

HEALTHSOUTH

Lessons for Board Members, Audit Committees, & Managers

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Deputy Attorney General – State of Alabama11

Audit & Compliance Committee Conference
HCCA – February 24, 2014

1



HEALTHSOUTH INVESTIGATION

2003-2006

2



History of HealthSouth

- 1983 HealthCare Reforms began – Richard Scrushy had an idea to coordinate all aspects of rehabilitation from Social Services to Occupational Therapy
- Under one roof.



"I told myself I was going to give it five years,"

Beam later recalled his reaction to the interview with Scrushy. "I went home and told my wife that I just interviewed with the biggest con artist I ever met or the most brilliant young man I ever met," he said. "Either way, I was taking the job because he was really, really good at what he did."

HRC

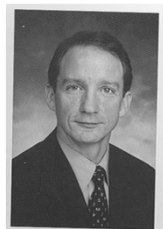
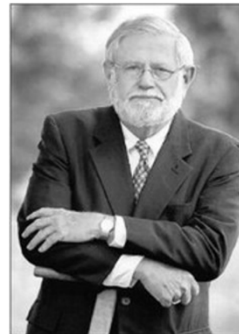
HRC

Accounting Fraud 1996-2003

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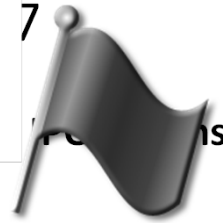
Second Quarter 1996

- **“Fix it” directive to Beam CFO and Owens Controller**
- **Fraudulent entries made Owens and Livesay**



8

Beam participated in the deception for 2 quarters – then retired



- Martin new CFO 1997-2000



9

**HEALTHSOUTH CORPORATION
SHORTFALL**
(In Thousands, except EPS Calculated)

	Current Estimates				4Q99
	1Q99	2Q99	3Q99	4Q99	Annualized
Pre-Tax Shortfall	-103,250	-138,318	-110,360	-65,476	-382,205
Projected Actual EPS with Operational Synergies Expected To Be Reported EPS	\$0.10	\$0.08	\$0.13	\$0.16	\$0.65
Earnings Shortfall	\$0.26	\$0.27	\$0.28	\$0.29	\$1.18
Earnings as a Percent of Total	67%	72%	54%	45%	45%
Accumulated Accounting Issue	-103,250	-524,568	-535,928	-5447,554	-5382,505

	Reduce Earnings Estimates				4Q99
	1Q99	2Q99	3Q99	4Q99	Annualized
Pre-Tax Shortfall	-103,250	-129,098	-50,448	-12,587	-50,346
Projected Actual EPS with Operational Synergies Expected To Be Reported EPS	\$0.10	\$0.08	\$0.13	\$0.16	\$0.65
Earnings Shortfall	\$0.26	\$0.23	\$0.20	\$0.18	\$0.72
Earnings as a Percent of Total	67%	70%	34%	9%	9%
Accumulated Accounting Issue	-103,250	-5232,348	-5282,796	-5295,383	-550,346

+ 50mm carry-over from 1998.

GX 13K
CR-03-BE-0530-S
01/05/2005

1B157-HSV-0045

10

Fourth Quarter 1999

- Henze reports fraud to Corporate Compliance

- Fraud approximately
• \$400 mm



11

Martin resigns 2000 – gets an
undisclosed \$45M loan from
HealthSouth & buys 4
HealthSouth properties to start
a new company

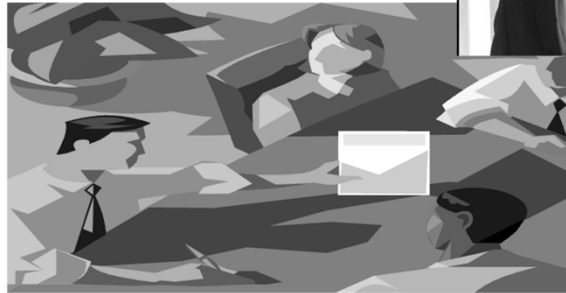
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IPO resigns



12

Fourth “Family” – “hole” – “dirt” 1997

- Fraud approximately \$300 mm
- “Keep stock price up”
- Executive stock sales



13

Timeline 1997

- Owens CFO 2000
 - Owens COO Aug 2001
 - Owens brief CEO stint in 2002
- resigns



Smith CFO 2001-2002



14

**8/4/02 SOX certification signed
In exchange for new surgery
Center company HS would
Split off**



**Earnings revised just after insiders sell
millions in options**

•
**8/27/2002 McVay becomes 5th CFO
in 6 years at this Fortune 500 NYSE**



15



Options – \$74M



**Data Analytics Key on May Sales
& August Earnings Revision
Derivative Shareholder Class Action civil suits filed**

•

16



August 2002
Insider Trading
Investigation
SEC

United States Attorney's Office
Birmingham
Insider Trading Investigation



17



Grand Jury Subpoenas

MARCH 2003

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17 St. Patrick's Day	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

www.PickOfCalendar.com



18

INVESTIGATION

- **Insiders Take Government "Inside"**

MARCH 2003

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
						1
2	3	4	5	6	7	8
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16	17 St. Patrick's Day	18	19	20	21	22
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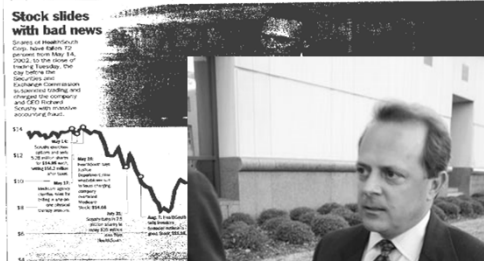


19

3/19/03
 NYSE Suspends trading
 USAO files Smith SOX indictment
 SEC files civil suit

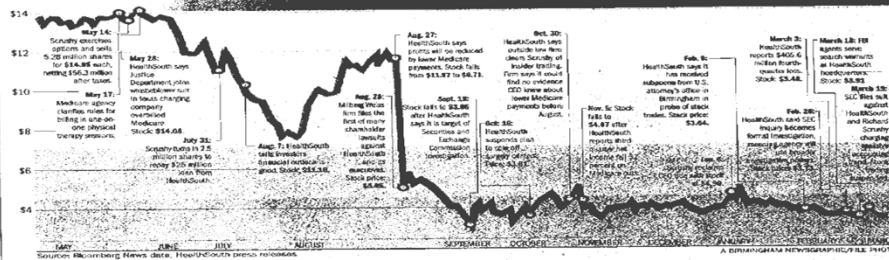
3/26/03 Bill Owens
 Pleads Guilty

Worker Bees
 3/31/03 5
 guilty pleas



Stock slides with bad news

Shares of HealthSouth Corp. have fallen 72 percent from May 14, 2002, to the close of trading Tuesday, the day before the Securities and Exchange Commission suspended trading and charged the company and CEO Richard Scrushy with massive accounting fraud.



Former HealthSouth executive admits fraud, false SEC filings

By VAL WALTON
News staff writer

A former HealthSouth Corp. executive admitted Wednesday he was part of a conspiracy to inflate the Birmingham company's earnings and that he signed financial documents that he knew were false.

Veston H. Smith, a 42-year-old Hoover resident and the company's former chief financial officer, pleaded guilty to three felony charges of conspiracy to commit wire fraud, securities fraud and filing false certification of financial information with the Securities and Exchange Commission.

His guilty plea came as the SEC charged HealthSouth and Chief Executive Officer Richard Scrushy in a civil complaint with overstating the company's earnings by at least \$1.4 billion in what it termed a "scheme" to meet or exceed Wall Street earnings expectations.

David McKnight, Smith's attorney, said after Wednesday's plea hearing that Smith is cooperating with the government and accepts full responsibility for his actions.

"He hopes his efforts will help HealthSouth get back on track," McKnight said.

U.S. Attorney Alice Martin said the HealthSouth probe is continuing and that Smith did the best thing he could to help himself. "He came forward and publicly admitted his guilt in a major accounting fraud," Martin said.

Martin said additional charges are expected. She encouraged anyone else at HealthSouth who has knowledge of the fraud to contact her office or the FBI.

See Executive, Page 2D

Action first under 2002 corporate law

By CHARLES R. MCCAULEY
News staff writer

The government lawsuit against HealthSouth Corp. and its chief executive is believed to be the first brought under a new law that makes corporate chiefs accountable for the truthfulness of company financial statements.

A Securities and Exchange Commission lawsuit filed Wednesday says HealthSouth's 2001 annual report overstated earnings by more than 4,700 percent. Yet CEO Richard Scrushy and the company's chief fi-

ALABAMA INC. Sunday, March 16, 2003

Needing rehab
HealthSouth Corp., one of Birmingham's biggest employers, is trying to recover from a series of shocks that have included lower Medicare payments, SEC and FBI investigations and \$140.9 million quarterly losses.

HealthSouth Stock Hits 11 cents a share 3/26/03

**4/5/03
Employees Sue
HealthSouth**

**Lawsuit claims HS employees
lost money in the company's
retirement plan because
of accounting fraud ...
HS has more than 51,000
employees nationwide**

Employees sue HealthSouth

Class action filed for thousands in retirement plan

By M. WILSON
The lawsuit claims that HealthSouth employees lost money in the company's retirement plan because of accounting fraud. The lawsuit is filed in federal court in Alabama.

HealthSouth employees filed a class action lawsuit against the company, claiming that the company's accounting practices led to a significant loss of money in the company's retirement plan. The lawsuit is filed in federal court in Alabama.

The lawsuit claims that HealthSouth employees lost money in the company's retirement plan because of accounting fraud. The lawsuit is filed in federal court in Alabama.

**4/25/03 HealthSouth
Co-Founder Aaron Beam
To admit to Bank Fraud**

**5/1/03
•Mike Martin
•Todd McVay
Plead Guilty**

**5/7/03
SEC Civil Suit**



CIVIL LITIGATION



25

4/11/03 Congress Launches Investigation



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

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26

3/19/03 - 12/31/03

- 18 pleas
- All 5 former CFOs
- PwC forensic audit in progress
- Putting the pieces together



27



Richard Scrushy

Acquitted after 5 month trial

\$24M legal defense: Pay & Pray Corner

Civil Judgment against him for \$2.88B

2006 Federal Bribery Conviction

Prison 5 years – released 2013

Long Fall from \$40M annual compensation



28

Corporate Integrity Agreement

- **Compliance – new Inspector General position**
- **Adequate staffing/expertise for compliance**
- **Off-site independent hot line provider**
- **Audit – new accounting firm, functional audit staff with GL access, new internal controls**
- **Integrity training requirements**
- **Corporate Compensation tied to compliance efforts in part**
- **Independent Board - Chairman**

29

Board Issues

- Audit Chairman – MD with no \$ background
- Audit Committee unaware that Compliance had no access to GL; that more was spent on 'white glove' audits that examination of books/records; that proprietary software E&Y was not permitted to be used; didn't raise concerns when some 'due diligence' for acquisitions lasted less than 2 days
- Did not listen to earnings calls & hear probing questions of some analyst
- Didn't question 'sell'/'hold' by some analyst when HS performing but all other competitors showing losses
- Financials given day of meetings & not permitted to keep a copy
- Minutes of corporate meetings were > 18 months behind so when presented for approval recall was poor
- Found Compensation Committee meeting minutes on days when committee didn't meet (federal holiday) & questionable back-dating of options

30

Advice

- Ask Questions & Continue Your Education
- Do an annual assessment of your compliance program
- Invest in compliance
- Test how your compliance efforts can be demonstrated

31