taxing authority.

(d) If, after the Executive's receipt of an amount advanced by the Company pursuant to this Section 10, the Executive becomes entitled to receive any refund with respect to such claim, the Executive shall (subject to the Company's complying with the requirements of this Section 10) promptly pay to the Company the amount of such refund (together with any interest paid or credited thereon after taxes applicable thereto). If, after the Executive's receipt of an amount advanced by the Company pursuant to this Section 10, a determination is made that the Executive shall not be entitled to any refund with respect to such claim and the Company does not notify the Executive in writing of its intent to contest such denial of refund prior to the expiration of 30 days after such determination, then such advance shall be forgiven and shall not be required to be repaid and the amount of such advance shall offset, to the extent thereof, the amount of Gross-Up Payment required to be paid.

11. No Mitigation or Offset

The Executive shall not be required to seek other employment or to reduce any severance benefit payable to him under Section 7, 8 or 9 hereof, and no such severance benefit shall be reduced on account of any compensation received by the Executive from other

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employment. The Company's obligation to pay severance benefits under this Agreement shall not be reduced by any amount owed by the Executive to the Company.

12. Tax Withholding; Method of Payment

All compensation payable pursuant to this Agreement, shall be subject to reduction by all applicable withholding, social security and other federal, state and local taxes and deductions. Any lump-sum payments provided for in Sections 7 or 9 hereof shall be made in a cash payment, net of any required tax withholding, no later than the fifth business day following the Executive's date of termination. Any payment required to be made to the Executive under this Agreement that is not made in a timely manner shall bear interest at the Applicable rate until the date of payment.

13. Restrictive Covenants

(a) Confidential Information. During the Employment Period and at all times thereafter, the Executive agrees that he will not divulge to anyone (other than the Company or any persons employed or designated by the Company) any knowledge or information of a confidential nature relating to the business of the Company or any of its subsidiaries or affiliates, including, without limitation, all types of trade secrets (unless readily ascertainable from public or published information or trade sources) and confidential commercial information, and the Executive further agrees not to disclose, publish or make use of any such knowledge or information without the consent of the Company.

(b) Noncompetition. During the Employment Period and in the event of a resignation by the Executive for any reason other than Good Reason, for the 24 month period following the termination of his employment, the Executive shall not, without the prior written consent of the Company, engage in the comprehensive rehabilitative and related healthcare services business on behalf of any person, firm or corporation within any geographical area in which the Company transacts such business, and the Executive shall not acquire any financial interest (except for an equity interest in publicly-held companies that do not exceed 5% of any outstanding class of equity of that company), in any business that engages in the comprehensive rehabilitative and related healthcare services business within any geographical area in which the Company transacts such business. Notwithstanding the foregoing, upon the occurrence of a Change in Control (whether before or after the termination of the Employment Period), the restrictions of this Section 13(b) shall cease to apply to the Executive for any period following his termination of employment hereunder.

(c) Enforcement. The Company shall be entitled to seek a restraining order or injunction in any court of competent jurisdiction to prevent any continuation of any violation of the provisions of this Section 13.

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14. Successors

(a) This Agreement shall be binding upon and shall inure to the benefit of the Company, its successors and assigns and any person, firm, corporation or other entity which succeeds to all or substantially all of the business, assets or property of the Company. The Company will require any successor (whether direct or indirect, by purchase, merger, consolidation, or otherwise) to all or substantially all of the business, assets or property of the Company, to expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used in this Agreement, the "Company" shall mean the Company as hereinbefore defined and any successor to its business, assets or property as aforesaid which executes and delivers an agreement provided for in this Section 14 or which otherwise becomes bound by all the terms and provisions of this Agreement by operation of law.

(b) This Agreement and all rights of the Executive hereunder shall inure to the benefit of and be enforceable by the Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If the Executive should die while any amounts are due and payable to him hereunder, all such amounts, unless otherwise provided herein, shall be paid to the Executive's designated beneficiary or, if there be no such designated beneficiary, to the legal representatives of the Executive's estate.

15. No Assignment

Except as to withholding of any tax under the laws of the United States or any other country, state or locality, neither this Agreement nor any right or interest hereunder nor any amount payable at any time hereunder shall be subject in any manner to alienation, sale, transfer, assignment, pledge, attachment, or other legal process, or encumbrance of any kind by the Executive or the beneficiaries of the Executive or by his legal representatives without the Company's prior written consent, nor shall there be any right of set-off or counterclaim in respect of any debts or liabilities of the Executive, his beneficiaries or legal representatives; provided, however, that nothing in this Section shall preclude the Executive from designating a beneficiary to receive any benefit payable on his death, or the legal representatives of the Executive from assigning any rights hereunder to the person or persons entitled thereto under his will or, in case of intestacy, to the person or persons entitled thereto under the laws of intestacy applicable to his estate.

16. Entire Agreement

This Agreement contains the entire understanding of the parties with respect to the subject matter hereof and, except as specifically provided herein, cancels and supersedes any and all other agreements between the parties with respect to the subject matter hereof, including, without limitation, that certain employment agreement dated July 23, 1986, as amended. Any

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amendment or modification of this Agreement shall not be binding unless in writing and signed by the Company and the Executive.

17. Severability

In the event that any provision of this Agreement is determined to be invalid or unenforceable, the remaining terms and conditions of this Agreement shall be unaffected and shall remain in full force and effect, and any such determination of invalidity or unenforceability shall not affect the validity or enforceability of any other provision of this Agreement.

18. Notices

All notices which may be necessary or proper for either the Company or the Executive to give to the other shall be in writing and shall be delivered by hand or sent by registered or certified mail, return receipt requested, or by air courier, to the Executive at:

Mr. Richard M. Scrushy
2406 Longleaf Street
Birmingham, Alabama 35243

and shall be sent in the manner described above to the Secretary of the Company at the Company's principal executives offices at One HealthSouth Parkway, Birmingham, Alabama 35243, with a copy to the Legal Services Department at the same address or delivered by hand to the Secretary and to the Legal Services Department of the Company, and shall be deemed given when sent, provided that any notice required under Section 6 hereof or notice given pursuant to Section 2 hereof shall be deemed given only when received. Any party may by like notice to the other party change the address at which he or they are to receive notices hereunder.

19. Governing Law

This Agreement shall be governed by and enforceable in accordance with the laws of the State of Alabama, without giving effect to the principles of conflict of laws thereof.

20. Legal Fees and Expenses

To induce the Executive to execute this Agreement and to provide the Executive with reasonable assurance that the purposes of this Agreement will not be frustrated by the cost of its enforcement should the Company fail to perform its obligations under this Agreement or should the Company or any subsidiary, affiliate or stockholder of the Company contest the validity or enforceability of this Agreement, the Company shall pay and be solely responsible for any attorneys' fees and expenses and courts costs incurred by the Executive as a result of a claim that

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the Company has breached or otherwise failed to perform this Agreement or any provision hereof to be performed by the Company or as a result of the Company or any subsidiary, affiliate or stockholder of the Company contesting the validity or enforceability of this Agreement or any provision hereof to be performed by the Company, in each case regardless of which party, if any, prevails in the contest.

21. Conversion to Chairman-Only Status

The Executive may elect at any time during the Employment Period to resign his position as Chief Executive Officer and serve the Company solely as the Chairman of the Board ("Chairman-Only Status") for the remainder of the Employment Period (as automatically extended in accordance with Section 2(a) hereof) under the terms and conditions hereof. An election by the Executive to maintain Chairman-Only Status shall not constitute a violation of the Executive's obligations under Section 3 hereof, nor shall it constitute a termination of the Executive's employment for any purpose under Section 6 hereof. As used in this Agreement, the term "employment" and similar terms shall be deemed to include service to the Company while maintaining Chairman-Only Status.

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IN WITNESS WHEREOF, the Company and the Executive have executed this Agreement as of the date first above written.

EXECUTIVE

Richard M. Scrushy

HEALTHSOUTH Corporation

By

Michael D. Martin
Executive Vice President
and Chief Financial Officer

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EXHIBIT A

HEALTHSOUTH CORPORATION

EXECUTIVE RETIREMENT PLAN
FOR RICHARD M. SCRUSHY

Summary of Terms[1]

Retirement Benefits:	In consideration of Executive's role as Founder, his service to the HEALTHSOUTH since its formation and in lieu of the benefits and compensation offered through full-time employment as Chairman, Executive shall be entitled to the benefits described below upon his retirement from the active employment with HEALTHSOUTH and continuing until his death (as more specifically set forth below). In addition, in recognition of the Executive's founder status, HEALTHSOUTH shall provide the Executive with suitable office and secretarial support within the Corporate headquarters for a period of up to 10 years following his retirement.
Benefit Formula:	Annual retirement benefit equal to 60% of Base Compensation (defined below) at Normal Retirement Age
Base Compensation:	Average Base Salary and Annual Target Bonus of Executive in effect as of the date of termination pursuant to the terms of the Employment Agreement
Vesting:	Fully vested at all times, such that all benefits provided for in this Exhibit A are payable upon Executive's termination for any reason during the period from and after the date Executive qualifies for Early Retirement. There can be no breach of this retirement plan by the Executive except for violation of Section 13(b) of the Employment Agreement. This consideration is fully earned by the Executive and HEALTHSOUTH has no right under any circumstances to discontinue any payments or other benefits under this plan.

[1] All defined terms shall have the meanings given to them in the Employment Agreement to which this Exhibit A is a part, and all determinations shall be made in accordance with the terms and provisions hereof.

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Normal Retirement Age:	Age 60
Early Retirement:	The retirement benefits provided for in this Exhibit A are fully vested and accrued in the event of termination for any reason prior to age 60, but earliest benefit commencement date is January 23, 2000, the date on which Executive will have completed sixteen consecutive years of service with HEALTHSOUTH (with actuarial reduction)
Change in Control:	In the event of a Change in Control (as defined in Section 9 of the Agreement) or in the event HEALTHSOUTH completes a transaction in which it sells or otherwise ceases to own a business unit, subsidiary, or division representing 30% of its consolidated revenues for the most recently completed fiscal year, Executive shall thereafter be entitled to full retirement benefits hereunder (i.e. 60% of Base Compensation) upon his termination for any reason, regardless of age or length of service, which benefits shall be in addition to any other benefits to which Executive is entitled upon such occurrence. While such a Change in Control gives the Executive the option to retire early regardless of age or length of service, the Executive may, at his sole discretion, choose to continue working for a period of time before exercising such option.
Payment:	Unless Executive chooses one of the alternative forms of payment listed below, payment of his retirement benefits will be in accordance with the normal payroll practices. If HEALTHSOUTH fails to provide payment in accordance with the selected schedule and remains delinquent for a period of 10 business days following receipt of written notice from the Executive (made in accordance with the provisions of Section 18 of the Employment Agreement), HEALTHSOUTH shall pay a penalty equal to three times the amount owed.
Forms of Payment:	Executive's choice of alternative forms: • Single Life Annuity • Single Life Annuity with 10 year guarantee • Joint and Survivor Annuity (50% or 100%) • Lump Sum

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- Payment of present value of retirement benefits in 5 equal annual installments

Death Benefit: For death prior to benefit commencement date and for death following benefit commencement date, Executive's estate will receive the annual retirement benefits payable hereunder (as if Executive had not died) for a period of 5 years

Actuarial Assumptions: Pre-age 60 commencement and alternative forms of payment adjusted on an actuarial equivalent basis:

- interest rate - 30 year Treasury rate
- mortality assumption - 1983 GAM Table

Unfunded Status: Plan is an unfunded, unsecured obligation of HEALTHSOUTH, but HEALTHSOUTH may elect to fund on a tax-neutral basis to Executive

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EXHIBIT B

FOUNDER RETIREMENT BENEFITS PROGRAM

In recognition of the significant contributions of the management founders of HEALTHSOUTH Corporation, upon their retirement from the Corporation, the Corporation shall provide the following benefits to each of them for the remainder of their natural life or until their written election to cease receiving them:

- Health Benefits. The Corporation will extend its regular Employee Health Benefit Program, as it may exist from time to time, to cover the retired founder, and his spouse, for the remainder of their natural lives, with the founder continuing to bear the cost of dependent coverage. When the individuals become eligible for the Medicare program, or any other such government-funded health benefit, the HEALTHSOUTH benefit program will become the individual's secondary coverage.

- Insurance. The Corporation will allow the retired founder to continue to participate in any of the Company's voluntary insurance programs, as they may exist from time to time, until age 72.

- Split-Dollar Policy. The Corporation will continue to pay the premiums on the retired founder's existing split-dollar life insurance policies (or any policies issued in substitution therefor) until such founder reaches age 65 or until the policies are fully paid, whichever comes first.

- Stock Options. The Corporation will waive the normal option termination period for the retired founder, so that all vested option grants will continue for the term of the original grant period.

- Travel. The Corporation will allow the retired founder to utilize the Corporation's travel department to make personal travel arrangements. In addition, the retired founder will also be able to use the Corporation's aircraft, at no cost, if the aircraft is already scheduled for the trip and there are seats available. Otherwise, the retired founder will be allowed to use the Corporation's aircraft at the standard use rate, including direct and indirect expenses.

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From: Owens, Bill

To: Scrushy, Richard

Tab 23

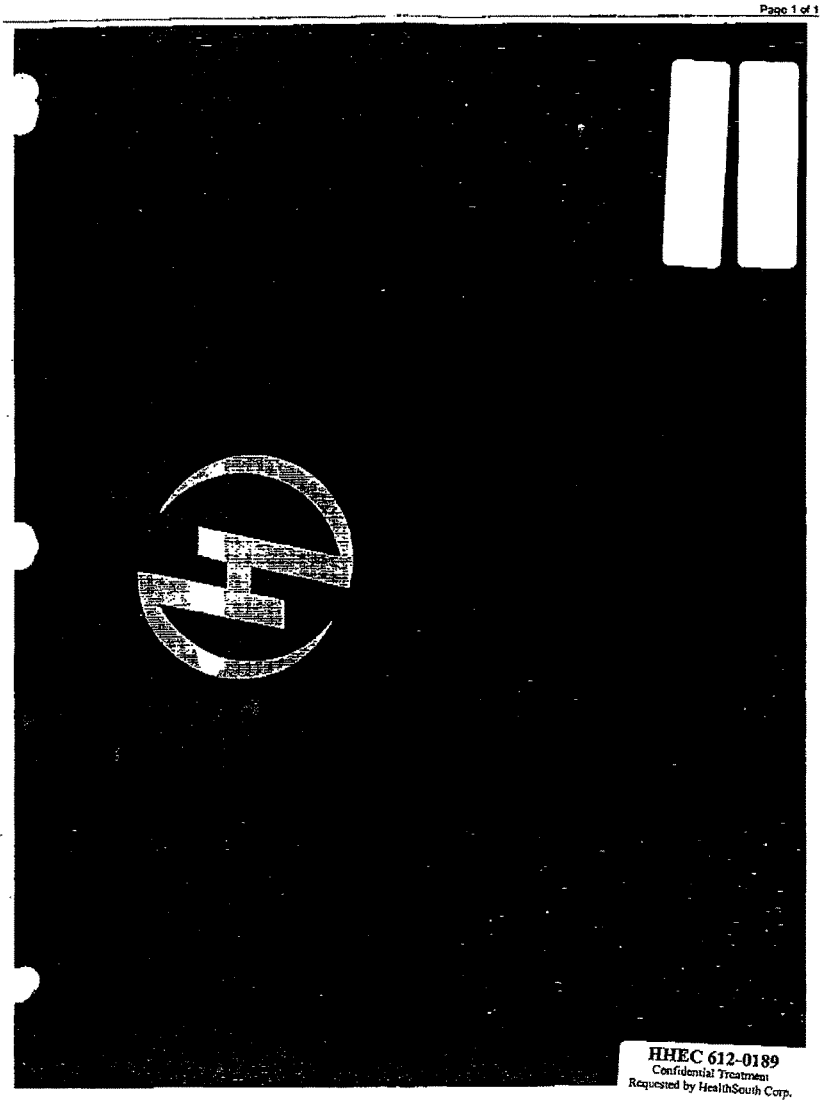
Subject: FW:

Date: 02/01/2002 12:46:10 PM EST

-----Original Message-----
From: Jones, Susan
Sent: Friday, February 01, 2002 8:27 AM
To: Owens, Bill; Horton, Bill; Taylor, Larry; Smith, Weston
Subject:

This is the latest version of the DOJ powerpoint slides for our discussions today.

Attachment files : op concurrent therapy.ppt



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What Is Concurrent Therapy?

- Practice of one licensed therapist treating more than one Medicare beneficiary at a time
- Each patient is working on an **individualized treatment goal**
- Concurrent therapy is different from group therapy, where all participants are working on some common skill development

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What Is Group Therapy?

- In 1995, the CPT codes were changed to include a "group code" for therapy services
- The new code, CPT 97150, was defined as "Therapeutic procedure(s), group (2 or more individuals)."
- In the June 1998, Medicare Focus, BCBS AL defined group as including patients with similar (or the same) diagnosis doing the same activity at the same time for the same purpose
- A therapist following the clinical standard would only bill for group therapy where the therapist was simultaneously treating multiple patients sharing a common treatment plan or goal

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Confusion Over Definitions of Group Therapy

- In April 1999, in draft Program Memorandum (PM) AB-99, CMS acknowledged that the CPT definition of group therapy may conflict with the clinical standard that is supported by the rehabilitation industry.
- June 1999, CMS convened a "listening session" where numerous providers and trade organizations expressed frustration with CMS's failure to incorporate clinical standards into a clear policy on group
- In the final PM, AB-00-14 released March 1, 2000, CMS failed to address group therapy

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PPS for SNF Established New Rules on Group Therapy

- PRM 2837 notes that "if the group has four or fewer participants per supervising therapist (or therapy assistant) then it is appropriate to report the full time as therapy for each patient."

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CMS Acknowledges Role Of Concurrent Therapy

- In May 2001, CMS acknowledged in the SNF context that it had not specifically addressed concurrent therapy in the past
- In July 2001, CMS acknowledged that concurrent therapy had a "***legitimate place in the spectrum of care options available to therapists treating Medicare beneficiaries***" and reiterated that ***the clinical judgment of the professional therapist should be the determining factor as to whether concurrent therapy is appropriate in each case.***

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CMS Addresses Issue of Concurrent Therapy

- In its May 10, 2001 proposed rulemaking, 66 Fed. Reg 23984, 23991-92, CMS questioned whether concurrent therapy services would meet the SNF benefit coverage criteria. CMS noted that
  - "Medicare relies on the professional judgment of the therapist to determine when, based on the complexity of the services to be delivered and the condition of the beneficiary, it is appropriate to deliver care to more than one beneficiary at the same time."

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CMS Comments on Concurrent Therapies

- CMS further states
  - "Medicare policy has not, until now, specifically addressed coverage of skilled rehabilitation therapy situations in which a single professional therapist (or therapy assistant under the supervision of the professional therapist) simultaneously provides different treatments to multiple beneficiaries."

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CMS Released Final SNF PPS Rule on July 31, 2001

- CMS noted that it had "received a large number of comments encouraging us to ***continue to recognize concurrent therapy*** as skilled therapy" and further stated that
- "[W]e ***continue to believe***...that ***concurrent therapy has a legitimate place in the spectrum of care options*** available to therapists treating Medicare beneficiaries..."

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HEALTHSOUTH's Position on Concurrent Therapy

- Consistent with CMS, HEALTHSOUTH believes that concurrent therapy is, where determined in the professional judgment of the professional therapist, an appropriate way of helping patients reach individualized treatment goals in accordance with individualized plans of care.
- There is no clinical justification for applying CMS policy differently in Part B therapy services in an outpatient setting

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Concurrent Therapy Involves Use of Therapy Aides and Extenders

- Medicare regulations, under the caption "Personnel Qualified to Provide Physical Therapy Services." provide that covered "[p]hysical therapy services are provided by, or ***under the supervision of***, a qualified physical therapist."
- Supervised aides and other unlicensed technicians are permitted to render covered therapy under Medicare regulations

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CPT Coding System and Reimbursement

- CPT coding system does not distinguish between licensed and unlicensed therapy providers
- Under cost-based system utilized by Medicare for outpatient therapy services until January 1, 1999, aides were recognized costs and included in the construction of the fee schedules now used for reimbursement
- Payment for these services under the CPT code-based system anticipates that aides will participate in the provision of therapy services

HEALTHSOUTH

HHEC 612-0200
Confidential Treatment
Requested by HealthSouth Corp.

- ADD SLIDE ON RATIO OF PTs TO AIDES 1996-2000

HHEC 612-0201
Confidential Treatment
Requested by HealthSouth Corp.

CMS Recognizes Use of Aides

- When discussing Part B $1500 Therapy cap:
  - "If the services are delivered by a physical or occupational therapist, speech-language pathologist, therapy assistant or ***therapy aide***, are part of a rehabilitation plan of care, or involve [certain other services], then the services are subject to the cap."

HEALTHSOUTH

HHFC 612-0202
Confidential Treatment
Requested by HealthSouth Corp.

CMS Recognizes Use of Aides

- When providing hypothetical situations in the PTIP rulemaking:
  - A corporation operates a physical therapy practice which employs four physical therapists and several physical therapy assistants and aides. Each therapist could enroll as a physical therapist in private practice and could personally supervise any of the ***assistants or aides who help to render therapy***.

HEALTHSOUTH

HHEC 612-0203
Confidential Treatment
Requested by HealthSouth Cor

Industry Practices

- American Occupational Therapy Association, Director of Reimbursement and Regulatory Policy, Judy Thomas states that "***They [CMS] agree that concurrent therapy has a legitimate place in treatment and bow to the therapist's clinical judgment.***"

HEALTHSOUTH

HHEC 612-0204
Confidential Treatment
Requested by HealthSouth Cor

Industry Practices

- Cindy Susienka, president of AEGIS Therapies (Beverly Healthcare) believes that what CMS calls ***"concurrent therapy" is actually what therapists for over 20 years have been calling "dovetailing," in which therapy sessions with different patients overlap***
- Peter Clendenin,Executive Vice President of National Assoc. for the Support of Long-Term Care says ***"If [concurrent therapy] is done conscientiously and seriously, there's absolutely no harm."***

HEALTHSOUTH

HHEC 612-0205
Confidential Treatment
Requested by HealthSouth Corp.

Patient Satisfaction

"Measuring Quality Through the Eyes of the Customer"

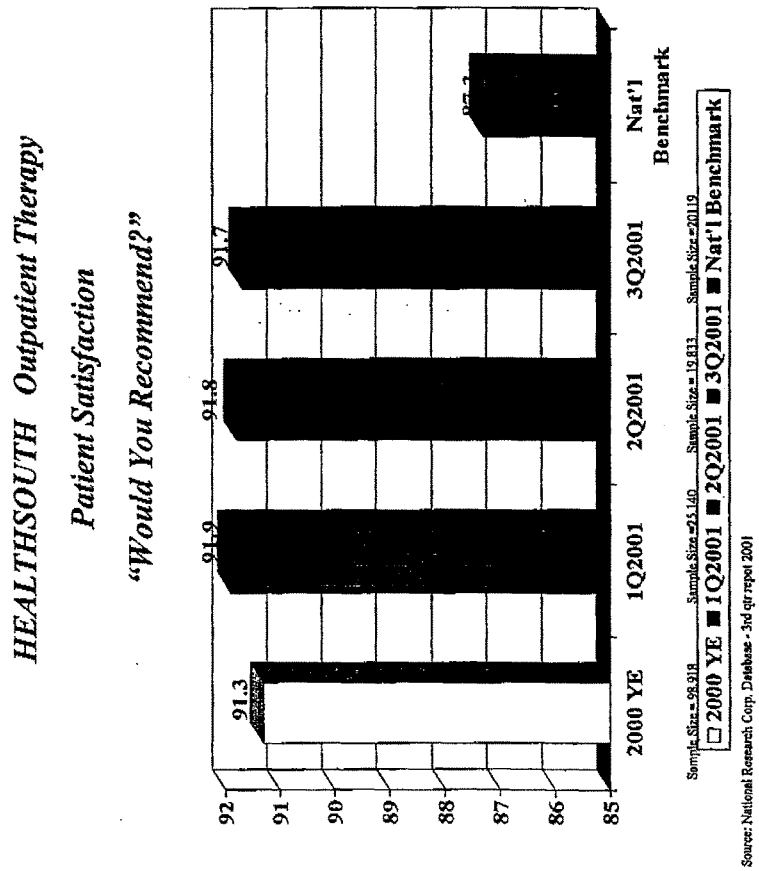
HHEC 612-0206
Confidential Treatment
Requested by HealthSouth Corp.

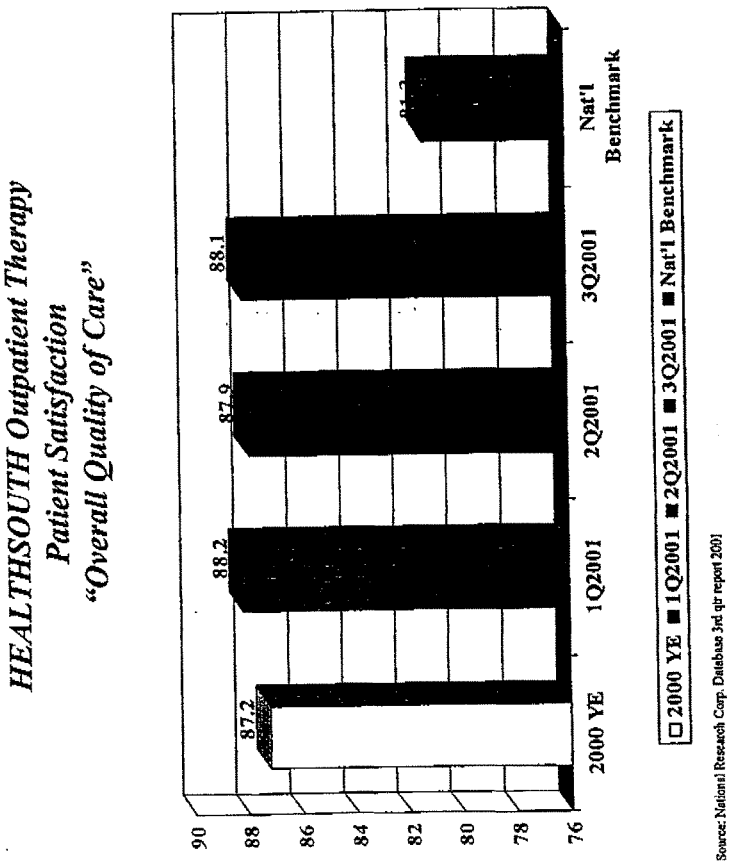
Commitment to Excellence

- Patient satisfaction is highly correlated with patient compliance and successful outcomes
- HealthSouth's tools used to analyze Patient Perception of Care:
  - Corporate Summary Reports
  - Corporate Ranking Reports
  - Facility level reports

HHEC 612-0207
Confidential Treatment
Requested by HealthSouth Corp.

10-07-03 05:02pm From-SASM&F LLP 2023717896 T-041 P.021/030 F-366



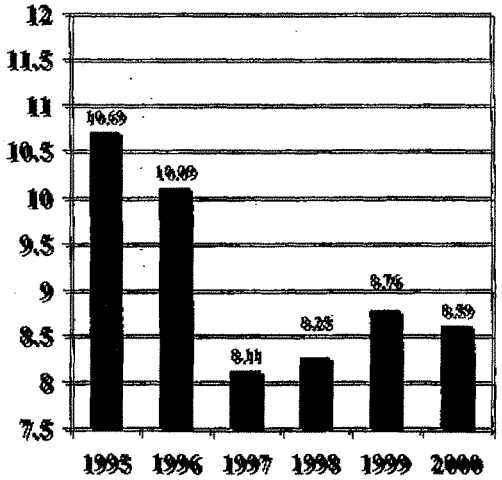

HEALTHSOUTH Outpatient Therapy
Patient Satisfaction
"Overall Quality of Care"
90
88
86
84
82
80
78
76
87.2
88.2
87.9
88.1
81.2
2000 YE
1Q2001
2Q2001
3Q2001
Nat'l Benchmark
2000 YE
1Q2001
2Q2001
3Q2001
Nat'l Benchmark
Source: National Research Corp. Database 3rd qtr report 2001

Outcome Data
Average Number of Visits per Case

Year by Year Comparison

*Mean Visits have decreased and stabilized

*Mean Visits: The average of visits for the sample size reported.



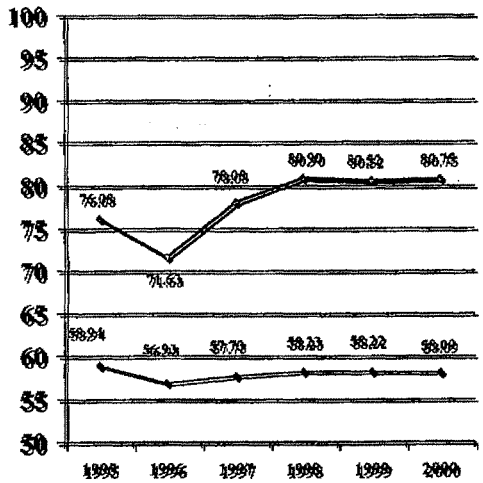
HHEC 612-0210
Confidential Treatment
Requested by HealthSouth Corp.

Outcome Data

Functional Levels at Admission Compared to Functional Levels at Discharge

Year by Year Comparison

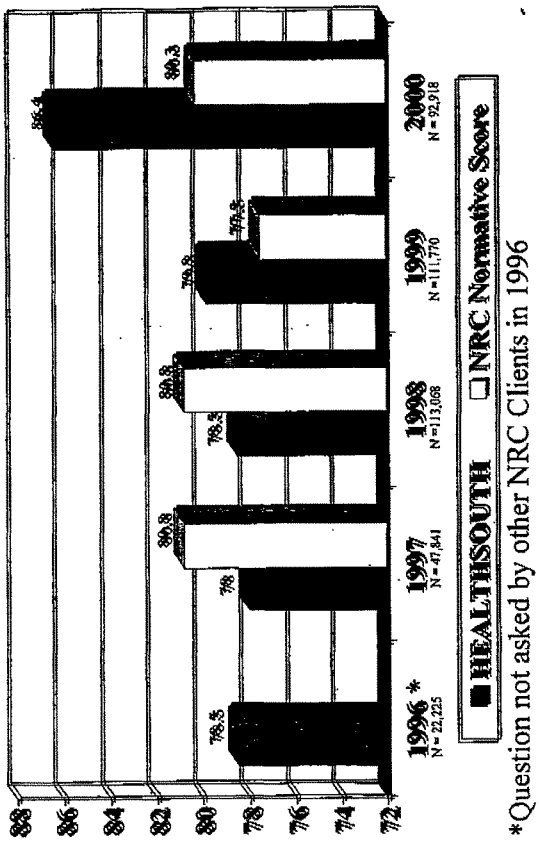
*Functional Scores have improved and stabilized



***Functional Scores:** The mean calculated functional score based on a Likert Scale. This score is based on patient input and clinical evaluation.

HHEC 612-0211
Confidential Treatment
Requested by HealthSouth Corp.

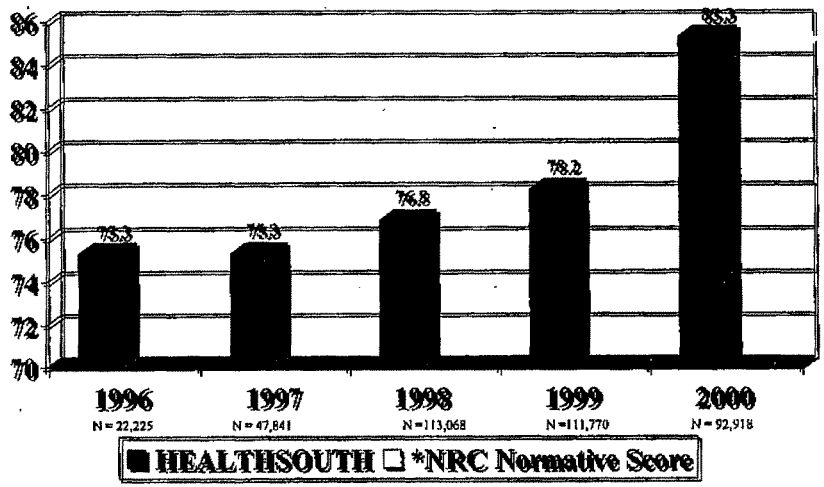
Helpfulness of Staff to Reduce Pain



*Question not asked by other NRC Clients in 1996

Source: National Research Corp. Database
Lincoln, NE

Clear & Complete Explanation About Therapy Goals/Progress



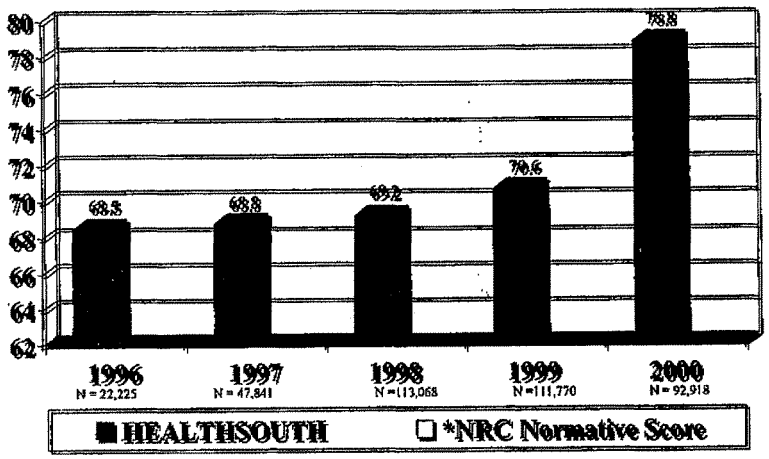
*Question not asked by other NRC Clients - This question is HEALTHSOUTH Specific

Source: National Research Corp. Database

Lincoln, NE

HHEC 612-0213
Confidential Treatment
Requested by HealthSouth Corp.

"Feeling That You Progressed Toward Rehabilitation Goal"



***Question not asked by other NRC Clients - This question is HEALTHSOUTH Specific**

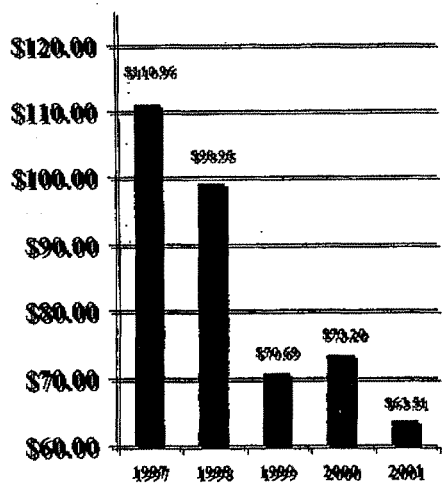
Source: National Research Corp. Database
Lincoln, NE

HHEC 612-0214
Confidential Treatment
Requested by HealthSouth Corp.

Outcome Data
Reimbursement per Visit

Year by Year Comparison

*Reimbursement per Visit decreased 43% over the last five years, while visits decreased 2%.

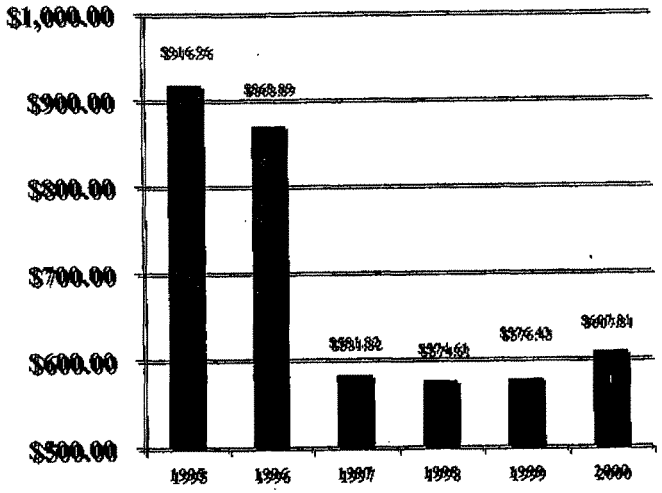


***Reimbursement:** This data is based on payments received and where the patient balance has been paid in full.

Outcome Data
Reimbursement per Case

Year by Year Comparison

*Reimbursement per Case



***Reimbursement:** This data is based on payments received as of 12/31/01.

HHRC 612-0216
Confidential Treatment
Requested by HealthSouth Corp.

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HHEC 612-0217
Confidential Treatment
Requested by HealthSouth Corp.

Hemard, Casey

From: b daut [b_daut@hotmail.com]
`ent: Tuesday, October 14, 2003 5:02 PM
‹o: Hemard, Casey
Subject: Fwd: Re: Current Stock Action

Tab 24

>From: "Scrushy, Richard" <rscrushy@healthsouth.com>
>To: "'b_daut@hotmail.com'" <b_daut@hotmail.com>
>Subject: Re: Current Stock Action
>Date: Fri, 8 Nov 2002 16:31:24 -0600
>
>We did well today with the pressure healthcare had. Tenant traded 93m
>shares. Hrc will do well over time. We will recover. I have a large
>position
>and I will do everything I can and is possible to build wealth for all
>shareholders. Don't forget the goverment cut was not our fault but we will
>do everything we can to reduce the impact. Hold on would be my advice and
>accumulate if possible. I believe we have a great company and time will
>prove just that. Thanks rs
>----------
>Sent from my BlackBerry Wireless Handheld (www.BlackBerry.net)
>Confidentiality Notice: This e-mail communication and any attachments may
>contain confidential and privileged information for the use of the
>designated recipients named above. If you are not the intended recipient,
>you are hereby notified that you have received this communication in error
>and that any review, disclosure, dissemination, distribution or copying of
>it or its contents is prohibited. If you have received this communication
in error, please notify me immediately by replying to this message and
>deleting it from your computer. Thank you.

Send instant messages to anyone on your contact list with MSN Messenger
6.0. Try it now FREE! http://msnmessenger-download.com

Tab 25

From: Hirsch, Hal <hhirsch@fulbright.com>
Sent: Monday, October 21, 2002 6:16 AM
To: LDavis@PattonBoggs.com, AGoldberg@PattonBoggs.com, ehanson@usstrategies.com, Hervey, Jason, rpmay@aol.com, bobmay9788@msn.com, jlpowell@webershandwick.com, state@webershandwick.com, hschwartz@webershandwick.com, michael.deaver@edelman.com, hollis.rafkin-sax@edelman.com, Scrushy, Richard
Subject: Re: Urgent--Privieged Attorney Client and Work Product

The document will be presented to the Board on Tuesday morning.
-hmh
Hal M. Hirsch, Partner
Fulbright & Jaworski, LLP
666 Fifth Avenue
New York, New York 10103
(212) 318-3105 (dir.)
(201) 788-9800 (cell)
(212 318-3400 (fax)
hhirsch@fulbright.com

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are not the intended recipient, please contact the sender by reply email and
destroy all copies of the original message and any attachments.

-----Original Message-----
From: Davis, Lanny <LDavis@PattonBoggs.com>
To: 'hhirsch@fulbright.com' <hhirsch@fulbright.com>; Goldberg, Adam <AGoldberg@PattonBoggs.com>; 'ehanson@usstrategies.com' <ehanson@usstrategies.com>; 'jason.hervey@healthsouth.com' <jason.hervey@healthsouth.com>; 'rpmay@aol.com' <rpmay@aol.com>; 'bobmay9788@msn.com' <bobmay9788@msn.com>; 'jlpowell@webershandwick.com' <jlpowell@webershandwick.com>; 'state@webershandwick.com' <state@webershandwick.com>; 'hschwartz@webershandwick.com' <hschwartz@webershandwick.com>; 'michael.deaver@edelman.com' <michael.deaver@edelman.com>; 'hollis.rafkin-sax@edelman.com' <hollis.rafkin-sax@edelman.com>; 'rscrushy@healthsouth.com' <rscrushy@healthsouth.com>
Sent: Sun Oct 20 23:00:25 2002
Subject: Urgent--Privieged Attorney Client and Work Product

Talked to RS for one hour late tonite and conferred with Bob May too. RS

now
leans in favor of public release of complete Fulbright Report on Wed am
after presentation to Board on Tues. Bob May agrees.

This is of course subject to everyone on this email list hearing the
report
read in full by Hal some time on Monday--and perhaps reading along with
Hal
if he can email us penultimate draft, as he has indicated to me.

In my opinion, after discussion with most of you Sun nite, just
releasing
the first section on methodology and just last paragraph clearing RS
will
lack context and credibility. I also believe once everyone hears the
full
factual chronology in the Fulbright Report, all will conclude that it
needs
to be available to shareholders and the public, and that it provides a
critical basis for accountabiity and remediation by the
Board--something
shareholders are demanding and the press is waiting for. Not releasing
it
also will look like a pullback on our prior commitment to
transparency--with
little credible explanation.

Adam--please set up conf call with all on the above email list so that
Hal
can read the report to all first thing in am. I will be out of town and
returning to DC at 2 pm EST. I propose a second conf call at 4 pm EST
to
reach final judgments on strategy.

This e-mail message contains confidential, privileged information
intended
solely for the addressee. Please do not read, copy, or disseminate it
unless you are the addressee. If you have received it in error, please
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us (collect) at (202) 457-6000 and ask to speak with the message sender.
Also, we would appreciate your forwarding the message back to us and
deleting it from your system. Thank you.

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http://www.pattonboggs.com.

JONES DAY
51 LOUISIANA AVENUE, N.W.
WASHINGTON, D.C. 20001-2113
TELEPHONE: 202-879-3939 • FACSIMILE: 202-626-1700

WRITER'S DIRECT NUMBER:
202-879-3888
jcrose@jonesday.com

Tab 26

October 7, 2003

VIA FACSIMILE

The Honorable Jim Greenwood
Chairman, Oversight and Investigations Subcommittee
U.S. House of Representatives
Committee on Energy and Commerce
2125 Rayburn Home Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am in receipt of your recent letter requesting that my client, Richard M. Scrushy, appear and testify before the Subcommittee on Oversight & Investigations next week. Mr. Scrushy will appear voluntarily at the hearing on Thursday, October 16, 2003 at 9:30 a.m. as you have requested, and therefore will not require a subpoena.

For all of the reasons that I explained in my September 24, 2003 letter to you, however, which I am attaching for your reference, he will not answer any questions and will instead assert his Constitutional rights under the Fifth Amendment not to testify. Nor will Mr. Scrushy be submitting a written statement in advance of the hearing as you invited him to do.

We are disappointed that the Committee has not seen fit to comply with our request that Mr. Scrushy's testimony be postponed until the conclusion of the criminal investigation so that he would be able to testify fully and answer the Committee's questions. The timing of this hearing, coming as it does at a very sensitive stage of the ongoing criminal investigation, leaves him no choice but to exercise his Constitutional rights under the Fifth Amendment.

We will see you at the hearing next Thursday.

Sincerely yours,

Jon Rose /gd

Jonathan C. Rose

JONES DAY
51 LOUISIANA AVENUE, N.W.
WASHINGTON, D.C. 20001-2113
TELEPHONE: 202-879-3939 • FACSIMILE: 202-626-1700

WRITER'S DIRECT NUMBER:
202-879-3888
jcrose@jonesday.com

September 24, 2003

The Honorable Jim Greenwood
Chairman, Oversight and Investigations SubCommittee
U.S. House of Representatives
Committee on Energy and Commerce
2125 Rayburn Home Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The purpose of this letter is to request on behalf of Mr. Scrushy that his appearance before the Committee scheduled for Wednesday, October 8 be postponed until the conclusion of the criminal fraud investigation of HealthSouth by the U.S. Attorney for the Northern District of Alabama. As stated below, if the requested postponement is not granted, Mr. Scrushy will voluntarily appear at the date and time stipulated and will not require a subpoena.

The requested postponement would not unduly inconvenience the Committee which, as far as we are aware, has no legislation currently pending before it nor any specific deadline for the completion of its HealthSouth investigation. However, the conclusion of the U.S. Attorney's criminal investigation would free Mr. Scrushy to testify fully to the Committee about the entire history of and current events at HealthSouth. It would also avoid intrusion by the Committee into the middle of the U.S. Attorney's investigative process at a very delicate stage.

Mr. Scrushy has nothing to hide from this Committee or the public. Indeed he cooperated as fully with the Committee's investigation as he reasonably can, given the pending criminal investigation. He has given the Committee full access to all his relevant documents, and is prepared, prior to the completion of the criminal investigation, to give either sworn testimony to the Committee, subject to use immunity, or to be interviewed by the Committee or its staff. The Committee's publicity agent, Mr. Ken Johnson, has inaccurately characterized the foregoing as a search for some sort of "sweetheart deal". It assuredly is not that. Rather, it is a sincere effort by Mr. Scrushy to provide the Committee with all relevant information, if information is what it truly seeks.

However, we have been advised that the Committee is unwilling to accept Mr. Scrushy's testimony either on a use immunity basis or, to make appropriate arrangements to interview him informally "because the Justice Department would object." We do not know if this is truly the Justice Department's position, but it underlines the central problem we face as Mr. Scrushy's counsel. Mr. Scrushy would very much like to tell his story and the sooner the better. However, all of us have seen the staff of this Committee work on past hearings in conjunction with the

(11)

JONES DAY

The Honorable W.J. "Billy" Tauzin
September 24, 2003
Page 2

Department of Justice to create "perjury traps" and other snares for grand jury targets involving allegedly inconsistent sworn statements on wholly collateral matters. We do not believe that is a legitimate function of a congressional investigation. Nor is testimony under these circumstances a risk that competent counsel can recommend to a client currently subject to an ongoing criminal investigation. For these reasons Mr. Scrushy will be forced to exercise his 5th amendment rights if his appearance is not postponed as we have requested.

We are of course aware that this sort of prudent legal advice aimed at avoiding perjury traps often leaves many false allegations in the national media unanswered and thereafter often repeated. For that reason we concurred with Mr. Scrushy's decision to give Mike Wallace an exclusive interview on 60-Minutes without lawyers present and with no questions barred. That interview will air this Sunday, September 28. Given the Committee's determination not to interview Mr. Scrushy on a similar basis, we trust that interview will serve any immediate public need for information from him.

This leaves the question of the propriety of the Committee's demand that Mr. Scrushy appear before it simply so that he can be compelled to assert his constitutional rights on national television and be subjected to whatever punitive rhetoric members may choose. This issue is not new. Indeed, it dates back to the so-called red-baiting or McCarthy era of the late 1940's and 50's. After that short period of abuse, more enlightened Congressional rules until very recently prohibited the public browbeating and humiliation of Committee witnesses on national television after they notified a Committee of their intention to assert the Fifth amendment. The partisan fervor generated by the Clinton fundraising scandals stimulated the abandonment of these protections and a return to prior, more primitive practices.

Recent articles in national publications have suggested that this Committee's hearings on corporate scandals are primarily geared toward attracting the broadest possible publicity. Last summer, *U.S.A. Today* published a penetrating analysis (copy attached) headlined "Rep. Tauzin Turns Business Scandals Into Must-See TV." The article laid out the now familiar strategy of the Committee's publicity staff: "dribble out damaging documents, orchestrate hearings down to camera angles, and put the panel's 57 numbers to work pummeling even silent witnesses."

While prior chairman John Dingell has stated, "There's nothing like a good public hanging," many thoughtful critics disagree. They state in the article the Committee's current focus on "media attention and public humiliation has helped turn the process into a circus." Other parts of *U.S.A. Today*'s piece deplore Committee press conferences "from which no one will recover" and further speculate about the multiple motives of member exposure, fundraising, and even retaliation underlying some of these hearings.

It is not necessary to agree with any of these speculations to deplore the process on which the Committee seems currently embarked. As the *Washington Post* editorialized (copy attached) when the corporate scandal hearings first began, "Congress should not be forcing any witness to

JONES DAY

testify solely in order to have television cameras filming their refusals. The whole idea of Congressional hearings is that they elicit information that can then be used for legislation . . . There is no legitimate purpose in creating a spectacle . . .".

However, as much as we may deplore it, we recognize that it is well within the power of this Committee to insist upon a spectacle if it wishes to do so. We therefore give our assurance to the Committee that Mr. Scrushy will appear here on the date and time set by the Committee if it wishes him to be here and that it will not be necessary, as its spokesman Ken Johnson colorfully expressed it, to "wallpaper his house with subpoenas".[1]

We would simply point out that many investors and employees of HealthSouth have already suffered from the massive publicity given to government claims which have greatly exaggerated the size of the frauds at HealthSouth. In addition to rumors of bankruptcy and widespread layoffs, these allegations drove HealthSouth's stock price from $3.91 to 10 cents and off the New York Stock Exchange thereby damaging countless investors. The truth has only just now caught up and the stock has fully recovered.

Indeed, the Committee's continued references to the so-called financial collapse at HealthSouth on its website and in press releases appear aimed at stimulating press hysteria about the company, rather than a factual analysis of its true situation. A company with a projected operating margin of 16.%, with projected EBITA of $650 million on consolidated net revenues of $4.1 billion is an exceedingly healthy company - hardly one on the verge of financial collapse. One can only hope that the Committee, in its proposed hearings. will attempt to avoid further damage to the Company through additional unwarranted negative publicity.

We are confident that Mr. Scrushy's conduct with respect to HealthSouth will be vindicated. Further, any unjustified humiliation he might temporarily experience at the hands of the Committee will be insignificant compared to the losses many shareholders and employees beyond himself have suffered. However, we submit that the Committee through what USA Today has characterized as its impatient search "for media exposure . . . with little concern for the objective facts or fairness" will further undermine public confidence in the integrity and justice of the political process in general and the Congress in particular.. This is a prospect which none of us can regard with any enthusiasm.

[1] Birmingham News, June 26, 2003, p. 1-D. (copy attached).

JONES DAY

The Honorable W.J. "Billy" Tauzin
September 24, 2003
Page 4

Thank you very much for your consideration of our postponement request.

Sincerely yours,

Jonathan C. Rose

Jonathan C. Rose

USATODAY.com

Rep. Tauzin turns business scandals into must-see TV ; Aggressive tactics have plenty of fans, critics:[FINAL Edition]

Jayne O'Donnell. USA TODAY. McLean, Va.: Jul 26, 2002. pg. B.01

Abstract (Article Summary)

Despite the naysayers, there's little question [Billy' Tauzin] has resuscitated a panel that was largely moribund after Republicans took over the House in 1994. It's too early to compare Tauzin's tenure with [John Dingell]'s 13-year reign, but many believe it will be hard for Tauzin to stack up.

With a Bell unit providing local phone service and a non-Bell long-distance business, Qwest was conflicted over Tauzin's telecom bill, which would require it to build costly high-speed Internet lines everywhere it operates, including sparsely populated areas. Tauzin's bill, co-sponsored by Dingell, passed the House handily on Feb. 27. But many members from areas where Qwest operates voted against it, angering some of the committee staff, according to people familiar with the situation. Qwest received an official letter within two weeks notifying it of an Energy and Commerce probe.

GRAPHIC, B/W, Source: Center for Responsive Politics (CHART); Ready for his close-up: Fox News' Grigory Khananayev, standing, gets Rep. Billy Tauzin ready for an interview last week in the Cannon House Office Building. Tauzin is a master of using the media to get his message out. On the go: Billy Tauzin walks with committee spokesman [Ken Johnson] between appointments in the House office buildings on Capitol Hill.

Full Text (2047 words)

Copyright USA Today Information Network Jul 26, 2002

WASHINGTON -- Corporate executives sit at a table -- some defensive, some contrite, some mute, all uncomfortable -- staring up at fist-pounding, paper-rattling members of the House Energy and Commerce Committee.

As corporate scandals have unfolded, a number of House and Senate committees have held hearings with similar scenarios. But no one has turned humdrum legislative process into made-for-TV melodrama like Energy and Commerce Chairman W.J. "Billy" Tauzin.

His strategy: Demand and then dribble out damaging documents, orchestrate hearings down to camera angles and put the panel's 57 members to work pummeling even silent witnesses. It's enough to strike fear in the hearts of businesses everywhere.

To those who believe public embarrassment is a deterrent to white- collar crime, the committee is doing yeoman's work. As John Dingell of Michigan, the committee's ranking Democrat and former chairman, likes to say, "There's nothing like a good public hanging."

But critics say the committee's emphasis on media attention and public humiliation has helped turn the process into a circus with little follow-through once the cameras go away.

Tauzin, a Louisiana Republican who was once a Democrat, says his efforts have changed the way CEOs and corporate directors view their responsibilities. Committee spokesman Ken Johnson -- nicknamed "Congressman Johnson" for his prominence in the media -- says the panel deserves considerable credit for the ouster of at least six CEOs, the guilty verdict against accounting giant Arthur Andersen and the attention to possible illegal trading on inside information at biotech company ImClone.

While Congress goes on its August recess, there will be little rest for committee investigators, who will comb through documents from companies they are investigating. Then, in September, Tauzin and Investigations Subcommittee Chairman James Greenwood, R-Pa., may ratchet up their probes with a hearing a week.

A 59-year-old lawyer and amateur actor, Tauzin has been a fixture in the media for the nearly two years he has been running the corporate inquisitions -- dating back to the Firestone tire/Ford Explorer hearings in fall 2000.

With what friends and colleagues describe as a razor-sharp mind and biting wit, the colorful Cajun is unrelenting with hearing witnesses and ever-ready with sound bites for reporters. But he dismisses talk that he's more of a showman than a legislator. He says his skin is as thick as that on the faux alligator head on his office coffee table.

"The thing I dislike most about this town is that everyone finds a reason to get in your way when you're doing your job," Tauzin says. "We have an obligation here."

While some in business recognize Energy and Commerce's approach as good public relations that they happen to be on the wrong side of, others say the committee's quest for ink and airtime has a dangerous downside.

In one much-criticized move, Tauzin announced at his third Ford/ Firestone hearing that seven of about 60 tires Ford was using to replace Firestone tires might be more dangerous than the ones that were being taken off. The list of replacement tires was released with no indication which ones were suspect.

The National Highway Traffic Safety Administration opened an investigation into one tire but closed it without a recall. Ford voluntarily took a tire off the replacement list -- a move Johnson says shows the committee did the right thing. Ford wouldn't comment, but people familiar with its position say the company was livid that the committee risked scaring people away from cooperating with the recall.

Cutting through the politics

But his supporters say Tauzin is the right kind of chairman for today.

"He's a pre-eminent legislator and never, ever makes a move without being fully informed," says Herschel Abbott, a longtime friend who is BellSouth's vice president of governmental affairs. "He is a larger-than-life personality and uses humor better than anyone I know to make his point."

With Enron, "It hasn't always been clear what was going on and who was involved, but they cut through the politics and the sophisticated finance to get to the heart of what all this means to average Americans," Sen. Peter Fitzgerald, R-Ill., says of Energy and Commerce. Tauzin "has really done a stellar job of organizing his committee's investigations, calling the right witnesses to testify and asking the right questions."

Greenwood says Justice Department and Securities and Exchange Commission probes of corporate wrongdoing take too long and are too secretive for most people. By opening portions of their investigations, the committee provides a valuable service, he says. "My view is that we need to send a big, big message to Corporate America that Congress is watching."

Some investors agree. "Our justice system is based on the theory of innocent until proven guilty. I don't think applies to congressional hearings, especially when all signs clearly point to malfeasance among the corporate executives," says Mike Gibson, a sales director for Hilton Hotels. "These executives should be held accountable for misusing their positions."

Tauzin honed his hearings skills before he was committee chairman, when he led the Firestone/Ford subcommittee hearings, which resulted in some great television. Photos of crashed Explorers were positioned in the hearing room so that they were in every shot as former Ford Motor CEO Jacques Nasser testified. When former Bridgestone/Firestone CEO Masatoshi Ono testified, his face was often captured through a tattered tire positioned in front of him.

Tauzin also points out that the committee produced tire-safety legislation at breakneck speed. The sweeping law requires, among other things, that automakers and tiremakers report defects discovered in the USA and other countries and lawsuits or claims that show a safety problem -- or risk going to jail.

But Energy and Commerce members have long believed photos of alleged bad guys raising their right hands before Congress can be as effective deterrents as new laws. "Results come in many different forms and fashions," Tauzin says. "I don't believe government ought to be solving every problem in America."

Defense lawyers critical of tactics

Many defense lawyers are sharply critical of the practice of dragging executives who refuse to testify before the panel. Some say the practice merely helps members impress the folks back home with statements and questions to silent witnesses.

"I don't believe they should require the presence of witnesses who they know will assert their Fifth Amendment rights in order to humiliate them in a public setting," says Washington lawyer, Robert Bennett, who represents Enron. "This does not advance the factual inquiry or the legislative or oversight goals and demeans the congressional process."

Some folks back home agree that it amounts to non-productive grandstanding. "I think it is a waste of time and my money to have them go to D.C. and stage this for the cameras," says South Dakota- based air traffic controller Bob Huggins. "If the politicians want to campaign . . . pay the money and advertise on TV."

Rusty Hardin, who defended Arthur Andersen in its criminal trial, says pretrial publicity by Energy and Commerce helped poison the well of potential jurors.

"I think that committee's use of documents is outrageously unfair. . . . They did it with Andersen, and they're doing it with WorldCom," he says. "I don't know the facts (on WorldCom), but they don't either. They have a bunch of documents, which they get by subpoena. And without investigating, they're giving press conferences from which no one will recover."

Says Tauzin: "If I lost the case, I'd be looking for an excuse, too."

Despite the naysayers, there's little question Tauzin has resuscitated a panel that was largely moribund after Republicans took over the House in 1994. It's too early to compare Tauzin's tenure with Dingell's 13-year reign, but many believe it will be hard for Tauzin to stack up.

Under Dingell, the panel helped send 13 Food and Drug Administration and industry officials to jail, helped bring down junk bond king Michael Milken and led the charge against Defense Department procurement scandals.

It's also too soon to know what Tauzin's role, if any, will be in the prosecution of officials from Enron to WorldCom. In an early sign of victory, Johnson cites the committee's discovery and release of an e-mail by Andersen attorney Nancy Temple to Arthur Andersen Enron auditor David Duncan suggesting he doctor a statement criticizing Enron's accounting. The e-mail was cited by jurors as the turning point in their decision to convict Andersen.

It is clear that Energy and Commerce's authority and visibility have made it one of the most highly sought-after committee assignments. Tauzin says at least 90% of the last incoming freshman class asked to be named to the panel. He says it's because of the panel's reputation and scintillating work, but the money can't hurt either. Energy and Commerce members received more corporate and individual contributions than any other House committee members during the 2000 election cycle and so far this election period, according to the Center for Responsive Politics.

Qwest could be next target

Energy and Commerce has taken advantage of – some say stretched the bounds of – the broadest committee jurisdiction in Congress. "We can literally investigate most anything that happens in the country," Tauzin says.

The next to feel that investigative zeal may be Qwest Communications. In February, the committee's investigations subcommittee was starting to look into telecom companies' questionable accounting practices just

as a House vote on Tauzin's prized bill to further deregulate local phone service was looming. Just days before the vote on the bill, Qwest, the one regional Bell company that wasn't actively lobbying for the bill, was presented with a letter, stamped "draft," asking for extensive documents on its accounting. A formal investigation might not have to be opened, Qwest was told.

With a Bell unit providing local phone service and a non-Bell long-distance business, Qwest was conflicted over Tauzin's telecom bill, which would require it to build costly high-speed internet lines everywhere it operates, including sparsely populated areas. Tauzin's bill, co-sponsored by Dingell, passed the House handily on Feb. 27. But many members from areas where Qwest operates voted against it, angering some of the committee staff, according to people familiar with the situation. Qwest received an official letter within two weeks notifying it of an Energy and Commerce probe.

People familiar with the discussions say there were no overt threats. Johnson says the company's lack of lobbying on the bill was not connected to the probe. He says the committee asked informally for documents and then opened an investigation after the SEC did so in early March.

"Did we twist some arms during the Tauzin-Dingell debate? Sure. But there was never any implied or expressed quid pro quos as far as Qwest was concerned," says Johnson. "It's just a coincidence." Qwest would not comment.

Now, Qwest joins WorldCom, Global Crossing and ImClone on the list of companies that may be the subject of hearings when Congress returns in September.

With their dual roles as legislators and investigators, Energy and Commerce members wield considerable clout. Some say it goes too far, but Johnson says Tauzin wouldn't allow the committee or its staff to abuse its power.

Adds staff director David Marventano: "We could have investigated everyone who came out against us on Tauzin-Dingell, but we didn't."

TEXT OF BIO BOX BEGINS HERE

About W.J. 'Billy' Tauzin

Career: Member of the U.S. House of Representatives 1980- present; chairman, Energy and Commerce Committee since January 2001; member, Resources Committee; lawyer; former state legislator

Age: 59

Family: Married; five children from first marriage

Hobbies: Hunting, fishing, comedy theater

Last book read: A Confederacy of Dunces by John Kennedy Toole

Favorite book: The Brothers Karamazov by Fyodor Dostoyevsky

Books he's written: The National Retail Sales Tax, a proposal to abolish federal income tax, and Cook and Tell, a Cajun cookbook

Book he's writing: A novel involving a one-legged stripper

Contributing: Greg Farrell

[Illustration]
GRAPHIC, B/W, Source: Center for Responsive Politics (CHART); PHOTO, Color, H. Darr Beiser, USA TODAY; PHOTO, B/W, H. Darr Beiser, USA TODAY; Caption: Ready for his close-up: Fox News' Grigory Khananayev, standing, gets Rep. Billy Tauzin ready for an interview last week in the Cannon House Office Building. Tauzin is a master of using the media to get his message out. On the go: Billy Tauzin walks with committee spokesman Ken Johnson between appointments in the House office buildings on Capitol Hill.

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Subjects:

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In Defense of Kenneth Lay

February 12, 2002; Page A24

FORMER ENRON chairman Kenneth Lay is due to testify today before a Senate panel. He has already announced that he will assert his Fifth Amendment right to remain silent, so you might wonder what the point of going through the entire exercise will be. How naive. It will serve three very critical purposes: Getting senators on TV, getting senators on TV and getting senators on TV. Oh, yes. It will also humiliate a witness who remains, lest senators forget, innocent until proven guilty. Mr. Lay isn't a sympathetic figure; nor are the Enron executives who were dragged up to Capitol Hill by a House subcommittee to take the Fifth last week. But the attractiveness of the witnesses is not the issue. Congress should not be forcing any witnesses to testify solely in order to have television cameras filming their refusals. The whole idea of congressional hearings is that they elicit information that can then be used for legislating. When members know that a witness is not going to provide information, there is no legitimate purpose in creating a spectacle. The idea is for the members to appear to be holding the witnesses' feet to the fire, and to impute guilt to them through their refusal to answer questions. That may be fun for the members, but it tarnishes an important constitutional protection. There are, after all, legitimate reasons why an innocent -- or largely innocent -- person might decline to testify under the current circumstances.

Admittedly, this sort of grandstanding has a long history. But not all congressional investigative committees have stooped to it. Sen. Sam Ervin, who chaired the Senate's Watergate investigation, refrained. That's the way to go now, too. An investigation with a lot of ground to cover shouldn't waste time putting on a show -- even to shame Mr. Lay.

Return to Search Results

Birmingham News (AL)

PANEL DEMANDS SCRUSHY RECORDS EX-CEO ACCUSED OF STALLING PROBE

June 26, 2003
Section: Business
Page: 1-D
MARY ORNDORFF News Washington correspondent

WASHINGTON - Congressional investigators on Wednesday accused Richard Scrushy of dodging their request for documents and threatened to force the former HealthSouth chief to provide the records.

"We got a song and dance from Mr. Scrushy's attorney today but not the documents we wanted," said Ken Johnson, a spokesman for the House Energy and Commerce Committee. "Mr. Scrushy must turn over everything we need to conduct our investigation, or we will wallpaper his house with subpoenas."

But Scrushy's attorney argued there was an agreement with the committee staff to provide only an index of the records they've asked for, and not the full 30 boxes. Jonathan Rose said the index was being delivered to Capitol Hill Wednesday night.

"He is in no way evading the committee's document request, and anybody that says he is flatly inaccurate about it," said Rose, a Washington-based lawyer for Scrushy.

Scrushy was asked two weeks ago to provide all of his records related to HealthSouth, its business partners and his private companies. The deadline was Wednesday, and Johnson said the index was inadequate.

The committee, chaired by Rep. W.J. "Billy" Tauzin, R-La., is known for its highly publicized interrogations of wealthy corporate chieftains whose companies have crumbled under massive accounting fraud. The committee plans a hearing on HealthSouth for later this summer.

Congressional investigators have expressed a special interest in whether Scrushy orchestrated the fraud that so far has snagged 11 criminal convictions of former executives, including those of every chief financial officer in the company's history.

The Securities and Exchange Commission and federal prosecutors allege HealthSouth inflated earnings and assets by $2.5 billion since 1997. Scrushy has not been charged with a crime.

There is also a dispute over the reason Scrushy gave for not turning over copies of the records. Johnson said the Scrushy lawyers provided a "sad story" that it would be a financial burden.

"Frankly, I am flabbergasted that Mr. Scrushy, who has hired an army of lawyers and who has made several hundreds of millions of dollars in selling HealthSouth stock over the years, would represent to this committee that he does not want to incur costs associated with copy ing documents that are responsive to our requests. That is unacceptable," said Rep. James Greenwood, R-Pa., and chairman of the investigations subcommittee.

But Rose countered that the committee is asking for documents that were either provided to Scrushy by the SEC during an earlier court hearing or already turned over to the committee by HealthSouth's former accountant, Ernst & Young.

"We offered to have them come down here and inspect them and tell us which they would like copied," Rose said. "Once they decide what they want, as long as it's a reasonable number of documents, we'll be happy to copy them."

Finally, the two sides differ on what "personal" information Scrushy is required to provide. The committee's definition of records includes e-mails, appointment books and diaries, and investigators specifically asked for anything related to Scrushy's other companies, such as Marin Inc. But Rose said it would provide information only related to HealthSouth Corp.

"Unfortunately this appears to be a public relations exercise by the committee," Rose said. "I was trying to deal with it as a serious legislative inquiry."

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09-30-03 03:11pm From-SASM&F LLP 2023717896 T-023 P.001 F-944

ORIGINAL

Tab 27

TELECONFERENCE OF HEALTHSOUTH CORPORATION

3D QUARTER FINANCIAL RESULTS

November 5, 2002

HHEC 581-0001
Confidential Treatment
Requested by HealthSouth Corp.

1 MR. SCRUSHY: Thank you very much
2 and I'd like to thank everyone for dialing
3 in today the HealthSouth third quarter
4 conference call. I'd like to begin by
5 stating that third quarter was a challenging
6 quarter for the company. The introduction
7 of Transmittal 1753 certainly had an impact
8 on the company. We had the negative press,
9 a lot of bad press on the company, which
10 created some problems for us in terms of
11 referrals, and so we took a hit in that
12 particular area.
13 The revenue increased by about 3
14 percent. That's excluding divestitures
15 versus third quarter of last year. The
16 impact, really where we were hurt the most,
17 was in the outpatient area. We had a 14
18 percent reduction in volume resulting in
19 about a 17 percent reduction in revenue
20 decline. This, of course, was due to lower
21 reimbursement, the Transmittal 1753 impact,
22 which that shows up in the pricing. Bill

HHEC 581-0003
Confidential Treatment
Requested by HealthSouth Corp.

1 Owens will talk about that in a moment,
2 which is about an 11 percent reduction in
3 pricing. So you had a 14 percent reduction
4 in volume driving a 17 percent reduction in
5 revenue in that particular area. But
6 there's a lot of good news we're going to
7 talk about as well in other divisions, and
8 we'll walk you through that in a moment and
9 go through all the statistics.
10 As we had a lower revenue number
11 we had an increase in our A.R. days. But if
12 we were able to keep those revenues flat we
13 would have shown only a very slight
14 increase. We had about an $18.5 million
15 increase in A.R., so our reduction, if we
16 hadn't have had -- without the reduction in
17 revenue we would have had about an 80.5 days
18 in A.R. But with the reduction it actually
19 drove it up to 86.5.
20 Now there were a lot of positives
21 in this challenging quarter. Outside of the
22 outpatient rehab all of the business lines

HHEC 581-0004
Confidential Treatment
Requested by HealthSouth Corp.

1 had higher revenues versus third quarter of
2 last year. Inpatient revenue was actually
3 up 12 percent versus third quarter of last
4 year. Same-store volume growth and
5 inpatient diagnostic and surgery, we had
6 double-digit growth in inpatient revenues.
7 Now pricing increased over third
8 quarter of last year in the inpatient and in
9 the surgery area. I think something very
10 important here is that the company had a net
11 debt reduction of $111 million in the
12 quarter even after buying back $31 million
13 of our stock. Obviously we were in the
14 market buying stock back as our pricing went
15 down. So we would have pushed $140-plus
16 million in debt reduction had we not spent
17 the $31 million on our stock. So very
18 strong in that respect and so there are some
19 very good positives here that I think we
20 need to take a look at.
21 Now I want to ask Bill Owens, our
22 CEO, to walk through the financial

HHEC 581-0005
Confidential Treatment
Requested by HealthSouth Corp.

Tab 28

Please address this with Vicki or myself no later than today, I'm sure you have a lot going on but I need some kind of information Thanks. I can be reached at 800/946-4646 pin 1439345.

-----Original Message-----
From: **Schlatter, Steve**
Sent: Wednesday, April 25, 2001 10:20 AM
To: Jimenez, Walt
Cc: Schmidt, Bill
Subject: FW: HCAP-HCFA GROUP THERAPY?

I have been advised that Bill is not in his office today. I really would like some Corporate input re: this matter. Thanks.

-----Original Message-----
From: **Schlatter, Steve**
Sent: Tuesday, April 24, 2001 4:53 PM
To: Schmidt, Bill
Subject: FW: HCAP-HCFA GROUP THERAPY?

I knew you have a lot going on right now but I feel this needs to be addressed from a compliance standpoint. Jon has not responded and when I mentioned it to Vicki she responded that she would worry about it when someone from Corporate told her to worry about it. Not the type response that I was hoping for. Appreciate your thoughts and suggestions.

-----Original Message-----
From: **Schlatter, Steve**
Sent: Monday, April 23, 2001 7:17 AM
To: Santini, Jon
Cc: Schmidt, Bill
Subject: HCAP-HCFA GROUP THERAPY?

I read something in the Eli rehab report that concerns me re: HCFA code 97150 which states the 97150 code must be used when a therapist performs procedures with two or more individuals concurrently or during the same time period. This code obviously pays much less and I do not see how that can be documented on HCAP? As you know treating two or more patients at the same time is probably the rule more than the exception. Vicki Sherman is coming here today and I will pose this question to her. I would appreciate your input. One of my therapists has presented this concern to me as well thus I must respond soon. THANKS.

Schlatter, Steve
From: Santini, Jon
Sent: Wednesday, April 25, 2001 1:49 PM
To: Jimenez, Walt
Cc: Sherman, Vicki; Schlatter, Steve; Schmidt, Bill
Subject: RE: HCAP-HCFA GROUP THERAPY?

There is a corporate policy regarding this topic. I forwarded this to David McMullan (HCAP Support Services Manager). He is going to try and get a copy of it and get it to me. As soon as I get it I will forward it on. I will also forward to everyone David's email response. I hope this helps. I believe the issue is all in interpretation.

Jon Santini, Jr., ATC
HCAP Implementation & Support
Office: 614-771-5545
Pager: 888-961-7765
E-mail: jon.santini@healthsouth.com

-----Original Message-----
From: **Jimenez, Walt**
Sent: Wednesday, April 25, 2001 2:34 PM
To: Santini, Jon
Cc: Sherman, Vicki; Schlatter, Steve; Schmidt, Bill
Subject: FW: HCAP-HCFA GROUP THERAPY?

Please address this with Vicki or myself no later than today, I'm sure you have a lot going on but I need some kind of information Thanks. I can be reached at 800/946-4646 pin 1439345.

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Sent: Tuesday, April 24, 2001 4:53 PM
To: Schmidt, Bill
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From: **Schlatter, Steve**
Sent: Monday, April 23, 2001 7:17 AM

Schlatter, Steve
From: Santini, Jon
Sent: Wednesday, April 25, 2001 1:49 PM
To: Jimenez, Walt
Cc: Sherman, Vicki; Schlatter, Steve; Schmidt, Bill
Subject: FW: HCAP-HCFA GROUP THERAPY?

Jon Santini, Jr., ATC
HCAP Implementation & Support
Office: 614-771-5545
Pager: 888-961-7765
E-mail: jon.santini@healthsouth.com

-----Original Message-----
From: McMullan, David
Sent: Monday, April 23, 2001 6:15 PM
To: Santini, Jon
Subject: RE: HCAP-HCFA GROUP THERAPY?

Jon,

Currently HCAP does not support Group PT/OT. Healthsouth has addressed this issue and has a policy regarding the interpretation described below. In both the paper and HCAP world you could consider 75-80% of HS patients treated in group if you interpreted the description below the way the writer of the email appears too.

Let me know if this helps. We are looking to add this into Pen 32 , but Group Therapy has significant impacts financially to the clinic.

Sincerely,

David

-----Original Message-----
From: Santini, Jon
Sent: Monday, April 23, 2001 4:56 PM
To: McMullan, David
Subject: FW: HCAP-HCFA GROUP THERAPY?

How is this handled? I can't remember if we have discussed it. I seems very familiar, but I can't remember what the explanation is.

Thanks

Jon

JON A. SANTINI, JR., ATC
HCAP Implementation & Support
Office: 614-771-5545
Pager: 888-961-7765

-----Original Message-----
From: Schlatter, Steve

Schlatter, Steve
From: Schlatter, Steve
Sent: Thursday, April 26, 2001 10:57 AM
To: Sherman, Vicki
Cc: Schmidt, Bill; Jimenez, Walt
Subject: RE: HCAP-HCFA GROUP THERAPY?

Thanks! As I mentioned to Jon I know some people in Indiana who are abiding by this regulation until APTA or someone can help us. I certainly understand the huge financial implications, but am not willing to jeopardize my license. I will feel a little more comfortable with the HS policy in hand to present to an auditor if needed. If an auditor does not agree with Healthsouth's "interpretation" who do they go after Healthsouth or the individual clinic or clinician?

-----Original Message-----
From: **Sherman, Vicki**
Sent: Thursday, April 26, 2001 10:18 AM
To: Schlatter, Steve
Cc: Santini, Jon; Jimenez, Walt; Schmidt, Bill
Subject: RE: HCAP-HCFA GROUP THERAPY?

Apparently there was a misunderstanding about what I said regarding this topic. The actual response that I made was that I knew corporate was looking into this issue but that (to my knowledge) it had not been resolved. I advised that we not change anything until we received direction from corporate. This is an extremely gray area that has a huge financial impact on the facility. I was unaware that there was a policy already in place. Jon, if you can obtain a copy of the policy, please forward it to me ASAP.

-----Original Message-----
From: **Santini, Jon**
Sent: Wednesday, April 25, 2001 2:49 PM
To: Jimenez, Walt
Cc: Sherman, Vicki; Schlatter, Steve; Schmidt, Bill
Subject: RE: HCAP-HCFA GROUP THERAPY?

There is a corporate policy regarding this topic. I forwarded this to David McMullan (HCAP Support Services Manager). He is going to try and get a copy of it and get it to me. As soon as I get it I will forward it on. I will also forward to everyone David's email response. I hope this helps. I believe the issue is all in interpretation.

Jon Santini, Jr., ATC
HCAP Implementation & Support
Office: 614-771-5545
Pager: 888-961-7765
E-mail: jon.santini@healthsouth.com

-----Original Message-----
From: **Jimenez, Walt**
Sent: Wednesday, April 25, 2001 2:34 PM
To: Santini, Jon
Cc: Sherman, Vicki; Schlatter, Steve; Schmidt, Bill
Subject: FW: HCAP-HCFA GROUP THERAPY?

Schlatter, Steve
From: Schlatter, Steve
Sent: Monday, April 30, 2001 7:27 AM
To: Jimenez, Walt
Cc: Schmidt, Bill
Subject: HCAP-HCFA GROUP THERAPY

Tab 29

As you know from last weeks e-mails I have expressed a concern re: this issue. I am still concerned as no one seems to be able to provide a copy of the HS policy that David Mc Mullan talks about. I base my concerns not only on the Eli Rehab Report article dated 4-13-01, but I also have talked to another Indiana P.T. who had an independent compliance audit done for his practice. Vicki Sherman states that this is an extremely gray area, but the auditor that visited my friend agreed with what is reported in the Eli report. I am not to trying to create trouble and certainly do understand the financial ramifications of this, but one must also consider the financial issues of a Medicare billing fraud claim. In Orlando we repeatedly hear "do the right thing" and listen to the compliance attorneys presentations. I will feel much more comfortable when someone is able to actually produce this policy. Your response to this issue will be appreciated.

Schlatter, Steve
From: Schlatter, Steve
Sent: Wednesday, May 02, 2001 7:11 AM
To: Schmidt, Bill
Subject: APTA discussion

I am sending this just to have it documented in my CYA file. I called Elizabeth O'Brien from the Dept. of Government Affairs with the American Physical Therapy Association to discuss HCFA transmittal 1828, specifically the group therapy. She advised me that the Group Therapy section of the original transmittal has been removed due to "language"? I then asked for clarification and she reiterated that the group therapy code should be used whenever treating two or more patients at the same time. She stated this has been a HCFA guideline dating back to 1996? If anyone else would like to speak to Ms. O'Brien she can be reached at 800-999 2782 ext.8547

Schlatter, Steve **Tab 31**

From: Schlatter, Steve
Sent: Tuesday, May 15, 2001 2:13 PM
To: Santini, Jon
Subject: RE: Stonewalled on group therapy

Hey Jon. Who is Mike McCracken? Could you call me re: this situation 765-747-9996? This really bothers me that no one can or will respond to this.

-----Original Message-----
From: Santini, Jon
Sent: Monday, May 14, 2001 9:45 AM
To: McCracken, Mike
Cc: Schlatter, Steve
Subject: FW: Stonewalled on group therapy

Hi Mike,

We seen to miss each other on the phone. I am forwarding this to you so you have an understanding of what my question is about the Group Therapy issue and what the current HEALTHSOUTH Policy is about it. I hope you can help resolve the problems and put everyone's minds at ease. Please let me know as soon as you can what the HS interpretation is and what our policy is regarding it. Thanks.

Jon Santini
HCAP Implementation & Support
Office 614-771-5545
Pager 888-961-7765

-----Original Message-----
From: Schlatter, Steve
Sent: Thursday, May 10, 2001 3:05 PM
To: Santini, Jon
Subject: FW: Stonewalled on group therapy

Just wanted to let you know that I have continued to pursue this and will do so until we get resolution. FYI. Steve

-----Original Message-----
From: Schlatter, Steve
Sent: Thursday, May 10, 2001 7:22 AM
To: Schmidt, Bill
Cc: Stahl, Floyd; Jimenez, Walt
Subject: Stonewalled on group therapy

As most of you know I have been repeatedly expressing my concerns re: group therapy billing dating back to 4-23-01. I know and realize that this is a very controversial issue and is open to many different interpretations. What concerns me is that many people and organizations (HCFA & APTA) state that when treating two or more people at the same time you must bill as group therapy I have the HCFA transmittal, a tape recorded message from Elizabeth O 'Brien from the APTA Dept. of Governmental Affairs, and a copy of the HCFA Federal Register all backing up this interpretation. I have been advised that HS has a policy on this, but all efforts on my part to obtain a copy of this have been unsuccessful. As you should know there is no way for us to bill for group therapy in the HCAP system even if we wanted to. The fact that we are being asked to continue billing with this system, knowing that

From: McCracken, Mike
Sent: Thursday, May 17, 2001 4:43 PM
To: Santini, Jon
Cc: Schlatter, Steve; McMullan, David
Subject: RE: Stonewalled on group therapy

From what I understand, HCAP does not allow the therapist to bill group therapy. Information received recently from APTA indicates that group therapy should be billed for 2 or more individuals receiving therapy. We hope that co-treatment (different services rendered on 2 patients at the same time while being supervised by one therapist) and dove-tailing will be considered as allowable for individual therapy by Medicare. This is being worked on at a high level in Healthsouth, but it sounds like you know as much as I do right now. Please call me if you have any questions. Thanks.

Mike

-----Original Message-----
From: **Santini, Jon**
Sent: Monday, May 14, 2001 9:45 AM
To: McCracken, Mike
Cc: Schlatter, Steve
Subject: FW: Stonewalled on group therapy

Hi Mike,

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HCAP Implementation & Support
Office 614-771-5545
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To: Santini, Jon
Subject: FW: Stonewalled on group therapy

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From: **Schlatter, Steve**
Sent: Thursday, May 10, 2001 7:22 AM
To: Schmidt, Bill
Cc: Stahl, Floyd; Jimenez, Walt
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Elizabeth O 'Brien from the APTA Dept. of Governmental Affairs, and a copy of the HCFA Federal Register all backing up this interpretation. I have been advised that HS has a policy on this, but all efforts on my part to obtain a copy of this have been unsuccessful. As you should know there is no way for us to bill for group therapy in the HCAP system even if we wanted to. The fact that we are being asked to continue billing with this system, knowing that some people may interpret this as billing fraud causes me significant concern. Once again I must ask for some support, statement or policy from HS to back up the clinicians who have no choice but to bill for "one on one" therapy even when in reality this is not the case. Might I suggest that we all re-read page 6 under the heading "Billing and Coding" from the HS Standards of Business Conduct "Pulling the Wagon" manual. Your prompt response to this matter will be appreciated as this has already gone unresolved for far too long of a time period.

Apr-28-03 10:14am From-SASM&F LLP 2023717896 T-795 P 004/007 F-315

F T I

FTI Consulting
Martin L. Cohen
1201 Eye Street
NW Suite 400
Washington, DC 20005
Telephone (202) 312 9230
Facsimile (202) 312 9108

Tab 32

TO: William Owens
President and Chief Executive Officer
HealthSouth Corp.

FROM: Martin L. Cohen, FTI Consulting

DATE: November 6, 2002

RE: Fulbright & Jaworski Report - Open Items and Follow-up Questions From Earnings Announcement

Dear Mr. Owens:

In order to finalize our report to Fulbright and Jaworski, we have prepared the following information request list. The list combines information outstanding from our fieldwork as well as new requests based on metrics that the Company released in Tuesday's earnings announcement. With respect to the latter, we need to better understand how the metrics released in the earnings announcements reconcile to the information in our report.

The following are key economic and statistical metrics that were referenced in your third quarter call:

i. 3Q2002 to 3Q2002 17% decline in outpatient rehabilitation revenue.
ii. 3Q2001 to 3Q2002 14% decline in outpatient rehabilitation volume.
iii. 3Q2001 to 3Q2002 2.2 M to 2.058 M decline in outpatient rehabilitation visits.
iv. 3Q2001 to 3Q2002 8.3% decline in outpatient rehabilitation visits.
v. 3Q2001 to 3Q2002 3.8% decline in "same store" outpatient rehabilitation visits.
vi. $98/visit to $89/visit decline in net revenues per visit.
vii. $23M impact due to Transmittal 1753.
viii. 2Q2002 to 3Q2002 $34M-volume impact.
ix. 2Q2002 to 3Q2002 11K decline in referrals.
x. 2Q2002 to 3Q2002 visits per discharge decline of one per discharge.
xi. $10M impact on inpatient division due to Transmittal 1753.

To facilitate the reconciliation of the above metrics with our report we would like the following information:

1. Clarification regarding which of these metrics refers to: (i) freestanding clinics, (ii) hospital outpatient and (iii) hospital satellite facilities;

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2. Supporting documentation and the opportunity to meet with the staff who prepared the above mentioned metrics;

3. Identification of any non-recurring or one-time contractual adjustments and/or changes to reserves for doubtful accounts during 3Q2002?

4. Revenue reconciliation's (at the detail trial balance level) for outpatient rehabilitation including: (i) freestanding clinics, (ii) hospital outpatient and (iii) hospital satellite facilities) for 3rd Qtr 2002 and 3rd Qtr 2001. As part of this analysis we would like to see the breakout, by major payor category, of the following:
   a. Gross charges
   b. Contractual adjustments and other contra-revenue adjustments
   c. Net revenue

5. Underlying data for the referral and visit volume comments included in the press release and the earnings conference call. In order to better understand this, we would propose the following:
   a. A year-over-year analysis of the following key metrics for the period 7/1/01 – 10/31/01 compared to 7/1/02 – 10/31/02:
      i. Changes in visits per discharge
      ii. Same store visit volume
      iii. Trend in admissions

In addition, the HealthSouth IT group has created an Oracle database for the period January 2002 through June 2002. We suggest that this database be updated with patient billing data for the period July 1, 2002 thru October 31, 2002 and July 1, 2001 thru October 31, 2001 to facilitate the above-mentioned analyses. The database should include all existing data structures, existing data fields and include two new data fields (1): Admission date, and (2) Discharge date.

Please call me at (240) 460-3452 to discuss our request.

CC: Hal Hirsch, Esq., Fulbright & Jaworski LLP
Thomas Dowdell, Esq., Fulbright & Jaworski LLP
Dominic DiNapoli, FTI Consulting
Debbie Smith, FTI Consulting

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Prepared by HealthSouth (approx 8/26/02)

Summary Sheet 1 of 1

$175MM Breakdown

(RUS Reference Sheet)

Tab 33

I/P Medicare	31%	Detail 2 $54.6 MM	A1
I/P Non-Medicare	29%	Detail 1 $51.4 MM	A2
	61%	$106.0 MM in I/P	
O/P Medicare	11%	Detail 2 $18.7 MM	B1
O/P Non-Medicare	25%	Detail 1 $43.2 MM	B2
	35%	$61.9 MM in O/P	
Higher Labor	4%	A3 $7.2 MM	
TOTAL	100%	$175.0 MM	

Medicare	42%	$73.2	(A1 $54.6M + B1 $18.7M)
Non-Medicare	54%	$94.6	(A2 $51.4M + B2 $43.2M)
Labor	4%	$7.2	
TOTAL	100%	$175.0	$108 MM After Tax

A3 assume new hire for therapists @ $40K p.a. ≈ 180 new therapists.

Prepared by Weston Smith, CFO HealthSouth (approx 8/26/02) actual sheet 1/13

Projected Effect of Outpatient Reimbursement Changes on Net Revenue

	Proforma 1	Proforma 2	Proforma 3	Proforma 4	Proforma 5	Proforma 6	**Average**	Percentage to Total
Hospital Outpatient								To Summary
Medicare	54,128,504	48,355,204	54,128,504	56,511,136	47,347,168	47,713,727	**51,364,041**	31%
Non-Medicare	51,052,971	51,052,971	41,961,591	81,370,980	51,052,971	51,052,971	**54,590,742**	32%
Totals	105,181,475	99,408,175	96,090,095	137,882,116	98,400,139	98,766,697	**105,954,783**	63%
Freestanding Outpatient Centers	From sheet 8	From sheet 2						
Medicare	16,239,303	20,879,104	25,132,255	11,599,502	28,805,431	9,279,602	**18,655,866**	11%
Non-Medicare	43,229,570	43,229,570	43,229,570	43,229,570	43,229,570	43,229,570	**43,229,570**	26%
Totals	From sheet 2 59,468,873	64,108,674	68,361,825	54,829,072	72,035,000	52,509,171	**61,885,436**	37%
		From sheet 3	From sheet 4	From sheet 5	From sheet 6	From sheet 7		
Grand Totals	164,650,348	163,516,849	164,451,920	192,711,187	170,435,139	151,275,869	**167,840,219**	100%

sheet 2

Projected Effect of Outpatient Reimbursement Changes on Net Revenue
Freestanding Outpatient
Proforma 1

		YTD 6/30/02 Visits	Avg. Billable Units	Total Units	Net Revenue Per Unit	Net Revenue	Annualized Net Revenue
Current Pricing and Volumes							
M/C One to One	65%	349,059	3.40	1,186,801	$ 18.00	21,362,417	42,724,834
M/C Concurrent	[redacted]	187,955	3.40	639,047	$ 18.00	11,502,840	23,005,680
Non M/C		3,759,093	4.40	16,540,009	$ 23.00	380,420,212	760,840,423
		4,296,107		18,365,857		413,285,468	826,570,937
Projected Pricing and Volumes							
M/C One to One	65%	349,059	3.40	1,186,801	$ 18.00	21,362,417	42,724,834
M/C Concurrent	35%	187,955	1.00	187,955	$ 18.00	3,383,188	6,766,376
Non M/C		3,759,093	4.15	15,600,236	$ 23.00	358,805,427	717,610,854
							767,102,064

Freestanding Outpatient- Decrease in Medicare Net Revenue	16,239,303
Freestanding Outpatient- Decrease in Non-Medicare Net Revenue	43,229,570
Freestanding Outpatient- Decrease in Total Net Revenue	59,468,873

TO Detail sheet 1

* Weston Smith spoke with Rick Schmidt for much of data

(a) Source: "Volume & Pricing analysis - Second Quarter 2002":
Total visits from Jan ~ June 2002 for outpatient 4,773,452 x 90% (10% exclusion for speech, OT and other) based on knowledge of the business.

- Total outpatient visits of 4773k per the schedule didn't agree with source data from IT Group of 5,115 visits (7% var
Freestanding 3,854 visits plus hospital output 1,261 visits.
- If total visits from "Volume & Pricing analysis" includes both freestd & hospital visits, W. Smith's visit count appears to be overstated by the hospital visits. Should be 3,854 x 90% = 3,46
variance of 19% overstated.

(b) M/C total visits per analysis 537k visits vs. 508K visits per IT Group support.
(c) difference between total visits and M/C visits.
Based on knowledge of business: M/C 3.4 units/vst vs 3.5 units/vst per IT report
: Other 4.4 units/vst vs 4.2 units/vst per IT report
(e) Based on knowledge of business: M/C $18 net rev per unit vs. $20.65 net rev per unit per IT report
Other $23 net rev per unit vs $21.49 net rev per unit per IT report

Draft – Privileged and Confidential - Subject to Attorney Client and Attorney Work Product Privileges

Date: October 31, 2002 **Tab 34**

To: Weston Smith, HealthSouth

From: James Horgan, FTI Consulting

CC: Martin Cohen, FTI Consulting

Re: Unreconciled Difference in Freestanding Clinic Visits Between Company's Analysis of "Projected Effect of Outpatient Reimbursement Changes on Net Revenue" and Company Reports.

Please let me know if you can provide me with assistance in reconciling the following:

		Visits	
Company's $175Million Impact Analysis (See attached)	From Page 2	4,296,107	100%
IT Report (See attached)	From page 4	3,485,135	
Variance		810,972	19%

Please feel free to call me on my cell phone (908) 337 2968 or send any information to james.horgan@fticonsulting.com or to my office at 1177 Avenue of the Americas, 3rd Floor, New York, NY 10036.

Thank you for your assistance.

HHEC 236-0091
Confidential Treatment Requested by HealthSouth Corp.

Projected Effect of Outpatient Reimbursement Changes on Net Revenue
Freestanding Outpatient
Proforma 1

		YTD 6/30/02 Visits	Avg. Billable Units	Total Units	Net Revenue Per Unit	Net Revenue	Annualized Net Revenue
Current Pricing and Volumes							
M/C One to One	65%	349,059	3.40	1,186,801	$ 18.00	21,362,417	42,724,834
M/C Concurrent	[redacted]	187,955	3.40	639,047	$ 18.00	11,502,840	23,005,680
Non M/C	35%	3,759,093	4.40	16,540,009	$ 23.00	380,420,212	760,840,423
From Page 3 →		4,296,107		18,365,857		413,285,468	826,570,937
			To page 1				
Projected Pricing and Volumes							
M/C One to One	65%	349,059	3.40	1,186,801	$ 18.00	21,362,417	42,724,834
M/C Concurrent	35%	187,955	1.00	187,955	$ 18.00	3,383,188	6,766,376
Non M/C		3,759,093	4.15	15,600,236	$ 23.00	358,805,427	717,610,854
							767,102,064

Freestanding Outpatient- Decrease in Medicare Net Revenue	**16,239,303**
Freestanding Outpatient- Decrease in Non-Medicare Net Revenue	**43,229,570**
Freestanding Outpatient- Decrease in Total Net Revenue	**59,468,873**

HHEC 236-0092
Confidential Treatment
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VOLUME & PRICING ANALYSIS -- SECOND QUARTER 2002 (1,2,3,4,5,6)

	SITES		QUARTER OVER QUARTER TOTAL		QUARTER OVER QUARTER SAME STORE (2)		6 MOS. VS 6 MOS. TOTAL		6 MOS. VS 6 MOS. SAME STORE		SEQUENTIAL QUARTER TOTAL		
OUTPATIENT REHAB (3)	1,427	2002	2,400,046	6.7%	2,393,583	6.5%	4,773,452	7.3%	4,761,194	7.2%	1Q02	2,400,046	1.1%
	1,432	2001	2,249,908		2,247,480		4,448,680		4,440,763		1Q02	2,373,406	
SURGERY CENTERS	209	2001	230,746	2.3%	229,442	4.8%	458,531	3.0%	456,132	5.7%	1Q02	230,746	1.3%
	216	2001	225,512		218,901		445,289		431,710		1Q02	227,785	
DIAGNOSTIC CENTERS	136	2002	278,262	1.3%	269,426	5.6%	543,435	0.0%	527,361	4.9%	1Q02	278,262	4.9%
	140	2001	274,623		255,028		543,268		502,859		1Q02	265,171	
INPATIENT REHAB	118	2002	29,873	5.5%	28,893	5.2%	58,890	5.2%	56,962	4.8%	1Q02	29,873	2.9%
	120	2001	28,307		27,458		55,972		54,345		1Q02	29,017	
MEDICAL CENTERS	4	2002	24,293	0.2%	24,293	0.2%	48,800	-8.8%	48,800	-8.8%	1Q02	24,293	-0.9%
	4	2001	24,243		24,243		53,514		53,514		1Q02	24,507	

(1) SAME STORE VOLUMES FOR OUTPATIENT, SURGERY CENTERS, DIAGNOSTIC CENTERS AND INPATIENT REHAB HAVE BEEN ADJUSTED FOR CLOSED FACILITIES (OPEN VS OPEN COMPARISON)
(2) OUTPATIENT REHAB EXCLUDES OCCUPATIONAL MEDICINE THAT WAS SOLD ON 3/31/01
(3) MEDICAL CENTERS EXCLUDES REHABILITATION WHICH WAS SOLD ON 6/30/01

REVENUE AND PRICING ANALYSIS

PRICING

1Q02				Yr. Over Yr. Pric. Variance
O/P	2,400,046	$100	$240,004,600	5%
ASC*	299,360	$1,140	$341,360,400	4%
DX	278,262	$118	$32,837,916	0%
I/P (Discharges)	29,873	$16,333	$488,000,000	5%
M/C*	24,293	$1,000	$24,293,000	2%
Divest			$0	
Corp			$13,322,500	
			$1,163,881,194	
I/P & Med Center - Weighted				5%

1Q01			
O/P	2,249,908	$99	$223,340,000
ASC*	229,332	$1,097	$251,500,000
DX	274,623	$118	$32,223,000
I/P (Discharges)	28,307	$15,435	$436,000,000
M/C*	24,243	$1,000	$24,243,000
Divest			$27,474,000
Corp (4)			$13,288,000
			$1,098,989,000
Revenue Excluding Divest			$1,071,515,000
2Q01 Variance over 1Q01			9%

E = 4773452 (10% Speed of 10K)
x 90%
4296107
To Page 2

1Q02				Eq. Qtr. Pric. Variance
O/P	2,393,583 (2,393,916 ex)	$99	$234,581,189	1%
ASC	255,785	$1,147	$294,336,418	3%
DX	269,426	$123	$33,026,942	2%
I/P	29,017	$16,152	$468,693,676	1%
M/C	24,293	$1,042	$25,317,266	3%
Divest			$0	
Corp			$10,016,586	
			$1,129,775,076	
I/P & Med Center - Weighted				1%
Revenue Excluding Divest			$1,129,775,076	
2Q02 Variance over 1Q02			3%	

REVENUE

1Q02 to 1Q01 Revenue Comparison	1Q02	1Q01	Year-To Change
O/P	238,971,407	213,388,000	12%
ASC	264,360,986	247,180,000	7%
DX	88,517,752	87,223,000	1%
I/P (Discharges)	485,653,605	436,643,000	11%
M/C	72,848,885	71,593,000	2%
Divest	0	27,474,000	-100%
Corp	13,322,560	15,288,000	-13%
	1,163,683,194	1,098,989,000	5.9%

2Q02 to 1Q02 Revenue Comparison	1Q02	1Q02	Seq. % Change
O/P	238,971,407	234,581,189	2%
ASC*	264,360,986	254,336,418	4%
DX	88,517,752	83,026,942	7%
I/P (Discharges)	485,653,605	468,693,676	4%
M/C*	72,848,885	71,117,266	2%
Divest	0	0	0%
Corp	13,322,560	10,001,586	-26%
	1,163,683,194	1,129,775,076	3.0%

PRICING + VOLUME = REVENUE

Sys of Oct Med and Richmond Invest Overall Percentages			
1Q02 to 1Q01 Revenue Comparison-Year over Year			
	Pricing *	Volume *	% Chg
O/P	5%	7%	12%
Surgery	4%	2%	7%
DX	0%	1%	1%
I/P	5%	6%	11%
M/C	2%	0%	2%
Divest	N/A	N/A	N/A
Corp	N/A	-13%	-13%
TOTAL *	4.4%	4.2%	5.9%

1Q02 to 1Q02 Revenue Comparison-Sequential			
	Pricing *	Volume *	% Chg
O/P	1%	1%	2%
Surgery	3%	1%	4%
DX	2%	5%	7%
I/P	1%	3%	4%
M/C*	3%	-1%	2%
Divest	N/A	N/A	N/A
Corp	N/A	-26%	-26%
TOTAL *	1.3%	1.6%	3.0%

* Total for volume and pricing is a weighted avg

(1) 2Q01 CORPORATE REVENUES EXCLUDE INPATIENT AND DIAGNOSTIC REVENUES ATTRIBUTABLE TO DIVESTITURES. THESE REVENUES ARE INCLUDED UNDER DIVEST
(2) 2Q01 DX REVENUE = $84.510M EXCLUDING HC, 4.2% SAME STORE REVENUE INCREASE
(4) 2Q01 I/P REVENUE = $426.264M EXCLUDING HORIZON I/P HOSPITALS, 14% SAME STORE REVENUE INCREASE

Page 3/4

HHEC 236-0093
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HS
Freestanding Facility Statistics by Discipline and Payor
January through June 2002

Payor		DISCIPLINE OT	PT	ST	Total	%	Units/ Visit	Contr%	Contract $	Rev/Unit
COM	Sum of Gross Charges	$23,592,167	$332,613,543	$952,981	$357,158,691	54.3%		51%	$182,150,932	
	Sum of TOTAL_UNITS	569,469	7,951,354	14,994	8,535,817	54.2%	4.2			$20.50
	Sum of TOTAL_VISITS	147,578	1,892,755	7,872	2,048,205	53.1%				
O	Sum of Gross Charges	$29,766,371	$198,264,751	$207,518	$228,238,641	34.7%		45%	$102,707,388	
	Sum of TOTAL_UNITS	678,096	4,740,301	3,805	5,422,202	34.4%	4.2			$23.15
	Sum of TOTAL_VISITS	171,057	1,124,794	1,965	1,297,816	33.7%				
COM&Other	Sum of Gross Charges	$53,358,538	$530,878,294	$1,160,499	$585,397,331	89.0%	4.2	49%	$284,858,320	
	Sum of TOTAL_UNITS	1,247,565	12,691,655	18,799	13,958,019	88.6%				$21.53
	Sum of TOTAL_VISITS	318,635	3,017,549	9,837	3,346,021	86.8%				
M/C	Sum of Gross Charges	$5,388,419	$67,022,189	$138,677	$72,549,285	11.0%		49%	$35,549,150	
	Sum of TOTAL_UNITS	134,465	1,655,209	1,879	1,791,553	11.4%	3.5			$20.65
	Sum of TOTAL_VISITS	39,570	467,586	1,028	508,184	13.2%				
Total Sum of Gross Charges		$58,746,957	$597,900,483	$1,299,176	$657,946,617	100.0%		49%	$320,407,470	
Total Sum of TOTAL_UNITS		1,382,030	14,346,864	20,678	15,749,572	100.0%	4.1			$21.43
Total Sum of TOTAL_VISITS		358,205	3,485,135	10,865	3,854,205	100.0%				
% of Visits		9.3%	90.4%	0.3%	100.0%					

Prepared based upon data queries from Henry Lovoy of HS.

To Page 1

HHEC 236-0094
Confidential Treatment
Requested by HealthSouth Corp.

Page 4/4

Tab 35

Goldberg, Adam

From: deborah.smith@fticonsulting.com
Sent: Tuesday, November 12, 2002 3:01 PM
To: LDavis@pattonboggs.com
Cc: Goldberg, Adam; Dominic.dinapoli@fticonsulting.com; Sjoquist, Mary
Subject: Re: Fw: HealthSouth

Lanny, Adam and Mary,

As requested, attached please find our estimated fees to complete.

Regards,

Debbie Smith

Deborah M. Smith
Senior Managing Director
FTI Consulting, Inc.
1177 Avenue of the Americas
New York, New York 10036
646-471-2313
deborah.smith@fticonsulting.com

Fee Estimate for Remaining Tasks

Task	*Estimated Fees and Expenses*
Unbilled actual time from November 6, 2002 through November 12, 2002.	$ 24,756
Presentation of the FTI report by Dom DiNapoli, Debbie Smith and Martin Cohen to the Board of Directors.	18,000
Review of the FTI report by Debbie Smith and Martin Cohen with management and minor edits to the report to incorporate management's comments and feedback.	19,000
Comparison of the Company's actual third-quarter outpatient therapy results with last year and with FTI's findings: Reconciliation of outpatient therapy net revenue, including changes in contractual allowances and other reserves; Comparison of 3Q2002 coding / billing patterns with 3Q2001; Comparison of 3Q2002 coding / billing patterns with FTI's re-coded sample data; 3Q2002 monthly coding / billing analysis.	42,000
Analysis of the Company's reported outpatient therapy referral and visit volume trends: Analyze change in referral (admission) volume between 3Q2002 and 3Q2001; Analyze change in visits per discharge between 3Q2002 and 3Q2001; Analyze change visits per therapist FTE between 3Q2002 and 3Q2001.	13,000
Total Remaining Fees and Expenses	$ 116,756

Re - HealthSouth
(Atty. Notes)

1177 Avenue of the Americas,3rd Floor
New York, NY 10036
646-471-1950 Telephone
646-471-2803 Facsimile

www.fticonsulting.com

formerly FTI Policano & Manzo
and PricewaterhouseCoopers
Business Recovery Services

To: Tom Dowdell, Fulbright & Jaworksi L.L.P
From: Debbie Smith, FTI Consulting, Inc.
Date: November 5, 2002
Re: HealthSouth Draft Report

Enclosed please find the preliminary draft Report to Fulbright & Jaworski L.L.P. as Counsel to HealthSouth Corporation, which was emailed to you last night.

PRIVILEGED AND CONFIDENTIAL
ATTORNEY WORK PRODUCT

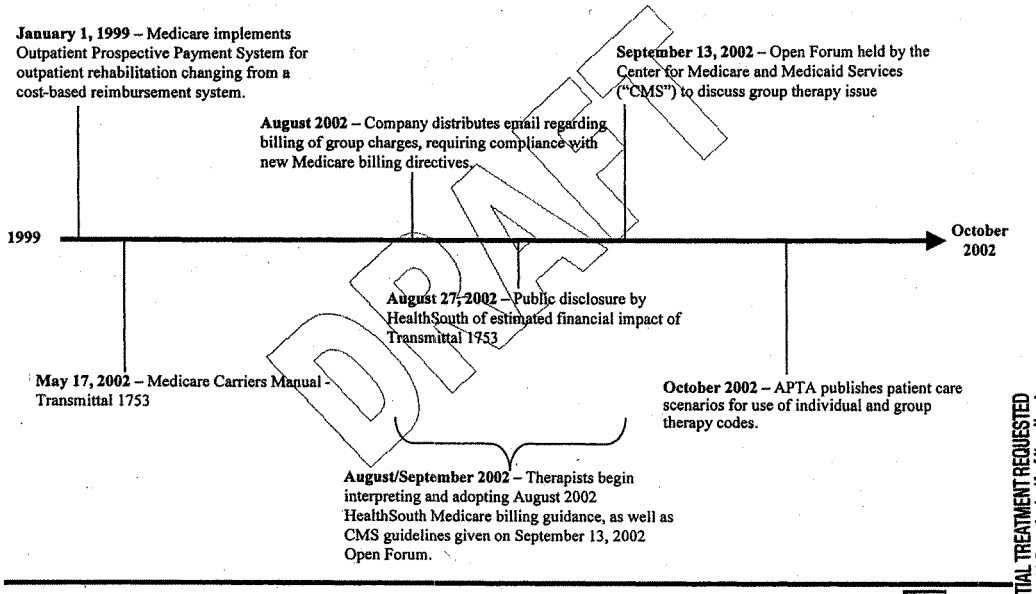
Tab 36

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

Executive Summary
Background

HEALTHSOUTH.

Timeline of Significant Events



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FJ 000008

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

311

Executive Summary

Background – Medicare's Recent Guidance Result in Decreased Revenue

HEALTHSOUTH

FJ 000010

Example of Change from Prior Concurrent Billing Approach to Medicare's Recent Guidance

Scenario A: One Therapist Treating Two Patients Concurrently

Assumes That Individual Therapy is Delivered in a Concurrent Manner and Sufficient Direct One-on-One Time to Support Billing Individual Codes.

Charge Codes (For Individual Therapy - 97110)

	10:00AM - 10:15AM	10:15AM - 10:30AM	10:30AM - 10:45AM	10:45AM 11:00AM	Total Billed Units	Medicare Payment / Unit	Total Payment	
PRIOR APPROACH:								
Patient A	97110	97110	97110	97110				
Units Charged	1	1	1	1	4	$26	$104	
Patient B	97110	97110	97110	97110				$208
Units Charged	1	1	1	1	4	$26	$104	
NEW GUIDANCE:								
Patient A	97110		97110					
Units Charged	1		1		2	$26	$52	
Patient B		97110		97110				$104
Units Charged		1		1	2	$26	$52	

- Decrease in total Medicare payments from $208 to $104 results in a 50% decrease in the Company's reimbursement for these two patient visits
- However, the following schedule depicting use of the Group code reveals a greater impact…

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

Executive Summary

Background – Medicare's Recent Guidance Result in Decreased Revenue

HEALTHSOUTH

FJ 000011

Example of Change from Prior Concurrent Billing Approach to Medicare's Recent Guidance

Scenario B: One Therapist Treating Two Patients Concurrently

Assumes The Two Patients in Scenario A Were Treated As Part of a Group Therapy Session With Two Other Patients.

Charge Codes (For Group Therapy - 97150)

	10:00AM - 10:15AM	10:15AM - 10:30AM	10:30AM - 10:45AM	10:45AM 11:00AM	Total Billed Units	Medicare Payment / Unit	Total Payment	
PRIOR APPROACH: (Group Codes Were Not Used)								
Patient A	97110	97110	97110	97110				
Units Charged	1	1	1	1	4	$26	$104	$208
Patient B	97110	97110	97110	97110				
Units Charged	1	1	1	1	4	$26	$104	
NEW GUIDANCE:								
Patient A	97150							
Units Charged	1				1	$18	$18	$36
Patient B	97150							
Units Charged	1				1	$18	$18	

- Decrease in total Medicare payments from $208 to $36 results in a 80% decrease in the Company's reimbursement for these two patient visits
- Use of group versus individual timed codes - grey area…

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

Executive Summary

Review of Company's Impact Analysis

HEALTHSOUTH

FJ 000012

[compare to BMGK]

	HealthSouth Analysis		
	Medicare	Non-Medicare	Total
Hospital (Inpatient and Satellite)	$ 51,364,041	$ 54,590,742	$ 105,954,783
As a Percentage of Total Impact	*29%*	*31%*	*61%*
Freestanding (Outpatient)	18,655,866	43,229,570	61,885,436
As a Percentage of Total Impact	*11%*	*25%*	*35%*
	$ 70,019,907	$ 97,820,312	$ 167,840,219
Labor			7,200,000
As a Percentage of Total Impact			*4%*
			$ 175,040,219

- Impact greater on Hospital Outpatient/Satellites due to assumption of higher concurrent therapy (68%) vs. (34%) for Freestanding Clinics.
- Indirect Impact is greater for Non-Medicare Payors than directly on Medicare.
- Additional labor costs included for new therapists to provide one-on-one treatments.

Four Major Assumption Drivers:

1) Use group therapy codes when Medicare patients are treated in a concurrent situation.
2) * Percentage of patients treated concurrently versus group.
3) * Degree to which Non-Medicare Payors (Commercial, Workers Compensation, etc.) adopt Medicare rules.
4) Net revenue per unit for group and individual therapy for Medicare and non-Medicare.

Findings:

- Most of the major assumptions were estimates made from management's knowledge of the business and hence not fully supported with detailed data.
- Preparation of the analysis over three business days limited management's ability to enhance their assumptions.
- Nevertheless, given the three day timeframe and information available, the framework for estimating the impact was reasonable.

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Executive Summary

Impact Estimate Summary – All Outpatient Rehabilitation

HEALTHSOUTH

($ in millions)	Scenario: High	Scenario: Mid	Scenario: Low
	> Medicare - assumes that 100% of all visits are impacted. > Commercial - assumes that 100% fee-schedule-reimbursed contracts are impacted. > Other - assumes that 80% of fee-schedule-reimbursed Workers Comp programs are affected.	> Medicare - assumes that 100% of all visits are impacted. > Commercial - assumes that 75% fee-schedule-reimbursed contracts are impacted. > Other - assumes that approximately 50% of fee-schedule-reimbursed Workers Comp programs are affected.	> Medicare - assumes that 100% of all visits are impacted. > Commercial - assumes that 50% fee-schedule-reimbursed contracts are impacted. > Other - assumes that approximately 30% of fee-schedule-reimbursed Workers Comp programs are affected.
Upside Case > Potential recognition by Medicare of recently issued APTA guidance which implies more aggressive coding. > Potential increase in Medicare rates.	$177	$139	$101
Base Case Fully apply alternate coding guidelines: > Cap of four units per hour for attended therapy. > Allow use of "59 Modifier."	$196	$154	$112
Downside Case > Eliminate use of "59 Modifier". > Eliminate simultaneous therapist billing of unattended modalities with timed procedures, untimed procedures or attended modalities.	$227	$177	$127

Note: Use of the "59 Modifier" refers to billing a group therapy code (using CPT modifier code# 59) and a timed one-on-one individual code during the same visit.

➢ These estimates are based on a series of assumptions that are not the actual practices utilized in the field. The actual results from operations may differ.

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FJ 000019

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Executive Summary

Other Findings and Recommendations

HEALTHSOUTH

FJ 000020

Potential Mitigation Strategies

- Company is analyzing / pursuing a number of different strategies to mitigate the impact of Transmittal 1753. Some mitigation strategies include:
  - Recruit additional licensed therapists - this is the direct response to the concurrent therapy issue. As long as there is a positive margin in providing an incremental unit of therapy, it makes economic sense to add therapists in order to fully prevent a decrease in billed units of therapy.
  - Alter patient scheduling patterns - to the extent excess therapist capacity exists, efforts to minimize scheduled overlap between a Medicare patient and other patients could mitigate the loss of overall billed therapy units. However, de-leveraging of therapist schedules in the face of capacity constraints has the undesirable effect of further eroding patient access. Facilities are also renewing efforts to minimize cancellations and no-shows. Altering patient scheduling patterns by payor may also have favorable mitigation effects.
  - Alter therapist scheduling patterns - extended clinical hours and matching therapist overlap to patient overlap may have favorable mitigation effects. However, creative scheduling options may be limited by the availability of licensed therapists.
  - Change in contracting strategy - while the response to commercial payors and managed care organizations is not yet fully known, the Company is taking steps to eliminate linkages between its non-Medicare contracts and Medicare's reimbursement methodology, rules and requirements. This can be accomplished by focusing on converting from fee screen reimbursement to flat-rate per visit, case rate or capitation. Other contractual ties to Medicare should also be carefully reviewed for reimbursement and operational implications.

✓ If Management has not already done so, the Company should actively pursue dialogue with CMS concerning repricing of therapy services in light of the significant change in claims coding patterns brought about by Transmittal 1753.

✓ It's recommended that the Company quickly and thoroughly assess all available mitigation strategies under the various alternative Medicare interpretation outcomes. To evaluate the the impact of the various mitigation strategies, we further recommend that analytical models be constructed and tested. Once the appropriate mitigation strategy(ies) has been identified, high-impact target locations should be quickly identified for priority implementation.

✓ It is important to note that certain of the operational mitigation options available to the Company involve disparate approaches for Medicare and non-Medicare patients. The Company should carefully evaluate all potential effects of these policies - both positive and negative.

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Other Findings and Recommendations

FJ 000021

Compliance

➢ The following potential compliance issues arose throughout the process:

- Use of Inappropriately Licensed Therapist to Bill Physical Therapy Treatments – Treasure Coast Rehabilitation Hospital
  - During the course of our sampling of patient billing data at the Treasure Coast Rehabilitation Hospital, HealthSouth regional staff discovered the hospital had been billing Medicare (as well as other payors) for outpatient physical therapy services provided by an individual who was not a licensed Physical Therapist. The therapist in question is licensed as a massage therapist; however, it is our understanding that Medicare requires a physical therapy license in order to bill for Physical Therapy Services.
- Billing of Individual Therapy Codes to Medicare Inconsistent with Transmittal 1753 – Rocky Ridge facility located in Birmingham, Alabama
  - During a review of Medicare billing procedures with the site administrator of the Rocky Ridge therapy center, we determined the center's therapists, intending to bill group therapy charges to Medicare patients, had incorrectly entered the group therapy identifier in the medical records/billing system. As a result, Medicare patients were billed individual therapy codes consistent with prior Medicare billing practices and in direct conflict with Transmittal 1753 and the Company's current stated policy throughout the month of September 2002.
  - As it was the intention of the therapists to follow the Company's policy, it appears that this issue was created due to improper training in the use of the facility's medical records/billing system for the delivery of group therapy.
- Incorrect Mapping of Lymphedema treatment to CPT code 97150 – Fort Worth Hospital
  - During the sample data recoding process for the Ft. Worth, Texas hospital, it was noted that two separate therapy services in the facility's charge master were mapped to CPT code 97150 (group therapy). In addition to group therapy, manual massage therapy for Lymphedema was also mapped to CPT code 97150, rather than code 97124. Notably, multiple units of service were being charged for Lymphedema treatment under CPT code 97150 (an untimed code limited to one unit of service per visit).

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FJ 000022

- In this specific instance, overall reimbursement to the Company is less than if such services were properly billed under CPT code 97124. However, the general compliance risks involved in mapping issues of this nature are
  - The Company may systematically receive excessive reimbursement for overstated units of services rendered, and
  - The Company may systematically receive reimbursement for services not performed.

✓ It is our understanding that the Company recently completed a comprehensive charge master review. We recommend that a follow-up initiative be launched to ensure that all internal charge codes are mapped to the appropriate CPT code.

- Certain hospitals are billing more than one unit of group therapy on the same visit
  - During our review of the September 2002 MedNet billing data for the Hospital Outpatient and Satellites, its was noted that certain facilities were billing CPT code 97150 (group therapy) using more than one unit of service per visit. Frank Dicesare (Controller – Inpatient Division) was asked to inquire with selected facilities as to the reason for such billing anomalies. Mr. Dicesare discovered that at least one facility was intentionally billing multiple units of group therapy in order to prevent the facility's internally-reported productivity statistics (i.e. billed units per FTE) from declining due to use of the group code. Mr. Dicesare has confirmed to FTI that the CareMedic Medicare claims software utilized by the Company currently includes an edit whereby all claims which include untimed CPT codes with units of service greater than one (1) are flagged for editing prior to the actual claim submission to Medicare. Although the CareMedic software will detect this group code billing issue, it's important to note that the CareMedic edits can be overridden by local billing personnel. Also noteworthy, but not necessarily problematic, is that the original MedNet billing data is not updated in instances where a bill has been subsequently edited using the CareMedic software.

➢ September recoding indicates that the Company is coding Medicare patients in a more aggressive pattern than our alternative coding guidelines based on our best judgement of current consensus in the industry.

➢ There has been no detailed formal guidance from Corporate to address the complex changes related to Transmittal 1753 resulting in inconsistent methodology of coding in the field.

✓ Develop a Company interpretation of and practice guidelines related to Transmittal 1753 and provide guidance to the field.

✓ Develop the best practices model to maximize return on operations by incorporating different settings, payor mix, and therapist leverage.

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Executive Summary

Other Findings and Recommendations

HEALTHSOUTH

FJ 000023

- There are no formal policies and procedures in place to roll out coding policy changes to the field and provide education of the new policies and procedures.
- The responsibility and authority to interpret and implement such a policy change such as Transmittal 1753 does not fall to one responsible party or division to ascertain implementation and compliance.
  - ✓ Implement procedures to disseminate Corporate positions on changes to the field and designate someone with the responsibility and authority to implement and oversee the process to include both education and training.
- No formal testing of coding procedures have been done to date, however, Internal Audit is presently adding a sample testing of Transmittal 1753 to its audit scope. The Corporate Integrity Agreement also requires an internal billing review of Inpatient Rehab Facilities billings and coding systems this year.
  - ✓ Implement controls to test the compliance with guidelines.
    - Consider adding a compliance testing section related to billing and coding to the HealthSouth Clinical Audit Review ("HCAR") program with the freestanding clinics.
    - Consider the extension of the Health Information Services ("HIS") department service of education, training, research, help desks, and compliance auditing to the Inpatient and Outpatient Rehab areas.
    - The Corporate Integrity Agreement compliance testing for May 2002 through May 2003 requires the test of coding for the Hospitals.

Risk Contracting

- We understand that the Company is considering entering into more risk contracts such as capitation agreements which generally provide for the Company to receive a fixed reimbursement rate (such as per member per month) in exchange for providing treatment to a payor's members, regardless of their utilization of services.
  - ✓ The Company should consider developing stronger systems and model the affect to assess the risks associated with these contracts to project profitability on this type of business model and to manage and track member utilization under the contract.

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Executive Summary

Other Findings and Recommendations

HEALTHSOUTH.

FJ 000024

Effect of Coding Changes in Visit Volume

- Based on very limited sample data for two months of past coding changes, August and September 2002 visits for September discharges, it appears that …
  - Hospital Outpatient and Satellite [redacted]
  - Freestanding

Effect on Medicare Coding Change on Non-Medicare Coding ("Creep")

- Management has indicated concern that clinicians will modify their coding of commercial and other payors as a result of coding changes being implemented to Medicare patients.
- Based on an analysis of a a sample of two weeks in September 2002, it does not appear that there has been a negative impact in freestanding commercial and other payor coding.
- However, some changes in non-Medicare coding were found at the hospitals and hospital satellites resulting in reductions in net revenue:
  - Hospital - $1.875 million annualized
  - Hospital satellites - $1.643 million annualized

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Impact Analysis of Medicare Coding Guidance

Impact Estimate Summary – By Payor and Setting

HEALTHSOUTH

FJ 000050

- Freestanding clinics comprise the largest percentage of the impact.
- The risk of Commercial and Workers Compensation insurers converting to Medicare's guidance comprises $110 million of the base case mid-range scenario.

June 2002 YTD Annualized
($ in millions)

Freestanding Clinics

Scenario	Medicare	Commercial Sensitivity High	Commercial Sensitivity Mid	Commercial Sensitivity Low	Other Sensitivity High	Other Sensitivity Mid	Other Sensitivity Low	Total High	Total Mid	Total Low
	100%	60%	45%	30%	45%	30%	15%			
Upside	$ 23.0	$ 75.1	$ 56.3	$ 37.6	$ 41.4	$ 27.6	$ 13.8	$ 139.5	$ 106.9	$ 74.3
Base Case	25.5	83.4	62.6	41.7	46.0	30.6	15.3	155.0	118.8	82.6
Downside	27.2	98.6	73.9	49.3	54.4	36.3	18.1	180.2	137.4	94.7

Hospital Outpatient

Scenario	Medicare	Commercial Sensitivity High	Commercial Sensitivity Mid	Commercial Sensitivity Low	Other Sensitivity High	Other Sensitivity Mid	Other Sensitivity Low	Total High	Total Mid	Total Low
	100%	60%	45%	30%	35%	25%	15%			
Upside	$ 10.5	$ 7.0	$ 5.2	$ 3.5	$ 1.9	$ 1.4	$ 0.8	$ 19.4	$ 17.1	$ 14.8
Base Case	11.7	7.7	5.8	3.9	2.1	1.5	0.9	21.5	19.0	16.4
Downside	11.8	9.0	6.7	4.5	2.6	1.9	1.1	23.4	20.4	17.4

Hospital Satellites

Scenario	Medicare	Commercial Sensitivity High	Commercial Sensitivity Mid	Commercial Sensitivity Low	Other Sensitivity High	Other Sensitivity Mid	Other Sensitivity Low	Total High	Total Mid	Total Low
	100%	60%	45%	30%	35%	25%	15%			
Upside	$ 6.4	$ 8.2	$ 6.2	$ 4.1	$ 3.1	$ 2.2	$ 1.3	$ 17.7	$ 14.7	$ 11.8
Base Case	7.1	9.2	6.9	4.6	3.4	2.4	1.5	19.6	16.4	13.1
Downside	7.4	11.6	8.7	5.8	4.5	3.2	1.9	23.5	19.3	15.1

Total

Scenario	Medicare	Commercial High	Commercial Mid	Commercial Low	Other High	Other Mid	Other Low	Total High	Total Mid	Total Low
Upside	$ 39.8	$ 90.3	$ 67.7	$ 45.1	$ 46.4	$ 31.1	$ 15.9	$ 176.5	$ 138.7	$ 100.9
Base Case	44.3	100.3	75.2	50.2	51.5	34.6	17.7	196.1	154.1	112.1
Downside	46.5	119.2	89.4	59.6	61.5	41.3	21.2	227.1	177.2	127.2

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Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Freestanding – Medicare

HEALTHSOUTH

FJ 000053

Scenario
Setting: Freestanding Clinics
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	895,880	-11.82%	789,979	2.67	-35.74%	1.72	2,391,064	-47.33%	1,354,935	$ 22.80	0.13%	$ 22.77	$ 54,524,985	-43.41%	$ 30,857,080
Untimed Procedures	116,970	-1.35%	115,153	1.00	0.02%	1.00	117,020	-1.33%	115,230	44.81	0.33%	44.96	5,243,304	-1.00%	5,180,438
Attended Modalities	123,614	-50.51%	61,176	1.06	0.00%	1.06	130,652	-50.51%	64,658	8.54	0.61%	8.59	1,115,701	-50.21%	555,546
Unattended Modalities	304,672	0.00%	304,672	1.33	-0.81%	1.32	671,200	-0.81%	665,867	3.62	0.06%	3.61	2,427,493	-0.89%	2,405,974
Group Therapy	364	0.00%	364	1.05	0.00%	1.05	382	0.00%	382	15.10	0.00%	15.10	5,768	0.00%	5,768
Total PT	935,172	0.00%	935,172	3.54	-33.51%	2.35	3,310,418	-33.51%	2,201,067	19.13	-7.35%	17.72	63,317,451	-38.40%	39,004,807
OT															
Timed Procedures	74,604	-4.39%	71,325	2.48	-22.67%	1.92	185,238	-26.06%	136,938	22.58	1.57%	22.94	4,182,659	-24.90%	3,141,123
Untimed Procedures	13,196	-43.30%	7,483	1.01	0.00%	1.01	13,260	-43.30%	7,576	40.43	23.10%	49.77	540,000	-30.19%	377,013
Attended Modalities	11,650	-6.62%	10,879	1.09	-29.56%	0.77	12,702	-34.22%	8,388	7.42	0.03%	7.42	94,641	-34.20%	62,272
Unattended Modalities	47,034	0.00%	47,034	1.22	0.00%	1.22	57,576	0.00%	57,576	3.84	0.00%	3.84	220,911	0.00%	220,911
Group Therapy	2	0.00%	2	2.00	0.00%	2.00	4	0.00%	4	15.10	0.00%	15.10	60	0.00%	60
Total OT	79,140	0.00%	79,140	3.40	-21.73%	2.66	268,930	-21.73%	210,501	18.73	-3.61%	18.06	5,038,402	-24.55%	3,801,378
SLP															
Timed Procedures	1,842	0.00%	1,842	1.85	0.00%	1.85	3,400	0.00%	3,400	63.44	0.00%	63.44	215,711	0.00%	215,711
Untimed Procedures	240	0.00%	240	1.49	0.00%	1.49	358	0.00%	358	78.04	0.00%	78.04	27,939	0.00%	27,939
Attended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	2,056	0.00%	2,056	1.83	0.00%	1.83	3,758	0.00%	3,758	64.84	0.00%	64.84	243,650	0.00%	243,650
Total	1,016,368	0.00%	1,016,368	3.53	-32.59%	2.38	3,583,106	-32.59%	2,415,326	$ 19.15	-6.90%	$ 17.82	$ 68,599,503	-37.24%	$ 43,049,836

Full Revenue Impact		$ 25,549,667
Low	100%	25,549,667
Mid	100%	25,549,667
High	100%	25,549,667

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Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Freestanding – Commercial

HEALTHSOUTH

FJ 000054

Scenario
Setting: Freestanding Clinics
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	3,700,190	-11.88%	3,260,711	3.26	-42.71%	1.87	12,050,064	-49.31%	6,083,528	$ 20.51	-0.39%	$ 20.43	$ 247,121,854	-49.71%	$ 124,277,512
Untimed Procedures	570,790	-3.68%	549,802	1.00	-1.60%	0.99	571,640	-5.22%	541,599	43.71	0.70%	44.02	24,980,477	-4.56%	23,841,133
Attended Modalities	776,552	-49.01%	395,929	1.08	-7.19%	1.00	838,628	-52.68%	396,848	18.65	-3.05%	18.08	15,636,525	-54.12%	7,174,749
Unattended Modalities	1,848,638	-0.26%	1,843,851	1.32	0.03%	1.32	2,441,392	-0.23%	2,435,792	13.56	0.01%	13.57	33,115,636	-0.22%	33,042,139
Group Therapy	842	0.00%	842	1.41	0.00%	1.41	1,184	0.00%	1,184	24.51	0.00%	24.51	29,019	0.00%	29,019
Total PT	3,785,510	0.00%	3,785,510	4.20	-40.52%	2.50	15,902,708	-40.52%	9,458,951	20.18	-1.31%	19.91	320,883,530	-41.30%	188,364,553
OT															
Timed Procedures	284,284	-13.23%	246,675	2.86	-25.59%	2.13	812,324	-35.44%	524,463	20.34	0.03%	20.34	16,521,681	-35.42%	10,669,392
Untimed Procedures	54,256	-8.12%	49,849	1.01	0.00%	1.01	54,680	-8.12%	50,239	39.97	2.21%	40.86	2,185,785	-6.09%	2,052,702
Attended Modalities	85,722	-22.49%	66,447	1.14	-13.31%	0.99	98,062	-32.81%	65,892	18.29	0.76%	18.43	1,793,539	-32.29%	1,214,355
Unattended Modalities	148,060	0.00%	148,060	1.17	0.00%	1.17	173,820	0.00%	173,820	12.83	0.00%	12.83	2,230,652	0.00%	2,230,652
Group Therapy	56	0.00%	56	0.93	0.00%	0.93	52	0.00%	52	23.73	0.00%	23.73	1,234	0.00%	1,234
Total OT	295,156	0.00%	295,156	3.86	-28.49%	2.76	1,138,938	-28.49%	814,466	19.96	-0.54%	19.85	22,732,891	-28.88%	16,168,735
SLP															
Timed Procedures	13,736	0.00%	13,736	2.02	0.00%	2.02	27,706	0.00%	27,706	28.02	0.00%	28.02	776,287	0.00%	776,287
Untimed Procedures	2,120	0.00%	2,120	1.08	0.00%	1.08	2,282	0.00%	2,282	61.96	0.00%	61.96	141,389	0.00%	141,389
Attended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	15,744	0.00%	15,744	1.90	0.00%	1.90	29,988	0.00%	29,988	30.60	0.00%	30.60	917,677	0.00%	917,677
Total	4,096,410	0.00%	4,096,410	4.17	-39.65%	2.52	17,071,634	-39.65%	10,303,405	$ 20.18	-1.20%	$ 19.94	$ 344,534,099	-40.37%	$ 205,450,964

Full Revenue Impact		$ 139,083,134
Low	30%	41,724,940
Mid	45%	62,587,410
High	60%	83,449,881

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Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Freestanding – Other

HEALTHSOUTH

FJ 000055

Scenario
Setting: Freestanding Clinics
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	2,211,432	-16.73%	1,841,045	3.27	-42.96%	1.87	7,240,816	-52.51%	3,438,292	$ 23.81	0.63%	$ 23.96	$ 172,376,481	-52.21%	$ 82,370,152
Untimed Procedures	281,452	-3.41%	271,851	1.01	0.00%	1.01	284,728	-3.38%	275,095	45.49	0.96%	45.92	12,951,040	-2.46%	12,633,036
Attended Modalities	404,472	-43.09%	230,198	1.06	-9.83%	0.96	429,714	-48.68%	220,535	19.96	1.31%	19.98	8,492,288	-48.11%	4,406,382
Unattended Modalities	1,134,526	-0.18%	1,132,451	1.34	0.03%	1.34	1,523,542	-0.13%	1,521,582	15.28	0.06%	15.29	23,285,076	-0.06%	23,270,190
Group Therapy	1,248	0.00%	1,248	1.44	0.00%	1.44	1,802	0.00%	1,802	24.56	0.00%	24.56	44,255	0.00%	44,255
Total PT	2,249,588	0.00%	2,249,588	4.21	-42.44%	2.43	9,480,602	-42.44%	5,457,407	22.90	-1.82%	22.49	217,149,140	-43.48%	122,724,215
OT															
Timed Procedures	334,080	-2.16%	326,848	3.03	-26.23%	2.23	1,011,342	-27.83%	730,045	26.58	0.87%	26.81	26,886,630	-27.20%	19,572,971
Untimed Procedures	48,054	0.00%	48,054	1.02	-0.94%	1.01	49,034	-0.94%	48,571	41.17	4.76%	43.13	2,018,542	3.77%	2,094,719
Attended Modalities	86,240	-22.20%	67,096	1.12	1.05%	1.13	96,336	-21.56%	75,742	21.83	-0.14%	21.80	2,103,028	-21.49%	1,651,136
Unattended Modalities	164,072	0.00%	164,072	1.21	0.00%	1.21	198,584	0.00%	198,584	15.43	0.00%	15.43	3,064,906	0.00%	3,064,906
Group Therapy	120	0.00%	120	5.80	0.00%	5.80	696	0.00%	696	18.79	0.00%	18.79	13,079	0.00%	13,079
Total OT	342,114	0.00%	342,114	3.96	-22.31%	3.08	1,356,192	-22.31%	1,053,638	25.13	-0.32%	25.05	34,086,185	-22.56%	26,396,811
SLP															
Timed Procedures	3,308	0.00%	3,308	2.09	0.00%	2.09	6,910	0.00%	6,910	20.72	0.00%	20.72	143,142	0.00%	143,142
Untimed Procedures	420	0.00%	420	1.04	0.00%	1.04	438	0.00%	438	50.51	0.00%	50.51	22,124	0.00%	22,124
Attended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Unattended Modalities	214	0.00%	214	1.22	0.00%	1.22	262	0.00%	262	32.76	0.00%	32.76	8,583	0.00%	8,583
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	3,930	0.00%	3,930	1.94	0.00%	1.94	7,610	0.00%	7,610	22.84	0.00%	22.84	173,849	0.00%	173,849
Total	2,595,632	0.00%	2,595,632	4.18	-39.89%	2.51	10,844,404	-39.89%	6,518,654	$ 23.18	-1.21%	$ 22.90	$ 251,409,174	-40.62%	$ 149,294,875

Full Revenue Impact		$ 102,114,299
Low	15%	15,317,145
Mid	30%	30,634,290
High	45%	45,951,435

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Freestanding – Total

HEALTHSOUTH

Scenario
Setting: Freestanding Clinics
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	6,807,302	-13.45%	5,891,735	3.19	-42.04%	1.85	21,681,944	-49.83%	10,876,855	$ 21.86	-0.12%	$ 21.84	$ 474,023,320	-49.90%	$ 237,304,744
Untimed Procedures	969,212	-3.34%	936,806	1.00	-0.93%	0.99	973,188	-4.24%	931,924	44.36	0.79%	44.70	43,175,021	-3.52%	41,654,607
Attended Modalities	1,304,638	-47.32%	687,304	1.07	-7.46%	0.99	1,398,994	-51.25%	683,042	18.04	-1.38%	17.79	25,244,513	-51.92%	12,136,878
Unattended Modalities	3,487,856	-0.20%	3,480,974	1.33	-0.08%	1.33	4,636,234	-0.28%	4,623,233	12.69	0.09%	12.70	58,828,226	-0.19%	58,718,304
Group Therapy	2,454	0.00%	2,454	1.37	0.00%	1.37	3,368	0.00%	3,368	23.47	0.00%	23.47	79,042	0.00%	79,042
Total PT	6,970,270	0.00%	6,970,270	4.12	-40.34%	2.46	28,693,728	-40.34%	17,117,425	20.96	-2.41%	20.45	601,350,122	-41.78%	350,093,575
OT															
Timed Procedures	692,968	-6.94%	644,849	2.90	-25.37%	2.16	2,009,104	-30.74%	1,391,466	23.69	1.28%	23.99	47,591,010	-29.83%	33,383,886
Untimed Procedures	115,306	-8.76%	105,286	1.01	-0.42%	1.01	117,074	-9.13%	106,286	40.52	4.94%	42.53	4,744,418	-4.64%	4,524,434
Attended Modalities	183,612	-21.34%	144,422	1.13	-7.93%	1.04	207,150	-27.58%	150,021	19.27	1.29%	19.52	3,991,208	-26.64%	2,927,763
Unattended Modalities	359,166	0.00%	359,166	1.20	0.00%	1.20	429,980	0.00%	429,980	12.83	0.00%	12.83	5,516,468	0.00%	5,516,468
Group Therapy	178	0.00%	178	4.22	0.00%	4.22	752	0.00%	752	19.11	0.00%	19.11	14,374	0.00%	14,374
Total OT	716,410	0.00%	716,410	3.86	-24.80%	2.90	2,764,060	-24.80%	2,078,685	22.38	-0.22%	22.31	61,857,478	-25.04%	46,366,924
SLP															
Timed Procedures	18,886	0.00%	18,886	2.01	0.00%	2.01	38,016	0.00%	38,016	29.86	0.00%	29.86	1,135,140	0.00%	1,135,140
Untimed Procedures	2,780	0.00%	2,780	1.11	0.00%	1.11	3,078	0.00%	3,078	62.20	0.00%	62.20	191,452	0.00%	191,452
Attended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Unattended Modalities	214	0.00%	214	1.22	0.00%	1.22	262	0.00%	262	32.76	0.00%	32.76	8,583	0.00%	8,583
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	21,730	0.00%	21,730	1.90	0.00%	1.90	41,356	0.00%	41,356	32.28	0.00%	32.28	1,335,176	0.00%	1,335,176
Total	7,708,410	0.00%	7,708,410	4.09	-38.93%	2.50	31,499,144	-38.93%	19,237,385	$ 21.10	-1.99%	$ 20.68	$ 664,542,776	-40.14%	$ 397,795,675

Full Revenue Impact		$ 266,747,101
Low	31%	82,591,732
Mid	45%	118,771,267
High	58%	154,950,982

FJ 000056

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Hospital Outpatient – Medicare

HEALTHSOUTH

FJ 000061

Scenario
Setting: Hospital Outpatient
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
FT															
Timed Procedures	314,178	-3.29%	303,827	3.85	-30.29%	2.68	1,209,738	-32.59%	815,533	$ 23.19	-0.91%	$ 22.98	$ 28,053,808	-33.20%	$ 18,739,474
Untimed Procedures	43,340	-4.32%	41,469	1.34	0.22%	1.34	58,034	-4.11%	55,649	43.66	0.27%	43.78	2,533,966	-3.85%	2,436,345
Attended Modalities	21,484	-41.89%	12,484	1.31	-2.92%	1.27	28,100	-43.59%	15,851	10.44	1.94%	10.64	293,330	-42.50%	168,676
Unattended Modalities	41,696	0.00%	41,696	1.36	0.00%	1.36	56,698	0.00%	56,698	4.18	0.00%	4.18	237,261	0.00%	237,261
Group Therapy	7,004	0.00%	7,004	2.47	0.00%	2.47	17,308	0.00%	17,308	15.27	0.00%	15.27	264,316	0.00%	264,316
Total FT	346,082	0.00%	346,082	3.96	-29.84%	2.78	1,369,898	-29.84%	961,039	22.91	-0.77%	22.73	31,382,682	-30.39%	21,846,072
OT															
Timed Procedures	92,230	-1.16%	91,158	3.85	-20.71%	3.05	354,944	-21.63%	278,180	25.21	-1.02%	24.95	8,946,462	-22.43%	6,940,122
Untimed Procedures	11,332	-6.67%	10,577	1.25	-17.77%	1.02	14,110	-23.26%	10,829	50.87	19.25%	60.67	717,814	-8.46%	656,930
Attended Modalities	4,088	0.00%	4,088	1.25	0.00%	1.25	5,110	0.00%	5,110	10.51	0.00%	10.51	53,684	0.00%	53,684
Unattended Modalities	8,612	0.00%	8,612	1.26	0.00%	1.26	10,880	0.00%	10,880	4.63	0.00%	4.63	50,396	0.00%	50,396
Group Therapy	5,328	0.00%	5,328	2.49	0.00%	2.49	13,426	0.00%	13,426	15.27	0.00%	15.27	205,033	0.00%	205,033
Total OT	102,886	0.00%	102,886	3.27	-20.09%	3.09	398,470	-20.09%	318,424	25.03	-0.80%	24.83	9,973,389	-20.73%	7,906,186
SLP															
Timed Procedures	33,120	-2.47%	32,302	1.88	-1.32%	1.85	62,238	-3.76%	59,917	56.28	1.42%	57.08	3,504,102	-2.39%	3,420,220
Untimed Procedures	9,232	14.29%	10,551	1.51	-12.50%	1.32	13,924	0.00%	13,924	69.67	3.86%	72.36	970,089	3.86%	1,007,564
Attended Modalities	10	0.00%	10	1.00	0.00%	1.00	10	0.00%	10	14.64	0.00%	14.64	146	0.00%	146
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	39,712	0.00%	39,712	1.92	-3.07%	1.86	76,192	-3.07%	73,851	58.72	2.10%	59.96	4,474,337	-1.04%	4,427,930
Total	488,680	0.00%	488,680	3.77	-26.63%	2.77	1,844,560	-26.63%	1,353,335	$ 24.85	1.65%	$ 25.26	$ 45,830,407	-25.42%	$ 34,180,188

Full Revenue Impact		$ 11,650,219
Low	100%	11,650,219
Mid	100%	11,650,219
High	100%	11,650,219

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Hospital Outpatient – Commercial

HEALTHSOUTH

Scenario
Setting: Hospital Outpatient
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	331,972	-3.04%	321,874	3.40	-26.00%	2.52	1,128,608	-28.25%	809,749	$ 29.37	-0.09%	$ 29.54	$ 33,373,148	-28.31%	$ 23,924,025
Untimed Procedures	51,632	-1.90%	50,649	1.46	0.00%	1.46	75,354	-1.90%	73,919	69.69	1.36%	70.64	5,251,124	-0.57%	5,221,388
Attended Modalities	54,808	-24.56%	41,346	1.19	-9.71%	1.07	65,086	-31.88%	44,334	24.20	-2.01%	23.71	1,574,903	-32.25%	1,051,170
Unattended Modalities	91,236	0.00%	91,236	1.45	0.00%	1.45	132,220	0.00%	132,220	19.18	0.00%	19.18	2,535,592	0.00%	2,535,592
Group Therapy	7,344	0.00%	7,344	3.20	0.00%	3.20	23,534	0.00%	23,534	35.09	0.00%	35.09	825,914	0.00%	825,914
Total PT	370,714	0.00%	370,714	3.84	-23.94%	2.92	1,424,802	-23.94%	1,083,756	30.57	1.28%	30.96	43,560,681	-22.96%	33,558,089
OT															
Timed Procedures	94,440	-2.45%	92,122	3.80	-21.76%	2.97	358,720	-23.68%	273,977	29.76	0.17%	29.82	10,677,270	-23.55%	8,162,817
Untimed Procedures	10,688	-6.25%	10,020	1.70	-27.27%	1.23	18,172	-31.82%	12,356	62.54	30.66%	81.71	1,133,341	-10.92%	1,009,630
Attended Modalities	7,928	-40.00%	4,757	1.26	0.00%	1.26	10,002	-40.00%	6,001	28.01	-1.37%	27.63	280,189	-40.82%	165,814
Unattended Modalities	15,024	0.00%	15,024	1.31	0.00%	1.31	19,742	0.00%	19,742	24.14	0.00%	24.14	476,599	0.00%	476,599
Group Therapy	4,876	0.00%	4,876	2.89	0.00%	2.89	14,112	0.00%	14,112	38.82	0.00%	38.82	547,879	0.00%	547,879
Total OT	103,640	0.00%	103,640	4.06	-22.51%	3.15	420,698	-22.51%	325,968	31.18	1.97%	31.79	13,115,278	-20.99%	10,362,728
SLP															
Timed Procedures	50,656	-2.13%	49,578	2.40	-1.20%	2.38	121,792	-3.31%	117,766	48.05	1.24%	48.64	5,851,565	-2.11%	5,728,200
Untimed Procedures	10,038	0.00%	10,038	2.36	0.00%	2.36	23,724	0.00%	23,724	49.62	0.00%	49.62	1,177,088	0.00%	1,177,088
Attended Modalities	48	0.00%	48	1.04	0.00%	1.04	50	0.00%	50	31.35	0.00%	31.35	1,567	0.00%	1,567
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	56,850	0.00%	56,850	2.56	-2.77%	2.49	145,566	-2.77%	141,540	48.30	1.04%	48.80	7,030,220	-1.75%	6,906,855
Total	531,204	0.00%	531,204	3.75	-22.09%	2.92	1,991,066	-22.09%	1,551,284	$ 32.00	2.40%	$ 32.76	$ 63,706,179	-20.22%	$ 50,827,673

Full Revenue Impact		$ 12,878,506
Low	30%	3,863,552
Mid	45%	5,795,328
High	60%	7,727,104

FJ 000062

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

327

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Hospital Outpatient – Other

HEALTHSOUTH

FJ 000063

Scenario
Setting: Hospital Outpatient
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	180,868	-3.52%	174,494	3.39	-26.47%	2.50	613,722	-39.06%	435,383	$ 28.06	2.51%	$ 28.76	$ 17,221,021	-27.28%	$ 12,523,178
Untimed Procedures	26,882	-5.26%	25,467	1.37	-2.17%	1.34	36,700	-7.32%	34,015	68.58	5.23%	72.17	2,516,876	-2.47%	2,454,752
Attended Modalities	32,688	-23.81%	24,252	1.15	-1.98%	1.13	37,608	-27.21%	27,345	23.38	2.87%	24.05	879,041	-23.19%	657,646
Unattended Modalities	58,970	0.00%	58,970	1.49	0.00%	1.49	87,716	0.00%	87,716	18.47	0.00%	18.47	1,620,026	0.00%	1,620,026
Group Therapy	4,004	0.00%	4,004	5.88	0.00%	5.88	23,560	0.00%	23,560	33.71	0.00%	33.71	794,093	0.00%	794,093
Total PT	204,312	0.00%	204,312	3.91	-23.93%	2.98	799,298	-23.93%	608,019	28.81	3.03%	29.69	23,031,057	-21.63%	18,049,695
OT															
Timed Procedures	57,828	-3.45%	55,834	3.76	-19.29%	3.03	217,394	-22.07%	169,333	28.87	7.40%	31.00	6,272,859	-16.31%	5,250,045
Untimed Procedures	11,798	0.00%	11,798	1.53	0.00%	1.53	18,016	0.00%	18,016	53.97	0.00%	53.97	972,290	0.00%	972,290
Attended Modalities	7,164	-25.00%	5,373	1.32	-20.00%	1.05	9,424	-40.00%	5,654	30.44	0.12%	30.47	284,841	-39.93%	172,309
Unattended Modalities	13,128	0.00%	13,128	1.41	0.00%	1.41	18,490	0.00%	18,490	25.21	0.00%	25.21	466,160	0.00%	466,160
Group Therapy	1,330	0.00%	1,330	2.60	0.00%	2.60	3,454	0.00%	3,454	44.20	0.00%	44.20	152,655	0.00%	152,655
Total OT	68,112	0.00%	68,112	3.92	-19.40%	3.16	266,878	-19.40%	214,947	30.56	6.75%	32.63	8,150,805	-13.95%	7,013,459
SLP															
Timed Procedures	23,280	0.00%	23,280	2.36	0.00%	2.36	54,854	0.00%	54,854	39.83	0.00%	39.83	2,185,017	0.00%	2,185,017
Untimed Procedures	4,550	0.00%	4,550	2.26	0.00%	2.26	10,296	0.00%	10,296	44.62	0.00%	44.62	459,430	0.00%	459,430
Attended Modalities	4	0.00%	4	1.00	0.00%	1.00	4	0.00%	4	19.26	0.00%	19.26	77	0.00%	77
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	25,986	0.00%	25,986	2.51	0.00%	2.51	65,154	0.00%	65,154	40.59	0.00%	40.59	2,644,524	0.00%	2,644,524
Total	298,410	0.00%	298,410	3.79	-21.48%	2.98	1,131,130	-21.48%	888,120	$ 29.90	4.32%	$ 31.20	$ 33,826,385	-18.09%	$ 27,707,679

Full Revenue Impact		$ 6,118,707
Low	15%	917,806
Mid	25%	1,529,677
High	35%	2,141,547

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Hospital Outpatient – Total

HEALTHSOUTH

June 2002 YTD Annualized

Scenario
Setting: Hospital Outpatient
Case: Base

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	877,018	-3.24%	800,195	3.57	-27.86%	2.58	2,952,088	-30.20%	2,060,685	$ 26.64	0.52%	$ 26.78	$ 78,647,978	-29.83%	$ 55,186,676
Untimed Procedures	121,854	-3.50%	117,585	1.40	-0.33%	1.39	170,088	-3.82%	163,582	60.37	2.06%	61.82	10,301,965	-1.84%	10,112,486
Attended Modalities	108,980	-28.35%	78,083	1.20	-6.50%	1.12	130,786	-33.00%	87,531	21.01	2.11%	21.45	2,747,274	-31.66%	1,877,492
Unattended Modalities	191,902	0.00%	191,902	1.44	0.00%	1.44	276,634	0.00%	276,634	15.88	0.00%	15.88	4,392,880	0.00%	4,392,880
Group Therapy	18,352	0.00%	18,352	3.51	0.00%	3.51	64,402	0.00%	64,402	29.26	0.00%	29.26	1,884,323	0.00%	1,884,323
Total PT	921,108	0.00%	921,108	3.90	-26.19%	2.88	3,593,996	-26.19%	2,652,834	27.26	1.57%	27.69	97,974,419	-25.03%	73,453,857
OT															
Timed Procedures	244,408	-2.20%	239,114	3.81	-20.78%	3.02	930,958	-22.52%	721,289	27.82	1.44%	28.22	25,896,591	-21.41%	20,352,984
Untimed Procedures	33,818	-4.21%	32,393	1.49	-14.40%	1.27	50,248	-18.01%	41,201	56.19	13.99%	64.05	2,823,445	-6.54%	2,638,861
Attended Modalities	19,180	-25.87%	14,218	1.28	-7.82%	1.18	24,536	-31.67%	16,769	25.30	-7.62%	23.37	620,714	-36.88%	391,807
Unattended Modalities	36,764	0.00%	36,764	1.34	0.00%	1.34	49,112	0.00%	49,112	20.22	0.00%	20.22	993,155	0.00%	993,155
Group Therapy	11,594	0.00%	11,594	2.67	0.00%	2.67	30,992	0.00%	30,992	29.22	0.00%	29.22	905,567	0.00%	905,567
Total OT	274,638	0.00%	274,638	2.95	-20.86%	2.13	1,085,846	-20.86%	859,360	28.77	2.26%	29.42	31,239,471	-19.07%	25,282,373
SLP															
Timed Procedures	107,036	-1.77%	103,160	2.23	-0.91%	2.21	238,904	-2.66%	232,537	48.31	0.89%	48.74	11,540,684	-1.80%	11,333,437
Untimed Procedures	23,820	5.54%	25,139	2.01	5.25%	1.91	47,944	0.00%	47,944	54.37	1.44%	55.15	2,606,607	1.44%	2,644,082
Attended Modalities	62	0.00%	62	1.03	0.00%	1.03	64	0.00%	64	27.98	0.00%	27.98	1,791	0.00%	1,791
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	122,548	0.00%	122,548	2.34	-2.22%	2.29	286,912	-2.22%	280,545	49.22	1.04%	49.83	14,149,081	-1.20%	13,979,309
Total	1,318,294	0.00%	1,318,294	3.37	-23.64%	2.88	4,966,756	-23.64%	3,792,739	$ 28.86	2.96%	$ 29.72	$ 143,362,972	-21.38%	$ 112,715,540

Full Revenue Impact		$ 30,647,432
Low	54%	16,431,377
Mid	62%	18,975,224
High	70%	21,318,870

FJ 000064

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Hospital Satellites – Medicare

HEALTHSOUTH.

FJ 000069

Scenario
Setting: Hospital Satellites
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	227,130	-3.88%	218,309	3.38	-29.68%	2.38	768,194	-32.41%	519,218	$ 22.95	-0.22%	$ 22.90	$ 17,627,297	-32.56%	$ 11,888,642
Untimed Procedures	27,964	-7.69%	25,813	1.30	0.00%	1.30	36,420	-7.69%	33,618	43.59	-12.27%	38.85	1,653,213	-18.97%	1,339,612
Attended Modalities	33,552	-53.66%	15,548	1.18	-3.27%	1.14	39,462	-55.17%	17,690	9.37	0.26%	9.40	369,832	-55.05%	166,226
Unattended Modalities	53,782	0.00%	53,782	1.49	0.00%	1.49	79,900	0.00%	79,900	5.89	0.00%	5.89	470,310	0.00%	470,510
Group Therapy	1,414	0.00%	1,414	2.98	0.00%	2.98	4,218	0.00%	4,218	15.27	0.00%	15.27	64,414	0.00%	64,414
Total PT	248,884	0.00%	248,884	3.73	-29.47%	2.63	928,194	-29.47%	654,648	21.75	-2.16%	21.28	20,185,267	-30.99%	13,929,205
OT															
Timed Procedures	39,814	-2.74%	38,723	3.52	-20.75%	2.79	140,024	-32.92%	107,935	25.28	0.16%	25.32	3,539,178	-22.79%	2,732,449
Untimed Procedures	4,916	0.00%	4,916	1.26	0.00%	1.26	6,184	0.00%	6,184	50.74	0.00%	50.74	313,777	0.00%	313,777
Attended Modalities	3,240	-27.27%	2,356	1.02	-2.60%	1.00	3,400	-29.17%	2,472	10.29	0.28%	10.32	35,899	-28.97%	25,500
Unattended Modalities	7,508	0.00%	7,508	1.27	0.00%	1.27	9,566	0.00%	9,566	4.96	0.00%	4.96	47,410	0.00%	47,410
Group Therapy	668	0.00%	668	2.63	0.00%	2.63	1,768	0.00%	1,768	15.27	0.00%	15.27	27,000	0.00%	27,000
Total OT	42,700	0.00%	42,700	3.77	-20.66%	3.00	161,032	-20.66%	127,925	24.61	-0.07%	24.59	3,963,264	-20.62%	3,146,136
SLP															
Timed Procedures	7,510	0.00%	7,510	2.09	0.00%	2.09	15,688	0.00%	15,688	56.75	0.00%	56.75	890,249	0.00%	890,249
Untimed Procedures	1,952	0.00%	1,952	1.32	0.00%	1.32	2,584	0.00%	2,584	74.47	0.00%	74.47	192,441	0.00%	192,441
Attended Modalities	14	0.00%	14	2.00	0.00%	2.00	28	0.00%	28	14.64	0.00%	14.64	410	0.00%	410
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Total SLP	9,142	0.00%	9,142	2.00	0.00%	2.00	18,300	0.00%	18,300	59.39	0.00%	59.39	1,083,100	0.00%	1,083,100
Total	300,726	0.00%	300,726	3.68	-27.69%	2.66	1,107,526	-27.69%	800,870	$ 22.78	-0.48%	$ 22.67	$ 25,231,631	-28.03%	$ 18,158,441

Full Revenue Impact		$ 7,073,189
Low	100%	7,073,189
Mid	100%	7,073,189
High	100%	7,073,189

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Hospital Satellites – Commercial

HEALTHSOUTH

FJ 000070

Scenario
Setting: Hospital Satellites
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	382,108	-6.13%	358,666	3.03	-29.13%	2.14	1,156,102	-33.48%	769,033	$ 31.15	-0.51%	$ 30.99	$ 36,010,461	-33.82%	$ 23,830,895
Untimed Procedures	51,580	-2.78%	50,147	1.42	0.04%	1.42	73,058	-2.74%	71,056	74.79	1.77%	76.12	5,464,115	-1.01%	5,408,715
Attended Modalities	86,376	-52.10%	41,373	1.14	2.80%	1.17	98,206	-50.76%	48,359	29.78	1.76%	30.30	2,924,418	-49.89%	1,465,462
Unattended Modalities	157,572	0.00%	157,572	1.45	0.00%	1.45	228,940	0.00%	228,940	22.83	0.00%	22.83	5,226,494	0.00%	5,226,494
Group Therapy	8,066	0.00%	8,066	2.15	0.00%	2.15	17,364	0.00%	17,364	26.84	0.00%	26.84	466,123	0.00%	466,123
Total PT	422,014	0.00%	422,014	3.73	-27.89%	2.69	1,573,670	-27.89%	1,134,753	31.83	0.77%	32.08	50,091,611	-27.34%	36,397,690
OT															
Timed Procedures	70,668	-3.17%	68,425	3.26	-18.83%	2.64	230,330	-21.45%	180,945	30.18	-0.04%	30.17	6,952,827	-21.48%	5,459,278
Untimed Procedures	8,102	0.00%	8,102	1.46	0.00%	1.46	11,818	0.00%	11,818	78.38	0.00%	78.38	926,266	0.00%	926,266
Attended Modalities	6,528	-29.17%	4,624	1.17	-5.88%	1.10	7,622	-33.33%	5,081	28.32	0.75%	28.53	215,833	-32.83%	144,967
Unattended Modalities	16,968	0.00%	16,968	1.17	0.00%	1.17	19,864	0.00%	19,864	27.24	0.00%	27.24	541,181	0.00%	541,181
Group Therapy	954	0.00%	954	1.83	0.00%	1.83	1,742	0.00%	1,742	52.48	0.00%	52.48	91,422	0.00%	91,422
Total OT	75,802	0.00%	75,802	3.58	-19.14%	2.90	271,396	-19.14%	219,451	32.16	1.50%	32.64	8,727,529	-17.93%	7,163,115
SLP															
Timed Procedures	31,994	0.00%	31,994	1.63	0.00%	1.63	52,832	0.00%	52,832	62.36	0.00%	62.36	3,294,412	0.00%	3,294,412
Untimed Procedures	3,106	0.00%	3,106	1.26	0.00%	1.26	3,908	0.00%	3,908	107.17	0.00%	107.17	418,858	0.00%	418,858
Attended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	128	0.00%	128	1.55	0.00%	1.55	198	0.00%	198	53.11	0.00%	53.11	10,516	0.00%	10,516
Total SLP	35,030	0.00%	35,030	1.63	0.00%	1.63	56,938	0.00%	56,938	65.40	0.00%	65.40	3,723,765	0.00%	3,723,765
Total	532,846	0.00%	532,846	3.57	-25.81%	2.65	1,902,004	-25.81%	1,411,141	$ 32.88	1.90%	$ 33.51	$ 62,542,906	-24.40%	$ 47,284,570

Full Revenue Impact		$ 15,258,336
Low	30%	4,577,501
Mid	45%	6,866,251
High	60%	9,155,002

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Hospital Satellites – Other

HEALTHSOUTH

FJ 000071

Scenario
Setting: Hospital Satellites
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	262,102	-7.34%	242,837	3.04	-22.08%	2.37	796,082	-27.80%	574,760	$ 32.92	0.03%	$ 32.93	$ 26,205,910	-27.78%	$ 18,925,516
Untimed Procedures	30,824	-10.00%	27,742	1.32	0.00%	1.32	40,634	-10.00%	36,571	81.94	5.86%	86.75	3,329,752	-4.72%	3,172,441
Attended Modalities	61,392	-33.71%	39,595	1.13	-9.48%	1.02	69,518	-41.81%	40,454	31.16	7.81%	33.60	2,166,502	-37.26%	1,359,211
Unattended Modalities	102,934	0.00%	102,934	1.46	0.00%	1.46	149,798	0.00%	149,798	24.46	0.00%	24.46	3,664,475	0.00%	3,664,475
Group Therapy	4,836	0.00%	4,836	2.14	0.00%	2.14	10,394	0.00%	10,394	27.87	0.00%	27.87	289,631	0.00%	289,631
Total PT	288,536	0.00%	288,536	3.70	-23.86%	2.81	1,066,426	-23.86%	811,976	33.44	0.97%	33.76	35,656,271	-23.12%	27,411,274
OT															
Timed Procedures	54,888	0.00%	54,888	3.06	-22.60%	2.37	168,158	-22.60%	130,156	33.90	-0.20%	33.83	5,700,436	-22.75%	4,403,437
Untimed Procedures	8,112	-12.50%	7,098	1.35	20.00%	1.88	10,924	-30.00%	7,647	112.78	31.06%	147.81	1,231,963	-8.26%	1,130,246
Attended Modalities	7,250	-40.00%	4,350	1.19	-13.33%	1.03	8,624	-48.00%	4,484	28.66	1.06%	28.96	247,154	-47.45%	129,877
Unattended Modalities	19,550	0.00%	19,550	1.20	0.00%	1.20	23,540	0.00%	23,540	30.38	0.00%	30.38	715,063	0.00%	715,063
Group Therapy	1,432	0.00%	1,432	1.46	0.00%	1.46	2,094	0.00%	2,094	66.91	0.00%	66.91	140,117	0.00%	140,117
Total OT	61,272	0.00%	61,272	3.48	-21.29%	2.74	213,340	-21.29%	167,921	37.66	3.88%	38.82	8,034,732	-18.87%	6,518,711
SLP															
Timed Procedures	17,408	0.00%	17,408	1.39	0.00%	1.39	24,270	0.00%	24,270	77.04	0.00%	77.04	1,869,813	0.00%	1,869,813
Untimed Procedures	2,978	0.00%	2,978	1.06	0.00%	1.06	3,170	0.00%	3,170	144.75	0.00%	144.75	458,866	0.00%	458,866
Attended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	482	0.00%	482	1.61	0.00%	1.61	774	0.00%	774	55.52	0.00%	55.52	42,973	0.00%	42,973
Total SLP	20,538	0.00%	20,538	1.37	0.00%	1.37	28,214	0.00%	28,214	84.06	0.00%	84.06	2,371,652	0.00%	2,371,652
Total	370,346	0.00%	370,346	3.53	-22.93%	1.72	1,307,980	-22.93%	1,008,112	$ 35.22	2.25%	$ 36.01	$ 46,062,655	-21.19%	$ 36,301,637

Full Revenue Impact		$ 9,761,018
Low	15%	1,464,153
Mid	25%	2,440,254
High	35%	3,416,356

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

DRAFT-FOR DISCUSSION PURPOSES ONLY

Impact Analysis of Medicare Coding Guidance – Base Case

Impact Estimate Summary by Payor – Hospital Satellites – Total

HEALTHSOUTH

FJ 000072

Scenario
Setting: Hospital Satellites
Case: Base

June 2002 YTD Annualized

	Category Visits			Units / Category Visit			Total Units			Avg. Net Revenue / Unit			Net Revenue		
	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After	Before	% Chg	After
PT															
Timed Procedures	871,340	-5.91%	819,832	3.12	-27.21%	2.27	2,720,378	-31.52%	1,863,011	$ 29.35	-0.06%	$ 29.33	$ 79,843,669	-31.56%	$ 54,644,854
Untimed Procedures	110,368	-6.04%	103,702	1.36	-0.14%	1.36	150,112	-5.91%	141,245	69.60	0.92%	70.24	10,447,080	-5.04%	9,920,769
Attended Modalities	181,520	-46.83%	96,517	1.14	-3.32%	1.10	207,186	-48.60%	106,503	26.36	6.55%	28.08	5,460,753	-45.23%	2,990,900
Unattended Modalities	314,288	0.00%	314,288	1.46	0.00%	1.46	458,638	0.00%	458,638	20.41	0.00%	20.41	9,361,479	0.00%	9,361,479
Group Therapy	14,336	0.00%	14,336	2.23	0.00%	2.23	31,976	0.00%	31,976	25.63	0.00%	25.63	820,168	0.00%	820,168
Total PT	959,434	0.00%	959,434	3.72	-27.10%	2.71	3,568,290	-27.10%	2,601,374	29.69	0.66%	29.88	105,933,149	-26.62%	77,738,169
OT															
Timed Procedures	163,370	-2.02%	162,036	3.26	-20.59%	2.59	538,523	-22.19%	419,151	30.07	-0.03%	30.06	16,192,441	-22.22%	12,593,134
Untimed Procedures	21,130	-4.80%	20,116	1.37	-6.86%	1.28	28,926	-11.33%	25,649	85.46	8.14%	92.41	2,472,006	-4.11%	2,370,290
Attended Modalities	17,018	-33.42%	11,330	1.16	-8.39%	1.06	19,736	-39.01%	12,038	25.28	-1.30%	24.95	498,885	-39.80%	300,344
Unattended Modalities	44,026	0.00%	44,026	1.20	0.00%	1.20	52,970	0.00%	52,970	24.61	0.00%	24.61	1,303,654	0.00%	1,303,654
Group Therapy	3,054	0.00%	3,054	1.83	0.00%	1.83	5,604	0.00%	5,604	46.13	0.00%	46.13	258,539	0.00%	258,539
Total OT	179,774	0.00%	179,774	3.59	-20.20%	2.87	645,768	-20.20%	515,397	32.09	1.75%	32.66	20,725,525	-18.81%	16,827,962
SLP															
Timed Procedures	56,912	0.00%	56,912	1.63	0.00%	1.63	92,790	0.00%	92,790	65.25	0.00%	65.25	6,054,474	0.00%	6,054,474
Untimed Procedures	8,036	0.00%	8,036	1.20	0.00%	1.20	9,662	0.00%	9,662	110.76	0.00%	110.76	1,070,145	0.00%	1,070,145
Attended Modalities	14	0.00%	14	2.00	0.00%	2.00	28	0.00%	28	14.64	0.00%	14.64	410	0.00%	410
Unattended Modalities	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%	-
Group Therapy	610	0.00%	610	1.59	0.00%	1.59	972	0.00%	972	55.03	0.00%	55.03	53,489	0.00%	53,489
Total SLP	64,710	0.00%	64,710	1.60	0.00%	1.60	103,452	0.00%	103,452	69.39	0.00%	69.39	7,178,517	0.00%	7,178,517
Total	1,203,918	0.00%	1,203,918	3.59	-25.42%	2.67	4,317,510	-25.42%	3,220,123	$ 31.08	1.93%	$ 31.68	$ 133,837,192	-23.98%	$ 101,744,648

Full Revenue Impact		$ 32,092,543
Low	41%	13,114,843
Mid	51%	16,379,693
High	61%	19,644,547

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

Other Findings & Recommendations

Potential Mitigation Strategies

HEALTHSOUTH

➢ Company is analyzing / pursuing a number of different strategies to mitigate the impact of Transmittal 1753. Some mitigation strategies include:

- Recruit additional licensed therapists - this is the direct response to the concurrent therapy issue. As long as there is a positive margin in providing an incremental unit of therapy, it makes economic sense to add therapists in order to fully prevent a decrease in billed units of therapy.
- Alter patient scheduling patterns - to the extent excess therapist capacity exists, efforts to minimize scheduled overlap between a Medicare patient and other patients could mitigate the loss of overall billed therapy units. However, de-leveraging of therapist schedules in the face of capacity constraints has the undesirable effect of further eroding patient access. Facilities are also renewing efforts to minimize cancellations and no-shows. Altering patient scheduling patterns by payor may also have favorable mitigation effects.
- Alter therapist scheduling patterns - extended clinical hours and matching therapist overlap to patient overlap may have favorable mitigation effects. However, creative scheduling options may be limited by the availability of licensed therapists.
- Change in contracting strategy - while the response to commercial payors and managed care organizations is not yet fully known, the Company is taking steps to eliminate linkages between its non-Medicare contracts and Medicare's reimbursement methodology, rules and requirements. This can be accomplished by focusing on converting from fee screen reimbursement to flat-rate per visit, case rate or capitation. Other contractual ties to Medicare should also be carefully reviewed for reimbursement and operational implications.

✓ If Management has not already done so, we recommend that the Company actively pursue dialogue with CMS concerning repricing of therapy services in light of the significant claims coding patterns brought about by Transmittal 1753. Historically, CPT rates were set based on the previous cost structure and then existing reimbursement patterns which allowed for Medicare patients to be treated concurrently and billed at the same rate as in one-on-one treatments. CMS might consider adjusting the fee schedule for this new billing paradigm.

✓ We also recommend that the Company quickly and thoroughly assess all available mitigation strategies under the various alternative Medicare interpretation outcomes. To evaluate the the impact of the various mitigation strategies, we further recommend that analytical models be constructed and tested. Once the appropriate mitigation strategy(ies) has been identified, high-impact target locations should be quickly identified for priority implementation.

✓ It is important to note that certain of the operational mitigation options available to the Company involve disparate approaches for Medicare and non-Medicare patients. The Company should carefully evaluate all potential effects of these policies - both positive and negative.

FJ 000092

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of the client

Other Findings and Recommendations

Compliance

FJ 000093

➢ The following potential compliance issues arose throughout the process:

- Use of Inappropriately Licensed Therapist to Bill Physical Therapy Treatments – Treasure Coast Rehabilitation Hospital
  - During the course of our sampling of patient billing data at the Treasure Coast Rehabilitation Hospital, HealthSouth regional staff discovered the hospital had been billing Medicare (as well as other payors) for outpatient physical therapy services provided by an individual who was not a licensed Physical Therapist. The therapist in question is licensed as a massage therapist; however, it is our understanding that Medicare requires a physical therapy license in order to bill for Physical Therapy Services.
- Billing of Individual Therapy Codes to Medicare Inconsistent with Transmittal 1753 – Rocky Ridge facility located in Birmingham, Alabama
  - During a review of Medicare billing procedures with the site administrator of the Rocky Ridge therapy center, we determined the center's therapists, intending to bill group therapy charges to Medicare patients, had incorrectly entered the group therapy identifier in the medical records/billing system. As a result, Medicare patients were billed individual therapy codes consistent with prior Medicare billing practices and in direct conflict with Transmittal 1753 and the Company's current stated policy throughout the month of September 2002.
  - As it was the intention of the therapists to follow the Company's policy, it appears that this issue was created due to improper training in the use of the facility's medical records/billing system for the delivery of group therapy.
- Incorrect Mapping of Lymphedema treatment to CPT code 97150 – Fort Worth Hospital
  - During the sample data recoding process for the Ft. Worth, Texas hospital, it was noted that two separate therapy services in the facility's charge master were mapped to CPT code 97150 (group therapy). In addition to group therapy, manual massage therapy for Lymphedema was also mapped to CPT code 97150, rather than code 97124. Notably, multiple units of service were being charged for Lymphedema treatment under CPT code 97150 (an untimed code limited to one unit of service per visit).

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

- In this specific instance, overall reimbursement to the Company is less than if such services were properly billed under CPT code 97124. However, the general compliance risks involved in mapping issues of this nature are
  - The Company may systematically receive excessive reimbursement for overstated units of services rendered, and
  - The Company may systematically receive reimbursement for services not performed.

✓ It is our understanding that the Company recently completed a comprehensive charge master review. We recommend that a follow-up initiative be launched to ensure that all internal charge codes are mapped to the appropriate CPT code.

- Certain hospitals are billing more than one unit of group therapy on the same visit
  - During our review of the September 2002 MedNet billing data for the Hospital Outpatient and Satellites, its was noted that certain facilities were billing CPT code 97150 (group therapy) using more than one unit of service per visit. Frank Dicesare (Controller – Inpatient Division) was asked to inquire with selected facilities as to the reason for such billing anomalies. Mr. Dicesare discovered that at least one facility was intentionally billing multiple units of group therapy in order to prevent the facility's internally-reported productivity statistics (i.e. billed units per FTE) from declining due to use of the group code. Mr. Dicesare has confirmed to FTI that the CareMedic Medicare claims software utilized by the Company currently includes an edit whereby all claims which include untimed CPT codes with units of service greater than one (1) are flagged for editing prior to the actual claim submission to Medicare. Although the CareMedic software will detect this group code billing issue, it's important to note that the CareMedic edits can be overridden by local billing personnel. Also noteworthy, but not necessarily problematic, is that the original MedNet billing data is not updated in instances where a bill has been subsequently edited using the CareMedic software.

➢ September recoding indicates that the Company is coding Medicare patients in a more aggressive pattern than our alternative coding guidelines based on our best judgement of current consensus in the industry.

➢ There has been no detailed formal guidance from Corporate to address the complex changes related to Transmittal 1753 resulting in inconsistent methodology of coding in the field.

✓ Develop a Company interpretation of and practice guidelines related to Transmittal 1753 and provide guidance to the field.

✓ Develop the best practices model to maximize return on operations by incorporating different settings, payor mix, and therapist leverage.

FJ 000094

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

Other Findings and Recommendations

Compliance

HEALTHSOUTH

- There are no formal policies and procedures in place to roll out coding policy changes to the field and provide education of the new policies and procedures.
- The responsibility and authority to interpret and implement such a policy change such as Transmittal 1753 does not fall to one responsible party or division to ascertain implementation and compliance.
  - ✓ Implement procedures to disseminate Corporate positions on changes to the field and designate someone with the responsibility and authority to implement and oversee the process to include both education and training.
- No formal testing of coding procedures have been done to date, however, Internal Audit is presently adding a sample testing of Transmittal 1753 to its audit scope. The Corporate Integrity Agreement also requires an internal billing review of Inpatient Rehab Facilities billings and coding systems this year.
  - ✓ Implement controls to test the compliance with guidelines.
    - – Consider adding a compliance testing section related to billing and coding to the HealthSouth Clinical Audit Review ("HCAR") program with the freestanding clinics.
    - – Consider the extension of the Health Information Services ("HIS") department service of education, training, research, help desks, and compliance auditing to the Inpatient and Outpatient Rehab areas.
    - – The Corporate Integrity Agreement compliance testing for May 2002 through May 2003 requires the test of coding for the Hospitals.

DRAFT

FJ 000095

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

ERNST & YOUNG LLP

AmSouth/Harbert Plaza
Suite 1900
1901 Sixth Avenue North
Birmingham, Alabama 35203

Phone: 205 251 2000

February 14, 1996 **Tab 37**

HEALTHSOUTH Corporation
Two Perimeter Park South
Birmingham, Alabama 35243

Attention: Aaron Beam

Dear Mr. Beam:

1. This will confirm our engagement to complete a Quality Standards Review Program (the Program) for HEALTHSOUTH Corporation (the Company) for the year ended December 31, 1996.

2. Should conditions not now anticipated preclude us from completing our engagement as contemplated by the following paragraphs, we will advise you and the audit committee promptly and take such action as we deem appropriate.

Details of Quality Standards Program

3. The Quality Standards Program is intended to provide a minimum 85% national coverage of all HEALTHSOUTH facilities during 1995. This is to be accomplished by Ernst & Young LLP (E&Y) staff performing unannounced site visits during an agreed upon twenty-week period, generally between April and September.

4. The procedures to be performed by E&Y staff will be determined by HEALTHSOUTH through the creation of a Quality Standards Program checklist, which E&Y will complete for each facility visited.

5. The Program will be completed over a twenty-week period which will be broken down into five 4-week "Designated Reporting Periods" (DRPs). Approximately one month prior to the beginning of each DRP, HEALTHSOUTH will provide E&Y with a listing of the facilities to be visited during the DRP. Once E&Y receives the listing of facilities to be visited, E&Y, Birmingham will coordinate with the other participating E&Y offices to schedule all of the unannounced site visits for that DRP.

6. Within two weeks of the end of each DRP, E&Y Birmingham office will forward the completed checklists to HEALTHSOUTH corporate office.

7. The anticipated starting date for the Program is mid April, 1996.

8. Prior to the commencement of the Program, there will be a one-day training seminar at the corporate office of HEALTHSOUTH. E&Y staff members participating in this Program will attend the training seminar. The training seminar will be led by HEALTHSOUTH and E&Y personnel.

Fees and Billing

9. We estimate that our fee for our services will be approximately $500,000, plus out-of-pocket expenses. We will make every effort to minimize travel expenses by utilizing local E&Y offices and by scheduling the visits in an effective and efficient manner, where appropriate. In subsequent years, we will provide you with a similar estimate of our fees and expenses prior to the commencement of the Program. We will submit our invoices at the beginning of each DRP, and payment of them will be expected upon receipt.

10. E&Y will absorb the cost of the professional hours associated with the one-day training program in Birmingham, while the travel expenses will be paid by the Company.

11. Our estimated fees and schedule of performance are based upon, among other things, the representations Company personnel have made to us and are dependent upon the Company's personnel providing the assistance outlined in this letter. Should our assumptions with respect to these matters be incorrect or should the degree of cooperation or other matters beyond our reasonable control require additional commitments by us beyond those upon which our estimated fees are based, we may adjust our fees and planned completion dates. All such adjustments will be discussed with you in advance.

12. In the event we are requested or authorized by the Company or are required by government regulation, subpoena, or other legal process to produce our documents or our personnel as witnesses with respect to our engagements for the Company, the Company will, so long as we are not a party to the proceeding in which the information is sought, reimburse us for our professional time and expense, as well as the fees and expenses of our counsel, incurred in responding to such requests.

Other Matters

13. Any controversy or claim arising out of or relating to the services covered by this letter or hereafter provided by us to the Company (including any such matter involving any parent, subsidiary, affiliate, successor in interest, or agent of the Company or of Ernst & Young LLP) shall be submitted first to voluntary mediation, and if mediation is n t successful, then to binding arbitration, in accordance with the dispute resolution procedures set forth in the attachment to this letter. Judgment on any arbitration award may be entered in any court having proper jurisdiction.

14. If any portion of this letter is held to be void, invalid, or otherwise unenforceable, in whole or part, the remaining portions of this letter shall remain in effect.

Pursuant to our agreement as reflected in this letter, we will complete the Quality Standards Program for the Company for each of its subsequent fiscal years until either the Company or we terminate this agreement.

If these arrangements are acceptable, please sign this letter and return it to us.

We very much appreciate the opportunity to serve as HEALTHSOUTH Corporation and would be pleased to furnish any additional information you may request concerning our responsibilities and functions. We trust that our association will be a long and mutually beneficial one.

Very truly yours,

Ernst + Young LLP

HEALTHSOUTH Corporation

By: _____

Chief Financial Officer

4/15/96

Date

Dispute Resolution Procedures

The following procedures shall be used to resolve any controversy or claim ("dispute") as provided in our engagement letter of February 14, 1996. If any of these provisions are determined to be invalid or unenforceable, the remaining provisions shall remain in effect and binding on the parties to the fullest extent permitted by law.

Mediation

A dispute shall be submitted to mediation by written notice to the other party or parties. In the mediation process, the parties will try to resolve their differences voluntarily with the aid of an impartial mediator, who will attempt to facilitate negotiations. The mediator will be selected by agreement of the parties. If the parties cannot agree on a mediator, a mediator shall be designated by the American Arbitration Association ("AAA") or JAMS/Endispute at the request of a party. Any mediator so designated must be acceptable to all parties.

The mediation will be conducted as specified by the mediator and agreed upon by the parties. The parties agree to discuss their differences in good faith and to attempt, with the assistance of the mediator, to reach an amicable resolution of the dispute.

The mediation will be treated as a settlement discussion and therefore will be confidential. The mediator may not testify for either party in any later proceeding relating to the dispute. No recording or transcript shall be made of the mediation proceedings.

Each party will bear its own costs in the mediation. The fees and expenses of the mediator will be shared equally by the parties.

Arbitration

If a dispute has not been resolved within 90 days after the written notice beginning the mediation process (or a longer period, if the parties agree to extend the mediation), the mediation shall terminate and the dispute will be settled by arbitration. The arbitration will be conducted in accordance with the procedures in this document and the Arbitration Rules for Professional Accounting and Related Services Disputes of the AAA as in effect on the date of the engagement letter ("AAA Rules"). In the event of a conflict, the provisions of this document will control.

The arbitration will be conducted before a panel of three arbitrators, regardless of the size of the dispute, to be selected as provided in the AAA Rules. Any issue concerning the extent to which any dispute is subject to arbitration, or concerning the applicability, interpretation, or enforceability of these procedures, including any contention that all or part of these procedures are invalid or unenforceable, shall be governed by the Federal Arbitration Act and resolved by the arbitrators. No potential arbitrator may serve on the panel unless he or she has agreed in writing to abide and be bound by these procedures.

The arbitrators may not award non-monetary or equitable relief of any sort. They shall have no power to award punitive damages or any other damages not measured by the prevailing party's actual damages, and the parties expressly waive their right to obtain such damages in arbitration or in any other forum. In no event, even if any other portion of these provisions is held to be invalid or unenforceable, shall the arbitrators have power to make an award or impose a remedy that could not be made or imposed by a court deciding the matter in the same jurisdiction.

No discovery will be permitted in connection with the arbitration unless it is expressly authorized by the arbitration panel upon a showing of substantial need by the party seeking discovery.

All aspects of the arbitration shall be treated as confidential. Neither the parties nor the arbitrators may disclose the existence, content or results of the arbitration, except as necessary to comply with legal or regulatory requirements. Before making any such disclosure, a party shall give written notice to all other parties and shall afford such parties a reasonable opportunity to protect their interests.

The result of the arbitration will be binding on the parties, and judgment on the arbitrators' award may be entered in any court having jurisdiction.

ERNST & YOUNG LLP

AmSouth/Harbert Plaza
Suite 1900
1901 Sixth Avenue North
Birmingham, Alabama 35203

Phone: 205 251 2000

March 25, 1997

HEALTHSOUTH Corporation
One HealthSouth Parkway
Birmingham, Alabama 35243

Attention: Aaron Beam

Dear Mr. Beam:

Per your request, we are pleased to submit this letter to confirm the scope and fee arrangements for our services related to the 1997 HEALTHSOUTH Pristine Audits.

The details of the Pristine Audits for 1997 will be consistent with those outlined in the section "Details of Quality Standards Program" per the original engagement letter dated February 14, 1996 (see attached) with the following exceptions:

1. All completed checklist will be electronically submitted to the Company within two business days of completion of the audit.

2. The anticipated starting date for the 1997 Pristine Audits is May 1, 1997.

3. The Pristine audits are intended to provide 100% coverage of all HEALTHSOUTH facilities during 1997. In addition, reaudits will be performed at 25% of the Company's facilities (compared to 10% in 1996). The scope as outlined in this paragraph results in an approximate 60% increase in the total number of Pristine Audits to be performed in 1997 as compared to 1996.

We estimate our fees for these services will be $750,000 plus expenses. If the scope of the reaudits is increased from 25% to 50%, and thereby doubling the number of 1997 Pristine Audits over 1996, the estimated fees would increase by $150,000 for a total fee of $900,000, plus expenses. We will submit our invoices at the beginning of each reporting period, and payment of them will be due upon receipt. Ernst & Young will

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absorb the cost of professional hours associated with the one-day training program in Birmingham on April 23, 1997, while the travel expenses will be paid by the Company. If additional work should be required because of circumstances not known to us at this time, or that arise during the engagement, we will discuss the circumstances with you at that time before extending the scope of this project.

If these arrangements are acceptable, please sign this letter and return it to us.

We very much appreciate the opportunity to serve HEALTHSOUTH Corporation and would be pleased to furnish any additional information you may request concerning our responsibility and functions.

Very truly yours,

Dick Dandurand

Richard L. Dandurand
Partner

HEALTHSOUTH Corporation

By: _____
Aaron Beam
Chief Financial Officer

4/22/97
Date

JUL-11-03 FRI 03:02 PM HS INTERNAL AUDIT DEPT FAX NO. 2059698668 P. 08

1998 Pristine

DRAFT

March 25, 1998

Mrs. Teresa Sanders
Group Vice President, Internal Audit
HEALTHSOUTH Corporation
One HealthSouth Parkway
Birmingham, Alabama 35243

Dear Mrs. Sanders:

Per your request, we are pleased to submit this letter to confirm the scope and fee arrangements for our services related to the 1998 HEALTHSOUTH Pristine Audits.

The details of the Pristine Audits for 1998 will be consistent with those outlined in the section "Details of Quality Standards Program" per the original engagement letter dated February 14, 1996 (see attached) with the following exceptions:

1. The anticipated starting date for the 1998 Pristine Audits is May 1, 1998.

2. The 1998 Pristine Audit checklist will be expanded to include procedures covering corporate compliance issues. We have estimated that these procedures will add one hour to each of the individual site visits.

your not at facility only passing out checklist or corp compliance your will be keying results tracking returned questionnaires

3. The Pristine audits are intended to provide 100% coverage of all HEALTHSOUTH facilities during 1998. In addition, reaudits will be performed at 25% of the Company's facilities.

4. The scope as outlined in this paragraph results in an approximate 45% increase in the total number of Pristine Audits to be performed in 1998 as compared to 1997. Total sites visited in 1997 was 1,269 compared to a planned 1,988 this year

We estimate our fees for these services will be $1,250,000 plus expenses. If the scope of the reaudits is increased from 25% to 50%, the estimated fees would increase by $260,000 for a total fee of $1,510,000, plus expenses. We will submit our invoices at the

beginning of each reporting period, and payment of them will be due upon receipt. Ernst & Young will absorb the cost of professional hours associated with the two-day training program in Birmingham on April 20th and 21st, while the travel expenses will be paid by the Company. If additional work should be required because of circumstances not known to us at this time, or that arise during the engagement, we will discuss the circumstances with you at that time before extending the scope of this project.

E Y to over hotel cost 12c per mile airline tickets

If these arrangements are acceptable, please sign this letter and return it to us.

We very much appreciate the opportunity to serve HEALTHSOUTH Corporation and would be pleased to furnish any additional information you may request concerning our responsibility and functions.

Very truly yours,

Richard L. Dandurand
Partner

HEALTHSOUTH Corporation

By: _____

Title: _____

_____
Date

ERNST & YOUNG LLP

AmSouth/Harbert Plaza
Suite 1900
1901 Sixth Avenue North
Birmingham, Alabama 35203

Phone: 205 251 2000

April 1, 1999

Mrs. Teresa Sanders
Group Vice President, Internal Audit
HEALTHSOUTH Corporation
One HealthSouth Parkway
Birmingham, Alabama 35243

Dear Mrs. Sanders:

Per your request, we are pleased to submit this letter to confirm the scope and fee arrangements for our services related to the 1999 HEALTHSOUTH Pristine Audits.

The details of the Pristine Audits for 1999 will be consistent with those outlined in the section "Details of Quality Standards Program" per the original engagement letter dated February 14, 1996 (see attached) with the following exceptions:

1. The anticipated starting date for the 1999 Pristine Audits is May 1, 1999.

2. At your request, the Corporate Compliance checklist and Employee Surveys will not be performed as part of the Pristine Audit project for 1999.

3. The Pristine Audits are expected to cover a total of 1,866 HEALTHSOUTH facilities during 1999, including reaudits. In past years, reaudits have approximated 25% of the Company's facilities. As in prior years, the scope of reaudits for 1999 will be determined solely by HEALTHSOUTH.

At your direction, we have estimated the number of sites to be visited based on a fixed total cost of $1,250,000, including both professional fees and expenses, which constitutes a $250,000 reduction in total Pristine Audit costs from 1998. However, by working with you to enhance the efficiency of the Pristine Audit process, the scope and approach as outlined herein results in coverage of approximately the same number of sites in 1999 as compared to 1998 (1,908 sites were visited in 1998, including reaudits).

Based on the fixed total cost of $1,250,000 and incorporating the estimated cost savings from the assumptions outlined above and in the attached Roles and Responsibilities, this scope results in an estimated total cost of $670 per site in 1999 as compared to an actual

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HEALTHSOUTH.
The Healthcare Company of the 21st Century

Mrs. Teresa Sanders

Pristine Audit
Engagement letter

total cost of $786 per site in of
professional fees and expens

We will submit our invoices ll
be due upon receipt. If a n
circumstances, we will obtai

If these arrangements are acc

We very much appreciate the opportunity to serve HEALTHSOUTH Corporation and would be pleased to furnish any additional information you may request concerning our responsibility and functions.

Very truly yours,

Ernst + Young LLP

HEALTHSOUTH Corporation

By: [signature]

Title: CEO & CHAIRMAN OF THE BOARD

Date

Teresa Sanders
Group VP & Chief Auditing Officer
5/19/99

HEALTHSOUTH.
One HealthSouth Parkway, Birmingham, AL 35243

MEMORANDUM

TO: Bill Horton

FROM: Teresa Sanders

Tab 38

DATE: December 9, 1998

SUBJECT: *Outpatient Audits 1996 - 1998*

Per your request below is a summary of the insurance verification portion of the outpatient audits performed during 1996 and 1997. I have also attached a list of the facilities audited for your reference.

Currently, we a performing audits on 50 outpatient facilities for 1998. We anticipate a December 24, 1998 completion date.

1996 Audits	
Total facilities audited	18
Total patient accounts tested	270
% of accounts without insurance verification sheet in financial file [1]	2.6%
1997 Audits	
Total facilities audited	22
Total patient accounts tested	225
% of accounts without insurance verification sheet in financial file [1]	3.1%
1998 Audits	
Total facilities audited	61
Total patient accounts tested	750
% of accounts without insurance verification sheet in financial file [1]	Results to be determined by 12/24/98

Let me know if you have any questions.

[1] Accounts without verification sheet in file does not indicate the insurance benefits were not verified. This only indicates the sheet was not filed in the financial record. If payment was received on the account, we concluded benefits were verified and the patient was certified for treatment.

MEMO DATED: December 9, 1998
SUBJECT: *Outpatient Audits 1996 - 1998*
PAGE: 2

[redacted]

1996	040120-00	Houston
1996	040052-00	Phoenix
1996	040034-00	Mobile
1996	040105-00	Florence
1996	040141-00	Emerson
1996	040093-00	East Brunswick
1996	040033-00	Santa Rosa
1996	040049-00	San Carlos
1996	040041-00	West Denver
1996	040134-00	St. Louis III
1996	040095-00	St. Louis II
1996	040113-00	Palos Heights
1996	040122-00	Carol Stream
1996	040166-00	Huntington
1996	040173-00	Manhattan
1996	040428-00	Freehold
1996	040451-00	Matawan
1996	040003-00	Birmingham

[redacted]

1997	040128-00	Knoxville
1997	040163-00	Fort Wayne
1997	040041-00	West Denver
1997	040422-00	Wethersfield
1997	040423-00	Meriden/Cloverleaf
1997	040424-00	New Britain
1997	040455-00	Elmwood
1997	040456-00	Glastonbury
1997	040460-00	Meriden/Birchwood
1997	040272-00	Texarkana
1997	040065-01	South Orange
1997	040426-00	Pennsauken
1997	040512-00	Lincoln Center
1997	040196-00	Opelika
1997	040254-01	Woodbury
1997	040420-03	Old Lyme
1997	040083-01	Alpharetta
1997	040037-00	West Palm Beach
1997	040373-00	NW Memorial
1997	040325-00	Plano
1997	040509-00	Harrison
1997	040327-01	Marysville/Arlington

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Medical Center Division

	Contractual Adjustments as a % of Gross Revenue			Bad Debt Expense as a % of Non-Medicare and Non-Medicaid Revenue		
	1996	1997	1998	1996	1997	1998
Birmingham	47.54%	46.52%	49.37%	4.19%	3.78%	3.80%
Richmond	41.00%	40.03%	44.04%	16.14%	13.28%	10.31%
Doctors	44.38%	42.80%	48.02%	7.38%	6.94%	7.41%
Larkin	36.14%			5.08%		
Dallas	28.63%	29.18%	35.92%	8.62%	4.27%	5.32%

Inpatient Division

	Contractual Adjustments as a % of Gross Revenue			Bad Debt Expense as a % of Non-Medicare and Non-Medicaid Revenue		
	1996	1997	1998	1996	1997	1998
Florence	41.06%	40.88%	45.85%	1.90%	4.04%	1.22%
Miami/Regional	49.94%	45.08%	53.20%	2.88%	2.79%	4.02%
Albuquerque	38.13%	38.49%	39.79%	5.54%	0.82%	4.53%
Columbia	42.40%	39.31%	45.05%	1.63%	5.81%	1.69%
St Louis	16.87%	17.31%	19.40%	1.99%	1.60%	9.95%
Humble	40.62%	39.93%	46.09%	0.00%	8.23%	3.98%
Oklahoma City	42.17%	41.98%	46.06%	7.98%	3.94%	4.19%
Largo	33.55%	37.05%	42.52%	2.85%	2.20%	2.49%
Fort Worth	22.41%	23.02%	34.91%	3.16%	3.60%	1.15%
Kingsport	44.03%	40.57%	42.91%	2.79%	7.03%	1.76%
Vanderbilt	35.27%	37.74%	41.21%	0.48%	1.79%	-0.36%
Concord	41.19%	35.57%	38.01%	2.59%	4.94%	2.86%
Charleston	33.30%	34.54%	43.46%	2.24%	4.93%	1.60%
Dothan	40.87%	36.01%	38.54%	1.97%	6.49%	3.45%
Memphis	41.62%	48.91%	50.62%	1.24%	2.21%	8.19%
Miami	30.81%	29.06%	41.91%	1.88%	1.68%	2.49%
Sea Pines	47.80%	47.07%	49.04%	3.79%	2.92%	2.30%
Sunrise	41.02%	40.74%	45.56%	2.87%	4.23%	3.24%
Toms River	42.51%	43.04%	45.52%	2.96%	5.19%	1.28%
Mechanicsburg	42.04%	36.79%	37.32%	2.86%	4.25%	1.87%
Mechanisburg Subacute	54.96%	49.78%	48.79%	1.62%	7.40%	1.89%
Lake Erie	49.20%	38.28%	39.93%	3.06%	4.57%	1.63%
Austin	39.40%	32.45%	33.13%	2.43%	3.42%	0.93%
North Houston	27.22%	31.11%	35.25%	1.01%	2.81%	2.56%
Midland/Odessa	40.96%	34.27%	39.26%	3.03%	6.68%	2.31%
Texarkana	40.91%	39.41%	43.28%	2.05%	8.26%	5.20%
Utah	29.30%	24.41%	25.75%	2.55%	5.08%	0.66%
Montgomery	43.69%	37.69%	45.76%	3.27%	4.64%	2.45%
Fort Smith	49.92%	41.82%	44.56%	8.29%	16.22%	8.80%
Tallahassee	26.98%	33.46%	43.68%	4.68%	2.33%	4.84%
Treasure Coast	34.04%	32.59%	41.81%	2.25%	6.62%	6.26%
Sarasota	26.36%	26.41%	34.41%	1.79%	1.87%	2.80%
Nimany Valley	42.22%	38.16%	42.01%	0.12%	2.44%	0.32%
York	37.58%	38.59%	39.15%	2.50%	2.88%	5.17%
Greater Pittsburgh	29.73%	28.93%	35.68%	0.63%	2.41%	2.11%
Altoona	38.22%	36.48%	40.50%	1.46%	5.83%	1.40%
Erie	37.84%			3.27%		
San Antonio	26.03%	24.65%	35.38%	1.24%	2.32%	0.96%
Reading			36.94%			1.48%
Lakeshore	37.07%	36.35%	36.84%	2.02%	1.66%	1.55%
Nashville	7.84%			1.37%		
Kansas City	20.01%	10.86%	32.08%	0.04%	5.24%	4.73%
North Alabama	46.80%	45.28%	48.23%	2.40%	4.84%	2.24%
Central Georgia	26.94%	34.68%	40.86%	1.12%	3.69%	1.37%
Chattanooga	45.43%	46.75%	49.44%	2.39%	6.28%	2.22%

Inpatient Division

	Contractual Adjustments as a % of Gross Revenue			Bad Debt Expense as a % of Non-Medicare and Non-Medicaid Revenue		
	1996	1997	1998	1996	1997	1998
South Louisiana	26.46%	24.87%	33.78%	7.43%	4.47%	18.96%
Northern Kentucky	28.00%	33.63%	38.25%	-0.40%	3.21%	2.48%
Huntington	26.70%	33.23%	38.27%	1.94%	4.84%	0.78%
Central Carolinas	25.04%	24.89%	36.10%	0.04%	-1.29%	2.01%
Middle Tennessee	14.30%			0.80%		
Sumter	9.80%	18.71%	29.73%	1.39%	26.38%	-8.47%
Cane Creek	44.13%	38.38%	40.40%	5.13%	9.21%	-0.46%
Tri-State	23.26%	26.62%	31.58%	5.26%	3.38%	5.75%
Mountainview	33.09%	37.81%	40.90%	0.63%	0.39%	3.88%
Bakersfield	35.66%	31.38%	46.88%	4.82%	5.11%	1.92%
Arlington	19.66%	19.72%	37.65%	3.87%	3.58%	0.65%
Chesapeake	37.01%	31.66%	34.27%	3.56%	8.01%	7.73%
Valley of the Sun	32.43%	32.11%	39.18%	4.38%	3.15%	2.78%
Virginia	43.81%	38.74%	41.39%	10.50%	9.32%	10.37%
Meridian Point	22.59%	26.35%	47.27%	2.73%	3.26%	-3.62%
Tucson	28.48%	29.66%	39.83%	3.69%	2.83%	1.71%
Western Hills	39.66%	39.42%	41.37%	8.81%	10.72%	5.30%
Southern Hills	41.97%	40.83%	43.75%	3.02%	5.29%	1.30%
Valley of the Sun II			66.21%			0.23%
Harmarville	52.17%	39.78%	43.01%	1.69%	4.39%	2.32%
Portland	49.69%	54.89%	58.11%	13.03%	3.50%	5.54%
Woburn	50.94%	45.13%	48.87%	2.97%	5.81%	3.57%
Western Mass	23.68%	25.79%	34.06%	1.99%	6.81%	3.06%
Wentworth Nursing Home	25.57%	25.24%	32.77%	0.80%	2.10%	3.44%
Lowell	35.03%			13.40%		
Portsmouth	28.46%	19.19%	27.74%	5.08%	5.04%	2.62%
Rusk		28.85%	40.17%		2.67%	2.91%
Emerald Coast		44.86%	44.67%		3.43%	3.19%
UVA			52.56%			0.00%
Penn State Geisenger Rehab		22.50%	48.76%		12.38%	2.12%
Southern Arizona		32.09%	37.49%		4.25%	3.47%
St. Vincent's		38.33%	38.59%		5.49%	8.49%
Fayetteville		47.68%	47.57%		3.35%	6.58%
Jonesboro		50.31%	44.50%		0.00%	3.96%
Colorado Springs		46.08%	35.27%		0.88%	1.14%
West Gables		39.23%	39.86%		1.04%	9.97%
Terre Haute		50.61%	45.19%		15.44%	12.28%
Kokomo		44.97%	39.28%		10.37%	6.82%
Fort Wayne		40.22%	39.01%		3.94%	8.01%
Topeka		33.12%	37.69%		-9.74%	10.04%
Mid-America		34.71%	36.10%		0.86%	3.30%
Wesley		37.42%	34.19%		1.13%	1.50%
Lakeview		34.63%	48.31%		2.36%	3.38%
Alexandria		39.26%	34.08%		5.79%	9.94%
North Louisiana		35.45%	42.04%		4.04%	10.91%

Inpatient Division

	Contractual Adjustments as a % of Gross Revenue			Bad Debt Expense as a % of Non-Medicare and Non-Medicaid Revenue		
	1996	1997	1998	1996	1997	1998
Baton Rouge		45.82%	44.88%		6.58%	8.11%
Lafayette		35.50%	34.65%		1.35%	8.39%
Maryland		46.45%	11.76%		27.26%	17.50%
Braintree		55.87%	48.95%		2.54%	3.38%
Las Vegas		46.85%	48.35%		1.94%	2.41%
Reno		38.96%	38.78%		-3.88%	2.88%
Tulsa		46.90%	42.04%		-0.81%	6.40%
Clear Lake		38.91%	39.10%		0.59%	1.56%
City View		28.59%	30.21%		-1.83%	2.89%
HRI		47.38%	44.38%		3.27%	6.20%
Plano		41.56%	38.81%		1.68%	3.40%
Beaumont		29.82%	35.17%		1.59%	7.82%
Tyler		44.07%	41.14%		3.68%	6.84%
Wichita Falls		49.85%	46.15%		0.00%	11.40%
BRVI		20.99%	17.82%		54.05%	17.81%
Lafayette Outpatient Center			13.38%			1.72%
Kansas City Back Center		23.33%	30.10%		1.70%	1.47%
Occupational Health Center		14.00%	11.19%		1.06%	1.82%

9 **WEDNESDAY**
DECEMBER 9, 1998

TO BE DONE TODAY (ACTION LIST)

Jane Pitts 8155 / Laura Pate 3582

Bill 3216 2838 - Chris McCain
Scottsdale AZ 5[illegible]
[illegible]

Ken Scarborough
VP HR at Parisian

Emera Harris

Charge days
Paid HS

Hour **DIARY AND WORK RECORD**

Menu

Wk 50 • Day 343, 22 Left

WEDNESDAY **9**
DECEMBER 9, 1998

APPOINTMENTS & SCHEDULED EVENTS

HRS	NAME • PLACE • SUBJECT	TIME
7 0700	Memo to Bill H / Bill O.	6:20am
8 0800	CRI meeting	8AM – 9:15
9 0900		
10 1000	Memo for Fraud a Hack	
11 1100		
12 1200	Lunch 1215 - 115	
1 1300	Memo Fraud 130 - 330	
2 1400	Andrea V. mtg 2 - 215	
3 1500		
4 1600	Conf Call - Australia Y2K	45.
5 1700		
6 1800		
7 1900		
8 2000		
9 2100		

EXPENSE & REIMBURSEMENT RECORD:

Item-What?	Where? Duration?	Purpose-Who What involved?	To whom Paid?	Reimbursed? By when?	Amount

Wed 9
Thu 10
Fri 11
Sat 12
Sun 13
Mon 14
Tue 15
Wed 16
Thu 17
Fri 18
Sat 19
Sun 20
Mon 21
Tue 22
Wed 23
Thu 24
Fri 25
Sat 26
Sun 27
Mon 28
Tue 29
Wed 30
Thu 31

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

Filed by the Registrant [X]
Filed by a Party other than the Registrant [ ]

Tab 39

Check the appropriate box:
[ ] Preliminary Proxy Statement
[ ] CONFIDENTIAL, FOR USE OF THE COMMISSION ONLY (AS PERMITTED BY RULE 14A-6(E)(2))
[X] Definitive Proxy Statement
[ ] Definitive Additional Materials
[ ] Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12

HEALTHSOUTH CORPORATION

(Name of Registrant as Specified In Its Charter)

HEALTHSOUTH CORPORATION

(Name of Person(s) Filing Proxy Statement)

Payment of Filing Fee (Check the appropriate box):
[X] No fee required.
[ ] Fee computed on table below per Exchange Act Rules 14a-6(i)14) and 0-11.

(1) Title of each class of securities to which transaction applies: N/A

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(2) Aggregate number of securities to which transaction applies: N/A

---

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:
N/A

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(4) Proposed maximum aggregate value of transaction:
N/A

---

(5) Total fee paid: N/A

[ ] Fee paid previously with preliminary materials. ---------- [ ] Check box if any part of the fee is offset as provided by Exchange Act Rule

0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount previously paid:
N/A

---

(2) Form, Schedule or Registration Statement No.:

N/A

---

(3) Filing Party:
N/A

---

(4) Date Filed:
N/A

HEALTHSOUTH CORPORATION
ONE HEALTHSOUTH PARKWAY
BIRMINGHAM, ALABAMA 35243

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

Our 2002 annual meeting of stockholders will be held at One HealthSouth Parkway, Birmingham, Alabama on Thursday, May 16, 2002, beginning at 2:00 p.m., Central Daylight Time. The meeting is being held for the following purposes:

(1) To elect nine Directors to serve until our next annual meeting of stockholders and until their successors shall have been duly elected and qualified; and

(2) To act on any other matter that may properly come before the annual meeting or any adjournment(s) or postponement(s) of the annual meeting.

All stockholders of record who own shares of HEALTHSOUTH common stock at the close of business on March 28, 2002 are entitled to receive notice of and to vote at the annual meeting.

---------- WHETHER OR NOT YOU INTEND TO ATTEND THE ANNUAL MEETING, PLEASE COMPLETE, DATE, SIGN AND PROMPTLY RETURN THE ACCOMPANYING FORM OF PROXY, USING THE ENCLOSED PREPAID ENVELOPE. IF YOU ATTEND THE ANNUAL MEETING IN PERSON, YOU MAY REVOKE YOUR PROXY AND VOTE IN PERSON. ATTENDANCE AT THE MEETING DOES NOT OF ITSELF REVOKE YOUR PROXY. ----------

BRANDON O. HALE
Secretary

April 12, 2002

HEALTHSOUTH CORPORATION

PROXY STATEMENT

INTRODUCTION

This proxy statement and the accompanying form of proxy are being sent to our stockholders in connection with our solicitation of proxies for use at the 2002 annual meeting of our stockholders or at any adjournment(s) or postponement(s) of the annual meeting. The annual meeting will be held on May 16, 2002, beginning at 2:00 p.m., Central Daylight Time, at our principal executive offices, located at One HealthSouth Parkway, Birmingham, Alabama. We encourage all of our stockholders to vote at the annual meeting, and we hope that the information contained in this document will help you decide how you wish to vote at the annual meeting. These proxy solicitation materials are being sent to our stockholders on or about April 12, 2002.

THE ANNUAL MEETING

Purpose of the Annual Meeting

The purpose of the annual meeting is to elect a Board of Directors to serve until our 2003 annual meeting of stockholders and until their successors are duly elected and qualified to act.

Voting at the Annual Meeting; Proxies

To vote at the annual meeting, you may attend the annual meeting and vote your shares of HEALTHSOUTH common stock in person, or you may appoint a person to act as your proxy who will vote your shares at the annual meeting in accordance with your instructions. If you wish to appoint a proxy who will vote your shares of HEALTHSOUTH common stock on your behalf at the annual meeting, you should complete, date, sign and return the form of proxy accompanying this document by using the enclosed prepaid envelope. If you properly complete, date and sign your proxy and it is received by Mellon Investor Services, L.L.C. before, or by us at, the annual meeting, your shares of HEALTHSOUTH common stock will be voted in accordance with the voting instructions you completed on the proxy, unless you have validly revoked the proxy. If you properly date and sign and return a proxy, but you fail to complete the voting instructions, your shares of HEALTHSOUTH common stock will be voted FOR the election of each nominee named under the section of this document captioned "Election of Directors".

We do not currently anticipate that any other matters will be presented for action at the annual meeting. If any other matters are properly presented for action, the person(s) named on your proxy will vote your shares of HEALTHSOUTH common stock on these other matters in their discretion and best judgment, under the discretionary authority you have granted to them in your proxy.

You may revoke your proxy at any time prior to its exercise at the annual meeting by:

o writing to us notifying us that you wish to revoke your proxy;

o properly completing, dating, signing and returning to us another proxy which is granted and dated after any other proxy previously granted by you; or

o attending the annual meeting and voting in person.

Notices of revocation should be addressed to us as follows:

HEALTHSOUTH Corporation One HealthSouth Parkway Birmingham, Alabama 35243 Attention: Brandon O. Hale, Secretary

Notices of revocation of your proxy must be received by us at the address above as originals sent by U.S. mail or overnight courier. You may not revoke your proxy by any other means.

If you grant a proxy, you are not prevented from attending the annual meeting and voting in person. However, your attendance at the annual meeting will not by itself revoke a proxy that you have previously granted; you must vote in person at the annual meeting to revoke your proxy. If you have instructed your broker, nominee, custodian or other fiduciary to vote your shares of HEALTHSOUTH common stock, you must contact that fiduciary and follow its directions on how to change your vote.

Quorum; Voting Rights

Our Board of Directors has determined that those stockholders who are recorded in our record books as owning shares of HEALTHSOUTH common stock as of the close of business on March 28, 2002, are entitled to receive notice of and to vote at the annual meeting. As of the record date, there were 392,793,890 shares of HEALTHSOUTH common stock issued and outstanding.

Before any business may be transacted at the annual meeting, a quorum must be present. A quorum will be present if a majority of the shares of HEALTHSOUTH common stock which are entitled to vote at the annual meeting are present in person or represented by proxy at the annual meeting.

Each share of common stock is entitled to one vote on any matter to properly come before the annual meeting.

There are no dissenters' rights of appraisal in connection with any stockholder vote to be taken at the annual meeting.

Proxy Solicitation

This proxy solicitation is being made by our Board of Directors. To assist us in soliciting proxies, we have retained Mellon Investor Services, L.L.C., a proxy soliciting firm, and we have agreed to pay Mellon Investor Services, L.L.C. a fee of $12,000, and all reasonable out-of-pocket expenses incurred by it in connection with the provision of its services. In addition, our Directors, officers and other employees, not specifically employed for this purpose, may also solicit proxies by personal interview, mail, telephone or facsimile. They will not receive additional compensation for their efforts. We will bear the entire cost of this proxy solicitation. We will request banks, brokers, nominees, custodians and other fiduciaries, who hold shares of HEALTHSOUTH common stock in street name, to forward these proxy solicitation materials to the beneficial owners of those shares and we will reimburse them the reasonable out-of-pocket expenses they incur in doing so.

Effect of "Abstentions" and "Broker Non-Votes"

We intend to count "abstentions" and "broker non-votes" only for the purpose of determining if a quorum is present at the annual meeting; they will not be counted as votes cast on any other proposal which requires the vote of our stockholders. An "abstention" will occur at the annual meeting if your shares of HEALTHSOUTH common stock are deemed to be present at the annual meeting, either because you attend the annual meeting or because you have properly completed and returned a proxy, but you do not vote on any proposal or other matter which is required to be voted on by our stockholders at the annual meeting. A "broker non-vote" will occur if your shares of HEALTHSOUTH common stock are held by a broker or nominee and your shares are deemed to be present at the annual meeting but you have not instructed your broker or nominee how to vote your shares. Brokerage firms which hold shares in street name may not vote a client's shares with respect to any "non-discretionary" item if the client has not furnished voting instructions to the brokerage firm. You should consult your broker if you have any questions about this.

Abstentions and broker non-votes will have no effect in connection with the election of Directors because the Directors are elected by a majority of the shares of HEALTHSOUTH common stock present or represented and entitled to be voted at the annual meeting. No other matters are expected to be voted on at the annual meeting.

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ELECTION OF DIRECTORS

GENERAL

Our bylaws permit our Board of Directors to determine the number of our Directors. Our Board of Directors proposes that each of the nine nominees listed below be elected at the annual meeting as members of our Board of Directors, to serve until the annual meeting of our stockholders in 2003 or until such nominee's successor is duly elected and qualified. The affirmative vote of a majority of the shares of HEALTHSOUTH common stock present or represented and entitled to vote at the annual meeting is required for the election of each nominee. Unless otherwise instructed on the proxy, the persons designated as proxies will vote the shares represented by them FOR the election of the nominees listed below. If a nominee becomes unable or unwilling to accept the nomination or election, the persons designated as proxies will be entitled to vote for any other person designated as a substitute nominee by our Board of Directors.

Our bylaws require that any stockholder wishing to nominate a candidate for Director (in addition to the nominees proposed by our Board of Directors) must submit such nomination in writing to our corporate secretary so that such nomination is received not later than the 30th day preceding the date set for any meeting of stockholders at which Directors are to be elected. Any such nomination must be accompanied by a written statement from the nominee indicating that he or she is qualified and willing to serve as a Director if so elected. As of the record date for the annual meeting, we had received no such nominations.

NOMINEES FOR DIRECTOR

Information relating to each of the nominees proposed by our Board of Directors for election as one of our Directors is set out below. We have no reason to believe that any of the following nominees will be unable to serve.

NAME	AGE	PRINCIPAL OCCUPATION AND ALL POSITIONS WITH HEALTHSOUTH	A DIRECTOR SINCE

Richard M. Scrushy	49	Chairman of the Board and Chief Executive Officer and Director	1984
Phillip C. Watkins, M.D.	60	Physician, Birmingham, Alabama, and Director	1984
George H. Strong	75	Private Investor, Locust, New Jersey, and Director	1984
C. Sage Givens	45	General Partner, Acacia Venture Partners and Directors	1985
Charles W. Newhall III	57	Partner, New Enterprise Associates Limited Partnerships, and Director	1985
John S. Chamberlin	73	Private Investor, Princeton, New Jersey, and Director	1993
Joel C. Gordon	72	Private Investor, Consultant to the Company and Director	1996
Larry D. Striplin, Jr.	72	Chairman and Chief Executive Officer, Nelson-Brantley Glass Contractors, Inc., and Director	1999
William T. Owens	43	President and Chief Operating Officer and Director	2001

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Richard M. Scrushy, one of our management founders, has served as Chairman of the Board and Chief Executive Officer of HEALTHSOUTH since 1984, and also served as President of HEALTHSOUTH from 1984 until March 1995. From 1979 to 1984, Mr. Scrushy was with Lifemark Corporation, a publicly owned healthcare corporation, serving in various operational and management positions. Mr. Scrushy was until February 2001 a director of CaremarkRx, Inc., a publicly traded pharmacy benefits management company, for which he also served as Acting Chief Executive Officer from January 16 through March 18, 1998 and as Chairman of the Board from January 16 through December 1, 1998.

Phillip C. Watkins, M.D., FACC, is and has been for more than five years in the private practice of medicine in Birmingham, Alabama. A graduate of The Medical College of Alabama, Dr. Watkins is a Diplomate of the American Board of Internal Medicine. He is also a Fellow of the American College of Cardiology and the Subspecialty Board of Cardiovascular Disease.

George H. Strong retired as senior vice president and chief financial officer of Universal Health Services, Inc. in December 1984, a position he held for more than six years. Mr. Strong is a private investor and continued to act as a director of Universal Health Services, Inc., a publicly traded hospital management corporation, until 1993. Mr. Strong is also a director of AmeriSource, Inc., a large drug wholesaler.

C. Sage Givens is a founder and managing general partner of Acacia Venture Partners, a private venture capital fund. From 1983 to June 30, 1995, Ms. Givens was a general partner of First Century Partners, also a private venture capital fund. Ms. Givens managed the fund's healthcare investments. Ms. Givens also serves on the boards of directors of several privately-held healthcare companies.

Charles W. Newhall III is a general partner and founder of New Enterprise Associates Limited Partnerships, Baltimore, Maryland, where he has been engaged in the venture capital business since 1978. Mr. Newhall is also a director of CaremarkRx, Inc.

John S. Chamberlin retired in 1988 as president and chief operating officer of Avon Products, Inc., a position he had held since 1985. From 1976 until 1985, he served as chairman and chief executive officer of Lenox, Incorporated, after 22 years in various assignments for General Electric. From 1990 to 1991, he served as chairman and chief executive officer of New Jersey Publishing Co. Mr. Chamberlin is chairman of the board of WNS, Inc. He is chairman of the Board of Trustees of the Medical Center at Princeton and is a trustee of the Woodrow Wilson National Fellowship Foundation.

Joel C. Gordon served as Chairman of the Board of Directors of Surgical Care Affiliates, Inc. from its founding in 1982 until January 17, 1996, when we acquired SCA. Mr. Gordon also served as Chief Executive Officer of SCA from 1987 until

The foregoing report is submitted by the following Directors of HEALTHSOUTH, constituting all of the members of the Compensation Committee of the Board of Directors for the year ending December 31, 2001 who continue to serve on the Board of Directors at the date of this Proxy Statement:

John S. Chamberlin
Phillip C. Watkins, M.D.
Larry D. Striplin, Jr., Chairman

AUDIT INFORMATION

RELATIONSHIP WITH INDEPENDENT PUBLIC ACCOUNTANTS

Our Board of Directors has engaged Ernst & Young LLP to audit our consolidated financial statements for the year ended December 31, 2001. We expect that Ernst & Young LLP will serve in that capacity for the 2002 fiscal year as well. We expect that representatives of Ernst & Young LLP will be present at the annual meeting to make a statement if they desire to do so and to respond to appropriate questions.

AUDIT FEES

The aggregate fees billed to us for the fiscal year ended December 31, 2001 by Ernst & Young LLP for the fiscal year ended December 31, 2001 or related to its audit for such fiscal year were as follows:

Audit Fees	$1,164,750
All Other Fees	
Audit-Related Fees	$2,387,676
Non-Audit-Related Fees	$ 121,580

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AUDIT COMMITTEE REPORT

The Audit Committee of the Board of Directors, consisting of C. Sage Givens, Larry D. Striplin, Jr. and George H. Strong, Chairman, is responsible for overseeing HEALTHSOUTH's financial reporting process on behalf of the Board of Directors. HEALTHSOUTH's management has the primary responsibility for the financial statements and the reporting process, including the systems of internal control. In fulfilling its oversight responsibilities, the Committee reviewed the audited financial statements contained in HEALTHSOUTH's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2001 with management, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements.

All members of the Audit Committee are "independent" under the standards established by the New York Stock Exchange. A copy of the Audit Committee charter is included as Appendix B to this Proxy Statement.

The Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with accounting principles generally accepted in the United States, their judgments as to the quality, not just the acceptability, of HEALTHSOUTH's accounting principles and such other matters as are required to be discussed with the Committee under generally accepted auditing standards. In addition, the Committee has discussed with the independent auditors the auditors' independence from management and HEALTHSOUTH, including the matters in the written disclosures required by the Independence Standards Board, and considered the compatibility of non-audit services with the auditors' independence. The Committee believes that the non-audit services are compatible with such independence.

The Committee discussed with HEALTHSOUTH's internal and independent auditors the overall scope and plans of their respective audits. The Committee meets with the internal and independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of HEALTHSOUTH's internal controls, and the overall quality of HEALTHSOUTH's financial reporting.

In reliance upon the reviews and discussions referred to above, the Committee has recommended to the Board of Directors (and the Board has approved) that the audited financial statements be included in HEALTHSOUTH's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2001 for filing with the Securities and Exchange Commission. Those audited financial statements are also included in Appendix A to this Proxy Statement.

The forgoing report is submitted by the following Directors of HEALTHSOUTH, constituting all the members of the Audit Committee of the Board of Directors for the year ended December 31, 2001:

C. Sage Givens
Larry D. Striplin, Jr.
George H. Strong, Chairman

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PRINCIPAL STOCKHOLDERS

The following table sets forth certain information regarding beneficial ownership of HEALTHSOUTH common stock as of March 28, 2002 (a) by each person who is known by us to own beneficially more than 5% of our common stock, (b) by each of our Directors, (c) by our five most highly compensated executive officers, (d) by a former executive officer who would have been among our five most highly compensated executive officers had he held such position at December 31, 2001 and (e) by all executive officers and Directors as a group.

NAME AND ADDRESS OF OWNER	NUMBER OF SHARES BENEFICIALLY OWNED (1)	PERCENTAGE OF COMMON STOCK
Richard M. Scrushy	20,904,955(2)	5.1%
John S. Chamberlin	407,000(3)	*
C. Sage Givens	310,100(4)	*
Charles W. Newhall III	50,000(5)	*
George H. Strong	473,350(6)	*
Phillip C. Watkins, M.D.	681,654(7)	*
William T. Owens	987,500(8)	*
Joel C. Gordon	1,961,968(9)	*
Robert E. Thomson	1,041,637(10)	*
Larry D. Striplin, Jr.	150,000(11)	*
Thomas W. Carman	905,000(12)	*
Patrick A. Foster	539,412(13)	*
Larry D. Taylor	583,866(14)	*
FMR Corp. 82 Devonshire Street Boston, Massachusetts 02109	50,673,509(15)	12.9%
All Executive Officers and Directors as a Group (17 persons)	29,235,535(16)	7.06%

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

Filed by the Registrant [X]
Filed by a Party other than the Registrant [ ]

Check the appropriate box:
[ ] Preliminary Proxy Statement
[ ] CONFIDENTIAL, FOR USE OF THE COMMISSION ONLY (AS PERMITTED BY RULE 14A-6(E)(2))
[X] Definitive Proxy Statement
[ ] Definitive Additional Materials
[ ] Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12

HEALTHSOUTH CORPORATION

(Name of Registrant as Specified In Its Charter)

HEALTHSOUTH CORPORATION

(Name of Person(s) Filing Proxy Statement)

Payment of Filing Fee (Check the appropriate box):
[X] No fee required.
[ ] Fee computed on table below per Exchange Act Rules 14a-6(i)14) and 0-11.

(1) Title of each class of securities to which transaction applies: N/A

---

(2) Aggregate number of securities to which transaction applies: N/A

---

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:
N/A

---

(4) Proposed maximum aggregate value of transaction:
N/A

---

(5) Total fee paid: N/A

[ ] Fee paid previously with preliminary materials. ---------- [ ] Check box if any part of the fee is offset as provided by Exchange Act Rule

0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount previously paid:
N/A

---

(2) Form, Schedule or Registration Statement No.:
N/A

---

(3) Filing Party:
N/A

---

(4) Date Filed:
N/A

HEALTHSOUTH CORPORATION
ONE HEALTHSOUTH PARKWAY
BIRMINGHAM, ALABAMA 35243

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

Our 2001 annual meeting of stockholders will be held at One HealthSouth Parkway, Birmingham, Alabama on Thursday, May 17, 2001, beginning at 2:00 p.m., Central Daylight Time. The meeting is being held for the following purposes:

(1) To elect nine Directors to serve until our next annual meeting of stockholders and until their successors shall have been duly elected and qualified; and

(2) To act on any other matter that may properly come before the annual meeting or any adjournment(s) or postponement(s) of the annual meeting.

All stockholders of record who own shares of HEALTHSOUTH common stock at the close of business on March 30, 2001 are entitled to receive notice of and to vote at the annual meeting.

---------- WHETHER OR NOT YOU INTEND TO ATTEND THE ANNUAL MEETING, PLEASE MARK, DATE, SIGN AND PROMPTLY RETURN THE ACCOMPANYING FORM OF PROXY, USING THE ENCLOSED PREPAID ENVELOPE. IF YOU ATTEND THE ANNUAL MEETING IN PERSON, YOU MAY REVOKE YOUR PROXY AND VOTE IN PERSON. ATTENDANCE AT THE MEETING DOES NOT OF ITSELF REVOKE YOUR PROXY. ----------

BRANDON O. HALE
Secretary

April 17, 2001

HEALTHSOUTH CORPORATION

PROXY STATEMENT

INTRODUCTION

This proxy statement and the accompanying form of proxy are being sent to our stockholders in connection with our solicitation of proxies for use at the 2001 annual meeting of our stockholders or at any adjournment(s) or postponement(s) of the annual meeting. The annual meeting will be held on May 17, 2001, beginning at 2:00 p.m., Central Daylight Time, at our principal executive offices, located at One HealthSouth Parkway, Birmingham, Alabama. We encourage all of our stockholders to vote at the annual meeting, and we hope that the information contained in this document will help

you decide how you wish to vote at the annual meeting. These proxy solicitation materials are being sent to our stockholders on or about April 17, 2001.

THE ANNUAL MEETING

Purpose of the Annual Meeting

The purpose of the annual meeting is to elect a Board of Directors to serve until our 2002 annual meeting of stockholders and until their successors are duly elected and qualified to act.

Voting at the Annual Meeting; Proxies

To vote at the annual meeting, you may attend the annual meeting and vote your shares of HEALTHSOUTH common stock in person, or you may appoint a person to act as your proxy who will vote your shares at the annual meeting in accordance with your instructions. If you wish to appoint a proxy who will vote your shares of HEALTHSOUTH common stock on your behalf at the annual meeting, you should complete, date, sign and return the form of proxy accompanying this document by using the enclosed prepaid envelope. If you properly complete, date and sign your proxy and it is received by Mellon Investor Services, L.L.C. before, or by us at, the annual meeting, your shares of HEALTHSOUTH common stock will be voted in accordance with the voting instructions you completed on the proxy, unless you have validly revoked the proxy. If you properly date and sign and return a proxy, but you fail to complete the voting instructions, your shares of HEALTHSOUTH common stock will be voted FOR the election of each nominee named under the section of this document captioned "Election of Directors".

We do not currently anticipate any other matters being presented for action at the annual meeting. If any other matters are properly presented for action, the person(s) named on your proxy will vote your shares of HEALTHSOUTH common stock on these other matters in their discretion and best judgment, under the discretionary authority you have granted to them in your proxy.

You may revoke your proxy at any time prior to its exercise at the annual meeting by:

o writing to us notifying us that you wish to revoke your proxy;

o properly completing, dating, signing and returning to us another proxy which is granted and dated after any other proxy previously granted by you; or

o attending the annual meeting and voting in person.

Notices of revocation should be addressed to us as follows:

HEALTHSOUTH Corporation One HealthSouth Parkway Birmingham, Alabama 35243 Attention: Brandon O. Hale, Secretary

Notices of revocation of your proxy must be received by us at the address above as originals sent by U.S. mail or overnight courier. You may not revoke your proxy by any other means.

If you grant a proxy, you are not prevented from attending the annual meeting and voting in person. However, your attendance at the annual meeting will not by itself revoke a proxy that you have previously granted; you must vote in person at the annual meeting to revoke your proxy. If you have instructed your broker, nominee, custodian or other fiduciary to vote your shares of HEALTHSOUTH common stock, you must contact that fiduciary and follow its directions on how to change your vote.

Quorum; Voting Rights

Our Board of Directors has determined that those stockholders who are recorded in our record books as owning shares of HEALTHSOUTH common stock as of the close of business on March 30, 2001, are entitled to receive notice of and to vote at the annual meeting. As of the record date, there were 389,487,541 shares of HEALTHSOUTH common stock issued and outstanding.

Before any business may be transacted at the annual meeting, a quorum must be present. A quorum will be attained if a majority of the shares of HEALTHSOUTH common stock which are entitled to vote at the annual meeting are present in person or represented by proxy at the annual meeting.

Each share of common stock is entitled to one vote on any matter to properly come before the annual meeting.

There are no dissenters' rights of appraisal in connection with any stockholder vote to be taken at the annual meeting.

Proxy Solicitation

This proxy solicitation is being made by our Board of Directors. To assist us in soliciting proxies, we have retained Mellon Investor Services, L.L.C., a proxy soliciting firm, and we have agreed to pay Mellon Investor Services, L.L.C. a fee of $12,000, and all reasonable out-of-pocket expenses incurred by it in connection with the provision of its services. In addition, our Directors, officers and other employees, not specifically employed for this purpose, may also solicit proxies by personal interview, mail, telephone or facsimile. They will not receive additional compensation for their efforts. We will bear the entire cost of this proxy solicitation. We will request banks, brokers, nominees, custodians and other fiduciaries, who hold shares of HEALTHSOUTH common stock in street name, to forward these proxy solicitation materials to the beneficial owners of those shares and we will reimburse them the reasonable out-of-pocket expenses they incur in doing so.

Effect of "Abstentions" and "Broker Non-Votes"

We intend to count "abstentions" and "broker non-votes" only for the purpose of determining if a quorum is present at the annual meeting; they will not be counted as votes cast on any other proposal which requires the vote of our stockholders. An "abstention" will occur at the annual meeting if your shares of HEALTHSOUTH common stock are deemed to be present at the annual meeting, either because you attend the annual meeting or because you have properly completed and returned a proxy, but you do not vote on any proposal or other matter which is required to be voted on by our stockholders at the annual meeting. A "broker non-vote" will occur if your shares of HEALTHSOUTH common stock are held by a broker or nominee and your shares are deemed to be present at the annual meeting but you have not instructed your broker or nominee how to vote your shares. Brokerage firms which hold shares in street name may not vote a client's shares with respect to any "non-discretionary" item if the client has not furnished voting instructions to the brokerage firm. You should consult your broker if you have any questions about this.

Abstentions and broker non-votes will have no effect in connection with the election of Directors because the Directors are elected by a majority of the shares of HEALTHSOUTH common stock present or represented and entitled to be voted at the annual meeting. No other matters are expected to be voted on at the annual meeting.

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ELECTION OF DIRECTORS

GENERAL

Our bylaws permit our Board of Directors to determine the number of our Directors. Our Board of Directors proposes that each of the nine nominees listed below be elected at the annual meeting as members of our Board of Directors, to serve until the annual meeting of our stockholders in 2002 or until such nominee's successor is duly elected and qualified. The affirmative vote of a majority of the shares of HEALTHSOUTH common stock present or represented and entitled to vote at the annual meeting is required for the election of each nominee. Unless otherwise instructed on the proxy, the persons designated as proxies will vote the shares represented by them FOR the election of the nominees listed below. If a nominee becomes unable or unwilling to accept the nomination or election, the persons designated as proxies will be entitled to vote for any other person designated as a substitute nominee by our Board of Directors.

NOMINEES FOR DIRECTOR

Information relating to each of the nominees proposed by our Board of Directors for election as one of our Directors is set out below. We have no reason to believe that any of the following nominees will be unable to serve.

NAME	AGE	PRINCIPAL OCCUPATION AND ALL POSITIONS WITH HEALTHSOUTH	A DIRECTOR SINCE
Richard M. Scrushy	48	Chairman of the Board	1984

		and Chief Executive Officer and Director	
Phillip C. Watkins, M.D.	59	Physician, Birmingham, Alabama, and Director	1984
George H. Strong	74	Private Investor, Locust, New Jersey, and Director	1984
C. Sage Givens	44	General Partner, Acacia Venture Partners and Director	1985
Charles W. Newhall III	56	Partner, New Enterprise Associates Limited Partnerships, and Director	1985
John S. Chamberlin	72	Private Investor, Princeton, New Jersey, and Director	1993
Joel C. Gordon	71	Private Investor, Consultant to the Company and Director	1996
Larry D. Striplin, Jr.	71	Chairman and Chief Executive Officer, Nelson-Brantley Glass Contractors, Inc., and Director	1999
William T. Owens	42	Executive Vice President and Chief Financial Officer and Director	2001

Richard M. Scrushy, one of our management founders, has served as Chairman of the Board and Chief Executive Officer of HEALTHSOUTH since 1984, and also served as President of HEALTHSOUTH from 1984 until March 1995. From 1979 to 1984, Mr. Scrushy was with Lifemark

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Corporation, a publicly owned healthcare corporation, serving in various operational and management positions. Mr. Scrushy was until February 2001 a director of CaremarkRx, Inc., a publicly traded pharmacy benefits management company, for which he also served as Acting Chief Executive Officer from January 16 through March 18, 1998 and as Chairman of the Board from January 16 through December 1, 1998.

Phillip C. Watkins, M.D., FACC, is and has been for more than five years in the private practice of medicine in Birmingham, Alabama. A graduate of The Medical College of Alabama, Dr. Watkins is a Diplomate of the American Board of Internal Medicine. He is also a Fellow of the American College of Cardiology and the Subspecialty Board of Cardiovascular Disease.

George H. Strong retired as senior vice president and chief financial officer of Universal Health Services, Inc. in December 1984, a position he held for more than six years. Mr. Strong is a private investor and continued to act as a director of Universal Health Services, Inc., a publicly traded hospital management corporation, until 1993. Mr. Strong is also a director of AmeriSource, Inc., a large drug wholesaler.

C. Sage Givens is a founder and managing general partner of Acacia Venture Partners, a private venture capital fund. From 1983 to June 30, 1995, Ms. Givens was a general partner of First Century Partners, also a private venture capital fund. Ms. Givens managed the fund's healthcare investments. Ms. Givens also serves on the boards of directors of several privately-held healthcare companies.

Charles W. Newhall III is a general partner and founder of New Enterprise Associates Limited Partnerships, Baltimore, Maryland, where he has been engaged in the venture capital business since 1978. Mr. Newhall is also a director of CaremarkRx, Inc.

John S. Chamberlin retired in 1988 as president and chief operating officer of Avon Products, Inc., a position he had held since 1985. From 1976 until 1985, he served as chairman and chief executive officer of Lenox, Incorporated, after 22 years in various assignments for General Electric. From 1990 to 1991, he served as chairman and chief executive officer of New Jersey Publishing Co. Mr. Chamberlin is chairman of the board of WNS, Inc. He is a member of the Board of Trustees of the Medical Center at Princeton and is a trustee of the Woodrow Wilson National Fellowship Foundation.

Joel C. Gordon served as Chairman of the Board of Directors of Surgical Care Affiliates, Inc. from its founding in 1982 until January 17, 1996, when we acquired SCA. Mr. Gordon also served as Chief Executive Officer of SCA from 1987 until January 17, 1996. Mr. Gordon is a private investor and serves on the boards of directors of Genesco, Inc., an apparel manufacturer, and SunTrust Bank of Nashville, N.A.

In the period since December 31, 1993, HEALTHSOUTH, under Mr. Scrushy's leadership, has grown from the fourth-largest provider of rehabilitative healthcare services to the largest provider, and since 1995 has established itself as the nation's largest provider of outpatient surgery services and outpatient diagnostic services. During that same period, the company has expanded its operations to 50 states, the United Kingdom, Australia, Canada and Puerto Rico and has been named to the S&P 500. The Committee believes that Mr. Scrushy's leadership has been essential to HEALTHSOUTH's success and growth. In view of these accomplishments, the Committee believes that it is important to ensure that, if Mr. Scrushy is successful in leading HEALTHSOUTH to achieve the goals set by the Board of Directors, his compensation will be at a level commensurate with that of chief executive officers of similarly-performing public companies and that he will continue to have the opportunity to obtain a significant equity interest in the company.

In evaluating Mr. Scrushy's performance in 2000 and recommending Mr. Scrushy's compensation for 2001, the Committee took note of the significant improvement in HEALTHSOUTH's stock price after a period of significant depression in late 1998 and 1999. The Committee noted that, under Mr. Scrushy's leadership, HEALTHSOUTH's stock price had increased 203% from December 31, 1999 through December 31, 2000, the fourth-best performance of all S&P 500 companies for 2000. The Committee further noted that Mr. Scrushy had voluntarily chosen to forgo receipt of his entire base salary and

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Annual Target Bonus from November 1, 1998 through March 31, 1999 and continued to receive, at his election, a substantially reduced portion of his annual base salary and Annual Target Bonus through the remainder of 1999. In addition, the Committee considered the increased responsibility taken on by Mr. Scrushy after the departure of HEALTHSOUTH's President and Chief Operating Officer in July 2000. In light of all these factors and Mr. Scrushy's continued leadership, the Committee believes that Mr. Scrushy's compensation for 2000 and 2001 is appropriate.

Other Executive Employment Agreements

HEALTHSOUTH also has Employment Agreements, dated April 1, 1998, with Thomas W. Carman, Executive Vice President -- Corporate Development, Robert E. Thomson, President -- Inpatient Operations, and Patrick A. Foster, President -- Ambulatory Services -- West, pursuant to which each of these persons is employed in these capacities for a three-year term initially expiring on April 1, 2001. Such terms are automatically extended for an additional year on each April 1 unless the Agreements are terminated in accordance with their terms. The Agreements currently provide for the payment of an annual base salary of at least $360,000 to Mr. Carman, $450,000 to Mr. Thomson and $450,000 to Mr. Foster. The Agreements further provide that each such officer is eligible for participation in all management bonus or incentive plans and stock option, stock purchase or equity-based incentive compensation plans in which other senior executives of HEALTHSOUTH are eligible to participate, and provide for certain specified fringe benefits.

If the Agreements are terminated by HEALTHSOUTH other than for Cause (as defined), Disability (as defined) or death, HEALTHSOUTH is required to continue the officers' base salary in effect for a period of one year after termination, as severance compensation. In addition, in the event of a voluntary termination of employment by the officer within six months after a Change in Control (as defined), HEALTHSOUTH is also required to continue the officer's salary for the same period. The Agreements restrict the officers from engaging in certain activities competitive with HEALTHSOUTH's business during their employment with the company and for any period during which the officer is receiving severance compensation, unless such termination occurs after a Change in Control.

Section 162(m) of the Internal Revenue Code

The Omnibus Budget Reconciliation Act of 1993 contains a provision under which a publicly traded corporation is sometimes precluded from taking a federal income tax deduction for compensation in excess of $1,000,000 that is paid to the chief executive officer and the four other most highly-compensated executives of the corporation during a corporation's tax year. Compensation in excess of $1,000,000 continues to be deductible if that compensation is "performance based" within the meaning of that term under Section 162(m) of the Internal Revenue Code. Certain transition rules apply with respect to stock option plans which were approved prior to December 20, 1993, pursuant to Rule 16b-3(b) under the Exchange Act.

HEALTHSOUTH believes that its employee stock option plans meet the requirements of Section 162(m) as performance-based plans. The Committee and the Board of Directors have made a decision not to amend HEALTHSOUTH's cash compensation programs to meet all requirements of Section 162(m) because such a decision would not be in the best interests of the company's stockholders. The Committee believes that, in establishing bonus and incentive awards, certain subjective factors must be taken into account in particular cases, based upon the experienced judgment of the Committee members as well as on factors which may be objectively quantified. The preservation of tax deductibility of all compensation is an important consideration. However, the Committee believes that it is important that HEALTHSOUTH retain the

flexibility to reward superior effort and accomplishment even where all cash compensation may not be fully deductible. The Committee will continue to review the requirements for deductibility under Section 162(m) and will take such requirements into account in the future as it deems appropriate and in the best interests of HEALTHSOUTH's stockholders. Approximately $2,654,849 of Mr. Scrushy's compensation paid with respect to 2000 will not be deductible; however, HEALTHSOUTH believes that all other compensation paid to executive officers will be fully deductible.

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Conclusion

The Committee believes that the levels and mix of compensation provided to HEALTHSOUTH's executives during 2000 were appropriate and were instrumental in the achievement of the company's goals for 2000. It is the intent of the Committee to ensure that the Company's compensation programs continue to motivate its executives and reward them for being responsive to the long-term interests of HEALTHSOUTH and its stockholders.

The foregoing report is submitted by the following Directors of HEALTHSOUTH, constituting all of the members of the Compensation Committee of the Board of Directors for the year ending December 31, 2000 who continue to serve on the Board of Directors at the date of this Proxy Statement:

John S. Chamberlin
Larry D. Striplin, Jr., Chairman(1)

---

(1) Jan L. Jones, a member of the Compensation Committee in 2000, no longer served on the Board at the date of this Proxy Statement.

AUDIT INFORMATION

RELATIONSHIP WITH INDEPENDENT PUBLIC ACCOUNTANTS

Our Board of Directors has engaged Ernst &Young LLP to audit our consolidated financial statements for the fiscal year ended December 31, 2000. We expect that Ernst & Young LLP will serve in that capacity for the 2001 fiscal year as well. We expect that representatives of Ernst & Young LLP will be present at the annual meeting to make a statement if they desire to do so and to respond to appropriate questions.

AUDIT FEES

The aggregate fees billed to us for the fiscal year ended December 31, 2000 by Ernst & Young LLP for the fiscal year ended December 31, 2000 or related to its audit for such fiscal year were as follows:

Audit Fees	$1,026,649
All Other Fees	
Audit-Related Fees	$2,583,854
Non-Audit-Related Fees	66,107
Total of All Other Fees ...	$2,649,961

AUDIT COMMITTEE REPORT

The Audit Committee of the Board of Directors, consisting of C. Sage Givens, Larry D. Striplin, Jr. and George H. Strong, Chairman, is responsible for overseeing HEALTHSOUTH's financial reporting process on behalf of the Board of Directors. HEALTHSOUTH's management has the primary responsibility for the financial statements and the reporting process, including the systems of internal control. In fulfilling its oversight responsibilities, the Committee reviewed the audited financial statements contained in HEALTHSOUTH's Annual Report on Form 10-K for the Fiscal Year Ended December

31, 2000 with management, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements.

All members of the Audit Committee are "independent" under the standards established by the New York Stock Exchange. A copy of the Audit Committee charter is included as Appendix B to this Proxy Statement.

The Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality, not just the acceptability, of HEALTHSOUTH's accounting

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principles and such other matters as are required to be discussed with the Committee under generally accepted auditing standards. In addition, the Committee has discussed with the independent auditors the auditors' independence from management and HEALTHSOUTH, including the matters in the written disclosures required by the Independence Standards Board, and considered the compatibility of non-audit services with the auditors' independence. The Committee believes that the non-audit services are compatible with such independence.

The Committee discussed with HEALTHSOUTH's internal and independent auditors the overall scope and plans of their respective audits. The Committee meets with the internal and independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of HEALTHSOUTH's internal controls, and the overall quality of HEALTHSOUTH's financial reporting.

In reliance upon the reviews and discussions referred to above, the Committee has recommended to the Board of Directors (and the Board has approved) that the audited financial statements be included in HEALTHSOUTH's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2000 for filing with the Securities and Exchange Commission. Those audited financial statements are also included in Appendix A to this Proxy Statement.

The forgoing report is submitted by the following Directors of HEALTHSOUTH, constituting all the members of the Audit Committee of the Board of Directors for the year ended December 31, 2000:

C. Sage Givens
Larry D. Striplin, Jr.
George H. Strong, Chairman

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PRINCIPAL STOCKHOLDERS

The following table sets forth certain information regarding beneficial ownership of HEALTHSOUTH common stock as of March 30, 2001, (a) by each person who is known by us to own beneficially more than 5% of our common stock, (b) by each of our Directors, (c) by our five most highly compensated executive officers, (d) by two former executive officers who would have been among our five most highly compensated executive officers had they held such positions at December 31, 2000 and (e) by all executive officers and Directors as a group.

Tab 40

MEMORANDUM

TO: **Richard M. Scrushy**

FROM: **Teresa L. Rubio**

DATE: **January 4, 1996**

SUBJECT: **Ernst & Young Evaluation Program**

As a follow-up to our meeting on January 2, 1996, I would like to verify my understanding of the program you proposed to be handled by Ernst & Young, as well as, bring potential issues to your attention.

1. We are to retain Ernst & Young staff auditors throughout the country to perform unannounced site evaluations at our facilities.

POTENTIAL ISSUE: *With Ernst & Young handling our annual audit, as well as the site evaluations, issues arising during these visits could affect our year end audit.*

SOLUTION: Retain another firm, possibly Peat Marwick, to handle the site evaluations.

2. Lower level personnel (i.e. staff auditors) with Ernst & Young would be trained by HEALTHSOUTH to perform the site evaluations. One site visit per week, during off-season weeks, would be performed by various locations throughout Ernst & Young's network.

POTENTIAL ISSUE: *An investment of time and training would be made on a non-HEALTHSOUTH employee.*

SOLUTION: Hire two new college graduates in internal audit whose <u>only</u> function is to perform site evaluations. This would provide a new graduate with a career opportunity as well as develop an entry level training program for a potential long-term employee. By maintaining the program in-house, we can better control the consistency in facility evaluations and monitor progress over a given time frame.

3. We have made an initial financial commitment of $500,000 to Ernst & Young to perform this program.

POTENTIAL ISSUE: *This is a significant commitment of company resources to an outside source. An outside source will not be able to provide the consistency, quality and efficiency of an in-house program.*

SOLUTION: Develop an in-house program which will cost approximately $300,000 and produce 750 - 800 site evaluations per year.

Successful implementation of this program will improve the quality of the facilities as HEALTHSOUTH strives to get the standard of excellence in the healthcare industry.

I would like the opportunity to further this program with you at your convenience.

TLR/tle

cc: Jim Bennett
Daryl Brown
Aaron Beam
Bill Owens

HEALTHSOUTH. The Pristine Factor _____ **Outpatient Division**

Tab 41

Date _____ **Time** _____

Facility Name _____ **Facility Location** _____

Satellite ○ Yes ○ No

Patient

Respect

Integrity

Service

Teamwork

Impression

No hassle

Extra mile

Exterior of Facility

1. Parking area is free of trash. (N/A for facilities leasing space within a building.) ○ Yes ○ No ○ N/A
2. **For leased-space facilities:** Facility is listed on building directory. ○ Yes ○ No ○ N/A
3. Entrance to non-leased buildings is free of trash and debris. ○ Yes ○ No ○ N/A
4. **For leased-space facilities:** Entrance to facility appears in good repair and building supports ***HEALTHSOUTH*** image. ○ Yes ○ No ○ N/A
5. Facility has a sign identifying it as a ***HEALTHSOUTH*** facility. If No, note when facility was acquired. _____ ○ Yes ○ No

Lobby/Waiting Area

6. Overall appearance is organized and neat. ○ Yes ○ No
7. No magazines on floor or in chairs. ○ Yes ○ No
8. Furniture appears in good repair. ○ Yes ○ No

Receptionist

9. Patients/visitors are greeted upon entry. ○ Yes ○ No
10. Receptionist has a friendly and helpful attitude. ○ Yes ○ No
11. Proper telephone etiquette is used. ○ Yes ○ No
12. Work area in patient/visitor view is organized and neat. ○ Yes ○ No
13. Patient admission/intake is handled in a private area. ○ Yes ○ No

Treatment/Examination Areas (Items 14. - 28.)

14. Staff is attentive to patients. ○ Yes ○ No
15. Staff exhibits a caring and professional attitude toward patients. ○ Yes ○ No
16. Equipment appears in good working condition. ○ Yes ○ No
17. Equipment has no rust or dust. ○ Yes ○ No
18. Carpet or flooring appears clean and in good repair. ○ Yes ○ No
19. Ceiling is free of stains and dust accumulation. ○ Yes ○ No
20. Facility has adequate lighting. ○ Yes ○ No
21. Walls are free of stains and marks. If No, note areas needing attention. ○ Yes ○ No

_____

_____

22. Doors to storage areas are closed to public view. ○ Yes ○ No
23. Music is at an acceptable level. ○ Yes ○ No ○ N/A
24. Pool is free of stains. ○ Yes ○ No ○ N/A
25. Charting area is organized and neat. (N/A if no specific charting area within patient treatment areas.) ○ Yes ○ No ○ N/A
26. Patient privacy is respected @ all times. ○ Yes ○ No

Patient

27. Clean laundry is neatly folded and stored in a designated area. ○ Yes ○ No
28. Soiled laundry is stored in a covered container. ○ Yes ○ No

Public Restrooms/Locker Rooms (Within facility)

29. Floors are free of trash. ○ Yes ○ No
30. Floors, walls and toilet areas are free of stains. ○ Yes ○ No
31. Overall appearance is sanitary. ○ Yes ○ No

Respect

Financial

32. Business office personnel are courteous and helpful. (N/A for facilities without a business office.) ○ Yes ○ No ○ N/A
33. Patient receipt book is pre-numbered and multicopied. ○ Yes ○ No
34. All pre-numbered receipts in patient receipt book are accounted for; one copy of all receipts issued remains in the receipt book. ○ Yes ○ No

Integrity

35. Over-the-counter collections are stored in a locked safe overnight until forwarded to a Regional Business Office or deposited in the bank. If No, note where money is stored. _____ ○ Yes ○ No
36. Three people or less have the safe combination. List names and titles: _____ ○ Yes ○ No ○ N/A

Service

37. One copy of all purchase orders (issued and voided) is maintained numerically. (N/A only for facilities which requisition supplies from another facility.) ○ Yes ○ No ○ N/A
38. Previous day's charge slips have been processed. ○ Yes ○ No ○ N/A

Obtain patient schedule for the day prior to the audit and pull five medical charts for patients seen on that date.

Teamwork

39. Charges documented for the date under review. ○ Yes ○ No
40. Patient name and account number agree with latest charge ticket. ○ Yes ○ No
Note any problems with 39 and 40. _____

Impression

General

Patient transportation and all company vehicles. Items 41 through 43:

41. Patient transportation vehicle has ***HEALTHSOUTH*** logo on exterior. If N/A or No, note reason. _____ ○ Yes ○ No ○ N/A
42. Interior of vehicle is clean and neat in appearance. ○ Yes ○ No ○ N/A
43. Tires on company vehicle do not have visibly worn tread. ○ Yes ○ No ○ N/A

No hassle

44. There are **no taped signs** (handwritten or printed) on walls, doorways, or equipment in areas open to patient/visitor view. ○ Yes ○ No
45. **"Pulling the Wagon"** poster is prominently displayed in the facility. ○ Yes ○ No
46. Throughout facility, employees are identified by ***HEALTHSOUTH*** name tags or apparel. ○ Yes ○ No
47. Overall attitude of the facility is courteous and professional. ○ Yes ○ No

Extra mile

Pristine Factor

_____%

3/29/96

HEALTHSOUTH

E & Y Auditor # _____

Date ____/____/____

Time_____ AM / PM

Facility Number **04 / 08** _____

Facility Location (City/State) _____/ _____

Facility undergoing construction/renovations at the time of audit. ○ Yes

Patient

Respect

Integrity

Service

Teamwork

Impression

No hassle

Extra mile

Exterior of Facility

1. Parking area is free of trash. (N/A for facilities leasing space within a building.)	○ Yes	○ No	○ N/A
2. Entrance to facility is free of trash and debris.	○ Yes	○ No	○ N/A
3. Entrance to building appears in good repair and building supports HEALTHSOUTH image.	○ Yes	○ No	○ N/A
4. Facility has a sign identifying it as a HEALTHSOUTH facility. If no, note reason and when facility was acquired. _____	○ Yes	○ No	○ N/A

Lobby/Waiting Area

5. Overall appearance is organized and neat.	○ Yes	○ No	○ N/A
6. Magazines appear neat and orderly.	○ Yes	○ No	○ N/A
7. Furniture appears in good repair.	○ Yes	○ No	○ N/A
8. Chairs/Seating have no stains, lint or broken parts.	○ Yes	○ No	○ N/A

Receptionist

9. Patients/Visitors are greeted upon entry.	○ Yes	○ No	○ N/A
10. Receptionist has a friendly and helpful attitude.	○ Yes	○ No	○ N/A
11. Proper telephone etiquette is used.	○ Yes	○ No	○ N/A
12. Work area in patient/visitor view is organized and neat.	○ Yes	○ No	○ N/A
13. **"HEALTHSOUTH receipts are issued to all patients making a payment at our facility"** sign is displayed at receptionist desk.	○ Yes	○ No	○ N/A

Treatment/Examination Areas

Answer items 14, 15 and 16 ONLY if patients are in the facility during the audit.

14. Staff is attentive to patients.	○ Yes	○ No	○ N/A
15. Staff exhibits a caring and professional attitude toward patients.	○ Yes	○ No	○ N/A
16. Patient privacy is respected at all times.	○ Yes	○ No	○ N/A
17. Carpet or flooring appears clean and in good repair.	○ Yes	○ No	○ N/A
18. Ceiling is free of stains.	○ Yes	○ No	○ N/A
19. Ceiling heating/cooling vents are free of dust accumulation.	○ Yes	○ No	○ N/A
20. Walls are free of stains and marks. If no, note areas needing attention. _____	○ Yes	○ No	○ N/A
21. Equipment appears in good working condition.	○ Yes	○ No	○ N/A
22. Equipment has no dust or rust.	○ Yes	○ No	○ N/A
23. Pool/Whirlpool is free of stains.	○ Yes	○ No	○ N/A
24. Facility has adequate lighting.	○ Yes	○ No	○ N/A
25. Doors to storage areas are closed to public view.	○ Yes	○ No	○ N/A
26. Music is at a level for holding conversations without raising voices.	○ Yes	○ No	○ N/A
27. CLEAN laundry is neatly folded and stored in a designated area.	○ Yes	○ No	○ N/A
28. SOILED laundry is stored in a covered container.	○ Yes	○ No	○ N/A

Patient

Respect

Integrity

Service

Teamwork

Impression

No hassle

Extra mile

Public Restrooms (located inside facility only)

29. Floors are free of trash. ○ Yes ○ No ○ N/A
30. Floors, walls and toilet areas are free of stains. ○ Yes ○ No ○ N/A
31. Overall appearance is sanitary. ○ Yes ○ No ○ N/A

Financial

32. Facility is using the "One-Write" system for issuing patient receipts. ○ Yes ○ No ○ N/A
33. Over-the-counter collections are stored in a LOCKED safe or cash box overnight until forwarded to RBO/CPC or deposited in the bank. ○ Yes ○ No ○ N/A
    If no, note where money is stored. _____
34. Three people or less have a key to cash box or the safe combination. ○ Yes ○ No ○ N/A
    List names and titles: _____
35. Throughout facility, assets are tagged with HEALTHSOUTH fixed asset tags. ○ Yes ○ No ○ N/A
    Note one asset description and tag #: _____

Obtain patient schedule for ONE business day prior to the audit and select three medical charts for patients treated on that date.

36. Procedure(s) is(are) documented for the date under review. ○ Yes ○ No ○ N/A
37. Patient has signed consent to treat form. ○ Yes ○ No ○ N/A
    Note problems with 36 and 37. _____

General

38. Facility business license is framed and displayed publicly. ○ Yes ○ No ○ N/A
39. Select three personnel files. Evidence of Completion form for Module One is on file. If no, note employee's name and date of hire. ○ Yes ○ No ○ N/A
    _____
40. Throughout facility, all trash receptacles have liners. ○ Yes ○ No ○ N/A
    If no, note location. _____
41. Throughout facility, all employees are identified by name/ID badges or HEALTHSOUTH apparel. ○ Yes ○ No ○ N/A
42. There are NO taped signs (handwritten or printed) on walls, doorways or equipment throughout facility. ○ Yes ○ No ○ N/A
43. HEALTHSOUTH merchandise brochure is displayed publicly. ○ Yes ○ No ○ N/A
44. "PULLING THE WAGON" poster is displayed publicly in the facility. ○ Yes ○ No ○ N/A
45. "WE'VE ADDED OUR 50TH STATE" poster is displayed publicly in facility. ○ Yes ○ No ○ N/A
46. "INTEGRITY IN ACTION" poster is displayed in area accessible to employees only. ○ Yes ○ No ○ N/A
47. Soda vending machines located in facility distribute Coca-Cola products. (N/A for facilities without vending machines inside the facility.) ○ Yes ○ No ○ N/A
48. Throughout facility, employee work areas are organized and neat. ○ Yes ○ No ○ N/A
49. Throughout facility, storage areas are organized and neat. ○ Yes ○ No ○ N/A
50. Overall attitude of the facility is courteous and professional. ○ Yes ○ No ○ N/A

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NSPI 20999

Why the HealthSouth Pristine Audits should not be considered Internal Audit Services.

The major role of internal audit is to focus on the efficiency and effectiveness of the internal control environment. While the Pristine Audits are an important part of the operational control of the management of HealthSouth facilities it is not a monitoring mechanism for the internal control environment.

HealthSouth determines the Pristine procedures to be performed, the timing of the procedures, the method of reporting, and the communication with executives and the board. Therefore the work that is performed is more like an Agreed-Upon Procedures engagement than any other type of engagement. The only difference being that there is perhaps more judgment involved in executing that Pristine Audit than would be allowed in a true Agreed-Upon Procedures report.

The nature of the focus of the pristine audit is much more operational than financial. In fact very few of the checklist items deal with financial matters. Operational auditing was not included in the SEC restrictions on Internal Audit Services and is not considered to be part of the current public debate.

The administration of the HealthSouth Pristine Audits is conducted not by the Internal Audit Department but by the Corporate Compliance Department.

Tab 42

Audit Fees for Proxy Disclosure
2000 Year End

		2000		2001
Audit Fees				
Annual Audit		939,400		1,093,750
Quarterly Reviews		87,249		93,750
Total Audit Fees		1,026,649		1,187,500
All Other Fees				
Audit Related Fees				
Pristine Audits		1,250,000		1,601,261
HIPAA Readiness Assessment		476,333		
Florida and Puerto Rico Statutory Audits		355,300		343,725
Partnership Audits				
Kansas	70,000		46,900	
Portland	46,000		28,750	
Any other Partnership Audits				
Symmes	3,027			
Memphis	14,400			
		133,427		75,650
UK Statutory Audits (US$)		48,827		
Other Attest Work				
Chesapeake Agreed Upon Procedures	19,400		21,650	
CMS Litigation Support	14,000			
Daly City and Australia	1,536			
Internal Audit - Australia			22,000	
Penn State Geisenger Review/Audit	4,750		29,500	
Horizon 401K audit	13,000		6,750	
Newport Beach Election Count	2,000			
		54,686		79,900
Registration Work		117,525		146,625
SCA Development Audit		53,575		38,124
FACIS		47,916		
Other Accounting and Consultation		40,015		16,450
Oracle Implemenation Assistance				288,540
Caremedic				475,225
AABSCAST		6,250		6,250
		2,583,854		3,071,750
All Other Fees Excluding Audit Related				
US Tax		19,762		75,215
UK Tax (US$)		46,345		
		66,107		75,215
Total "All Other" Fees		2,649,961		3,146,965
Total Fees		3,676,610		4,334,465

Proxy Disclosure

The aggregate fees billed to us by Ernst & Young LLP for the fiscal year ended December 31, 2001 and 2002 or related to its audit of such fiscal years were as follows:

	2001	2002
Audit Fees	$ 1,867,702	$ 2,157,225
Audit Related Fees	1,684,724	2,671,049
Tax Fees	121,580	163,611
All Other Fees	-	-
Total Fees	$ 3,674,006	$ 4,991,885

Tab 43

Fees for Proxy Disclosure
2002 Year End

	2001		2002	
Audit Fees				
Annual Audit	1,071,000		1,189,500	estimate
Quarterly Reviews	93,750		250,500	
Registration Work	146,625		88,650	
Florida and Puerto Rico Statutory Audits	343,725		420,675	
Partnership Audits				
Kansas	46,900		49,625	
Portland	28,750		61,400	
Penn State Geisenger	29,500		44,250	
	105,150		155,275	
UK Statutory Audits (US$)	47,678			
SCA Development Audit	38,124		28,125	
Chesapeake Agreed Upon Procedures	21,650		24,500	
	1,867,702		2,157,225	
Audit Related Fees				
Attest Services				
Pristine Audits	1,332,261	1	1,401,400	2
Surgery Company Audit			960,000	
Synthetic Lease Consultation			114,300	
Other Accounting and Consultation	28,923			
Horizon 401K audit	6,750		6,750	
AABSCAST	6,250			
Control Review Services				
Oracle System Control Assessment	288,540	3		
HIPAA transaction code assistance			28,663	
Peoplesoft HRMS Security & Controls review			120,993	4
Other Advisory Services				
Litigation Support - Lloyd Noland			8,943	5
Internal Audit - Australia	22,000			
Doctors Hospital Disproportionate Share Assistance			30,000	
	1,684,724		2,671,049	
Tax Fees				
Cost Segregation Study			125,000	
US Tax	75,215		38,611	
UK Tax (US$)	46,365			
	121,580		163,611	
Total Fees	3,674,006		4,991,885	

Tab 44

Audit Fees for Proxy Disclosure
2000 Year End
2

HS - Fees

		2000		2001
Audit Fees				
Annual Audit		939,400		1,071,000
Quarterly Reviews		87,249		93,750
Total Audit Fees		1,026,649		1,164,750
All Other Fees				
Audit Related Fees				
Pristine Audits		1,250,000		1,332,261
HIPAA Readiness Assessment		476,333		
Florida and Puerto Rico Statutory Audits		355,300		343,725
Partnership Audits				
Kansas	70,000		46,900	
Portland	46,000		28,750	
Any other Partnership Audits				
Symmes	3,027			
Memphis	14,400			
		133,427		75,650
UK Statutory Audits (US$)		48,827		47,678
Other Attest Work				
Chesapeake Agreed Upon Procedures	19,400		21,650	
CMS Litigation Support	14,000			
Daly City and Australia	1,536			
Internal Audit - Australia			22,000	
Penn State Geisenger Review/Audit	4,750		29,500	
Horizon 401K audit	13,000		6,750	
Newport Beach Election Count	2,000			
		54,686		79,900
Registration Work		117,525		146,625
SCA Development Audit		53,575		38,124
FACIS		47,916		
Other Accounting and Consultation		40,015		28,923
Oracle System Control Assessment				288,540
AABSCAST		6,250		6,250
		2,583,854		2,387,676
All Other Fees Excluding Audit Related				
US Tax		19,762		75,215
UK Tax (US$)		46,345		46,365
		66,107		121,580
Total "All Other" Fees		2,649,961		2,509,256
Total Fees		3,676,610		3,674,006

Audit Fees

The aggregate fees billed to us by Ernst & Young LLP for the fiscal year ended December 31, 2001 c audit of such fiscal year were as follows:

Audit Fees	1,164,750
All Other Fees	
Audit Related Fees	2,387,676
Non-Audit Related Fees	121,580
Total of All Other Fees	2,509,256

EYDF 002397
CONFIDENTIAL

From: Mike Vines

E-mail: Michaelvines302@cs.com

Title: Other

Company:

Address1:

Address2:

City:

State:

Zip:

Country:

Phone: 205-529-6732

Size:

Industry:

Interest:

Reason:

Comments: I know that HealthSouth based out of Birmingham,AL has severe problems in the Accounting Department. In December 2001 HealthSouth moved expenses to capital accounts. The following accounts need to be looked at as of 12-31-2001. 7000,7200 and 7995.

Web Page: http://www.ey.com/global/content.nsf/International/Home

Tab 45

Tab 46

Curtis W. Miller
07/01/2002 10:32 AM

To: James P. Lamphron/Southeast/AUDIT/EYLLP/US@EY-NAmerica
cc:
Subject: *EY.COM REQUEST* HealthSouth Corporation (July 1, 2002)

----- Forwarded by Curtis W. Miller/Southeast/AUDIT/EYLLP/US on 07/01/2002 10:29 AM -----

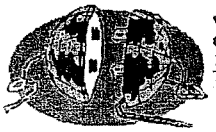
Victoria L. Motes
07/01/2002 10:08 AM

To: Chris L. Abston/SWPacific/AUDIT/EYLLP/US@EY-NAmerica, Curtis W Miller/Southeast/AUDIT/EYLLP/US@EY-NAmerica
cc:
Subject: *EY.COM REQUEST* HealthSouth Corporation (July 1, 2002)

As an FYI...

Submitted (June 30, 2002) through the global ey.com site, the following comments pertain to HealthSouth Corporation.

Regards,
Vicky Motes



Victoria L. Motes
Global Assurance & AABS Infrastructure
1300 Huntington Building, 925 Euclid Ave., Cleveland, OH 44115-1405
Telephone: (216) 583-4553, EY/COMM: 2486683, E-mail: victoria.motes@ey.com
Communications Professional/US AABS Practice Internet Web Steward

----- Forwarded by Victoria L. Motes/National/AUDIT/EYLLP/US on 07/01/2002 11:03 AM -----

Webmaster
07/01/2002 09:56 AM

To: Victoria L. Motes/National/AUDIT/EYLLP/US@EY-NAmerica
cc:
Subject: Re:

---------- Forwarded by Webmaster/EY-APP/US on 07/01/2002 10:02 AM ----------

From: Cecile Le Moigne@EYI-EMEA on 07/01/2002 07:50 AM GDT
To: Webmaster/EY-APP/US@EY-NAmerica
cc:
Subject: Re:

Michaelvines302@cs.com

Michaelvines302@cs.com
30/06/2002 22:53

To: eyi.webmaster@marketing.eyi.uk.eyi.com
cc:
Subject:

To: eyi.webmaster@marketing.eyi.uk.eyi.com

From: Mike Vines

E-mail: Michaelvines302@cs.com

Title: Other

Company:

Address1:

Address2:

City:

State:

Zip:

Country:

Phone: 205-529-6732

Size:

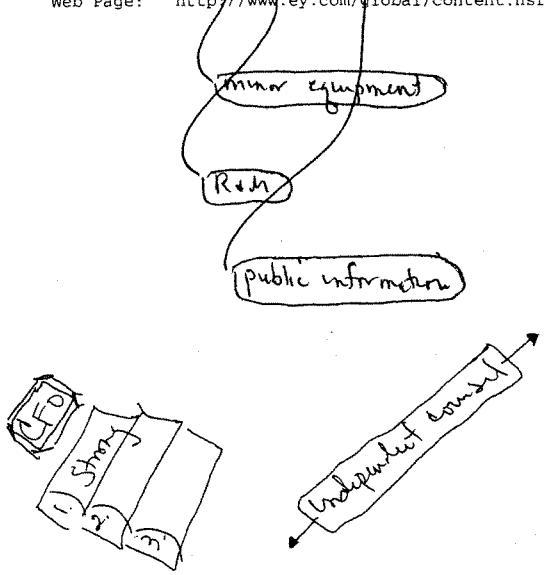
Industry:

Interest:

Reason:

Comments: I know that HealthSouth based out of Birmingham,AL has severe problems in the Accounting Department. In December 2001 HealthSouth moved expenses to capital accounts. The following accounts need to be looked at as of 12-31-2001. 7000,7200 and 7995.

Web Page: http://www.ey.com/global/content.nsf/International/Home



Accounts 7000, 7200, 7995
HRC
12/31/2001

7000 Minor Equipment

Division	12/31/2000	12/31/2001	Variance
01	51,222	128,490	
02	272,445	236,565	
03	2,054,001	2,433,709	
04	374,459	418,987	
05	2,161,850	1,811,829	
06	365,442	398,837	
07	23,939	273,140	
08	145,531	68,383	
09	-	-	
10	-	2,801	
94	21,976	310,520	
95	952	3,353	
96	-	-	
	5,471,817	6,086,614	614,797

7200 Repairs + Maintenance

01	1,977,841	2,250,945	
02	2,841,198	3,066,604	
03	8,364,840	9,632,797	
04	4,036,967	3,663,753	
05	13,082,663	13,703,201	
06	5,701,908	6,775,519	
07	119,858	250,786	
08	1,333,764	398,599	
09	-	-	
10	-	334	
94	157,839	174,402	
95	116,508	91,401	
96	-	-	
	37,733,386	40,008,341	2,274,955

7995 Public Information

01	612,810	3,885,412	
02	1,066,789	1,199,809	
03	2,398,231	1,862,027	
04	2,751,373	2,993,662	
05	1,191,788	1,277,066	
06	834,475	937,305	
07	7,303	11,768	
08	658,865	122,277	
09	-	-	
10	-	1,749	
94	310,436	732,145	
95	-	2,071	
96	-	-	
	9,832,070	13,025,291	3,193,221

ERNST & YOUNG LLP ■ Internal Correspondence ■ Birmingham Office

July 13, 2002

To: HealthSouth Corporation 2002 Annual Audit File
HealthSouth Corporation 2nd Quarter Review File

From: J. P. Lamphron

Results of Review of Allegation of Accounting Irregularities
at HealthSouth Corporation

On June 30, 2002, a former employee of HealthSouth Corporation (HRC) sent an e-mail to an Ernst & Young website alleging certain irregularities in accounting at HRC during the year ended December 31, 2001. Specifically, the allegation was as follows: "I know that HealthSouth based out of Birmingham, AL has severe problems in the Accounting Department. In December 2001 HealthSouth moved expenses to capital accounts. The following accounts need to be looked at as of 12-31-01. 7000, 7200 and 7995."

The former HRC employee who had made the allegation had been employed with HRC until recently as an accounting supervisor in their Fixed Asset Department. The account descriptions for the three accounts in questions are as follows: 7000 – Minor Equipment; 7200 – Repairs and Maintenance; and, 7995 – Public Information.

By July 1, 2002, this message was forwarded to me at which time I called Bob Seaman to inform him of the situation and to discuss the necessary follow-up by us. The actions we decided upon were to 1) inform HRC's CFO of the allegation; 2) discuss the situation with either the COO or CEO, or both; 3) to allow the Company a brief period of time to do a preliminary investigation; and, 4) to inform the Chairman of HRC's Audit Committee of the situation. We did not feel there was any need at this time to inform anyone in our legal department.

By July 2, 2002, I had contacted the CFO and discussed the allegations with him. Both the COO and CEO were on vacation and our efforts to arrange a conference call for July 3, 2002 were not successful. Through conversations with the CFO and the COO's secretary, I learned that the COO had been made aware of the allegations. On Monday, July 8, 2002, I had a conference call with HRC's COO, CFO and Controller. We discussed 1) the specifics of the allegation; 2) the person who had made the charges; and, 3) the results of the Company's preliminary investigation into the allegations. As a result of our conference call we decided that E&Y would review the results of HRC's investigation and then follow-up with a call to the Chairman of the Audit Committee. Since the COO indicated during this conference call that the CEO had been briefed on both the charges and the results of HRC's investigation, I did not discuss this situation directly with the CEO.

During the conference call mentioned in the previous paragraph, and in an earlier conversation with the CFO, the former employee was described as having left HRC under "less than favorable circumstances." Specifically, he had violated HRC policy on dating a direct subordinate. After being counseled and placed on probation another instance of dating a direct subordinate occurred and he decided to resign. The HRC executives believe this persons experiences with the Company may have motivated him to make these allegations. With respect to the charges of reclassifying amounts from expense accounts and capitalizing them in fixed asset accounts the COO and CFO described a "normal recurring process" whereby certain expenses accounts (the three specifically identified and several more) are reviewed as a part of the monthly close process with the express purpose of identifying items that should have been capitalized instead of expensed. This process often results in amounts being reclassified from expense to capital accounts.

The COO and CFO represented that this review had been done for many years because of controls in place to limit capital spending. The Company's capital spending is significant and has been criticized by certain analysts. Accordingly, the Company instituted a very rigorous approval process for capital expenditures with the result being that HRC's 2000+ locations will attempt to circumvent the controls by expensing certain "borderline" capital items (these "borderline" items being purchases that are not substantially over the $500 capitalization limit or that could readily be invoiced piecemeal to keep the individual invoices below the capitalization limit).

On Wednesday, July 10, 2002, Wayne Dunn, Audit Senior Manager, visited the client, spending time with the Controller and the Manager of Fixed Assets with the goals of 1) gaining an understanding of the review of these accounts that is being done as a regular part of the closing process; and, 2) to review specific finding and documents that had been accumulated by the client based upon our request. A memo from Dunn describing the procedures he performed and his findings is attached and made a part of this memo.

Conclusion

Dunn's review determined that amounts had been reclassified from the accounts mentioned above to fixed asset accounts. Based upon his review of certain documents and discussion with HRC personnel, it appears as though this review process is a normal recurring part of the close process. We reviewed the amounts that had been reclassified from expense to capital for two months during 2001 and found that all such amounts appear to have been properly capitalized. We determine that all such reclassifications totaled approximately $3.3 million during 2001 (an amount that is immaterial to HRC's 2001 operating results, and an amount that if posted to the 2001 SAD would not cause us to change our conclusion regarding the fairness of HRC's financial statements). Based upon these procedures and the substantive audit procedures done in fixed asset and expense accounts during the 2001 audit, nothing has come to our attention that would support the allegations made. In addition, it should be noted that the 2001 HRC audit was subject to review during the AQR process and no deficiencies were noted in the scope or execution of the audit.

These findings will be communicated to the Chairman of HRC's Audit Committee.

Copy to: C. Miller
K. Lloyd
J. Cegala
B. Seaman

ERNST & YOUNG LLP

HealthSouth

Conference call w/
Bill Owens (CFO) + George Strong

7/24/02 4:00

- Bill led discussion, informed G.S. of facts, discussed results of their review, our review, findings, etc.
- Also discussed employee who made allegations
- Discussed specific accts. that were name, dis. co's procedures for reviewing capital items and expenses
- GS satisfied we had done enough (co. + E+Y) to put an end to "review"
- Also, decided to communicate w/ employee and let him know we had follow-up on his concerns and found nothing of any concern

Authorized by Bill + George

EYDF 004006
CONFIDENTIAL

Prepared by: J. Index No. Y

HealthSouth Capitalization Policy
HRC
12/31/01

HRC policy requires facilities to submit a capital expenditure request (CER) to purchase capital items greater than $500 (all facilities except O/P) or $100 (O/P). The CER is reviewed at corporate and when approved, the facility can purchase the item or perform the upgrade that is requested.

The facilities have more latitude on expensing items. Corporate approval is required on items greater than $5,000 (after the fact) in order to finalize the check processing. Facilities can approve expenditures without pre-approval.

In certain situations, the facility may believe they need an item immediately and cannot wait on the CER process or they may be close to exceeding their capital budget and may choose to circumvent company policy and just expense the item.

On a monthly basis the fixed asset department runs a listing of all transactions affecting expense accounts 7000 (minor equipment), 7200 (repairs and maintenance) and 7001 (minor surgical instruments). This is done to make sure amounts that should be capitalized are not being expensed. Amounts could be expensed either due to coding error by the facility or by the facility attempting to circumvent the system. (NOTE – facilities do not book entries, they fill out the voucher package for AP processing, and on the voucher package the facility indicates the account where the amount should be booked).

The fixed asset department looks at the amounts of the individual expenditures and at the vendor names to determine if it is likely that an amount should be capitalized. They then obtain the AP log – which includes the backup – and review it to determine if the item is a capitalizeable cost or an expense. Based on the review, amounts that should be capitalized are identified and a correcting entry is made (most items are reclassed to equipment, leasehold improvements, surgical instruments). In addition, the facility is notified of the change and the reason for the change in an effort to improve the process at the facility level.

Examples of items that facilities may expense that should be capitalized are certain surgical instruments, construction, new carpeting, and smaller dollar items that individually do not meet the policy but do in the aggregate (i.e. 10 - $400 TV's).

On July 10, 2002, Wayne Dunn-EY senior manager met with Emery Harris-HRC controller and Cathy Edwards-HRC fixed asset manager and reviewed the process. The transaction listings and the correcting entries were reviewed for May 2001 and December 2001. In addition, a sample of invoices was pulled to determine if amounts being capitalized were being appropriately considered. Based on our review, the items sampled were properly considered as capitalizeable items and the reclass is appropriate. For the

year ended December 31, 2001 – total amount of reclasses from the accounts were as follows:

7200 - $1,275,736
7000 - $948,093
7001 - $1,124,128

In addition we reviewed the reclasses made out of the 7995 Public Information Account. Based on review with the Emery Harris, this account is also reviewed on a monthly basis to make sure items are being accounted for properly. The items that are most common in this area are (1) Items that are expensed which should be set up as a prepaid and then amortized over a period of time, (2) Items which have already been accrued for (outside of AP-in other accruals) for which the item should be offset instead of being expensed, and (3) on a limited basis, there are some items that should be capitalized as PPE. We reviewed the transaction listing for May and December of 2001 and pulled 5 invoices. Based on our review, we noted (1) invoice that was for display racks that was reclassed to PPE, (2) invoice for marketing materials which was reclassed to inventory – these were materials on hand – HRC performs an inventory and adjusts these amounts at that time, (3) invoice for items which had been accrued for in "other payables", (4) invoice for a 3 month sponsorship – item was set up as a prepaid and amortized over three months, and (5) invoice for a sponsorship that was set up as a deferred expense and later expensed – similar to the item in #4 above. No unusual items were noted, all items reviewed were accounted for properly.

1 UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
2 SOUTHERN DIVISION

3

UNITED STATES OF AMERICA,	)	CR-03-C-183-S
4	)	
Plaintiff,	)	Birmingham, Alabama
5	)	
vs.	)	April 3, 2003
6	)	
REBECCA KAY MORGAN, ANGELA C.	)	4:10 P.M.
7 AYERS, CATHY C. EDWARDS,	)	
VIRGINIA B. VALENTINE,	)	
8	)	Tab 47
Defendants.	)	
9 ----------	)	

10 TRANSCRIPT OF PLEAS
BEFORE HON. U. W. CLEMON
11 CHIEF UNITED STATES DISTRICT JUDGE

12 APPEARANCES:

13 FOR THE PLAINTIFF: HON. J. PATTON MEADOWS
HON. GEORGE A. MARTIN, JR.
14 Assistants U.S. Attorney
1801 Fourth Avenue North
15 Birmingham, AL 35203

16

FOR THE DEFENDANT HON. RICHARD S. JAFFE
17 REBECCA KAY MORGAN: Attorney at Law
2320 Arlington Avenue
18 Birmingham, AL 35205

19

FOR THE DEFENDANT HON. JAMES L. O'KELLEY
20 CATHY C. EDWARDS: Attorney at Law
300 Park Place Tower
21 Birmingham, AL 35203

22

FOR THE DEFENDANT HON. HENRY FROHSIN
23 ANGELA C. AYERS: Attorney at Law
1600 SouthTrust Tower
24 Birmingham, AL 35203

25 (Appearances cont'd)

1 MR. FROHSIN: I am.
2 THE COURT: Mr. Mathis?
3 MR. MATHIS: Yes, sir.
4 THE COURT: Mrs. Morgan, tell me what you did wh
5 to your being here in court to answer to this criminal ch
6 DEFENDANT MORGAN: Yes, sir. I participated with
7 others to cause entries to be made into our accounting sys
8 which inflated earnings and assets, and that resulted in fa
9 and misleading financial statements to be filed with th
10 THE COURT: All right. Now, did you know what you
11 doing when you caused these false entries to be made into th
12 books and records of the company?
13 A. Yes, sir.
14 Q. All right. And what did you get out of it?
15 A. I got to keep my job. And I participated in the bonus pl
16 and stock options.
17 Q. All right. And this happened here in Birmingham?
18 A. Yes, sir.
19 Q. And you knew what you were doing?
20 A. Yes, sir.
21 Q. And you knew it was a crime?
22 A. Yes, sir.
23 Q. All right.
24 THE COURT: Mrs. Edwards --
25 A. Yes, sir.

1 Q. -- tell me what you did.
2 DEFENDANT EDWARDS: I participated in falsifying the
3 asset records on the balance sheets and on asset listings.
4 Q. Did you do this on your own, or at someone's direction?
5 A. I was directed to do it.
6 Q. By whom?
7 A. Bill Owens and Emery Harris.
8 Q. All right. And did you know that what you were doing was a
9 crime?
10 A. Sir, in the beginning, I did not. I don't have an
11 accounting decree. I was told what would happen to these
12 accounts.
13 Q. What -- what were you told?
14 A. I was told a debit would be made to the asset accounts, and
15 that it was temporary, and not to worry about it.
16 Q. All right. Well, when did you discover that this
17 representation was not true?
18 A. Two years later when the temporariness was still there, and
19 the balances were inflated regularly.
20 Q. All right. So at that time, you knew that what was -- what
21 was being done was criminal?
22 A. Yes, sir.
23 Q. All right. And with that knowledge, you continued to
24 participate in it?
25 A. Yes, sir.

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DOWJONES TUESDAY, MAY 20, 2003 - VOL. CCXLI NO. 98 - ★★

Missed Signal

Accountant Tried In Vain to Expose HealthSouth Fraud

Ex-Employee Took His Case To Auditors, Then Web— But Convinced No One

What About the Otters?

By CARRICK MOLLENKAMP

At 10:06 a.m. on Feb. 13, someone made a sensational claim on the Yahoo bulletin board devoted to discussion of HealthSouth Corp.

"What I know about the accounting at HRC will be the blow that will bring HRC to its knees," wrote the individual, alluding to the company's stock symbol and using the alias Junior followed by eight numbers. A few minutes later, he added, "what is going on at HRC ... if discovered by the right people will bring change to the accounting department at HRC if not the entire company."

"Junior" was Michael Vines, a former bookkeeper in HealthSouth's accounting department. Since leaving the company in May 2002, Mr. Vines tried to spread the word about alleged questionable practices in the department—but at every turn his disclosures came to nothing. He sent an e-mail to HealthSouth's auditor, Ernst & Young LLP, flagging one small area of alleged fraud, but Ernst concluded that the accounting was legitimate. Later, he tried to make his case online, where readers of the Yahoo forum dismissed his claims as typical Internet blather.

But his warnings were on target—and today they offer a lesson in how hard it can be to sound the alarm against corporate wrongdoing. On March 19, the Securities and Exchange Commission filed a civil lawsuit claiming that HealthSouth and its chairman, Richard M. Scrushy, had committed "massive accounting fraud" to overstate earnings by a total of $1.4 billion since 1999. Within seven weeks, the Justice Department had reached plea agreements in its criminal investigation with all five of the chief financial officers who have worked at HealthSouth, as well as six lower-level former executives, one of whom detailed an additional $1.1 billion of allegedly fraudulent accounting.

The company, the largest operator of outpatient surgery and rehabilitation facilities in the nation, is now under the temporary control of a corporate turnaround specialist, and company officials are fighting to keep the Birmingham, Ala., company out of Chapter 11 bankruptcy proceedings. Mr. Scrushy has denied wrongdoing through his attorneys.

Mr. Vines, a 31-year-old who made about $39,000 a year at HealthSouth, lives at the end of a gravel driveway off a two-lane road 30 miles from downtown Birmingham. Mr. Vines and others familiar with the investigation confirm that he is "Junior." Mr. Vines is cooperating with the federal investigation, and testified at an April federal court hearing.

A native of Birmingham, Mr. Vines learned accounting by taking classes over several years at three Alabama colleges but hasn't completed a degree. "I

Please Turn to Page A13, Column 1

investigation with all five of the chief financial officers who have worked at HealthSouth, as well as six lower-level former executives, one of whom detailed an additional $1.1 billion of allegedly fraudulent accounting.

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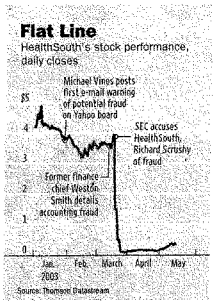

Continued From First Page

just like working with numbers and making sure everything balances at the end of the day," he says.

He began work in HealthSouth's asset-management division in 1997, one of three employees overseeing expenses and the purchase of equipment at the company's 1,800 facilities. By late 2001, he had become uncomfortable with how the accounting department operated.

Over the course of that year, according to his testimony at the April federal court hearing, he came to believe that people in the department were falsifying assets on the balance sheet. The accountants, he testified, would move expenses from the company's income statement—where the expenses would have to be deducted from profits immediately—to its balance sheet, where they wouldn't have to be deducted all at one time. Thus, the company's expenses looked lower than they were, which helped artificially boost net income.

The individual expenses were relatively small—between $500 and $4,999 apiece, according to Mr. Vines's testimony—because the auditor, Ernst & Young, examined expenses over $5,000. Overall, according to the SEC complaint, about $1 billion in fixed assets were falsely entered. In his testimony, Mr. Vines identified about $1 million in entries he believed were fraudulent.

Mr. Vines told his immediate superior, Cathy C. Edwards, a vice president in the accounting department, that he wouldn't make such entries unless she first initialed them. "I wanted her signature on it," Mr. Vines testified.

Ms. Edwards, according to Mr. Vines's testimony, signed off on the entries, and he logged them. Mr. Vines also testified that he saw Ms. Edwards falsifying an invoice, which according to his testimony was a way to cover up the larger fraud involving the accounts. In December 2001, Mr. Vines said on the stand, Ernst was conducting a routine review of how HealthSouth depreciated its assets. As part of the review, Ernst asked about an asset on the company's balance sheet.

The problem: There was no invoice showing that the asset, for a facility in Kansas, had been purchased. (The court papers don't specify what the asset actually was.) So, Mr. Vines testified, Ms. Edwards ordered Mr. Vines to pull an invoice for a different purchase, for a facility in Braintree, Mass., that roughly matched the asset's price. She then scanned the invoice into her computer and altered the shipping cost and other information to make it fit the asset that Ernst was asking about, according to Mr. Vines's testimony.

On April 3, Ms. Edwards pleaded guilty to conspiracy to commit wire and

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THE WALL STREET JOURNAL.

Accountant Tried to Flag Fraud at HealthSouth

securities fraud. As part of the plea, she admitted to falsifying records, although the plea doesn't mention specific incidents. Ms. Edwards's attorney didn't return calls seeking comment.

In May 2002, Mr. Vines grew more concerned about the accounting practices, particularly in light of the scandal that had recently erupted at Enron Corp. He quit his job and moved to the accounting office of a Birmingham country club. HealthSouth's current management says that Mr. Vines left the company voluntarily.

Not long afterward, he sent the e-mail to Ernst, alleging fraudulent transactions between the company's accounts and identifying three account numbers that Ernst should investigate. The accounts covered expenses for "minor equipment," "repairs and maintenance" and "public information," which included costs for temporary workers and advertising job openings, he said in an interview and in court testimony.

When asked about the e-mail by a reporter last month, Mr. Vines denied writing it, but now confirms he did. In an interview, Mr. Vines says he didn't send the information to a regulatory agency because he assumed Ernst "would in turn get with the SEC and say, 'We have a problem here.' Of course, that never happened."

Mr. Vines's e-mail was passed on to James Lamphron, a partner in Ernst's Birmingham office. Mr. Lamphron testified at the April federal court hearing that he contacted William T. Owens, who was then president and chief operating officer at HealthSouth, and George Strong, who served as chairman of the audit committee of HealthSouth's board. A HealthSouth spokesman says Mr. Strong, who hasn't been named in the civil or criminal proceedings, felt the matter was being resolved.

According to Mr. Lamphron's testimony, Mr. Owens defended the company's accounting practices. He acknowledged that the company had moved expenses from one category to another, but he argued that the company had done it for several years and that it was an acceptable practice. Mr. Lamphron testified that Mr. Owens called Mr. Vines a "disgruntled employee."

On March 26, Mr. Owens pleaded guilty to wire and securities fraud and certifying a false financial report to the SEC. Mr. Owens's attorney, Frederick Helmsing, declines to comment on Mr. Lamphron's testimony.

Then, Mr. Lamphron testified, Ernst conducted "audit-related procedures" with the accounts Mr. Vines pointed out. The result: Ernst "reached a point where we were satisfied with the explanation that the company had provided to us .... We then closed the process."

What happened? According to Mr. Lamphron's testimony, Mr. Vines never specified that invoices were being falsified—only that there was a problem with the three accounts he mentioned. So Ernst never investigated the falsified invoices and didn't find any evidence of fraud.

Meanwhile, Mr. Owens's attorney, Mr. Helmsing, says that while his client admits to fraud, the accounts that Mr. Vines pointed out to Ernst actually involved legitimate accounting maneuvers different from the fraudulent schemes.

In May 2002, Mr. Vines grew more concerned about the accounting practices, particularly in light of the scandal that had recently erupted at Enron Corp.

Mr. Vines acknowledges that he didn't mention the falsification of invoices. But he argues that the three accounts he pointed out raise plenty of serious questions by themselves—and an accounting expert agrees.

For example, court documents show that one of the expenses that was shifted to the balance sheet was the sponsorship of the Erie Otters junior-league hockey team in Pennsylvania—which was listed as a Dec. 31, 2001, Internet cost. Charles Mulford, director of the DuPree Financial Reporting and Analysis Lab at the Georgia Institute of Technology, acknowledges there's a gray area in accounting for assets. But he argues that assets such as the hockey sponsorship and others, such as newspaper advertisements, clearly should be expensed immediately and don't belong on the balance sheet, where things such as land, buildings and equipment reside.

A spokesman for Ernst declines to comment on Mr. Vines's e-mail and the firm's handling of it. In prior statements, the firm emphasized the difficulty of detecting accounting fraud in the midst of a conspiracy involving senior executives and allegedly false documentation. Ernst hasn't been named or charged as a defendant in the government cases, and the firm says it is cooperating with investigators.

After the review, Mr. Lamphron testified, he attempted to reach Mr. Vines to tell him that Ernst "found nothing that was inappropriate," but he was never able to reach Mr. Vines by phone.

Mr. Vines confirms he never heard from Ernst. He did nothing more to try to bring to light HealthSouth's accounting practices during 2002.

He had become a regular reader of the Yahoo bulletin board devoted to his former employer, one of many company message boards that Yahoo maintains. Late in January 2003, he began posting warnings as Junior "to get the truth out there," he says in an interview. He wrote, among other things, that HealthSouth's ledger contained "bogus accounts" and that management needed to go, starting with the accounting department.

In early February, local media reported that the FBI had begun interviewing HealthSouth employees about insider-trading allegations. The Yahoo board lit up with messages, including one from Mr. Vines: "The FBI needs to look into the accounting department."

In response to doubters on the Web site, Mr. Vines fired off a flurry of postings on Feb. 13, describing the alleged irregularities. "OK. What about moving telephone expense to a capital account calling it 'cap internet expense.' Or moving repairs and maintenance out to a capital account and calling it the same thing."

That afternoon, skeptics pummeled him on Yahoo: "Sounds like jr. may have been one of the many people churned through hrc's accounting dept. and now has an axe to grind." Another derided Mr. Vines's postings as "water cooler talk."

James Goodreau, HealthSouth's former security chief, who was laid off last week, testified during the April federal court hearing that on the day Mr. Vines posted the messages describing the alleged fraud, Mr. Owens and other executives told him to determine the identity of "Junior."

Mr. Goodreau testified that he asked Ms. Edwards, Mr. Vines's former supervisor, for the names of the current and former employees who might have posted the message on the board. Mr. Goodreau, who hasn't been named in the civil or criminal complaints, testified that he didn't know the posting was describing real potential wrongdoing at the company.

Ms. Edwards wrote 10 names on yellow note paper, and pointed out that Mr. Vines and one other employee on the list no longer worked for HealthSouth. Mr. Goodreau pulled those two workers' personnel files and noticed that some digits of Mr. Vines's Social Security number matched some digits in the Yahoo pseudonym of Junior. He reported that Junior was Mr. Vines, but took no further action. What Mr. Owens planned to do with the knowledge of Junior's identity isn't clear. Mr. Owens's attorney, Mr. Helmsing, declines to comment on the Yahoo episode.

On Feb. 21, Mr. Vines was back on Yahoo: "I know for a fact that HRC has assets on the books that are made up to trick the auditors." A naysayer replied: "If you really had information, you would have shorted the stock and given your info to the appropriate people. You wouldn't be babbling about it here. You'd be too busy picking out your new trailer." Mr. Vines says he owns few shares of HealthSouth and never shorted the stock, a strategy in which traders sell borrowed shares in hopes of buying them back later at a lower price.

Mr. Vines was finally able to crow on March 29—the day after a former HealthSouth chief financial officer pleaded guilty to fraud in the criminal investigation and the SEC filed its civil complaint in U.S. District Court in Birmingham.

"Everyone sees what I have been talking about," he wrote on the Yahoo board.

—Jonathan Weil contributed to this article.

Tab 49

Name	Social Security Number	Title	2001 Bonus	2002 Bonus
RMS			4,509,000.00	18,000,000.0
Owens,William T.		President & COO HSC & Dir	$1,500,000.00	~~1,750,000.00~~ 2,000,000
Smith,W. Greg		VP Internal Audit	$30,000.00	35,000.00
Hervey,Jason		SVP Media and Communication	$0.00	75,000.00
Horton,William W.		EVP & Corporate Counsel	$100,000.00	150,000.00
Murphy,Tyler		Investment Analyst	$8,000.00	12,500.00
Ledbetter,Raymond		Aviation Manager/Chief Pilot	$30,000.00	30,000.00
Clark,Jr.Rendell		Chief Pilot	$30,000.00	30,000.00
Lowery,Jeremy Layne		Pilot Captain Sr.	$20,000.00	20,000.00
Priest,Marlin J.		Maintenance Chief	$25,000.00	30,000.00
Adams,Larry		Maintenance Tech Supervisor	$12,000.00	12,000.00
McClain,Michael		Pilot Captain Sr.	$15,000.00	15,000.00
Goodreau,James		Director of Corporate Security	$35,000.00	40,000.00
Chandler,Michael		Medical Director	$100,000.00	
Swaid,Swaid		Doctor (1099 recp.)	$500,000.00	
Bill Ow ns				
Taylor,Larry D.		President & COO	$500,000.00	600,000.00
Foster,Patrick		President & COO	$500,000.00	600,000.00
Carman,Thomas W		EVP Corp Development	$75,000.00	250,000.00
Smith,Weston L		EVP CFO	$100,000.00	400,000.00
McVay,Malcolm E.		EVP & Treasurer	$100,000.00	175,000.00
Hale,Brandon O.		SVP Administration	$75,000.00	100,000.00
Jones,Susan M.		SVP Finance - Reimbursement	$60,000.00	125,000.00
Henninger,Suzanne T		SVP Ambulatory Development	$0.00	0.00
ks,William G.		VP Investments	$50,000.00	75,000.00
[redacted]		VP External Affairs	$6,000.00	15,000.00
[redacted]		AVP International Marketing	$0.00	15,000.00
Jason Hervey				
Whitten,James T.		GVP Marketing Services	$40,000.00	
Christian,Philip L.		VP Comm & Mkting Serv.	$30,000.00	
Gilmore,Kristi S		VP Communications	$25,000.00	
Hix,Barry		VP Strategic Alliances	$50,000.00	
Bishop,Chris		AVP Strategic Alliances	$16,776.95	
Nix,Gerald B.		GVP Mkting Resources	$40,000.00	
Howell,Michael T.		VP Creative Services	$25,000.00	
Richardson III,David Gray		VP Marketing Resources	$20,000.00	
Walker,Cinnamon L.		AVP Market Resources	$20,000.00	
Vernon,Matt		VP Media and Communications		
Carman,Thomas W				
Skelton,Loree		VP Corp Development	$40,000.00	50,000.00
Pate,Lecia Louise		RVP Corp Development	$17,000.00	T
Hyde,Heidi		AVP Corporate Development	$10,000.00	12,500.00
Dance,Jeffrey		AVP Corporate Development	$12,500.00	10,000.00
Kelleher,Cindy		Director of Corporate Development	$10,000.00	10,000.00
Short,Kristi		Director of Corporate Development	$0.00	7,500.00
Bullock,Jennifer		Director of Corporate Development	$0.00	7,500.00
Smith,Weston				
Harris,Emery		GVP Fin & Asst Contr	$55,000.00	100,000.00
rgan,Kay		GVP Fin & Asst Contr	$55,000.00	80,000.00
aters,Julie W.		VP Payroll	$20,000.00	30,000.00
Patton,Barbara B		VP Accounting	$25,000.00	20,000.00
Edwards,Cathy C.		VP Asset Management	$20,000.00	27,000.00
Ayers,Angela C.		AVP Fin Accounting	$17,500.00	35,000.00
Valentine,Virginia Brooks		AVP Fin Accounting	$14,500.00	20,000.00

leman,Kelly Hughes	AVP Finance	$5,000.00	15,000.00
ley-Fowler,Dawn	AVP Finance	$5,000.00	7,500.00
Blalock,Christy D.	AVP Budget	$7,500.00	15,000.00
Dreyfus,Timothy	Director of Accounting	$0.00	5,000.00
Livesay,Kenneth K	SVP Chief Info Officer-CIO	$60,000.00	65,000.00
Carpenter,Randall	VP Info Technology & Asst CIO	$7,500.00	35,000.00
Whisenhunt,Terry F.	VP ITG	$20,000.00	20,000.00
Larson-Monear,Debra	VP Operations Finance	$15,000.00	20,000.00
Yeager,Rusty	Director of Technology	$0.00	15,000.00
Boykin,Greg	ITG Engineer, Sr.	$0.00	5,000.00
Foy,Tracy	Director, Information Tech	$0.00	5,000.00
Paules,Bill	Systems Engineer L4 App	$0.00	2,000.00
Botts,Richard E	SVP Finance - Tax	$60,000.00	60,000.00
Menke,Brian M.	GVP Finance-Tax	$30,000.00	40,000.00
Desantis,Terri D.	VP Tax	$20,000.00	20,000.00
Martin,Michael D.	AVP Finance-Tax	$7,500.00	10,000.00
Eaton,Byron	Tax Supervisor	$0.00	0.00
Smith,UJ	Tax Supervisor	$0.00	0.00
Patzkowsky,Shawn	Tax Supervisor	$0.00	0.00
Scrushy,Gerald P.	SVP Physical Resources	$50,000.00	
Chamblee Jr.,Jack	GVP IP Design & Construction	$30,000.00	40,000.00
Hawkins,Jack H	GVP Materials Mgmt	$40,000.00	45,000.00
Yeager,Tommy Travis	GVP Amb. Design & Const	$30,000.00	40,000.00
Carr,S. Wayne	VP IP Design & Construction	$20,000.00	22,500.00
Harchelroad,Laura R	VP IP Design & Construction	$15,000.00	22,500.00
Coggins,Kimberly	VP Materials Management	$0.00	7,500.00
ocker,Greg W.	AVP Amb Design & Construction	$7,000.00	8,500.00
arrell,James A.	AVP Amb Design & Construction	$7,000.00	8,500.00
McKee,Mike	Print Shop Manager	$12,000.00	15,000.00
Moxley,Jim	Director of Facility Mangement	$0.00	10,000.00
Miller,Kelly	Director of Architect	$0.00	2,500.00
McGill,Allison	Project Manager Sr. Design & Const	$0.00	2,500.00
Blackwood,Jeff	Director of Architect	$0.00	2,500.00
Horton,William			
Gary Jr.,Beall D.	GVP & Asst Corp Counsel	$40,000.00	40,000.00
Bishop,Ralph	GVP & Senior Counsel	$40,000.00	40,000.00
Reilly,James C.	GVP Legal Services	$40,000.00	40,000.00
Demaray,Drew	VP Admin & Attorney	$20,000.00	30,000.00
Waters Jr.,Daniel H	AVP Legal Services	$15,000.00	15,000.00
Smitherman,Dianne	AVP Legal Services	$7,500.00	12,500.00
Byrd,Lisa M.	VP Broker/Dealer Operations	$0.00	10,000.00
Barkworth,Helena	Attorney, Sr.	$6,000.00	7,500.00
Henderson,Mike	Attorney, Sr.	$6,000.00	7,500.00
Fleenor,Stacey	Attorney, Sr.	$6,000.00	4,000.00
Parker,Fran	Attorney	$0.00	2,500.00
McVay,Malcolm E.			
Davis,Richard S.	GVP Finance & Asst Treasurer	$30,000.00	45,000.00
Byrd III,Charles	VP Real Estate	$20,000.00	10,000.00
Brown,Jason Marc	VP Treasury	$20,000.00	30,000.00
Fowler,Catherine Noojin	VP & Mgr	$20,000.00	20,000.00
Knapp,Brooks Gambrell	AVP Real Estate	$2,500.00	5,000.00
itchie,Cindy B.	AVP Real Estate	$2,500.00	5,000.00
Hale,Brandon O.			
Wade,Dennis	GVP Human Resources	$30,000.00	50,000.00
Pearson,Marca S.	VP Employee Benefits	$20,000.00	20,000.00

HHEC 252-0251
Confidential Treatment
Requested by HealthSouth Corp.

Higginbotham,Lauren A.	AVP Human Resources	$5,000.00	5,000.00
Howell,Robert W.	GVP Payor Contracting &Support	$40,000.00	50,000.00
Stec,Richard	VP Payor Contracting & Support	$7,500.00	15,000.00
Horton,Johnna C.	VP Payor Contracting & Support	$20,000.00	20,000.00
Jenkins,Corale K.	AVP Network Services	$15,000.00	15,000.00
Mink,Randall M.	GVP Risk Management	$30,000.00	50,000.00
Sheedy,Susan A.	VP Quality Standards	$20,000.00	20,000.00
Mulligan,Edward P.	AVP Operations	$5,000.00	5,000.00
VanWanderham,Andrea	AVP - HIPAA Privacy Officer	$5,000.00	5,000.00
Calvert,Tracy	AVP Risk Management	$5,000.00	5,000.00
Stone,Charles Scott	GVP Internet Services	$40,000.00	25,000.00
Creel,Steve C.	VP Internet Services	$20,000.00	20,000.00
Henze,Diana Olszews	VP Internet Services	$15,000.00	20,000.00
Douglas,Dennis	AVP Corporate Compliance	$0.00	5,000.00
Crumpton,Jeff P.	AVP Conference Services	$40,000.00	40,000.00
Hollman,Jonathan	Banquet Manager	$30,000.00	30,000.00
Dunaway,Danny	Conference Center Setup Supervisor	$3,000.00	3,000.00
Davis,Richard	Event Services Rep.	$6,000.00	10,000.00
Layne,Greg	Banquet Captain	$1,700.00	1,700.00
Kendrick,Terry	Banquet Captain	$1,700.00	1,700.00
Bruce,Wilbert	Wait Staff	$1,700.00	1,700.00
Jones,Tammy	Wait Staff	$1,700.00	1,700.00
Henderson,Rosemary	Wait Staff	$1,700.00	1,700.00
Williams,Lattia	Wait Staff	$1,700.00	1,700.00
Morgan,Clarence	Exec Sous & Food Serv Mgr.	$10,000.00	10,000.00
Pruitt,Jim	Chef Exec & Purchasing Mgr.	$5,000.00	7,500.00
Boone,Patrick	Audio Visual Coordinator Lead	$0.00	1,500.00
Jones,Susan			
Dean,Judy	GVP Payor Relations	$40,000.00	40,000.00
Douglass Jr.,William Daniel	VP ITG	$30,000.00	5,000.00
Pillitteri,Sam A.	VP Finance Reimbursement	$20,000.00	40,000.00
Johnson,Daniel	RVP Operations	$8,000.00	15,000.00
Bakkegard,Robin	AVP Reimbursement	$10,000.00	15,000.00
Caskey,Jill Wynn	AVP Reimbursement	$5,000.00	15,000.00
Dew,Coleen	CPC Manager	$0.00	5,000.00
Granburry,Kathy	Reimbursement Specialist, Sr.	$0.00	7,500.00
Henninger,Suzanne T			
Fisher,Melanie Van Reenen	GVP Corp Development	$30,000.00	37,500.00
[redacted]	VP Corp Development	$30,000.00	20,000.00
Taylor,Larry D.			
Riviere,Daniel	Market Leader/SVP Operations	$80,000.00	150,000.00
Huffman,Michael S.	Market Leader/SVP Operations	$80,000.00	130,000.00
Nantz,Jessica	Market Leader/SVP Operations	$80,000.00	60,000.00
Reading,Chris	Market Leader/SVP Operations	$65,000.00	75,000.00
Stark,Charles A.	GVP Operations	$45,000.00	125,000.00
Katz,Richard	SVP Operations	$40,000.00	50,000.00
Goff,Marconia	SVP Operations	$80,000.00	100,000.00
Rickman II,James Michael	Market Leader/VP Operations	$35,000.00	45,000.00
Edwards,J. Mark	VP Controller - East	$35,000.00	65,000.00
McClune,Erin Jean	VP Health Information Systems	$20,000.00	35,000.00
Rickman,Kerry A.	AVP Operations	$20,000.00	30,000.00
Scharpe,Peter UK			30,000.00

H[illegible]inger,Gary		Marketing Program Director	$5,000.00	8,000.00
T[illegible],Rob		VP Clinical Services	$10,000.00	18,000.00
Kesner,Jennifer		Quality Assurance Manager	$0.00	7,500.00
Wood,Dr. Kimberly		Education Director	$0.00	7,500.00
Vardeman,Deanna		Quality Assurance Analyst	$0.00	5,000.00
Schisler,Rikki		Special Projects Manager	$0.00	10,000.00
Walker,John Mark		AVP Controller - East	$8,000.00	18,000.00
Hobbs,Daniel		Financial Analyst Development	$5,000.00	12,000.00
Ransom,Chris		Regional Controller	$5,000.00	12,000.00
Ransom,Jim		Regional Controller	$5,000.00	12,000.00
Brock,Julie		Administrator,Clinical	$2,500.00	7,500.00
Young,Janet		RVP Operations	$0.00	10,000.00
Plugge,Rosh		Regional Controller	$5,000.00	12,000.00
Brandt,David		Director of business office ops	$2,000.00	5,000.00
Foster, Patrick				
Fuller,David B.		SVP Operations	$90,000.00	90,000.00
Nico,Vincent		SVP Operations	$85,000.00	100,000.00
Deigan,Faith A.		SVP Operations	$85,000.00	140,000.00
Moscato,Mary K		SVP Operations	$80,000.00	120,000.00
Maxhimer,Terry R		GVP Operations	$65,000.00	90,000.00
Brockette,C.D.		VP Operations	$60,000.00	110,000.00
Davis,Jeanie M.		VP Operations	$30,000.00	60,000.00
Taylor,Jacquelyn A.		VP Operations	$40,000.00	50,000.00
Dicesare,Frank		VP Controller - Inpatient	$40,000.00	50,000.00
Armstrong,Justin		Director Operations	$17,000.00	15,000.00
Norris,Bobbi		Director Business Off ops	$5,000.00	3,000.00
[illegible]ming,Lynn		RVP Operations	$17,000.00	20,000.00
[illegible]ers,Neal		RVP Marketing Ops/Bus Dev	$17,000.00	T
[illegible]dan,Katrice		Business Office Coordinator	$5,000.00	3,000.00
Jemison,Amy		Marketing Operation Coordinator	$3,000.00	5,000.00
Tarr,Mark J.		GVP Operations	$75,000.00	90,000.00
Wilder,Linda Masone		VP Operations	$60,000.00	100,000.00
Flannery,Donna K		RVP Operations	$40,000.00	T
Mendez,Lincoln S.		RVP Operations	$50,000.00	75,000.00
Cannon,Eudora G.		AVP Operations	$20,000.00	10,000.00
Duck,Julia Lawrence		AVP Operations	$13,000.00	25,000.00
			$7,237,476.95	$8,692,200.00

HHEC 252-0253
Confidential Treatment
Requested by HealthSouth Corp.

Name	Social Security Number	Title	2001 Bonus	2002 Bonus	
RMS			6,500		
Owens,William T.		President & COO HSC & Dir	$1,500,000.00	1,750,000	
~~Hale, Brandon O.~~		~~SVP Administration~~	~~$75,000.00~~		
Smith,W. Greg		VP Internal Audit	$30,000.00	35,000	
Hervey,Jason		SVP Media and Communication	$0.00	75,000	
Horton,William W.		EVP & Corporate Counsel	$100,000.00	150,000	
Murphy,Tyler		Investment Analyst	$8,000.00	12,500.00	
Ledbetter,Raymond		Aviation Manager/Chief Pilot	$30,000.00	30,000	
Clark,Jr.Rendell		Chief Pilot	$30,000.00	30,000	
Lowery,Jeremy Layne		Pilot Captain Sr.	$20,000.00	20,000	
Priest,Marlin J.		Maintenance Chief	$25,000.00	30,000	
Adams,Larry		Maintenance Tech Supervisor	$12,000.00	12,000	
McClain,Michael		Pilot Captain Sr.	$15,000.00	15,000	
Goodreau,James		Director of Corporate Security	$35,000.00	40,000	
Chandler,Michael		Medical Director	$100,000.00		
Swaid,Swaid		Doctor (1099 recp.)	$500,000.00		
Bill Owens					
Taylor,Larry D.		President & COO	$500,000.00	600,000.00	
Foster,Patrick		President & COO	$500,000.00	600,000.00	
Carman,Thomas W		EVP Corp Development	$75,000.00	250,000.00	
Smith,Weston L		EVP CFO	$100,000.00	400,000.00	
McVay,Malcolm E.		EVP & Treasurer	$100,000.00	175,000.00	
Hale,Brandon O.		SVP Administration	$75,000.00	100,000.00	
Jones,Susan M.		SVP Finance - Reimbursement	$60,000.00	125,000.00	
Henninger,Suzanne T		SVP Ambulatory Development	$0.00	– 0 –	
Hicks,William G.		VP Investments	$50,000.00	50,000.00	75K
[redacted]		VP External Affairs	$6,000.00	7,500.00	15K
[redacted]		AVP International Marketing	$0.00	5,000.00	10K
Jason Hervey					
Whitten,James T.		GVP Marketing Services	$40,000.00		
Christian,Philip L.		VP Comm & Mkting Serv.	$30,000.00		
Gilmore,Kristi S		VP Communications	$25,000.00		
Hix,Barry		VP Strategic Alliances	$50,000.00		
Bishop,Chris		AVP Strategic Alliances	$16,776.95		
Nix,Gerald B.		GVP Mkting Resources	$40,000.00		
Howell,Michael T.		VP Creative Services	$25,000.00		
Richardson III,David Gray		VP Marketing Resources	$20,000.00		
Walker,Cinnamon L.		AVP Market Resources	$20,000.00		
Vernon,Matt		VP Media and Communications			
Carman,Thomas W					
Skelton,Loree		VP Corp Development	$40,000.00	~~60,000.00~~	50K
Pate,Lecia Louise		RVP Corp Development	$17,000.00 T		
Hyde,Heidi		AVP Corporate Development	$10,000.00	12,500.00	
Dance,Jeffrey		AVP Corporate Development	$12,500.00	12,500.00	10,000.00
Kelleher,Cindy		Director of Corporate Development	$10,000.00	10,000.00	
Short,Kristi		Director of Corporate Development	$0.00	10,000.00	7,500.00
Bullock,Jennifer		Director of Corporate Development	$0.00	10,000.00	7,500.00
Smith,Weston					
Harris,Emery		GVP Fin & Asst Contr	$55,000.00	100,000.00	
Morgan,Kay		GVP Fin & Asst Contr	$55,000.00	70,000.00	80,000.00
Waters,Julie W.		VP Payroll	$20,000.00	25,000.00	30,000.00
Patton,Barbara B		VP Accounting	$25,000.00	25,000.00	20,000.00
Edwards,Cathy C.		VP Asset Management	$20,000.00	27,000.00	
Ayers,Angela C.		AVP Fin Accounting	$17,500.00	32,000.00	35,000.00
Valentine,Virginia Brooks		AVP Fin Accounting	$14,500.00	17,000.00	20,000.00
Coleman,Kelly Hughes		AVP Finance	$5,000.00	10,000.00	15,000.00
Richey-Fowler,Dawn		AVP Finance	$5,000.00	7,500.00	

Blalock,Christy D.	AVP Budget	$7,500.00	15,000.00	
·us,Timothy	Director of Accounting	$0.00	3,500.00	5,000.00
Livesay,Kenneth K	SVP Chief Info Officer-CIO	$60,000.00	65,000.00	
Carpenter,Randall	VP Info Technology & Asst CIO	$7,500.00	25,000.00	35,000.00
Whisenhunt,Terry F.	VP ITG	$20,000.00	20,000.00	
Larson-Monear,Debra	VP Operations Finance	$15,000.00	20,000.00	15,000.00
Yeager,Rusty	Director of Technology	$0.00	15,000.00	
Boykin,Greg	ITG Engineer, Sr.	$0.00	5,000.00	
Foy,Tracy	Director, Information Tech	$0.00	5,000.00	
Paules,Bill	Systems Engineer L4 App	$0.00	2,000.00	
Botts,Richard E	SVP Finance - Tax	$60,000.00	60,000.00	
Menke,Brian M.	GVP Finance-Tax	$30,000.00	40,000.00	
Desantis,Terri D.	VP Tax	$20,000.00	15,000.00	20,000.00
Martin,Michael D.	AVP Finance-Tax	$7,500.00	10,000.00	
Eaton,Byron	Tax Supervisor	$0.00	5,000.00	0.00
Smith,UJ	Tax Supervisor	$0.00	5,000.00	0.00
Patzkowsky,Shawn	Tax Supervisor	$0.00	5,000.00	0.00
Scrushy,Gerald P.	SVP Physical Resources	$50,000.00	-0-	
Chamblee Jr.,Jack	GVP IP Design & Construction	$30,000.00	40,000.00	
Hawkins,Jack H	GVP Materials Mgmt	$40,000.00	42,500.00	45,000
Yeager,Tommy Travis	GVP Amb. Design & Const	$30,000.00	40,000.00	
Carr,S. Wayne	VP IP Design & Construction	$20,000.00	22,500.00	
Harchelroad,Laura R	VP IP Design & Construction	$15,000.00	22,500.00	
Coggins,Kimberly	VP Materials Management	$0.00	12,000.00	7,500.00
Crocker,Greg W.	AVP Amb Design & Construction	$7,000.00	8,500.00	
Harrell,James A.	AVP Amb Design & Construction	$7,000.00	8,500.00	
McKee,Mike	Print Shop Manager	$12,000.00	15,000.00	
Moxley,Jim	Director of Facility Mangement	$0.00	10,000.00	
·,Kelly	Director of Architect	$0.00	2,500.00	
·ll,Allison	Project Manager Sr. Design & Const	$0.00	2,500.00	
Blackwood,Jeff	Director of Architect	$0.00	2,500.00	
Horton,William				
Gary Jr.,Beall D.	GVP & Asst Corp Counsel	$40,000.00	40,000.00	
Bishop,Ralph	GVP & Senior Counsel	$40,000.00	40,000.00	
Reilly,James C.	GVP Legal Services	$40,000.00	40,000.00	
Demaray,Drew	VP Admin & Attorney	$20,000.00	30,000.00	
Waters Jr.,Daniel H	AVP Legal Services	$15,000.00	15,000.00	
Smitherman,Dianne	AVP Legal Services	$7,500.00	12,500.00	
Byrd,Lisa M.	VP Broker/Dealer Operations	$0.00	10,000.00	
Barkworth,Helena	Attorney, Sr.	$6,000.00	7,500.00	
Henderson,Mike	Attorney, Sr.	$6,000.00	7,500.00	
Fleenor,Stacey	Attorney, Sr.	$6,000.00	4,000.00	
Parker,Fran	Attorney	$0.00	2,500.00	
McVay,Malcolm E.				
Davis,Richard S.	GVP Finance & Asst Treasurer	$30,000.00	40,000.00	45,000.00
Byrd III,Charles	VP Real Estate	$20,000.00	20,000.00	10,000.00
Brown,Jason Marc	VP Treasury	$20,000.00	30,000.00	
Fowler,Catherine Noojin	VP & Mgr	$20,000.00	20,000.00	
Knapp,Brooks Gambrell	AVP Real Estate	$2,500.00	5,000.00	
Ritchie,Cindy B.	AVP Real Estate	$2,500.00	5,000.00	
Hale,Brandon O.				
Wade,Dennis	GVP Human Resources	$30,000.00	~~50,000.00~~	[illegible]
·rson,Marca S.	VP Employee Benefits	$20,000.00	20,000.00	
·nbotham,Lauren A.	AVP Human Resources	$5,000.00	5,000.00	
Howell,Robert W.	GVP Payor Contracting &Suppori	$40,000.00	50,000.00	
Stec,Richard	VP Payor Contracting & Support	$7,500.00	15,000.00	

HHEC 252-0255
Confidential Treatment Requested by HealthSouth Corp.

Hadon,Johnna C.	VP Payor Contracting & Support	$20,000.00	20,000.00	
ns,Corale K.	AVP Network Services	$15,000.00	15,000.00	
Mink,Randall M.	GVP Risk Management	$30,000.00	50,000.00	
Sheedy,Susan A.	VP Quality Standards	$20,000.00	20,000.00	
Mulligan,Edward P.	AVP Operations	$5,000.00	5,000.00	
VanWanderham,Andrea	AVP - HIPAA Privacy Officer	$5,000.00	5,000.00	
Calvert,Tracy	AVP Risk Management	$5,000.00	5,000.00	
Stone,Charles Scott	GVP Internet Services	$40,000.00	25,000.00	~~20,000.00~~
Creel,Steve C.	VP Internet Services	$20,000.00	20,000.00	~~15,000.00~~
Henze,Diana Olszews	VP Internet Services	$15,000.00	20,000.00	~~15,000.00~~
Douglas,Dennis	AVP Corporate Compliance	$0.00	5,000.00	
Crumpton,,Jeff P.	AVP Conference Services	$40,000.00	40,000.00	
Hollman,Jonathan	Banquet Manager	$30,000.00	30,000.00	
Dunaway,Danny	Conference Center Setup Supervisor	$3,000.00	3,000.00	
Davis,Richard	Event Services Rep.	$6,000.00	10,000.00	
Layne,Greg	Banquet Captain	$1,700.00	1,700.00	
Kendrick,Terry	Banquet Captain	$1,700.00	1,700.00	
Bruce,Wilbert	Wait Staff	$1,700.00	1,700.00	
Jones,Tammy	Wait Staff	$1,700.00	1,700.00	
Henderson,Rosemary	Wait Staff	$1,700.00	1,700.00	
Williams,Lattia	Wait Staff	$1,700.00	1,700.00	
Morgan,Clarence	Exec Sous & Food Serv Mgr.	$10,000.00	10,000.00	
Pruitt,Jim	Chef Exec & Purchasing Mgr.	$5,000.00	7,500.00	
Boone,Patrick	Audio Visual Coordinator Lead	$0.00	1,500.00	
nes,Susan				
n,Judy	GVP Payor Relations	$40,000.00	50,000.00	40,000.00
oglass Jr.,William Daniel	VP ITG	$30,000.00	40,000.00	~~45,000.00~~ 50
Pillitteri,Sam A.	VP Finance Reimbursement	$20,000.00	40,000.00	
Johnson,Daniel	RVP Operations	$8,000.00	15,000.00	
Bakkegard,Robin	AVP Reimbursement	$10,000.00	15,000.00	
Caskey,Jill Wynn	AVP Reimbursement	$5,000.00	15,000.00	
Dew,Colleen	CPC Manager	$0.00	10,000.00	5,000.00
Granburry,Kathy	Reimbursement Specialist, Sr.	$0.00	15,000.00	5,000.00
Henninger,Suzanne T				
Fisher,Melanie Van Reenen	GVP Corp Development	$30,000.00	50,000.00	35,000.00
[redacted]	VP Corp Development	$30,000.00		
Taylor,Larry D.				
Riviere,Daniel	Market Leader/SVP Operations	$80,000.00	150,000.00	
Huffman,Michael S.	Market Leader/SVP Operations	$80,000.00	130,000.00	
Nantz,Jessica	Market Leader/SVP Operations	$80,000.00	50,000.00	
Reading,Chris	Market Leader/SVP Operations	$65,000.00	75,000.00	
Stark,Charles A.	GVP Operations	$45,000.00	50,000.00	
Katz,Richard	SVP Operations	$40,000.00	50,000.00	
Goff,Marconia	SVP Operations	$80,000.00	105,000.00	
Rickman II,James Michael	Market Leader/VP Operations	$35,000.00	50,000.00	
Edwards,J. Mark	VP Controller - East	$35,000.00	65,000.00	
McClune,Erin Jean	VP Health Information Systems	$20,000.00	35,000.00	
Rickman,Kerry A.	AVP Operations	$20,000.00	30,000.00	
Scharpe,Peter UK			30,000.00	
Huntsinger,Gary	Marketing Program Director	$5,000.00	8,000.00	
Tillman,Rob	VP Clinical Services	$10,000.00	18,000.00	
sner,Jennifer	Quality Assurance Manager	$0.00	7,500.00	
ood,Dr. Kimberly	Education Director	$0.00	7,500.00	
vardeman,Deanna	Quality Assurance Analyst	$0.00	5,000.00	
Schister,Rikki	Special Projects Manager	$0.00	10,000.00	
Walker,John Mark	AVP Controller - East	$8,000.00	18,000.00	
Hobbs,Daniel	Financial Analyst Development	$5,000.00	12,000.00	

[illegible]om,Chris		Regional Controller	$5,000.00	12,000.00	
[illegible]m,Jim		Regional Controller	$5,000.00	12,000.00	
B[illegible]k,Julie		Administrator,Clinical	$2,500.00	7,500.00	
Young,Janet		RVP Operations	$0.00	10,000.00	
Plugge,Rosh		Regional Controller	$5,000.00	12,000.00	
Brandt,David		Director of business office ops	$2,000.00	5,000.00	
Foster, Patrick					
Fuller,David B.		SVP Operations	$90,000.00	90,000.00	
Nico,Vincent		SVP Operations	$85,000.00	100,000.00	
Deigan,Faith A.		SVP Operations	$85,000.00	140,000.00	
Moscato,Mary K		SVP Operations	$80,000.00	120,000.00	
Maxhimer,Terry R		GVP Operations	$65,000.00	95,000.00	
Brockette,C.D.		VP Operations	$60,000.00	110,000.00	
Davis,Jeanie M.		VP Operations	$30,000.00	60,000.00	
Taylor,Jacquelyn A.		VP Operations	$40,000.00	50,000.00	
Dicesare,Frank		VP Controller - Inpatient	$40,000.00	50,000.00	
Armstrong,Justin		Director Operations	$17,000.00	15,000.00	
Norris,Bobbi		Director Business Off ops	$5,000.00	3,000.00	
Fleming,Lynn		RVP Operations	$17,000.00	20,000.00	
Sanders,Neal		RVP Marketing Ops/Bus Dev	$17,000.00	T	
Jordan,Katrice		Business Office Coordinator	$5,000.00	3,000.00	
Jemison,Amy		Marketing Operation Coordinator	$3,000.00	5,000.00	
Tarr,Mark J.		GVP Operations	$75,000.00	100,000.00	
Wilder,Linda Masone		VP Operations	$60,000.00	100,000.00	
Flannery,Donna K		RVP Operations	$40,000.00	T	
Mendez,Lincoln S.		RVP Operations	$50,000.00	75,000.00	
Cannon,Eudora G.		AVP Operations	$20,000.00	10,000.00	
Duck,Julia Lawrence		AVP Operations	$13,000.00	35,000.00	25,000.00
			$7,312,476.95	$6,464,700.00	

HHEC 252-0257
Confidential Treatment
Requested by HealthSouth Corp.

From: Scrushy, Richard
Sent: Thursday, December 19, 2002 12:39 PM
To: Hale, Brad
Subject: Re:

Let's look at in at noon. Rs

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: Hale, Brad <Brad.Hale@healthsouth.com>
To: Scrushy, Richard <rscrushy@healthsouth.com>
Sent: Thu Dec 19 09:11:43 2002
Subject:

Do you want to get together on the options before you leave for the holidays? Also I need to get signatures from you on minutes. Thanks,
Brad
Brad Hale

Tab 50

Appointment

Organiser: Esclavon, Mary
Subject: Make sure RMS signs Mottola Stock Agreement & return to Brad Hale

Start Date: 04/18/2002 11/00 AM EST
End Date: 04/18/2002 11/30 AM EST

Importance: Normal
ReminderMinutesBeforeStart: 15

Tab 51

JOEL C. GORDON

3102 West End Avenue, Suite 650
Nashville, TN 37203
(615) 385-3541
Fax: (615) 298-5641

FAX TRANSMISSION COVER SHEET

TO: BRAD HALE

FROM: JOEL GORDON

FAX #: (205) 969-4750

DATE: MARCH 12, 2003

SUBJECT: BOARD MINUTES

You should receive 2 page(s), including this cover sheet. If you do not receive all the pages, please call Judy Ernst at (615) 385-3541.

Brad, I have reviewed the minutes listed on the attached sheet and find no changes. I still am missing August 8, September 17, and November 13. Please forward them to me as soon as possible.

Thanks, Joel

Tab 52

CONFIDENTIAL
TREATMENT REQUESTED

HEALTHSOUTH.
One HEALTHSOUTH Parkway
Birmingham, AL 35243

MEMORANDUM

TO: Joel C. Gordon

FROM: Brandon O. Hale

DATE: March 3, 2003

SUBJECT: Board Minutes

Enclosed please find Board Minutes for January 31, 2003, February 6, 2003, February 7, 2003, February 14, 2003, and February 21, 2003. Please review and we will discuss and finalize at the Board Meeting in Orlando.

CONFIDENTIAL
TREATMENT REQUESTED

HP Fax Series 900
Plain Paper Fax/Copier

Fax History Report for

Mar 12 2003 3:03pm

Last Fax

Date	Time	Type	Identification	Duration	Pages	Result
Mar 12	3:02pm	Sent	12059694750	0:42	2	OK

Result:
OK - black and white fax

CONFIDENTIAL
TREATMENT REQUESTED

Memorandum

To: George Strong

CC: Governance Committee

From: Bob May

Date: 3/12/03

Re: 10 K Signature(s) 2003

George in reviewing the latest package of minutes sent out by Brad Hale, I read with interest the statements from Mr. Lamphron of E & Y from the March 15, 2002 minutes. I will not attempt to duplicate the minutes but simply paraphrase the comfort he gave the board, by stating that there were no Enron type issues or exposures. E&Y "focused heavily" on those types of items when evaluating our books.

Mr. Lamphron, gave the Board similar if not stronger assurances during our most recent meeting in Orlando, where the Board signed this years 10k. Many of us relied on the Audit Committee and Mr. Lamphron assurance when signing this document.

HEALTHSOUTH may not have "Enron" type issues. However, we did have some unusual charge offs relating to prior years/periods (in particular bad debt) that we were informed of at the 11th hour before our 4th Quarter earnings release.

My issue is simply this. What assurances can we have from E & Y that next year we will not have the same issues? Obviously, if we do the consequences would be disastrous.

I leave this question in your hands to handle as you deem appropriate.

Tab 53

CONFIDENTIAL
TREATMENT REQUESTED

Memorandum

To: Brad Halé, Bill Horton

CC: Governance Committee Jad

From: Bob May Bob

Date: 3/12/03

Re: Minutes

After reviewing what I believe are the latest complete sets of minutes I now have my suggested corrections/edits:

1. October 1, 2002 minutes incorrectly reports Larry Striplin resigning from Litigation Committee. That event is reported correctly in the October 15, 2002 minutes, the October 1, 2002 minutes need to be corrected

2. October 22, 2002 minutes still missing. I understand these are being reviewed by Fulbright & Jaworski.

3. October 29, 2002 minutes under executive session first item– should be expanded to read that in addition to presenting the F&J documents, Jon and I made preliminary recommendations concerning actions taken/not taken surrounding transmittal 1753, after reviewing the F&J documents and interviewing key members of management.

4. January 6, 2003 minutes should reflect an additional bullet item under the TCV/Source Medical. Bullet point number four should be added to reflect the Boards instruction to search for additional partner/venture firms who could purchase Source under more favorable conditions.

5. February 6, 2003—Jon Hanson reports that he was on the telephone board call.

Tab 54

CONFIDENTIAL
TREATMENT REQUESTED

JC 0001227

Memorandum

To: Brad Halé, Bill Horton

CC: Governance Committee

From: Bob May Bob

Date: 3/12/03

Re: Minutes

After reviewing what I believe are the latest complete sets of minutes I now have my suggested corrections/edits:

never needed

1. October 1, 2002 minutes incorrectly reports Larry Striplin resigning from Litigation Committee. That event is reported correctly in the October 15, 2002 minutes, the October 1, 2002 minutes need to be corrected

2. October 22, 2002 minutes still missing. I understand these are being reviewed by Fulbright & Jaworski.

3. October 29, 2002 minutes under executive session first item-- should be expanded to read that in addition to presenting the F&J documents, Jon and I made preliminary recommendations concerning actions taken/not taken surrounding transmittal 1753, after reviewing the F&J documents and interviewing key members of management.

4. January 6, 2003 minutes should reflect an additional bullet item under the TCV/Source Medical. Bullet point number four should be added to reflect the Boards instruction to search for additional partner/venture firms who could purchase Source under more favorable conditions.

5. February 6, 2003—Jon Hanson reports that he was on the telephone board call.

Unknown

From: Hervey, Jason
Sent: Friday, December 20, 2002 2:40 PM
To: May, RP
Subject: RE: Nap

nap? you say nap? i am wide awake with my feet in the pool and a tiny umbrella drink....pass the shrimp balls please. will look into.
jh

-----Original Message-----
From: May, RP
Sent: Friday, December 20, 2002 1:27 PM
To: Hervey, Jason
Subject: Nap

Hat to disturbe ur nap however I need a favor I would go to rs on this but its trivial yet important. When are we going to see pasr board min(not including last) we have not seen them in months yet RS keeps telling Brad to send them out, yet nothing happens. What gives? If u could explain what the hold up is or better yet get them out that would be great. Go back to ur nap. Hope to see u in FL bob
---
Sent from my BlackBerry Wireless Handheld (www.BlackBerry.net)

Tab 55

Attachment A

Report by James Goodreau

HEALTHSOUTH

One HEALTHSOUTH Parkway
Birmingham, AL 35243

MEMORANDUM

TO: File
FROM: Jim Goodreau
DATE: October 3, 2002

SUBJECT: Shredder documents in fifth floor file room

---

assigned Scott Pierce (Security) to escort/assist the outside attorney group while they reviewed items in the fifth floor file room. Scott advised me that the attorneys removed items from that file room and did not want him in the room while they searched it. They asked him to leave the room and shut the door. Scott stated that he observed the attorneys collect and remove shredded materials that were located inside the shredder in the file room. It is important to note that the shredder in that area is very large and seldom requires the contents be removed. Therefore, the materials that were removed could be items shredded over a period of several months, as this shredder is very rarely used.

Tab 56

CONFIDENTIAL TREATMENT REQUESTED
By Dechert LLP on behalf of its client

Horton, Bill

From: Horton, Bill
Sent: Friday, December 06, 2002 11:44 PM
To: Stark, Chuck
Subject: RE: Elevators

Tab 57

I don't know the answer, but I am pretty confident that any issues could be addressed with a simple, tasteful sign near the buttons saying "Security Cameras In Use" or some such. If you want real legal research, let me know.

-----Original Message-----
From: Stark, Chuck
Sent: Friday, December 06, 2002 11:14 AM
To: Horton, Bill
Subject: Fw: Elevators

Any thoughts on Number 3 below.

Chuck Stark

HEALTHSOUTH Corporation

-----Original Message-----
From: Reams Mark <mark.reams@siemens.com>
To: Stark, Chuck <Chuck.Stark@healthsouth.com>
CC: 'DanL@CLAinc.net' <DanL@CLAinc.net>; McLeod Max <max.mcleod@siemens.com>; Pettry David <david.pettry@siemens.com>
Sent: Fri Dec 06 09:18:40 2002
Subject: RE: Elevators

Chuck,
Several issues to address here before definitive answer can be given.
1. Does elevator traveling cable have any spare conductors (or fiber) that can be used for cameras (quantity and size of conductors is important)?
2. Can we power the camera from the power in the elevator cab? If not, power conductors will be needed in the traveling cable.
3. HealthSouth should consider the privacy issue here. There has been some litigation concerning the fact that there is a reasonable expectation of privacy in an elevator which could be violated by the use of cameras. I am not a legal expert on this subject matter. I am simply suggesting it for your consideration.
4. Additional signage may be required in the cabs if cameras are to be used in the cabs.

We'll check with Jason Hard of B&G on the traveling cable limitations, if any, before we proceed further. I'll keep you informed.

Thanks,
Mark

-----Original Message-----
From: Stark, Chuck [mailto:Chuck.Stark@healthsouth.com]
Sent: Thursday, December 05, 2002 6:21 PM
To: Reams Mark
Cc: 'DanL@CLAinc.net'
Subject: Elevators

Richard would like security cameras in each elevator. Cost? Possible?
Chuck Stark

HHEC 355-0073
Confidential Treatment
Requested by HealthSouth Corp.

EALTHSOUTH Corporation

Confidentiality Notice: This e-mail communication and any attachments may contain confidential and privileged information for the use of the designated recipients named above. If you are not the intended recipient, you are hereby notified that you have received this communication in error and that any review, disclosure, dissemination, distribution or copying of it or its contents is prohibited. If you have received this communication in error, please notify me immediately by replying to this message and deleting it from your computer. Thank you.

From: Goodreau, Jim
Sent: Thursday, December 12, 2002 12:20 PM
To: Scrushy, Richard
Subject: Re: Come to 5th floor. Hang out with mary and follow joel as he goes in and out. See what he is doing. Rs

Ok

Jim Goodreau

Tab 58

Memo To: Jim Goodreau

From: Les Moore

Tab 59

Subject: Jean Davis Files

Date: March 25, 2003

On Friday, March 21, 2003, I was contacted by Patience Layton who advised that Jean Davis had advised that the FBI must have been in her office because there were files missing.

On Monday, March 24, 2003, I emailed Jean Davis and left a message for her to call me in regards to the missing files.

On Tuesday, March 25, 2003, I received a call from Jean Davis who stated that she had folders in her desk containing information on "Group Therapy". She further stated that the file folders were still there but the contents of the folders were missing. She stated that she was in her office on March 19th and 20th. She stated that on the 20th, she spoke with an attorney who needed some of the information and when she went to retrieve it from the folder, it was not there.

Let it be noted that the FBI did not search the office of Jean Davis during any of their searches. Also, there are no cameras that would allow security to observe any activity in or around this office.

-----Original Message ----

Tab 60

From: Goodreau, Jim
Sent: Friday, October 04, 2002 10:10 AM
To: Scrushy, Richard
Cc: Horton, Bill
Subject: FYI

All shredders at the Corporate office have been secured in a room on the 1 st floor, this includes shredders that were in individual offices. Access to this room is limited to Les Moore and myself, and the room has 24 hour video coverage. In addition, you asked me to look into a situation which took place on the third floor north area of Network Services. Lea Patterson of Network Services did shred some items, however, those items contain proprietary information which accompanies the Group Health Capitation Checks. This is membership information which contains social security numbers, names, and the date of birth of the individual covered. We are required under the Privacy Act to ensure the aforementioned information is properly disposed of in order to protect the privacy of the individual. It has been the common practice of Network Services to periodically destroy these records by shredding them. There will be no shredding of any documents in the Corporate Offices until the completion of the SEC investigation.

FULBRIGHT & JAWORSKI L.L.P.
A REGISTERED LIMITED LIABILITY PARTNERSHIP
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NEW YORK, NEW YORK 10103-3198
WWW.FULBRIGHT.COM

Tab 61

HHIRSCH@FULBRIGHT.COM
DIRECT DIAL: (212) 318-3105

TELEPHONE: (212) 318-3000
FACSIMILE: (212) 318-3400

CONFIDENTIAL ATTORNEY WORK PRODUCT
FOR BOARD OF DIRECTORS EYES ONLY

October 1, 2002

The Board of Directors of HealthSouth Corp.
One HealthSouth Parkway
Birmingham, Alabama 35243

HHEC 293-0300
Confidential Treatment Requested by HealthSouth Corp.

Ladies and Gentlemen:

As you are aware, HealthSouth Corp. (**"HealthSouth"** or the **"Company"**) and its Board of Directors have engaged Fulbright & Jaworski L.L.P. to represent them in an investigation by the Securities and Exchange Commission and to conduct a review of the Company's disclosures and related events. Among other things, we have been asked to assess, to the extent ascertainable, whether (i) at the time of the exercise of options and sale of HealthSouth Common Stock by Richard M. Scrushy on or about May 14, 2002 (the **"Option Exercise and Sale"**) or (ii) at the time of transfer of HealthSouth Common Stock to the Company by Mr. Scrushy in satisfaction of the principal amount of loans from HealthSouth on or about July 31, 2002 (the **"Loan Repayment"**), he was aware of the potential effect on the Company of Transmittal 1753 of the MEDICARE CARRIERS MANUAL or the policy expressed therein (**"Transmittal 1753"**).

We understand that the Board of Directors has formed a special investigatory committee (the **"Special Committee"**) to review a variety of allegations made against the Company in a shareholder derivative litigation, including allegations relating to the Loan Repayment. The Special Committee has retained its own independent counsel to assist the Special Committee in its review of these allegations. The independent members of the Board of Directors should look to the Special Committee and its independent counsel for their report on these and other matters.

Our review only began on September 24, 2002. We have begun to review documents and other materials produced by certain officers and employees of HealthSouth in response to a memorandum prepared at our request by the Company's General Counsel, William W. Horton, and the minutes of the Board of Directors and the committees of the Board of Directors. We have not yet received responses from all of the officers and employees to whom the memorandum was addressed or copies of minutes of all meetings of the Board of Directors or certain of its committees. In addition, we have reviewed and are continuing to review electronic data produced by HealthSouth consisting of the e-mail and application files of seventeen key

CONFIDENTIAL
ATTORNEY WORK PRODUCT

officers and directors.

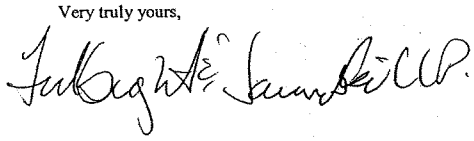
Our review is far from complete, and we are awaiting additional data from certain officers and employees. In addition, we have conducted interviews with Richard M. Scrushy, William T. Owens, William W. Horton, Jeanie Davis, Frederick Schmitt, Jr. and Susan Jones Smith. We expect to conduct additional interviews with some or all of these individuals and to interview additional officers and employees before completing our investigation.

The Board of Directors has requested an update for its meeting on October 1, 2002, of the status of our investigation of the Option Exercise and Sale and the Loan Repayment. In the course of our preliminary work, we have not found any factual data that establish that Richard M. Scrushy was aware at the time of the Option Exercise and Sale or at the time of the Loan Repayment of the potential effect on the Company of Transmittal 1753. In the course of our preliminary work, we have determined that certain members of senior management other than Mr. Scrushy had varying levels of knowledge concerning Transmittal 1753 commencing no later than June 2002; however, we have not ascertained at this time that they disclosed such knowledge to Mr. Scrushy prior to early August.

We have not completed our investigation, and facts and circumstances that come to our attention during the course of our engagement may lead to a conclusion different than that suggested by the limited amount of materials we have reviewed to date. Accordingly, the Board of Directors should not view this letter as a conclusion with respect to any of the matters discussed herein or the potential outcome of any regulatory investigation or legal action. In addition, please note that this letter is not a comment on any other matter we have investigated or may be asked to investigate in the future.

This letter has been prepared solely for the purpose of updating the Board of Directors on the status of our investigation. The existence and contents of this letter are confidential and privileged information intended for the private use of the Board of Directors, and may not be used for any other purpose or quoted or disclosed to any third party, or referred to in any manner, without our express written consent. This letter may not be furnished to any other persons or entities without our prior written consent.

Very truly yours,



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Tab 62

TELEPHONE: (212) 318-3000 FACSIMILE: (212) 318-3400

October 21, 2002

Privileged and Confidential:
Attorney Work Product Doctrine Applies

BY HAND DELIVERY

The Board of Directors of HealthSouth Corporation
One HealthSouth Parkway
Birmingham, Alabama 35243

HHEC16/0111

Ladies and Gentlemen:

On September 18, 2002, HealthSouth Corporation (**"HealthSouth"** or the **"Company"**) and its Board of Directors engaged Fulbright & Jaworski L.L.P. (or **"F&J"**) to represent them in an investigation by the Securities and Exchange Commission (the **"SEC"**) and to conduct a review of the Company's disclosures and related events (the **"Review"**). In the process of that Review, you have also asked F&J to assess, to the extent ascertainable, whether (i) at the time of the exercise of options and sale of HealthSouth common stock by Richard M. Scrushy on or about May 14, 2002 (the **"Option Exercise and Sale"**) or (ii) at the time of transfer of HealthSouth Common Stock to the Company by Mr. Scrushy in satisfaction of the principal amount of a loan from HealthSouth on or about July 31, 2002 (the **"Loan Repayment"**), Mr. Scrushy was aware of the potential financial effect on the Company of Transmittal 1753 of the Centers for Medicare and Medicaid Services (**"CMS"**) to the Medicare Carriers Manual, specifically the language "added to clarify payment policy for group therapy services" (**"Transmittal 1753"**). This letter supplements F&J's letter dated October 1, 2002.

Fulbright & Jaworski L.L.P. understands that the Board of Directors has formed a special investigation committee (the **"Special Committee"**) to review a variety of allegations made against the Company in a shareholder derivative action suit, including allegations relating to the Loan Repayment. The Special Committee has retained its own independent counsel to assist the Special Committee in its review of these allegations. The individual members of the Board of Directors should look to the Special Committee and its independent counsel for their report on these and other matters.

Fulbright & Jaworski L.L.P. is in the process of a broad inquiry concerning Transmittal 1753, the Company's response to and operations in consideration of Transmittal 1753, and the Option Exercise and Sale and the Loan Repayment by Mr. Scrushy. The Review of Transmittal 1753 and the Company's response to and operations in consideration of Transmittal 1753 are ongoing and will likely not be completed for some time. While Fulbright & Jaworski L.L.P.'s Review concerning Transmittal 1753 is not yet complete, this letter sets forth F&J's findings

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regarding the facts and circumstances surrounding the Option Exercise and Sale and the Loan Repayment by Mr. Scrushy.

A summary of Fulbright & Jaworski L.L.P.'s Review, chronology of relevant events, interviews conducted, and specific factual findings are set forth below. At your request, F&J continues its Review of certain matters relating to Transmittal 1753. Should F&J discover any facts or circumstances that are material to the matters expressed in this letter with respect to Mr. Scrushy, F&J will supplement its findings.

I. REVIEW PROCESS

HealthSouth maintains certain practices in regard to the regular and routine destruction of non-electronic data and electronic data. On September 19, 2002, Fulbright & Jaworski L.L.P. requested orally and in writing that the Company act immediately to preserve documents. On September 20, 2002, William Horton, Executive Vice President and General Counsel, directed all HealthSouth personnel to "IMMEDIATELY take all steps necessary to ensure that all documents, electronic files and e-mails under your control are preserved until [the Company] can ensure that all relevant documents have been appropriately gathered and reviewed." Fulbright & Jaworski L.L.P. discovered destroyed documents: on September 26, 2002 in a file room where F&J has been advised that certain HealthSouth executives other than Mr. Scrushy maintained files; and on October 2, 2002 in a copy room in the north wing of the third floor of HealthSouth's corporate offices. Fulbright & Jaworski L.L.P.'s Review is necessarily predicated in part upon the preservation and production of documents by HealthSouth, and that none of the destroyed documents were relevant to the Review.

A. Non-electronic Data Collection

Between September 24, 2002 and October 3, 2002, Fulbright & Jaworski L.L.P. requested and obtained numerous documents and materials from Mr. Horton. The requested documents and materials included but were not limited to documents requested by the SEC in its September 17, 2002 letter (the **"SEC Request"**). The documents produced by Mr. Horton were reviewed both for relevance to F&J's Review and for responsiveness to the SEC Request.

On September 24, 2002, Fulbright & Jaworski L.L.P. prepared a memorandum that directed its recipients to search their files and produce all documents that were, as outlined in the memorandum, relevant to F&J's Review and responsive to the SEC Request. On September 25, 2002, Mr. Horton distributed the memorandum to 39 Company employees, as well as to members of the Board of Directors. The Company employees who received the search memorandum, who were selected by F&J in consultation with Mr. Horton, were:

1. Brooks Adams Assistant to the Chairman	3. Jason Brown Vice President of Finance
2. Cristy Blalock Vice President, Budgets	4. Jean Davis Vice President, Inpatient Operations

5. Richard S. Davis Group Vice President, Finance and Assistant Treasurer	16. Jason Hervey Chief Marketing and Communications Officer
6. Judy B. Dean Group Vice President, Payor Relations	17. Pam Hodges Administrative Assistant to Mr. Owens
7. William Daniel Douglas, Jr. Vice President, Information Technology	18. William W. ("Bill") Horton Executive Vice President and Corporate Counsel
8. Aprile Edwards Case Manager	19. M. Sean Huffman Senior Vice President, Ambulatory Services
9. Mary Esclavon Administrative Assistant to the Chairman	20. Kenneth K. Livesay Senior Vice President and Chief Information Officer
10. Lynn Fleming Regional Vice President Inpatient Operations	21. Malcolm E. ("Tadd") McVay Executive Vice President and Treasurer
11. Patrick A. Foster President and Chief Operating Officer, Inpatient Operations	22. John Monteith Regional Vice President
12. Beall D. ("Nap") Gary, Jr. Senior Vice President and Assistant Corporate Counsel	23. Jessica Nantz Senior Vice President, Ambulatory Services
13. Marconia C. Goff Senior Vice President, Ambulatory Services	24. Aimee Nichols Administrative Assistant to the Chairman
14. Brandon O. ("Brad") Hale Executive Vice President, Administration and Corporate Secretary	25. William T. ("Bill") Owens Chief Executive Officer; former President and Chief Operating Officer, former Executive Vice President and Chief Financial Officer, and former Senior Vice President of Finance and Controller
15. Emery Harris Group Vice President and Assistant Controller	26. Sam A. Pilliteri, Jr. Vice President, Finance and Reimbursement

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27. Christopher J. Reading Group Vice President, Ambulatory Services	34. Richard Stec Vice President, Payor Contracting and Support
28. Daniel J. Riviere Senior Vice President, Ambulatory Services	35. Larry D. Taylor President and Chief Operating Officer, Ambulatory Services
29. Frederick L. ("Rick") Schmitt, Jr. Vice President Business Offices, Ambulatory Services	36. Robert C. Tillman Regional Vice President Clinical Department, Ambulatory Services
30. Gerald P. Scrushy Senior Vice President, Physical Resources	37. Gail Watson Administrative Assistant to Mr. Horton
31. Richard M. Scrushy Chairman of the Board and former Chief Executive Officer	38. Casey Worrell Former Assistant to the Chairman
32. Susan Jones-Smith Senior Vice President, Finance and Reimbursement	39. Matthew Zurek, PT Regional Vice President, Clinical Coordinator
33. Weston L. Smith Executive Vice President and Chief Financial Officer	

In addition to Richard M. Scrushy and William T. Owens, the members of the Board of Directors who received the search memorandum were:

1. John S. ("Jack") Chamberlin	5. Charles W. Newhall III
2. C. Sage Givens	6. Larry Striplin, Jr.
3. Joel C. Gordon	7. Phillip C. Watkins, M.D.
4. Robert May (prospective member)	

By September 30, 2002, all persons who had received the search memorandum had responded either with what they indicated were all of the responsive documents in their possession or a notification that they had no such documents. The total documents produced by all persons comprised approximately four bankers' boxes. These documents were reviewed both for relevance to F&J's Review and for responsiveness to the SEC Request.

On September 30, 2002, Fulbright & Jaworski L.L.P. drafted a second search memorandum that requested all documents relating to any trade or transfer of Company stock by any Company executive, officer or member of the Board of Directors during the period April 1, 2002 to August 31, 2002. Mr. Horton distributed this search memorandum to the following persons, who were selected by F&J in consultation with Mr. Horton:

1.	Jason Brown	6.	William T. ("Bill") Owens
2.	Jean Davis	7.	Richard M. Scrushy
3.	Richard S. Davis	8.	Susan Jones-Smith
4.	Brandon O. ("Brad") Hale	9.	Weston L. Smith
5.	Malcolm E. ("Tadd") McVay		

By the close of business on October 1, 2002, all persons who had received the search memorandum had responded.

B. Electronic Data Collection

On September 26, 2002, in an effort to devise an accurate and efficient strategy for data collection and review, members of Fulbright & Jaworski L.L.P.'s Information Systems staff obtained information from HealthSouth's Information Technology Department regarding the Company's protocol for managing and storing electronic business records, including email and attachments, word processing documents, spreadsheets, and other types of electronic data. Beginning on September 28, 2002, the Company's Information Technology Department, under the direction and supervision of F&J, began electronically collecting and producing data, on a "rolling delivery basis." The data delivery was completed on October 14, 2002. During that period, approximately 59,000 documents (approximately 546,300 pages) were collected from HealthSouth computer records relating to 19 HealthSouth employees and loaded to a discovery management system for review by Fulbright & Jaworski L.L.P. These documents were not reviewed but filtered for relevance using electronic search terms and methods selected by F&J. Such "sorting" produced a total of approximately 12,300 documents (approximately 119,600 pages) that F&J deemed more likely to be pertinent to its Review. A team of approximately ten F&J lawyers has reviewed these documents both for relevance to F&J's Review and for responsiveness to the SEC Request. Fulbright & Jaworski L.L.P. has not examined electronically-produced documents that were not responsive to the search terms.

All electronic documents were retrieved from one of three primary sources: (i) the Company's file server, which houses "sub-directories" for each employee; (ii) the hard drives of individual desktop computers, using HealthSouth's computer network to capture information remotely; and (iii) emails stored directly on HealthSouth's computer network. Preexisting HealthSouth document retention policy has been that undeleted emails are maintained and saved by the Company for 90 days after the date of creation, and deleted emails are saved and maintained by the Company for 14 days after the date of deletion. Thus, any undeleted emails that were received or created prior to June 30, 2002, which is more than 90 days prior to F&J's gathering of data on September 28, 2002, or any emails that were deleted more than 14 days prior to September 28, 2002, were not available unless stored by the employee to the hard drive of his or her desktop computer.

The individuals from whom electronic data have been collected are:

1.	Jean Davis	11.	John Monteith
2.	Mary Esclavon	12.	Jessica Nantz
3.	Lynn Fleming	13.	Aimee Nichols
4.	Patrick A. Foster	14.	William T. ("Bill") Owens
5.	Beall D. ("Nap") Gary, Jr.	15.	Frederick L. ("Rick") Schmitt, Jr.
6.	Brandon O. ("Brad") Hale	16.	Richard M. Scrushy
7.	Jason Hervey	17.	Susan Jones-Smith
8.	Pam Hodges	18.	Weston L. Smith
9.	William W. ("Bill") Horton	19.	Larry D. Taylor
10.	Malcolm E. ("Tadd") McVay		

C. Interviews

Fulbright & Jaworski L.L.P.'s efforts have also included conducting interviews. The following HealthSouth executives, employees, managers and members of the Board of Directors, as well as certain of the Company's outside agents and counsel, have been interviewed by F&J, some on more than one occasion:

1.	Gary F. Capistrant (US Strategies)	11.	M. Sean Huffman
2.	John S. ("Jack") Chamberlin	12.	John Monteith
3.	Jean Davis	13.	William T. ("Bill") Owens
4.	Patrick A. Foster	14.	Frederick L. ("Rick") Schmitt, Jr.
5.	Thomas C. Fox (Reed Smith)	15.	Richard M. Scrushy
6.	Joel C. Gordon	16.	Susan Jones-Smith
7.	Brandon O. ("Brad") Hale	17.	Larry Striplin, Jr.
8.	Eric R. Hanson (US Strategies)	18.	Larry D. Taylor
9.	Scot T. Hasselman (Reed Smith)	19.	Brad Traverse (US Strategies)
10.	William W. ("Bill") Horton		

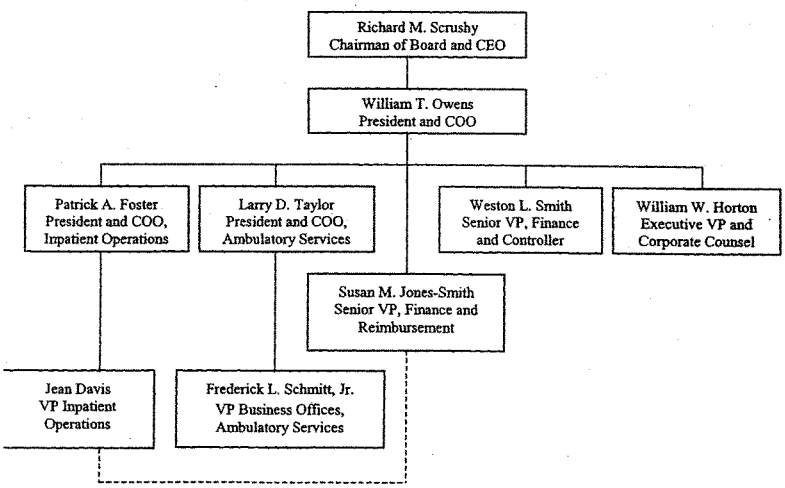
D. Other Sources

Although Fulbright & Jaworski L.L.P. did not attempt to make a comprehensive survey of publicly available material regarding either the Company or Transmittal 1753, F&J has consulted certain materials in addition to those listed above, including press releases, news reports, analyst reports and SEC filings.

On October 4, 2002, Fulbright & Jaworski L.L.P. produced to the SEC an initial installment of approximately 3,460 documents obtained from the Company's corporate files, the Company's officers and directors, and the electronic data provided by the Company. On October 17, 2002, F&J produced to the SEC a summary of events relating to the matters covered by the SEC Request. Fulbright & Jaworski L.L.P. expects to supplement its initial production with additional documents on an ongoing basis.

II. COMPANY ORGANIZATION AND REPORTING PROCESS DURING TIME PERIOD MAY 2002 THROUGH AUGUST 6, 2002

Fulbright & Jaworski L.L.P. has determined from its interviews with various members of senior management and review of documents that from May 2002 through August 6, 2002, the Company organization and reporting process relevant to Transmittal 1753 were as set forth in the chart below.



III. SELECTED CHRONOLOGY AND FACTUAL FINDINGS

This section sets forth a chronology of selected events and also Fulbright & Jaworski L.L.P.'s factual findings through August 6, 2002, relevant to the issue of whether Mr. Scrushy was aware of the potential financial effect on the Company of Transmittal 1753.

In June 1998, HealthSouth's primary Medicare intermediary, Blue Cross Blue Shield of Alabama (**"BCBS-AL"**), issued a publication entitled "Medicare Focus," which included the following language regarding billing for certain therapy services:

> 97150: Therapeutic procedure(s), group (2 or more individuals) 1. Since many group procedures do not require the professional skills of a provider, coverage of this procedure will be determined on a case-by-case basis. 2. Documentation must be submitted with the claim identifying the specific treatment technique(s) used in the group, how the treatment technique will restore function, the frequency and duration of the particular group setting, and the treatment goal in the individualized plan. The number of persons in the group must also be furnished.

On September 11, 1998, a meeting was held between HealthSouth and BCBS-AL representatives to discuss the June 1998 Medicare Focus and the instructions therein regarding billing for therapy services in the group setting.

On November 2, 1998, CMS (formerly the **"Health Care Financing Administration"** or **"HCFA"**) published a final rule implementing a physician fee schedule-based payment system for therapy services, effective January 1, 1999, as required by Congress in the Balanced Budget Act of 1997.

In April 1999, CMS made publicly available draft Program Memorandum (Intermediaries/Carriers), Transmittal No. AB-99-, Change Request 842, which included the following language:

> Group Therapy—Code 97150[.] The current policy has been to use the CPT definition of group therapy, 97150. We are concerned that some providers may not be familiar with the CPT definition, which may not be the same as their clinical concept of group therapy. CPT defines a group as treatment of two or more patients at the same time. If a therapist or physician performs any of the CPT Physical Medicine procedures with two or more individuals concurrently or during the same time period, then only 97150 is reported. . . . If a therapist or a physician performs the treatment on two or more patients during the same time period, or with the assistance of an aide or an assistant, the treatment must be reported using the group therapy code, 97150. For example, for a 25 minute group session of three patients being treated with aquatic therapy or therapeutic exercise, one unit of 97150 should be billed.

On June 18, 1999, HCFA held a "Listening Forum" at which the April 1999 draft Program Memorandum (Intermediaries/Carriers), Transmittal No. AB-99-, Change Request 842 was discussed.

On or about September 10, 1999, HealthSouth made a loan in the principal amount of $25,218,114.87 to Mr. Scrushy, as evidenced by a promissory note of the same date, plus interest at the "Lender's Effective Rate" (as that term is defined in the note), with a maturity date of September 10, 2006 (the **"Loan"**). The Loan was provided pursuant to HealthSouth's 1999

Executive Equity Loan Plan (the **"Plan"**). The stated purpose of the Plan was to provide a mechanism to enhance ownership of HealthSouth's common stock by executives and other key employees and to enable HealthSouth to retain such executives and key employees. Loans made under the Plan were only to be used to purchase HealthSouth common stock.

In March 2000, HCFA published final Program Memorandum (Intermediaries/Carriers), Transmittal AB-00-14, which did not contain any of the discussion in the April 1999 draft Program Memorandum regarding billing for group therapy services.

By letter dated November 7, 2000, HealthSouth's Medicare regulatory outside counsel, Thomas C. Fox of Reed Smith L.L.P. (**"Reed Smith"**), informed the Company that, "[w]hile HCFA may issue program guidance in the future, which defines group therapy in accordance with an earlier policy statement that was withdrawn, there is no current legal basis that would support a finding that HealthSouth's policies and procedures violate applicable Medicare laws and regulations."

On May 10, 2001, HCFA promulgated its proposed rule "Prospective Payment System and Consolidated Billing for Skilled Nursing Facilities." 66 Fed. Reg. 23984 (May 10, 2001). In this proposed rule, HCFA included the following discussion in the preamble:

> We note that there have always been isolated instances in which a professional therapist has been allowed to have some overlap in the time of concluding treatment to one individual and the time of commencing the treatment of another, even to the point of briefly providing therapy concurrently in certain cases. However, the key principle here is that Medicare relies on the professional judgment of the therapist to determine when, based on the complexity of the services to be delivered and the condition of the beneficiary, it is appropriate to deliver care to more than one beneficiary at the same time. Our concern now is that in some areas of the country, concurrent therapy is becoming a standard practice rather than the exception, and is being dictated by facility management personnel rather than according to the professional judgment of the therapists involved.
>
> We believe it is important to heighten the SNF and therapy industries' awareness of the applicable Medicare policy in this regard. Medicare policy has not, until now, specifically addressed coverage of skilled rehabilitation therapy in situations in which a single professional therapist (or therapy assistant under the supervision of the professional therapist) simultaneously provides different treatments to multiple beneficiaries. As noted above, we have relied on the professional therapist's judgment as to when it is appropriate for an individual therapist to provide services to more than one beneficiary. We now wish to advise the providers of care of our concern about the potentially adverse effect of this practice on the quality of therapy provided to beneficiaries in Part A SNF stays, as well as our concern about the implications of making payments in such situations. We solicit public comments regarding the scope and magnitude of this problem, and possible approaches for addressing this issue.

66 Fed. Reg. at 23992.

On July 31, 2001, CMS promulgated its final rule "Prospective Payment System and Consolidated Billing for Skilled Nursing Facilities-Update." 66 Fed. Reg. 39561 (July 31, 2001). In this final rule, CMS stated in part:

> We received a large number of comments encouraging us to continue to recognize concurrent therapy or skilled therapy. . . . However, we continue to believe, as do many of the commenters, that concurrent therapy has a legitimate place in the spectrum of care options available to therapists treating Medicare beneficiaries. Our goals are to safeguard the health and safety of beneficiaries and assure that they are provided the most effective, skilled care available. We agree that, at times, such care can be provided concurrently with another therapy patient, as long as the decision to do so is driven by valid clinical considerations.

66 Fed. Reg. at 39568.

On December 12, 2001, HealthSouth released its 2002 earnings objectives, raising its expectations for 2002 earnings per share to $1.14 due to the expected effects of changes in government reimbursement practices and changes in the accounting for goodwill and intangible assets. This guidance was reiterated, in various forms, a number of times over the following four months.

Between March and May 2002, certain members of the Board of Directors, including Joel C. Gordon, John Chamberlin, Phillip C. Watkins, M.D., and Larry Striplin, Jr., impressed upon Mr. Scrushy the desirability of his repaying the Loan.

On April 29, 2002, during a meeting of the Corporate Compensation Committee, Mr. Owens advised the Committee that the Company had exhausted its efforts to find a way to extend Mr. Scrushy's options and that, because "there were no good choices to consider[,] . . . Mr. Scrushy may have to sell shares in the market."

On May 2, 2002, HealthSouth issued a press release in which it announced its "42% Growth in First Quarter EPS." The Company expressed that, "[g]iven these positive trends, we are actively pursuing additional strategic growth and development opportunities across our product lines. After a very successful 2001, the first quarter has positioned us well to move forward to a new level in 2002."

Prior to Mr. Scrushy's exercise of his options effective May 14, 2002, there were discussions beginning in the Fall, 2001, between Mr. Scrushy and numerous other individuals regarding whether he could properly extend certain options due to expire on May 15 and June 16, 2002, rather than exercise such options. Considerable effort was spent to determine whether Mr. Scrushy could properly extend the options before it was determined that he could not.

On May 14, 2002, Mr. Scrushy exercised options to purchase 5,275,360 shares of HealthSouth common stock. These represented options with an expiration date of May 15, 2002

to purchase 2,275,360 shares under the 1991 Stock Option Plan and options with an expiration date of June 16, 2002 to purchase 3,000,000 shares under the 1992 Stock Option Plan. In each case, the exercise price of the options was $3.7825 per share, for an aggregate exercise price of $19,954,049.20. Mr. Scrushy sold these shares in a block trade on the date of exercise. On May 14, 2002, the average of the high and low prices of HealthSouth common stock was $14.03 per share, indicating sale proceeds of approximately $74,013,300.80 and net proceeds of approximately $54,059,251.60. After the Option Exercise and Sale, Mr. Scrushy continued to own 15,629,595 shares of HealthSouth common stock and derivative securities.

On May 17, 2002, CMS issued Transmittal 1753, with the notation "NEW/REVISED MATERIAL" and an effective date of July 1, 2002. Transmittal 1753 instructs Medicare carriers in part as follows:

> GROUP THERAPY SERVICES (CODE 97150)[,] Pay for outpatient physical therapy services (which includes outpatient speech-language pathology services) and outpatient occupational therapy services provided simultaneously to two or more individuals by a practitioner as group therapy services. The individuals can be, but need not be performing the same activity. The physician or therapist involved in group therapy services must be in constant attendance, but one-on-one patient contact is not required.

On June 6, 2002, Thomas C. Fox, Esq. of Reed Smith sent an email to Mr. Horton regarding pending *qui tam* litigation against the Company involving therapy services provided in the free-standing ambulatory care setting, not in the hospital setting, and possible legislative strategy relating to such litigation. Mr. Fox stated in part that "[s]ome strategic decisions need to be made [regarding Transmittal 1753] in the near term on how the company wants to approach these issues. I leave to you the need for decision making at the level of Richard [Scrushy] and/or Bill [Owens], but we want to be certain any legislative approach is fully aired within ther [sic] company." That same day, Mr. Horton, attaching the email from Mr. Fox, emailed Messrs. Owens, Smith and Taylor and Ms. Jones-Smith, stating that "[a]s soon as Bill [Owens] is back in the office, we need to discuss our planned response to the CMS Program Transmittal provision on Group Therapy described below. This is quite important." By email, Mr. Horton reiterated to Messrs. Owens, Smith and Taylor and Ms. Jones-Smith on June 15, 2002 that, "CMS has put out a program transmittal directing intermediaries to pay for any PT or OT services provided to two or more individuals as group therapy, even if the patients are performing different activities."

The days following June 15, 2002 included various email and other communications seeking an understanding among HealthSouth executives other than Mr. Scrushy, outside counsel and representatives from Medicare intermediaries and CMS regarding the impact of the "clarification of Transmittal 1753" on the provision of physical therapy services by HealthSouth.

On June 20, 2002, Ms. Jones-Smith called Dr. Greg McKinney, Medical Director for BCBS-AL, and inquired about the application of Transmittal 1753. According to Ms. Jones-Smith, Dr. McKinney stated that Transmittal 1753 applies only to physicians and individual therapists, and not to hospitals, rehabilitation agencies, or Comprehensive Outpatient Rehabilitation Facilities ("**CORFs**") furnishing therapy services. According to Ms. Jones-

Smith, Dr. McKinney indicated that the purpose of Transmittal 1753 is "to educate physicians on group therapy and to make them aware of this code." Ms. Jones-Smith emailed a summary of her discussion with Dr. McKinney to Mr. Horton and Mr. Taylor on June 21, 2002. On June 25, 2002, Ms. Jones-Smith emailed Dr. McKinney and requested that he "[p]lease verify that [her] understanding [regarding their prior discussion about the application of Transmittal 1753] is correct, as we are trying to make every effort to ensure that we are complying with this transmittal to the extent it is applicable to us."

On June 26, 2002, Mr. Horton emailed Ms. Jones-Smith and stated his belief that "anything that is paid under Part B (incl. CORFs and rehab agencies) is covered by the new policy. Bill [Owens] and Weston [Smith] agree. I want to see what [Dr.] McKinney gives us in writing, if anything, but I am less and less comforted by what he told you before. I have recommended to Bill [Owens] that [the Company] proceed to modify [its] policies, and he agreed."

On the same day, Rick Schmitt notified Lynn Fleming, Ms. Jones-Smith, Patrick Foster, Chris Reading, Dan Riviere, Jessica Nantz, Marc Goff, Mike Rickman, Rick Katz, Sean Huffman, Larry Taylor, Aprile Edwards, and Matthew Zurek, that "[s]enior management has determined the new group code requirements that we have been discussing the past few days applies to us both in Part A and Part B as well as inpatient outpatient." Mr. Schmitt explained to F&J that his reference to "senior management" in the foregoing email was to Larry Taylor, President and Chief Operating Officer of HealthSouth's Ambulatory Services Division. As President of the Ambulatory Services Division, Mr. Taylor has primary responsibility for the Company's rehabilitation agencies and CORFs, although as a result of certain acquisitions by HealthSouth, he is also responsible for a few rehabilitation hospitals. Mr. Schmitt reports to Mr. Taylor, and not to the President of the Company's Inpatient Operations Division, Patrick Foster. *See* reporting process as described in Section II above. It appears, therefore, that Mr. Schmitt was addressing Transmittal 1753's potential application to the Company's Ambulatory Services Division, and not the Inpatient Operations Division.

Also on June 26, 2002, Lynn Fleming sent an email to Mr. Foster to which was attached a preliminary "Estimated Effect of Group Therapy Change Rehabilitation Hospitals – Outpatient Therapy." This preliminary estimate was prepared by Eudora Cannon, who estimated that Transmittal 1753 could impact the Company's net revenue for its rehabilitation hospitals between positive $2,792,073 and negative $22,894,995 for the time period July through December 2002.

On June 28, 2002, Dr. McKinney responded by email to Ms. Jones-Smith's request of June 25, 2002 for verification and stated that "[T]ransmittal [1753] was a clarification on [CPT code] 97150 for independent practitioners (MDs who perform the service or Independent PTs [physical therapists]). The definition of 97150 as per the CPT manual is applicable to all providers of this service." On the same day, Scot Hasselman, Esq. of Reed Smith recommended in an email to Mr. Horton that "HealthSouth decide (as soon as possible) what approach to take on this issue (i.e., the pm [Transmittal 1753] and July 1 effective rules on group therapy and aides) and provide appropriate policy direction to Gary [Capistrant of US Strategies]." On the same day, Mr. Horton described in a memorandum to the file that, after some discussion among

William Owens, Weston Smith, Susan Jones-Smith and Patrick Foster, "a decision was made to continue seeking clarification from Blue Cross as to appropriate billing procedures and to refrain from changing any policies or procedures until further clarification was received."

At the end of June, 2002, Mr. Owens directed that all billing for therapy services in HealthSouth's ambulatory division be suspended until the Company could determine the applicability of Transmittal 1753. At or around this time, Mr. Owens believed that CMS may take the position that Transmittal 1753 applied to the physical therapy services HealthSouth provides in its CORFs and rehabilitation agencies, which are included in the Company's Ambulatory Services Division.

On or about June 30, 2002, Mr. Scrushy informed Brandon Hale of his willingness to repay the Loan prior to its maturity date of September 10, 2006. In the first week of July 2002, Mr. Scrushy informed Messrs. Owens and Horton of his willingness to repay the Loan, and asked Mr. Horton to effectuate the repayment. In mid-July 2002, Mr. Horton advised Mr. Scrushy that the Corporate Compensation Committee would need to approve the Loan Repayment, and he scheduled such a meeting for July 25, 2002.

In a letter dated July 5, 2002, in the context of the pending *qui tam* litigation against the Company involving therapy services furnished in the free-standing ambulatory care setting, not in the hospital setting, and possible legislative strategy relating to such litigation, Thomas C. Fox of Reed Smith informed HealthSouth that "the definition of Group Therapy to be effective July 1, 2002, would also apply to [HealthSouth's] hospital outpatient billings," and that "if HealthSouth were to continue to utilize the clinical standards followed in the past, which essentially limited billing under the Group Therapy Code only when two or more patients were treated at the same time with the same modality, as opposed to billing for concurrent therapy if the patients were treated with different modalities, the risk of liability for claims submitted by HealthSouth for services provided after July 1, 2002 is greatly increased, and could implicate [the Company's] rehab[ilitation] hospitals."

On July 7, 2002, Mr. Horton forwarded the July 5, 2002 letter from Mr. Fox to Messrs. Owens and Weston Smith and to Ms. Jones-Smith, and stated that he agreed with "Reed Smith's strong advice . . . that the recent group therapy transmittal should be read to apply to any non-PPS PT [Physical Therapy] or OT [Occupational Therapy] services." Mr. Horton further stated that he did "not believe what we have gotten from BCBS[-]AL is inconsistent with that or particularly helpful to us. I think we need to get clarification to the field on this right away, and I'd like to discuss this with you as soon as possible."

On July 8, 2002, the Company held its "Monday Morning Meeting," a regularly scheduled meeting at which approximately 65 to 100 of HealthSouth's managers make presentations of 30 seconds to two minutes each to the Chief Executive Officer and the President. The Monday Morning Meeting, which lasts approximately one and one half hours, is intended to generally inform the Chief Executive Officer and the President of any developments and activities for each executive and manager's region, division, or group from the period since the previous Monday Morning Meeting, and of their planned activities for the next several weeks. In advance of the meetings, the managers prepare an "Activity Report," outlining such

developments and activities. The Activity Reports may be viewed by Mr. Scrushy during Monday Morning Meetings using a laptop computer as the presentations are made. According to her interview with F&J and her Activity Report, during her presentation at the July 8, 2002 Monday Morning Meeting, Ms. Jones-Smith addressed eight items including that she was "[w]orking with BCBS[-]AL on interpretation of various [M]edicare regulations ([T]ransmittal 1753 pertaining to Group Therapy). Steve Speil is arranging a meeting with CMS for us to discuss the various interpretations." Interviews with several members of management indicate that after Ms. Jones-Smith completed her presentation regarding Transmittal 1753, there was no follow-up discussion at the July 8, 2002 Monday Morning Meeting regarding Transmittal 1753 or Ms. Jones-Smith's reference thereto.

Also on July 8, 2002, the Hospital Association of Pennsylvania emailed Frank Dicesare, Ms. Jean Davis and Ms. Jones-Smith advising that it had "confirmation from Veritus Medicare today that Transmittal 1753 and specifically Group Therapy Services (code 97150), pertains to physician billing, not hospital billing. In other words, it does not apply to your outpatients that are receiving PT, OT, or SLP [Speech/Language Pathology] services at one of your outpatient satellites."

On July 11, 2002 the Company held a telephonic meeting of the Board of Directors to update the directors on a sharp decline in the price of HealthSouth common stock. The stock price had been falling since mid-June, and on July 11, 2002, the average of the high and low prices was $8.95 per share. On the same day, HealthSouth issued a press release in which it announced that "it remained comfortable with consensus Wall Street estimates for the remainder of 2002."

On July 18, 2002, Steve Speil of the Federation of American Hospitals and Ms. Davis met with Tom Grissom of CMS in Washington, D.C., to discuss the applicability of Transmittal 1753 to the Company's various physical therapy services. Mr. Grissom asked Ms. Davis to provide him with follow-up information and promised Ms. Davis that he would look into the matter internally at CMS.

On the morning of July 24, 2002, Thomas C. Fox of Reed Smith sent an email to Mr. Horton in which he stated "[t]his is what I would say to Bill Owens (and Richard [Scrushy] if I had the opportunity). Unless and until Transmittal 1753 is withdrawn, outside counsel is telling the company it faces substantial risk of false claims liability by not following that coding and billing policy for therapy effective July 1, 2002."

Also on July 24, 2002, Mr. Horton sent an email to members of HealthSouth's Compensation Committee, *i.e.*, Mr. Striplin, Dr. Watkins and Mr. Chamberlin, and to Brandon Hale and advised them that "[l]ast month, Richard [Scrushy] paid the accrued interest on the loan and indicated that he wanted to satisfy the principal amount by transferring to the company shares with a value equal to the principal amount. . . . Because the Plan does not expressly provide for this method of repayment, the Compensation Committee needs to ratify this transaction."

On July 25, 2002, Rick Schmitt communicated to certain HealthSouth personnel that, based on an extensive review by the Company, it had been determined that the billing code for group therapy must be used when billing Medicare if a therapist supervises more than one patient at a time.

Also on July 25, 2002, the Corporate Compensation Committee convened and Mr. Horton presented for the Committee's consideration the request by Mr. Scrushy to repay the principal amount of the Loan by transferring to the Company shares of HealthSouth common stock with a value equal to the principal amount of the Loan. Certain Compensation Committee members have indicated that Mr. Scrushy requested that the shares be calculated based upon the price of HealthSouth common stock at the time of his original request on June 30, 2002. HealthSouth common stock closed at $12.79 per share on June 29, 2002. The average of the high and low trading price of HealthSouth common stock on July 25, 2002, was $7.63 per share.

On July 26, 2002, Christopher Arrigo, MS, PT, National Director of Clinical Services, emailed to William Owens, William Horton, and Larry Taylor a document entitled "Clinical Considerations and Implications of Group Therapy Coding in the Medicare Population," which addressed the application of Transmittal 1753 to concurrent physical therapy furnished by the Company to Medicare patients.

On July 31, 2002, the Corporate Compensation Committee reconvened and approved the repurchase of shares from Mr. Scrushy to repay the principal of the Loan. Fulbright & Jaworski L.L.P. notes that neither the Company nor the Corporate Compensation Committee obtained a fairness opinion for the terms of the Loan Repayment, which may have been required pursuant to certain of the Company's debt instruments. The Loan Repayment was approved by the Corporate Compensation Committee at a share price equal to the average of the high and low trading price on July 31, 2002. The average of the high and low trading prices of HealthSouth common stock on July 31, 2002 was $10.06 per share.

On August 1, 2002, Mr. Scrushy transferred 2,506,770 shares of HealthSouth common stock to HealthSouth in payment of the $25,218,114.87 principal amount of the Loan.

Also on August 1, 2002, an internal memorandum entitled "Group Therapy" was distributed *via* email by Pam Hodges on behalf of William Owens to various Company personnel, including Patrick Foster, Larry Taylor and Christopher Arrigo, attaching a document entitled "Clinical Considerations and Implications of Group Therapy Coding in the Medicare Population," which addressed the application of Transmittal 1753 to concurrent physical therapy furnished by the Company to Medicare patients.

Mr. Owens stated that on August 6, 2002, he informed Mr. Scrushy of the existence of Transmittal 1753, its possible application to CORFs and rehabilitation agencies, and that if, as he believed would be the case, CMS would take the position that the Transmittal applied to CORFs and rehabilitation agencies, the financial impact on HealthSouth would be approximately $10,000,000 to $30,000,000. He further stated that HealthSouth had met with CMS officials in mid-July 2002 but left the meeting with "more questions than answers." Both Mr. Owens and Mr. Scrushy agreed that another meeting with CMS should be scheduled to seek further

clarification from CMS on its interpretation of Transmittal 1753. Such a meeting was subsequently scheduled for August 15, 2002.

Mr. Owens has stated that he did not speak with Mr. Scrushy earlier about Transmittal 1753 because he did not believe that Transmittal 1753, and its potential financial impact of a reduction in earnings of approximately $10,000,000 to $30,000,000, was material or significant. He further stated that the reason he brought the matter to Mr. Scrushy's attention on August 6, 2002, was that Mr. Owens and HealthSouth's investment bankers were going to discuss a spin-off of HealthSouth's surgery division at the upcoming August 8, 2002 Board meeting. He believed that if there were such a spin-off, the possibility of a $10,000,000 to $30,000,000 reduction in earnings, while still not material, would be more significant to HealthSouth's remaining businesses and operations.

On August 7, 2002, the Company issued a press release that quoted Mr. Scrushy as saying that "[t]he second quarter showed strength across all product lines with each of our businesses demonstrating continued positive volume and pricing trends.... We were especially pleased with the performance of our inpatient rehabilitation facilities as they generated an 11% increase in revenue. This clearly demonstrates the success the [C]ompany is having under Medicare's new prospective payment system."

On August 8, 2002, at a regularly scheduled Board of Directors meeting, Mr. Scrushy (i) presented a plan for spinning off HealthSouth's surgery division; (ii) informed the Board of Transmittal 1753 and stated that it "appeared to change regulations for payment of group and concurrent therapy for outpatient Medicare reimbursement"; and (iii) advised the Board of his Loan Repayment under the 1999 Executive Loan Program by transferring shares to HealthSouth.

IV. CONCLUSION

The chronology set forth in Section III of this Review identifies that certain members of HealthSouth senior management other than Richard Scrushy had varying levels of knowledge of Transmittal 1753.

During the course of its Review, Fulbright & Jaworski L.L.P. has uncovered no oral interview or written document (including electronic data) that establishes that Mr. Scrushy was aware at the time of the Option Exercise and Sale, on May 14, 2002, of the pending issuance of Transmittal 1753. Fulbright & Jaworski L.L.P. also has uncovered no oral interview or written document (including electronic data) that establishes that Mr. Scrushy knew prior to the Loan Repayment, on July 31, 2002, of: (i) Transmittal 1753; (ii) the application of Transmittal 1753 to the Company's various outpatient therapy services; or (iii) the transmittal's potential financial effect on the Company, other than that Mr. Scrushy was present during a "Monday Morning Meeting" on July 8, 2002, during which the existence of Transmittal 1753 was referenced.

Fulbright & Jaworski L.L.P. has prepared this letter solely for the purpose of informing the Board of Directors of its findings regarding the facts and circumstances surrounding the Option Exercise and Sale and the Loan Repayment by Mr. Scrushy. The Board of Directors should not view anything in this letter as a conclusion with respect to the potential outcome of any regulatory investigation or legal action. Fulbright & Jaworski L.L.P. expresses no views as to the inferences that may be drawn from the facts and circumstances contained in this Review. In addition, please note that this letter is not a comment on any other matter Fulbright & Jaworski L.L.P. reviewed or may be asked to review in the future.

Very truly yours,

Fulbright & Jaworski L.L.P.

Confidential Treatment
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Corp.

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Tab 63

October 29, 2002

Privileged and Confidential:
Attorney Work Product Doctrine Applies

The Board of Directors of HealthSouth Corporation
One HealthSouth Parkway
Birmingham, Alabama 35243

Ladies and Gentlemen:

On October 21, 2002, at the request of the Board of Directors of HealthSouth Corporation (**"HealthSouth"** or the **"Company"**), Fulbright & Jaworski L.L.P. (or **"Fulbright"**) submitted its findings regarding the facts and circumstances surrounding the exercise of options and sale of HealthSouth common stock by Richard M. Scrushy on or about May 14, 2002 and the transfer of HealthSouth common stock to the Company by Mr. Scrushy in satisfaction of the principal amount of a loan from HealthSouth on or about July 31, 2002 (the **"October 21, 2002 Review"**). The Board of Directors has asked that Fulbright & Jaworski L.L.P. assess, to the extent ascertainable, the facts and circumstances relating to the destruction of documents at HealthSouth subsequent to the receipt on September 17, 2002 of a request from the Securities and Exchange Commission (the "SEC") for certain documents pertaining to an investigation of HealthSouth's August 27, 2002 announcement (the "SEC Request") that was referred to in the October 21, 2002 Review.

DISCOVERY OF DESTROYED DOCUMENTS

On September 26, 2002, Fulbright attorneys reviewing files in a file room containing files of Brandon O. ("Brad") Hale (Executive Vice President Administration, Corporate Secretary and Compliance Officer), Malcolm E. ("Tadd") McVay (Chief Financial Officer), William Owens (Chief Executive Officer) and Weston Smith on the fifth floor of the Executive Office Tower (the **"Executive Level"**), noticed a large and a small shredder. Each shredder contained shreds in its collection bag (the **"September 26th Materials"**). When some of the shredded material was examined, such phrases as "mittal 1753" and "175 m" were noted. Some of the shreds appeared to be from e-mail documents. There was no indication of when the documents had been shredded. The Fulbright attorneys removed the contents of each shredder and took custody of them. The aggregate amount of shreds collected from both shredders fit into one banker's box.

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On October 2, 2002, Fulbright attorneys observed a Company employee shredding documents in the Network Services copier room, located in the North Wing of the third floor. Later that day a large bag of shreds was discovered in the same copier room beside a shredder, apparently awaiting ordinary pick-up by cleaning personnel. The Fulbright attorneys removed the bag from the corporate offices and took custody of it.

SCOPE OF FULBRIGHT'S SUPPLEMENTAL REVIEW

At the Company's request, Fulbright has sought to determine whether the shredding of the documents that were discovered on September 26 and October 2, 2002, or of any other documents, was done outside the routine and ordinary course of HealthSouth's business. In that regard, on October 23 and 24, 2002, Fulbright performed an inquiry and conducted interviews relating to HealthSouth's document retention efforts from September 17, 2002 to early October 2002.

Between October 23 and October 24, 2002, two Fulbright attorneys visited the HealthSouth Corporate headquarters in Birmingham and interviewed in person or by telephone, (i) Mary Esclavon, Assistant to Mr. Scrushy, Susan Evans, Assistant to Tom Carmen, Executive Vice President of Mergers and Acquisitions, Brandon Hale, Pam Hodges, Assistant to Mr. Owens, Malcolm McVay, William Owens, and Kathee Parks, Assistant to Messrs. Hale, McVay and Weston Smith; (ii) all Fulbright attorneys who discovered destroyed documents at HealthSouth during the course of Fulbright's Review; (iii) James Goodreau, Director of Corporate Security, HealthSouth Corporate, and Les Moore, Assistant Director of Security; and (iv) Lea Patterson, Lead Cash Coordinator for Group Health Claims, Network Services Department.

FACTUAL FINDINGS

Prior to the receipt of the SEC Request, HealthSouth did not have a formal, written policy regarding the retention and destruction of non-electronic documents. However, in consideration of: (i) common law individual privacy protections and federal requirements regarding the confidentiality of certain Medicare patient information (42 C.F.R. § 482.13(d)(1) ("The patient has the right to the confidentiality of his or her clinical records."), Medicare Hospital Manual 413 ("To insure the confidentiality of the [patient] records, destroy them by shredding, mutilation or other protective measures.")); (ii) the federal Health Insurance Portability and Accountability Act of 1996 ("HIPAA") security and privacy requirements (security requirements are in proposed rule form; mandatory compliance with the privacy requirements begins April 14, 2003); and (iii) in accordance with standard practices in the healthcare industry, HealthSouth routinely destroyed documents that contained private data regarding its patients. In addition, HealthSouth executives routinely destroyed documents that contained financial data or information they otherwise regarded as strategic or proprietary, including draft minutes of meetings of the Company's board of directors, draft press releases and draft contracts.

HealthSouth received the SEC Request on September 17, 2002 and retained Fulbright on September 18, 2002.

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On September 19, 2002, Fulbright requested orally and in writing that the Company act immediately to preserve documents.[1] On September 20, 2002, William W. Horton, Executive Vice President and General Counsel, directed all HealthSouth personnel to:

> IMMEDIATELY take all steps necessary to ensure that all documents electronic files and e-mails under your control are preserved until we can ensure that all relevant documents have been appropriately gathered and reviewed . . . . [P]lease make sure that nothing you control is destroyed or deleted. There is no need to send any documents anywhere at this time in connection with our review . . . . Again, strict compliance with this memorandum is critical.

On October 2, 2002, Lea Patterson, Lead Cash Coordinator for Group Health Claims, Network Services Department, destroyed material containing private and confidential patient information. In consideration of common law individual privacy protections and the federal requirements regarding the confidentiality of certain Medicare patient information, it has been the common practice of Network Services to periodically destroy patient identifying information by shredding relevant documents. Ms. Patterson stated to Fulbright that she believed the document retention memorandum she received from Mr. Horton was limited to email. Ms. Patterson also stated that she has not destroyed any documents since October 2, 2002, and displayed to Fulbright a cubicle filled with several boxes of computer printouts.

Fulbright notified Mr. Horton of its discoveries of shredded documents on September 26 and October 2, 2002, on the evening of October 2, 2002. On the same day, at the request of Fulbright, Mr. Horton sent another company-wide memorandum reiterating a "no-shredding" policy.

On or about October 3, 2002, when Richard M. Scrushy was advised of the shredding, he ordered James Goodreau, Director of Corporate Security, HealthSouth Corporate, to seize every shredder (approximately 50) in HealthSouth's corporate headquarters and to secure them under lock and key. Each of the sequestered shredders contained some amount of shredded materials. Mr. Goodreau undertook and completed this task on or about the same day and communicated such to Mr. Scrushy and to Mr. Horton by e-mail on October 4, 2002. Mr. Goodreau stated to Fulbright that HealthSouth has suspended all shredding of any documents in the corporate headquarters until the completion of the SEC investigation. *See* Attachment A (reports prepared by Mr. Goodreau).

Prior to October 3, 2002, many and perhaps most executives in the fifth floor Executive Level had small shredding machines in their offices, typically of the variety that fits on top of a

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[1] A shareholder derivative action and the first of several class action complaints relating to the Company's August 27,2002 announcement were filed against the Company on August 28, 2002. On September 3, 2002, Mr. Horton received an email from Michael Rediker, Esq., of the law firm Haskell Slaughter Young & Rediker, regarding the pending litigation and advising the Company, among other things, to suspend normal disposal and document retention policies during the pendence of the litigation with respect to relevant or even potentially relevant electronic files and paper files and to move relevant e-mails to a secure storage.

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wastebasket. Shredding machines also were available in at least two file rooms on the Executive Level. In addition, each executive has a "shred basket" the contents of which, prior to October 3, 2002, were collected and destroyed by Mr. Goodreau and other Executive Level staff as needed. Mr. Goodreau and all other Executive Level staff have informed Fulbright that they have not shredded documents in months, and Fulbright's examination of the contents of several shred baskets appeared to support that statement. *See, for example,* Attachment B (inventory of contents of William Owens' shred basket).

William W. Horton's October 2, 2002 memorandum generated a number of questions from the Company's facilities regarding routine shredding of materials not related to the SEC investigation. Mr. Horton in turn sought guidance from Fulbright as to how the Company might balance the preservation of documents and information relevant to Fulbright's Review and the SEC's Request against the Company's obligations to protect patients' privacy and confidentiality. In an email to Fulbright on October 2, 2002, Mr. Horton wrote:

> I sent out a company-wide memo reiterating a "no-shredding" policy. This has, not unexpectedly, generated a flood of questions from our facilities, ranging from the mundane ("Have questions:
>
> > Your direction not to shred anything. At the facility level we generate massive amounts of paperwork in the normal course of our daily routine. For example, copy of drivers [*sic*] license, insurance cards. Typically these are front and back. Naturally, in process of copying both sides you have duplicate of one side. WE also have errors on fee tickets which must be corrected. Did you intend to include this type of information in direction to not shred?
> >
> > Do you have guidance on storage of such material that would normally be shredded?")
> >
> > [T]o the profound ("Could you please explain/clarify how with this directive we are supposed to comply with the HIPAA laws that require shredding/proper disposal of documents containing patient information.").
>
> I would appreciate your prompt guidance on what will satisfy you, and what in your view will satisfy the SEC, etc., since we produce a vast quantity of irrelevant paper that must be disposed. In particular, I would appreciate hearing whether you have any concern about the routine paperwork at the facility level. Your attention and response will be appreciated.

On October 8, 2002, Fulbright provided HealthSouth with guidance regarding its document retention policy pending its Review and the SEC's investigation. Among other things, Fulbright advised that:

> "[R]outine paperwork at the facility level" does not necessarily have to be retained in consideration of this firm's review and the pending SEC investigation. It would appear to be sufficient if the strict prohibition against the shredding of documents would only apply to the files of the following [HealthSouth] personnel and their secretaries and personal assistants: (i) all Executive Officers; (ii) Ambulatory Services East and West, Inpatient Operations, and Corporate Office: (a) Senior Vice Presidents, (b) Group Vice Presidents, (c) Vice Presidents, (d) Regional Vice Presidents, and (e) Assistant Vice Presidents; (iii) John Monteith (if he is not otherwise covered under the personnel categories herein); and (iv) individual HealthSouth hospital chief executive officers and chief financial officers. With one possible exception explained herein, other [HealthSouth] personnel should continue to treat company documents consistent with both federal law, including but not limited to the Medicare hospital conditions of participation applicable to medical record services codified at 42 C.F.R. 482.24 (as interpreted in Medicare Hospital Manual 413), and the company's existing document retention policy. The possible exception is that any [HealthSouth] employees that have any documents in any way relevant to the company's August 27, 2002 press announcement must preserve such documents.

Fulbright's complete guidance is set out in full in Attachment C.

Correspondence between Fulbright and Mr. Horton continued from October 8, 2002 through October 14, 2002 in order to develop the details of a policy that would be as conservative as possible with regard to the preservation of documents pending Fulbright's Review and the SEC investigation, yet nevertheless be sensitive to the Company's business needs and privacy obligations. On October 15, 2002, Mr. Horton distributed a further memorandum clarifying the documents to be retained. The text of Mr. Horton's October 15, 2002 memorandum is set out in Attachment D.

RECONSTRUCTION OF DOCUMENTS

Fulbright has attempted to determine whether it is feasible to reconstruct the shredded documents Fulbright removed from HealthSouth's offices. The contents of the smaller shredder in the Executive Level file room were cut into strips approximately one-eighth of an inch wide. The contents of the larger shredder in the Executive Level file room and the contents of the bag from the Network Services copy room were cross-cut into pieces approximately one-eighth of an inch by one inch. Fulbright has contacted several third-party vendors that offer document reconstruction services. One such vendor, Corefacts, estimated that this material could be reconstructed in two to three weeks, although it cannot be guaranteed that they can completely reconstruct the contents of each bag.

CONCLUSION AND RECOMMENDATIONS

HealthSouth is required by federal regulations and common law individual privacy protections to ensure patients' privacy and the confidentiality of their medical information. HealthSouth routinely destroys documents containing certain patient information in order to

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comply with these requirements and protections. The only clear instance Fulbright discovered of shredding during this period was in the Network Services Department on October 2, 2002. Fulbright is unable to determine when any other documents were destroyed, why they were destroyed, who destroyed them or what was contained in the destroyed documents.

Fulbright recommends that the HealthSouth Board of Directors: (1) implement a formal document retention policy and, as a temporary measure during the SEC investigation, take steps to ensure the preservation of all documents potentially relevant to the SEC investigation; (2) preserve and catalog all material in the shredders currently impounded at HealthSouth's corporate headquarters as well as the material removed by Fulbright; (3) ascertain when to provide this report to the SEC pursuant to their investigation; and (4) consider the retention of an independent third-party vendor to attempt reconstruction of: (a) the September 26th Materials, and (b) a random selection of other selected shredded materials.

Fulbright & Jaworski L.L.P. has prepared this letter solely for the purpose of informing the Board of Directors of its findings regarding the destruction of documents by HealthSouth personnel subsequent to September 17, 2002. The Board of Directors should not view anything in this letter as a conclusion with respect to the potential outcome of any regulatory investigation or legal action. Fulbright & Jaworski L.L.P. expresses no views as to the inferences that may be drawn from the facts and circumstances contained in this letter. In addition, please note that this letter is not a comment on any other matter Fulbright & Jaworski L.L.P. reviewed or may be asked to review in the future.

Very truly yours,

Fulbright & Jaworski L.L.P.

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Attachment A

Report by James Goodreau

HEALTHSOUTH

One HEALTHSOUTH Parkway
Birmingham, AL 35243

MEMORANDUM

TO: File
FROM: Jim Goodreau
DATE: October 3, 2002

SUBJECT: Shredder documents in fifth floor file room

I assigned Scott Pierce (Security) to escort/assist the outside attorney group while they reviewed items in the fifth floor file room. Scott advised me that the attorneys removed items from that file room and did not want him in the room while they searched it. They asked him to leave the room and shut the door. Scott stated that he observed the attorneys collect and remove shredded materials that were located inside the shredder in the file room. It is important to note that the shredder in that area is very large and seldom requires the contents be removed. Therefore, the materials that were removed could be items shredded over a period of several months, as this shredder is very rarely used.

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—Original Message —

From: Goodreau, Jim
Sent: Friday, October 04, 2002 10:10 AM
To: Scrushy, Richard
Cc: Horton, Bill
Subject: FYI

All shredders at the Corporate office have been secured in a room on the 1 st floor, this includes shredders that were in individual offices. Access to this room is limited to Les Moore and myself, and the room has 24 hour video coverage. In addition, you asked me to look into a situation which took place on the third floor north area of Network Services. Lea Patterson of Network Services did shred some items, however, those items contain proprietary information which accompanies the Group Health Capitation Checks. This is membership information which contains social security numbers, names, and the date of birth of the individual covered. We are required under the Privacy Act to ensure the aforementioned information is properly disposed of in order to protect the privacy of the individual. It has been the common practice of Network Services to periodically destroy these records by shredding them. There will be no shredding of any documents in the Corporate Offices until the completion of the SEC investigation.

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Goodreau, Jim

From:	Patterson, Lea
Sent:	Thursday, October 03, 2002 4:24 PM
To:	Goodreau, Jim; Moore, Les
Subject:	Shredding

Per our conversation, I would like to reaffirm I did shred on October 2, 2002. I was disposing of proprietary information which accompanies the Group Health Capitation Checks. This is membership information which contains social security numbers, names, and dates of birth. I shredded approximately 4 reams of membership prior to receiving the email requesting we retain all documents. This membership will continue to come with the capitation checks and will need to be stored somewhere off site eventually as we discussed.

LEA PATTERSON
LEAD CASH UNIT COORDINATOR
1-800-634-8536 EXT. 3530
1-205-262-3928. FAX
LEA.PATTERSON@HEALTHSOUTH.COM

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Attachment B

Inventory of William Owens's Shred Basket

Date	Document
10/21/2002	Activity Report
10/02/2002 - 10/03/2002	Itinerary for trip to D.C for Bill Owens, Dan Riviere, Rob Tillman and Susan Smith
10/02/2002	Email from Bill Horton to Bill Owens, William McGahan regarding attached draft press release
10/01/2002	Emails from Sean Huffman to MdeCarlo@methjodistsports.com regarding meetings and group therapy
09/24/2002	Payor Contracting and Support - contract breakdown by Operating Area
09/24/2002	Letter from B V Clemons (AAPT) to Bill Owens
09/20/2002	Letter from Charlene Portee (AAPT) to Bill Owens
09/19/2002	Final -- HealthSouth Corporation Conference Call
09/09/2002	Will Hicks HealthSouth Investment Overview PowerPoint printout
06/1998 - 09/2002	Timeline
08/13/2002	Email from BridgetS@comphealth.com to Bill Owens; cnewhall@nea.com; Pam Hodges; and mambrose@nea.com regarding CompHealth Board Meeting
06/28/2002 - 08/02/2002	Workers' Compensation Current Lost Time Report
07/24/2002	Email from Bill Horton to ldsjr66@aol.com; phil390@bellsouth.net; jackchamberlin@aol.com and Brad Hale regarding Information for Compensation Committee Meeting
07/20/2002	Memo from Judy Dean to Bill Owens and Susan Jones regarding National Charts/Graphs from 45 day AR hit list - Surgery and Diagnostic
07/15/2002	Model Assumptions - Income statements and transaction summaries
07/15/2002	Revised - Model Assumptions - Income statements and transaction summaries
07/12/2002	Memo from Tadd McVay to R. Scrushy, B. Owens, W. Smith, E. Harris, B. Horton, R. Davis and J. Brown regarding Debt Repurchases

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07/09/2002	Meeting Agenda (post-it "Bill O." and "Tom Williams Porsche $544.87")
Jul-02	Project Longhorns Overview Power Point printout
Jul-02	UBSWarburg Project Longhorns Discussion Materials
06/21/2002	Memo from Richard Davis to Bill Owens, Tadd McVay, Weston Smith, Emery Harris, Bill Horton, Jason Brown, Catherine Fowler regarding Fixed to Floating Swap
06/17/2002	LostTime Cases Review Over 6 Weeks
11/21/01 - 05/21/02	Trade Line
05/17/2002	Email from John Dwyer to Bill Owens regarding attached Revised Term Sheet
04/29/2002	Pro Forma - Proposed (post-it "Marc Goff, Jessica Nantz")
04/25/2002	Inland Marine Service Order
04/24/2002	Email from Scott Wollard to Thom Carman, Roderick Oneill regarding The Fitness Company
04/24/2002	Project FIT printout
04/12/2002	Letter from Bruce Fischman to Gerald Scrushy regarding HealthSouth ADA Cases
Apr-02	Sumamry Description & Financial Information
Apr-02	HealthSouth Corporation Discussion Materials - UBS Warburg
03/31/2000 - 2002	Internal Projections
03/31/2002	Facility Incentive Plan
03/19/2002	Memo from Scott Wollard (UBSWarburg) to Bill Owens regarding remarks on accretion/dilution model, income statement analysis and wall street consensus
03/19/2002	UBS Warburg Transaction Overview- Crimson
03/15/2002	Recommended Promotions - Board of Directors Meeting
03/12/2002	Revised Draft of 10-K
03/12/2002	Press Release "HealthSouth Announces Record Revenues; Operating Earning Per Share of $.22, up 16% for Fouth Quarter"
03/09/2002	Internal Memo from Weston Smith to Bill Owens re FIT Due Diligence
03/07/2002	Physician Activity Report - Uribe, Constance Gail, MD
03/07/2002	Physician Activity Report - Farrell, Patrick, Unk
03/07/2002	Physician Activity Report - Herr, Timothy Mark, MD
03/07/2002	Physician Activity Report - Miller, Louis Mark,

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	MD
03/04/2002	Email from Kim Kettl to Jessica Nantz regarding Pet Scans
03/01/2002	Fax from Eric Hanson to Bill Owens regarding attached letter of recommendation
02/28/2002	Volume Comparison - Impatient Discharges by Market Leader
02/28/2002	Salary - Actual vs. Budget spreadsheet
02/28/2002	Letter from Robert Montgomery to Bill Owens regarding Polawana Property
02/28/2002	Volume Comparison - Total By Market Leader and Manager
02/27/2002	Letter from Larry Lanford (Jefferson County Commission)to Bill Owens regarding political support
02/26/2002	Letter from William Horton to Dorian Daley (Oracle) regarding Termination of Strategic Partnership
02/22/2002	Memo from Brett Grauss to Bill Owens attaching a HCA Proposal
02/22/2002	Workers' Compensation Current Lost Time Report
02/19/2002 - 02/21/2002	Cullman Surgery Center - opposition letters
02/20/2002	Memo from Jack Hawkins to Members of the Board of Trustees regarding attached article from the Alabama School Journal
01/23/2002	Letter from George Pugh to Rick Katz and Peggy Wellman regarding fate of the funds at Summit Bank
2001 - 2002	HealthSouth Hospitals of Las Vegas Combined Financials
2002	Facility Examples
07/25/2001	Options and Awards Summary (post-it "from Brad Hale")
07/03/2001 - 07/21/2001	Employee Expense Report - William Owens (Post-It "Replacement Exp Rpt. From Kay M.)
04/30/2001	HealthSouth - Rob Thomson - Income Statement (New Store; Same Store 02,03,04,05,06; Medical Center; Same Store Impatient; Same Store Outpatient; Same Store Surgery; Same Store Diagnostic)
04/30/2001	HealthSouth - Larry Taylor - Income Statement (New Store; Same Store 02,03,04,05,06; Medical Center; Same Store Impatient; Same Store Outpatient; Same Store Surgery; Same Store Diagnostic)

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04/30/2001	HealthSouth - Pat Foster - Income Statement (New Store; Same Store Impatient; Same Store Outpatient; Same Store Surgery; Same Store Diagnostic)
03/31/2001	Per Working Day Analysis - Encounters and Expenses (post-it"Bill Owens - complete set")
03/31/2001	Per Working Day Analysis - Encounters and Expenses (post-it "Pat Foster")
02/28/2001	EBITDA spreadsheet
2001	Draft letter to Eugene Smith regarding termination of employment with HealthSouth
n/a (2001)	Partners/projected increase in distribution
2Q00 - 2Q01	Consolidated Statements of Income Comparison Summary
05/24/2000	Walt Disney World Coronado Springs Resport - 2003 Contract Cancellation
04/26/1999	Invoice - Yamaha of Sylacauga
06/01/98	Medicare Focus Journal - Important Information for Medicare Providers
08/13	Phone Message for Bill from Darby
August	Patient Feedback Summaries
n/a	Facility Financial Report
n/a	HealthSouth Counteroffer on Purchase of Doctors Hospital by University of Miami
n/a	HealthSouth Surgery Center of Hilton Head, L.P. PowerPoint printout (post-it "For Bill Owens from Suzanne)
n/a	Post-It
n/a	Phone Message for Bill from Mary
n/a	Business Card of Ken Woodby - Pilot Aviation Department
n/a	paper shred with phone number 310-454-6591
n/a	MapQuest.com directions
n/a	Draft License Agreement between HealthTech, Inc. and HealthSouth Corporation
n/a	Power Point slide printout
n/a	JPMorgan Executive Summary Power Point printout
n/a	Power Point slide printout - New Ideas to Strategically Grow Markets
n/a	PT State Analysis - Plan B
n/a	Check shreds
n/a	Project Bulldogs Term Sheet
n/a	Project Bulldogs Key Shareholder Returns

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n/a	Note - "PHICO Almost Bankrupt Insurance Company in PA - Faith"
n/a	HET Roll Out PowerPoint Printout
n/a	HealthSouth & HET Revenue Analysis
n/a	EPS Sensitivity Analysis on CRIMSON
n/a	Miscellaneous email page(?) (Post-it "From Randy Mink - Has not been sent. Has been reviewed & approved (clinically))
n/a	Year 1- 4 quarter spreadsheet
n/a	Draft HS-HET Strategic Agreement between NET, Inc. and HS Corporation
n/a	Draft Promotion Agreement between HealtheTech, Inc. and HealthSouth Corporation
n/a	2004-2006 HealthSouth Administrators Meeting Locations Plan
n/a	Draft CMS Capital Ventures, Inc. Consent in Lieu of Special Meeting of Stockholders (note "Bill- FYI Will Hicks has signed this in your absence")
n/a	PowerPoint presentation printout
n/a	PowerPoint presentation printout (post-it "for Bill's Review")
n/a	Proposed Promotions
n/a	PowerPoint presentation printout (post-it "Bill- your presentation for tommorrow with notes on Deta - Jes")
n/a	Budget Bonus Plan
n/a	photocopies of notebook pages
n/a	SEC Form 10-K HealthSouth Corporation
n/a	Phone Message for Bill from Thom
n/a	cell phone care charger
n/a	candy wrappers

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Attachment C

Guidance from Fulbright & Jaworski L.L.P. regarding document retention

"[R]outine paperwork at the facility level" does not necessarily have to be retained in consideration of this firm's review and the pending SEC investigation. It would appear to be sufficient if the strict prohibition against the shredding of documents would only apply to the files of the following HealthSouth personnel and their secretaries and personal assistants: (i) all Executive Officers; (ii) Ambulatory Services East and West, Inpatient Operations, and Corporate Office: (a) Senior Vice Presidents, (b) Group Vice Presidents, (c) Vice Presidents, (d) Regional Vice Presidents, and (e) Assistant Vice Presidents; (iii) John Monteith (if he is not otherwise covered under the personnel categories herein); and (iv) individual HealthSouth hospital chief executive officers and chief financial officers. With one possible exception explained herein, other HealthSouth personnel should continue to treat company documents consistent with both federal law, including but not limited to the Medicare hospital conditions of participation applicable to medical record services codified at 42 C.F.R. 482.24 (as interpreted in Medicare Hospital Manual 413), and the company's existing document retention policy. The possible exception is that any HealthSouth employees that have any documents in any way relevant to the company's August 27, 2002 press announcement must preserve such documents.

The federal Health Insurance Portability and Accountability Act of 1996 ("HIPAA") includes both security and privacy requirements. The disposal of documents containing protected health information is addressed in the HIPAA proposed security regulation (63 Fed. Reg. 43242 (Aug. 12, 1998)). The Centers for Medicare & Medicaid Services ("CMS"), however, has not yet promulgated these requirements in a final rule, and thus, these requirements at the present time do not have the force of law. Until CMS publishes a final rule implementing the security requirements, HealthSouth is not strictly required to comply with the proposed requirements. Of course, the company may decide to follow now the security requirements even though only proposed. If this is the case, and you desire specific guidance regarding attempting to adhere to these proposed security requirements, please let us know, and we will furnish you with more detailed compliance guidance.

The HIPAA privacy requirements govern the use and disclosure of protected health information (for example, information regarding demographics, and the physical or mental condition of an individual). While these requirements do not specifically address the issue of the proper disposal of documents containing protected health information, the requirements do include other provisions (for example, the rights of patients to access and amend their files), which may affect how a "covered entity" under the HIPAA requirements disposes of its records. The HIPAA privacy requirements became effective on April 14, 2001 (65 Fed. Reg. 82462), with certain modifications to these requirements to become effective October 15, 2002 (67 Fed. Reg. 53182). However, health care providers are not strictly required to comply with the privacy requirements until April 14, 2003. Again, the company may decide that it will now attempt to follow the HIPAA privacy requirements even though not strictly required to do so until next year. If so, and you want specific compliance suggestions from us, please let us know.

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Attachment D

Memorandum from William W. Horton, Esq. regarding document retention

MEMORANDUM

FROM: Bill Horton
EVP & Corporate Counsel

DATE: October 15, 2002

RE: Document Retention/Disposition/Shredding

This is a further clarification to my previous memoranda regarding the preservation of documents. For purposes of this clarification and except as otherwise specified below, "documents" generally should be considered to be written materials, including letters, memoranda, email correspondence, and notes, either prepared by or sent to Company personnel relating to: (i) clinical protocols or coding, billing, or reimbursement instructions relating to therapy services provided in either the freestanding setting (rehabilitation agencies, and comprehensive outpatient rehabilitation facilities) or the hospital setting; (ii) accounting policies; (iii) filings with the Securities and Exchange Commission; and (iv) trading in the Company's securities. The term "documents" excludes newspapers, magazines, seminar brochures, junk mail, or similar materials not related to the matters described in (i) - (iv) above. Until further notice from Richard Scrushy, Bill Owens, or me, there must not be any destruction, removal, or other disposition of any documents in the personal possession or control of the following persons (including their secretaries or assistants): (a) all corporate officers, whether based in the corporate office or in the field; and (b) all facility administrators and controllers/CFOs.

In addition, (i) there must not be any destruction, removal, or other disposition of any documents in the corporate office, regardless of who possesses or controls such documents, until further notice from one or more of the above-listed individuals; and (ii) under no circumstances should anyone at any location destroy, remove, or otherwise dispose of any documents relevant to the subject matter of our August 27 public announcement concerning the impact of Medicare Program Transmittal 1753, group therapy coding, and the proposed tax-free separation of our surgery center division and related management changes. All other documents not related to the matters described in this paragraph and the preceding paragraph, including documents containing patient identifying information or other protected health information, should be handled in accordance with applicable law and the Company's existing document retention policies and may be destroyed or otherwise disposed of in accordance with such policies. Thank you for your assistance in helping us ensure that all documents that we are required to maintain and preserve in connection with pending investigations and litigation are appropriately handled, and for your patience and cooperation during this process. Please contact me directly if you have any questions regarding the proper treatment of any particular document(s) under this clarification.

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FULBRIGHT & JAWORSKI L.L.P.
A REGISTERED LIMITED LIABILITY PARTNERSHIP
666 FIFTH AVENUE, 31ST FLOOR
NEW YORK, NEW YORK 10103-3198
WWW.FULBRIGHT.COM

TELEPHONE: (212) 318-3000 FACSIMILE: (212) 318-3400

October 29, 2002 **Tab 64**

Privileged and Confidential:
Attorney Work Product Doctrine Applies

BY HAND DELIVERY

The Board of Directors of HealthSouth Corporation
One HealthSouth Parkway
Birmingham, Alabama 35243

Ladies and Gentlemen:

As part of Fulbright & Jaworski L.L.P.'s (or "**F&J**") continuing review of HealthSouth Corporation ("**HealthSouth**" or the "**Company**"), pursuant to its engagement, the Board of Directors of HealthSouth requested that by October 22, 2002, Fulbright & Jaworski L.L.P. set forth its findings regarding the facts and circumstances surrounding the exercise of options and sale of HealthSouth common stock by Richard M. Scrushy on or about May 14, 2002 and the transfer of HealthSouth common stock to HealthSouth by Mr. Scrushy in satisfaction of the principal of a loan from HealthSouth on or about July 31, 2002 (the "**October 21, 2002 Review**"). F&J delivered the October 21, 2002 Review to the Board on October 22, 2002.

The conclusion set forth in Section IV of the October 21, 2002 Review states in part:

> During the course of its Review, Fulbright & Jaworski L.L.P. has uncovered no oral interview or written document (including electronic data) that establishes that Mr. Scrushy was aware at the time of the Option Exercise and Sale, on May 14, 2002, of the pending issuance of Transmittal 1753. Fulbright & Jaworski L.L.P. also has uncovered no oral interview or written document (including electronic data) that establishes that Mr. Scrushy knew prior to the Loan Repayment, on July 31, 2002, of: (i) Transmittal 1753; (ii) the application of Transmittal 1753 to the Company's various outpatient therapy services; or (iii) the transmittal's potential financial effect on the Company, other than that Mr. Scrushy was present during a "Monday Morning Meeting" on July 8, 2002 during which the existence of Transmittal 1753 was referenced.

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Upon its review and consideration of the October 21, 2002 Review, the Board has requested that Fulbright & Jaworski L.L.P. assess, to the extent ascertainable, additional facts and circumstances relating to the "Monday Morning Meeting" (as that term is defined below and in the October 21, 2002 Review) which was held at the Company's corporate offices on July 8, 2002, and in particular, any report or presentation which was made at such meeting which mentioned or discussed Transmittal 1753 or the policy contained therein. This letter sets forth F&J's findings from such inquiry, and supplements F&J's letter dated October 1, 2002 and the October 21, 2002 Review. The entire contents of the October 21, 2002 Review are incorporated into and made a part of this letter as though set forth in full herein.

The chronology set forth in Section III of the October 21, 2002 Review identifies that certain members of HealthSouth senior management other than Richard Scrushy had varying levels of knowledge of Transmittal 1753. This finding is not modified by the findings set forth in this letter. Should F&J discover any facts or circumstances that are material to the matters expressed in this letter or in the October 21, 2002 Review with respect to Mr. Scrushy, F&J will supplement its findings. At your request, Fulbright & Jaworski L.L.P. continues its Review of certain matters relating to Transmittal 1753.

I. INTERVIEWS OF CERTAIN HEALTHSOUTH PERSONNEL CONCERNING THE JULY 8, 2002 MONDAY MORNING MEETING

Fulbright & Jaworski L.L.P. has interviewed the following HealthSouth personnel concerning the facts and circumstances surrounding the July 8, 2002 Monday Morning Meeting, some more than once: Brooks Adams, Jean Davis, Patrick A. Foster, Brandon O. ("Brad") Hale, Jason Hervey, William W. ("Bill") Horton, M. Sean Huffman, Malcolm E. ("Tadd") McVay, Frederick L. ("Rick") Schmitt, Richard M. Scrushy, and Susan Jones-Smith. Set forth below are the results of these interviews.

On July 8, 2002, the Company held its "Monday Morning Meeting," a regularly scheduled meeting that is held approximately once a month, at which approximately 65 to 100 of HealthSouth's managers make presentations of 30 seconds to two minutes each to the Chief Executive Officer and the President. The Monday Morning Meeting, which usually lasts approximately one and one half to two hours, is intended to generally inform the Chief Executive Officer and the President of any developments and activities for each executive and manager's region, division, or group for the period since the previous Monday Morning Meeting, and of the planned activities for each manager making a presentation for the next several weeks. In advance of the meetings, the managers prepare an "Activity Report," outlining such developments and their own activities. The Activity Reports may be viewed by Messrs. Scrushy and Owens during Monday Morning Meetings using a laptop computer as the presentations are made. The managers who make oral presentations often report on some but not all of the contents of their "Activity Report" during the 30 seconds to 2 minutes allotted to each of them for their presentations.

According to her interviews with F&J and her Activity Report, during her presentation at the July 8, 2002 Monday Morning Meeting, Ms. Jones-Smith addressed eight different subjects.

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Ms. Jones-Smith has stated that the focus of her presentation at the July 8, 2002 Monday Morning Meeting was to announce that HealthSouth's cash collections were at a "record high" of over one-billion dollars in that financial quarter, that she was "excited" about announcing this fact, and that she began her presentation with the expression "Good news." Also, Ms Jones-Smith's Activity Report stated that she was "[w]orking with BCBS[-]AL on interpretation of various [M]edicare regulations ([T]ransmittal 1753 pertaining to Group Therapy). Steve Speil is arranging a meeting with CMS for us to discuss the various interpretations." Ms. Jones-Smith has explained that she read this statement verbatim in approximately 16 seconds at the July 8, 2002 Monday Morning Meeting, and that her entire presentation at that meeting, consisting of each of the eight different subjects, lasted, in total, approximately "one minute or so." She has stated that she usually reads "directly" and "verbatim" from her Activity Report, and "pretty much sticks to what is on her [Activity] Report," when she makes her presentations at the Monday Morning Meetings. She has stated that after her presentation at the July 8, 2002 Monday Morning Meeting, there was no follow-up discussion regarding Transmittal 1753 at that meeting.

According to Ms. Jones-Smith, no one at the July 8, 2002 Monday Morning Meeting would have had "any reason" to focus on her reference to Transmittal 1753 or to have known what Transmittal 1753 was, unless they had already been made aware of the group therapy issue. She identified such HealthSouth personnel as Rick Schmitt, Bill Horton, Larry Taylor and Jean Davis. She further stated that she did not intend for anyone other than these HealthSouth personnel "to pay attention" to the reference to Transmittal 1753. Ms Jones-Smith stated that she only mentioned Transmittal 1753 so that these HealthSouth personnel would know that she was working on the matter. She further recalled that she used the term "group therapy" in conjunction with the term Transmittal 1753 because she realized that the reference to Transmittal 1753 itself was "meaningless" to the attendees at the meeting, with the exception of the HealthSouth personnel who had already been made aware of the group therapy "issue."

With the exception of Ms. Jones-Smith, no other HealthSouth personnel whom F&J has interviewed has stated that they mentioned Transmittal 1753 or any issue relating to group therapy at the July 8, 2002 Monday Morning Meeting.[1] Attendees of the July 8, 2002 Monday Morning Meeting, other than Ms. Jones-Smith, have described their recollections of what they heard Ms. Jones-Smith say, or not say, about Transmittal 1753 or any issue concerning group therapy at that meeting as follows:

- Mr. Adams has stated that he did not hear Ms. Jones-Smith mention Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting, and that Ms. Jones-Smith first mentioned Transmittal 1753 either during the August 27, 2002 Monday Morning Meeting or following that meeting.

---

[1] It should be noted that the last entry on Mr. Horton's Activity Report for the June 17, 2002 Monday Morning Meeting states: "Follow up with Operations and Reimbursement on new Medicare Carriers Manual language re: group therapy." However, Mr. Scrushy did not attend the June 17, 2002 Monday Morning Meeting. In addition, Mr. Horton has stated that he does not recall making any statement regarding Transmittal 1753 or any issue concerning group therapy at a Monday Morning Meeting.

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- Ms. Davis has stated that she does not recall Ms. Jones-Smith or anyone else mentioning Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting, and that July 8, 2002 was her first day back from vacation. She has also indicated that if she herself discussed Transmittal 1753 or any issue concerning group therapy at any Monday Morning Meeting, it would have been reflected in her Activity Report for such meeting. The only Activity Report for Ms. Davis that mentions any issue concerning group therapy is her report for the August 20, 2002 Monday Morning Meeting, which states, in part: "Meet with CMS, w S. Smith and L. Taylor on outpatient reimbursement changes."

- Mr. Foster has stated that he recalls Ms. Davis mentioning Transmittal 1753 or the group therapy issue at a Monday Morning Meeting held on August 20, 2002 or "more likely" September 9, 2002, and that he recalls Ms. Jones-Smith mentioning Transmittal 1753 during her presentation at a Monday Morning Meeting prior to the one at which Ms. Davis mentioned Transmittal 1753 or the group therapy issue. He has stated that he does not recall the exact date of the meeting at which Ms. Jones-Smith mentioned Transmittal 1753, but that at the time of that meeting, "it wasn't a big deal," and he is "sure" it was after she had received an email from Blue Cross Blue Shield of Alabama on the subject.

- Mr. Hale has stated that he did not hear Ms. Jones-Smith mention Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting.

- Mr. Hervey has stated that he did not hear Ms. Jones-Smith mention Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting.

- Mr. Horton has stated that he does not recall Ms. Jones-Smith mentioning Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting.

- Mr. Huffman has stated that he did not hear Ms. Jones-Smith mention Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting, that he takes detailed notes of the matters mentioned at the Monday Morning Meetings, and that his notes do not reflect that Ms. Jones-Smith mentioned either subject.

- Mr. McVay has stated that he did not hear Ms. Jones-Smith mention Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting, that he is "primarily focused" on his own presentations at the Monday Morning Meetings, and that when he is not presenting, he focuses on "work that [he] brings with [him] to the meetings."

- Mr. Schmitt has stated that he "honestly do[es] not remember" whether Ms. Jones-Smith mentioned Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting.

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- Mr. Scrushy has stated that Ms. Jones-Smith "did not say anything" about Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting.

- Mr. Taylor has stated that he does not recall Ms. Jones-Smith mentioning Transmittal 1753 or any issue concerning group therapy at the July 8, 2002 Monday Morning Meeting. He has stated that the term "Transmittal 1753" did not have any "special meaning" to him on July 8, 2002 even though he had heard the term before and, prior to July 8, 2002, he was working on the definition of "group therapy" and the application of Transmittal 1753 thereto.

The Activity Reports for the Monday Morning Meetings are available for inspection.

II. CONCLUSION

In view of the October 21, 2002 Review and the Board's request that Fulbright & Jaworski L.L.P. make further inquiry with respect to the matters contained herein, and based on the additional factual findings set forth above, Fulbright & Jaworski L.L.P. has uncovered no oral interview or written document (including electronic data) that establishes that Mr. Scrushy was aware at the time of his option exercise and sale of HealthSouth common stock on May 14, 2002, of the pending issuance of Transmittal 1753. Fulbright & Jaworski L.L.P. also has uncovered no oral interview or written document (including electronic data) that establishes that Mr. Scrushy knew prior to the time of the transfer by Mr. Scrushy of HealthSouth common stock to HealthSouth on or about July 31, 2002, in satisfaction of the principal amount of a loan made to him by HealthSouth under its 1999 Executive Equity Loan Plan, of: (i) Transmittal 1753; (ii) the application of Transmittal 1753 to the Company's various outpatient therapy services; or (iii) the transmittal's potential financial effect on the Company.

Fulbright & Jaworski L.L.P. has prepared this letter solely for the purpose of informing the Board of Directors of its findings regarding the facts and circumstances surrounding the July 8, 2002 Monday Morning Meeting and whether, and to what extent, Transmittal 1753 or the policy addressed therein was mentioned or discussed at such meeting. The Board of Directors should not view anything in this letter as a conclusion with respect to the potential outcome of

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any regulatory investigation or legal action. Fulbright & Jaworski L.L.P. expresses no views as to the inferences that may be drawn from the facts and circumstances contained in this letter. In addition, please note that this letter is not a comment on any other matter Fulbright & Jaworski L.L.P. reviewed or may be asked to review in the future.

Very truly yours,

Fulbright & Jaworski L.L.P.

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Sheet1

HEALTHSOUTH Corporation Fees

	8/27/96 Through 9/30/97	Through 12/31/97	Total
12/31/97 audit		75,000	75,000
12/31/96 audit	382,500		382,500
1996 Postmt Audits	750,000		750,000
Corporate Compliance Program (160,000 x ½)	80,000	40,000	120,000
Florida Separate Opinion Audits and Methodist Hospital	140,000		140,000
Information Security Review Project	130,000		130,000
Lotus Notes Project	68,595		68,595
Other ISAAS Projects	48,600		48,600
Registration Statements:			
ReadiCare S-4	45,000		45,000
Fort Sutter Surgery Center S-4	20,000		20,000
Health Images S-4	45,000		45,000
Horizon/CMS S-4	165,000		165,000
Stock Option S-8's	15,000		15,000
Health Images S-3	5,000		5,000
Health Images 8-K Financial Statements	20,000		20,000
Other Miscellaneous Audits:			
Advantage Healthcare Benefit Plan		16,000	16,000
SCA Development Inc.	30,000		30,000
Eastern Rehab Network	40,000	5,000	45,000
Chesapeake Rehabilitation Hospital	15,000		15,000
Larkin Hospital	13,000		13,000
Boca Raton O/P Surgery Center	9,500		9,500
SCA Development Company NASD Mock Audit	9,000		9,000
ReadiCare	30,000	20,000	50,000
Horizon/CMS Long-Term Care Division	75,000	100,000	175,000
Horizon/CMS Comp Health Division	50,000	125,000	175,000
Tax Services:			
HRC Sports Medicine Council		3,400	3,400
Tax Planning - Austrian acquisition		58,000	58,000
DHC Franchise tax issues		1,500	1,500
Horizon/CMS 5/31/97 federal and state tax returns		200,000	200,000
Expenses ***	325,893	110,500	436,393
Total	2,512,088	754,400	3,266,488

*** Does not include expenses related to corporate compliance

LESS:	
1997 Year end audit	75,000
1997 Year end audit expenses	11,250
Corporate Compliance	120,000
Tax Services	262,900
	2,797,338

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What Ernst Did for HealthSouth

Proxy Document Says Company Performed Janitorial Inspections Misclassified as Audit-Related

By Jonathan Weil

Ernst & Young LLP collected $2.6 million from **HealthSouth** Corp. for conducting janitorial inspections of the health-services company's facilities in 2000 and 2001 and advised it to classify the payments as "audit-related fees," leading HealthSouth to make inaccurate public disclosures about **Ernst & Young**'s fees for nonaudit services.

The brainchild of former HealthSouth Chairman and Chief Executive Richard Scrushy, the inspections were part of a program HealthSouth called "Pristine Audits." Despite the name, these reviews had nothing to do with Ernst's audits of the company's financial statements. Rather, the primary purpose of the inspections was to check the cleanliness and physical appearance of HealthSouth's approximately 1,800 surgical and rehabilitation facilities.

Under the program, Ernst made unannounced visits to each facility once a year, using dozens of junior-level accountants who were trained for the inspections at HealthSouth's Birmingham, Ala., headquarters. The accountants carried out the reviews armed with a 50-point checklist designed by Mr. Scrushy. The checklist included seeing if magazines in waiting rooms were orderly, the toilets and ceilings were free of stains, and the trash receptacles all had liners. HealthSouth paid Ernst more money to inspect its facilities than it did to audit its books.

An Ernst spokesman, Donald Howarth, says: "E&Y believes that HealthSouth's fees were properly classified." He declined to comment when asked how the pristine audits were related to HealthSouth's financial-statement audits. HealthSouth's new management team takes a different view. "HealthSouth relied on Ernst & Young to classify the audit- and nonaudit-related fee information," says Andrew Brimmer, a HealthSouth spokesman. "We do not consider the pristine audit work to be related to the financial audit."

The wording of the disclosures, contained in HealthSouth's two most recent proxy statements, came amid widespread investor criticism over hefty fees auditing firms receive from corporate clients for nonaudit services. Since 2000, when the Securities and Exchange Commission began requiring auditor-fee disclosures, audit fees at large companies typically have been about one-third the size of the fees paid to auditors for other services. The disclosures have prompted many investors to complain that accountants might not be impartial and independent in audits with so much other business at stake.

Many companies, encouraged by their auditors, have tried to allay such concerns by voluntarily disclosing how much of their fees for "other" services are "audit-related." The SEC's 2000 rules didn't envision this practice or define the term "audit-related." But it would be considered improper for a proxy to use the term "audit-related" in a false and misleading way. More-common ex-

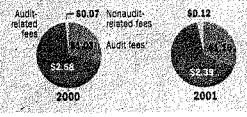
Please Turn to Page C3, Column 1

Hardly a Clean Bill of Health

"Pristine Audits" (form shown, below left) were the brainchild of former HealthSouth Chairman and CEO Richard Scrushy. Despite the name, the primary purpose of the inspections, by Ernst & Young, was to check the cleanliness of HealthSouth's approximately 1,800 surgical and rehabilitation facilities. Below, a HealthSouth sports-medicine facility in an Evanston, Ill., strip mall.

Ernst & Young's 'Audit-Related' Fees

How HealthSouth's proxy statements characterized Ernst's annual fees; fees are in millions:



'Audit-Related Fees' to Ernst Were for Janitorial Inspections

Continued From Page C1

amples of audit-related services include pension-plan audits and consultations on accounting rules. "Pristine audits" previously had been unheard of, according to accounting-industry executives.

HealthSouth's April 2001 proxy, filed with the SEC, said the company paid Ernst $1.03 million to audit its 2000 financial statements and $2.65 million of "all other fees." The proxy said the other fees included $2.58 million of "audit-related fees," and $66,107 of "nonaudit-related fees." In its April 2002 proxy, HealthSouth said it paid Ernst $1.16 million for its 2001 audit and $2.51 million for "all other fees." The proxy said the other fees included $2.39 million for "audit-related fees" and $121,580 for "nonaudit-related fees."

Neither proxy described in any detail the audit-related or nonaudit-related services for which Ernst was paid. Mr. Brimmer, the HealthSouth spokesman, says the audit-related-fee figures for each year included about $1.3 million for the pristine audits.

Mr. Scrushy was fired by HealthSouth's board in March, as was Ernst, shortly after the first of 11 former HealthSouth executives pleaded guilty to felony charges over an accounting fraud that overstated profits by $2.5 billion. In a civil complaint, the SEC has accused Mr. Scrushy of participating in the fraud. Prosecutors are considering whether to file criminal charges against him. Last month, in a victory for Mr. Scrushy, a federal judge denied an SEC request to freeze Mr. Scrushy's assets. Through his attorneys, Mr. Scrushy has denied wrongdoing.

HealthSouth hasn't filed its 2003 proxy or its 2002 year-end financial statements, as a result of the ongoing investigations. Mr. Brimmer said HealthSouth paid Ernst $5.4 million for 2002, including $1.1 million for financial-statement audit services and $1.4 million for the pristine audits. Upon firing Ernst, HealthSouth discontinued the pristine audits.

The government's fraud complaints against former HealthSouth executives haven't cited the pristine audits. But the program illustrates how Ernst had become an instrument of HealthSouth's marketing machine when it was supposed to be acting as the company's financial watchdog. Mr. Scrushy touted the company's nearly perfect pristine-audit scores at public appearances. Ernst says its auditors had been unaware of HealthSouth's accounting deceptions.

Describing the pristine audits at a Feb. 3, 2003, investor conference, Mr. Scrushy said: "We believe one of the reasons that we have done so well has to do with the fact that we do audit all of our facilities, 100%, annually. And we use an outside audit firm, our auditors, Ernst & Young. They visit all our facilities, 100%."

On its Web site, HealthSouth said the pristine audit, "administered independently by Ernst & Young LLP ... ensures that all of our patients enjoy a truly pristine experience during their time at HealthSouth. The average score was 98 percent, with more than half of our facilities scoring a perfect 100 percent."

Thomas Sjoblom, an attorney for Mr. Scrushy, says the pristine audits were aimed at providing better care for HealthSouth patients. "The intent was not to use Ernst & Young as part of its marketing program," Mr. Sjoblom says.

Critics question the wording of the proxy disclosures. "E&Y arguing that checking the cleanliness of a facility is 'audit related' goes well beyond the pale of sanity and common sense," says Lynn Turner, the SEC's chief accountant from 1998 until 2001.

Walter Schuetze, another former SEC chief accountant, says Ernst should stop insisting that HealthSouth properly characterized the firm's fees.

"Calling that audit-related is false and misleading," Mr. Schuetze says. "Not only does it fly in the face of facts. It suggests that Ernst & Young was covering up the facts .... When Ernst & Young deliberately misclassifies something that is clearly on its face wrong, that undermines everything Ernst & Young says and does."

The responsibility for the accuracy of proxy disclosures lies with the companies that prepare them. However, Mr. Brimmer points to a March 2002 report by Ernst to HealthSouth's management and board, covering Ernst's services for the fiscal year ended Dec. 31, 2001. The report included an attachment that summarized Ernst's fees and provided a suggested "Proxy Disclosure Format." The attachment shows that Ernst classified the pristine audits as "audit-related services" and the fees for them as "audit-related fees."

Mr. Howarth, the Ernst spokesman, declines to comment on Ernst's proxy-disclosure advice. In a statement, he says Ernst "for the most part" used "audit personnel who were not members of the HealthSouth audit-engagement team" to conduct the pristine audits. Therefore, he says, "the program did not detract from the work done by Ernst & Young on the audits of HealthSouth's financial statements." Mr. Howarth adds: "At the time of HealthSouth's disclosures, there were no SEC rules that defined audit-related services. Describing operational audit procedures as audit-related services was reasonable."

Donald Watkins, a lawyer for Mr. Scrushy, says shareholders could have asked about Ernst's services at HealthSouth's annual meetings, but that SEC rules didn't require the company to describe them in its proxies. "That ain't required by nobody at any time," he says.

Among other items on the 50-point checklist: check the walls, furniture, floors and whirlpool areas for stains; check that the heating and cooling vents "are free of dust accumulation"; that the "floors are free of trash"; and that the "overall appearance is sanitary."

Clean laundry was to be neatly folded and stored, while soiled laundry was to be stored "in a covered container," the checklist said. Ernst accountants also had to make sure the facilities' soft-drink machines distributed Coca-Cola Co. products. In 1997, HealthSouth and Coke signed a five-year, exclusive agreement for Coke to provide its beverages at HealthSouth facilities.

A small portion of the checklist pertained to money matters, though none of it pertained to accounting. Assignments included checking if petty-cash drawers were secure and company equipment was properly tagged. The checklists didn't cover insurance-billing procedures or the quality of the medical treatment.

According to the company's self-published book, "The Story of HealthSouth," Mr. Scrushy got the idea for facility inspections one day in 1996 while lying in bed, worried about keeping HealthSouth's facilities spotless and friendly. He assigned HealthSouth internal auditor Teresa Sanders that year to work out the details, Ms. Sanders testified at a court hearing this spring. Asked by the judge at the hearing whether the pristine audits were related to HealthSouth's audits, Ms. Sanders, who left the company in 1999, said: "No ma'am. This was a totally separate thing."

—Carrick Mollenkamp contributed to this article.

Journal Link: *WSJ.com subscribers can see copies of HealthSouth's "Pristine Facto" checklists for inpatient and outpatient services, in the Online Journal at* **WSJ.com/PersonalJournal**.

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Presentation

Tab 66

Regarding Department of Justice

HealthSouth Outpatient Physical Therapy Investigation

December x, 2001

Timeline:

1998 Cahaba (HealthSouth's Medicare Fiscal Intermediary) initiates a review of HealthSouth's billing practices, hiring several physical therapists to conduct a review of approximately 600 Medicare claims from HealthSouth facilities located throughout the country.

In the June 1998 edition of its publication Medicare Focus, Cahaba issued guidance to health care providers regarding proper application of therapy codes at issue in this matter. During the months of July and August 1998, several phone conversations occurred between HealthSouth and Cahaba regarding the June 1998 edition of Medicare Focus. In

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September 1998, HealthSouth met with Cahaba, discussed these coding issues in greater detail, and issued a memorandum to outpatient rehabilitation facilities regarding use of these codes, based upon guidance from Cahaba, based upon guidance from Cahaba.

In or about late 1998 or early 1999, Cahaba developed a presentation detailing Cahaba's findings during its review of HealthSouth's billing practices. These findings were presented to DOJ.

1999 On May 7, 1999, DOJ informed HealthSouth that DOJ was conducting an investigation of the Company's billing practices. The DOJ investigation purportedly focused on claims submitted to Medicare and other federal payors for physical therapy services "performed in outpatient rehabilitation facilities." Specifically, DOJ expressed concern that HealthSouth inappropriately billed physical therapy and aquatic therapy exercises as individual therapy services, rather than group therapy services. The DOJ also requested information on HealthSouth's policies and procedures regarding group and individual therapy.

Over the next two years, and in view of DOJ's request for legal analyses of these issues, Reed Smith provided numerous legal memoranda addressing these matters. One legal memoranda, submitted in addition to an October 4, 1999 submission to DOJ, totaled over 525 pages. During this period, Reed Smith also provided DOJ with voluminous information concerning HealthSouth's operations. The documents provided included corporate documents, patient billing records, patient medical records, and internal Company memoranda. Finally, several HealthSouth employees were provided for interviews by DOJ.

2000 On or about December 4, 2000, Reed Smith met with DOJ and requested that DOJ make some good faith showing of factual evidence, substantiation of scienter, or controlling legal authority for the issues being investigated. Specifically, Reed Smith stated that DOJ has been provided with comprehensive legal analyses persuasively demonstrating that HealthSouth's policies and procedures complied with Medicare laws and regulations. Despite these analyses and the extensive documentation provided to DOJ, as well as the testimony of the HealthSouth employees who were interviewed, DOJ had never provided HealthSouth with any memorandum of law, policy statement, or other document supporting its continuing investigation of HealthSouth.

2001 On January 4, 2001, Reed Smith again met with DOJ attorneys Mr. Henebery and Michael Granston regarding the investigation. After repeated requests, HealthSouth was given copies of the audit documentation used by the two therapists hired by Cahaba for its review of HealthSouth. During the meeting, DOJ renewed its request for HealthSouth's cooperation with a DOJ survey of the Company's medical and billing records. As part of its survey, DOJ would create a survey template to be validated in a test survey at an alleged "problem" HealthSouth outpatient facility located in Alabama. Once the template was validated, DOJ would commence surveys in four different states, at four facilities in each state. In addition to a review of documents, DOJ also would conduct interviews at each facility. The DOJ stated that HealthSouth would have a brief opportunity to review and comment on the survey template.

In April, DOJ detailed its survey request. Specifically, DOJ reiterated its plan to conduct a sample review of Medicare claims submitted by HealthSouth for services provided at its outpatient rehabilitation facilities. The proposed plan would survey approximately twenty-five claims at twenty-four HealthSouth facilities across four states for an approximate total of 600 observed claims. To complete this task, DOJ proposed utilization of a survey form and an investigative team of one or two consultants who would review the billing and clinical records, and complete the survey form. These 600 claims would be randomly selected from a population with dates of service from January 1, 1994 through December 31, 2000.

In a May correspondence, Reed Smith detailed substantial problems with the proposed survey instrument, the substantive flaws in the methodology proposed for the survey, a potential conflict of interest with the therapists who would conduct the survey, and the relationship of the survey to Cahaba's 1998 review. Reed Smith's analysis totaled twenty-three pages and attached forty documents amounting to approximately 328 pages in support of its position.

Throughout the summer, HealthSouth attorneys repeatedly met with DOJ, in an attempt to agree on the proposed survey. The intractable and underlying problem with any survey is that the parties have a fundamental disagreement on the law. In other words, DOJ has a view of

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Medicare therapy services that so significantly differs from HealthSouth's experience, that a survey could only serve to confirm DOJ's forgone conclusion.

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Contested Issues:

1. Concurrent Therapy
2. Unlicensed Aides

The United States is investigating the allegation that HealthSouth improperly charged the Medicare program for therapy services in two instances: 1) by billing for "concurrent" therapy (*i.e.*, "excessive one-on-one"); and 2) by using therapy aides to perform certain therapy tasks.

Concurrent therapy is the practice of one professional therapist treating more than one Medicare beneficiary at a time--in some cases, many more than one individual at a time. DOJ's expressed view to HealthSouth is that it is *per se* illegal for a therapist to concurrently treat more than one patient. The primary stated argument is that this is because certain coding guidelines (adopted by Medicare) require all therapy to be provided "one-on-one."

DOJ's expressed view to HealthSouth on unlicensed individuals is that it is illegal (as a reimbursement proposition) for an unlicensed individual to provide any therapy service under Medicare. As expressed by DOJ, the bright line rule is that an aide (or any other unlicensed individual) could not assist a patient with any skilled task when a licensed therapist is not physically present and treating the same patient.

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Concurrent Therapy: Our View of the Law

There is no guidance, rule, regulation, or law that specifically prohibits concurrent therapy.

There has been a significant controversy, however, over "group therapy" that arose over a proposed CMS program memorandum. Because "group therapy" is also the provision of therapy to more than one individual, these issues are linked, if not two-sides of the same issue.

In April 1999, CMS released its Draft Program Memorandum AB-99 ("Draft PM") concerning payment for outpatient rehabilitation services. In the Draft PM, CMS promoted the CPT's definition of group therapy. Essentially, the CPT's definition of group therapy is based on a distinction between group therapy and individualized therapy, and the number of patients present during the provision of therapy services. According to this standard, a therapist's services would be reimbursed as group therapy under CPT code 97150 simply if two or more patients were treated at the same time. CMS based its adoption of the CPT position by citing the November 1996 preamble to a rule adjusting the physician fee schedule amounts.

In the Draft PM, CMS acknowledged that the CPT definition of group therapy may conflict with the clinical standard supported by the rehabilitation industry. The clinical standard focuses on the level of individualized treatment provided by a therapist to the patient, as opposed to the CPT emphasis on the number of patients treated. Pursuant to the clinical standard, a therapist may bill for individualized therapy using CPT code 97110 if the therapist provides direct one-on-one treatment to accommodate the distinct, individual needs and treatment goals of each patient, regardless of the number of other patients present. A therapist following the clinical standard would only bill for group therapy where the therapist was simultaneously treating multiple patients sharing a common treatment plan or goal. The AMA defines

On June 18, 1999, CMS convened a "Listening Session" (the "Session") to discuss the Draft PM. The Session provided a forum for the controversy generated by CMS's support of the CPT definition. More than thirty representatives from approximately eighteen trade associations and therapy providers attended the Session. During the Session, profound frustration was expressed with CMS's failure to incorporate clinical standards into a cohesive, clear policy on group therapy.

Despite the Session, CMS declined the opportunity to resolve the controversy between the CPT and clinical standards of group therapy in the final program memorandum. See Payment for Outpatient Rehabilitation Services, Program Memorandum, No. AB-00-14, March 1, 2000, Medicare & Medicaid Guide (CCH) ¶ 150,987 (the "Final PM"). Effectively, CMS failed to adopt any definition of group therapy. Indeed, the Final PM does not even address group therapy, despite the fact that it otherwise uses the same captions and addresses the same issues as the Draft PM.

In light of this situation, HealthSouth has continued to follow the appropriate clinical practices for provision of concurrent therapy. Indeed, CMS, in the May 10, 2001 SNF PPS Rulemaking, specifically identifies this practice as clinically appropriate.

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CMS on Concurrent Therapy

SNF Proposed Rulemaking 66 Fed. Reg. 23984, 23991-92 (May 10, 2001)

"Further, in the context of our ongoing efforts to ensure accurate payment for appropriate care, we note a situation regarding rehabilitation therapy that is being provided in SNFs in a manner that conflicts with Medicare coverage guidelines. This issue involves providers that refuse to employ therapists who are unwilling to perform, on a routine basis, concurrent therapy. Concurrent therapy is the practice of one professional therapist treating more than one Medicare beneficiary at a time--in some cases, many more than one individual at a time.

Concurrent therapy is distinguished from group therapy, because all participants in group therapy are working on some common skill development and the ratio of participants to therapist may be no higher than 4 to 1. In addition, in the July 30, 1999 SNF PPS final rule (64 FR 41662), we specified that the minutes of group therapy received by the beneficiary may account for no more than 25 percent of the therapy (per discipline) received in a 7 day period. **By contrast, a beneficiary who is receiving concurrent therapy with one or more other beneficiaries likely is not receiving services that relate to those needed by any of the other participants. Although each beneficiary may be receiving care that is prescribed in his individual plan of treatment, it is not being delivered according to Medicare coverage guidelines; that is, the therapy is not being provided individually, and it is unlikely that the services being delivered are at the complex skill level required for coverage by Medicare.**

The Medicare SNF benefit provides coverage of therapy services only when the services are of such a level of complexity and sophistication (or the beneficiary's condition is such) that the services can **be safely and effectively performed only by or under the supervision of a qualified professional therapist. Therapy services that are concurrently being delivered by one treating therapist to many beneficiaries would not appear to meet these criteria. If the therapist or therapy assistant can provide distinct services to several beneficiaries at once, then it**

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is unlikely that the services are sufficiently complex and sophisticated to qualify for coverage under the Medicare guidelines.

We note that there have always been isolated instances in which a professional therapist has been allowed to have some overlap in the time of concluding treatment to one individual and the time of commencing the treatment of another, even to the point of briefly providing therapy concurrently in certain cases. **However, the key principle here is that Medicare relies on the professional judgment of the therapist to determine when, based on the complexity of the services to be delivered and the condition of the beneficiary, it is appropriate to deliver care to more than one beneficiary at the same time. Our concern now is that in some areas of the country, concurrent therapy is becoming a standard practice rather than the exception, and is being dictated by facility management personnel rather than according to the professional judgment of the therapists involved.**

We believe that it is important to heighten the SNF and therapy industries' awareness of the applicable Medicare policy in this regard. **Medicare policy has not, until now, specifically addressed coverage of skilled rehabilitation therapy in situations in which a single professional therapist (or therapy assistant under the supervision of the professional therapist) simultaneously provides different treatments to multiple beneficiaries.** As noted above, we have relied on the professional therapist's judgment as to when it is appropriate for an individual therapist to provide services to more than one beneficiary. We now wish to advise the providers of care of our concern about the potentially adverse effect of this practice on the quality of the therapy provided to beneficiaries in Part A SNF stays, as well as our concern about the implications of making payments in such situations. We solicit public comments regarding the scope and magnitude of this problem, and possible approaches for addressing this issue."

Comment: This "view" appears consistent if not identical to DOJ's expressed views to HealthSouth. *I.e.,* DOJ has expressed that "[t]herapy services that are concurrently being delivered by one treating therapist to many beneficiaries would not appear to meet these [coverage] criteria." As noted in the text, however, Medicare policy has not (until now) addressed this coverage issue, this practice has been allowed (in isolated incidents); and the key principle (rather than any bright line rule) is the professional judgement (with implied state law restrictions) of the therapist.

CMS on Concurrent Therapy

SNF Final Rulemaking (July 31, 2001)

> *"Comment:* A few commenters indicated that they were unfamiliar with the term concurrent therapy until encountering the concept in the discussion in the proposed rule. **They asked whether it is the same as the practice referred to as dovetailing, and questioned whether it is a significant problem. We received a large number of comments encouraging us to continue to recognize concurrent therapy as skilled therapy. These commenters contended that therapists are treating more than one beneficiary concurrently only when appropriate. All of these commenters opposed any development of new guidance or regulation regarding the delivery of concurrent therapy services.** However, some other comments indicated that our concerns regarding concurrent therapy were warranted. Several commenters reported that since the implementation of the SNF PPS, professional therapists are encountering increased pressure to be more productive than they have in the past, including the need to see more than one patient at a time, and performing documentation and collaboration with other members of the care team as non-reimbursed time.
>
> *Response:* Concurrent therapy and dovetailing are synonymous terms. While the practice of providing concurrent therapy is by no means universal, we perceived a need to discuss this practice in the proposed rule, in order to alert providers to the inappropriate uses of this practice in certain areas of the country. We addressed the practice of concurrent therapy in the proposed rule (66 FR 23991) in order to reiterate Medicare policy and to solicit public comment. Our concern was two-fold: that therapists' professional judgment was being overridden by pressures to be more productive by treating multiple beneficiaries concurrently; and that the Medicare policy (reiterated below) that allows for the treatment of multiple beneficiaries was being used inappropriately and could lead to diminished quality of care. Apparently, this may not be a problem in the particular localities of most of the commenters. However, we expect that our discussion in the proposed rule may raise awareness and help prevent the inappropriate use of this practice from becoming more widespread.

> The proposed rule's discussion also provided an opportunity for us to reiterate Medicare coverage policy regarding skilled rehabilitation therapy. The Medicare SNF benefit provides coverage of skilled, individualized rehabilitation services that are of such a level of complexity and sophistication that the services can be safely and effectively performed only by or under the supervision of a qualified professional therapist. Accordingly, we wished to make clear that it is inappropriate to require, as a condition of employment, that a therapist agree to treat more than one beneficiary at a time in situations where providing treatment in such a manner would compromise the therapist's professional judgment. **However, we continue to believe, as do many of the commenters, that concurrent therapy has a legitimate place in the spectrum of care options available to therapists treating Medicare beneficiaries.** Our goals are to safeguard the health and safety of beneficiaries and assure that they are provided the most effective, skilled care available. **We agree that, at times, such care can be provided concurrently with another therapy patient, as long as the decision to do so is driven by valid clinical considerations. At this time, we will not change our approach, but recognize that we may need to revisit this issue should the need to do so arise."**

Comment: Three months later and concurrent therapy now has "a legitimate place in the spectrum of care options available to therapists treating Medicare beneficiaries." Furthermore, CMS now agrees that "at times, such care can be provided concurrently with another therapy patient, as long as the decision to do so is driven by valid clinical considerations."

HealthSouth has a former high-level CMS official, with operational responsibility for Medicare policies, who is ready and willing to testify to CMS' past policies regarding concurrent therapy.

- [Summary of her statement]
-
-

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Therapy Aides: Our View of the Law

Basic Rule

With respect to physical therapy, Medicare regulations, under the caption "Personnel Qualified to Provide Physical Therapy Services," provide that covered "[p]hysical therapy services are provided by, or under the supervision of, a qualified physical therapist." 42 C.F.R. § 485.713(c). The regulation does not require the person being supervised to meet any qualifications (e.g., standards for a PTA). Therefore, supervised aides and other unlicensed technicians are permitted to render covered therapy under Medicare.

The regulatory definition of "supervision," as used above, explicitly provides for supervision of unlicensed personnel. Supervision is defined as:

> Authoritative procedural guidance that is for the accomplishment of a function or activity and that (1) includes initial direction and periodic observation of the actual performance of the function or activity; and (2) is furnished by a qualified person --
>
> > (i)whose sphere of competence encompasses the particular function or activity; and (ii) who (unless otherwise provided in this subpart) is on the premises if the person performing the function or activity does not meet the assistant-level practitioner qualification specified in § 485.705.

42 C.F.R. § 485.703 (emphasis added). By delineating two separate standards, this definition clearly contemplates provision of therapy functions by aides or other unlicensed personnel. More specifically, if a physical therapy assistant (distinguished from a therapy aide) is performing therapy services, the supervising physical therapist need not be on the premises. On the other hand, if an aide is performing services, the supervising physical therapist must be on the premises. See id.

The Medicare Conditions of Participation ("COPs") for rehab agencies provide generally that:

> all personnel who are involved in the furnishing of outpatient physical therapy, occupational therapy, and speech-language pathology services directly or by

> under arrangements with an organization must be legally authorized (licensed or, if applicable, certified or registered) to practice by the State in which they perform the functions or actions, and must act only within the scope of their State license or State certification or registration.

42 C.F.R. § 485.705(a) (emphasis added). Where no state standards exist for physical therapists ("PTs") or physical therapy assistants ("PTAs"), certain minimum standards are imposed by federal regulation. Various state laws allow aides or other unlicensed personnel to provides skilled services under certain restrictions (*i.e.*, supervision). Similarly, some states do not allow for the utilization of unlicensed personnel.

Coding System

The CPT coding system used by Medicare does not distinguish between licensed and unlicensed therapists.

Medicare Payment System Recognizes the Cost of Aides

Under the previous Medicare outpatient therapy cost-based system, aides were recognized costs that were captured with other costs in the data used to construct the therapy relative value units ("RVUs"), which compose the current payment system under the physician fee schedule. These costs were incorporated into the practice expense value of the therapy codes. See 63 Fed. Reg. 58,814, 58,822 (Nov. 2, 1998); 63 Fed. Reg. 30,817, 30,832 (June 5, 1998). Therefore, the payment for these services anticipates that aides will participate in the provision of the services. CMS acknowledged this fact during the rulemaking enacting the outpatient therapy prospective payment system:

> *Comments:* The American Occupational Therapy Association commented that the practice expense pool for occupational therapy codes was understated because the time values of 15 minutes that we arbitrarily assigned were too low.
>
> [...]
>
> *Response:* We believe that the time of 15 minutes we assigned to these codes is appropriate and does not lead to an underestimation of the practice expense pool for

> outpatient rehabilitation services. [...] Also, we have been told by some physical therapy associations that at times some of the 15 minute period time may be performed by therapy aides or assistants.
> 63 Fed. Reg. 58,814, 58,824 (Nov. 2, 1998)

In other words, when a professional association complained that the payment amount for a therapy services was understated, CMS replied that it was appropriate, because the pool of costs used to determine payment was not composed solely of higher-cost therapists. Instead, that pool was composed of lower cost aides and assistants. Therefore, the new payment system for therapy services (including physical and occupational), reimburses providers at a rate that contemplates that a portion of the 15 minute service would be performed by aides or assistants. One view is that a therapist who does not utilize lower cost extenders like aides is not properly reimbursed.

No Exclusion for Aides

Like the other issue subject to this investigation, there is no specific, law, regulation or instruction that specifically and plainly prohibits the utilization of aides.

Our Position

While we do not argue that aides can initiate therapy or engage in an unsupervised skilled service outside the scope of the relevant state practice act, it is irrefutable that the services of aides are contemplated by Medicare. Not only is this view supported by the plain language of the statute, but the Medicare payment system anticipates and properly reimburses providers for their services.

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CMS on Therapy Aides

Anyone reading recent HCFA discussions on payment policy, for example, would never guess that it is a false claim for the use of aides in rendering therapy services. We have reviewed recent rulemakings and found the following references to aides by CMS:

When discussing the $1,500 therapy cap:

> If the services are delivered by a physical or occupational therapist, speech-language pathologist, therapy assistant or therapy aide, are part of a rehabilitation plan of care, or involve services included in the aforementioned Addendum D, then the services are subject to the cap.

63 Fed. Reg. 30,817, 30,859 (June 5,1998) (emphasis added).

When providing hypothetical situations in the PTIP rulemaking:

> Three PTs operate an unincorporated group practice, which employs several physical therapy assistants and aides and maintains two offices in two towns. Each therapist could enroll as a physical therapist in private practice and could furnish services in either office, while personally supervising any of the assistants or aides who are helping to render therapy.
>
> A corporation operates a physical therapy practice which employs four physical therapists and several physical therapy assistants and aides. Each therapist could enroll as a physical therapist in private practice and could personally supervise any of the assistants or aides who help to render therapy.

Id. at 30,861 (emphasis added)

When calculating payment values for overhead:

> We used the clinical payroll expenses for "All Physicians" instead of the salary equivalency data for physical therapy assistants and aides since we are concerned that there may be an overlap between the cost of therapy assistants and aides reflected in the practice

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expenses and the amount of work allocated to services provided by occupational and physical therapists.

Id. at 30,832

Medicare Contractors – the fiscal intermediaries and contractors who process claims and publish local coverage policies that are relied upon by providers are similarly not aware of any bright line rule that aides cannot be alone with a patient while that patient is engaged in a skilled service. A sample of the many policies we have on this subject:

Florida -- First Coast Service Options (Part B)

A May/June 1995 Medicare B Update! includes an article on "Services Furnished by an Occupational Therapist's Aide." Occupational and physical therapy have the identical statutory authority and regulation. The policy specifies that:

> Medicare law allows coverage for services furnished by auxiliary personnel (e.g., aides, assistants, etc.) of an occupational therapists when the following requirements are met:
>
> - The auxiliary personnel are employed by the occupational therapist (i.e., the common law definition of an employer-employee relationship exists);
> - The services of the auxiliary personnel are furnished under the direct supervision of the occupational therapist (i.e., the occupational therapist must be on the premises and immediately available to assist and/or direct the auxiliary personnel) or the services must be furnished under the direct supervision of a qualified occupational therapy assistant who is under the general supervision of the occupational therapist; and
> - The services are the type which are typically furnished by the occupational therapist.

> If these requirements are met, the services may be reported and covered as if the occupational therapist personally performed the services.

Oregon/Idaho/Washington, Utah – Medicare Northwest (Part A)

Medicare Northwest's Physical Therapy LMRP specifically allows coverage of physical therapist aides/supportive personnel. Physical Therapist Aides/Support Personnel are defined as:

> Personnel performing services as delegated by a physical therapist and within the scope of applicable state regulation. (Absent state regulations, the contractor will use Oregon Administrative Rules ("OAR") 848-020-0000 to 848-020-0060 to define qualifications and scope of practice).

Note that OAR 848-020-0000, which is included as an appendix to the LMRP, specifies that:

> A treatment-related task [i.e., a physical therapy service rendered directly to a patient] requires that the supervising physical therapist or physical therapist assistant be in the same building and in the proximity to the location where an aide is performing the treatment-related task, such that the supervising physical therapist or physical therapist assistant is readily available at all times to provide direction, assistance, advice, or instruction to the aide or the patient in person. This task may be delegated to the physical therapist assistant.

The policy also states that:

> A physical therapy aide shall not perform a treatment related task or a non-treatment patient-related task except under the supervision of a physical therapist or physical therapist assistant.

With regard to recordkeeping:

An aide must record only objective data specific to the treatment provided by the aide, and entries made by the aide must be co-signed by the supervising physical therapist or physical therapist assistant.

North Dakota & Minnesota -- Noridian (Part A)

Includes the following language in its PT policy covering North Dakota, on page 4, effective 9/1/00.

> Physical Therapy Aides, techs, etc. can assist the PT and/or the PTA with "setup" of equipment and some lower skilled interventions (applying moist heat, assisting with routine exercises, etc). The PT must provide direct, on-site supervision.
>
> Documentation should be available that PT aides have had "on-site" training of the duties they are carrying out.

This policy revised effective 8/1/01 for North Dakota and Minnesota. The new policy reads as follows:

> Physical Therapy Aides, technicians, athletic trainers, etc. can assist the PT and/or the PTA with "setup" of equipment and some lower skilled interventions (applying moist heat, assisting with routine exercises, etc). The PT must provide direct, on-site supervision. Direct personal supervision requires that the Physical Therapist be physically present and immediately available to direct and supervise tasks that are related to patient/client management. The direction and supervision is continuous throughout the time these tasks are performed. Documentation should be available that PT support staff have had "on site" training of the duties they are carrying out.
>
> 1. Physical therapy aides are any support personnel who perform designated tasks related to the operation of the physical therapy service. Tasks are those

activities that do not require the clinical decision making of the Physical Therapist or the clinical problem solving of the physical therapist assistant. Tasks related to patient/client management must be assigned to the physical therapy aide by the Physical Therapist and may only be performed by the aide under direct personal supervision of the Physical Therapist.

2. The licensed Physical Therapist must observe the patient's status before and after the treatment administered by the physical therapy aide. The physical therapy aide may perform tasks related to preparation of patient and equipment for treatment, housekeeping, transportation, clerical duties, departmental maintenance and selected treatment procedures. The tasks must be performed under the direct supervision of a licensed Physical Therapist who is readily available for advice, instruction or immediate assistance.

South Carolina/Palmetto

Overheads from an April 2000 SNF Workshop state that:

> A therapy assistant cannot supervise a therapy aide. A therapy aide must be supervised personally by a professional therapist in such a way that the therapist has visual contact with the aide at all times. Therapy aides should never be responsible for provision of group therapy services.

All States -- Mutual of Omaha

Mutual of Omaha's occupational therapy local medical review policy ("LMRP") states that:

> An occupational aide/tech may assist an occupational therapist, under the "direct supervision" of the qualified

occupational therapist at the time the services are given. Direct supervision is the physical presence of the qualified occupational therapist.

California/NHIC (Part B)

National Heritage Insurance Company's ("NHIC") physical therapy guidelines from 1996 include a policy allowing independently practicing physical therapists to employ other physical therapists, as well as aides and assistants. The services must be performed under the "direct supervision" of the independently practicing/employing therapist. The employer must be present in the office suite and immediately available to provide assistance and direction throughout the time the employee is performing services in order to be covered.

The HHS-OIG on aides:

OIG Report on Physical and Occupational Therapy In Nursing Homes

The Office of Inspector General ("OIG") of the Department of Health and Human Services includes in its August 1999 report entitled "Physical and Occupational Therapy in Nursing Homes -- Medical Necessity and Quality of Care," the following definition *of physical therapy aide/technician:*

> *Physical therapy aide/technician*--a nonlicensed worker, trained under the direction of a physical therapist. The aide performs designated routine therapy tasks that are delegated by the physical therapists or, in accordance with the State law, by a physical therapist assistant. The aide performs only with the continuous on-site supervision of the physical therapist or, where allowable by State law or regulation, the physical therapist assistant.

Outpatient Physical Therapy was formerly paid on a cost basis. If there has been a change in CMS policy, it has never been published.

Until April 1, 1998, Medicare outpatient rehab agencies were paid on a cost reimbursement system. Under this system, the Medicare services of the rehab agency were reimbursed through a cost reporting methodology that included the direct and indirect costs of providing covered Medicare services. Upon passage of the Balanced Budget Act of 1997 ("BBA") in August of 1997, HCFA began implementation of a prospective payment system ("PPS") for rehabilitation services. Under this new PPS, the physician fee schedule (the "RBRVS") would be utilized as the basis for payment. The system is prospective because payment for services is determined in advance for each service or modality and identified using the system of coding currently used for Part B physician services. This system is based upon the CPT system maintained by the AMA. Specifically, it is an amended version of the CPT known as "HCPCS" (the HCFA Common Procedure Coding System).

We believe that the genesis of this controversy relates to the changes in reimbursement for rehab agencies. Specifically, that while the payment methodology changed, the coverage or clinical practice of therapy did not. Previously, when CMS was "paying" for the costs of rehab agencies, it directly paid for the costs of personnel, including physical therapists and aides. If a lower cost individual was utilized to provide a service to Medicaid beneficiaries, the Medicare program was responsible for fewer costs. Similarly, if a physical therapist provided clinically appropriate concurrent therapy, then the overall costs might be lower. As these assumptions (and cost bases) were built into the new prospective system in use today, it was not appropriate for the rules governing the provision of therapy to change. Congress, when it authorized a new prospective payment system for rehab agencies, did not change the coverage rules governing therapy services (i.e., "provided by or under the supervision of...."). The general perception, however, seems to be that because services are provided on a "per service" basis, that somehow these past practices are inappropriate (even though the service reimbursement take these practices into account).

If CMS does not believe that concurrent therapy or therapy that utilizes aides are appropriate practices, it should prohibit these practices using notice and comment rulemaking, as it is required under the Administrative Practice Act.

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HealthSouth Does Not Stand Alone

HealthSouth does not stand alone on these issues. In letters to CMS, in comments on proposed rulemakings (i.e., the group therapy rulemaking) and in other circumstances, the following entities have made comments that are in accord with our views:

Federation of American Health Systems

National Association for Support of Long-Term Care

[others?]

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0723743

This is Not a False Claims Case:

The federal False Claims Act ("FCA") imposes civil penalties on parties who "knowingly" submit false claims for payment to the United States government. 31 U.S.C. §§ 3729(a)(1) and (a)(2)(1996). There are three main elements of a FCA cause of action. Specifically, in order to demonstrate liability under the FCA, the government (or qui tam plaintiff) bears the burden of showing: (1) that the defendant submitted or caused the submission of a claim to the federal government; (2) that the claim was false or fraudulent and/or the defendant made or used false or fraudulent records or statements to obtain the claim's payment or approval; and (3) that the party submitting the claim had knowledge of the claim's falsity. Civil money penalties for violations of the FCA range from $5,000 to $10,000 per false claim, plus triple the amount of actual damages. 31 U.S.C. § 3729.

"Knowledge" has been defined to include actual knowledge, deliberate indifference, and reckless disregard of the truth). Also, in determining whether a provider knowingly submitted false claims, United States Attorneys have been instructed to examine: (1) the magnitude and pervasiveness of the false claims; and (2) the existence of a compliance plan, in addition to a number of other factors. Memorandum from Eric H. Holder, Jr., Deputy Attorney General (June 3, 1998).

There is no evidence that HealthSouth intended to submit false claims in this instance. On the contrary, the Company took all available precautions to ensure that its claims follow appropriate regulatory authorities. HealthSouth repeatedly engaged in a discourse with its fiscal intermediary and issued conforming instructions to its facilities. HealthSouth engaged CMS through the "listening session" regarding concurrent therapy and at other opportunities. HealthSouth followed the letter of the law and followed the available published clinical and regulatory guidelines for outpatient therapy services. Considering the contrary and confusing statements by CMS, various fiscal intermediaries, Medicare contractors, consultants, and others, it is highly unreasonable to think that the requisite knowledge existed for a false claims case. In the final analysis, there is not one single law, rule, regulation or other that CMS or DOJ can identify that prohibits the conduct alleged in this investigation. Without such legal authority, there will be no basis to find knowledge in a False Claims Act action.

NOV-11-98 17:58 FROM:ERNST & YOUNG LLP ID:212 773 1898 PAGE 1/1

Copy to Tom Milan

Tab 67

Post-it® Fax Note 7671	Date 11-11-98	# of pages ▶ 1
To Jim Cowley	From Ed C.	
Co./Dept.	Co.	
Phone #	Phone #	
Fax # 404-577-4273	Fax #	

TO: List

FROM: Fleeced Shareholder

RE: Healthsouth/Ernst & Young

You bring the smoke, I'll bring the mirrors. At least the market has shown the wisdom to devalue HS stock. Wish I got out in time. I have a list of questions, which I hope might interest you.

How can the HS outpatient clinics treat patients without precertification, book the revenue, and carry it after being denied payment ?

How can the company carry tens of millions of dollars in accounts receivable that are well over 360 days ?

How can some hospitals have NO bad debt reserves ?

How did the E&Y auditors in Alabama miss this stuff ?

Are these clever tricks to pump up the numbers, or something that a novice accountant could catch ?

How is it that a year ago Vencor announced that the BBA would have a major impact on its Tefra reimbursement, but HS management, similarly affected by BBA cutbacks in all divisions , was mute? They were busy though, cashing out before the big hit.

Does anyone really believe that nonsense about managed care pressure? It's the Medicare, stupid.

If the accounting is slick, what do the cost reports look like ?

You people and I have been hoodwinked. This note is all that I can do about it. You all can do much more, if all you do is look into it to see if what I say is true.

Distribution

Barry Melancon, AICPA
Phil Laskaway, Ernst & Young
Nancy Ann Min De Paula, HCFA
Steve Jones, Business Week
D. Scott Mackesy, Morgan Stanley
Darren Robbins, Milberg Weiss
SEC Division of enforcement

Tab 68

Eli's REHAB REPORT™

NEWS & ANALYSIS ON FINANCE, LAW, RESEARCH, & TECHNOLOGY

Volume VIII, Number 10 May 28, 2001

HCFA Coins, Criticizes "Concurrent Therapy." In an announcement that shocked and confused provider associations, the **Health Care Financing Administration** stated that therapists who treat more than four patients simultaneously should not bill Medicare under skilled nursing's prospective payment system. (Page 74)

HealthSouth Settles Accusations Of Parental Overbilling. **HealthSouth** will pay the government $7.9 million to settle accusations that it overbilled for items purchased from a company owned by the parents of HealthSouth CEO **Richard Scrushy**. (Page 74)

Stay On Top Of Rising Copays. They're easy to overlook, but as employers and insurers look to cut health care costs, copays will account for a greater percentage of rehab practices' revenue than ever before. (Page 75)

Little Copays Can Grow Into Big Legal Risks. Neglecting to collect copays can get practices in legal and compliance trouble for kickbacks, filing false claims and violating private insurer contracts. (Page 76)

Lawmakers Urge Fast Track For HCFA Reform. A pair of top ranking House Ways and Means Subcommittee members are pushing for dramatic and "immediate" changes to HCFA. (Page 77)

New Bill Of Rights Faces Old Battles. The newest patient bill of rights is receiving relatively positive reviews from provider groups, but a lack of support on Capitol Hill could give it the same fate as past bills. (Page 78)

Job Market Improving For PTs. Despite cloudly economic forecasts and widespread layoffs in other industries, a survey by the **American Physical Therapy Association** shows that physical therapists are enjoying their strongest job market since 1997. (Page 79)

Therapy Boosts Beverly's Earnings. **Beverly Enterprises Inc.'s** newly renamed therapy branch, **AEGIS Therapies**, helped the company overcome the future loss of 32 nursing homes. (Page 79)

In Other News...

APTA Opposes American Chiropractic Association's Lawsuit Against HCFA. APTA challenges the government's position that PTs cannot provide manual manipulation of the spine to correct a subluxation.....Page 80

HCFA Eases Home Health PPS Billing Edits. The move should cut down on denied therapy claims for patients discharged early from home care.....Page 80

MedPAC Chairwoman Ousted. **Gail Wilensky**, longtime head of the **Medicare Payment Advisory Commission**, was replaced due to conflict of interest concerns.....Page 80

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We welcome your comments and suggestions! Please let us know what issues you would like to see addressed in our report.

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SNF PPS

HCFA COINS, CRITICIZES "CONCURRENT THERAPY"

One month after accidentally posting — and then removing — guidance on group therapy coding, the **Health Care Financing Administration** is addressing a similar issue: concurrent therapy in skilled nursing facilities.

The two terms sound similar, and indeed many experts contacted by **Eli** confessed that they had never even heard of the phrase "concurrent therapy." But buried deep in a notice in the May 10 *Federal Register* — which mostly dealt with payment for hospital swing beds — are five paragraphs in which HCFA worries about the practice.

In the notice, the agency defines concurrent therapy as "the practice of one professional therapist treating more than one Medicare beneficiary at a time — in some cases, many more than one individual at a time."

According to HCFA, concurrent therapy differs from group therapy in that there are more than four patients, and/or the patients are not "working on some common skill development." HCFA notes: "The Medicare SNF benefit provides coverage of therapy services only when the services are of such a level of complexity and sophistication" that a skilled therapist must deliver them. Concurrent therapy does not qualify as sufficiently complex or sophisticated, HCFA argues, and therefore is not reimburseable.

Judy Thomas, the **American Occupational Therapy Association**'s director of reimbursement and regulatory policy department, says HCFA is arguing that "the more people you treat, the harder it is going to be to justify that the therapy is skilled."

In the notice, HCFA also expresses concern that, in certain parts of the country, "concur-

Fraud & Abuse

HEALTHSOUTH SETTLES ACCUSATIONS OF PARENTAL OVERBILLING

A family affair has led to trouble for rehab giant **HealthSouth**.

On May 22, the company reached a $7.9 million settlement with the **Department of Justice** in connection with overbilling Medicare for equipment, supplies and rental property from 1992 and 1997.

The *qui tam* settlement resolves allegations that HealthSouth had filed false claims, overcharging Medicare and the **Department of Defense's** TRICARE program for equipment and supplies it bought from **G.G. Enterprises** — a company owned by the parents of HealthSouth's CEO, **Richard Scrushy**. The government had alleged that HealthSouth had billed the government more than it had been charged by G.G. Enterprises.

"This settlement again demonstrates the United States' commitment to protecting taxpayer funds from fraud and abuse," said Acting Attorney General **Stuart Schiffer** in a statement. **Doug Jones**, U.S. attorney for the Northern District of Alabama, added: "It is the American taxpayer that suffers when health care providers are reimbursed for goods and services above what the law allows."

HealthSouth noted in a statement that it has admitted no wrongdoing, and that none of the allegations were related to patient care issues, quality of care, or billing for services not rendered. Jones also noted that HealthSouth was "forthcoming and cooperative" and had already changed its equipment reimbursement procedures.

As part of the settlement, HealthSouth will enter into a corporate integrity agreement with the **HHS Office of Inspector General**. HealthSouth explained that this CIA will supplement its compliance programs and will focus on employee education and safeguards against erroneous billing. Scrushy said in the statement that HealthSouth "regret[s] that these issues ever arose" and is "pleased to put [them] behind us."

Whistleblower **Greg Madrid**, a billing clerk formerly employed by HealthSouth, will receive $1.48 million as part of the settlement. ◊

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rent therapy is becoming a standard practice rather than the exception, and is being dictated by facility management personnel rather than according to the professional judgment of the therapist involved."

Thomas has "heard stories" that this is indeed going on, though she says, "I don't think it's going on to the extent that HCFA seems to suggest here." If HCFA is aware of some facilities abusing this, Thomas opines, then HCFA would be better served by just going after those offenders, rather than "tarring everybody with the same brush."

Other sources were even more skeptical that such practices exist. "I know a lot of people in the industry, a lot of companies, and I've never heard of that." **Cindy Susienka**, president of **AEGIS Therapies** tells **Eli**. Susienka, who is also the chair of the medical services committee for the **National Association for the Support of Long-Term Care**, thinks HCFA may be basing its comments on anecdotal information rather than empirical evidence.

Susienka also thinks that what HCFA calls "concurrent therapy" is actually what therapists for over 20 years have been calling "dovetailing," in which therapy sessions with different patients overlap. Susienka likens dovetailing to a standard physician practice in which the doctor administers medication to a patient and then, while waiting to observe the patient after the medicine has been absorbed, visits another patient in an adjacent office. With dovetailing, however, patients are always within the therapist's sight.

HCFA's comments "came as a real surprise," to NASL, according to **Peter Clendenin**, NASL's executive vice president (Thomas says that AOTA was also caught off guard.) Clendenin noted that "we're definitely concerned about it because therapy is highly correlated with positive outcomes in skilled nursing patients." He told **Eli** that NASL is looking into HCFA's comments and is further researching the issue and will prepare "a very significant response."

Should HCFA enforce this anti-concurrent therapy position, "it would be a big problem for the professional expertise of therapists and their professional judgment," says Susienka. "Therapists are going to do what is in the best interests of the patients ... but we continue to be restrained as professionals based upon what I believe is a lot of anecdotal information that's misinterpreted."

"If [concurrent therapy] is done conscientiously and seriously, there's absolutely no harm," Clendenin says. Susienka also notes that this policy "could actually be detrimental to the patients," since sometimes it is beneficial to have social interaction between patients.

Elsewhere in the notice, HCFA issued a proposed rule that Medicare begin switching its payment system for hospital swing beds from a reasonable cost basis to the skilled nursing facility prospective payment system. HCFA's annual SNF PPS annual update would give SNFs a raise for fiscal year 2002 — though SNFs shouldn't expect the dramatic Medicare increases they enjoyed last year. ◊

Practice Management

STAY ON TOP OF RISING COPAYS

They might seem like the most insignificant part of your revenue, but neglecting to collect those little copayments can cost you in more ways than one.

Whether the economy is entering a recession or just taking a brief pause during its sustained boom, one thing is certain: businesses are cutting health care costs. Both employers and insurers are looking for ways to stay ahead by passing costs on to consumers. According to a survey recently conducted by **Watson Wyatt Worldwide**, the **Washington Business Group on Health** and the **Health Care Financial Management Association**, half of employers will be increasing their copays over the next year.

Although the increases are not expected to be severe — from $5 to $10, or $15 to $20 — they certainly add up. Rehab facilities that fail to collect copays — either through administrative oversight, staff laziness, lack of adequate training, or sympathy for patients who have been stuck in the waiting room for too long — stand to lose a growing percentage of their income.

"There are some legal risks" from failure to collect copayments, says attorney **Joe Mislove** of **Coppersmith Gordon Schermer Owens & Nelson** in Phoenix (*for more on legal risks, see the following article*). But Mislove says that "the economic risks are equally or of greater importance in

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the private insurance context." The reason for this, he explains, is that "one way employers try to soften premium increases is by going to higher copayments, so that the percentage of revenue that a [provider] will get from a patient increases."

"If the name of the game is to maximize your reimbursement," Mislove notes, "a provider would be well advised ... to collect copayments."

This is easier said than done, according to practitioners. "The patients may not understand what their insurance covers," says **Laura Mann**, director of outpatient business services for **Brooks Rehabilitation Network**. "Sometimes the customers just think that they have insurance and it covers everything, and it may cover PT services but not OT or speech, and it's important that we convey that information first so the patient's not surprised on the back end."

Brooks has standard procedures in which staff find out what a patient's deductible is, whether the patient has met it, and what the copay is — all when the patient first makes the appointment. That way, Mann explains, when they see the patient they have the information with them and can communicate to the patient. Though not every rehab facility is equipped with the resources necessary for such research, it's important to at least discuss copays to patients before they are seen.

Staff training is critical. Mann notes that "what a lot of people forget is that there are a number of customers we deal with: the patients, the managed care companies, the case managers and the physicians themselves."

She also points out that, often, the "staff member who may be the lowest-paid staff member in their clinic is the person who's having that first contact with the patient" and with the insurance company and the case manager. "That's the person who has to have great customer skills and really understand how things work," she notes.

Mann recommends having in the office a standard form that explains the procedures to staff.

Robert Shryock, director of managed care for Brooks, points out that most people "generally don't understand the difference between a copayment and a coinsurance and a deductible and how all those things relate together." Your frontline staff needs to help in that education process, and "your return on the time spent educating will be your increased collectibles," Shryock says. If patients are "forewarned, fore-educated, and know that they've got to bring a $25 check," he notes, "it's just much more successful for you." ◊

Reimbursement

LITTLE COPAYS CAN GROW INTO BIG LEGAL RISKS

Letting copays fall by the wayside can take a financial bite out of your rehab practice. Not collecting from privately insured patients can put you in violation of a contract with an insurer, and not collecting from a Medicare patient can get you in even worse trouble.

"There's different levels of risk and different rules depending on who the patient is and what kind of health insurance they have," explains **Art Lerner**, a managed care attorney with **Crowell & Moring** in Washington, DC. If you have a habit of "blowing off the co-pay" for a Medicare patient, he says, "that's potentially a violation of a whole series of federal laws." It could be interpreted as bribing the patient to see you in order to get more Medicare dollars than the practice down the street — in other words, a kickback, notes **Joe Mislove** of **Coppersmith Gordon Schermer Owens & Nelson** in Phoenix.

You could also be hit with False Claims charges for billing for a charge that you have no real intention of collecting, Mislove adds.

"It's generally a bad, bad, bad thing," Lerner summarizes.

Forgiving a copay for an indigent patient, if done occasionally and done with patients who genuinely cannot afford to pay, probably won't summon the feds to your door, Lerner says. "But if you have ... a practice of promoting this, or as a general business matter you just tell people, 'Don't worry, you don't have to pay the co-pays,' you're in big trouble." If you do forgive a copay due to financial hardship, you should document this decision and note what research you did to arrive at the conclusion that the patient was indigent, advises **Denise Fletcher**, attorney with **Brown & Fortunato** in Amarillo, TX.

Failing to collect an occasional Medicare copay due to staff laziness is also forgivable, usually, since there is no intent to defraud Medicare,

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Lerner notes. But staff should know better, and if it's done often enough, you could be at risk. Fletcher says that your policy should be to contact patients at least three times if they owe you for a copayment.

Insurers Look for Rehab Copay Violations

Things get a bit messier with private insurance, Lerner admits. If the charge for a patient visit is $100, Lerner explains, and the plan says it will pay you $90 and that there will be a $10 copay which isn't collected, the plan could argue that you've defrauded it. The insurer could say that when you sent a bill for $100, you represented that $100 was what you really intended to charge, so it paid you 90 percent of that. If the insurer had known that you weren't going to collect the other $10, you should have billed for only $90, in which case the payor would have paid you $81 (90 percent of $90).

Such circuitous arguments can be difficult for insurers to win, though. The odds are more in their favor when you have a contract. There is often "contractual language which tells the provider and obligates the provider to collect the copay," Lerner says, "in which case, the provider is in breach of contract if he or she doesn't." This also presents insurers with a "stronger fraud case."

"On the other hand," he notes, "you have

Medicare

LAWMAKERS URGE FAST TRACK FOR HCFA REFORM

A pair of top-ranking House Ways and Means Health Subcommittee members want **Health Care Financing Administration** reform to happen sooner rather than later, and to that end have crafted a slate of recommendations that, if implemented, would dramatically transform the long-embattled agency.

Subcommittee Chairwoman **Nancy Johnson** (R-CT) and ranking member **Pete Stark** (D-CA) sent the recommendations May 14 to **Health and Human Services** Secretary **Tommy Thompson**. While the pair acknowledged that some Medicare reforms require legislative action, many HCFA improvements can be made administratively. "There is no reason to delay sensible changes which will make Medicare more responsive to beneficiaries and the providers that serve them, if they can be made immediately," they write.

The 17-page roster of proposed changes include recommendations that address longstanding provider beefs with HCFA. Among other things, the letter urges HCFA to:

- establish a regular schedule — once every six months — for the release of all program memoranda, interim final rules, final rules and notices of proposed rulemaking;
- set up advisory panels to streamline burdensome assessment instruments such as the minimum data set and the outcome and assessment information set;
- develop new, trimmed-down cost report forms for hospitals, home health agencies and nursing homes;
- expand provider education initiatives and require Medicare contractors to provide technical experts to visit providers and assist in compliance efforts (providers with fewer than 25 employees would be entitled to special assistance); and
- reexamine the circumstances under which home health agencies should have to give patients advance beneficiary notices.

Provider associations cheered the proposals. "The **[American Medical Association]** applauds the House Ways and Means Subcommittee's support of much-needed HCFA reform," said AMA President-elect Dr. **Richard Corlin**. **American Hospital Association** Executive Vice President Rick Pollack said the AHA was pleased with the call for action, and dubbed the slate of proposals "a good first step in unclogging a system choked with paperwork."

"This is a new day," chimed in **American Health Care Association** President and Chief Executive Officer Dr. **Charles Roadman**. ◊

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some managed care contracts with providers that really don't say much on this topic." You should check the language of your contract to see where you fall.

Mislove points out that some privately insured patients — usually elderly patients who have retired from a company and are partially covered on its health plan — have Medicare as a secondary payor. So a blanket waiver of copayments for private insurance could cause you to inadvertently violate Medicare policy.

And don't think that the relatively small value of copays means that you can get away with skirting the rules. Fletcher warns that insurers sometimes find out about a provider's lax copay policy through communication with their enrollees, but usually they find out because "other providers will rat on you."

Still, Lerner feels that health plans don't get involved in copay disputes "unless they think that it is driving over-utilization." Unfortunately, rehab is one of the few areas where this indeed is an issue, he observes. This is because insurers use high copays as a way of discouraging patients from seeking medical care plans think they don't need. The logic is that a patient will think twice about making an extra and possibly unnecessary visit to a therapist if it will cost her $20 — but if she never has to pay her copay, Lerner says, she'll come to think of the therapy as "free candy."

"Not too many people are going to go have unnecessary, frivolous heart-bypass surgeries," Lerner quips. "But for some things like chiro, mental health [or] rehab services, some people might go five times a week when really they could get by with two." If you fail to collect those copays, you are "defeating the health plan's purpose" of limiting utilization, Lerner says, and the insurer could take issue with that. ◊

Patients' Rights

NEW BILL OF RIGHTS FACES OLD BATTLES

Provider groups and politicians are cautiously optimistic about the newest patients' bill of rights now up for debate on Capitol Hill.

The bill is sponsored by Sens. **Bill Frist** (R-TN), **John Breaux** (D-LA) and **James Jeffords** (I-VT). Frist, the chief sponsor, who as a heart surgeon brings a provider's perspective to the debate, described the bill as "a centrist proposal." He noted that he had incorporated criteria set forth by **President Bush**, and indeed he received immediate support from Bush, who said of the bill: "It provides strong patient protections for all Americans, ensures that doctors and patients make medical decisions and holds health plans accountable by providing patients with meaningful remedies when they have been wrongfully denied medical care."

Bush is one of the few politicians who has come out in support of the bill, however, as it is being attacked from both sides of Congress. Democrats, many of whom support a rival bill introduced by Sens. **John McCain** (R-AZ), **John Edwards** (D-NC) and **Edward Kennedy** (D-MA), denounced the bill's limits on health plan liability and its federalization of state issues. Rep. **Charlie Norwood** (R-GA), a dentist who has spoken out in support of patients' rights, vowed to defeat the bill, which he said "protects health maintenance organizations, not patients."

Meanwhile, Sen. **Don Nickles** (R-OK) accused Frist of moving "significantly to the left of where most Senate Republicans were," claiming that the bill gives patients too much right to sue insurers, which will drive up premiums.

The **American Physical Therapy Association** voiced its support for the bill, pointing out that the bill is bipartisan. "APTA has been a long-standing advocate for federal patient protection legislation," said APTA President **Ben Massey Jr.** in a press release. "The American people have waited too long for patients' rights legislation, and now it is time for Congress to pass this bill and ensure these protections for their constituents."

APTA noted that its ideal bill of rights would include four criteria: an option allowing patients to see out-of-network providers so long as they pay "a reasonable co-payment," an "anti-discrimination provision" that protects providers being excluded based on their licenses or certifications, an exclusion of gag rules, and a "peer review of denied physical therapy services by licensed physical therapists." Massey noted, "We believe that, with an added peer review provision, this bill will meet all four criteria."

The American Medical Association, which

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said that it is carefully reviewing the bill, also listed four criteria necessary for a successful bill of rights: It should contain "a binding, independent, external review process without any of the loopholes contained in previous bills passed by the Senate;" the reviewers should not be bound by "medical necessity" definitions handed down by "insurance companies or government bureaucrats;" the bill should not be written such that the entire law would be nullified if a court struck down any of its provisions; and it should not preclude state law "or a growing body of case law that allows HMOs to be held accountable."

Indeed, case law has recently been working out in favor of patients, as high courts in Pennsylvania and California have ruled that patients have the right to sue insurers on matters of medical necessity and treatment. ◊

Industry News

JOB MARKET IMPROVING FOR PTs

Despite cloudy economic forecasts and widespread layoffs in other U.S. industries, 2001 is a particularly good time to be a physical therapist.

The latest in a series of surveys by the **American Physical Therapy Association** shows that unemployment among PTs has dropped to levels not seen since the Balanced Budget Act of 1997.

"The current 1.4 percent unemployment rate marks a substantial decrease from the 1.8 percent of physical therapists unemployed just six months ago," said **Ben Massey Jr.**, APTA president. It is the lowest unemployment rate since APTA first collected data in 1998.

Twenty-two percent of therapists in skilled nursing facilities reported reduced salaries, though this is still much better than in spring and fall of 1999, when the number was more than double. And though 10 percent of respondents reported involuntary decreases in hours worked, this too is half the 1999 number.

The numbers for physical therapy assistants, though better than six months ago, remain low. Nearly 20 percent of respondents said their hours had been reduced involuntarily, down from 24.5 percent six months ago. PTAs in home care fared worst: Nearly 40 percent reported reduced hours. Massey concedes that these numbers are low, though he did say that "we are happy to see many physical therapy assistants reporting overall improved job satisfaction and increased salaries."

For the third time, APTA used its employment survey to point out the benefits of membership: according to the surveys, APTA members were less likely than nonmembers to experience employment turbulence. ◊

Industry Briefs

THERAPY BOOSTS BEVERLY'S EARNINGS

A terrible market for long-term care in Florida didn't hurt **Beverly Enterprises Inc.** as much as it could have in recent months, thanks mainly to a strong performance by its recently renamed therapy division, **AEGIS Therapies.**

Beverly posted earnings of 8 cents per share diluted in the first quarter of 2001, before special charges of $86 million relating to the upcoming sale of its Florida nursing operations.

Taking those and other pre-tax reorganization charges into account, there was a net loss of $52,274,000, or 50 cents per share diluted, in the first quarter, compared to a net income of $6,261,000, or six cents per share diluted, in the first quarter of 2000.

Overall revenues climbed 2 percent from the year-ago quarter despite the company's reduction of 32 nursing homes. AEGIS Therapies and Beverly's nursing home business each exceeded the quarter's profit objectives and out-performed the year-ago quarter on a same-facility basis.

The company noted that the accelerated growth of its rehabilitation business is a key facet of its three-year strategic plan. "We began to offer contract rehabilitation services to other nursing home operators during 2000," said **William Floyd,**

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Beverly's president and chief executive officer. He noted that that Beverly will now begin to offer its rehab services in states where Beverly has no nursing home presence.

• The **American Physical Therapy Association** wants to intervene in the **American Chiropractic Association's** lawsuit against the **Health Care Financing Administration**. APTA challenges the government's position that physical therapists cannot provide manual manipulation of the spine to correct a subluxation under Medicare.

"In recent years, chiropractic organizations have made a concerted effort to obtain legislation that restricts the ability of physical therapists to perform manual manipulation as part of a physical therapy plan of care," APTA said in its pleading to the **U.S. District Court for the District of Columbia.** "This lawsuit can fairly be viewed as another front to this ongoing campaign."

ACA president **James A. Mertz** says his organization will strongly oppose APTA's intervention and argue that the government should not be allowed to reverse its position.

• In a move that should help cut down on denied therapy and supplies claims for patients who are discharged early from home care, the **Health Care Financing Administration** is easing its home health prospective payment system consolidated billing edits.

Originally, once agencies submitted a request for anticipated payment, intermediaries and carriers rejected any outside claims for bundled therapy or supplies for a 60-day episode after the start of care. Only after an HHA submitted a final claim would contractors pay for therapy or supplies provided to patients who had been discharged early, say after day 30 of the episode.

Under a May 1 program memorandum (AB-01-70: www.hcfa.gov/pubforms/transmit/AB0170.pdf), the contractors will pay therapists and suppliers even if a RAP has been submitted for the patient. The payment will carry a remark code, N88, saying the payment is being made "conditionally." When the final claim for the patient's home health episode comes in, the contractors will go back and compare the therapy and/or supplies claims already paid with the patient's home care dates, then recoup payment for any services or items that should have been bundled.

• There's new leadership at the **Medicare Payment Advisory Commission**: Comptroller General **David Walker** May 15 replaced longtime chairwoman **Gail Wilensky** with health care consultant **Glenn Hackbarth**, as well as appointing three new members to the influential panel.

Indeed, former **Health Care Financing Administration** chief Wilensky not only lost the chair, she's off the panel altogether — according to the *New York Times*. Walker chose not to reappoint her due to potential conflict of interest concerns connected with her substantial investments in health care companies.

Wilensky suggested that she lost the post because her independence and candor alienated powerful House Ways and Means Chairman **Bill Thomas** (R-CA), the *Times* reports. ◊

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Activity Report for: 6/17/2002

Name: Hardy, William W. (Bill) Department: Legal Services

Title: Sr. Corporate Counsel

Accomplishments by Key Corporate Objectives

Utilization Improvements:

Pricing Improvements:

Cash Collections:

Salary Cost Control:

Capital Cost Control:
Closed new revolving credit facility

Strategic Market Development:
Worked on closing sale of Massachusetts Greenery facilities

Other Accomplishments:
Worked on potential acquisition projects (FR, Longhorns, etc.)
Worked on strategy in Devage litigation
Followed up on other pending lawsuits

Tab 69

Plans by Key Corporate Objectives

Utilization Improvements:

Pricing Improvements:

Cash Collections:

Salary Cost Control:

Capital Cost Control:

Strategic Market Development:
Close sale of Massachusetts Greenery facilities

Other Accomplishments:
Work on potential acquisitions
Work on pending litigation
Wrap up NWA/TNA financing arrangements (Jeff Jarrett)
Follow up with Operations and Reimbursement on new Medicare Carriers Manual language re: group therapy

Schedule

Day	Location	Phone
Monday	Office all week	
Tuesday		
Wednesday		
Thursday		
Friday		

Attachments

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HHEC16/0712

Horton, Bill

From: Horton, Bill
Sent: Tuesday, June 18, 2002 11:55 AM
To: Taylor, Larry
Subject: RE: Group Code.

Tab 70

Based on what I've seen/been told, the new policy only applies to CPT-code reimbursed services, thus only to Part B O/P. Wouldn't apply to PPS-reimbursed (or cost-reimbursed, for that matter) I/P services, since they're not paid based on CPT codes.

-----Original Message-----
From: Taylor, Larry
Sent: Tuesday, June 18, 2002 11:52 AM
To: Horton, Bill
Subject: FW: Group Code.

Bill, just to keep you in the loop it causes even greater issues when we did into the billing info.

Do you know if it effects IP as well. Would like to catch you for a few minutes tomorrow as well to discuss our plans to be communicated next week to the field.

LT
Larry D. Taylor
President and Chief Operating Officer
Ambulatory Services

-----Original Message-----
From: McPherson, Steve <Steve.McPherson@healthsouth.com>
To: Taylor, Larry <Larry.Taylor@healthsouth.com>; Huffman, Sean <Sean.Huffman@healthsouth.com>
Sent: Tue Jun 18 09:43:31 2002
Subject: FW: Group Code.

Loop see below non covered with 97150. Rick and I will continue to dig.

-----Original Message-----
From: Steadham, Cheryl
Sent: Tuesday, June 18, 2002 10:34 AM
To: Schmitt, Rick
Cc: McPherson, Steve
Subject: RE: Group Code.

Per the Program Transmittal 1753

15302. GROUP THERAPY SERVICES (CODE 97150)
Pay for outpatient physical therapy services (which includes outpatient speech-language pathology
services) and outpatient occupational therapy services provided simultaneously to two or more
individuals by a practitioner as group therapy services. The individuals can be, but need not be
performing the same activity. The physician or therapist involved in group therapy services must be
in constant attendance, but one-on-one patient contact is not required.

****

Per the 2002 CPT Code Book

97150 Therapeutic procedure(s), group (2 or more individuals)

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The description does not specifically say this is a timed procedure. Therefore, this is paid as 1 unit per day/visit.

****

Per the 2002 National Correct Coding Manual, Version 8.1 (effective 4/1/2002 to 6/30/2002)

97150 cannot be billed on the same day with the following codes:

97110 Therapeutic procedure/exercise, 15 minutes
97112 Neuromuscular reeducation, 15 minutes
97113 Aquatic therapy, 15 minutes
97116 Gait training, 15 minutes
97140 Manual therapy, 15 minutes
97530 Therapeutic activities, 15 minutes

****

OK - don't kill the messenger. The mutually exclusive codes I gave yesterday were from an old version of the NCC. The above is the most current edition. The NCC is actually updated every quarter. So the codes could change in the next version. I'll check it once we get that update.

Cheryl Steadham
Medicare Coordinator
HEALTHSOUTH Pelham RBO
Phone 205-917-3800
Fax 205-917-1082

-----Original Message-----
From: Schmitt, Rick
Sent: Tuesday, June 18, 2002 8:37 AM
To: Steadham, Cheryl
Cc: McPherson, Steve
Subject: Groupp Code.

Can you summarize the special considerations concerning use of the group code.

For example it can not be billed with ...
You can only use one unit etc.

Let me know.

Thanks.

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Tab 71

Horton, Bill

From: Hasselman, Scot T. [SHasselman@ReedSmith.com]
Sent: Monday, June 24, 2002 11:56 AM
To: Horton, Bill
Subject: RE: Group Therapy

Rehabilitation therapies (i.e., used as a generic term) are covered under both Part A and B. However, "outpatient physical therapy services" is a specific and defined Part B benefit. That means that "outpatient physical therapy" provided by a rehab agency, a corf, or by a number of other providers (under certain conditions) is covered and paid by the Part B fund. See SSA sec. 1833(a)(8). Before the BBA, these services were paid under a reasonable cost methodology which did not use CPT codes (as a mandatory component). HealthSouth prepared and filed cost reports under which HealthSouth received interim payments. These reports were reviewed and settled by Medicare fiscal intermediaries. The BBA implemented uniform coding (to be chosen by the Secretary) and use of a fee schedule (the RBRVS) for these services.

The confusion arises because although outpatient physical therapy services are Part B services, the traditional reimbursement methodology was a Part A mechanism (until the BBA). Our position (I think an uncontroversial one) would be that the coding, coverage and payment rules for the Medicare benefit are unrelated to the Medicare contractor administering the claims. In most circumstances, these memos are addressed to both carriers and FIs, it is possible that the failure to address FIs was an oversight.

In this case, a transmittal has been issued to the Medicare carriers, but not the fiscal intermediaries, that contains the identical language from the proposed (and withdrawn) program memorandum from April of 1999 regarding group therapy. That April draft program memorandum was the source of significant controversy from the entire therapy community and resulted in the "listening session," where HCFA/CMS heard complaints from a myriad of providers that the proposed implementation (which tracked the cpt language) was not clinically accurate. The final PM (dated March 2000) was identical to the draft PM except for the language regarding group therapy. I think it is reasonable to infer that CMS withdrew this proposal in light of the opposition from providers. The only difference from the current PM is that the draft and final PMs were addressed to both fiscal intermediaries and carriers. I do not think that CMS's failure to address the transmittal to fiscal intermediaries is sufficient for us to argue that the change does not apply.

This is the likely government position: CMS has issued a new instruction on a Part B service provided by the Company. While it neglected to instruct intermediaries, this failure is immaterial as all PMs are technically clarifications of existing rules. In other words, since CMS did not change these instructions through an APA rulemaking, it is likely that CMS would argue that this is simply an instructional clarification of existing policy. The likely argument is: 1) we already issued a policy on this issue via our wholesale adoption of the CPT and its policies (which includes this language); and 2) our PM to carriers is just further evidence of our position (and notice to HealthSouth) on how a certain Part B service should be provided.

We know this is false, especially considering the "listening session" et al. If anything, this is more of an attempt to "backdoor" some of these policies. We already saw it at the carrier and fi level (i.e., local policies) and now it is clear that CMS is trying to implement the group therapy policies from 1999. This is further reason why we do not believe that they excepted certain providers; this is a deliberate implementation of

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a policy that was too controversial several years ago.

The bottom line is that CMS has issued direction on group therapy for Part B. While they neglected to issue it to the Medicare contractor that administers your claims, it is still "notice" of a policy regarding the outpatient physical therapy benefit. While you could argue that failure to present this instruction to the FI does not constitute notice to HealthSouth, this could be risky in light of the current FCA action. While our litigation strategy does not rely upon a scienter defense (because we have much stronger and better arguments), this is certainly a "fall-back" position. Also, since this is effective July 1, we could argue that this demonstrates that this is the first time CMS has ever stated a policy on the therapy issues, and that the FCA allegations could only apply for claims submitted after July 1. From a litigation perspective, this is an excellent opportunity to demonstrate to DOJ (via a motion to dismiss) that CMS has once again pulled the rug out from under their feet.

One note on lobbying:
This issue has (at least in the past) generated significant interest in the provider community. Because the aide issue is bootstrapped onto this language, it may be an opportunity to build some legislative traction and push the issue on that front where APTA and others are not in support. Also, my sense is that other providers have not made the fi/carrier distinction and are proceeding with the PM in mind.

Please call me if you want to discuss.

> -----Original Message-----
> From: Horton, Bill [mailto:Bill.Horton@healthsouth.com]
> Sent: Monday, June 24, 2002 11:10 AM
> To: 'Scot Hasselman (E-mail)'
> Subject: FW: Group Therapy
>
> Scot--We are trying to figure out what the Program Transmittal means to
> us. When Susan called Dr. McKinney, the Med. Dir. for Blue Cross of
> Alabama, he at first was not aware of the transmittal, and after Susan
> sent it to him the conversations summarized below occurred. The gist is
> that BCBSAL is telling us that this is only directed to physicians. That
> does not seem to make sense to me, given paragraph 15004 of the Carriers
> Manual. However, that's what our intermediary is telling us. We also
> have a contingent that tells us that these provisions only apply to
> billings on a HCFA 1500, not a UB-92, which makes even less sense to me.
> However, the theory (from both our folks and BCBSAL) seems to be that
> payments made with respect to UB-92s are Part A payments, even though they
> are paid (as to these services) on the Part B fee schedule (as you will
> recall, rehab agencies and CORFs are Part A providers), and thus that this
> transmittal has no applicability to our setting.
>
> Any interpretive help you could provide would be most appreciated.
>
> -----Original Message-----
> From: Jones, Susan
> Sent: Friday, June 21, 2002 10:39 AM
> To: Horton, Bill
> Cc: Taylor, Larry
> Subject:
>
> Bill, below is a summary of discussions with Dr. Greg McKinney. Medical
> Director, BCBS AL.
>
> 6/20/02
> 10:00 I left Dr McKinney a message requesting clarification on

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> transmittal released on May 17, 2002 on group therapy.
>
> 12:30 Dr. McKinney called back and left me a message that he could not
> find this transmittal and requested a fax copy.
>
> 2:30 I faxed Dr. McKinney a copy of the transmittal with a
> message that I would email him questions on Friday relating to the
> transmittal.
>
> 6/21/02 10:30 AM
> Dr McKinney called me and said that he received the fax and asked if I
> still had questions.
>
> I explained that we were unclear on how this transmittal applied to our
> hospitals, rehab agencies and corfs.
> Dr. McKinney stated that this transmittal is in the Medicare Carriers
> manual for Part B and applies to PTs employed by physicians and
> Independent Practioners. He said that this was the definition of Group
> Therapy under the CPT code verbatim. I said that I had not recently
> compared this to the CPT definition however I did not recall one sentence
> being part of the CPT definition and that was the sentence stating that
> the individuals need not be performing the same activity. Dr McKinney
> said that this means they don't have to be doing the exact same thing to
> be group, however they would be in a group setting. He used an example of
> hammering nails. Saying that one might be hammering while another is
> doing something similar but not necessarily hammering.
>
> I said, "so this does not apply to our rehab agencies or hospitals?" and
> Dr McKinney said "no it does not. This transmittal is to educate
> physicians on group therapy and to make them aware of this code."
>
> I asked Dr McKinney about the CCI edits on the code for group therapy,
> 97150. He said this means that for that group service, you can't charge
> for the group and an additional exercise for the one service. This did
> not mean that they could not received group therapy and those other
> services on the same day.
>
> He said that BCBS AL is not making any system changes related to this
> transmittal or the CCI edits.
>
>
>
>
> Confidentiality Notice: This e-mail communication and any attachments may
> contain confidential and privileged information for the use of the
> designated recipients named above. If you are not the intended recipient,
> you are hereby notified that you have received this communication in
> error and that any review, disclosure, dissemination, distribution or
> copying of it or its contents is prohibited. If you have received this
> communication in error, please notify me immediately by replying to this
> message and deleting it from your computer. Thank you.

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Nantz, Jessica

n: Zurek, Matthew
t: Tuesday, June 25, 2002 11:29 AM
To: Nantz, Jessica
Subject: RE: DO NOT FORWARD

Tab 72

Importance: High

Yes, Given the impact, holding is a good idea.

nz

-----Original Message-----
From: Nantz, Jessica
Sent: Tuesday, June 25, 2002 9:40 AM
To: Zurek, Matthew; Folts, Barbara
Cc: Mosier, Mary
Subject: DO NOT FORWARD

Do we need to hold on the call today?

-----Original Message-----
From: Schmitt, Rick
Sent: Tuesday, June 25, 2002 8:27 AM
To: Chris Reading; Dan Riviere; Jessica Nantz; Marc Goff; Mike Rickman; Rick Katz; Sean Huffman
Subject: Group Code Roll Out

Here is an update on the group code roll out.

Currently Susan Jones and Bill Horton are evaluating if the group code changes apply to HealthSouth. Because of the financial impact they want to be certain that we roll it out properly and there appears to be conflicting information between the various entities involved.

We are getting the billing functionality established but we are on hold as far as rolling the plan out to the field.

I will let you know as soon as I know where we are going with this.

Please let me know if you have any questions.

Thanks

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Layton, Patience

From: Fleming, Lynn
Sent: Wednesday, June 26, 2002 11:27 AM
To: Foster, Pat
Cc: Layton, Patience
Subject: FW: GROUP THERAPY/RICK SCHMITT

Tab 73

see below

-----Original Message-----
From: Duck, Julie
Sent: Wednesday, June 26, 2002 11:24 AM
To: Fleming, Lynn
Subject: Fw: GROUP THERAPY/RICK SCHMITT

Just wanted to forward you this message that went out to ambulatory.

-----Original Message-----
From: Desousa, Lourdes <Lourdes.Desousa@healthsouth.com>
To: OPS - OP RBOM [EX:/O=HRC/OU=HEALTHSOUTH/CN=Distribution Lists/cn=OP RBOM]
CC: Schmitt, Rick <Rick.Schmitt@healthsouth.com>; McDaniel, Brannon <Brannon.McDaniel@healthsouth.com>
Sent: Wed Jun 26 11:19:44 2002
Subject: GROUP THERAPY/RICK SCHMITT

Rick, has asked I send this e-mail to all rbom's.

Bill Hornton has advised that we need to begin using the group therapy charge 97150. Brannon will be adding this code sometime today. All rbo's will need to price out this code $10.00 less than therex. If you have any questions, feel free to Brannon McDaniel or Rick Schmitt.

Lourdes DeSousa
Regional Business Office Manager
Healthsouth Corporation
800-288-0024

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Horton, Bill

From: Horton, Bill
Sent: Wednesday, June 26, 2002 9:45 PM
To: Jones, Susan
Subject: RE: From Pat Foster-Group Code

Tab 74

I talked to Bill today and Weston yesterday. In light of (a) my reading of the Carriers Manual and (b) Reed Smith's reading of the Carriers Manual, I believe that anything that is paid under Part B (incl. CORFs and rehab agencies) is covered by the new policy. Bill and Weston agree. I want to see what McKinney gives us in writing, if anything, but I am less and less comforted by what he told you before. I have recommended to Bill that we proceed to modify our policies, and he agreed. I spent some time with Rick this morning and will meet with Pat tomorrow. Give me a call if you get a chance and I'll catch you up.

-----Original Message-----
From: Jones, Susan
Sent: Wednesday, June 26, 2002 4:37 PM
To: Horton, Bill
Subject: Fw: From Pat Foster-Group Code

I can't get Schmitt to give us any time on this.
My read on the current situation remains BUSINESS AS USUAL.

I sent Dr McKinney the email and connie verified that he recd it.

I have not recd a reply to the email.

I'm out of town today and tomorrow but will let u know when I receive a response from dr mckinney.

Do u agree?
Susan Jones
HEALTHSOUTH Corp.

-----Original Message-----
From: Fleming, Lynn <Lynn.Fleming@healthsouth.com>
To: Jones, Susan <Susan.Jones@healthsouth.com>
CC: Foster, Pat <Pat.Foster@healthsouth.com>
Sent: Wed Jun 26 11:52:30 2002
Subject: From Pat Foster-Group Code

Susan see below. Pat's email is down. Is this email below correct? From Pat's last conversation with you, we were told to sit tight. Has there been a change in that directive? Please advise. Thanks

-----Original Message-----
From: Schmitt, Rick
Sent: Wednesday, June 26, 2002 10:17 AM
To: Chris Reading; Dan Riviere; Jessica Nantz; Marc Goff; Mike Rickman; Rick Katz; Sean Huffman
Cc: Taylor, Larry; Edwards, Aprile; Zurek, Matthew; Fleming, Lynn
Subject: Group Code

Senior management has determined the new group code requirements that we have been discussing the past few days applies to us both in both Part A and Part B as well as inpatient outpatient. We are currently working on all of the interfaces with HCAP, HPAS and the billing and charge structure. Matt Zurek will be sending some clinical and documentation guidelines out today to all administrators to get them started.

HCAP will not be ready to document group codes until mid next week but we need to have

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out therapist using the one on one treatment protocols starting July 1.

will be traveling today and tomorrow but you can reach me by Blackberry if you have any questions.

Thanks

Confidential Treatment
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Corp.

HHEC16/0785

Horton, Bill

From: Horton, Bill
Sent: Wednesday, June 26, 2002 9:45 PM
To: Jones, Susan
Subject: RE: From Pat Foster-Group Code

I talked to Bill today and Weston yesterday. In light of (a) my reading of the Carriers Manual and (b) Reed Smith's reading of the Carriers Manual, I believe that anything that is paid under Part B (incl. CORFs and rehab agencies) is covered by the new policy. Bill and Weston agree. I want to see what McKinney gives us in writing, if anything, but I am less and less comforted by what he told you before. I have recommended to Bill that we proceed to modify our policies, and he agreed. I spent some time with Rick this morning and will meet with Pat tomorrow. Give me a call if you get a chance and I'll catch you up.

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To: Horton, Bill
Subject: Fw: From Pat Foster-Group Code

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My read on the current situation remains BUSINESS AS USUAL.

I sent Dr McKinney the email and connie verified that he recd it.

I have not recd a reply to the email.

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Do u agree?
Susan Jones
HEALTHSOUTH Corp.

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To: Jones, Susan <Susan.Jones@healthsouth.com>
CC: Foster, Pat <Pat.Foster@healthsouth.com>
Sent: Wed Jun 26 11:52:30 2002
Subject: From Pat Foster-Group Code

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Subject: Group Code

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out therapist using the one on one treatment protocols starting July 1.

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Thanks

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HHEC16/0783

Horton, Bill

From: Horton, Bill
Sent: Friday, June 28, 2002 10:47 PM
To: Jones, Susan; Owens, Bill; Smith, Weston; Foster, Pat; Taylor, Larry; Davis, Jean (AL); Fleming, Lynn
Subject: RE: Re: FW: Transmittal 1753--ATTORNEY-CLIENT PRIVILEGED AND CONFIDENTIAL

This, I think, is the point that I was afraid of. What McKinney is saying can be construed as meaning that this is just clarifying for physicians what everybody else should already know. I don't think this is helpful to us. What we need to do, if we are going to pursue this, is get advice (face-to-face with witnesses or, better, in writing) as to how BCBSAL is interpreting the same activity/different activity issue. This can easily be read just to mean that physicians/PTIPs are being held to the same standard as CORFs/rehab agencies.

-----Original Message-----
From: Jones, Susan
Sent: Friday, June 28, 2002 1:47 PM
To: Owens, Bill; Horton, Bill; Smith, Weston; Foster, Pat; Taylor, Larry; Davis, Jean (AL); Fleming, Lynn
Subject: Fw: Re: FW: Transmittal 1753

This is email I just recd from medical director at bcbsal.

Note the transmittal is to physicians. Be further states that the CPT code applies to all providers. There is no change to the CPT definition of group.

Susan Jones
HEALTHSOUTH Corp.

-----Original Message-----
From: Dr. Greg McKinney <gmckinney@bcbsal.org>
To: Jones, Susan <Susan.Jones@healthsouth.com>
CC: Glenda Bradley <gbradley.Medicare.BCBSAL@bcbsal.org>
Sent: Fri Jun 28 12:23:45 2002
Subject: Re: FW: Transmittal 1753

The transmittal was a clarification on 97150 for independent practitioners (MDs who perform the service or Independent PTs). The definition of 97150 as per the CPT manual is applicable to all providers of this service.
Thanks

Greg McKinney, MD, MBA
CMD Fiscal Intermediary
Alabama
205-220-4894
(Fax) 205-220-4708

>>> "Jones, Susan" <Susan.Jones@healthsouth.com> 06/26/02 11:05AM >>>

> -----Original Message-----
> From: Jones, Susan
> Sent: Tuesday, June 25, 2002 11:03 AM
> To: 'gmckinney@bcbs.org'
> Cc: 'gbradley@bcbs.org'
> Subject: Transmittal 1753
>

Confidential Treatment Requested by HealthSouth Corp.

HHEC16/0805

> Dear Dr McKinney:
>
> Per our discussion last Friday, I am forwarding my understanding of your
> interpretation related to transmittal 1753.
>
> Transmittal 1753, dated May 17, 2002 is in the Medicare Carriers Manual
> pertaining to Part B. You indicated that this applies only to Part B
> physician services, to services rendered by a physical therapist employed
> by a physician or to services rendered by an independent practitioner.
> Based on our conversation, you have advised us this does not apply to
> hospital outpatient services, CORFs or rehabilitation agencies, even
> though such entities are reimbursed from the physician fee schedule.
>
> Typically Part B services are billed on form 1500 and Part A services on
> UB92. All of HEALTHSOUTH's outpatient therapy services are billed on UB92
> through a Part A provider agreement. We are governed and regulated as
> Part A providers and not by individual practioner regulations, although
> benefits for our services are paid under Part B. Thus, in your view, this
> transmittal does not apply even where Part B benefits are being paid, so
> long as they are being paid under a Part A provider agreement.
>
> Please verify that my understanding of our discussion is correct, as we
> are trying to make every effort to ensure that we are complying with this
> transmittal to the extent it is applicable to us. I can be reached at
> 205-970-5580. Thanks for your assistance.
>
>
> Susan Jones
> Sr. Vice President Reimbursement
> HEALTHSOUTH Corporation
>
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designated recipients named above. If you are not the intended recipient,
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it or its contents is prohibited. If you have received this communication
in error, please notify me immediately by replying to this message and
deleting it from your computer. Thank you.

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Tab 75

Horton, Bill

From: Horton, Bill
Sent: Friday, June 28, 2002 10:47 PM
To: Jones, Susan; Owens, Bill; Smith, Weston; Foster, Pat; Taylor, Larry; Davis, Jean (AL); Fleming, Lynn
Subject: RE: Re: FW: Transmittal 1753--ATTORNEY-CLIENT PRIVILEGED AND CONFIDENTIAL

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HEALTHSOUTH Corp.

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Confidential Treatment Requested by HealthSouth Corp.

HHEC16/0805

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> long as they are being paid under a Part A provider agreement.
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> Please verify that my understanding of our discussion is correct, as we
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> transmittal to the extent it is applicable to us. I can be reached at
> 205-970-5580. Thanks for your assistance.
>
>
> Susan Jones
> Sr. Vice President Reimbursement
> HEALTHSOUTH Corporation
>
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contain confidential and privileged information for the use of the
designated recipients named above. If you are not the intended recipient,
you are hereby notified that you have received this communication in error
and that any review, disclosure, dissemination, distribution or copying of
it or its contents is prohibited. If you have received this communication
in error, please notify me immediately by replying to this message and
deleting it from your computer. Thank you.

Confidential Treatment Requested by HealthSouth Corp.

HEALTHSOUTH Rehabilitation Corporation
One HealthSouth Parkway
Birmingham, Alabama 35243

MEMORANDUM

TO: File **Tab 76**

FROM: William W. Horton

DATE: June 28, 2002

RE: Group Therapy

This memorandum is intended to summarize the discussion of a meeting today among Bill Owens, Weston Smith, Susan Jones, Pat Foster, Bill Horton and others concerning the interpretation of Medicare Program Transmittal 1753, Section 15302, relating to use of the group therapy billing code for outpatient physical therapy and occupational therapy services. Those present discussed the nature of the program transmittal, including its issuance only to Part B carriers and not to Part A intermediaries. Also discussed was the advice from Dr. McKinney, Medical Director of Blue Cross of Alabama, indicating that this program transmittal only applied to therapy rendered in a Part B setting. After considerable discussion, a decision was made to continue seeking clarification from Blue Cross as to appropriate billing procedures and to refrain from changing any policies or procedures until further clarification was received. Susan Jones and Bill Horton will attempt to continue to try to get clarification from Blue Cross. It is anticipated that the issue will be revisited during the first week in July. In the interim, we will continue to work under our understanding of the most recent interpretation from Dr. McKinney.

WWH/gw/9496.1

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Nantz, Jessica

From: Zurek, Matthew
Sent: Friday, June 28, 2002 4:19 PM
To: Nantz, Jessica
Subject: RE: Group Code Update

Tab 77

Just got off the fone with Rick Scmitt and Bill Owens. We need to move forward as if this is going to happen. I have been on the fone with admins, site managers,and some site visits in Austin. Folks seem to be handling well, some good creative ways of managing (capturing volume and $$).

Hope all is well in AZ. Safe flight!

-----Original Message-----
From: Nantz, Jessica
Sent: Friday, June 28, 2002 4:02 PM
To: Zurek, Matthew
Subject: Fw: Group Code Update

Didn't know if you heard.
Jessica Nantz

-----Original Message-----
From: Schmitt, Rick <Rick.Schmitt@healthsouth.com>
To: OPS - OP RBOM [EX:/O=HRC/OU=HEALTHSOUTH/CN=Distribution Lists/cn=OP RBOM]; OPS - ML & MM [EX:/O=HRC/OU=HEALTHSOUTH/CN=Distribution Lists/cn=OPS MLMM]; OPS - Market Coordinators [EX:/O=HRC/OU=HEALTHSOUTH/CN=Distribution Lists/cn=East Coordinator]
CC: Taylor, Larry <Larry.Taylor@healthsouth.com>; Edwards, Mark <Mark.Edwards@healthsouth.com>; Fleming, Lynn <Lynn.Fleming@healthsouth.com>
Sent: Fri Jun 28 15:54:52 2002
Subject: Group Code Update

As you heard on Bill's call we are going to continue to evaluate if the group code changes effect our facilities. Bill also said that we had to be in a position to go either way from a billing and documentation perspective. The only way we can do that is to implement the group code documentation requirements as we have been working on them over the past week.

ITG is scheduled to send the HCAP group documentation upgrades to the field over the weekend. The clinicians should begin documenting as if the group code requirement is in place. This way we can change the way we bill Medicare as needed.

Please contact your individual administrators to make sure they understand what they need to do effective Monday July 1..

If you have any questions contact either Matt Zurek or myself.

Thanks

HHEC 09-00734
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Requested by HealthSouth Corp

Tab 78

From: Jones, Susan

To: OPS - IP Market Leaders

CC: Foster, Pat; Taylor, Larry; Schmitt, Rick; Horton, Bill

Subject: n/a

Date: 07/02/2002 11:04:58 AM EST

As a follow up on the group therapy definitions, I am scheduling a meeting with CMS for clarification.

Please continue business as usual as directed by Bill Owens last Friday.

When we have definitive information from CMS, we will let you know.

Thanks

Horton, Bill

From: Horton, Bill
Sent: Sunday, July 07, 2002 4:40 PM
To: Owens, Bill
Cc: Smith, Weston; Jones, Susan
Subject: FW: Sent on behalf of Tom Fox/Scot Hasselman--IMPORTANT; PLEASE READ

Importance: High

Tab 79

0298484.DOC

Please review the attached memo from Tom Fox on the status of group therapy issues and legislative initiatives. In particular, I point out that Reed Smith's strong advice is that the recent group therapy transmittal should be read to apply to any non-PPS PT or OT services. I agree with this position, and I do not believe what we have gotten from BCBSAL is inconsistent with that or particularly helpful to us. I think we need to get clarification to the field on this right away, and I'd like to discuss this with you as soon as possible.

Tom also indicates that Gary Capistrant is not hopeful about legislative fixes, and particularly that Hatch's staff does not seem interested in trying to be responsive. I believe that we need to get Eric and Gary in for a meeting to get a clear picture on what is doable/not doable in this area, as the picture that Tom seems to be getting from Gary is fairly grim relative to what I had understood from Eric week before last.

Please review this and let me know how you want to proceed as soon as possible.

-----Original Message-----
From: Bird, Beverly M. [mailto:BBird@ReedSmith.com]
Sent: Friday, July 05, 2002 3:24 PM
To: Jones, Susan; Horton, Bill
Cc: 'Joseph Mays'; 'Jack Selden'; 'Richard Sharff'; Cody, Daniel A.; Hurst, Andrew L.
Subject: Sent on behalf of Tom Fox/Scot Hasselman

<<0298484.DOC>>

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(see p 6)

ReedSmith

MEMORANDUM

TO: Susan M. Jones
William Horton

DATE: July 5, 2002

FROM: Thomas C. Fox
Scot T. Hasselman

CC: Joseph Mays
Jack W. Selden
Richard Sharff, Jr.
Daniel A. Cody
Andrew L. Hurst

RE: Transmittal 1753

Background

Medicare Carriers Manual Part 3 – Claims Process was revised by the Centers for Medicare & Medicaid Services ("CMS") in the subject transmittal dated May 17, 2002, to provide the following guidance regarding group therapy ("Group Therapy") services (Code 97150) and therapy students. The transmittal group therapy definition essentially follows the coding guidance provided by the American Medical Association ("AMA") which promulgates the Physicians Current Procedural Terminology ("CPT") codes used in the physician fee schedule (the payment system for Part B physical therapy). Because the definition is so expansive, it would encompasses all therapy provided to more than one patient at the same time, whether "concurrent" or utilizing an extender such as an aide:

> 15302. GROUP THERAPY SERVICES (Code 97150)
>
> Pay for outpatient physical therapy services (which includes outpatient speech-language pathology services) and outpatient occupational therapy services provided simultaneously to two or more individuals by a practitioner as group therapy services. The individuals can be, but need not be performing the same activity. The physician or therapist involved in group therapy services must be in constant attendance, but one-on-one patient contact is not required.

1301 K Street, N.W.
Suite 1100 - East Tower
Washington, D.C. 20005-3373
202.414.9200
Fax 202.414.9299

Delaware
New Jersey
New York
Pennsylvania
United Kingdom
Virginia
Washington, DC

r e e d s m i t h . c o m

DCUA-0298-484 01-STHA-1551

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15304. THERAPY STUDENTS

A. General. – Only the services of the therapist can be billed and paid under Medicare Part B. The services performed by a student are not reimbursed even if provided under "line of sight" supervision of the therapist; however, the presence of the student "in the room" does not make the service unbillable. Pay for the direct (one-to-one) patient contact services of the physician or therapist provided to Medicare Part B patients. Group therapy services performed by a therapist or physician may be billed when a student is also present "in the room."

Examples — Therapists may bill and be paid for the provision of services in the following scenarios:

- The qualified practitioner is present and in the room for the entire session. The student participates in the delivery of services when the qualified practitioner is directing the service, making the skilled judgment, and is responsible for the assessment and treatment.

- The qualified practitioner is present in the room guiding the student in service delivery when the therapy student and the therapy assistant student are participating in the provision of services, and the practitioner is not engaged in treating another patient of doing other tasks at the same time.

C. Therapy Assistants as Clinical Instructors – Physical therapist assistants and occupational therapy assistants are not precluded from serving as clinical instructors (CIs) for therapy students, while providing services within the scope of work and performed under the direction and supervision of a licensed physical or occupational therapist to a Medicare beneficiary.

D. Services Provided under Part A and Part B – The payment methodologies for Part A and B therapy services rendered by a student are different. Under the physician fee schedule (Medicare Part B), Medicare pays for services provided by physicians and practitioners that are specifically authorized by statute. Students do not meet the definition of practitioners under Medicare Part B. Under SNF PPS, payments are based upon the case mix or RUG category that describes the patient. In the rehabilitation groups, the number of therapy minutes delivered to the patient determine the RUG category. Payment levels for each category are based upon the costs of caring for patients in each group rather than providing specific payment for each therapy service as is done in Medicare Part B.

Significantly, the cover page of the transmittal for "Section 15302, Group Therapy Services (Code 97150)" states as follows:

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HHEC16/0820

NEW/REVISED MATERIAL – EFFECTIVE DATE: July 1, 2002
IMPLEMENTATION DATE: May 17, 2002

Section 15302, Group Therapy Services (Code 97150), is added to clarify payment policy for group therapy services.

By comparison, "Section 15304, Therapy Students," provides as follows:

CLARIFICATION/MANUALIZATION – EFFECTIVE DATE: Not Applicable
IMPLEMENTATION DATE: Not applicable.

Section 15304, Therapy Students, manualizes PM AB-01-56, "Questions and Answers Regarding Payment for the Services of Therapy Students Under Part B of Medicare."

U.S. Strategies

We met with Gary Capistrant of U.S. Strategies on Wednesday, July 3, 2002,and learned the following information:

- The House Ways and Means staff views Transmittal 1753 as not representing any change in CMS policy.
- The staff of Senator Hatch is closely aligned with CMS (via a former staffer) and views Transmittal 1753 as resolving any issues on the definition of Group Therapy, and thus sees no need for any legislation.
- Recent Congressional action on the therapy cap and physician fee schedule is likely to be all Congress will do (or want to do) that relates to therapy issues.
- Staff in both the House and Senate are skeptical on the need for any legislation, and not open to any arguments that suggest Medicare should be billed for more than 4 units in an hour.
- Staff see this as a payment problem to be taken up with CMS as opposed to a coding problem, i.e., there is a code which describes the service. That code is group therapy and the problem providers have (in their view) is that payment is too low.

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HHEC16/0821

- Senate not likely to take up anything on Medicare until September.

- Some opportunity may exist to educate Hatch's staff on therapy issues in response to a series of questions given to Capistrant, but the therapy issues are not at the top of their list, and any legislation is unlikely.

National Association for Support of Long Term Care ("NASL")

We learned from NASL's outside counsel that a letter has been drafted for NASL to send to Terry Kaye (CMS official) protesting issuance of Transmittal 1753 and adoption of the CPT Code definition of Group Therapy previously withdrawn by CMS after the "Listening Session." Counsel speculated that issuance of Transmittal 1753 was the work of Dr. Laurie Feinberg (CMS Official), who has in the past been identified as a somewhat "rogue official" and that the issuance was not the result of any internal CMS deliberative process.

Listening Session

We do not have any information on the other organizations (approximately 18 trade associations) who participated in the Listening Session and submitted comments protesting the CPT code definition of group therapy,[1] and the failure of CMS to incorporate the clinical definition of group therapy into its policy. Some of these organizations included:

---

1 On June 18, 1999, at the insistence of rehabilitation therapy provider organizations, HCFA (now CMS) convened a "Listening Session" to discuss Draft PM AB-99, which stated as follows with respect to group therapy:

> Group Therapy – Code 97150
>
> The current policy has been to use the CPT definition of group therapy, 97150. We are concerned that some providers may not be familiar with the CPT definition, which may not be the same as their clinical concept of group therapy. CPT defines a group as treatment of two or more patients at the same time. If a therapist or physician performs any of the CPT Physical Medicine procedures with two or more individuals concurrently or during the same time period, then only 97150 is reported. (Note that 97150 is not a timed code, so one unit should be billed for a calendar day.) CPT Assistant Vol. 5, No. 2, Summer 1995, p.8; response to a question: CPT Assistant Vol. 7, Issue 2, Feb. 97, p. 10). This CPT policy was also used as a example in the preamble of the November 22, 1996

Continued on following page

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HHEC16/0822

- American Academy of Physician Medicine and Rehabilitation
- American Association of Homes and Services for the Aging
- American Health Care Association
- American Medical Rehabilitation Providers Association
- Federation of American Health Systems
- NASL
- American Occupational Therapy Association
- American Physical Therapy Association
- American Speech-Language Hearing Association
- Various state associations of rehabilitation facilities

DOJ Civil False Claims Litigation

The above action by CMS in Transmittal 1753 and the language used to describe the material and effective date of the Group Therapy Services (Code 97150) presents a further argument for dismissing the alleged claims against HealthSouth for periods prior to July 1, 2002, and based upon DOJ alleged application of the CPT code definition of Group Therapy.

The position of HealthSouth has been that the Health Care Financing Administration (now CMS) never adopted the CPT code definition of Group Therapy and therefore it cannot be liable with respect to claims that it allegedly inappropriately billed as concurrent therapy for therapy that should have been billed under the Group Therapy Code. The transmittal presents strong evidence to support the position of HealthSouth.

Continued from previous page

Federal Register notice (P. 59542) on the MPFS. The two patients are counted as being treated concurrently or in the same time period by the therapist (or an assistant under his or her supervision). If a therapist or a physician performs the treatment on two or more patients during the same time periods, or with the assistance of an aide or an assistant, the treatment must be reported using the group therapy code, 97150. For example, for a 25 minute group session of three patients being treated with aquatic therapy or therapeutic exercise, one unit of 97150 should be billed.

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HHEC16/0823

Operations and Legal Issues Presented for
HealthSouth by Transmittal 1753

Accepting the CPT code definition of Group Therapy as effective July 1, 2002, assumes that HealthSouth would now follow that guidance in its Medicare billing practice. We understand, however, that there are significant implications of HealthSouth accepting this definition in billing for outpatient therapy provided through satellite operations of its rehabilitation hospitals. While the DOJ false claims case relates only to HealthSouth outpatient agencies, and currently carves-out any claims on rehabilitation hospital billings, the definition of Group Therapy to be effective July 1, 2002, would also apply to its hospital outpatient billings.

Although Congress directed that CMS establish a separate prospective payment system for hospital outpatient departments, Congress specifically excluded therapy services as a covered prospective payment system service. Social Security Act ("SSA") § 1833(t)(1)(B)(iv). Instead, physical therapy services provided by a hospital to an outpatient are paid under the physician fee schedule via the same Medicare Part B authority as those physical therapy services provided in a rehab agency, clinic, comprehensive outpatient rehabilitation facility, or other settings. SSA § 1833(b)(8)(B). Since hospital outpatient departments use the physician fee schedule, which utilizes CPT coding for payment determination, the problem associated with the group therapy definition is the same.

There are, however, some minor regulatory differences between hospital outpatient physical therapy services and those physical therapy services provided in other settings such as a rehabilitation agency. Specifically, the conditions of participation ("COPs") for hospital outpatient departments are abbreviated when compared to the COPs for agencies. For example, the hospital COPs provide that "physical therapy services...must be provided by staff who meet the qualifications specified by the medical staff, consistent with State law." 42 C.F.R. § 482.57. This is in contrast with the personnel qualifications requirements provided for agencies, which specifies certain educational and other requirements for physical therapists and physical therapy assistant. See 42 C.F.R. § 485.705. This difference is worth noting because DOJ's solitary citation in the Devage complaint regarding the use of aides is to the COPs for agencies and other providers (i.e., those COPs that are inapplicable to hospitals and outpatient departments). Therefore, in a defensive position, we could argue that the use of

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HHEC16/0824

aides in hospital outpatient departments is permitted to the extent they are in accord with state law. While this is essentially our argument on the agency site of service, the argument is better supported in the hospital through the concise regulatory language. Also, the citation relied upon by DOJ does not apply to hospitals as a matter of law.

However, if HealthSouth were to continue to utilize the clinical standards followed in the past, which essentially limited billing under the Group Therapy Code only when two or more patients were treated at the same time with the same modality, as opposed to billing for concurrent therapy if the patients were treated with different modalities, the risk of liability for claims submitted by HealthSouth for services provided after July 1, 2002, is greatly increased, and could implicate its rehab hospitals.

Options Available to HealthSouth

1. Due to federal jurisdictional issues, there is little, if any, likelihood that a federal court challenge to this manual adoption of the definition of Group Therapy for failure to follow the Administrative Procedure Act rulemaking requirement would be successful.

2. Based upon the discussions with Gary Capistrant, it appears unlikely that any federal legislation would override the actions by CMS and legislate adoption of the clinical standards followed by therapy providers. Capistrant suggests that through the responses to the questions from the staff of Senator Hatch and some educational efforts, the staff might be willing to seek clarifications from CMS on its Group Therapy policy. While this also appears unlikely, it has the downside of the clarifications being that Transmittal 1753 simply clarified existing payment policy, and thus could undercut the arguments to be advanced in the DOJ false claims litigation for dismissal of the group therapy claims if it came out in any legislative context.

3. Assuming HealthSouth and other therapy groups, such as NASL and the Federation could mount a successful effort such as was accomplished by the prior Listening Session and have CMS, once again, withdraw Transmittal 1753, this could be favorable to HealthSouth with respect to the litigation as well as the operational issues. On the former, it would prevent yet another instance of CMS putting forth the CPT code definition of Group Therapy and then abandoning or withdrawing it. On the operation side, HealthSouth could

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HHEC16/0825

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HHEC16/0826

Horton, Bill

From: Horton, Bill
Sent: Sunday, July 07, 2002 4:40 PM
To: Owens, Bill
Cc: Smith, Weston; Jones, Susan
Subject: FW: Sent on behalf of Tom Fox/Scot Hasselman--IMPORTANT; PLEASE READ

Importance: High

0298484.DOC

Please review the attached memo from Tom Fox on the status of group therapy issues and legislative initiatives. In particular, I point out that Reed Smith's strong advice is that the recent group therapy transmittal should be read to apply to any non-PPS PT or OT services. I agree with this position, and I do not believe what we have gotten from BCBSAL is inconsistent with that or particularly helpful to us. I think we need to get clarification to the field on this right away, and I'd like to discuss this with you as soon as possible.

Tom also indicates that Gary Capistrant is not hopeful about legislative fixes, and particularly that Hatch's staff does not seem interested in trying to be responsive. I believe that we need to get Eric and Gary in for a meeting to get a clear picture on what is doable/not doable in this area, as the picture that Tom seems to be getting from Gary is fairly grim relative to what I had understood from Eric week before last.

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<<0298484.DOC>>

Confidential Treatment Requested by HealthSouth Corp.

HHEC16/0827

(see p 6)

ReedSmith

MEMORANDUM

TO: Susan M. Jones
William Horton

DATE: July 5, 2002

FROM: Thomas C. Fox
Scot T. Hasselman

CC: Joseph Mays
Jack W. Selden
Richard Sharff, Jr.
Daniel A. Cody
Andrew L. Hurst

RE: Transmittal 1753

Background

Medicare Carriers Manual Part 3 – Claims Process was revised by the Centers for Medicare & Medicaid Services ("CMS") in the subject transmittal dated May 17, 2002, to provide the following guidance regarding group therapy ("Group Therapy") services (Code 97150) and therapy students. The transmittal group therapy definition essentially follows the coding guidance provided by the American Medical Association ("AMA") which promulgates the Physicians Current Procedural Terminology ("CPT") codes used in the physician fee schedule (the payment system for Part B physical therapy). Because the definition is so expansive, it would encompasses all therapy provided to more than one patient at the same time, whether "concurrent" or utilizing an extender such as an aide:

> 15302. GROUP THERAPY SERVICES (Code 97150)
>
> Pay for outpatient physical therapy services (which includes outpatient speech-language pathology services) and outpatient occupational therapy services provided simultaneously to two or more individuals by a practitioner as group therapy services. The individuals can be, but need not be performing the same activity. The physician or therapist involved in group therapy services must be in constant attendance, but one-on-one patient contact is not required.

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HHEC16/0819

15304. THERAPY STUDENTS

A. General. – Only the services of the therapist can be billed and paid under Medicare Part B. The services performed by a student are not reimbursed even if provided under "line of sight" supervision of the therapist; however, the presence of the student "in the room" does not make the service unbillable. Pay for the direct (one-to-one) patient contact services of the physician or therapist provided to Medicare Part B patients. Group therapy services performed by a therapist or physician may be billed when a student is also present "in the room."

Examples — Therapists may bill and be paid for the provision of services in the following scenarios:

- The qualified practitioner is present and in the room for the entire session. The student participates in the delivery of services when the qualified practitioner is directing the service, making the skilled judgment, and is responsible for the assessment and treatment.

- The qualified practitioner is present in the room guiding the student in service delivery when the therapy student and the therapy assistant student are participating in the provision of services, and the practitioner is not engaged in treating another patient of doing other tasks at the same time.

C. Therapy Assistants as Clinical Instructors – Physical therapist assistants and occupational therapy assistants are not precluded from serving as clinical instructors (CIs) for therapy students, while providing services within the scope of work and performed under the direction and supervision of a licensed physical or occupational therapist to a Medicare beneficiary.

D. Services Provided under Part A and Part B – The payment methodologies for Part A and B therapy services rendered by a student are different. Under the physician fee schedule (Medicare Part B), Medicare pays for services provided by physicians and practitioners that are specifically authorized by statute. Students do not meet the definition of practitioners under Medicare Part B. Under SNF PPS, payments are based upon the case mix or RUG category that describes the patient. In the rehabilitation groups, the number of therapy minutes delivered to the patient determine the RUG category. Payment levels for each category are based upon the costs of caring for patients in each group rather than providing specific payment for each therapy service as is done in Medicare Part B.

Significantly, the cover page of the transmittal for "Section 15302, Group Therapy Services (Code 97150)" states as follows:

Confidential Treatment Requested by HealthSouth Corp.

HHEC16/0820

NEW/REVISED MATERIAL – EFFECTIVE DATE: July 1, 2002
IMPLEMENTATION DATE: May 17, 2002

Section 15302, Group Therapy Services (Code 97150), is added to clarify payment policy for group therapy services.

By comparison, "Section 15304, Therapy Students," provides as follows:

CLARIFICATION/MANUALIZATION – EFFECTIVE DATE: Not Applicable
IMPLEMENTATION DATE: Not applicable.

Section 15304, Therapy Students, manualizes PM AB-01-56, "Questions and Answers Regarding Payment for the Services of Therapy Students Under Part B of Medicare."

U.S. Strategies

We met with Gary Capistrant of U.S. Strategies on Wednesday, July 3, 2002,and learned the following information:

- The House Ways and Means staff views Transmittal 1753 as not representing any change in CMS policy.
- The staff of Senator Hatch is closely aligned with CMS (via a former staffer) and views Transmittal 1753 as resolving any issues on the definition of Group Therapy, and thus sees no need for any legislation.
- Recent Congressional action on the therapy cap and physician fee schedule is likely to be all Congress will do (or want to do) that relates to therapy issues.
- Staff in both the House and Senate are skeptical on the need for any legislation, and not open to any arguments that suggest Medicare should be billed for more than 4 units in an hour.
- Staff see this as a payment problem to be taken up with CMS as opposed to a coding problem, i.e., there is a code which describes the service. That code is group therapy and the problem providers have (in their view) is that payment is too low.

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HHEC16/0821

- Senate not likely to take up anything on Medicare until September.

- Some opportunity may exist to educate Hatch's staff on therapy issues in response to a series of questions given to Capistrant, but the therapy issues are not at the top of their list, and any legislation is unlikely.

National Association for Support of Long Term Care ("NASL")

We learned from NASL's outside counsel that a letter has been drafted for NASL to send to Terry Kaye (CMS official) protesting issuance of Transmittal 1758 and adoption of the CPT Code definition of Group Therapy previously withdrawn by CMS after the "Listening Session." Counsel speculated that issuance of Transmittal 1753 was the work of Dr. Laurie Feinberg (CMS Official), who has in the past been identified as a somewhat "rogue official" and that the issuance was not the result of any internal CMS deliberative process.

Listening Session

We do not have any information on the other organizations (approximately 18 trade associations) who participated in the Listening Session and submitted comments protesting the CPT code definition of group therapy,[1] and the failure of CMS to incorporate the clinical definition of group therapy into its policy. Some of these organizations included:

---

1 On June 18, 1999, at the insistence of rehabilitation therapy provider organizations, HCFA (now CMS) convened a "Listening Session" to discuss Draft PM AB-99, which stated as follows with respect to group therapy:

> Group Therapy – Code 97150
>
> The current policy has been to use the CPT definition of group therapy, 97150. We are concerned that some providers may not be familiar with the CPT definition, which may not be the same as their clinical concept of group therapy. CPT defines a group as treatment of two or more patients at the same time. If a therapist or physician performs any of the CPT Physical Medicine procedures with two or more individuals concurrently or during the same time period, then only 97150 is reported. (Note that 97150 is not a timed code, so one unit should be billed for a calendar day.) CPT Assistant Vol. 5, No. 2, Summer 1995, p.8; response to a question: CPT Assistant Vol. 7, Issue 2, Feb. 97, p. 10). This CPT policy was also used as a example in the preamble of the November 22, 1996

Continued on following page

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HHEC16/0822

- American Academy of Physician Medicine and Rehabilitation
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- American Health Care Association
- American Medical Rehabilitation Providers Association
- Federation of American Health Systems
- NASL
- American Occupational Therapy Association
- American Physical Therapy Association
- American Speech-Language Hearing Association
- Various state associations of rehabilitation facilities

DOJ Civil False Claims Litigation

The above action by CMS In Transmittal 1753 and the language used to describe the material and effective date of the Group Therapy Services (Code 97150) presents a further argument for dismissing the alleged claims against HealthSouth for periods prior to July 1, 2002, and based upon DOJ alleged application of the CPT code definition of Group Therapy.

The position of HealthSouth has been that the Health Care Financing Administration (now CMS) never adopted the CPT code definition of Group Therapy and therefore it cannot be liable with respect to claims that it allegedly inappropriately billed as concurrent therapy for therapy that should have been billed under the Group Therapy Code. The transmittal presents strong evidence to support the position of HealthSouth.

Continued from previous page

Federal Register notice (P. 59542) on the MPFS. The two patients are counted as being treated concurrently or in the same time period by the therapist (or an assistant under his or her supervision). If a therapist or a physician performs the treatment on two or more patients during the same time periods, or with the assistance of an aide or an assistant, the treatment must be reported using the group therapy code, 97150. For example, for a 25 minute group session of three patients being treated with aquatic therapy or therapeutic exercise, one unit of 97150 should be billed.

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HHEC16/0823

Operations and Legal Issues Presented for
HealthSouth by Transmittal 1753

Accepting the CPT code definition of Group Therapy as effective July 1, 2002, assumes that HealthSouth would now follow that guidance in its Medicare billing practice. We understand, however, that there are significant implications of HealthSouth accepting this definition in billing for outpatient therapy provided through satellite operations of its rehabilitation hospitals. While the DOJ false claims case relates only to HealthSouth outpatient agencies, and currently carves-out any claims on rehabilitation hospital billings, the definition of Group Therapy to be effective July 1, 2002, would also apply to its hospital outpatient billings.

Although Congress directed that CMS establish a separate prospective payment system for hospital outpatient departments, Congress specifically excluded therapy services as a covered prospective payment system service. Social Security Act ("SSA") § 1833(t)(1)(B)(iv). Instead, physical therapy services provided by a hospital to an outpatient are paid under the physician fee schedule via the same Medicare Part B authority as those physical therapy services provided in a rehab agency, clinic, comprehensive outpatient rehabilitation facility, or other settings. SSA § 1833(b)(8)(B). Since hospital outpatient departments use the physician fee schedule, which utilizes CPT coding for payment determination, the problem associated with the group therapy definition is the same.

There are, however, some minor regulatory differences between hospital outpatient physical therapy services and those physical therapy services provided in other settings such as a rehabilitation agency. Specifically, the conditions of participation ("COPs") for hospital outpatient departments are abbreviated when compared to the COPs for agencies. For example, the hospital COPs provide that "physical therapy services...must be provided by staff who meet the qualifications specified by the medical staff, consistent with State law." 42 C.F.R. § 482.57. This is in contrast with the personnel qualifications requirements provided for agencies, which specifies certain educational and other requirements for physical therapists and physical therapy assistant. See 42 C.F.R. § 485.705. This difference is worth noting because DOJ's solitary citation in the Devage complaint regarding the use of aides is to the COPs for agencies and other providers (i.e., those COPs that are inapplicable to hospitals and outpatient departments). Therefore, in a defensive position, we could argue that the use of

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aides in hospital outpatient departments is permitted to the extent they are in accord with state law. While this is essentially our argument on the agency site of service, the argument is better supported in the hospital through the concise regulatory language. Also, the citation relied upon by DOJ does not apply to hospitals as a matter of law.

However, if HealthSouth were to continue to utilize the clinical standards followed in the past, which essentially limited billing under the Group Therapy Code only when two or more patients were treated at the same time with the same modality, as opposed to billing for concurrent therapy if the patients were treated with different modalities, the risk of liability for claims submitted by HealthSouth for services provided after July 1, 2002, is greatly increased, and could implicate its rehab hospitals.

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HHEC16/0825

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Confidential Treatment
Requested by HealthSouth
Corp.

HHEC16/0826

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Cc: Smith, Weston; Jones, Susan
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Importance: High

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Confidential Treatment Requested by HealthSouth Corp.

HHEC16/0827

(see p 6)

Reed Smith

MEMORANDUM

TO: Susan M. Jones
William Horton

DATE: July 5, 2002

FROM: Thomas C. Fox
Scot T. Hasselman

CC: Joseph Mays
Jack W. Selden
Richard Sharff, Jr.
Daniel A. Cody
Andrew L. Hurst

RE: Transmittal 1753

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HHEC16/0820

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HHEC16/0821

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HHEC16/0822

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Accepting the CPT code definition of Group Therapy as effective July 1, 2002, assumes that HealthSouth would now follow that guidance in its Medicare billing practice. We understand, however, that there are significant implications of HealthSouth accepting this definition in billing for outpatient therapy provided through satellite operations of its rehabilitation hospitals. While the DOJ false claims case relates only to HealthSouth outpatient agencies, and currently carves-out any claims on rehabilitation hospital billings, the definition of Group Therapy to be effective July 1, 2002, would also apply to its hospital outpatient billings.

Although Congress directed that CMS establish a separate prospective payment system for hospital outpatient departments, Congress specifically excluded therapy services as a covered prospective payment system service. Social Security Act ("SSA") § 1833(t)(1)(B)(iv). Instead, physical therapy services provided by a hospital to an outpatient are paid under the physician fee schedule via the same Medicare Part B authority as those physical therapy services provided in a rehab agency, clinic, comprehensive outpatient rehabilitation facility, or other settings. SSA § 1833(b)(8)(B). Since hospital outpatient departments use the physician fee schedule, which utilizes CPT coding for payment determination, the problem associated with the group therapy definition is the same.

There are, however, some minor regulatory differences between hospital outpatient physical therapy services and those physical therapy services provided in other settings such as a rehabilitation agency. Specifically, the conditions of participation ("COPs") for hospital outpatient departments are abbreviated when compared to the COPs for agencies. For example, the hospital COPs provide that "physical therapy services...must be provided by staff who meet the qualifications specified by the medical staff, consistent with State law." 42 C.F.R. § 482.57. This is in contrast with the personnel qualifications requirements provided for agencies, which specifies certain educational and other requirements for physical therapists and physical therapy assistant. See 42 C.F.R. § 485.705. This difference is worth noting because DOJ's solitary citation in the Devage complaint regarding the use of aides is to the COPs for agencies and other providers (i.e., those COPs that are inapplicable to hospitals and outpatient departments). Therefore, in a defensive position, we could argue that the use of

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aides in hospital outpatient departments is permitted to the extent they are in accord with state law. While this is essentially our argument on the agency site of service, the argument is better supported in the hospital through the concise regulatory language. Also, the citation relied upon by DOJ does not apply to hospitals as a matter of law.

However, if HealthSouth were to continue to utilize the clinical standards followed in the past, which essentially limited billing under the Group Therapy Code only when two or more patients were treated at the same time with the same modality, as opposed to billing for concurrent therapy if the patients were treated with different modalities, the risk of liability for claims submitted by HealthSouth for services provided after July 1, 2002, is greatly increased, and could implicate its rehab hospitals.

Options Available to HealthSouth

1. Due to federal jurisdictional issues, there is little, if any, likelihood that a federal court challenge to this manual adoption of the definition of Group Therapy for failure to follow the Administrative Procedure Act rulemaking requirement would be successful.

2. Based upon the discussions with Gary Capistrant, it appears unlikely that any federal legislation would override the actions by CMS and legislate adoption of the clinical standards followed by therapy providers. Capistrant suggests that through the responses to the questions from the staff of Senator Hatch and some educational efforts, the staff might be willing to seek clarifications from CMS on its Group Therapy policy. While this also appears unlikely, it has the downside of the clarifications being that Transmittal 1753 simply clarified existing payment policy, and thus could undercut the arguments to be advanced in the DOJ false claims litigation for dismissal of the group therapy claims if it came out in any legislative context.

3. Assuming HealthSouth and other therapy groups, such as NASL and the Federation could mount a successful effort such as was accomplished by the prior Listening Session and have CMS, once again, withdraw Transmittal 1753, this could be favorable to HealthSouth with respect to the litigation as well as the operational issues. On the former, it would prevent yet another instance of CMS putting forth the CPT code definition of Group Therapy and then abandoning or withdrawing it. On the operation side, HealthSouth could

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continue its current practice of providing and billing for concurrent therapy, utilizing the current clinical standards, for both its clinics and rehab hospital outpatient departments. The period of time it would take to accomplish such an initiative, if at all, and the billing practices HealthSouth would follow in the interim for services provided after July 1, 2002, need to be addressed as part of this strategy.

4. On the DOJ civil false claims litigation, we do not think that the Transmittal 1753 arguments (in the contemplated initial motion to dismiss in Devage to be filed by July 22) would be a good strategic move, given all the other arguments the court will be asked to decide, such as the "first to file bar" and "original source" arguments, which if successful could result in dismissal of the complaint to all relators, and require DOJ to re-file. Our concern at this point is avoiding making the case too complex for the judge initially and risk losing on what is a strong legal argument based on Transmittal 1753. Therefore, we do not see the DOJ litigation, at this time as offering a viable option on resolving the definition of Group Therapy, if at all.

5. We do not see any potential benefits to seeking further clarification from CAHABA on Transmittal 1753. From the exchange of e-mails with Susan Jones, it would appear that after his initial oral response to Susan, and her follow-up e-mail, Dr. McKinney sought guidance from CMS. Our view is that any further guidance from CAHABA could be unfavorable to HealthSouth and result in a statement that Transmittal 1753 was simply a clarification of CMS and CAHABA policy on Group Therapy. We have the same concerns with a HealthSouth meeting with Tom Grissom at CMS, in that rather than resulting in a withdrawal of Transmittal 1753, CMS could clarify that it reflects long-standing CMS policy. Therefore, any individual meeting by HealthSouth with CMS on group therapy, if at all, should be carefully considered.

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HHEC16/0826

Horton, Bill

From: Fox, Thomas C. [TFox@ReedSmith.com]
Sent: Wednesday, July 24, 2002 7:52 AM
To: Horton, Bill
Subject: RE: Healthsouth congressional strategy on group therapy

Tab 80

This is what I would say to Bill Owens(and Richard if I had the opportunity).Unless and until Transmittal 1753 is withdrawn,outside counsel is telling the company it faces substantial risk of false claims liability by not following that coding and billing policy for therapy effective July 1,2002. The company, through the Federation has raised with CMS the issues, and perhaps created questions in the mind of Tom Grissom.NASL is about to take a position that is "four square" with the Company. Others would be likely to come aboard if a concerted approach is put together. NASL helps make the issue, not just a Healthsouth issue, but a professional/industry issue. It also makes it a Medicare beneficary issue.It presents a real opportunity for Healthsouth to move privately and publically on the issue and lead an effort for Congressional intervention.The Congressional "ask" is not unreasonable and should be hard for the Company's supporters to turn down--create a forum for the therapy professionals to provide public input on the policy and clear up the confusion created by HCFA/CMS.If the Company has support from key member of the Senate, now is the time to marshall that support.These key supporters, not their staffers, need to be approached by those who have the direct and personal relationships with the "ask." It is very reasonable. If more horsepower is needed,the company should recruit it, given what we understand the magnitude of the issue to be, and the ramifications.This strategy is used frequently and successfully by companys with similar problems who appear to have significantly less favorable relations with Members than Healthsouth. Talking simply to congressional staff now about modifying payments for CPT codes can be part of a rulemaking exercise, but that approach is not going to get the job done that ealthsouth needs now.

Thomas C. Fox, Esq.
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Reed SmithLLP
1301 K Street, N.W.
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Fax : 202.414.9299

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-----Original Message-----
From: Horton, Bill [mailto:Bill.Horton@healthsouth.com]
Sent: Tuesday, July 23, 2002 10:54 PM
To: 'Fox, Thomas C.'
Subject: RE: Healthsouth congressional strategy on group therapy

I'm meeting with Bill Owens when he returns to town Thursday, and he is going to talk with Eric Hanson. If you had your druthers, what what your preferred marching orders to Eric be?

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HHEC16/0864

-----Original Message-----
From: Fox, Thomas C. [mailto:TFox@ReedSmith.com <mailto:TFox@ReedSmith.com>
]
Sent: Tuesday, July 23, 2002 9:56 AM
To: Horton, Bill
Subject: Healthsouth congressional strategy on group therapy

Any decision on what we should tell Gary Capistrant to make his "ask" priority?

> Thomas C. Fox, Esq.
> tfox@reedsmith.com
> Reed SmithLLP
> 1301 K Street, N.W.
> Washington, D.C. 20005
> Tele: 202.414.9222
> Fax : 202.414.9299
>
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> 202.414.9222 or e-mail tfox@reedsmith.com if you need assistance.
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HHEC16/0865

Tab 81

Subj:	**Information for Compensation Committee Meeting**
Date:	7/24/2002 6:32:58 PM Central Daylight Time
From:	Bill.Horton@healthsouth.com
To:	ldsjr66@aol.com, phil390@bellsouth.net, jackchamberlin@aol.com
CC:	Brad.Hale@healthsouth.com

Sent from the Internet (Details)

As you know, Richard has a loan in the principal amount of $25,218,114.87 under the 1999 Executive Equity Loan Plan. That loan was used to purchase, and is secured by, 4,362,297 shares of HRC common stock. Last month, Richard paid the accrued interest on the loan and indicated that he wanted to satisfy the principal amount by transferring to the company shares with a value equal to the principal amount. Using the average of the high and low prices on July 1 (he made the request at the end of June), that would result in his transferring approximately 2,035,360 shares back to the company in satisfaction of the loan.

This transaction accomplishes three significant things:

1. It satisfies Richard's loan, thereby eliminating the last loan under the 1999 Plan to an executive officer and cleaning up the proxy disclosure.

2. It allows the company to acquire over 2 million shares as part of the current buyback effort without any additional cash outlay.

3. It likely reduces the depressive effect that would result if Richard sold shares for cash in a down market to pay back the loan.

As a point of information, Richard would recognize taxable income (capital gains) in the amount of the difference between the July 1 value and his basis in the stock.

Because the Plan does not expressly provide for this method of repayment, the Compensation Committee needs to ratify this transaction. Note that the net result is exactly the same to all parties as if Richard had sold the stock and paid off the loan and the company had then applied the proceeds to the current stock buyback, but it avoids the likely adverse impact of a 2-million share block (almost one day's volume in a normal market) going into the market at one time.

I will be happy to answer questions or explain this further on the call tomorrow.

Bill

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bill.horton@healthsouth.com

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Horton, Bill

From: Horton, Bill
Sent: Tuesday, August 27, 2002 10:36 PM
To: Owens, Bill
Subject: ATTORNEY-CLIENT PRIVILEGED--Draft Chronology

Importance: High

Tab 82

Chronology.doc

Attached is a draft of the chronology RMS requested. I have prepared this from information in my files or of which I have personal knowledge. I do not know the dates on which you had discussions with RMS, or the dates on which activities were undertaken with respect to estimating the financial impact of 1753, and accordingly will need your input on those things. I will be happy to discuss this with you at your convenience.

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PRIVILEGED SELF-EVALUATION MATERIAL

May 14	RMS exercises options expiring in May and June and sells underlying stock
May 17	CMS publishes Program Transmittal 1753, directed to Part B carriers
June 6	Tom Fox (Reed Smith) initially notifies HEALTHSOUTH of PT 1753
Mid-June	HEALTHSOUTH personnel begin efforts to interpret PT 1753 and determine its application to Part A-certified providers and inpatient/outpatient facilities
June 20	Susan Smith calls Dr. McKinney (Medical Director BCBSAL) requesting clarification; McKinney says he hasn't seen 1753 and asks for a copy
	Several conference calls among inpatient and outpatient billing/coding/operations personnelHEALTHSOUTH clinical personnel raise questions because they believe the transmittal relates on its face to claims billed on a HCFA-1500, not on a UB-92 (used by rehab agencies, CORFs and hospitals for payments made through Part A intermediaries)
June 21	McKinney advises Susan that 1753 only applied to patients in a group setting doing similar activities, and that 1753 did not apply to rehab agencies or hospitals; purpose of transmittal was to educate physicians on group therapy code; said BCBSAL was not making any system changes related to the transmittal or CCI edits relating to group therapy
June 24	HEALTHSOUTH asks Scot Hasselman of Reed Smith for additional interpretation in light of McKinney's statements; Hasselman reviews history of group therapy interpretations since 1999 and notes that 1753 appears to be an attempt to backdoor group therapy/concurrent therapy provisions proposed and withdrawn in 1999 and 2001
June 25	Susan Smith sends e-mail to McKinney reiterating her understanding from the June 21 discussion
June 28	McKinney e-mails back that "[t]he transmittal was a clarification on 97150 [the group therapy CPT code] for independent practitioners (MDs who perform the service or Independent PTs). The definition of 97150 as per the CPT manual is applicable to all providers of this service."

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	Bill Owens direct that we hold all Medicare outpatient billings effective July 1 and seek a meeting with CMS for further clarification
Late June/ Early July	RMS discusses with Bill Owens his desire to transfer stock to the company to pay off loan before second quarter earnings announcement, after having paid accrued interest around June 25
July 5	Fox and Hasselman send memo to Susan Smith and Bill Horton providing history and legal analysis of group therapy issues operationally and in light of Devage case and outlining potential options
July 9	Operations personnel in Pennsylvania forward information from Hospital Association of Pennsylvania, advising that Pennsylvania intermediary has said that 1753 applies only to physician billing and not billing by hospital outpatient satellites
July 19	Jean Davis, along with Steve Speil of the Federation of American Hospitals, meets with Tom Grissom of CMS (meeting rescheduled from a few days earlier) to seek clarification on 1753; at meeting, Jean and Speil review history of concurrent therapy/group therapy issues, including May/July 2001 SNF rulemaking (Grissom indicates he is not familiar with statements in that rulemaking and will need to review); Jean discusses clinical confusion and issues with correct coding; Jean and Speil request withdrawal of 1753
July 25 – 31	Ops begins rolling out new clinical/coding/billing directives on group therapy
July 31	Compensation Committee approves RMS's transfer of stock in satisfaction of loan based on average of high and low sale prices on that date (resulting price, calculated after market close, of $10.06 per share)
August 1	Instructions given to Brockelman Group/SSB to transfer shares from loan account to HEALTHSOUTH account at July 31 value, per Comp Committee
August 6	Board meeting—Board advised of potential issues surrounding 1753
August 7	Earnings release
August 14	10-Q filed
August 15	Larry Taylor, Susan Smith, Jean Davis, Matt Zurek, along with Steve Speil, meet at CMS with Tom Grissom, Director, Center for Medicare

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	Management, and his staff of Terry Kay, Director, Division of Practitioner & Ambulatory Care, and Lawrence Wilson, Director, Division of Institutional Post Acute Care to follow up with Grissom from July 18 meeting; much discussion concerning Part A/Part B and APTA input; Terry Kay indicated that two patients at the same time may not be group, despite language of 1753, but that billed time had to be allocated among the two patients (no concurrent therapy; only clock time)
August 16 – August 26	Continued analysis of financial impact
August 26	Board meeting
August 27	Announcement

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Horton, Bill

From: Horton, Bill
Sent: Tuesday, August 27, 2002 10:36 PM
To: Owens, Bill
Subject: ATTORNEY-CLIENT PRIVILEGED--Draft Chronology

Importance: High

Chronology.doc

Attached is a draft of the chronology RMS requested. I have prepared this from information in my files or of which I have personal knowledge. I do not know the dates on which you had discussions with RMS, or the dates on which activities were undertaken with respect to estimating the financial impact of 1753, and accordingly will need your input on those things. I will be happy to discuss this with you at your convenience.

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ATTORNEY-CLIENT PRIVILEGED AND CONFIDENTIAL
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May 14	RMS exercises options expiring in May and June and sells underlying stock
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	Management, and his staff of Terry Kay, Director, Division of Practitioner & Ambulatory Care, and Lawrence Wilson, Director, Division of Institutional Post Acute Care to follow up with Grissom from July 18 meeting; much discussion concerning Part A/Part B and APTA input; Terry Kay indicated that two patients at the same time may not be group, despite language of 1753, but that billed time had to be allocated among the two patients (no concurrent therapy; only clock time)
August 16 – August 26	Continued analysis of financial impact
August 26	Board meeting
August 27	Announcement

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Tab 83

From: Horton, Bill

To: Scrushy, Richard

Subject: RE: Fw: questions for Mr. Scrushy

Date: 09/05/2002 08:47:21 PM EST

I will send him something, although Aimee apparently didn't get his message until a good while after he sent it, because I just got it from her when I sent it you -- so, deadline may already have passed. From the tone of the questions, I think he'll kill us either way.

-----Original Message-----
From: Scrushy, Richard
Sent: Thursday, September 05, 2002 7:40 PM
To: Horton, Bill
Subject: Re: Fw: questions for Mr. Scrushy

Pls tell him something. I never said we had or I had a hint of anything. Bill pls tell him something to let him know the wsj was wrong. You know what to do. Tell him same stuff you told bham news. Let him know clearly I had no knowlege till after aug 15 th. If we don't say this he will kill us tomm. Pls respond. Rs
---
Sent from my BlackBerry Wireless Handheld (www.BlackBerry.net)

Tab 84

From: Horton, Bill

To: Lanny J. Davis (E-mail)

CC: Scrushy, Richard; Owens, Bill; McVay, Tadd; Harvey, Jason

Subject: Thursday Conference Call --PRIVILEGED AND CONFIDENTIAL

Date: 09/14/2002 11:56:30 AM EST

Attached is a rough outline of discussion points for the Thursday call, based mostly on what Richard outlined at lunch day before yesterday. It has not been reviewed by anyone on this end, and is thus subject to considerable further input. It also has more technical detail than we can profitably use on the Medicare issues, but I thought it best to put everything out there so we could see it. Richard, Bill and Tadd McVay will need to plug the info in the two sections (on the $175 MM and future strategies). I am also awaiting a summary on yesterday's CMS call to use to fill in the blanks there. I will defer to your folks to figure out how to take this and make it work, but I encourage you to look at the facts outlined carefully so there is no confusion.

I will be generally unreachable the rest of the day, but in my office Sunday afternoon.

Bill

William W. Horton
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Facsimile (205) 969-4730
bill.horton@healthsouth.com

Attachment files : 9-19ConfCallOutline.doc

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OUTLINE FOR 9/19 CONFERENCE CALL

1. Status of SCA Transaction

A. Process is moving forward, as outlined in our August 27 call.
B Management team has been fully established; orientation and transition of responsibilities has taken place this month; SCA management team is fully focused on surgery center activities
C. Management team and field operations are excited, motivated and ready to move forward
D Response from physician partners has been very positive
E. Audit of surgery center business is expected to be completed by late September (?)
F. Currently expect to file transaction documents with SEC in mid-October
G. When transaction is completed, this will be the largest network of surgery centers in United States – 209 centers in 37 states, with annual revenues of over $1 billion and EBITDA after minority interests of $___ million

2. Two Important Points Relative to Outpatient Therapy/Group Therapy Billing

A. Developments on the CMS front

(1) We announced on August 27 our initial estimate of the impact that CMS Program Transmittal 1753 would have on the results of our rehabilitation operations. Since then, many people have been quoted in the press as saying that they don't understand why there is an issue with use of the "group therapy" code in billing for outpatient therapy services, or that Transmittal 1753 doesn't represent any change in policy. But let's look at what has really happened.

(2) On August 27, the same day as our announcement, CMS had a Skilled Nursing Facility Open Door Forum conference call. On that call, Terry Kay and Lawrence Wilson of CMS indicated that there had been questions about use of the group therapy code and Transmittal 1753 in earlier forums. The CMS representatives explained that there were circumstances where two patients were receiving therapy in the same time period that could be billed as individual therapy, and other circumstances where the group code was required. A caller from an industry group pointed out that this was not

consistent with Transmittal 1753, which says that the group code must be used whenever two or more patients are receiving therapy. The CMS representatives agreed that they needed to revisit the language and make sure it was clear.

(3) On September 4, in a CMS Hospital Open Door Forum, Tom Scully, the Administrator of CMS, said there were "gray areas" on outpatient therapy billing that CMS needed to clarify. He reiterated that CMS was committed to clearing up any questions that existed and eliminating any lack of clarity and guesswork on appropriate billing, and stated that CMS would be issuing additional guidance to clarify Medicare policy.

(4) On September 6, the National Association for the Support of Long-Term Care (NASL) sent Terry Kay at CMS a formal letter pointing out that "there is real confusion about the legal affect of Transmittal 1753 on the interpretation of CPT coes, about the applicability of those interpretations to Part A services, and about whether the transmittal removes the professional discretion which, as CMS formerly acknowledged, would permit a therapist to determine what coding was appropriate". NASL stated that there was "still controversial and incomplete guidance emerging from CMS on the proper interpretation of the coverage and coding rules applicable to therapy." NASL extensively reviewed the history of CMS's guidance and statements on the group therapy code and the clinical understanding of group therapy, and requested that CMS withdraw the relevant portion of Transmittal 1753 and work with therapy providers to develop comprehensive guidance for coverage and coding of therapy services in all treatment settings.

(5) On September 13, CMS held a special Open Door Forum on group therapy [DISCUSS WHAT HAPPENED]

(6) Despite what reports in the press may have led some people to believe, this is not just a HEALTHSOUTH issue. CMS policies on coding and payment for therapy services affect every physical therapist, every occupational therapist, every hospital in the country that provides outpatient therapy services. Others in the industry have pointed out that CMS's statements have been ambiguous and confusing, as well as being inconsistent with the clinical standards followed by professional therapists. While CMS keeps saying this is a clear policy, the questions at the September 13 forum, as well as the inconsistency in CMS statements from one week to the next, shows how much confusion there is and has been on this issue.

(7) Given the limited number of therapists, the policies that CMS has tried to implement through Transmittal 1753 will make it more and more difficult for Medicare beneficiaries in all settings to receive timely access to care. Further, if these restrictive payment policies are followed, we believe that many therapists in private practice will simply not be able to afford to treat Medicare patients.

(8) We believe that there is significant interest in Congress in ensuring that CMS does not jeopardize Medicare beneficiaries' access to therapy services through policies that are both inconsistent with good clinical practice and ambiguous and confusing on their face.

B. Review what we knew at HEALTHSOUTH, when we knew it and what we did.

(1) There have been many questions directed at us about what we knew when and what we did about it. Before we move on to the impact of these reimbursement changes, and what our plans are, let's review the answers to the questions

(2) Transmittal 1753 was issued on May 17, with an effective date of July 1. The transmittal was not a notice to providers like HEALTHSOUTH. The transmittal was not a notice to Medicare Part A fiscal intermediaries, who administer Medicare claims for providers like HEALTHSOUTH. The transmittal was directed only to Medicare Part B carriers, who administer payments to physicians and private-practice therapists.

(3) We first learned of the transmittal on June 6, when one of our outside lawyers noticed it and called it to our attention. We reviewed it and saw that it was directed only to Part B carriers, not the Part A intermediaries who interpret Medicare changes for us and process our Medicare claims.

(4) Later in June, as part of our efforts to understand what the transmittal meant to us, Susan Smith, our Senior Vice President of Reimbursement, contacted our national fiscal intermediary to ask for clarification. Our intermediary's response was "We haven't seen any transmittal. Can you send it to us?"

(5) After we provided a copy of the transmittal, our intermediary told us, "This doesn't apply to you, this applies to physicians and private-practice therapists." When we tried to get that in writing from the intermediary, we couldn't, so we decided to go straight to CMS for clarification.

(6) We were able to schedule a meeting with a senior CMS official for July 18. At that meeting, we explained that we needed clarification of the meaning of Transmittal 1753 as it

applied to us. We pointed out that, in July 2001, CMS had expressly stated that clinical considerations were to be given priority in determining whether therapy could be appropriately delivered to more than one patient by a single therapist at one time. We asked how the arbitrary rule imposed by Transmittal 1753 squared with these earlier statements by CMS.

(7) The CMS official told us that he was not familiar with the July 2001 rulemaking, and asked us to provide further background information while he investigated the history with other CMS officials.

(8) While we worked to provide the information that CMS had asked for, we began analyzing the potential financial impact assuming that the policy announced in Transmittal 1753 applied only to our outpatient division facilities. Our estimates indicated that the potential impact was of a size that we could manage around, without the likelihood of a material impact on our results.

(9) On August 6, Bill Owens raised the matter with RMS, indicating that based on our current understanding, and pending further CMS clarification, our people believed the impact would be within a range that would probably not be material. RMS told Bill that he thought we should go back to CMS for one more meeting to make sure we had as much clarity as possible so that we could make sure our estimates were good.

(10) On August 7, we sent a letter to the CMS official we had me with in July, providing the additional background information that he had requested on CMS's past statements and the clinical understanding of group therapy.

(11) On August 15, we had a late afternoon meeting with senior CMS officials At that meeting, the officials advised us that CMS policy was to apply Transmittal 1753 to all outpatient therapy services in all settings, even thought it was only directed to Part B providers. The officials then provided further guidance that contradicted the language of Transmittal 1753, confusing the issue further.

(12) After the August 15 meeting, it was clear to us that CMS would interpret the transmittal to apply even to outpatient services provided through our inpatient division facilities, which have a Medicare mix much higher than our outpatient division facilities. Further, we became concerned that private managed care contracts that base their reimbursement on the Medicare fee schedule would adopt the Medicare policy on group therapy billing, and concluded that we needed to estimate that impact as well.

(13) We worked for a solid week trying to get our best estimate of the potential financial impact on all these fronts - outpatient facilities, outpatient services at inpatient facilities, and managed care contracts incorporating Medicare policies. We intentionally took a conservative approach, not wanting to present an unfairly optimistic picture that we would later have to come back and revise downward.

(14) We presented our findings to our Board on August 26, including our estimate that the potential negative impact of applying Transmittal 1753 across all our operations, including the effect through managed care contracts, could be as high as $175 million. The next day, we announced this to the public.

(15) Since our announcement, many people have said "Other providers weren't confused. Other providers said the CMS policy was clear. Why does HEALTHSOUTH say it wasn't?" But look at the facts:

(a) The transmittal was sent only to Part B carriers, not the Part A intermediaries who pay us or to providers like us. Our Part A intermediary first told us it didn't apply to us. We have been told of other Part A intermediaries who still say it only applies to Part B providers, like physicians.

(b) On September 4, CMS said, "there's been some confusion, and we want to clear it up." On September 13, CMS says, "There's no confusion, and we don't understand why people think there is." In the same call, CMS says, "Don't read Transmittal 1753 to say what it says, read it to say what we meant it to say." Meanwhile, the providers who call in make it clear that there is significant confusion.

(c) When CMS's own Medicare contractors don't know what the transmittal means, when CMS itself can't seem to make up its mind from one week to the next about what its policies are or even whether there is confusion about the policies, how are providers to know what statements to rely on?

(16) We have made good faith efforts to clarify the rules we are supposed to follow. We are joined by other providers who have tried to get CMS to be consistent and clear, and to make policy with public input, as it is supposed to do. We have tried to give the public our best estimates of the impact of these ever-changing interpretations on us, and we will continue to work through CMS and Congress to try to ensure that access to quality care is not jeopardized by backdoor rulemaking.

3. What Makes Up the $175 million impact on HEALTHSOUTH?

[To be completed]

4. What Are We Doing Operationally to Mitigate the Impact?

[To be completed]

5. Personal Discussion from RMS

A. Many people, in the press and elsewhere, have made attacks on me personally. Even where we have tried to explain the truth, people have preferred to print speculation and falsehoods. One reporter even published a story that said I had sold 94% of my stock in HEALTHSOUTH, when my stock ownership is a matter of public record, on file with the SEC. We when called him to ask him how he could make such a mistake, he said "Oops! I read the form wrong. Sorry!" I want to take just a moment in this setting to get the facts out once and for all.

B. I sold some stock in May. I sold that stock on May 14, after exercising options I had held for 10 years that were about to expire. Those options were awarded to me for work that I had done when this company had revenues and assets of well under a billion dollars, and I had held them for ten years while we grew to be a company with $4.5 billion in revenues, $7 billion in assets and the largest group of healthcare facilities in America. They represented a significant chunk of my net worth. I wasn't about to let them expire, and I don't think any of you would have either. Like you, I also have a family to think about and estate planning needs, so when I exercised those options, I sold the stock and used the cash, after paying a lot of taxes, to diversify my holdings. My advisors tell me to do that, just like your advisors tell you to do that.

C. I did that on May 14. That's three days before the date on Transmittal 1753. That's three weeks before we even found out about Transmittal 1753. That's five weeks before our intermediary told us they didn't know anything about Transmittal 1753. That's nearly three months before anybody even mentioned to me that Transmittal 1753 might have an impact on HEALTHSOUTH.

D. In September 1999, I borrowed money from the company under a plan approved by a vote of our stockholders. I used that money to buy stock, because our Board and our investors wanted me to buy more stock. That loan was not due to be repaid, under the terms of our stockholder-approved plan, until September 2006. This year, however, many of those same people who thought it was a great idea for companies to lend officers money to buy stock wanted those loans paid back. I didn't want this to be a cloud over us, so around the end of June I began discussing ways to pay the company back without dumping a big block of stock in the market.

We had announced a stock buy-back program, and I agreed that, if the Compensation Committee approved, I would transfer stock back to the company to satisfy the loan, letting the company acquire a big block of stock for the buy-back program without incurring transaction costs and commissions. On July 31, our Compensation Committee approved that, and I gave the company back more than half the stock I had purchased, and I paid more than $10 million in cash for interest on the loan and taxes on the transaction. And remember – this is on July 31, a week before our management even told me about Transmittal 1753, when our team still did not think its impact would be material, and more than two weeks before our meeting with CMS. Since that time, I have spent over $4 million more – in cash – to buy more stock by exercising more options. Anybody who takes those transactions and puts them on the timeline we've gone over here and who still thinks that there's anything wrong just doesn't want to look at the facts. We've given you all the information here that you need to understand what happened. We know that the press and the plaintiffs' lawyers will say whatever they want to say, but those of you who listen to this call know the truth.

E. On August 27, we announced that Bill Owens was stepping up as CEO of HEALTHSOUTH and that Larry Taylor would be the CEO of SCA. We announced that I would be chairman of both companies. Some people have tried to say that means that I've been pushed aside or kicked upstairs. That's just not true. As we've said already, our tax advisors told me I couldn't be involved with either company if I continued as CEO of either one. I said that was great, because I've got two guys who've been in training for years to be CEOs. Our Board agreed with me, and expressed the same confidence in Bill and Larry that I have. I'm still here, I'm going to be here, and I'm going to continue the work I've always done on the vision and strategy of HEALTHSOUTH while helping the SCA management team build a new public company. That's all we're going to say on that subject, but anyone who thinks I've been pushed out the door is welcome to come to my office and watch me working harder than ever with both these great companies.

6. Final Comments/Open for Questions

From: Hicks, Will

To: Horton, Bill **Tab 85**

Subject: FW: MCD

Date: 09/20/2002 12:29:56 PM EST

Call me on this. I talked to Owens want to get your perspective.

Will

-----Original Message-----
From: Owens, Bill
Sent: Friday, September 20, 2002 11:27 AM
To: Hicks, Will; Horton, Bill
Subject: RE: MCD

Let's discuss this ASAP.

-----Original Message-----
From: Hicks, Will
Sent: Friday, September 20, 2002 11:05 AM
To: Horton, Bill; Owens, Bill
Subject: RE: MCD

Chuck is out of the office until Tuesday.

Will

-----Original Message-----
From: Horton, Bill
Sent: Thursday, September 19, 2002 11:33 PM
To: Owens, Bill; Hicks, Will
Subject: MCD

I have had zero time to think about MCD this week, for which I apologize. Rick Miller has called me to see what's going on, as they apparently can't meet payroll at end-of-month. While I philosophically agree with Will that the time has probably come just to let them go, I am concerned about the need to get Chuck on board with whatever we do or don't do. Bill, not meaning to put more on your plate, but not being able to avoid it, how do you think we should deal with the situation?

From: Horton, Bill
Sent: Sunday, September 29, 2002 4:33 PM
To: Hale, Brad, Smith, Weston
Subject: Audit Committee

Tab 86

I am finding no record that I was ever given drafts of Audit Committee minutes for 2001 (after March 27) or 2002. Do either of you know the status of Audit Committee minutes?

From: Smith, Weston
Sent: Monday, October 7, 2002 9:49 AM
To: Harris, Emery
Cc: Horton, Bill
Subject: FW: Audit Committee

Tab 87

Emery, please forward copies of the minutes to Bill.

Bill, copies of the minutes were sent to George Strong last week, he had requested them in response to Fulbright. We have 2002 minutes, none were prepared in 2001.

-----Original Message-----
From: Horton, Bill
Sent: Monday, October 07, 2002 8:45 AM
To: Smith, Weston
Subject: Audit Committee

Just a reminder that I need drafts of all audit committee meeting minutes after Orlando 2001. Thanks.

From: Horton, Bill
Sent: Wednesday, December 11, 2002 3:13 PM
To: Scrushy, Richard
Cc: Hale, Brad
Subject: Board Meeting -- ATTORNEY-CLIENT PRIVILEGED AND CONFIDENTIAL

Tab 88

I mentioned to you before the last BOD meeting that, in order to clean up the issue regarding the limitation on affiliate transactions in our bond indentures, we need the whole Board (with you abstaining) to ratify the Compensation Committee's approval of your loan repayment transaction in July. If that wasn't done at the last meeting, it should be done at this meeting so we can get certified resolutions to the trustee this month. Please call with any questions.

From: Horton, Bill
Sent: Wednesday, March 5, 2003 12:02 AM
To: Scrushy, Richard
Subject: FW: Board Meeting -- ATTORNEY-CLIENT PRIVILEGED AND CONFIDENTIAL

Tab 89

Richard, take a look at the e-mail below. I don't have any record that this has been done at any recent Board meeting. In order to avoid having to include in our 10-K the language that was in our third quarter 10-Q concerning the possible assertion of a default under our bond indentures, we need the Board to ratify the July transaction at a meeting this month. Once that is done, we can provide the fairness opinion and the certified resolutions to the trustee and clear this up. Please let me know if you have questions about this. Sorry to bother you, but this needs to be handled before we file the 10-K if at all possible.

-----Original Message-----
From: Horton, Bill
Sent: Wednesday, December 11, 2002 2:14 PM
To: Scrushy, Richard
Cc: Hale, Brad
Subject: Board Meeting -- ATTORNEY-CLIENT PRIVILEGED AND CONFIDENTIAL

I mentioned to you before the last BOD meeting that, in order to clean up the issue regarding the limitation on affiliate transactions in our bond indentures, we need the whole Board (with you abstaining) to ratify the Compensation Committee's approval of your loan repayment transaction in July. If that wasn't done at the last meeting, it should be done at this meeting so we can get certified resolutions to the trustee this month. Please call with any questions.

Tab 90

From: Horton, Bill
Sent: Monday, January 6, 2003 1:41 PM
To: Esclavon, Mary
Subject: FW: PRIVILEGED AND CONFIDENTIAL -- Drafts of Governance Documents
Attach: CorpGovGuidelines.doc; NomGovCmteCharter.doc; InsiderTradingv3.doc

Please print this e-mail and attachments and give to RMS. Thanks.

-----Original Message-----
From: Horton, Bill
Sent: Sunday, January 05, 2003 5:58 PM
To: Scrushy, Richard
Subject: PRIVILEGED AND CONFIDENTIAL -- Drafts of Governance Documents

Attached are revised drafts of the documents Bob May circulated, marked to show proposed changes. These changes reflect (a) my own review of Sarbanes-Oxley and the proposed NYSE listing standards and related SEC rule proposals, (b) comments received from Phil Watkins, George Strong and Jack Chamberlin, (c) a review of the drafts that Phil had done by Maynard Cooper, and (d) further discussions with Phil this past Friday. They do not reflect anything much from the Disney standards, and I need to get with you to discuss your thoughts on those. Where the changes are not self-explanatory, I have footnoted the source or the explanation.

Joel Gordon told me Thursday that he had sent "several" comments directly to Bob May (despite the direction at the Board meeting that they be sent to me). Joel said that he would send me a copy of his comments, but I have not received them yet.

I am available to discuss these and the Disney proposal at your convenience.

Horton, Bill

From: phil390 [phil390@bellsouth.net]
Sent: Friday, January 17, 2003 10:36 AM
To: Horton, Bill
Cc: Scrushy, Richard; Owens, Bill; 'cnewhall@nea.com'; Strong, George; 'jackchamberlin@healthsouth.com'; 'jcgordon@msn.com'; Hanson, Jon; 'ldsjr66@aol.com'; 'sgivens@acaciavp.com'; 'rpmay@aol.com'; May, RP
Subject: Re: FW: Various Documents Attached

Tab 91

Bill,

I have reviewed the proposed changes on insider trading policy from the Corp Gov Com.

As you and I have discussed, the reduction of the window from 45 days to 30 days is overly
restrictive and not consistent with what other companies do. Outside lawyers suggested that
a 45 day window is "a middle of the road approach".

I see no reason to have such a short window that could be shortened further if an additional
quiet period is declared.

The rest of the policy should be acceptable.

We can discuss further as a full board.

Phil Watkins

"Horton, Bill" wrote:

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**********************
Warning: The attached file, hsCleanInsiderTradingPolicy.ZIP, was not scanned by
***********_***********
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Attached below in a ZIP file is a transmittal from Bob May, containing a cover letter and comments on the Nominating/Governance Committee Charter and insider trading policy from the Corporate Governance Committee. These documents, including Bob's cover letter, are also being distributed to each of you by hand delivery or UPS Overnight on Friday morning. As you will see from Bob's memo, the Committee proposes to defer action on the Corporate Governance Guidelines, so there are no comments included on those.

I will be out of the office Friday, but if you cannot open this file and do not receive the overnight/hand

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delivery package, please send me an e-mail and I will try to arrange to get the documents to you in some other fashion.

Bill

William W. Horton
Executive Vice President and Corporate Counsel
HEALTHSOUTH Corporation
One HealthSouth Parkway
Birmingham, AL 35243
Telephone (205) 969-4977
Facsimile (205) 969-4730
bill.horton@healthsouth.com

-----Original Message-----
From: RPMAY@aol.com [mailto:RPMAY@aol.com]
Sent: Thursday, January 16, 2003 4:21 PM
To: Horton, Bill
Subject: Various Documents Attached

Please distribute as outlined in cover letter thank you bob
Confidentiality Notice: This e-mail communication and any attachments may contain confidential and privileged information for the use of the designated recipients named above. If you are not the intended recipient, you are hereby notified that you have received this communication in error and that any review, disclosure, dissemination, distribution or copying of it or its contents is prohibited. If you have received this communication in error, please notify me immediately by replying to this message and deleting it from your computer. Thank you.

From: Horton, Bill
Sent: Thursday, February 13, 2003 1:43 PM
To: McVay, Tadd
Subject: RE: Source call

Tab 92

Okay.

-----Original Message-----
From: McVay, Tadd
Sent: Thursday, February 13, 2003 12:15 PM
To: Horton, Bill
Subject: Source call

I am lining up a loan from UBS to Source which HRC will gtee. Ubs wants short legal update call with you tomorrow. Will 2:00 work?
Tadd McVay

PERSONAL AND CONFIDENTIAL

Tab 93

Bill—

I appreciated the conversation we had the other day, in which you spoke to my as my friend and not as my boss. In order to organize my own thoughts and solicit your advice, and also to vent, I write to you on the same basis and ask that you treat this as confidential.

First, it goes without saying that working at HEALTHSOUTH has been the most exciting and rewarding professional opportunity of my life, and one that I cherish greatly. I love my job most days, I have worked and continue to work with people that I admire, respect and just plain like, and I derive great pride from being able to tell people what I do and where I do it. It is my hope to stay here and be a valuable contributor for a long time to come, or at least until I hit my number, which gets larger each year. I am grateful to Richard, to you, and to many others for the chance that I have to do exciting and challenging work in an environment that I enjoy.

I am disappointed and troubled to think that Richard has doubts about my enthusiasm, my dedication or my commitment to helping the company move forward. I want to change that view, and I want your help in figuring out how best to do that. In order to clear the air and to help you see my perspective so that, perhaps, you can help me modify it, though, I need to speak my mind on some things to you.

I live and breathe HEALTHSOUTH. While I am usually not the first one in the Batcave, I am almost invariably the last one out. I am generally the only one there on Saturdays and Sundays, and I am there for part of almost every one of those. More nights than not, I put my kids to bed and do another hour or so of work at home. I devote a great deal of my own time to keeping up with legal and business developments that help me do my job, and I think it is immodest but not inaccurate to say that I am probably the best public-company securities lawyer in Birmingham, and quite possibly one of the best working as internal counsel at any healthcare company. I have achieved some small but national reputation as a speaker and writer on various aspects of healthcare and transactional law due in part to my efforts and in part to the platform that HEALTHSOUTH has given me. This in turn makes me even more committed to the future of the company, because if something bad happens to the company the professional reputation and contacts I have developed would be significantly impaired.

Day in and day out, I use my experience and judgment to find ways for the company to achieve its goals, in many cases finding ways to get comfortable with approaches that more conservative lawyers would not. Most of these things Richard doesn't know about, because they never reach his level. Indeed, if any but the most significant legal issues reach Richard's level, I have always felt that to be a sign that I was not doing my job. Maybe that has been a mistake, because I don't think he has any idea how many difficult decisions I have had to make and how many times I have had to

guide our inside lawyers, our outside lawyers, and lawyers (and businesspeople) on the other side of a deal around to finding a way to get where we want them to be.

Moreover, I think I probably have the most comprehensive institutional knowledge of HEALTHSOUTH – our history, our culture, our strengths and weaknesses – of anyone still with the company except Richard and you. This doesn't necessarily give me many skills that would translate to other settings, but I think it makes me a helluva lot better for my job than anyone else would be.

What is frustrating to me right now, though, is that I don't feel like I am given much credit for knowing what I'm doing, for accomplishing what I've accomplished, for being creative and hardworking, and for being dedicated to the best interests of the company. I am out of more loops than I seem to be in. Every time I open my mouth, Richard seems prepared to discount what I say. Every time I deliver bad news, I seem to be blamed for creating it. Every time I suggest a way to handle a problem, or suggest that we might have to bite the bullet and face up to one, I get told that I'm going to ruin the company or kill the deal or whatever. As I tell my wife, I promise I never do anything with the intention of making you or Richard mad. Sometimes, though, my job entails saying things y'all are not going to want to hear. It's hard to do that job when, if I have to express some doubt or caution or suggest an unpleasant course of action, I'm going to get yelled at and told that I'm wrong before I can even finish my thought.

If Richard doesn't think I'm a can-do sort of guy, I would point out things like these:

- When we returned to the capital markets in the fall of 1999, I spent hours being the voice of the company to the UBS investment banking team, all of whom were strangers to us (McGahan having stayed very, very remote from the structuring of that deal once he had sold it to us). You were tied up on other things. Tadd had no real idea how to run that sort of transaction. Weston was still trying to get up to speed on being controller. You guys had to go on the road and sell it, and that's the more important job and one that you did well. The fact remains, however, that it took yeoman work from me and the legal team I supervised to get a totally restructure offering document done, to get the indenture terms negotiated, and to get Leder and Barth and those guys to understand our company in order to get a deal in place for you to sell.

- When we did the overnight deal in January 2000, I worked night and day – literally – to make that come together. I went up and dealt with the closing, which was one of the most difficult ones I've had, during an extremely difficult time for me personally, and I got it done despite huge problems back here.

- In the Madrid case, I got us a resolution that was at least $2 million less than what the government expected us to get. I got that without a single employee's having to be deposed, without Richard being interviewed or deposed about a situation involving his parents, without his parents being interviewed and without Weston

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or Susan being interviewed. I had an excellent legal team, but I think they will tell you that my handling of the settlement negotiations was the most significant factor in what was a very good result for us given the facts of the case.

- During the pendency of the Manning and Madrid cases, I have handled responses to legal due diligence on three bond deals, three synthetic lease financings and the $400 million credit agreement in a way that allowed the deals to go forward without adverse disclosures and, I believe, without losing the credibility with bankers and underwriters and their counsel that I need to have to get future deals done.

- I have held the key members of our internal legal team together at a time when legal salaries were skyrocketing (and ours were not keeping up) and when there has been significant frustration on the part of some of our team with the apparent willingness of some of our operations people to ignore critical legal issues.

Obviously, there are numerous areas where I have fallen short, and areas where I have failed to achieve things I would have liked to have achieved for us. However, I have worked hard when it was easy and fun, and I have worked hard when it has been challenging, unpleasant, and to some degree unrewarding. I liked it when the deals were plentiful and the market loved us. Unlike some others now departed, I think I have found ways to be useful and productive when things have gone the other way.

You indicated that Richard wondered why, when he met with other executives, their lawyers seemed to have more positive attitudes. In part, I suspect, that is because those lawyers were given some opportunity to be involved in strategizing the deals in question, or at least informed about the relevant factors before the meeting. Sometimes, I fear, it is because the people involved in those deals are seeking to sell us on things that will be advantageous to them and not advantageous to us. We have, frankly, made the decision to jump prematurely at some things – Oracle, WebMD, Lloyd Noland, College Sports Southeast, for example – because we decided to take chances that we could make things work out. If we had more carefully considered the potential downsides and tried to structure around them, we might not have done some things we should have done, but we might also have avoided some costs in money, time and resources (and some difficult public relations issues).

I don't expect to win every argument, and I've been pushed – by Richard, by you, by Mike – to take some chances that I wouldn't have taken, but that it turned out I would have been wrong not to take. I value that very much. However, I'm a fairly smart and knowledgeable guy, and I probably have as much knowledge as anybody in the office about how the rest of the world does deals. I'm also pretty good at analyzing things and seeing how the pieces fit together. If I have a voice in the discussion, I think I can contribute. Lately, however, there doesn't seem to be much desire to hear my voice.

I'm also frustrated at the level of confidence that has been placed in people who, speaking bluntly, do not seem to be up to the challenges given to them. Jason Hervey

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may have many fine qualities, but I have real questions about his ability to see what the risks are in a deal and plan around them. Jim Whitten has been asked to do things that are totally beyond his capacities. Scott Stone appears bent on disregarding any issues that are raised by the healthcare regulatory environment. Closer to home, I continue to be concerned about our attention to detail on accounting and collections matters, where I have great respect for the people involved but where the quality of results has been erratic. Yet, if I say there's a legal or contractual issue to be considered and Jason or Jim says there's not, I'm the bad guy. I may be right or I may be wrong, but I think I deserve more than being dismissed out of hand.

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MEMORANDUM

TO: David Barrack
CC: Hal Hirsch
FROM: Glen Banks
DATE: September 23, 2002
RE: HealthSouth

Tab 94

I reviewed the class action complaints and derivative complaint in the binder delivered to me on Friday. The one derivative complaint alleges a host of self-dealing transactions involving Richard Scrushy, HealthSouth's Chairman of the Board and CEO at the time of the transactions. The self-dealing transactions in the derivative complaint are summarized in point A. below.

The 13 securities law class actions all allege fraud in violation of § 10(b) and Rule 10b-5 of the '34 Act and § 20(a) of that statute, the control person provision.

The allegations of the securities fraud complaints are similar. In December 2001, HealthSouth gave guidance of $1.14 eps for 2002 and subsequently repeatedly confirmed that guidance, doing nothing to correct or update it through August 26, 2002. That guidance was disseminated with knowledge that Medicare, the source of nearly one-third of HealthSouth's revenues, would be setting new regulations in a Prospective Payment System ("PPS") which HealthSouth allegedly knew would reduce reimbursement to it.

The key reimbursement issue addressed in the complaints, concurrent therapy, can be explained as follows. Assume in a one hour physical therapy session, a therapist treats two Medicare patients, for example, one who had a right knee replacement and another who had a left knee replacement. During the session, the therapist directs and supervises both patients and, at various times, works individually with each patient.

Prior to the PPS becoming effective, HealthSouth would bill Medicare for one hour of "individual therapy" for each patient. The complaints insinuate that Medicare believed such therapy should have been billed as "group therapy" which would have been reimbursed at a substantially lower rate.

The complaints allege that a focus of the PPS was to definitively define what constituted individual therapy so that HealthSouth and others would no longer get paid for concurrent therapy at individual therapy rates but would be paid at the lower group therapy rate.

The crux of the complaints is that despite knowing that the PPS would lower Medicare payments for concurrent therapy and thereby impact its revenues and earnings, from December 14, 2001 through August 26, 2002, HealthSouth repeatedly falsely told the investing public that

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(i) the company would benefit from the PPS and (ii) the company was comfortable with the $1.14 eps guidance for 2002 that it had disseminated in December 2001. While HealthSouth was making these allegedly false statements, Scrushy disposed of 75% of his interest in the company selling 5,275,360 shares on May 17 at $14.05 for proceeds of in excess of $74 million and, on July 31, delivering 2,506,770 shares to HealthSouth valued at $10.06 per share in repayment of a loan from the company.

Named as defendants in the securities law complaints are HealthSouth, Scrushy, Western Smith, the company's CFO and Executive Vice President, William Owens, the company's Chief Operating Officer, and George Strong, a director of the company who sold stock in the class period for proceeds of approximately $2.8 million.

Point A below summarizes the allegations in the Derivative Claim. Point B below sets forth a timeline of the allegations in the securities fraud claims

A. <u>The Allegations in the Derivative Claim</u>

- The compensation paid to Scrushy was "grossly excessive."
- Scrushy caused HealthSouth to purchase equipment and services from GG Enterprises, a company he controlled, at prices greater than what could have been paid to an independent vendor.
- Scrushy caused HealthSouth to loan $10m. to 21st Century Health Venture L.L.C. which went out of business causing a loss on the loan. Money that went to 21st Century was part of a scheme to improperly divert company funds to Scrushy.
- Scrushy has an interest in Capstone Capital Corporation. HealthSouth sold certain depreciable buildings to Capstone and then leased back the property at inflated rental amounts as part of a plan to divert HealthSouth funds to Scrushy. A <u>Qui tam</u> proceeding arising from this sale/leaseback resulted in a $7.9 million settlement.
- HealthSouth improperly made substantial loans to officers and directors at below market interest rates.
- HealthSouth invested $2 million in Med.Center.Direct.com, Inc. a company in which Scrushy and other insiders had a substantial interest. HealthSouth also entered into 10 year agreement under which Med.Center would be the company's exclusive e-procurement vendor of medical product and supplies. Med.Center was a HealthSouth corporate opportunity and should not have been independently pursued by HealthSouth executives.
- HealthSouth established Source Medical Solutions, Inc. and let the insiders buy-in at sweetheart deal prices.

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- HealthSouth advanced $82m. to Source.
- HealthSouth did a sweetheart sale-leaseback transaction with Source for HealthSouth intellectual property on terms favorable to Source.

- In July 2002, HealthSouth accepted 2,506,770 shares from Scrushy, valued at $10.06 per share, in repayment of a loan. The valuation was excessive and unreasonable given what Scrushy knew about the Medicare/Medicaid problem which would have an estimated impact of reducing HealthSouth's earnings by $175 million.

- Claims
  - Breach of Fiduciary Duty
  - Waste
  - Misappropriation of Corporate Assets
  - Unjust Enrichment
  - Breach of Contract
  - Willful Violation of Law
  - Civil Conspiracy

B. <u>The Timeline for the Securities Fraud Claims</u>

12/14/2001	• HealthSouth press release projected EPS of $1.14 in 2002. • Scrushy said: "we believe that the new rules [the Prospective Project System ("PPS") being implemented by Medicare as of January 1] will enhance our 2002 results of operations as they are phased in across our inpatient rehabilitation facilities next year."
1/14/2002	• HealthSouth press release stated that the company is comfortable with an estimate of $1.14 EPS for 2002. • The release stated that HealthSouth expected a positive impact from the implementation of the new PPS. • Scrushy said: "We have been preparing for the implementation of PPS for several years. . . this new system is not a surprise, and our intensive

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	cost management efforts have prepared us well for it."
1/22	• HealthSouth press release stated that the Company had received notification of its first PPS payments. • According to the press release, the payments were "identical to the expected payment predicted by HealthSouth's internal PPS payment model." • Scrushy said the notifications validated the accuracy of HealthSouth's internal claims model and that he expected "future payments will continue to support the positive PPS impact to earnings that we have previously predicted." • Scrushy reaffirmed the earnings guidance of $1.14 EPS.
2/14	• HealthSouth director George Strong sold 73,885 shares for proceeds of $895,121
3/12	• HealthSouth press release announced fourth quarter results. Scrushy said: "our early experience under the new impatient rehabilitation prospective payment system is confirming our expectations for the positive impact that PPS will have on our business."
3/27	• HealthSouth filed its Form 10-K which stated: "freestanding impatient rehabilitation facilities and hospital based rehabilitation units are being placed under a PPS to be phased in beginning January 1, 2002." The PPS regulations were implemented pursuant to the Balanced Budget Act of 1997. • The 10-K stated: "we believe that our low-cost profile favorably positions us to respond to reimbursement pricing pressure."
5/2	• HealthSouth press release announced first quarter earnings consistent with consensus estimates. • Scrushy said: "Our first wave of inpatient rehabilitation facilities moved into the new inpatient rehabilitation prospective payment system beginning January 1, and just as we had projected, PPS had a positive impact on our bottom line. We have spent years preparing for this change. Lowering our costs and increasing our efficiencies, and our initial PPS payments have continued to come in on target with our preliminary estimates."
5/10	• HealthSouth filed its Form 10-Q for the first quarter.

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5/14	•	Scrushy sold 5,275,360 shares at $14.05 per share for proceeds in excess of $74 million. This was his first sale of HealthSouth stock since 1997.
5/17	•	As alleged in ¶ 28 of the Strauss Complaint: "In addition to the existing policies for group therapy reimbursement that had been in place for years, defendants were most recently notified of CMS' [Center for Medicare and Medicaid Services] Program Transmittal clarifying certain reimbursement policies for outpatient rehabilitation services when one of the lawyers for HealthSouth came across the CMS Transmittal on May 17, 2002. The Transmittal (effective as of July 1, 2002) reiterated that outpatient therapy services provided to two or more patients in a single time period (concurrent therapy) be billed as group therapy services, rather than as an individual therapy code that generates a higher reimbursement per treatment than the group therapy code. As an analyst in the industry explained, Medicare reimbursement for group therapy services is approximately $14 per patient per day whereas reimbursement for individual therapy service is $21 per patient for each 15-minute increment of therapy. Thus, under the CMS directive, Medicare reimbursement for a patient receiving one hour of concurrent therapy could potentially be reduced from $84 to $14." • The complaints insinuate that the referenced CMS Transmittal was merely a reiteration of the government's prior position that concurrent therapy should be billed and reimbursed as "group therapy," not "individual therapy." • According to paragraph 27 of the Strauss complaint, the required billing practice for concurrent therapy was set forth in a proposed rule of the Department of Health and Human Resources dated May 10, 2001. 42 C.F.R. §410, 411, 413, 424, 482, 489 (2000). • Since the mid-1990s, according to CMS policy, group therapy included services provided simultaneously to two or more individuals by practitioners. The individuals can be, but need not be, performing the same activity. Although the therapist must provide constant attendance, one-on-one patient contact is not required. Thus, "[i]f the provider is overseeing the therapy of more than one patient during a period of time, he or she must bill the code for group therapy…since he or she is not furnishing constant attendance to a single patient." 42 C.F.R. §410, 414 (1994). The same policy and identical language was reiterated in the 1996 rules and regulations. 42 C.F.R. §410, 415 (1996).

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David Barrack
September 23, 2002
Page 6

	***	**Although the securities fraud complaints are focused on the events in 2002, consideration should be given to the possibility of the following assertion that could lead to far broader problems: Since the mid 1990s, despite applicable Medicare regulations requiring concurrent therapy to be billed as group therapy, HealthSouth improperly billed concurrent therapy as individual therapy.**
6/7	•	Strong sold 66,665 shares for proceeds of $933,310.
6/11	•	Strong sold 67,216 shares for proceeds of $941,024.
7/11	•	HealthSouth press release said it was comfortable with its EPS estimate. It said: "the fundamentals of our business continue to be solid, and we remain confident in our guidance for the rest of the year."
7/29	•	Barron's published an article prepared with HealthSouth input which said the PPS will have a positive impact on HealthSouth because, since its costs tend to be lower, the PPS will allow HealthSouth, for the first time, to make a profit on some portion of the 31% of its business that comes from Medicare.
7/31	•	To repay a loan owed to the company, Scrushy transferred 2,506,770 shares to the Company. Given the price of HealthSouth stock at the time ($10.06), the transferred shares had a value of $25,218,106.
	•	As a result of the May sale and the July transfer, Scrushy disposed of 75% of his interest in HealthSouth.
8/7	•	HealthSouth press release reported 2Q results that showed increased revenues and earnings. Scrushy said: "This clearly demonstrates the success we are having under the new Prospective Payment System."
8/8	•	A management sponsored conference call gave no hint of PPS adversely impacting HealthSouth's revenues or earnings.
8/12	•	Follow-up article in Barron's described HealthSouth as a health-care business at a "bargain price."
8/14	•	HealthSouth filed its Form 10-Q for the second quarter.
	•	Although the 10-Q represented that HealthSouth could not predict the impact of any proposals regarding Medicare reimbursement limits, it was totally silent on the effect of the PPS upon the Company.
	•	HealthSouth filed Form 8-K to comply with SEC Order 4-460.

	Scrushy and the CFO certified the company's results.
8/26	• HealthSouth prospectus in a $998 million note exchange became effective. The Registration Statement on Form S-4/A generally talked about the risk of a change in Medicare reimbursement policy. There was no discussion of any adverse impact upon the company by the PPS.
8/27	• HealthSouth press release said impact of reimbursement change "will require material revisions" to the company's business model and that EBITA will be $175 million less than previously projected. • Press release said that effective July 1, CMS had issued a directive requiring out-patient therapy provided to two or more patients at a single time to be billed a "group therapy" which would significantly lower reimbursement for services that had been billed as individual therapy. HealthSouth believed there was "substantial confusion" concerning what this directive meant and, in July and August, HealthSouth "sought clarification" through meetings with its intermediary and CMS officials. HealthSouth contended that "pending further clarification," it was implementing a "conservative interpretation of current Medicare coding requirements." • The press release stated: "the directive implemented on July 1 is inconsistent with many providers' understanding of appropriate coding practices."
8/27-28	• News media reported CMS directive was no surprise to industry insiders who knew about it for months. • Analysts downgraded HealthSouth and question management's credibility. • Rating agencies put HealthSouth on CreditWatch. • CMS Administrator was quoted in Reuters that he is "astounded" by the claims in HealthSouth's press release. • A Prudential report expressed "surprise" at HealthSouth's announcement and the timing of HealthSouth's reaction to the CMS revisions because such revisions are the result of a long process so that companies have ample time not only to challenge proposed changes but to effect necessary operational changes.

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Smith, Susan M. (Corporate)

From: Jones, Susan
Sent: Tuesday, July 02, 2002 9:05 AM
To: OPS - IP Market Leaders
Cc: Foster, Pat; Taylor, Larry; Schmitt, Rick; Horton, Bill

As a follow up on the group therapy definitions, I am scheduling a meeting with CMS for clarification.

Please continue business as usual as directed by Bill Owens last Friday.

When we have definitive information from CMS, we will let you know.

Thanks

Tab 95

HHEC 301-0607
Confidential Treatment Requested by HealthSouth Corp.

Horton, Bill

From: Horton, Bill
Sent: Thursday, June 06, 2002 9:10 PM
To: Owens, Bill; Smith, Weston; Taylor, Larry; Jones, Susan
Subject: FW: Transmittal on group therapy

Tab 96

As soon as Bill is back in the office, we need to discuss our planned response to the CMS Program Transmittal provision on Group Therapy described below. This is quite important. We also need to discuss what Fox has told me about what Gary Capistrant has told him about his meetings with Hatch's staff.

-----Original Message-----
From: Fox, Thomas C. [mailto:TFox@ReedSmith.com]
Sent: Thursday, June 06, 2002 7:55 AM
To: Horton, Bill
Cc: Jones, Susan; Hasselman, Scot T.; Cody, Daniel A.
Subject: FW: Transmittal on group therapy

I don't see any need to raise this information today but we should take it up soon as part of the company's overall strategy. One trade group, NASL is registering strong concerns already with the language and its inclusion in a Program Transmittal. Second, Scot has keep in close touch with Gary Capistrant and reactions he(Capistrant) is getting on a legislative proposal, most recently from the staff of Senator Hatch, no less. Some strategic decisions need to be made in the near term on how the company wants to approach these issues.I leave to you the need for decision making at the level of Richard and/or Bill, but we want to be certain any legislative approach is fully aired within ther company.

> Thomas C. Fox, Esq.
> tfox@reedsmith.com
> Reed SmithLLP
> 1301 K Street, N.W.
> Washington, D.C. 20005
> Tele: 202.414.9222
> Fax : 202.414.9299
>
> This e-mail is confidential and may well be legally privileged. If you
> have received it in error, you are on notice of its status. Please notify
> us immediately by reply e-mail and then delete this message from your
> system. Please do not copy it or use it for any purposes, or disclose its
> contents to any other person. To do so could violate state and Federal
> privacy laws. Thank you for your cooperation. Please contact Tom Fox at
> 202.414.9222 or e-mail tfox@reedsmith.com if you need assistance.
>
>
> -----Original Message-----
> From: McCurdy, Debra A.
> Sent: Thursday, June 06, 2002 8:10 AM
> To: Fox, Thomas; Hasselman, Scot
> Subject: Transmittal on group therapy
>
> CMS has issued a transmittal, dated May 17, 2002, which clarifies payment
> policy for group therapy services. It includes the following language on
> group therapy:
>
> 15302. Group Therapy Services (Code 97150)
>
> Pay for outpatient physical therapy services
> (which includes outpatient speech-language
> pathology services) and outpatient occupational therapy services provided
> simultaneously to two or more individuals

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> by a practitioner as group therapy services. The individuals
> can be, but need not be performing the same activity. The physician or
> therapist involved in group therapy services
> must be in constant attendance, but one-on-one patient contact
> is not required.
>
> The transmittal also "manualizes" PM AB-01-56, the therapy student Q&A
> document. The document is on the internet at:
> http://www.hcfa.gov/pubforms/transmit/R1753B3.pdf. I'm forwarding the
> NASL's reaction to the new policy -- they basically oppose the policy and
> the way it was issued through the transmittal.
>
>
> -----Original Message-----
> From: Barbara Morehouse [mailto:barbara@nasl.org]
> Sent: Wednesday, June 05, 2002 4:19 PM
> To: barbara@nasl.org
> Subject: Medical Services Committee Conference Call
>
> TO: NASL Medical Services Committee
> FROM: Cindy Susienka, Chair
> Tracy Gregg, Co-Chair
> Date: June 5, 2002
> Re: Committee Conference Call
>
> The Medical Services Committee will meet by conference call on Monday,
> June 10, 2002 at 10:00 a.m. Eastern to discuss status and NASL direction
> on the following issues:
>
> * 1,500 Therapy Cap: The House Ways and Means Committee is scheduled
> to markup a Medicare reform package next week which is expected to include
> a proposal for three separate $1,500 caps. While it is still uncertain as
> to how the House Energy & Commerce and Senate Finance Committees will
> approach the issue, it is clear that we need to sharpen our strategy,
> including our grassroots efforts.
> * Group Therapy: Below please find a link to Carriers Transmittal
> 1753 which was just recently posted to the CMS website. The Transmittal
> includes the following instructions to the Carriers:
> "15302. Group Therapy Services (Code 97150)
> Pay for outpatient physical therapy services
> (which includes outpatient speech-language
> pathology services) and outpatient occupational therapy services provided
> simultaneously to two or more individuals
> by a practitioner as group therapy services. The individuals
> can be, but need not be performing the same activity. The physician or
> therapist involved in group therapy services
> must be in constant attendance, but one-on-one patient contact
> is not required."
>
> NASL has already registered strong concerns with CMS as to the
> substance of the language and the process by which it was included in
> the Transmittal. Also included in the Transmittal is a prohibition for
> the payment of bad debts for services paid under the Medicare physician
> fee schedule. It is expected that a Fiscal Intermediary counterpart to
> Transmittal 1753 will be issued shortly.
>
> The phone number to participate is (800) 526-7151. No pass code is
> needed, you need only ask for the NASL conference call. Please note that
> you will be individually billed by Genesys Conferencing for your
> participation on the call.
>
> Please contact Barbara Morehouse (Barbara@nasl.org) or (703) 549-8500 with
> any questions.
>
>
> http://www.hcfa.gov/pubforms/transmit/R1753B3.pdf

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HHEC16/0698

03/19/2000 TX- 122099-01 12/20/99
Informational TX-
Correct policy/procedure reviewed with caller
policy on cutting off-cycle checks <$500

Tab 97

03/19/2000 State not given 122099-02 12/20/99
Allegation or Complaint State not given
Caller referred to someone outside the CCO,specify
Jennifer Hodge,corp p/r

03/21/2000 TN- 030018-00 121799-02 12/22/99
Allegation or Complaint TN- 030018-00
Allegation(s) unsubstantiated
investigated by Beth Hosmer,corp HR

03/16/2000 State not given 121799-01 12/17/99
Informational State not given
Caller referred to someone outside the CCO,specify
Policy on personnel record; HR director

03/16/2000 VA- 020220-00 121799-03 12/17/99
Venting VA- 020220-00
Caller referred to conflict resolution procedures

03/16/2000 WA- 121799-04 12/17/99
Allegation or Complaint WA-
Caller referred to conflict resolution procedures

03/15/2000 State not given 121699-02 12/16/99
Informational State not given
Correct policy/procedure reviewed with caller
Policy on taking a personal day

03/15/2000 CT- 030662-00 121699-04 12/16/99
Allegation or Complaint CT- 030662-00
Caller referred to someone outside the CCO,specify
Beth Hosmer,Corporate HR

03/15/2000 CA- 121699-05 12/16/99
Venting CA-
Caller referred to conflict resolution procedures

03/15/2000 CA- 049805-00 121699-03 12/16/99
Venting CA- 049805-00
Caller referred to conflict resolution procedures

04/04/2000 AL- 102899-04
01/05/2000 Allegation or Complaint AL-
Allegation(s) unsubstantiated
investigated by CCO

03/21/2000 TN- 030018-00 121599-02 12/22/99
Allegation or Complaint TN- 030018-00
Allegation(s) unsubstantiated
investigated by Beth Hosmer,corp HR

STRATEGIC MANAGEMENT SYSTEMS, INC.

112 S. WEST STREET • ALEXANDRIA, VIRGINIA 22314

TELEPHONE (703) 683-9600 • FAX (703) 836-5255

December 3, 1997

Ms. Kelly L. Cullison
Assistant Vice President for Internal Audit
One HealthSouth Parkway
Birmingham, AL 35243

Tab 98

Re: Compliance Policies and Procedures for Roles and Responsibilities for the Compliance Officer, Employee Issue Resolution Process, and Protocols between the Compliance Office and Legal Counsel

Dear Kelly:

This letter is a follow-up to our previous telephone discussion regarding the development of Compliance Policies and Procedures for HealthSouth. We previously provided you a list of 14 issue areas which will be developed into draft policies and procedures by us for the Compliance Office. We have developed the first three "straw" policies and procedures for your review. According to your desire to have them as quickly as possible we began with the following: "Roles and Responsibilities for the Compliance Officer," "Employee Issue Resolution Process" and "Protocols between the Compliance Office and Legal Counsel."

As per our previous discussion, we have taken the charted roles and responsibilities and converted them into Compliance Office Policies and Procedures on the subject. Everything related to the function will be in one place as a result. It is also important that you ensure this policy and procedure is crafted sufficiently to account for your role as well as the Compliance Officer.

While every company has their own process, consistent with their culture, in dealing with problems, it is important that your method be cast in the form of a policy and procedure. We have tried to follow your desired approach in dealing with this, however it may not be exactly on track. The enclosed draft policy and procedures will need to be modified so as to be consistent with the way HealthSouth traditionally operates.

Most of the concerns, allegations and complaints that come into the Compliance Office are best handled by the Compliance Office. But, occasions will arise when Legal Counsel needs to direct the issue resolution process. It is important that HealthSouth have a policy that determines when it is appropriate to notify Legal Counsel. The enclosed draft policy and procedure is designed to address this issue. You will need to discuss this with Legal Counsel to ensure that it is consistent with your intended modis operendi.

If you would like to discuss any of the policies and procedures submitted to date, or if you have any questions or concerns, please contact me at (703) 683-9600.

Sincerely,

Dick

Richard P. Kusserow
President

cc: Anthony J. Tanner, Executive Vice President, Corporate Compliance Officer

HHEC 259-0171
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Requested by HealthSouth Corp.

HEALTHSOUTH

Roles and Responsibilities for the Compliance Officer

COMPLIANCE POLICY NO. _____

Effective Date: _____
Page ___ of ___

BACKGROUND/PURPOSE

The critical issue from the standpoint of the Guidelines of the United States Sentencing Commission and standards of the Model Compliance Programs of the Office of Inspector General that the Roles and Responsibilities for the Compliance Officer be clearly delineated. This is particularly important as to the positioning of the Compliance Officer in relationship to the CEO and Board.

POLICY

It is the Policy of Health South that the Compliance Officer have direct access to the CEO and, if deemed necessary, to the Board. The Compliance Officer is to be the focal point for all compliance activities and is an integral part of management and not subordinate to either the Legal Counsel or financial management. However, the Compliance Officer shall consult with these functions in making compliance decisions.

PROCEDURES

The Compliance Officer shall carry out the responsibilities of the office by engaging in the following procedures:

1. Oversee and monitor HealthSouth's compliance activities. This includes designing and implementing the compliance program, as well as reviewing the content and performance of the Compliance Program on a continuing basis and taking appropriate steps to improve its effectiveness.

2. Periodically prepare and deliver reports to the CEO and Board on the status of HealthSouth's compliance efforts.

3. Investigate compliance violations and acts as appropriated to resolve problems. In carrying out the responsibilities of the function, will have access to all needed information, including contracts, billing records, and arrangements entered into by HealthSouth purposes of review.

4. Act in the role of Executive Director of the Executive Compliance Committee in reporting results of the compliance efforts of the company; and in providing oversight and guidance for the Chairman of the Board, President, Chief Operating Officer, Legal Counsel, and senior management on matters relating to compliance.

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5. Be responsible, together with the Executive Compliance Committee, to implement all necessary actions to ensure achievement of the objectives of an effective compliance program by means of reviews, relevant training, a system of consistent enforcement of the rules, and the development/implementation of corrective action plans.

6. Work with legal counsel, reviews and updates on a periodic basis the Standards of Conduct to ensure its continuing currency and relevance in providing guidance to management and employees.

7. Institute, maintain, and revise policies and procedures consistent with the HealthSouth Compliance Program for the general operation of the program and related activities to prevent illegal, unethical, or improper conduct.

8. Oversee and manage the performance of the compliance program and identify potential areas of compliance vulnerability and risk; and thereafter, provide specific direction as to the resolution of problematic issues, as well as general guidance to the company at large on how to deal with similar situations.

9. Develop and oversee the HealthSouth "Hotline" operation to solicit, evaluate, and respond to complaints and problems. Provide direction, oversight, and day-to-day management of the "Hotline" operation and other "feedback" mechanisms from employees.

10. Assist in the development and implementation of an effective compliance communication program for all company managers and employees, including promoting (a) use of the "Hotline," (b) heightened awareness of the Standards of Conduct, (c) understanding of new and existing compliance issues and related policies and procedures, and (d) reporting violations of laws, regulations, company policies, and Standards of Conduct.

11. Work with the Chief Financial Officer in ongoing monitoring and evaluating of HealthSouth's regulatory compliance in business activities and recommending the development of internal systems and controls to reinforce compliance.

12. Analyze the organization's business, industry environment and legal requirements with which it must comply, including specific risk areas; and assessing existing policies and procedures which address these areas.

13. Prepare periodic reports and evidence for the Executive Compliance Committee and the Board on the progress and effectiveness of HealthSouth's compliance activities and efforts.

14. Develop and oversee a system for uniform enforcement of violations of rules, regulations, policies, procedures, and the Standards of Conduct; and where appropriate, ensure proper reporting of potential violations of law to the duly authorized law enforcement agencies.

15. Coordinate with Human Resources compliance problems that involve personnel related issues, including, (a) assuring that appropriate sanction and disciplining agencies of the government have been checked for new and current employees, such as the Cumulative Sanction List of the Office of Inspector General; and (b) verifying credentials and licenses have been checked for new and current employees.

16. Ensure that individuals, entities and organizations with whom HealthSouth engages in a business relationship have been checked for sanctioning information with duly authorized regulatory and enforcement agencies.

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HEALTHSOUTH CORPORATION

Employee Issue Resolution Process

COMPLIANCE POLICY NO. _____

Effective Date: _____
Page ___ of ___

BACKGROUND/PURPOSE

The Compliance Office has been created to act as a facilitator of issues and problems arising from expressed employee concerns, complaints, and allegations. In addition, work of the Compliance Office may generate information that warrants closer examination or steps to resolve problems. As a rule, the Compliance Office will be engaging others to assist in resolution of issues on an ad hoc basis. The following policies and procedures are designed to provide guidance as to how this process will work.

POLICIES

1. Any contact by employees concerning compliance matters with Corporate executives and managers will be routed to the Compliance Office for handling through the Employee Issue Resolution Process. All communications will be stamped, logged, and sequentially numbered upon receipt by the Compliance Office.

2. All calls received on the Hotline will be handled in accordance with the Compliance Office Policies and Procedures concerning Hotline Operations. All those calling the Compliance Office Hotline are assured anonymity within legal and practicable limits should they choose not to identify themselves. Care must be taken to assure the anonymity of these hotline callers. In the event that an anonymous hotline caller is identified, then confidentiality must be maintained, as per the Policies and Procedures for Hotline Operations (Compliance Policy Number _____).

3. In general, the Employee Issue Resolution Process should be completed, to include an analysis of the situation and a clear-cut decision, within twenty (20) business days from receipt. Not all matters can be reasonably foreseen, therefore there may be circumstances that warrant a continuation of this timeframe. Such extensions and their reasons should be noted in the file.

4. If potential legal issues exist, the report will be provided to Legal Counsel as provided for under the Policies and Procedures set forth under Protocols between the Legal Counsel and Compliance Office (Compliance Policy Number _____).

5. Complaints received from attorneys or law enforcement agencies will generally be referred to Legal Counsel for advice as provided for under the Policy and Procedure for Protocols Between Legal Counsel and the Compliance Office (Compliance Policy Number _____). Compliance issues will likewise be referred to the Compliance Office for resolution. Anonymous compliance complaints will be investigated only if the Company deems it to be appropriate.

6. All written reports stemming from such an investigation will be kept separately from the complaining employee's personnel file and will be filed only with the Compliance Office. Access to these records

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Confidential Treatment
Requested by HealthSouth Corp.

will be strictly limited and available only to senior management with prior approval of the Compliance Office. The Compliance Policies and Procedures for Record Management (Compliance Policy Number ____) will be followed.

7. Management at all levels should ensure that no action is taken which may appear to be retaliation for an employee's utilization of the Corporate Compliance Hotline or Issue Resolution Process and be sensitized to this issue as provided for under the Non-Retribution/Non-Retaliation Policies and Procedures (Compliance Policy Number ____).

PROCEDURES

While it is inappropriate to establish rigid procedures for the conduct of inquiries arising from employee complaints, certain guide lines should be followed. A consistent framework/approach will lend to the clarity of the process and provide management with a formula for addressing issues raised to them from within the various business units. The following operational guidelines should provide the desired frame work:

1. The matter will be assigned to a person who is in a recognized and responsible position, organizationally removed from the employees immediate management, and who is free from prior involvement in the circumstances of the particular case or individual's appeal.

2. Before alerting management, the individual making the complaint should be fully debriefed on all relevant facts. It is important to understand the situation from their perspective. While it is not the role of the party examining the issue to be an advocate for either the employee or the object of the complaint, it is clearly expected that every effort will be made to find a solution satisfactory to the employee, while maintaining good business practices. Success is a fair hearing solution for both the employee and HealthSouth.

3. In addition, the individual making the inquiries should ensure the following:

    a) Conduct a fair impartial review of all relevant facts.

    b) Understand there are often two sides to an issue and the review process may substantiate the individual's point of view or that of the opposing party, or an alternate position acceptable to the parties may be found.

    c) Restrict the inquiry to those necessary to resolve the issues.

    d) In rare instances, it may be necessary to meet with the two parties simultaneously to clarify a key issue.

    e) Conduct the inquiry with as little visibility as possible while gathering pertinent facts relating to the complaint.

3. A summary of the results of the inquiry will be submitted to the Compliance Office along with recommendations for final resolution. Every effort must be made to protect the privacy of those contacted during the inquiry and in no case should the employee be advised as to the extent, if any, of management discipline resulting from the matter. If a manager's action is reversed, the reasons for that reversal must be reviewed with that manger, the appropriate level of management within the organization, and the complaining employee.

4. The field employee managing the process of determining the facts behind the allegation, complaint, and concern should generally follow the outline set forth below:

    - **Fully debrief complainant;**
    - **Notify appropriate internal parties;**
    - **Determine cause of problem, desired outcome, affected parties, applicable guidelines, possible regulatory or financial impact;**
    - **Provide a complete list of findings and recommendations;**
    - **Determine corrective action measures necessary;** e.g. Policy changes, Operational changes, System changes, Personnel changes, Training/education, etc.
    - **Documentation of results through an Issue Report.**

5. Confidentiality is a requirement in a reporting system if that system is to be trusted by its users. HealthSouth employees must have confidence that any information gathered during the course of an investigation will be handled carefully and not be available to those without a business need to know. This right to confidentiality is not only preferred, but is essential if HealthSouth's employees are to utilize the system. For this reason, written or verbal communication concerning the review conducted under these policies are strictly limited to those with a business need to know.

6. A written report, to be filed with the original written communication, should be prepared and filed with the Compliance Office. This report will enable the business to have an appropriate record of the management actions, if any, taken. It should include a summary of the individual's complaint, a chronology of events, findings/conclusions, and recommended actions with specific responsibilities identified at the appropriate management level to ensure the required implementation takes place. The manager responsible for the implementation plan must notify the Compliance Office, in writing, that the appropriate actions have been implemented.

7. Complaints received from former employees, applicants, or others on their own behalf will be handled within the same guidelines applicable to current employees as discussed above. Reports or pertinent information will not be provided to a third party.

8. All files relative to the Hotline or Executive Communication will be filed in the Compliance Office by year, month, and sequential number with cross references to operating division and location code. The files will be housed in the Corporate Compliance Department and will be locked at all times.

HEALTHSOUTH CORPORATION

Protocols between the Compliance Office and Legal Counsel

COMPLIANCE POLICY NO. _____

Effective Date: _____
Page ___ of ___

BACKGROUND/PURPOSE

The importance of establishing and maintaining a protocol between Legal Counsel and the Compliance Office is a matter of high priority for the Compliance Program. Although most allegations, concerns, and complaints received by the Compliance Office and Hotline are matters that are most appropriately addressed by the Compliance Office, on occasion issues arise that should be addressed under direction of Legal Counsel. This is to be done to adequately protect the identity of individuals cooperating with the resolution of the matter and to protect the evidence for possible future action.

POLICY

Whenever there are allegations of violations of criminal law, Legal Counsel must be called in to address the legal sufficiency of the allegations. In view of the fact that the Office of Inspector General, in their pronouncements and Model Compliance Plans, has stated that all of these decisions need to be made within 30 days. With the extremely limited time available to carry out all these steps, Legal Counsel should be notified immediately upon receipt of allegations or evidence suggesting criminal wrongdoing. Legal Counsel must also take steps to ensure that employee rights are protected and evidence is preserved. It will be important for you to decide whether such matters would be referred directly to inside or outside counsel.

PROCEDURES

Legal Counsel will conduct their investigation and evaluate the facts and evidence with utmost dispatch to determine whether there is reason to believe a criminal violation may have occurred. It will be further their responsibility, as Legal Counsel to the company, to:

- Determine how to address the issue;
- Determine a proper course of action to resolve the facts of the situation;
- Determine whether the fact and evidence warrant action;
- Determine whether referral to a duly authorized law enforcement agency is called for;
- Establish the appropriate enforcement agency to be notified,
- Determine when that referral or disclosure should be made; and,
- Determine under what circumstances it should take place.

Once all the facts have been evaluated and determinations made, Legal Counsel will report back to Senior Management with recommended courses of action, including referral to a duly authorized law enforcement agency. All of the foregoing steps will be completed within 30 days.

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The following form shall be used to engage Legal Counsel in this effort. On a case by case basis, this document may need to be reviewed with Legal Counsel for modification to meet specific needs. The language will need to reflect whether the Legal Counsel is inside or outside the company. This type of document will also evidence that the matter has been turned over to Legal Counsel and establish the necessary "audit trail" to that end. The enclosed document is also designed to make clear the fact that matters would be investigated under direction of Legal Counsel. It thereby assists in establishing Attorney-Client Privilege.

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(ATTACHMENT)

(DATE)

TO: , HealthSouth Legal Counsel

Subject:_____

I was informed on (DATE) of a possible violation of the Standards of Conduct regarding (NAME OF UNIT OR PARTIES) that may raise to the level of a criminal violation. In order to assess this properly, we need your legal advice and counsel as to the likely facts and the applicable law. Please look into this possible irregularity and advice accordingly. Based upon the results of your inquiry and evaluation of the facts, you can advise as to the appropriate manner by which this issue can be addressed, as well as whether sufficient evidence exists to warrant referral to a duly authorized law enforcement agency. We recognize that in conducting an investigation you may require the assistance of others. It should be made clear to those who assist you that any such assistance is being specifically provided at your request and under your direction and not the Compliance Office. As per our understanding with you, you should consider your work on this matter and the efforts of those assisting you to be confidential; accordingly, those with whom you work, as well as those whom you may interview, should be cautioned that the conversations and investigation itself are not to be discussed or otherwise disclosed except to you.

Thank you for your cooperation and assistance.

(COMPLIANCE OFFICER)

HHEC 259-0179
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STRATEGIC MANAGEMENT SYSTEMS, INC.

112 S. WEST STREET • ALEXANDRIA, VIRGINIA 22314

TELEPHONE (703) 683-9600 • FAX (703) 836-5255

November 21, 1997

Kelly L. Cullison
Assistant Vice President for Internal Audit
HealthSouth Corporation
One HealthSouth Parkway
Birmingham, AL 35243

Tab 99

Re: Policies and Procedures for the HealthSouth Corporation Compliance Office

Dear Kelly,

This is a follow-up to our telephone discussion on November 20th concerning development of the Compliance Office Manual of Policies and Procedures. We touched on a variety of issues that you are particularly concerned about, as well as a number of topics which I believe are important for HealthSouth. Herewith, I am providing you with a recapitulation of the points we covered. My notes indicated that we identified some 14 issue areas that you requested that we try to render into policies and procedures for the Compliance Office. We are operating under the understanding that we can always modify or add to this list at any time. The documents provided you will be in rough draft form and will require some hammering out by HealthSouth. It is very important that you take the time to evaluate each of the draft policy and procedure documents, not only for their face value, but also to determine how each one will fit in the larger scheme of things. The policies and procedures should be in harmony with your existing Compliance Program, and should reflect the way you want the program to operate. What we want to avoid, is developing a Compliance Manual that creates an overly bureaucratized function that drives the program. As a result of this, we will submit documents for each of the identified areas as they are developed. We want to ensure that you have enough time to involve others in deciding how to properly tailor it to "fit your culture."

My notes indicate that we agreed to work in developing compliance policies and procedures for the following areas:

1. Protocols between the Compliance Office and Legal Counsel
2. Process for resolution of issues brought to the Compliance Office
3. Roles and responsibilities for the compliance officer
4. Compliance officer confidentiality agreements
5. Sanctions policy
6. Hotline operations
7. Non-retribution/non-retaliation policy
8. Voluntary disclosure to the government of violations of law
9. Search warrant compliance policy
10. Employee compliance training policy
11. Patient confidentiality
12. Records management
13. Ongoing monitoring and auditing for compliance
14. Billing and coding

I will work with Julian De La Rosa and Andy Joseph to ensure that we craft these documents to be consistent with the philosophy and operating business environment at HealthSouth. As you evaluate the documents we submit to you, please consider that these are the policies and procedures for the Compliance Office, and not necessarily for HealthSouth at large. In some cases, these documents will be exclusive to the Compliance Officer operations. However, in most cases these are rules for how the Compliance Office will intersect with operational and Human Resources policies and procedures. Because these policies and

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procedures will be sent to you in rough draft form, we suggest that you use a task force team approach in refining each individual policy and procedure. This team should include Legal Counsel and Human Resources, as well as people from operations. As such, we believe it is better to develop a straw document that can be refined. We will work with you to tailor it to HealthSouth's environment. As you receive each of these documents please review them carefully and then we can discuss what alterations you would like to make to each one. In some cases, I suspect that a lot of work will be needed to ensure that they reflect your current thinking about the proper role of the Compliance Officer in the larger context of the system operations.

According to our conversation, and the discussions you have had with Julian, we will focus first on issues relating to: (a) operating protocols between the Compliance Office and Legal Counsel; (b) general operating rules of the Compliance Office; and (c) process to be followed in resolving issues raised to the Compliance Office. Thereafter, we will begin with the easier problems and work towards the more difficult. If there other issues of special priority, besides those mentioned above, please let me know and we will put them on the top of the list. During our conversation we briefly discussed developing a process for employee exit interviews and for medical director/advisor agreements, but agreed to work on them later in the process in order to take advantage of work under development related to these areas. However, when you are ready to move forward with these, or any other compliance policies you would like to add to this list, let Julian, Andy, or myself know. Also, if the foregoing list is incomplete or includes a subject matter that you would want to defer action on at this point in time, please let us know. Feel free to call me at (703) 683-9600.

Sincerely,

Dick

Richard P. Kusserow
President

cc: Anthony J. Tanner, Executive Vice President and Corporate Compliance Officer

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A - STANDARDS OF BUSINESS CONDUCT

Tab 100

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HealthSouth Compliance Program Overview

HealthSouth Corporation formalized its compliance efforts with the implementation of its Corporate Compliance Program in 1997. Development and relevant features of the program are summarized below.

Program Development

In early 1997, HealthSouth contracted with external consultants Strategic Management Systems, Inc. ("SMS") to formalize the Company's Corporate Compliance Program within the framework of the "U.S. Sentencing Guidelines for Organizations." This was accomplished through the following:

- Organizational assessment utilizing focus group discussions and employee surveys
- Formalization of the Company conduct standards, in the form of the HealthSouth Standards of Business Conduct ("Standards"). (Document A)
- Designation of a high-level Corporate Compliance Officer
- Development of an employee training program
- Establishment of a Compliance Hotline ("Hotline") for reporting compliance violations or concerns
- Screening of all employees through OIG sanctions listings as well as numerous state and regulatory databases

Standards of Business Conduct

The Standards contain the basic conduct standards expected of HealthSouth employees, and are provided to all employees during compliance training. The Standards were created with input from employees from all levels and functions and were written to ensure that all employees have a clear understanding of the business, professional, legal and personal ethics that are expected in the workplace. A Spanish version of the Standards is available to meet the needs of HealthSouth's large Hispanic employee population.

The Standards are applied to the following eight categories:

- Quality of Care
- Compliance with Laws & Regulations
- Billing & Coding
- Conflicts of Interest
- Protection of Property
- Health & Safety
- Human Resources
- Communication

Within each category, specific topics of concern are presented and discussed. Employees are directed to avoid illegal practices, and those practices which may be legal but which present ethical and moral dilemmas or opportunity for misimpression. The Standards outline each employee's responsibility to act in accordance with the Standards and to report violations, and compliance is an element of each employee's performance evaluation.

The Standards were first approved by the Compliance Committee of the Board of Directors on October 15, 1997, and last amended May, 2001.

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Employee Training

Compliance training for HealthSouth employees is tracked and monitored from the corporate office. Current training standards for the Compliance Program are as follows:

- Orientation: New hires are trained within 10 business days of hire date.
- Refresher: All employees participate in refresher training annually.

Orientation Training

A detailed Trainer's Manual is distributed to facilities for use in preparing and conducting the Compliance Orientation. New moderators are encouraged to participate in sessions conducted by experienced trainers prior to conducting their own sessions.

In many cities, training is conducted on a market basis, with employees from multiple facilities taking part. In other areas, where facilities may be isolated, training is conducted at the facility level.

Compliance Orientation consists of a live two-hour session. A brief introductory video explains the nature and purpose of the Company's Compliance Program. Through the use of slides and/or employee handouts, the moderator discusses key aspects of the Standards and the importance of maintaining compliance. Employees are then asked to review a number of case studies to identify the relevant compliance issues and determine the ideal resolution process.

Upon completion of the training session, the following documentation is completed:

- Evidence of Completion form - documents employee's attendance and receipt of the Standards; filed in the employee's personnel file.
- Classroom Roster - a listing of attendees; forwarded to the Corporate Office for entry into the tracking system.
- Participant Evaluation - significant comments are forwarded to the Corporate Office for review and evaluation.

Currently, steps are underway to integrate training documentation into the Company's intranet; this will facilitate the process and ensure greater reporting accuracy. The training session itself will continue to be a live presentation.

Refresher Training

The Refresher Course is a self-paced module which employees complete every year. A Moderator's Guide is distributed to facilities to assist in administering the training. The course requires the employee to review the basic elements of the Compliance Program (including the Standards) and complete a number of exercises. Upon completion, the following documentation is prepared:

- Evidence of Completion form
  - Employee acknowledges he/she has completed the refresher workbook and possesses a copy of the Standards.
  - Moderator certifies that employee has completed the workbook.
  - Form is filed in employee personnel file.
- Employee Contact Page - provides contact information for key personnel to guide employees in resolving conflicts.
- Refresher Training Summary Report - completed by facility and forwarded to Corporate Office for entry into the training tracking system.

Currently, steps are underway to integrate the refresher training and documentation into the Company's intranet; this will allow for greater employee interactivity and ensure greater reporting accuracy.

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Compliance Hotline

The Hotline was established in November, 1997, as an integral element of HealthSouth's Compliance Program. The Hotline complies with the OIG guidance documents as a secure mechanism through which employees can raise concerns in a confidential or anonymous manner, without fear of retaliation or retribution. Both in employee compliance training and in the Standards, the importance of the Hotline is emphasized to employees. Additionally, the Hotline number and operating hours are posted in each facility. Employees have an affirmative duty to report suspected violations of the Standards to the management team, Human Resources or the Hotline.

HealthSouth's toll-free Hotline operates 8 A.M. until 5 P.M. CST. Each employee receives a wallet-sized card with the hotline number and confidentiality information. Calls are not traced or recorded.

All calls are anonymous and confidential to the extent allowed by law, and each issue is investigated fully by the Corporate Compliance Office, or referred to another internal department as appropriate.

In addition to calling the hotline, employees may report concerns or allegations to the Compliance Office by secure fax or by U.S. mail to a designated post office box.

Cases are recorded in a secure, encrypted database to facilitate monitoring and follow-up. In accordance with Compliance Office policy, case details are purged from the system 90 days after the date of closure. A summary log is maintained documenting the type of case received and noting the general disposition of the case. As of August 6, 2001, 3,269 cases had been logged by the Compliance Office (from inception 1/97).

Non-Retaliation Policy

An important element of HealthSouth's compliance initiative is a well-publicized Company policy forbidding retaliation against any employee who, in good faith, reports a concern to management, Human Resources, the Corporate Compliance Office, or the Hotline. The non-retaliation policy is communicated to employees both in the context of the Standards and in overall compliance training. The Hotline is an important element of the non-retaliation policy because it permits anonymous communication with the Compliance Program.

Corporate Compliance Officer

The Corporate Compliance Officer is independent of Company executive officers, and can bring issues directly to the Board of Directors. Reports are made to the Board of Directors at regularly scheduled Board meetings (at least quarterly).

Board Compliance Subcommittee

The Company's Board of Directors has established a compliance subcommittee. The subcommittee meets quarterly, at which point the Compliance Officer presents a summary of recent activities and initiatives of the Compliance Office. The subcommittee consists of three outside directors and the Corporate Compliance Officer.

Sanctions Screening

Upon implementation of the Company's Compliance Program, all existing employees were screened through OIG sanctions listings as well as numerous state and regulatory databases. Currently, all new employees and contractors are screened upon hire.

The HealthSouth Employment Application requires applicants to acknowledge any sanctions or felony convictions they have received.

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Monitoring & Auditing

Ongoing compliance monitoring occurs within the Company as follows:

Corporate Compliance Audits

The Compliance Office conducts and/or coordinates routine audits of selected sites and divisions pursuant to the OIG's annual work plan. Over 400 routine reviews have been conducted to date during the year 2000; these have focused on outpatient rehabilitation centers. Additionally, the Compliance Office conducts investigations as issues are raised through the Hotline. Recently, the Compliance Office began reviewing facilities' compliance with the training standards.

Internal Audits

The HealthSouth Internal Audit department conducts routine unannounced audits on an ongoing basis. In addition, the Internal Audit department conducts reviews of selected sites upon management request or as the result of issues reported to the Compliance Office. As of November 10, 2000, The Internal Audit Department had logged 130 audits for the year 2000.

Pristine Audits

HealthSouth's Pristine Factor Audit is a yearly, unannounced audit of each of the Company's 2,000 locations. Administered independently by external auditing firm Ernst & Young, LLP, the Pristine Factor Program grades all facilities using a standardized 50-point checklist. One item on the checklist verifies that the facility has posted the Compliance Hotline number. For year 2000 audits conducted as of November 10, 2000, 94.68% of facilities were compliant with this item.

Health Information Reviews

HealthSouth's Health Information Department assists field locations with billing and coding questions, and conducts site reviews as needed.

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SG 0000201

To: Tony Tanner
Copy of my memo to
Tried to follow

RECEIVED
NOV 21 1995
PHYSICAL RESOURCES

HEALTHSOUTH®

Tab 101

MEMORANDUM

TO: Ken Livesay
Jack Hawkins

FROM: Teresa L. Rubio

DATE: November 14, 1995

SUBJECT: Fixed Assets

Jack H – how are you going to address Teresa's on-arm?

For 1995, the Audit Department added a program step to audit facilities fixed assets. During recent audits, we have noted a few recurring deficiencies. These deficiencies have led to two significant audit concerns which I would like to bring to your attention.

CONCERN:
Fixed Asset Valuation

Many facilities have fixed assets in storage, both on and off site. Assets in both storage areas are either obsolete, damaged, or not used in current product lines. In some cases, off-site storage areas have not been inventoried.

Stored fixed assets not only increase outside storage costs, but also waste valuable facility square footage. Any non-inventoried fixed assets increase the risk of company property being used for personal financial gain.

CONCERN:
Safeguarding Of Assets

Fixed asset numbers per corporate fixed asset lists do not always agree with facility tag numbers. Also, fixed assets are not consistently tagged or descriptions are not standardized on the corporate fixed asset list.

In cases of new acquisitions (i.e., NME, Re-Life, Novacare, etc.), fixed asset inventories gathered by contracted valuation personnel have either not been communicated to the field, or field personnel have not reconciled these inventories to facility assets. Without standardized descriptions it is difficult to locate assets. For example: One facility may tag and describe a cybex machine in detail whereas another facility may tag and describe the same machine as PT equipment.

Without consistent and proper identification of assets, the risk of company property being used for personal financial gain significantly increases.

RECOMMENDATION:

All facilities should take a complete fixed asset inventory. This inventory should include the following: (1) all assets in storage, (2) a reconciliation to corporate fixed asset lists, (3) a review of valuation amounts and (4) current asset status (i.e., obsolete, damaged, in use, etc.).

Should you have any questions or need to discuss the above concerns, feel free to contact me.

Thank you for your attention into these concerns and recommendations.

TLR/tle

cc: Richard Scrushy
Jim Bennett
Aaron Beam
Tony Tanner
Daryl Brown
Gerald Scrushy
Bill Owens

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1 company for twenty years, there wouldn't be any reason
2 to fire him, would there be?
3 A I don't think there would be.
4 MR. SJOBLOM: Thank you, Your Honor.
5 THE COURT: Do you know, and if you don't,
6 it's perfectly fine, do you know who is responsible
7 for signing 10-Qs and 10-Ks for a publicly traded
8 company?
9 THE WITNESS: Generally it's the chairman,
10 president and chief financial officer.
11 THE COURT: Do you know if the chief
12 operating officer has to sign it?
13 THE WITNESS: In some cases they do, and
14 some cases not.
15 THE COURT: You are not familiar with that?
16 THE WITNESS: I'm not familiar. I know I
17 always signed -- when I was chairman of the company, I
18 always signed the reports.
19 THE COURT: So if Mr. Owens wanted to be
20 moved to COO instead of CFO, that would mean he didn't
21 have to sign anymore, would he?
22 THE WITNESS: I can't say that. I don't
23 know.
24 THE COURT: Anything else for Mr. Gordon?
25 MR. LOOMIS: No, Your Honor.

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1 MR. SJOBLOM: No, Your Honor.
2 MR. COOPER: Your Honor, may he be excused
3 from subpoena?
4 THE COURT: That's fine.
5 THE WITNESS: Sorry I talked so fast.
6 THE COURT: That's all right. I got the
7 hang of it.
8 THE WITNESS: This is a new experience for
9 me.
10 MR. LOOMIS: Your Honor, we would call Kelly
11 Coleman. She's in the witness room right there.
12 MR. STURDIVANT: Your Honor, I'm Jim
13 Sturdivant, and I represent Ms. Coleman.
14 THE COURT: Please have a seat.
15 (James Sturdivant representing Ms. Coleman)
16 KELLY HUGHES COLEMAN, SWORN.
17 THE WITNESS: Will you state your full name
18 for the record.
19 THE WITNESS: Kelly Hughes Coleman.
20 THE CLERK: Kelly, K-E-L-L-Y?
21 THE WITNESS: Yes, ma'am.
22 THE CLERK: Hughes, H-U-G-H-E-S?
23 THE WITNESS: Yes, C-O-L-E-M-A-N.
24 THE CLERK: The city and the state where you
25 live.

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1 THE WITNESS: Birmingham, Alabama.
2 DIRECT EXAMINATION
3 BY MR. LOOMIS:
4 Q Good afternoon, Ms. Coleman. Can you give us the
5 benefit of your education?
6 A Yes. I went to high school at Chelsea High
7 School and I went to college at University of
8 Alabama.
9 Q Did you obtain a degree from the University of
10 Alabama?
11 A I did. I have an accounting degree.
12 Q Is that BS or BA?
13 A BS.
14 Q When did you graduate?
15 A In May '96.
16 Q Where did you go to work after you graduated from
17 Alabama?
18 A I went to work at HealthSouth.
19 Q Are you still employed at HealthSouth?
20 A Yes, I am.
21 Q Can you walk us through your progression at
22 HealthSouth since starting in May of '96?
23 A Yes. When I first started, I was hired as an
24 accountant level one. And then I was later promoted
25 to accountant level two, and then senior accountant,

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1 and then accounting supervisor, accounting manager,
2 director of accounting. And then my current title is
3 assistant vice-president of finance.
4 Q When did you become assistant vice-president of
5 finance?
6 A In March, 2001.
7 Q Can you give me a rough idea of when you became
8 director of accounting?
9 THE COURT: What did you say, assistant
10 vice-president of finance, when was that?
11 THE WITNESS: March, 2001.
12 THE COURT: All right.
13 A Director of accounting was probably a year or so
14 before that, roughly.
15 Q Sometime maybe fall of 2000?
16 THE COURT: A year before March 2001, would
17 be March 2000.
18 MR. LOOMIS: March 2000, sorry.
19 Q Sometime around the spring of 2000?
20 A That's probably about right.
21 Q Okay.
22 THE COURT: When were you accountant
23 manager?
24 THE WITNESS: If I remember correctly, I
25 became a manager in the fall of '99, roughly.

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1 THE COURT: And accountant supervisor?
2 THE WITNESS: Probably within nine to twelve
3 months before that.
4 THE COURT: Thanks.
5 Q Who was your supervisor when you were an
6 accounting supervisor, who was your immediate
7 reporter?
8 A As a supervisor, my direct supervisor was Jenny
9 Valentine.
10 Q And as an accounting manager?
11 A Angela Ayers.
12 Q As a director of accounting?
13 A Angela Ayers.
14 Q And then as an AVP of finance?
15 A Emery Harris was my first supervisor. But then
16 later it was -- it became Angela Ayers again.
17 Q Prior to becoming an AVP of finance, were you an
18 officer of HealthSouth?
19 A No, sir.
20 Q So is an AVP of finance considered an officer?
21 A Yes, sir.
22 Q Did you have a meeting in or around August of
23 2002 in which Weston Smith attended the meeting?
24 A Yes.
25 Q Who else was in that meeting?

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1 A It was Weston Smith, Emery Harris, Kay Morgan,
2 Angela Ayers, and Jenny Valentine and myself.
3 Q Did Mr. Smith -- Weston Smith say anything during
4 that meeting?
5 A Yes, he did.
6 Q Tell me about that.
7 A When he first came into the meeting, he seemed
8 kind of emotional or distraught. And when he came
9 into the room, he said that he was having difficulty
10 sleeping at night and he didn't want to sign the
11 financials anymore.
12 THE COURT: Didn't what?
13 THE WITNESS: He did not want to sign the
14 financials. And he said that the entries have got to
15 stop. And he said that there was a plan that had been
16 thought of, and he said that the Medicare announcement
17 on the changes in the outpatient group therapy billing
18 was supposed to be coming out the following week
19 sometime.
20 And he said that that announcement was going
21 to come out, and also they were going to announce that
22 the surgery center division was going to be split off
23 into its own company. And then he said that the
24 diagnostic division was going to be sold. And after
25 all of that, after all of that took place, whatever

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1 was left of HealthSouth Corporation was going to be
2 taken private.
3 Q Did you understand then that this Medicare policy
4 was part of the plan to stop the entries?
5 A I knew that -- he had said that the entries were
6 coming to a stop. And I didn't know that the Medicare
7 announcement was necessarily part of that. But it was
8 all going to be part of the plan to be announced at
9 the same time.
10 Q Okay. And shortly after that, was there an
11 announcement made by HealthSouth regarding the impact
12 of a new Medicare billing policy?
13 A Yes, sir.
14 Q Did Mr. Smith in that meeting say anything to
15 suggest that Mr. Scrushy had authorized this plan?
16 MR. SJOBLOM: Objection, leading.
17 THE COURT: Sustained.
18 Q Did he say anything about Mr. Scrushy?
19 A He did say that he thought the plan would work
20 and he said that Richard was in support of the plan.
21 Q After the meeting, did you have any discussions
22 with Emery Harris?
23 A I did. There was a meeting with Emery, Angela
24 and Jenny and myself that I recall.
25 THE COURT: I've got to know when.

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1 THE WITNESS: It was -- it was either later
2 that afternoon or possibly the next day.
3 THE COURT: Tell me who was there.
4 THE WITNESS: It was Emery Harris, Angela
5 Ayers, Jenny Valentine, and myself.
6 THE COURT: What did Emery say in that
7 meeting?
8 THE WITNESS: It was a follow-up meeting
9 after the meeting with Weston and he was just saying
10 that I know all of this is shocking and a lot to take
11 in, but there's a lot of work to be done on the -- to
12 get information ready for the surgery center split off
13 and the possible sale of the diagnostic division.
14 Q Now, in this meeting with Weston Smith, he said
15 something about entries had to be stopped. What did
16 you understand "entries" to be?
17 A Well, after he said that, he was uncomfortable
18 signing financials, the entries that I thought of were
19 the entries that were made at the end of -- at the end
20 of quarters.
21 Q What kind of entries are you talking about?
22 A They are referred to as management entries or
23 corporate pushdowns that would adjust certain revenue
24 categories or expense line items or sometimes balance
25 sheet categories.

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1 Q Would the balance sheet category include entries
2 to Property, Plant and Equipment?
3 MR. SJOBLOM: Objection, leading.
4 THE COURT: Sustained.
5 Q What categories on the balance sheet would be
6 included in these management entries?
7 A Different categories, Property, Plant and
8 Equipment was one of the categories. I remember
9 inventory on some of the pre-paids, and sometimes
10 maybe even liability accounts.
11 Q Were you involved in making any of these
12 entries?
13 A I was periodically from time to time.
14 Q Who else was involved in making these entries?
15 A To my knowledge, Angela Ayers and Jenny
16 Valentine, and Cathy Edwards and Kay Morgan made some
17 entries as well.
18 Q Did you ever raise any questions about the
19 legitimacy of these entries?
20 A Whenever the -- whenever we would get questions
21 on the entries from facilities or whomever would be
22 giving explanations, then I would communicate those
23 explanations back down. Some of the explanations made
24 more sense than others. But after receiving
25 explanations, I didn't even question it further than

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1 that.
2 Q Who did you receive explanations from?
3 A It was primarily Emery Harris that would give me
4 explanations, occasionally maybe Jenny or maybe
5 Angela.
6 Q There's been testimony by other witnesses in this
7 case about meetings of accounting personnel behind
8 closed doors and they mentioned that it was you and
9 Jenny Valentine, Angela Ayers, Emery Harris, Kay
10 Morgan and Cathy Edwards.
11 MR. SJOBLOM: Objection, misstates the
12 testimony in this courtroom.
13 THE COURT: If you want to ask a question,
14 don't lead, because I know you are fixing to ask a
15 leading question.
16 Q Did you participate in meetings with other
17 accounting personnel in peoples' offices?
18 A Yes, I did.
19 Q Did those people to your knowledge have meetings
20 outside of your presence?
21 A Yes, sir.
22 Q How do you know about those meetings?
23 A It would be to where maybe I was going downstairs
24 to Emery's office to carry him a piece of
25 documentation or ask a question, and I would knock on

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1 the door. We would say come in, and there would be
2 two, three, four people in there.
3 Q Who would those two to three, four people be?
4 A It would vary. Sometimes it would consist of
5 Angela Ayers, Cathy Edwards, Kay Morgan and sometimes
6 Jenny Valentine.
7 Q You said knock on the door, was the door
8 closed?
9 A A lot of the times it was very common for Emery
10 especially to close his door whenever meeting on
11 certain items because he sat in a high traffic area.
12 There were cubes right outside his office or people
13 always coming in and out. And it was very common to
14 close the door, you know, for meetings so that there
15 would be fewer disturbances.
16 Q You said hot shot -- I'm sorry?
17 A High traffic area.
18 Q To your knowledge, did Emery Harris and other
19 accounting people have social gatherings outside of
20 HealthSouth in which you were not involved?
21 MR. SJOBLOM: Objection, relevancy.
22 MR. LOOMIS: It goes to show whether she was
23 involved in various accounting meetings, Your Honor.
24 THE COURT: Social is not accounting. I
25 mean, as much as accountants might think they are.

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1 I'm going to sustain the objection.
2 MR. LOOMIS: Okay.
3 Q After you became assistant vice-president of
4 finance, did you attend officers' meetings?
5 A Yes, sir.
6 Q Did you attend those meetings regularly?
7 A I did.
8 Q From March of 2001 until the present, I think
9 there was sometime that you were on maternity leave;
10 is that correct?
11 A Correct.
12 Q When was that?
13 A From March 25th, 2002 through mid June 2002.
14 Q Other than that time, did you attend the officer
15 meetings regularly?
16 A Yes, sir. If I was at work and not sick or on
17 vacation, I was at the meetings.
18 Q Did Mr. Scrushy also attend all the officer
19 meetings that you attended?
20 A Yes, sir, from what I recall. There may have
21 been one to where I don't remember him being there.
22 Q Did Mr. Scrushy, in those meetings, take an
23 active role?
24 A Yes, sir.
25 Q Do you recall a meeting, an officers' meeting on