HealthSouth Debacle Gives Lessons to Members of Boards of Directors

The business and healthcare press exploded in March when HealthSouth's former Chief Financial Officer admitted that he had conspired with other Company executives to commit criminal accounting fraud by overstating profits by $1.4 billion since 1999. The former CFO pled guilty to four federal criminal charges, including the certification of financial records which knowingly misstated amounts the Company could collect from patients' insurers. The Company's outside accountants appear to have based their clean audit opinions on sample testing procedures which satisfied accepted auditing standards, but which could not detect of the willful misstatements of the conspirators.

What are directors of health enterprises to make of this? The answer is . . . plenty. Public companies are now subject to the Sarbanes-Oxley Act of 2002, which imposes sweeping new rules in three areas:

- Certification: CEOs and CFOs must certify the company's financial statements, and those who knowingly certify falsely are liable for criminal and civil penalties.
- Auditability: The company must develop and publish internal procedures and processes which outsiders can use to attest to the existence of appropriate financial controls.
- Disclosure: The company must report rapidly its actual financial results and significant changes in its financial condition or operations.

Prudent public company directors are requiring regular written reports from management on their Sarbanes-Oxley compliance efforts.

Many readers serve as directors of non-profit healthcare providers which are not subject to Sarbanes-Oxley. What are they to do? Most of them have educated themselves on healthcare fraud enough to know that their organizations should adopt effective compliance programs satisfying the Program Guidance issued by the Office of Inspector General of the U.S. Department of Health and Human Services.
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Now they must assure that they are doing all they reasonably can to assure that their organizations do not fall prey to insiders' financial fraud. Here are some practical steps directors can take.

- Require regular reports on all direct and indirect compensation arrangements for all members of the top management team. Executives who commit financial fraud have a simple goal - more money for themselves. Directors should know all of the direct and indirect means by which their organizations compensate top management.

- Adopt a written conflict of interest policy satisfying the IRS recommendations for tax-exempt entities and require all that all top managers, and all directors, complete and certify annually detailed questionnaires regarding all direct and indirect transactions with the exempt entity.

- Assure that the audit committee is made up solely of outside directors and that it includes people sophisticated in financial management and willing to turn over every stone.

- Distribute copies of the entity's annual report to the IRS on Form 990 to the Audit Committee before filing and allow Committee members to question management on all entries.

- Require auditors, lawyers, and other highly compensated outside consultants to report from time to time directly to the Board or to duly constituted committees of the Board.

Directors must leave day to day management to the executives they have chosen. They cannot and should not substitute themselves for the officers whose full time job is leading, managing, and operating the organization's business. But the Directors should perform their duties of oversight, care, and loyalty energetically and with their eyes wide open.

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