

# Healthsouth fraud: overview

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In 2003, HealthSouth was accused of one of the largest accounting fraud cases in healthcare history and those involved are still being tried today, nine years later. HealthSouth was founded in Birmingham, Alabama in the year 1984 by a respiratory therapist named Richard Scrushy.

By the year 1999, HealthSouth had grown to house 230 surgical centers, 120 inpatient hospitals, 5 medical centers, 129 diagnostic centers and 1379 outpatient rehab centers and was worth an estimated billion dollars. It was revealed that HealthSouth started their downward spiral in the year 2002, which paralleled the timeframe that Scrushy sold off ~ \$100,000 in HealthSouth Stock Options. Within the following 6 plus months to follow, the FBI announced allegations against HealthSouth and opened a criminal investigation for probable SEC violations.

The FBI investigation initially uncovered wrong doings from the years 1999-2002 where Scrushy had overstated his salary 1 million + dollars to meet expectations of shareholders and Wallstreet. Unfortunately, this was just the beginning, and as forensic accountants dug deeper, the FBI soon found that HealthSouth's corporate accountants were adjusting entries to offset liabilities, reduce expense accounts and state elevated salaries to balance their bookkeeping. It was reported ~\$373 million dollars of cash on the books was fictitious.

It was eventually revealed that all four Accounting Statements were incorrect and that much of the inflated numbers were modifications made to the contractual adjustments and agreements; which in turn, made it fairly easy to hide from outside auditors. The outside auditing firm used by HealthSouth was Ernest and Young, LLP. Ernest & Young, LLP not only was hired as outside

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auditor, but they were also hired as the consulting firm for Healthsouth throughout the fiscal year.

Such arrangements are illegal today secondary to the new guidelines implemented during the Sarbanes-Oxley Act of 2002. To further put it into perspective, you must take into account that it has been reported that Ernest & Young, LLP earned 3.6 million dollars for their auditing services at HealthSouth, yet they did not uncover the fraud. Does that create a question to you? The fraud was uncovered by Forensic Accountants from Pricewater-HouseCoopers who were brought in 2004 by the FBI. Pricewater-HouseCooper were accountable for finding the 1. billion dollar financial reporting discrepancy. Today, nine years later Ernest & Young is still under the microscope as the judicial system continues to wade through this fraud case. In regards to prosecutions, thus far 15 employees pled guilty and Scrushy was brought up on 85 counts of criminal charges, still serving his 7 year sentence today. The consequences to HealthSouth Investors were devastating starting in 2002 upon the start of the investigation and the removal of CEO Richard Scrushy. (reference chart below)

In March 2003, the NYSE stripped HealthSouth of their S&P 500 rating and stock values continued to drop from \$19.55 to \$.60 by the end of the investigation. In addition, HealthSouth's assets and loans were frozen and JP Morgan chase used the assets to pay its bondholders \$350 million plus interest. Other companies that share the HealthSouth's industry vertical were also affected by this fraud case; thus many losing stock value overnight. One of the financial metrics specifically that was a red flag fell under the earnings category.

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For ten years, reported earnings did not fluctuate and stayed a constant. The goal of a public company is to have a steady rise in earnings versus jagged or flat line earning curve. I question as to why investors did not pick up on the flat line earning curve in addition to E&Y's Auditors? Although I do realize hindsight is 20/20 and if my income was continuously increasing, I would most likely not spend much time scrutinizing the Operations Statement. Here are statistics pulled from Hoovers(\*2) that provide a visual reference to the Fraud and its trend:

Due to acts of fraud like that committed by HealthSouth and Enron (along with several others), the Sarbanes-Oxley Act of 2002 was implemented by the SEC. Although there are pages of guidelines and rules; some of the key points of focus of the SOX ACT 2002 include:

- It prohibits onsite
- Consultants
- Every 5 years firms must change Auditors
- External Auditors must certify internal audit controls
- CEO's, CFO's and Officers must sign audits holding them accountable with legal obligation
- Real Time Disclosure of entries
- Whistle Blower protection
- Criminal Penalties for altering entries

In Conclusion, HealthSouth's fraud brought many weaknesses in the previous healthcare accounting methods to light. While many fraudulent participants are paying for their criminal mistakes and wrong doings, there is still a need for additional regulation. Due to the events in the late 90's and early 2000's

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we now have tighter regulations and penalty systems in place to address fraud in all public corporations. References (\*1) Bernet, Patrick Michael and Getzen, Thomas E.

The Company You Keep: Spreading Effects of Financial Fraud on Investor Trust. *Journal ofHealthCareFinance*29 (2003): 17-28. \* \* (\*2) Source: Hoover's Inc. <http://premium.hoovers.com>. HeathSouth Corporation-Historical Financials and Employees \* Appendix Each Appendix appears on its own page. Footnotes 1Complete APA style formatting information may be found in the Publication Manual. Table 1 Type the table text here in italics; start a new page for each table [Insert table here] Figure Captions Figure 1. Caption of figure [Figures - note that this page does not have the manuscript header and page number]