HealthSouth Corp.: The First Test of Sarbanes-Oxley

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Abstract

In 2003, federal authorities obtained thousands of documents pertaining to the accounting records of HealthSouth Corporation, headquartered in Birmingham, Alabama. The SEC alleged that the Company deliberately overstated its earnings by a total amount of over $2.5 billion. Over a dozen executives pled guilty to various charges in connection with these fraudulent misstatements, and the former CEO, Richard Scrushy, was indicted on eighty-five criminal counts, including three counts under the Sarbanes-Oxley Act. As a result, he became the first CEO of a major company to be charged with violating the Act. PricewaterhouseCoopers, LLP, was contracted to perform a special audit to identify the misstatements in HealthSouth’s publicly issued financial statements for the period 1999-2001, to quantify the impact of those misstatements, and to make recommendations associated with necessary improvements in internal controls in order to reduce the future likelihood of the occurrence of fraud. The report on the special audit provides details on a number of potentially significant deficiencies in HealthSouth’s controls over its financial reporting process. Case questions are designed to have students consider the implications of the Act on the conduct of the audit, as well as to examine the link between weaknesses in HealthSouth’s internal control over financial reporting and the resulting fraud. They are also given the opportunity to draft sample audit reports for different opinions.

Keywords: Sarbanes-Oxley, fraud, forensic audit report.

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