Fall 2022

The Implications of Fraud on Non-Shareholder Stakeholders

Chasen P. Spicer
University of South Carolina - Columbia

THE IMPLICATIONS OF FRAUD ON NON-SHAREHOLDER STAKEHOLDERS

By

Chasen Spicer

Submitted in Partial Fulfillment
of the Requirements for
Graduation with Honors from the
South Carolina Honors College

May, 2023

Approved:

Donna Schmitt

Dr. Donna Bobek Schmitt
Director of Thesis

Spenser Seifert
Second Reader

Steve Lynn, Dean
For South Carolina Honors College

University of South Carolina Honor's College

December 2022

The Implications of Fraud on Non-Shareholder Stakeholders

Chasen Spicer

THE IMPLICATIONS OF FRAUD ON NON-SHAREHOLDER STAKEHOLDERS

Chasen Spicer

ABSTRACT

Popular news outlets such as *The New York Times* or *The Wall Street Journal* frequently release articles detailing the financial losses incurred by shareholders of a company that have recently been publicly exposed for their fraudulent activities (Shumsky, 2018; Whitmire, 2005). Given that shareholders are visibly impacted by fraud, it is also reasonable to believe that other stakeholders experience repercussions from the fraudulent activities carried out by the company (Velikonja, 2013). To provide more insight into the implications of fraud incurred by non-shareholder stakeholders, I conduct a case study analysis of HealthSouth's various fraudulent activities between the years of 1997 and 2007. The results of my analysis indicate that non-shareholder stakeholders experience significant impacts from fraudulent activities. Considering this evidence, the impacts non-stakeholder stakeholders face should also be considered when discussing the resounding complications following fraudulent events. In conclusion, my research has demonstrated that non-shareholder stakeholders, particularly employees, communities, and consumers, are significantly impacted parties when it comes to fraudulent activities.

THE IMPLICATIONS OF FRAUD ON NON-SHAREHOLDER STAKEHOLDERS

TABLE OF CONTENTS

INTRODUCTION

Between 2016 and 2019, an average of 228 cases of securities fraud were reported by the U.S. Sentencing Commission and cost shareholders $2,271,606, on average, for an estimated total annual financial impact of $517, 926,168 ("Quick Facts on Securities," 2021). However, this value that does not include non-shareholder financial impacts. Stakeholder Theory suggests that all parties relevant to a company are interconnected to the extent that the success or failure of a firm will carry similar consequences for both owners and other stakeholders alike (Beckenstein et al., 2019). As defined in the International Standard Providing Guidance on Social Responsibility or ISO 26000, stakeholders are any "individual or group that has an interest in any decision or activity of an organization" (ASQ, 2022). In addition to shareholders, stakeholders can also include suppliers, consumers, employees, and communities. According to the ISO 26000, the primary requirement for an individual or group to be considered a stakeholder is that they must be directly or indirectly impacted by the actions of a company (ASQ, 2022). As such, when a company commits fraud and incurs a major loss, all stakeholders are either directly or indirectly impacted. In some cases, employees may lose their jobs; consumers may be deprived of access to commodities; and surrounding communities may lose a large source of tax revenue. However, while stakeholder theory suggests all stakeholders are impacted by fraud, prior research and media coverage has focused predominantly on shareholders, ignoring non-shareholder stakeholders.

To better understand how non-shareholder stakeholders are impacted, this research utilizes a case-study approach to illustrate the ways non-shareholder stakeholders are impacted by fraud. Understanding how and to what degree non-shareholder stakeholders are impacted by

fraud is essential given that the average American is likely a stakeholder of at least one company. Although it is not always clear, most people play the role of stakeholder through some facet of their life. This study focuses on three common non-shareholder stakeholder roles: employees, consumers, and community members.

The case study analysis of HealthSouth focuses on individual lawsuits and events which followed the discovering of both HealthSouth's financial and healthcare frauds. These events are then analyzed to identify and illustrate the ways non-shareholder stakeholders can be influenced by corporate fraud.

The results of the case study analysis suggest that non-shareholder stakeholders incur significant financial losses rivalling those of shareholders. After a fraudulent event occurs, employees may lose their jobs and undergo the cost of lost wages while seeking new employment (Velikonja, 2013). Communities where this company used to be a major employer realize increased levels of unemployment in the short-term (Velikonja, 2013). Consumers who frequented these establishments may lose access to the commodities or services they used to obtain from these companies as well (Velikonja, 2013). Presently the major avenue of recourse for non-shareholder stakeholders following fraud events is through class action lawsuits (Velikonja, 2013). Although these lawsuits do allow for some financial returns, they generally overcompensate shareholders and lawyers while ignoring the plights of the other stakeholders (Velikonja, 2013). These findings indicate a clear need for legislation to provide non-shareholder stakeholders with the means to seek restitution following fraud events. Additionally, the results of this study form the foundation for future research into the implications of fraud for non-shareholder stakeholders and encourage media sources to focus on both shareholder and non-shareholder stakeholders when covering fraud cases.

I. HOW FRAUD CAN TAKE SHAPE

According to the AICPA, fraud is defined as an intentional act that results in the material misstatement of a company's financial statements (AICPA, 2002). For fraud to occur there are generally three conditions which must be met: incentive to commit the fraud, a circumstance which provides an opportunity for the fraud to occur, and the ability for an individual to rationalize committing the fraud (AICPA, 2002). The ways in which fraud is carried out varies dramatically. As an overview, there are two broad categories of fraud: misstatements arising from fraudulent financial reporting and misstatements arising from the misappropriation of assets (AICPA, 2002). According to the AICPA, financial reporting fraud is usually accomplished in one of three ways: through the "manipulation, falsification, or alteration of accounting records or supporting documents" used to prepare financial statements; through the "misrepresentation in or intentional omission from the financial statement of events, transactions, or other significant information;" through the "intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure" (AICPA, 2002). Conversely, misappropriation of assets occurs when an individual engages in the "theft of an entity's assets where the effect of the theft causes the financial statements" to be materially misstated (AICPA, 2002).

This research focuses on three instances of fraud associated with the HealthSouth scandal, Medicare and securities fraud relating to fraudulent financial reporting and Medicare fraud pertaining to the misappropriation of assets. Medicare fraud generally involves the submission of false or misrepresented information to Medicare with the intention of receiving undue payments (CMS, 2021). Whereas securities and investment fraud is defined by the Federal

Bureau of Investigation as actions taken that "involve the deception of investors or the manipulation of financial markets" with the intent to secure profits for the one committing fraud (FBI, n.d.).

Examples of Medicare fraud include overbilling for treatment and billing for treatments or supplies that were never provided to patients. Medicare fraud is especially pervasive in the way it carries a visible impact on patients, the federal government, and individual taxpayers alike. For instance, when a patient is administered an unnecessary treatment, they incur unnecessary costs and may even experience physical harm, depending on the type of care administered. Additionally, because the federal government's Medicare fund is funded by U.S. taxpayers, Medicare fraud negatively affects everyone that contributes to the Medicare fund.

Securities fraud carried out by a corporation generally involves the misrepresentation of the company's annual financial performance (PCAOB, 2002). Those who commit securities fraud do this to make their company appear to be performing better, which can mislead investors (PCAOB, 2002). This eventually increases demand for the stock, causing its price to increase and subsequently generating higher returns for the original shareholders (Adkins, 2021). There are various methods of carrying out securities fraud. However, this study focuses on the improper capitalization of expenses and the illegitimate reduction of contra-revenue accounts (Adkins, 2021). The Generally Accepted Accounting Principles (GAAP) requires "the capitalization of costs associated with the acquisition or construction of property, plant, and equipment" (Ohy, 2007). GAAP defines property, plant, and equipment as "all tangible and intangible assets acquired, fabricated, or constructed for use in the operation of the institution, whose use or consumption will cover more than one year" (Ohy, 2007). An example of normal capitalization of expenses would be when a company acquires a costly long-term asset and elects

to gradually depreciate the cost over time instead of recognizing the entire expense at once (Cornell Law, 2021). The type of costs that are permitted to be capitalized are the ones that correspond to the purchase of an asset that will be used long term. Fraud occurs when expenses that are ineligible for capitalization are capitalized, which in turn reduces overall expenses and increases profits in the short-term, misleading investors to believe a company is performing better than it is (Cornell Law, 2021).

Contra-revenue accounts reduce the amount of revenue recognized from the amount based on the stated rates for services to the amount expected to be received based on contractual agreements with the third-party payors of medical care (e.g., Medicare, insurance companies). Specifically, a contra-revenue account known as "contractual adjustments" is used to show the difference between the amount billed for services provided and what insurance companies are willing to cover according to the applicable payment schedule (Reck et al., 2021).

Under normal circumstances, a hospital will bill its patients for treatment at a standard rate, which is often higher than what insurance providers are willing to pay (Value Healthcare Services, 2013). The reason for this initial overbilling is that insurance providers pay the hospital the lesser of what is billed and the amount referenced by their current fee schedule (Value Healthcare Services, 2013). The amount billed by the hospital results in an increase to accounts receivable and operating revenue. Once the insurance providers submit to the hospital what they have contractually agreed to pay for the provided treatments, the difference between this amount and the standard rate is referred to as a contractual adjustment (Jitendra, 2019).

As a contra-revenue account, increasing contractual adjustments also leads to a decrease in accounts receivable. In some cases, companies may commit fraud by incorrectly lowering this contractual adjustment account, essentially indicating that the insurance company's payment

schedule covers a greater portion of the standard rate bill than it really did (Hicks et al., 2003). If the contractual adjustment account is understated, either because the revenue reduction was never recorded, or because it is reversed, the result is overstated revenue and overstated accounts receivable (SEC, 2003). However, these fictious receivable account amounts will never be resolved through the receipt of actual cash. Thus, companies committing this type of fraud have to find another way to balance their books.

In the case of HealthSouth, instead of increasing accounts receivable, a "corporate suspense account" was debited in its place (SEC, 2003). Suspense accounts are those "in which entries can be temporarily recorded before being permanently allocated to the proper account" (Bloomenthal, 2022). After this transaction, the corporate suspense account balance is gradually decreased through the additon of fictious assets on the individual balance sheets of subsidiary companies (SEC, 2003). Ultimately, this fraud method artificially increases net revenues, misleading investors to perceive the company as having a higher gross profit.

In the following sections, I conduct a case study analysis of HealthSouth. HealthSouth was found to have carried out Medicare fraud, improper capitalization of expenses, and the illegitimate reduction of contra-revenue accounts. The background and analysis sections of the HealthSouth case study reviews the implications these forms of fraud had on employee, consumer, and community stakeholders.

II. CASE BACKGROUND: HEALTHSOUTH

By the beginning of the 21st century, HealthSouth Corporation had made a name for itself as one of the largest post-acute healthcare service providers in the United States (Galloro, 2001).

Richard Scrushy, the company's CEO and founder grew the company considerably since its incorporation in 1984. The company began as a single rehabilitation facility in Birmingham Alabama and within four years had grown to include 39 facilities spread across 15 states (Advameg, 2000). In the early 1990s, HealthSouth continued its successful rise by acquiring numerous other post-acute healthcare service providers and reporting annual revenues of close to a billion dollars. Despite its apparent success in the former part of the decade, the latter half of the 90s signaled a difficult time for the company as a result of the Federal Government's Balanced Budget Act of 1997 (Advameg, 2000). The new legislation was the largest reduction in federal Medicare spending in the history of the United States - a major source of revenue for HealthSouth - and effectively decreased the company's annual profit by limiting the amount of money that could be received for procedures (Advameg, 2000). By 1998, HealthSouth's earnings growth had slowed dramatically from the ~30% it reported in the past to between 15% and 20% (Galloro, 2001). In direct response to HealthSouth's relatively poor performance, the company's share price dropped considerably (Galloro, 2001). Miraculously, over the next few years HealthSouth reported impressive earnings, and by 2001 the company's stock had recovered a significant portion of the value it carried during its 1998 peak (Advameg, 2000).

In March of 2002, both HealthSouth and CEO Richard Scrushy were charged with accounting fraud (Gilpin, 2002). The Securities and Exchange Commission alleged that the company had been overstating its earnings since 1999 and that Scrushy had directly ordered this overstatement to "match Wall Street analysts' expectations" (Hicks et al., 2003). The fraud was carried out primarily through overestimating the revenue from insurance reimbursements and excessively capitalizing expenses (Hicks et al., 2003). Additionally, Scrushy had directly benefited from the fraud through the sale of his personal HealthSouth shares at the inflated stock

prices and increased bonuses awarded to him based on the company's fraudulently overstated earnings (Hicks et al., 2003).

Although Scrushy was acquitted of all charges brought by the SEC in June of 2005, he was sentenced to serve 82 months in jail for bribery and mail fraud by a federal court in 2006 (Pavlo, 2012). Following his stint in jail, Scrushy was then taken to civil court where he was ordered to pay an impossible $2.9 billion in restitution with 60% to be returned to former HealthSouth investors (Dickinson, 2009). Although it is unclear the exact amount of money Scrushy has paid to date, he is still living comfortably and earning a living as a small business consultant and author (Patel, 2020).

Even though HealthSouth's scandal lost their investors millions of dollars, the implications of the fraud goes way beyond individual shareholders. HealthSouth's employees, the communities that relied on the newly foreclosed hospitals, patients, and other non-shareholders alike also experienced consequences because of the fraud.

Immediately following the scandal, HealthSouth found itself in complete disarray with a guilty CEO and $354 million worth of bond repayments that were rapidly approaching (Freudenheim & Abelson, 2003). Both of these factors made it seem highly likely that the once billion-dollar corporation would soon go bankrupt. For HealthSouth, the nearly 60% loss in share valuation was unparalleled (Piotrowski, 2003). HealthSouth had nowhere near the amount of money they needed to overcome the net $3.3 billion they owed in bank and bond debt (Richards, 2003). Their dire situation became even more solidified when J.P. Morgan, one of HealthSouth's bankers, determined that their involvement in the fraud was terms for default on a $1.25 billion line of credit, effectively eliminating any immediately viable means of staying solvent (Peterson & Atlas, 2003). As a result, the company was forced to find other ways to keep themselves from

going under in the short term. They started by hiring an expensive crisis management team to help them work through their current messy situation (Mollenkamp, 2003). Under the direction of the team, HealthSouth began doing their best to cut unnecessary expenses and generate revenue through the sale of assets. They sold off their luxury assets, terminated the jobs of 225 Birmingham corporate staff, and laid off any other personnel deemed unnecessary (Mollenkamp, 2003). In spite of their efforts, HealthSouth was still in urgent need of funds and eventually found themselves being forced to sell or shut down numerous underperforming facilities across the country (Bassing, 2004).

Although HealthSouth was ultimately able to resist bankruptcy in the short term, the company would continue to face the repercussions of the fraud for most of the next two decades. By 2006, HealthSouth was able to work out an arrangement to restructure its debt at the expense of having to sell off a large portion of their remaining facilities (Birmingham, 2006). Shortly after, the company was eventually able to rejoin the New York Stock Exchange after spending three and a half years trading as a pink sheet stock, a restricted trading status for companies that cannot meet certain stock exchange requirements (Alabama, 2006).

The vast majority of HealthSouth's employees were in the medical field and before the scandal were not as concerned with the inner workings of the company's financials. This of course changed for many of the employees after the SEC claimed that both their employer and the CEO of the company that they worked for had been involved in massive accounting fraud (Hicks et al., 2003).

In addition to financial fraud, it was also discovered that HealthSouth had been involved in significant Medicare fraud (Department of Justice, 2004). HealthSouth had been filing false claims for outpatient therapy that was administered by unlicensed employees, primarily interns

and even some students (Peterson, 2003). In addition to this, HealthSouth had been billing Medicare for individualized therapy when in actuality they were providing group sessions (Peterson, 2003).

Over the remainder of the decade HealthSouth was repeatedly found committing other forms of Medicare fraud like billing Medicare for improper expenses and falsely representing patient diagnoses to Medicare, all of which were summarized in multiple Medicare fraud lawsuits (Price, 2020).

III. CASE STUDY ANALYSIS

A. Employee Impacts

i. General Overview

When a company commits fraud, employees find themselves in positions where they are forced to accept the repercussions without recourse. Apart from a few cases, employees are often caught off guard when the fraudulent event becomes public (Velikonja, 2013). This becomes significantly more relevant considering the financial impacts fraudulent activities can have on an employee. Many employees receive forms of compensation, like annual bonuses and pensions, from their employer which are contingent on the overall performance of the firm (Velikonja, 2013). Before the fraud is caught, the temporarily inflated corporate performance-based compensation may benefit employees. The true extent of employee centric consequences become clear after companies charged with fraud are faced with large fines and penalties in addition to a

handful of other financially damaging factors. In response, their overall fiscal performance decreases, and with it, the earnings contingent compensation of employees also diminishes.

ii. In Re HealthSouth Corp. ERISA Litigation

Employee stock benefit plans are a type of retirement plan that provides former employees with a regular income after they retire. These plans are funded through annual employer contributions, which are then invested by plan managers. HealthSouth's employee stock benefit plan was comprised in part of 3.3 million HealthSouth shares representing nearly $100 million of the plan total (Jia, 2005). Following the scandal and the subsequent drop in HealthSouth stock price, the pension plan lost an approximate $98.5 million, severely limiting its ability to compensate eligible employees (Jia, 2005). Following a class action lawsuit against HealthSouth for violating their fiduciary duties to employees participating in the employee stock benefit plan, a settlement of $25 million was reached (In Re HealthSouth, 2005). Eventually a settlement was reached concluding that HealthSouth violated the Employee Retirement Income Security Act of 1974 through its improper diversification of benefit plan investments (Jia, 2005). However, the amounts awarded to those impacted only covered a small portion of the total money lost.

B. Consumer Impacts

i. General Overview

Fraud carried out by firms, especially those involved in the health services industry, has the potential to carry significant implications for their consumers. Medicare fraud, which involves an entity providing Medicare with false or misrepresented information for their own

benefit, hurts not only the government agency but also those who received treatment (Kyriakakis, 2015). Medicare fraud can be carried out in various ways. It could involve the intentional misdiagnosis of patients so that Medicare can be billed for unnecessary treatment, the intentional incorrect classification of treatments provided to patients to receive more money from the insurance provider, as well as through various other means (Kyriakakis, 2015). Although the party being defrauded in these situations is Medicare, the actions taken to facilitate the fraud carry direct consequences to the patients involved as well.

Medicare is a government insurance program where patients must first pay out of pocket for a set amount of approved medical services and supplies known as a deductible (Medicare, 2022). Following this, all further purchases of approved medical services and supplies are covered entirely by Medicare with the exception of a few instances where a copayment must be paid out of pocket by the individual being covered (Medicare, 2022). It is because of this that when patients are overbilled for services rendered, Medicare is not the only party being overcharged.

Non-financial implications for consumers also can occur. An example of this is when HealthSouth allowed untrained employees to provide treatments that should have only been administered by a licensed professional.

ii. Darling v. HealthSouth Sports and Rehabilitation Center of Clearwater

Prior to the discovery of HealthSouth's securities fraud, the company had been accused of committing Medicare fraud on multiple occasions (Freudenheim & Abelson, 2002). One of the more prominent cases, *Darling v. HealthSouth Sports and Rehabilitation Center of Clearwater,* which was settled on December 30, 2004, involved HealthSouth allowing an

unlicensed employee to provide physical therapy to a patient, John Darling. The suboptimal care provided by the unlicensed employee resulted in an injury that left Mr. Darling in severe long-term pain (Freudenheim & Abelson, 2002). In an interview, John Darling said that for the first few weeks of therapy everything went well until a session where HealthSouth assigned a different employee to work with him (Brink, 2005). During this session, Darling was instructed to lift excessively heavy objects, which worsened his condition (Brink, 2005). The supposed new therapist assigned to work with Darling was later reported to have been a janitor at the facility. Darling's initial claim uncovered something even more concerning for HealthSouth - a multitude of other fraudulent Medicare practices (Freedman, 2004). Alongside billing Medicare for therapy provided by unlicensed employees, HealthSouth was also charging group therapy sessions as if they were individual sessions (Freedman, 2004). When Darling's case came to court it piqued the interest of the United States Department of Justice who eventually decided to take over the portion of his lawsuit regarding the overbilling of Medicare (Freedman, 2004).

C. Community Impacts

i. General Overview

There are many benefits that come with the addition of new companies to a community. For example, a new company may introduce access of a new product or service to the community that was previously unavailable. Overall employment opportunities increase with the new demand for labor, which in turn increases local tax revenue (Lister, 2016). The increase in the number of paid laborers will eventually lead to an increase in consumer spending, which supports other local businesses (Lister, 2016). All of which promotes localized economic growth,

a net positive for the community. Despite this, when these same companies are found guilty of committing fraud, many of these benefits are reversed. These resulting negative consequences are particularly substantial when a community has been relying on the guilty company as a major employer.

When companies are caught committing fraud, they are faced with various expenses from lawsuits and financial losses. After incurring these prior mentioned costs, companies may need to generate cash flows to meet these expenses quickly. For many companies, one possible means of doing this is by selling or foreclosing unprofitable subsidiaries. Although this action makes fiscal sense for companies, for health care providers, these subsidiaries are often hospitals or clinics relied upon by patients who reside in the surrounding community. An example of this can be seen in the case study conducted on HealthSouth following their 2003 financial statement fraud event.

ii. Fairfield, Alabama: Metro West Hospital

In the small town of Fairfield, Alabama the now foreclosed Metro West Hospital used to be the largest employer of jobs. The town itself only had a population of 12,381 during the census conducted in the year 2000, of which HealthSouth formally employed roughly 500 people (Alabama Public Radio, 2004). Following their 2003 fraud scandal, HealthSouth closed the hospital stating that they could no longer afford to continue losing around half a million dollars each month (Bassing, 2004). The Metro West Hospital had been a key aspect of the Jefferson County community for nearly 100 years primarily assisting underserved clientele (Bassing, 2004). The 500 affected employees, many of which had been working there years before

HealthSouth's acquisition, were given two months to find new work before the finalization of the hospital's closure (Bassing, 2004; Park, 2000).

Employees that are terminated following the discovery of corporate fraud are generally caught off guard due to the information asymmetry between those complicit with the fraud and personnel who are not. Employers intentionally conceal fraud from employees to keep them from leaving as well as encourage new potential hires to join (Velikonja, 2013). When HealthSouth acquired the Metro West Hospital, both the existing physicians and the surrounding community were ecstatic (Birmingham, 2000). After the historic yet deteriorating hospital was purchased and renovated by HealthSouth, the mayor of Fairfield, Larry Langford, was thrilled to say many things about the acquisition during an interview with the Birmingham Business Journal:

> This hospital has been part of the community for almost 90 years. It was at one time the primary hospital in Jefferson County. [Lloyd Noland hospital] was once synonymous with quality, but over the years that quality eroded. It's back, and I have no doubt that this will be the No. 1 hospital [in Birmingham] in three to five years. Before, we couldn't pay doctors to come here. Now we're beating them off with a stick. (Birmingham, 2000)

The new hospital CEO Karen Davis stated in response to a question about the existing employees:

> Many [physicians] have been here for years. They've stayed because they care, not because they had to or needed the job. They're committed. We want to empower our employees. They are in control of their own destiny. (Birmingham, 2000)

Within three years following this interview, nearly 500 employees comprised of new hirers, medical students completing their fellowships, and long-term employees who had been working there through the three previous ownership changes would lose their jobs (Birmingham, 2000;

Bassing, 2004). The quotes presented demonstrate that not only were the employees unaware of the fraud taking place, but they were reassured in their job security through the misrepresented financial success of HealthSouth. Being caught off guard by an immediate termination forces employees to accept the cost of lost wages while unemployed, as well as various non-quantifiable costs for those who have lived in the area for an extended period (Velikonja, 2013). The employees described by hospital CEO Karen Davis have remained at that hospital through sheer dedication to its success, a possibility that was eliminated the day the facility was foreclosed. Many of these employees, having worked there for so long, had mortgages, family, and other social relationships tied to the area. The employees preexisting financial and social ties to the community caused them additional strain following the fraud as well as during their dismissal from employment.

IV. CONCLUSION

When a company is found guilty of fraud, resulting consequences can be found, to some degree, for all parties who are directly or indirectly involved with the corporation. Apparently indifferent to this fact, the popular news coverage and academic research of fraud seems to only address the financial losses of shareholders in the aftermath of these events. Through my research, I have ascertained that the reason for this limited coverage is due to the easily quantifiable losses in the share price of company's stock after fraud is uncovered. Given the primarily qualitative nature of the implication's non-shareholder stakeholders' experience, summarizing their losses as a dollar amount is fairly difficult. As a result, even when a news article mentions the impact non-shareholder stakeholders' experience, the implications described

appear less drastic than they are in reality. However, some of the research done to estimate non-shareholder stakeholder loss has suggested that it greatly outweighs the losses experienced by shareholders alone (Velikonja, 2013). Shareholders can diversify their investments across multiple stocks and remove their invested capital with little delay and consequence. On the other hand, the interests of non-shareholder stakeholders in a company are more than often not just invested capital, which impairs their ability to mitigate fraud risks (Velikonja, 2013).

I started this research by defining the nature of the relationships stakeholders have with their mutually affiliated companies and with each other. I then selected three stakeholder groups that I felt would be the most impacted and disproportionality unrepresented by fraud in research and the media. Following this I examined various well known fraud cases to find one that's non-shareholder impacts were the least documented in popular media. I ended up selecting HealthSouth both due to its diverse fraudulent past and because of how geographically widespread its individual subsidiaries were dispersed. My primary sources of information were Worker Adjustment and Retraining Notification (WARN) notices and publicly available litigation records. Using the locations mentioned in these various documents I was able to find local newspaper articles that provided background information on how individuals and communities were affected following the various HealthSouth fraud events. Referencing the data I collected I was then able to apply what I found to my stakeholder groups of interest to examine how non-shareholder stakeholders are impacted by fraud.

As fraud tends to occur and be carried out by high-level executives, stakeholders are often completely unaware of the action and have little warning to prepare before the fraud becomes public knowledge. Companies that are caught engaging in fraud usually experience intense financial losses immediately after the fact. In response to this, they may consider

generating the necessary additional capital to meet their short-term expenses through the sale of individual subsidiaries. Even though this makes fiscal sense for the company, this decision delivers a rippling effect to every other party involved.

Employees who worked at these subsidiaries are put out of work and potentially may need to relocate for a new career. They are forced to find new employment in a short period of time, leaving them susceptible to the risk of accepting a lower-paying job. Employees experience the cost of lost wages during their period of unemployment while finding new work. Some of these employees who had long worked for their prior employer are forced to move away from their interpersonal relationships in the pursuit of new employment. Communities where this business use to be the predominant employer, may experience a significant increase in short-term unemployment. Consumers lose access to the products or services offered by the now-closed business. In some cases where the fraud occurred through mismanagement in the service industry consumers may even have been injured. The implications of fraud on non-shareholder stakeholders are difficult to quantify. As such news coverage of fraud events hardly addresses non-shareholder consequences despite this affected population being far greater in number than shareholders alone. Only about 58% of Americans hold stock in a company, in contrast nearly all Americans are consumers, employees, or are otherwise involved with these major companies (Saad and Jones, 2021). Despite this when performing my preliminary research on the implications of fraud, I rarely came across any description of what happened to any party other than shareholders. It was this lack of information that served as the primary directive for my research; to increase awareness of the implication's fraud has on non-shareholder stakeholders.

By researching and describing various ways fraud can impact these stakeholders, I believe my work will encourage employees, consumers, and communities to become more

concerned with their company relationships. Currently in the United States there are many avenues of recourse for shareholders to recover their financial losses from fraud. These methods include: “fair funds and disgorgement funds; receiverships; brokerage account customer protections; corporate bankruptcy proceedings; and private class action lawsuits” (SEC, 2022). However, the ways for non-shareholders to recoup their losses after fraud are limited or at best not well known. My goal for this thesis was to describe how these groups are impacted by fraud in the hopes that increased research and awareness will follow. If information like this becomes more readily accessible to the public, then support for remedying this disparity in recourse will increase. In the coming decades I hope my research contributes to a movement to pass litigation that provides non-shareholder stakeholders a way to protect themselves from the implications of fraud.

V. REFERENCES

Adkins, T. (2021, December 12). *How to spot financial statement manipulation*. Investopedia. Retrieved from https://www.investopedia.com/articles/fundamental-analysis/financial-statement-manipulation.asp

Advameg. (2000). *HealthSouth Corporation - Company Profile*. Reference for Business. Retrieved from https://www.referenceforbusiness.com/history2/77/HealthSouth-Corporation.html

Alabama Public Radio. (2006, October 27). *HealthSouth returns to NYSE*. Alabama Public Radio. Retrieved from https://www.apr.org/2006-10-27/healthsouth-returns-to-nyse

American Institute of Certified Public Accountants. (2002, December 15). *Consideration of Fraud in a Financial Statement Audit*. AICPA. Retrieved from https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-00316.pdf

American Society for Quality. (2022). *What are stakeholders?* ASQ. Retrieved from https://asq.org/quality-resources/stakeholders

Bailey, C. D. (2019). The joint effects of narcissism and psychopathy on accounting students' attitudes towards unethical professional practices. *Journal of Accounting Education*, *49*, N.PAG. https://doi-org.pallas2.tcl.sc.edu/10.1016/j.jaccedu.2019.08.001

Bassing, T. (2004, June 6). *HealthSouth's new CEO ready for challenges he faces*. Bizjournals.com. Retrieved from https://www.bizjournals.com/birmingham/stories/2004/06/07/story1.html

Bassing, T. (2004, July 1). *HealthSouth to close Metro West Hospital*. Bizjournals.com.

Retrieved from https://www.bizjournals.com/birmingham/stories/2004/06/28/daily27.html

Beckenstein, A., Freeman, R. E., Harder, J., Thomas, D., Weiss, E., & Whitler, K. (2019, August 22). *Principles and purpose: A statement on stakeholders*. Principles and Purpose a Statement on Stakeholders. Retrieved from https://ideas.darden.virginia.edu/principles-and-purpose-a-statement-on-stakeholders

Bhatt, A. (2020, May 20). *HealthSouth scam: Reason, Investigation & Aftermath*. The Company Ninja. Retrieved from https://thecompany.ninja/healthsouth-scam-reasons-investigation-inquire-judgment-and-aftermath/#Recovery

Birmingham Business Journal. (2000, February 13). *HealthSouth Metro West Former Lloyd Noland Hospital wants to attract more doctors, new patients*. Bizjournals.com. Retrieved from https://www.bizjournals.com/birmingham/stories/2000/02/14/focus1.html?s=print

Birmingham Business Journal. (2006, March 10). *HealthSouth replaces billions in prior debt with less restrictive bank financing*. Bizjournals.com. Retrieved from https://www.bizjournals.com/birmingham/stories/2006/03/06/daily34.html

Brink, G. (2005, September 2). *Painful back injury turns into federal case*. Tampa Bay Times. Retrieved from https://www.tampabay.com/archive/2002/03/17/painful-back-injury-turns-into-federal-case/

CMS. (2021, January). *Medicare Fraud & Abuse: Prevent, Detect, Report - CMS*. Center for Medicare and Medicaid Services. Retrieved from https://www.cms.gov/Outreach-and-Education/Medicare-Learning-Network-MLN/MLNProducts/Downloads/Fraud-Abuse-MLN4649244.pdf

Cornell Law. (2021, June). *Capitalized expenditure*. Legal Information Institute. Retrieved from

https://www.law.cornell.edu/wex/capitalized_expenditure

Department of Justice. (2004, December 30). *HealthSouth to pay United States $325 million to resolve Medicare fraud allegations*. USDOJ. Retrieved from https://www.justice.gov/archive/opa/pr/2004/December/04_civ_807.htm

Dickinson, M. (2009, June 18). *Former HealthSouth Boss found liable for $2.9 billion*. Reuters. Retrieved from https://www.reuters.com/article/us-healthsouth-scrushy/former-healthsouth-boss-found-liable-for-2-9-billion-idUSTRE55H4IP20090618

Ekdahl, V. (2015). The impact of press releases on stock prices.

FBI. (n.d.). *Securities Fraud Awareness & Prevention Tips*. FBI. Retrieved from https://www.fbi.gov/stats-services/publications/securities-fraud

Frecka, T. (2008). Ethical Issues in Financial Reporting: Is Intentional Structuring of Lease Contracts to Avoid Capitalization Unethical? *Journal of Business Ethics*, *80*(1), 45–59. https://doi-org.pallas2.tcl.sc.edu/10.1007/s10551-007-9436-y

Freedman, L. (2004, December 30). *United States' and HealthSouth False Claims Act Settlement Agreement*. SEC. Retrieved from https://www.sec.gov/Archives/edgar/data/785161/000119312505001672/dex101.htm

Freudenheim, M., & Abelson, R. (2002, September 19). *The markets: Market place; growing concerns on the health of HealthSouth*. The New York Times. Retrieved from https://www.nytimes.com/2002/09/19/business/the-markets-market-place-growing-concerns-on-the-health-of-healthsouth.html

Freudenheim, M., & Abelson, R. (2003, March 21). *HealthSouth regroups in effort to avoid bankruptcy*. The New York Times. Retrieved from

https://www.nytimes.com/2003/03/21/business/healthsouth-regroups-in-effort-to-avoid-bankruptcy.html

Freudenheim, M. (2005, January 27). *Vital signs return to HealthSouth*. The New York Times. Retrieved from https://www.nytimes.com/2005/01/27/business/vital-signs-return-to-healthsouth.html

Galloro, V. (2001). Picking up speed. *Modern Healthcare*, *31*(28), 28.

Gilpin, K. N. (2003, March 19). *HealthSouth and chief charged with fraud*. The New York Times. Retrieved from https://www.nytimes.com/2003/03/19/business/healthsouth-and-chief-charged-with-fraud.html

HealthSouth will close Fairfield Hospital. Alabama Public Radio. (2004, July 2). Retrieved from https://www.apr.org/2004-07-02/healthsouth-will-close-fairfield-hospital

Hicks, W., Loomis, M. G., Rue, A., & Diskin, P. (2003). *Complaint: HealthSouth Corporation and Richard M. Scrushy*. SEC. Retrieved from https://www.sec.gov/litigation/complaints/comphealths.htm

IN RE HEALTHSOUTH CORP. ERISA LITIGATION (Securities and Exchange Commission August 22, 2005).

Jia, D. (2005, August 1). *HealthSouth and its insurers Settle Employee Class action*. The Wall Street Journal. Retrieved from https://www.wsj.com/articles/SB112266179798600188

Jitendra. (2019, December 6). *What is contractual adjustment in Hospital Medical Billing?* -. Medical Coding Guide. Retrieved from https://www.americanmedicalcoding.com/contractual-adjustment-medical-billing/

Kim, P. H., Wiltermuth, S. S., & Newman, D. T. (2021). A Theory of Ethical Accounting and Its

Implications for Hypocrisy in Organizations. *Academy of Management Review*, *46*(1), 172–191. https://doi-org.pallas2.tcl.sc.edu/10.5465/amr.2018.0161

Kyriakakis, A. (2015). The Missing Victims of Health Care Fraud. *Utah Law Review*, *2015*(3), 605–657.

Lister, J. (2016, October 26). *How does hiring additional employees affect the economy?* Small Business - Chron.com. Retrieved from https://smallbusiness.chron.com/hiring-additional-employees-affect-economy-31964.html

Made in Alabama. (2022). *WARN list: Made in Alabama: Alabama Department of Commerce*. Made in Alabama. Retrieved from https://www.madeinalabama.com/warn-list/

Medicare. (2022). *How does Medicare work?* Medicare. Retrieved from https://www.medicare.gov/basics/get-started-with-medicare/medicare-basics/how-does-medicare-work

Mollenkamp, C. (2003, October 21). After a Devastating Prognosis, HealthSouth Seeks a Recovery. *Wall Street Journal - Eastern Edition*, *242*(79), A1–A6.

Ogunwole, S., Rabe, M., Roberts, A., & Caplan, Z. (2021, October 8). *Population under age 18 declined last decade*. Census.gov. Retrieved from https://www.census.gov/library/stories/2021/08/united-states-adult-population-grew-faster-than-nations-total-population-from-2010-to-2020.html#:~:text=In%202020%2C%20the%20U.S.%20Census,from%20234.6%20million%20in%202010.

Ohy, J. (2007, March 31). *Capitalization of property, plant, and equipment P-415-10 ... - UCOP*. UCOP. Retrieved from https://policy.ucop.edu/doc/3410279/AM-P415-10

OIG. (2018, April 16). *What is considered fraud, waste, or abuse?* Office of Inspector General.

Retrieved from https://oig.usaid.gov/node/221#:~:text=Fraud%20includes%20false%20representation%20of,detriment)%20of%20the%20U.S.%20government.

Park, J. (2000, February 13). *Lloyd Noland Hospital wants to attract more doctors, new patients*. Bizjournals.com. Retrieved from https://www.bizjournals.com/birmingham/stories/2000/02/14/focus1.html

Patel, V. (2020, May 10). *Where is Richard Scrushy now? is he still in prison?* The Cinemaholic. Retrieved from https://thecinemaholic.com/richard-scrushy/

Pavlo, W. (2012, January 26). *Former HealthSouth CEO, Richard Scrushy, gets prison sentenced reduced*. Forbes. Retrieved from https://www.forbes.com/sites/walterpavlo/2012/01/26/former-healthsouth-ceo-richard-scrushy-gets-prison-sentenced-reduced/?sh=e79ef6438e29

PCAOB. (2002, July 30). *Sarbanes-Oxley Act of 2002*. Public Company Accounting Oversight Board. Retrieved from https://pcaobus.org/About/History/Documents/PDFs/Sarbanes_Oxley_Act_of_2002.pdf

Petersen, M. (2003, March 22). *HealthSouth's chart: Guarded but clearly unstable*. The New York Times. Retrieved from https://www.nytimes.com/2003/03/22/business/healthsouth-s-chart-guarded-but-clearly-unstable.html

Petersen, M., & Atlas, R. (2003, March 28). *Bank says HealthSouth is in default*. The New York Times. Retrieved from https://www.nytimes.com/2003/03/28/business/bank-says-healthsouth-is-in-default.html

Piotrowski, J. (2003). HealthSouth fallout. *Modern Healthcare*, *33*(14), 14.

Price, O. (2020, March 26). *Whistleblowers expose HealthSouth Medicare fraud*. Price

Armstrong. Retrieved from https://www.pricearmstrong.com/blog/whistleblowers-expose-healthsouth-medicare-fraud/

Quick Facts on Securities and Investment Fraud Offenses. United States Sentencing Commission. (2021, July). Retrieved from https://www.ussc.gov/research/quick-facts/securities-and-investment-fraud

Reck, J. L., Lowensohn, S. L., & Neely, D. G. (2021). *Accounting for Governmental & Nonprofit Entities*. McGraw-Hill LLC.

Richards, M. (2003, July 8). *HealthSouth: Bankruptcy is avoidable*. The Star Banner. Retrieved from https://www.ocala.com/story/news/2003/07/08/healthsouth-bankruptcy-is-avoidable/31282380007/

Saad, L., & Jones, J. M. (2021, August 20). *What percentage of Americans owns stock?* Gallup.com. Retrieved from https://news.gallup.com/poll/266807/percentage-americans-owns-stock.aspx#:~:text=Thus%20far%20in%202021%2C%20Gallup,Gallup%20has%20measured%20since%202009.

SEC. (2022). *Recovering funds*. U.S. Securities and Exchange Commission. Retrieved from https://www.investor.gov/introduction-investing/investing-basics/glossary/recovering-funds#:~:text=Processes%20that%20may%20help%20victims,are%20able%20to%20recover%20money.

Shumsky, T. (2018, September 26). *Former bankrate CFO sentenced to 10 years for accounting fraud*. The Wall Street Journal. Retrieved October 10, 2021, from https://www.wsj.com/articles/former-bankrate-cfo-sentenced-to-10-years-for-accounting-fraud-1537915844.

Smieliauskas, W., Bewley, K., Gronewold, U., & Menzefricke, U. (2018). Misleading Forecasts in Accounting Estimates: A Form of Ethical Blindness in Accounting Standards? *Journal of Business Ethics*, *152*(2), 437–457. https://doi-org.pallas2.tcl.sc.edu/10.1007/s10551-016-3289-1

Tschakert, N., Needles Jr., B., & Holtzblatt, M. (2016). The red flags of FRAUD: Internal auditors' knowledge of the business makes them ideal candidates to detect unethical behaviors. *Internal Auditor*, *73*(5), 60–65.

Urska Velikonja, *The Cost of Securities Fraud*, 54 Wm. & Mary L. Rev. 1887 (2013), https://scholarship.law.wm.edu/wmlr/vol54/iss6/4

Value Healthcare Services. (2013, July 18). *Contractual adjustment: A hospital billing term: Value Healthcare Services*. Value Healthcare Services | Patient Bankruptcy Receivables. Retrieved from https://valuehealthcareservices.com/education/contractual-adjustment-a-hospital-billing-term/#:~:text=A%20Contractual%20Adjustment%20is%20a,patient%20account%20for%20any%20reason.

Velikonja, U. (2013). The Cost of Securities Fraud. *William & Mary Law Review*, *55*(1), 1886–1957.

Whitmire, K. (2005, December 10). *Executive gets 5-year term in fraud case*. The New York Times. Retrieved October 10, 2021, from https://www.nytimes.com/2005/12/10/business/executive-gets-5year-term-in-fraud-case.html.

Wynne, M. (2007, October). HealthSouth's Collapse and Recovery. Retrieved from https://documents.uow.edu.au/~bmartin/dissent/documents/health/healthsouth_busi

ness.html