Dr. Sterling’s Disability Insurance Claim: A Case Study

Diane M. Matson
Wen Yu *

This is the case of Dr. Albert Sterling, a fictitious surgeon who has submitted a disability income claim to Guardian Protection Insurance Corporation, a fictitious insurance company. Dr. Sterling is making a disability claim, stating that he cannot continue to work as a surgeon, due to debilitating depression. While the doctor and the insurance company are fictitious, several aspects of this case are real.

Students assume the role of an insurance investigator who is assigned to assess the validity of the claim. The case is divided into two phases, Phase 1 and Phase 2. Phase 1 contains most of the information and questions, and requires most of the analysis. Phase 2 contains six additional sources of evidence, and allows for a more in-depth investigation about the validity of the claim. Phase 1 is effective by itself, but Phase 2 shows that a fraud investigation usually proceeds in stages, with information coming in at various times.

This case provides an opportunity to practice forensic accounting techniques in the specific context of disability insurance. Students will find several “red flags of fraud” to investigate. Tracy Coenen, CPA, CFE, and insurance investigator, notes: “For insurance claims that deal with illness or injury, such as workers compensation, disability or personal injury the key to finding red flags of fraud is looking for financial information that doesn’t add up or is inconsistent with the claims submitted” (Drax, 2006).

The sections of this paper are as follows: Applications; Features; Implementation; Case (Phase 1); Suggested Solution (Phase 1); Case (Phase 2); Suggested Solution (Phase 2); and Conclusion.

* The authors are, respectively, Associate Professor and Assistant Professor both at the University of St. Thomas.
Applications

This case is appropriate for a forensic accounting course at the undergraduate or graduate level. We have primarily implemented this case in the advanced auditing course in our Masters of Science in Accountancy (MSA) program, which includes significant coverage of forensic accounting and fraud investigations. This case was tested and found effective in three sections of this course. We have also provided this case in independent studies in forensic accounting to both undergraduate and graduate students many times, and received positive feedback from these students.¹

Features

Several features of this case may be of interest to instructors. These features include the development of analytical skills in a specific context, the focus on where funds are spent, and the search for additional information.

**Use Analytical Skills in a Specific Context.** This case is set in a specific context, the insurance industry, where accounts, amounts and relationships are of particular concern when viewed in the light of a disability claim. This case encourages students to develop their analytical skills, as they will identify accounts, amounts and relationships that do not make sense for a high-earning individual and his family. For example, students should notice that Dr. Sterling has taken a loan against his pension, which may seem surprising for a high-income person to do. In addition, students are provided two guidelines or “rules of thumb” commonly used in determining the validity of disability claims. When students investigate the relationship and patterns with a specific purpose in mind—determining the validity of a disability claim—they should find that Dr. Sterling has not built up his net worth as much as would be expected. Students can transfer such analytical skills to other types of fraud investigation cases, even at a corporate level.

¹ The university at which the authors work does not currently offer an undergraduate forensic accounting course in the regular curriculum, due to the time constraints of the other required accounting courses.
**Consider Accounts that are Not Included.** Students are encouraged to consider the reasonableness of accounts that are listed. Furthermore, students are directed to consider what accounts could be missing and what the potential impact (of those missing accounts) is on the validity of the claim. For instance, the Sterlings do not report any investments in stocks, or a vacation home. High-earning families often own these types of assets. In addition, these families may have other sources of income, such as interest and dividends from investments. Under some policies, the existence of other sources of income could decrease disability insurance benefits.

**Focus on Where Money is Spent.** This case also requires students to take a different perspective about the funds, than do other cases based on an investigative technique. In a typical net worth analysis problem, students are provided some limited base year information and more detailed information for two or three years, from which they can list assets and liabilities, compute net worth, and add various expenditures (such as living costs, alimony, vacations and school tuition) to arrive at a measure of total increase in net worth. This measure is then compared to known sources of funds (such as salaries and inheritances) to arrive at unexplained sources of funds (if any). The possible presence of unexplained funds may indicate that the person is getting funds from illegal activities. The focus of this type of problem is: Where is the money coming from?

In this case, however, students should discover that the person does not seem to have a lot of assets or an extravagant lifestyle, as might be expected for a high-earning professional. Understanding where the money is being spent will help the investigator determine the validity of the claim. This case provides a completed net worth analysis (a short version, with only assets, liabilities, and net worth) and other relevant information on the person’s salary and the family’s lifestyle. The focus in this case is: Where is the money going?

**Search for Useful Sources of Information.** This case gives students a chance to consider what information would be useful in making a decision about this claim. In our experience, students tend to be unfamiliar with the types of information that are available in an investigation. This is not a surprise, as they often have limited experience with company documents, and even personal documents. So, this case encourages students to think about what type of information
would be useful, and what documents would be relevant. For instance, to learn more about the family’s spending, they could request bank statements, and to learn more about the value of the home, they could ask for an appraisal report.

Implementation

In an undergraduate or graduate course in forensic accounting, this case could be given after the basics have been covered, such as types of fraud, the fraud triangle, and different types of investigative techniques, such as the net worth analysis, the expenditures method, and the bank deposit method. In an advanced auditing course, this case could be given at the end of the forensic accounting coverage.

The case could be assigned as an individual or a team assignment. Because the case is not particularly lengthy, Phase 1 could be handed out at the end of one class and be turned in or covered in the next class. If Phase 2 is used, that could be due in the subsequent class.

This case can serve as a written assignment or a class presentation (or both). Students could prepare the answers in writing and turn this in as an assignment. Or, they could be ready to present their findings in front of the class. We have tested it as an assignment to be presented by selected teams in front of the class (advanced auditing), as an individual assignment to be prepared with written responses (independent studies in forensic accounting) or as part of a midterm exam with handwritten responses (advanced auditing).

Please note that there are many details in disability insurance policies that are not covered in class or in this case. These details include renewing policies, canceling policies, raising premiums, starting benefits, paying during recovery periods and establishing the length of benefits. We attempt to provide enough background information on disability insurance to make the context understandable, without adding complexities that are irrelevant to the case.
Case

Phase 1

This case asks you to apply your forensic accounting skills to a specialized area of forensic accounting, insurance fraud. In particular, you should consider the possibility of a fraudulent claim for long-term disability insurance. The Background Information provides a brief description of disability insurance. The Disability Insurance Claim Information gives details about the policyholder’s claim and financial condition. In the Questions for Phase 1, you will identify and discuss issues and concerns you might have as an insurance fraud investigator.

Background Information

Disability insurance, also known as disability income insurance, provides income if a person is unable to work. This form of insurance protects the earned income of the beneficiary (the insured policyholder). A disability policy protects income against the risk that disability will make working (and therefore earning) impossible. Such a policy is designed to pay for living expenses if the policyholder becomes unable to work due to accident or illness. There are several sources of disability insurance, including federal government social insurance programs, employer-supplied disability insurance, and state-run workers’ compensation benefits. In addition, policies can be sold and issued to individuals through insurance companies, which is applicable in this case.

There are two types of disability policies: Short-Term Disability (STD) and Long-Term Disability (LTD). STD policies typically take effect after 14 days of disability and may extend for two years. LTD policies usually take effect after several weeks of disability and may provide benefits for a few years, to the time when the person can collect social security payments, or even the remaining years of the person’s life.

Disability insurance policies differ in the definition of “disability.” One definition views the disability as a condition that prevents the person from performing the major duties of his or her chosen occupation. So, if a person cannot perform the main duties of his or her chosen occupation.
occupation, this person will receive benefits. This is the “own occupation” approach, applicable in this case. Another definition views disability as a condition that prevents the person from performing the main duties of any gainful occupation. So, if a person cannot perform the main duties of his or her chosen occupation, he or she will be expected to obtain employment in another area. Earnings from another occupation may offset the disability insurance benefits. This is the “any occupation” approach.

Disability Insurance Claim Information

Guardian Protection Insurance Corporation File
February 10, 2010

Assume that you are a claims investigator with Guardian Protection Insurance Corporation (GPIC), a large insurance company based in Chicago. You have received a claim on the long-term disability policy for Dr. Albert Sterling. His policy is of the “own occupation” type. You are responsible for determining the validity of the claim. Here is the information that you have at this time:

1. Dr. Albert Sterling is 59 years old.
2. He is a general surgeon.
3. He is the sole owner of his medical practice. There are two offices, one in downtown Chicago and one in Lake Forest.
4. He has ten employees between the two clinics. They are nurses, office managers, medical records specialists and receptionists.
5. He has hospital privileges and does his surgery at two well-known hospitals.
6. He works around 60 hours a week performing surgery, visiting patients in the hospital, and conducting office appointments.
7. Mrs. Melissa Sterling and Dr. Sterling have been married for 35 years.
8. Mrs. Melissa Sterling has been a full-time homemaker since her marriage.
9. They have two children, Lauren and Albert Jr. (A.J.).
10. Lauren works in her father’s Lake Forest office. She attended college for 2 years. She is married with one child.
11. A.J. graduated from a local university with a degree in business administration and is employed with a local market research firm.
12. Dr. Sterling reports the following salary information:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>$550,000</td>
</tr>
<tr>
<td>2006</td>
<td>575,000</td>
</tr>
<tr>
<td>2007</td>
<td>610,000</td>
</tr>
<tr>
<td>2008</td>
<td>620,000</td>
</tr>
<tr>
<td>2009</td>
<td>630,000</td>
</tr>
</tbody>
</table>
13. The combined federal and state individual income tax rate is approximately 40%.
14. Dr. Sterling states that he has been suffering from debilitating depression recently. He has filed a claim for long-term disability insurance, asserting that he cannot continue to work in his profession, as a surgeon.
15. Dr. and Mrs. Sterling’s personal financial statement (Personal Statement of Net Worth/Balance Sheet) has not changed significantly since the policy was issued in December of 2005. Copies of the Personal Statements from December 31, 2005; December 31, 2006; December 31, 2007; and December 31, 2008 are in GPIC files. The Personal Statement for December 31, 2009 is provided next.
Dr. and Mrs. Albert Sterling  
Personal Statement of Net Worth/Balance Sheet  
As of December 31, 2009

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$10,000</td>
</tr>
<tr>
<td>Automobile</td>
<td>50,000</td>
</tr>
<tr>
<td>Personal Property</td>
<td>60,000</td>
</tr>
<tr>
<td>Boat</td>
<td>100,000</td>
</tr>
<tr>
<td>Collectables</td>
<td>350,000</td>
</tr>
<tr>
<td>House</td>
<td>600,000</td>
</tr>
<tr>
<td>Pension</td>
<td>210,000</td>
</tr>
<tr>
<td>Interest in Professional</td>
<td>1,200,000</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$2,580,000</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Automobile Loan</td>
<td>$25,000</td>
</tr>
<tr>
<td>Home Mortgage</td>
<td>400,000</td>
</tr>
<tr>
<td>Pension Loan</td>
<td>15,000</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>$440,000</strong></td>
</tr>
</tbody>
</table>

**Net Worth =**  
**Total Assets - Total Liabilities**  
**$2,140,000**

Under federal penalties of perjury, I do swear and affirm that the information provided above is true and correct to the best of my knowledge and belief.

Signed: **Albert Sterling, M. D.**  
Date: **January 15, 2010**
Questions for Phase 1

1. What type of income is Dr. Sterling hoping to replace?

2. In general, do you notice anything unusual about the Personal Statement? Consider that Dr. Sterling is 59 years old and his children are adults. He is a surgeon, and surgeons usually work a lot, and are usually high-income professionals.

3. What accounts on the Personal Statement should you investigate? Why? Please be specific as to why these accounts are of concern.

4. Consider accounts that you do not see on the Personal Statement. Please identify these accounts and discuss what concerns you would have because these accounts are not reported by the Sterlings. In other words, what accounts might you expect to see on such a Personal Statement for a high-income family?

5. Here are two guidelines usually used by claims investigators in these types of cases:

   (1) If a person is trying to accumulate wealth, his or her home should cost at least twice as much as his or her take-home pay.

   (2) A commonly-used formula for expected net worth is:

   \[
   \text{Expected Net Worth} = \left( \frac{\text{Age} - 10 \text{ years}}{\text{Current Yearly Pretax Household Income}} \right) \times \frac{10}{10}
   \]

   Please apply these guidelines to the Sterlings. Show your calculations. How do the Sterlings “measure up” here?

6. What concerns do you have about Dr. Sterling and his disability insurance claim?

7. What additional sources of information (documents, interviews, etc.) should you request or search for?
Suggested Solution for Phase 1

The solution to this case can be obtained from the authors.

Case

Phase 2

Assume you have found, requested and received some additional information and documents after starting your investigation. These documents provide more information about Dr. Sterling. Please find these documents attached, as follows.

Exhibit 1: Disability Insurance Policy
Exhibit 2: Credit Card Statement
Exhibit 3: W-2 (Selected Information)
Exhibit 4: Memo of Interview with Dolores Jones, Office Manager of the Clinic
Exhibit 5: Appraisal Report for the Sterlings’ Home
Exhibit 6: Statement of Activities for Dr. Sterling’s Clinics
Exhibit 1: Disability Insurance Policy

Guardian Protection Insurance Corporation
115 North LaSalle Street
Chicago, IL  60602
312-744-2345

Disability Income Policy
Schedule Page

Insured – Albert Sterling
Owner – Albert Sterling
Loss Payee – Albert Sterling
Occupation Class – Medical/General Surgeon
Date of Birth – January 14, 1951
Policy Number – A123456
Date of Issue – December 31, 2005
Age at Issue – 54
Last Renewal Date – December 31, 2009
Term – 12 months

Annual Premium for:
Basic benefits  $25,000

Table of Basic Benefits:
Monthly Indemnity Payments  $30,000

Lifetime Extension for Total Disability:
If you become totally disabled between age 54 and age 65, the monthly indemnity amount will be paid.

Benefits and Premiums after Age 65:
If you renew this policy when you are age 65, we will issue a new contract at that time.
Premiums for this policy may increase on renewal at or after age 65.

Licensed Resident Agent’s Countersignature

Edward J. Feldman, Senior Agent
Licensed, State of Illinois
Exhibit 2: Credit Card Statement

FINANCE ONE BANK

Credit Card Statement for January 3 to February 2, 2010

<table>
<thead>
<tr>
<th>Account #</th>
<th>Albert Sterling, MD</th>
<th>VIP Platinum</th>
<th>Since 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>1714 9600 4444</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Beginning Balance: $45,100.00
- Payments: -$27,800.00
+ Purchases: $31,300.00
+ Finance Charge: $1,200.00
= Ending Balance: $49,800.00

Minimum Balance: $3,500.00
Due Date: 28-Feb-10

Detail for January 3 to February 2, 2010

Payments
Payment--Thank you: $27,800.00

Transactions

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>10-Jan-10</td>
<td>Java Joe Coffee Shop Chicago</td>
<td>$14.00</td>
</tr>
<tr>
<td>14-Jan-10</td>
<td>Boca Chica Restaurant Chicago</td>
<td>$590.00</td>
</tr>
<tr>
<td>15-Jan-10</td>
<td>Brooks Brothers Evanston</td>
<td>$3,699.00</td>
</tr>
<tr>
<td>18-Jan-10</td>
<td>Delta Airlines CHICA VEGAS FLTS 3489, 2378</td>
<td>$2,100.00</td>
</tr>
<tr>
<td>20-Jan-10</td>
<td>Access Check #17 Cash</td>
<td>$12,000.00</td>
</tr>
<tr>
<td>25-Jan-10</td>
<td>Mirage Hotel Las Vegas Deluxe Suite Jan 18-25</td>
<td>$8,397.00</td>
</tr>
<tr>
<td>29-Jan-10</td>
<td>Continental Airlines RES—4 Flts 345, 458 First Class Rd Tr Atlantic City</td>
<td>$4,500.00</td>
</tr>
</tbody>
</table>
Exhibit 3: W-2 (selected information)

Wages and Salaries $630,000  
Federal Tax Withholding $189,000  
State Tax Withholding $63,000  

Exhibit 4: Memo of Interview with Dolores Jones, Office Manager of Clinic

Memo for File

Date: February 16, 2010

I interviewed Dolores Jones, Office Manager of Dr. Sterling’s downtown Chicago clinic. We met on Monday, February 15, 2010, from 10:00 to 11:15 am in a coffee shop, Java Joe’s, near the clinic. Here are some relevant excerpts of our conversation:

Ms. Jones has been the office manager for 10 years. Before that, she had been home with her three children. She works about 45 hours a week, 5 days a week. She lives in Evanston. She supervises the receptionists and medical records specialists. She also is in charge of billing the patients and their insurance providers. She reports that much of her time is spent filing the necessary paperwork with insurance companies (for patients covered by their employers or other private insurance plans) or with various government agencies (for patients covered by medical assistance plans or Medicare).

She reports that she likes her job and plans to stay indefinitely. She says she gets along fine with Dr. Sterling, and that he is a fair boss. When I asked her if she has any concerns about Dr. Sterling, she said that he has been somewhat moody lately, and seems a bit “down.” When I asked her for more specifics, she said that he has snapped at the office staff and even a few patients recently. This is out of character, she explained, but she figures that he is just tired. She did not have any other comments relative to this.

Ms. Jones does not know Dr. Sterling’s family personally very well. She has seen Mrs. Sterling and A. J. at the clinic a few times. Lauren, the Sterlings’ daughter, is the office manager at Dr. Sterling’s clinic in Lake Forest. As such, Ms. Jones and Lauren do talk on the phone and correspond by e-mail about various scheduling and patient matters, but apparently do not interact on a personal level. Ms. Jones could not say if there seemed to be issues in the family, as she does not know the family in that way.
February 20, 2010

To Whom it May Concern:

I conducted an appraisal of the property at:

1415 Birchwood Road
Lake Forest, IL  60045

To arrive at the appraisal value, I considered the age, size, condition and location of the house. Other factors in this case included the small lot size and lack of a swimming pool. I researched the sales prices of similar properties in the same and adjacent neighborhoods.

In my professional judgment, the value of this property is:

$625,000

Thank you for allowing me to be of service.

Very sincerely yours,

Barbara Belle

Barbara Belle, Appraiser
Barbara Belle Real Estate Services, Inc.

Specializing in Residential and Commercial Real Estate
Sales and Appraisals
233 LaSalle Street South
Chicago, IL  60606
312-444-0077
Exhibit 6: Statement of Activities for Dr. Sterling’s Clinics

Upon request, Dr. Sterling provided his clinics’ Statement of Activities for the last five years. A local accounting firm, Phipps LLP, has performed annual audits and issued unqualified opinions. The following is a copy of the Statement of Activities.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue, gains and other support:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net medical service revenue</td>
<td>$2,100,000</td>
<td>$2,050,000</td>
<td>$2,500,000</td>
<td>$2,220,000</td>
<td>$2,150,000</td>
</tr>
<tr>
<td>Investment returns allocated to current activities</td>
<td>(50,000)</td>
<td>(120,000)</td>
<td>100,000</td>
<td>50,000</td>
<td>48,000</td>
</tr>
<tr>
<td>Contributions available for current activities</td>
<td>15,000</td>
<td>20,000</td>
<td>40,000</td>
<td>38,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Other</td>
<td>81,000</td>
<td>80,000</td>
<td>110,000</td>
<td>105,000</td>
<td>95,000</td>
</tr>
<tr>
<td><strong>Total revenue, gains and other support</strong></td>
<td>$2,146,000</td>
<td>$2,030,000</td>
<td>$2,750,000</td>
<td>$2,413,000</td>
<td>$2,328,000</td>
</tr>
<tr>
<td><strong>Expenses:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and benefits</td>
<td>1,300,000</td>
<td>1,290,000</td>
<td>1,260,000</td>
<td>1,180,000</td>
<td>1,150,000</td>
</tr>
<tr>
<td>Supplies and facilities</td>
<td>470,000</td>
<td>450,000</td>
<td>510,000</td>
<td>480,000</td>
<td>450,000</td>
</tr>
<tr>
<td>Provision for uncollectible accounts</td>
<td>45,000</td>
<td>41,000</td>
<td>55,000</td>
<td>48,000</td>
<td>46,500</td>
</tr>
<tr>
<td>Finance and investment expenses</td>
<td>12,000</td>
<td>12,000</td>
<td>18,000</td>
<td>16,000</td>
<td>15,500</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>$1,827,000</td>
<td>$1,793,000</td>
<td>$1,843,000</td>
<td>$1,724,000</td>
<td>$1,662,000</td>
</tr>
<tr>
<td><strong>Income from current activities</strong></td>
<td>$319,000</td>
<td>$237,000</td>
<td>$907,000</td>
<td>$689,000</td>
<td>$666,000</td>
</tr>
<tr>
<td><strong>Non-current and other items:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions not available for current activities, net</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$25,000</td>
<td>$20,000</td>
<td>$18,000</td>
</tr>
<tr>
<td>Unallocated investment returns, net</td>
<td>(125,000)</td>
<td>(300,000)</td>
<td>250,000</td>
<td>125,000</td>
<td>120,000</td>
</tr>
<tr>
<td>Pension and postretirement expenses</td>
<td>(24,000)</td>
<td>(22,000)</td>
<td>(30,000)</td>
<td>(28,000)</td>
<td>(26,500)</td>
</tr>
<tr>
<td><strong>Total noncurrent and other items</strong></td>
<td>$139,000</td>
<td>$(312,000)</td>
<td>$245,000</td>
<td>$117,000</td>
<td>$111,500</td>
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<tr>
<td><strong>Increase in net assets</strong></td>
<td>$180,000</td>
<td>$(75,000)</td>
<td>$1,152,000</td>
<td>$806,000</td>
<td>$777,500</td>
</tr>
</tbody>
</table>
Questions for Phase 2

1. How does this additional information affect your judgment about the validity of the claim? Why?

2. What should you do now?

Suggested Solution for Phase 2

The solution to this case can be obtained from the authors.
REFERENCES

A Specimen Disability Income Policy, Guardian Disability Insurance Brokerage. 


