GAO

United States
General Accounting Office
Washington, D.C. 20548

Health, Education and Human Services Division

B-261970

July 18, 1995

The Honorable Ron Wyden
Ranking Minority Member
Subcommittee on Oversight and Investigations
Committee on Commerce
House of Representatives

Dear Mr. Wyden:

Medicare reimburses certain institutional providers for their operating expenses, such as buildings and equipment, employee salaries, utilities, accounting fees, and legal fees.[1] Concerned about the possible abuse of the Medicare provision that allows reimbursement of providers' legal expenses, particularly by home health agencies, you asked us to provide you with information on: (1) the conditions that Medicare imposes on provider legal expense reimbursements and whether those conditions are different from those applied in other government contexts; (2) the amount that Medicare spends on providers' legal expenses; and (3) whether any evidence exists that providers have abused current provisions covering legal expense reimbursement.

BACKGROUND

The Health Care Financing Administration (HCFA), within the Department of Health and Human Services (HHS), is responsible for administering the Medicare Hospital Insurance Program, also known as Medicare Part A. Part A covers the cost of inpatient hospital stays, home health care, and hospice and skilled nursing facility stays. HCFA contracts with about 52 private companies--such as Blue Cross plans and Aetna--to handle claims screening and to audit providers of Part A services. HCFA contractors review providers' claims and audit their cost reports. Contractors may deny claims submitted by providers and may determine that certain

[1]Institutional providers that are reimbursed by Medicare on a cost basis include home health care agencies, skilled nursing facilities, rehabilitation, and psychiatric hospitals.

costs are not allowable under provisions of Medicare. In turn, providers have the right to appeal denied claims, cost report adjustments, or both and may enlist the services of legal counsel throughout the appeal process.

Under Medicare, some providers, such as home health agencies, and skilled nursing facilities are paid on the basis of their reasonable costs. To receive reimbursement for such costs, Medicare requires providers to submit an annual financial statement that lists their expenses.

Providers' expenses are reimbursed on a pro rata basis, determined by their Medicare utilization rate.[2] Thus, a company that provided 50 percent of its services to Medicare beneficiaries would have 50 percent of its allowable expenses paid by Medicare.

To respond to your request, we focused on the reimbursement received by home health agencies because a high percentage of their legal expenses are reimbursed by Medicare. We reviewed documents provided to us by the Office of the Inspector General (OIG) of HHS and spoke with HCFA officials and representatives of several Medicare contractors. To obtain a preliminary estimate of what Medicare spends on providers' legal expenses, we asked one contractor to provide us with 1994 cost report information for 46 home health agencies headquartered within a four-state area.[3]

MEDICARE REIMBURSEMENT OF PROVIDERS' LEGAL EXPENSES

Legal fees that are directly or indirectly related to patient care are considered reasonable costs under section 1861(v) of the Social Security Act[4] and the

---

[2]This payment method is used because it is inherently difficult to distinguish Medicare-related expenses from other expenses incurred by a provider.

[3]We reviewed cost reports of home health agencies in Florida, Georgia, Alabama, and Mississippi.

[4]42 USC 1395x(v)

implementing regulation at 42 C.F.R. 413.9 (see Enclosure 1). These provisions' are quite broad and HCFA has not developed operational guidelines that would specify the conditions under which legal fees are reimbursable. Lacking formal guidelines, contractors determine whether provider legal fees are allowable on a case-by-case basis. One contractor representative told us that legal services such as reviewing contracts, giving general legal advice, and bringing lawsuits against another company for nonperformance are activities that would constitute allowable legal expenses.

More generally, HCFA and its contractors have reached what one HCFA official termed a "working understanding" with regard to certain types of legal expenses. The following discussion highlights some of the "rules of thumb" that guide contractors.

-- Legal Expenses Incurred to Appeal Denied Claims. Both HCFA and contractor representatives stated that legal expenses incurred by providers to appeal denied claims and cost adjustments are reimbursable by Medicare. Medicare reimburses providers regardless of whether they win or lose an appeal throughout all levels of the appeal process (that is appeals made before the Provider Reimbursement Review Board, administrative law judge, or civil court). However, legal expenses incurred to appeal claims that involve an issue in which the provider has already received an adverse final determination will not be reimbursed.

-- Legal Expenses Incurred to Defend Against Criminal Charges. A HCFA official told us that the legal expenses incurred to defend against a criminal indictment would not be reimbursed by Medicare. Although this principle seems straightforward, its application is sometimes difficult. This official acknowledged that if a provider was under investigation but not actually indicted, legal expenses incurred as a result of the investigation might be reimbursable. Similarly, a contractor representative pointed out that the outcome of the trial might influence the decision of whether to allow legal expenses. That is, if a provider was found innocent of criminal charges, his or her legal expenses might also be reimbursable.

-- Rate for Billable Hours. Because HCFA regulations and manuals do not place a dollar limit on legal costs, contractors must exercise their own judgment, on a case-by-case basis, in determining the reasonableness of costs submitted by providers. A contractor representative told us that legal fees submitted by providers reflecting the local average hourly rate for legal services would be allowable. However, higher-than-average hourly fees would be reimbursed if the provider could show that special expertise was needed. He added that in his experience legal rates were rarely if ever challenged by contractors.

MEDICARE REIMBURSEMENT OF LEGAL EXPENSES APPEARS MORE GENEROUS THAN IN OTHER GOVERNMENT CONTEXTS

Outside the Medicare context, there are many federal statutes that provide for the federal government to pay the legal expenses of others. For example, federal contract cost principles generally permit legal expenses to be included as costs under government contracts, but they are unallowable if incurred in connection with litigation against the government.[5] Also, the Equal Access to Justice Act (EAJA) requires payment of legal expenses on behalf of the prevailing parties in a broad range of agency actions and judicial proceedings involving the United States.[6] Payments under EAJA are not required, however, when the government's position is substantially justified or special circumstances would make such payments unjust. In addition, payments for attorneys fees under EAJA are subject to a cap.

Consequently, Medicare provisions for reimbursing providers' legal expenses appear more generous in two ways: (1) cost-based providers are able to sue HCFA and its contractors and have their legal expenses reimbursed by Medicare--regardless of outcome and (2) providers' legal expenses are not capped, Medicare will reimburse all legal expenses so long as they are reasonable and related to patient care.

---

[5]48 C.F.R. § 31.205-47(f)(1) (1994).

[6]Public Law No. 96-481, Title II, 94 Stat. 2325 (codified at 5 USC 504 & 28 USC 2412).

MEDICARE SPENDING ON PROVIDERS' LEGAL EXPENSES

Whereas 10 years ago Part A providers that were reimbursed on a cost basis (skilled nursing and home health agencies) received only 5 percent of Part A expenditures, today they receive about 20 percent and are rapidly growing segment of Medicare.[7] Because HCFA does not accumulate data on providers' legal expenses, to gauge the magnitude of Medicare spending in this area we reviewed cost report information from 46 home health agencies within a four-state region.

In 1994, the 46 home health agencies that we examined had a combined total of $6,549,791 in allowed legal expenses. There was significant variation in the amount of legal expenses claimed by the home office of each provider. Seventeen agencies had allowed legal expenses of less than $1,000 in 1994. On the other hand, 8 agencies had Medicare-related legal expenses of more than $100,000, while two companies claimed more than $1.6 million. Similarly, as a percentage of total expenses, legal expenses also varied among providers. Twenty-nine agencies had legal expenses of 1 percent or less, whereas for 3 agencies these expenses exceeded 6 percent of total expenses. (See Enclosure 2.)

ONE CASE SHOWS POTENTIAL FOR ABUSE OF LEGAL REIMBURSEMENT PROVISIONS

Recent allegations brought against one home health agency illustrate why current provisions governing the reimbursement of providers' legal fees should be closely scrutinized. In a letter proposing exclusion from the Medicare program, the HHS OIG identified numerous

---

[7]A HCFA official we spoke with believed that little attention has been given to the matter of providers' legal expenses since 1983, the year in which the Prospective Payment System (PPS) was introduced for most hospitals. Under PPS, hospitals receive a flat fee for treating a particular diagnosis, irrespective of their actual costs--overhead expenses, such as legal fees, are factored into the fee. Home heath agencies, skilled nursing facilities, and hospital outpatient services (for example, rehabilitation therapy) are still paid on a reasonable cost basis.

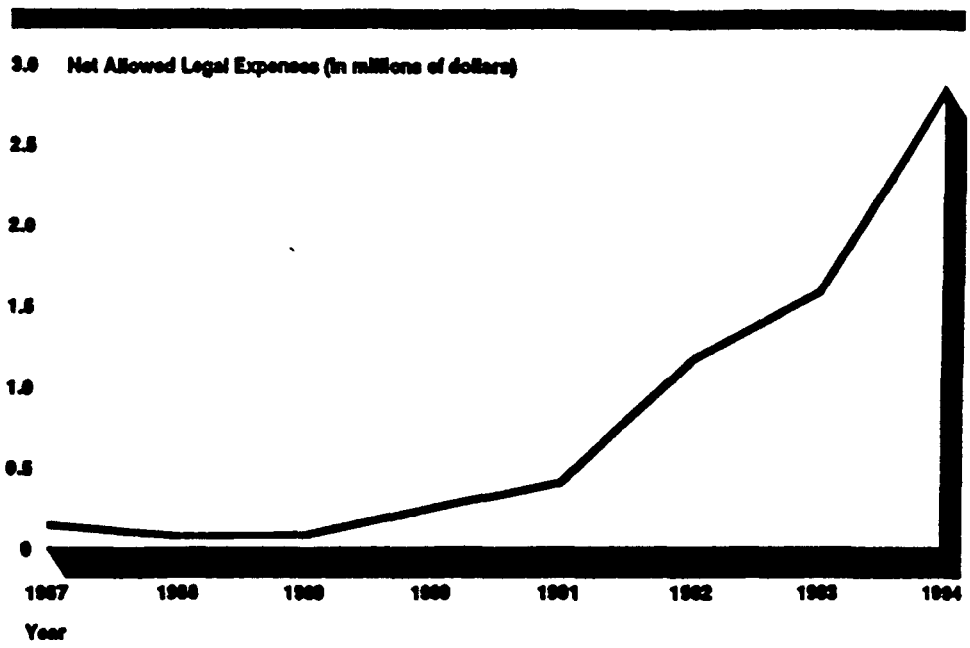
instances in which this home health agency allegedly submitted fraudulent claims for Medicare reimbursement.[8]

As shown figure 1, this home health agency's allowable legal expenses have dramatically escalated over the past 8 years, from $140,666 in 1987 to $2,853,748 in 1994. According to the contractor responsible for auditing the agency's cost reports from 1987 to 1991, the agency's high legal expenses may result from the fact that it had engaged in lengthy litigation regarding the contractors' and HCFA's administrative determinations. Contractor officials believed that the litigious behavior of this agency could, in part, be attributed to Medicare's policy that allows home health agencies to be reimbursed for their legal expenses. Such a policy can provide an incentive for companies to appeal denied cost adjustments, even if there is little likelihood of success.

---

[8]Among the more questionable items identified by the OIG were lease payments for an imported automobile used by the owner's son, country club golf course membership fees, maid services for the owner's personal luxury condominium, and cable television charges for the home of the owner's mother. As a result of its investigation, the OIG has recommended that this home health agency be excluded from the Medicare program for 7 years. GAO's Office of Special Investigations is currently examining allegations raised by the fiscal intermediary that the agency charged HCFA for expenses that were not reimbursable under Medicare. These include (1) home health care visits to ineligible patients and (2) payments to employees and physicians for costs not related to patient care.

Figure 1: Legal Expenses Submitted by One Home Health Agency (1987-94)



Note. Allowed legal costs for some years listed above are subject to change pending the completion of the final cost report audit.

- - - -

If you have any questions or would like to discuss this material further, please contact Edwin Stropko, Assistant Director, at (202) 512-7108 or Richard Lipinski, Project Manager, at (202) 512-3597.

Sincerely yours,

Jonathan Ratner

Jonathan Ratner
Associate Director
Health Financing Issues

Enclosures - 2

ENCLOSURE 1

REGULATIONS GOVERNING REIMBURSEMENT OF PROVIDERS' LEGAL FEES

HCFA officials cited the regulations contained in 42 C.F.R. § 413.9 as the basis for determing whether providers' legal fees are reimbursible under Medicare.

§ 413.9. Cost related to patient care.

Principle. All payments to providers of services must be based on the reasonable cost of services covered under Medicare and related to the care of beneficiaries. Reasonable cost includes all necessary and proper costs incurred in furnishing the services, subject to principles relating to specific items of revenue and cost. However, for cost reporting periods beginning after December 31, 1973, payments to providers of services are based on the lesser of the reasonable cost of services covered under Medicare and furnished to program beneficiaries or the customary charges to the general public for such services, as provided for in § 413.13.

Definitions

(1) Reasonable cost. Reasonable cost of any services must be determined in accordance with regulations establishing the method or methods to be used, and the items to be included. The regulations in this part take into account both direct and indirect costs of providers of services. The objective is that under the methods of determining costs, the costs with respect to individuals covered by the program will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by the program. These regulations also provide for the making of suitable retroactive adjustments after the provider has submitted fiscal and statistical reports. The retroactive adjustment will represent the difference between the amount received by the provider during the year for covered services from both Medicare and the beneficiaries and the amount determined in accordance with an accepted method of cost apportionment to be the actual cost of services furnished to beneficiaries during the year.

(2) Necessary and proper costs. Necessary and proper

ENCLOSURE 1

costs are costs that are appropriate and helpful in developing and maintaining the operation of patient care facilities and activities. They are usually costs that are common and accepted occurrences in the field of the provider's activity.

Application

(1) It is the intent of Medicare that payments to providers of services should be fair to the providers, to the contributors to the Medicare trust funds, and to other patients.

(2) The costs of providers' services vary from one provider to another and the variations generally reflect differences in scope of services and intensity of care. The provision in Medicare for payment of reasonable cost of services is intended to meet the actual costs, however widely they may vary from one institution to another. This is subject to a limitation if a particular institution's costs are found to be substantially out of line with other institutions in the same area that are similar in size, scope of services, utilization, and other relevant factors.

(3) The determination of reasonable cost of services must be based on cost related to the care of Medicare beneficiaries. Reasonable cost includes all necessary and proper expenses incurred in furnishing services, such as administrative costs, maintenance costs, and premium payments for employee health and pension plans. It includes both direct and indirect costs and normal standby costs. However, if the provider's operating costs include amounts not related to patient care, specifically not reimbursable under the program, or flowing from the provision of luxury items or services (that is, those items or services substantially in excess of or more expensive than those generally considered necessary for the provision of needed health services), such amounts will not be allowable. The reasonable cost basis of reimbursement contemplates that the providers of services would be reimbursed the actual costs of providing quality care however widely the actual costs may vary from provider to provider and from time to time for the same provider.

[51 FR 34795, Sept. 30, 1986; 51 FR 37398, Oct. 22, 1986]

ENCLOSURE 2

TABLE II.1: 1994 ALLOWED LEGAL EXPENSES FOR HOME HEALTH CARE AGENCIES IN A FOUR-STATE AREA

Company Identification	Legal expenses allowed	Total expenses allowed	Legal expenses as a percent of total expenses
7010	$2,853,748	$46,340,794	6.2
7280[a]	1,628,381	14,675,497	11.1
7610	50,224	725,109	6.9
7095	27,867	489,633	5.7
7240	31,068	563,704	5.5
7715	104,194	2,401,152	4.3
7260	146,150	3,385,142	4.3
7480	288,560	7,490,396	3.9
7745	238,185	7,147,907	3.3
7565	92,401	3,035,718	3.0
7140	588,153	22,307,651	2.6
7060	34,279	1,401,949	2.5
7575	42,248	2,252,562	1.9
7030	18,685	1,004,941	1.9
7430	24,955	1,900,845	1.3
7485[a]	47,381	4,158,168	1.1
7535	17,154	1,516,995	1.1
7393	2,972	293,197	1.0
7790	39,661	4,698,596	0.8
7540[b]	148,134	19,865,205	0.8
7590	19,925	3,235,685	0.6
7320	11,669	2,104,452	0.6
7605[a]	70,686	15,392,415	0.5
7445	8,422	1,935,487	0.4
7587	3,308	892,710	0.4
7470	2,964	957,591	0.3
7620	726	426,641	0.2

ENCLOSURE 2

Company Identification	Legal expenses allowed	Total expenses allowed	Legal expenses as a percent of total expenses
7315	1,513	1,208,151	0.1
7245	3,218	2,618,825	0.1
7380	2,508	3,163,456	0.1
7450	452	1,370,874	0.0
7247[c]	0	699,773	0.0
7650[c]	0	763,706	0.0
7673[c]	0	450,183	0.0
7760[c]	0	1,137,505	0.0
7150[c]	0	750,270	0.0
7730[c]	0	34,663	0.0
7170[c]	0	2,102,520	0.0
7607[c]	0	3,419,629	0.0
7365[c]	0	699,773	0.0
7528[c]	0	438,120	0.0
7390[c]	0	1,210,356	0.0
7350[d]	0	997,620	0.0
7265[c]	0	300,253	0.0
7585[c]	0	4,318,330	0.0
7337[c]	0	459,921	0.0
Total	$6,549,791	$196,744,070	3.3

[a]Company combined legal and accounting expenses in its 1994 cost report.

[b]Two cost reports were filed by this agency, the cost report covering a 3-month period is ommitted from this table.

[c]Company may have included legal expenses under other categories, such as accounting, and thus may not report a separate amount for legal expenses. For this reason, the figures presented in this table are best understood as a "ball park" estimate of provider legal expenses--actual legal expenses reimbursed by Medicare could be higher. A complete audit of each provider's cost report would be necessary to verify the amounts listed in this table.

(101353)