



## Going South: Lessons Learned From the HealthSouth Fraud (GS)

### Teaching Note

#### Introduction

GS is designed to help students increase their ethical awareness by exposing them to both the inner workings and aftermath of one of the largest corporate scandals in U.S. history. This case presents several key ethical lessons based on the story of the company's former CFO and his transformation from active fraud participant to subsequent whistleblower.

#### Recommended Course Adoption Plan

It is recommended that instructors assign the GS e-case as an out-of-class assignment in which students are required to review the twenty-four minutes of video and accompanying text. Instructors can choose to break up the learning modules over the course of 2-3 class periods or use all learning modules at once. The most effective way to use GS is as follows:

1. Assign the GS e-case during a class meeting.
2. Discuss the GS e-case with your students, in class, on the designated due date. You may use either the:
  - a. Helios Digital PowerPoint slides for this discussion; or
  - b. Helios Digital suggested discussion questions.
  - c. Module multiple choice questions.<sup>1</sup>
3. Choose one of the recommended GS writing assignments (see p.3)
4. Grade and incorporate into your course syllabus accordingly.

For instructors with limited time for in-class discussions, we recommend (in lieu of #2 above) using the discussion thread feature common to most course management systems (e.g., Blackboard, Moodle, etc.) for the purposes of posting discussion questions. In addition to mitigating in-class time constraints, this approach has several advantages:

1. It ensures 100% class participation in the discussion;
2. It provides the students and the instructor a means for asynchronous interaction on the topics;
3. It provides an additional opportunity to evaluate students' writing skills.

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<sup>1</sup> These multiple choice questions can appear after each learning module or at the end of the e-case.

## **GS Learning Modules**

GS is comprised of five learning modules, represented by each of the first four chapters:

### Chapter 1: Introduction

This chapter introduces students to Weston Smith, former HealthSouth Chief Financial Officer, who discusses his role with the company and the corporate culture that precipitated the massive accounting fraud. The main learning objective in this module is to help students understand how pro-organizational crimes, such as corporate accounting fraud, are distinguished from other types of employee workplace crimes.

### Chapter 2: HealthSouth Background

In this chapter, Weston discusses the four stages of how the fraud scheme evolved at HealthSouth. The chapter also discusses the two main tactics the company used to inflate earnings – exaggerated revenues and improper capitalization of operating expenses.<sup>2</sup>

### Chapter 3: What Lies Beneath

This learning module provides a detailed analysis of how the fraud scheme was executed and hidden from the auditors. It is important to emphasize to students that most of the fraud activity took place prior to the Sarbanes-Oxley Act of 2002.

### Chapter 4: Whistle While You Work

This chapter emphasizes the importance of whistleblowing as an effective means of detecting fraud. Weston shares his thought process that ultimately lead him to blow the whistle on HealthSouth. Students are also presented with a list of guidelines to be considered before becoming a whistleblower.

### Chapter 5: Lessons learned

Weston reflects on his role in the fraud and its aftermath. This chapter also discussed four main lessons that can be learned from this case.

## **Supplemental Module Readings**

Additionally, we recommend that instructors assign both supplemental readings for the GS e-case. The following additional readings have been identified in order to enhance your selected assignment. These supplemental readings include a published academic journal article authored by Weston Smith, former HealthSouth CFO, and a document filed with SEC about the case.

1. [Former HealthSouth CFO Aaron Beam Charged with Bank Fraud](#)

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<sup>2</sup> For example, instructors assigning GS in an Intermediate Accounting course may wish to link discussion of this module with the chapters covering revenue recognition and operational assets, respectively.

2. [Securities and Exchange Commission v. William T. Owens and Weston L. Smith](#)
3. [Lessons of the HealthSouth Fraud: An Insider's View](#)<sup>3</sup>

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<sup>3</sup> Weston L. Smith (2013) Lessons of the HealthSouth Fraud: An Insider's View. *Issues in Accounting Education*: November 2013, Vol. 28, No. 4, pp. 901-912.

## **Recommended GS Assignments**

The following assignments are recommended:

1. GS Reflection Research Paper
2. GS In-class discussion questions
3. GS multiple-choice questions

### Reflection Research Paper

It is recommended that instructors assign a 2 to 3 page reflection paper writing assignment which could account for 10 to 15% of the course grade. Instructors should direct students to pay attention to the following points as they read and view the e-case for the reflection paper assignment:

- Corporate culture;
- Fraud schemes used;
- Elements of the fraud triangle (specifically the rationalization component of the fraud triangle);
- Accounting implications of the fraud for financial statement users;
- Fraud discovery method.

In order for students to write a strong reflection paper, they will need to read the supplemental readings and do minimal outside research depending on the previous topics covered in your course. We have received positive feedback from instructors who have incorporated the reflection paper assignment into their course curriculum.

### **Suggested Discussion Questions**

The following questions can help guide your classroom discussion or used as the topics for student reflection papers. These questions can also be selected as the reflection paper assignment or discussion board topics.

1. What is your perception of pro-organizational crimes, compared to anti-organizational crimes or unaligned organizational crimes? Do you feel that punishments for pro-organizational crimes should be less severe than the others, given that they are not intended to harm anyone? Why or why not?
2. What were the balance sheet and income statement implications of HealthSouth's aggressive revenue recognition tactics? Also, in what specific way did this scheme violate the revenue recognition principle?
3. What are the financial reporting motivations for capitalizing expenditures that should be classified as operating expenses? Please provide additional examples where other companies have used this (or a similar) strategy.
4. Weston explained that, in order to hide the fraud from auditors, the fraudulent entries were broken down into amounts small enough to fall beneath the audit scope. How might auditors combat this behavior, given the limited scope of a financial statement audit?
5. In your opinion, why didn't the EY partner more fully investigate the whistleblower e-mail from Michael Vines? How might you have handled the situation differently?

## GS Multiple Choice Questions

The following multiple choice questions can be embedded within the e-case. Questions can either be added or removed.

1. Weston has prior work experience at a Big 4 accounting firm.
  - a. True
  - b. False
2. Financial statement fraud is classified as what type of employee workplace crime?
  - a. Non-aligned employee crime
  - b. Pro-organizational crime
  - c. Anti-organizational crime
  - d. None of the above
3. HealthSouth is the United States' largest owner and operator of:
  - a. inpatient rehabilitative hospitals
  - b. surgical centers
  - c. rest homes
  - d. none of the above
4. HealthSouth manipulated their financial statements by making \_\_\_ in false or unsupported entries in the company's accounting systems.
  - a. \$3.5 billion
  - b. \$2.7 billion
  - c. \$1.8 billion
  - d. \$5 billion
5. The entries that allowed HealthSouth to inflate earnings allowed the Company to exaggerate revenue and improperly characterize and record operating expenses.
  - a. True
  - b. False
6. Improper characterization and recording operating expenses was the largest component of the income statement manipulation.
  - a. True
  - b. False
7. Accounting manipulations were able to exist because there often existed a gap between:
  - a. what a patient was charged for a service versus what was partially collected from the patient.
  - b. what a patient was charged for a service versus what was actually collected.
  - c. both A and B
  - d. none of the above

8. HealthSouth fabricated hundreds of millions of dollars in pre-tax earnings by booking false entries. These entries had the following characteristics:
  - a. They routinely carried generic, non-descriptive explanations.
  - b. Many entries self-reversed during successive reporting periods.
  - c. Both a and b
  - d. None of the above
9. HealthSouth's capitalization policies allowed the company to defer recognizing over \$200 million in expenses.
  - a. True
  - b. False
10. HealthSouth corporate accountants referred to the fraudulent entries as "management entries,"
  - a. True
  - b. False.
11. The accountant that attempted to whistle-blow by sending an email to the Company's external auditor was?
  - a. Micheal Vick
  - b. Michael Vines
  - c. Cynthia Cooper
  - d. Betty Vinson
12. Weston was the first of five CFOs that held the position of CFO during the years the Company was perpetrating the fraud.
  - a. True
  - b. False
13. One of the tips offered by Stephen Kohn, the author of *The Whistle-blower's Handbook* is:
  - a. Keep details notes.
  - b. Use the internal hotlines.
  - c. Don't take legal advice from a corporate compliance officer.
  - d. Be sure talk to your supervisor before whistle-blowing to the audit committee.
14. HealthSouth took advantage of the internal control deficiencies to conceal the fraud.
  - a. True
  - b. False
15. Weston received a monetary payout under which federal regulation?
  - a. Dodd Frank Act
  - b. Sarbanes Oxley Act
  - c. Whistleblower Protection Act
  - d. None of the above
16. Research shows that CFOs engage in accounting manipulation because of pressure from the \_\_\_\_\_ than for personal gain.
  - a. Audit committee
  - b. Chief Executive Officer (CEO)
  - c. Chief Operating Officer (COO)

d. None of the above

17. How many months did Weston receive in federal prison?

- a. 27 months
- b. 17 months
- c. 9 months
- d. 36 months

18. Former CEO Richard Scrushy was the first CEO charged for violating the Sarbanes-Oxley Act.

- a. True
- b. False

19. Scrushy was charged with former Alabama Governor Don Siegelman for money laundering, extortion, obstruction of justice, racketeering and bribery and spent six years in federal prison.

- a. True
- b. False

20. Judge Allwin E. Horn ruled in favor of the HealthSouth shareholders and determined that Scrushy was responsible for HealthSouth's fraud and ordered him to pay \$2.87 billion.

- a. True
- b. False

### **The Story Matters!**

This e-case offers an innovative method to teach several important concepts to both undergraduate and graduate business students. We are always interested in your feedback. If you have any questions or concerns, we would love to hear from you! Contact [kelly@heliosdigital.com](mailto:kelly@heliosdigital.com) or [ivy@heliosdigital.com](mailto:ivy@heliosdigital.com) and let us know your name, area of expertise, and where you are located. We will get back to you within 24-48 hours.