

HEALTHSOUTH

Lessons for Board Members, Audit Committees, & Managers

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Audit & Compliance Committee Conference
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HEALTHSOUTH INVESTIGATION 2003-2006

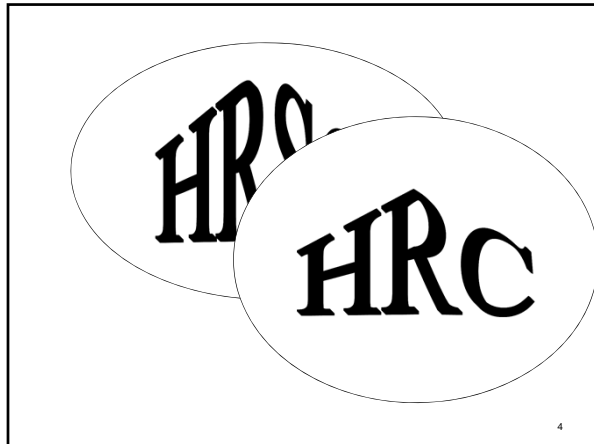
History of HealthSouth

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

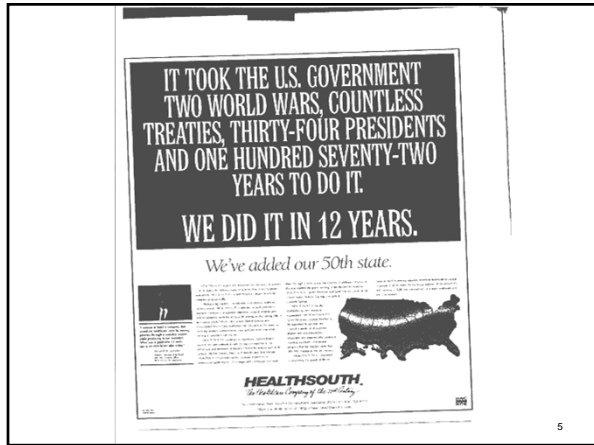


"I told myself I was going to give it five years." ... knew it would be ... say I ... has ... an

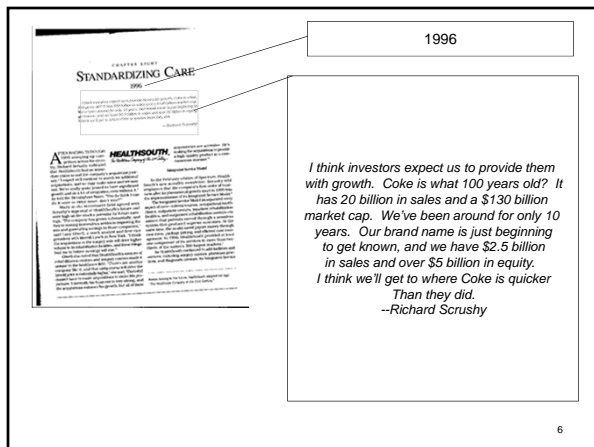
Beam later recalled his reaction to the interview with Scrushy. "I went home and told my wife that I just interviewed with the biggest con artist I ever met or the most brilliant young man I ever met," he said. "Either way, I was taking the job because he was really, really good at what he did."



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Accounting Fraud 1996-2003

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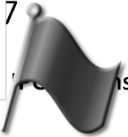
Second Quarter 1996

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




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Beam participated in the deception for 2 quarters – then retired



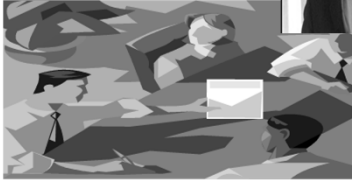
- **Martin new CFO 1997-2000**



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Fourth "Family" – "hole" – "dirt" 1997

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



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



Smith CFO 2001-2002



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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



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Options – \$74M



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

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August 2002 Insider Trading Investigation SEC



United States Attorney's Office
Birmingham
Insider Trading Investigation

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Grand Jury Subpoenas

MARCH 2003

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



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INVESTIGATION

• Insiders Take Government “Inside”



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
5 guilty pleas

Stock slides with bad news

Stock slides with bad news

Former HealthSouth executive admits fraud, false SEC filings

Action first under 2002 corporate law

HealthSouth gets back on track

SEC sues HealthSouth

NYSE suspends trading

Smith indicted

SEC files civil suit

Bill Owens pleads guilty

Worker bees


NYSE suspends trading

Smith indicted

SEC files civil suit

Bill Owens pleads guilty

Worker bees



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

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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

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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

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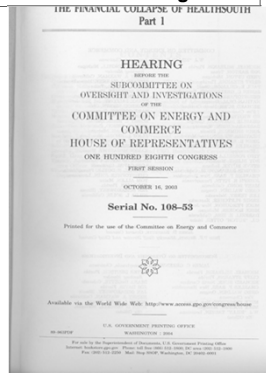
CIVIL LITIGATION



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4/11/03 Congress Launches Investigation

THE FINANCIAL COLLAPSE OF HEALTHSOUTH
Part 1



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3/19/03 - 12/31/03

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



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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



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

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

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

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