Employee Fraud at Miami Rehabilitation Services

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Case Objectives and Use

The case exposes students to internal control and fraud and their related impacts on small business. Although the issues of internal control and fraud are involved in almost every discussion of accounting, only recently has this concept received increased discussion specific to small business organizations. Through the chronicling of a real case scenario involving a health care provider, the case helps students understand investigative accounting in an environment where forensic data are scarce and few controls are in place. Secondary issues explored include the interaction between small business owners and their CPA advisors and the need for employee screening in small business. The case can be used in a graduate or undergraduate auditing or forensic accounting course, or as a module in a course emphasizing small business issues.

Juan Martinez sat motionless in his small office and reflected on the day’s events. By this time, the police were long gone. The police officer remarked that, without a confession, they really had no valid reason to arrest anyone. There were so many signs, and Juan had been certain that the police would be able to resolve the issue of the missing $1,400. Juan continued to rehash the recent events in his mind. He could not understand how things had gone wrong. He was heartbroken. He had always approached his employees like they were family. How could any of them have stolen? It was almost 10:00 pm on Friday, November 22, 2009, and Juan was nowhere closer to fully understanding or solving the theft. After all the decisions that Juan had made relative to his business, it was as if he had no clue what to do next. Was this merely a discrepancy due to sloppy bookkeeping or did he have a bigger problem of fraud in his organization? As he gathered his thoughts and began to reflect on the company’s history and how he had gotten to this point, he wondered what to do next. How would he tell his wife that he didn’t have any answers? The business represented their children’s future.

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He found himself calling his wife.

Juan: Isabella, I can’t determine what happened to the missing $1,400. I’m really angry that I didn’t do something to avoid this.

Isabella: Juan, when are you coming home? I know you must be extremely tired. I’m certain that we will get this resolved. Please come home.

Juan: I am going to stay a little longer. I’ll be home in a little while.

THE COMPANY’S HISTORY

Juan remembered how he and four other physical therapists had started the original company in 1994. It was a very exciting time, and everyone was thinking about the company’s potential. The five physical therapists decided to name the company Miami Rehabilitation Services (MRS). The company was located in Miami, Florida and began in one office with five owners. During the next eight years, MRS grew steadily as the demand for physical therapy had grown. Juan reflected on all the conversations he had with his business partners about other healthcare providers that had been covered by the local press when they encountered difficulty and even fraud. Juan felt strongly that one reason why MRS had a good reputation was the way they treated their patients. MRS had also developed a good reputation among insurance companies, HMOs, and local attorneys who referred patients from motor vehicle accidents, personal injury cases, and workers’ compensation cases. Juan thought for a moment about these third party payers. During 2008, third party payers represented about 90 percent of Miami’s annual revenues of nearly $1 million. These were the good times Juan was remembering. From 1994 until 2002, Juan and his partners expanded the business to seven locations. Juan even remembered all the attorney meetings when they separated the business into three corporations. The business had gotten so large he and his partners wanted to limit their liability.

In 2002, Juan and his partners took advantage of an opportunity to sell their business to the U. S. subsidiary of a publicly owned Canadian health care company called Canada Health. The opportunity provided the partners with cash from the sale, and it also allowed the partners to continue their physical therapy activity. For his part, Juan agreed to manage the Miami operations as a regional vice president. To take advantage of their brand recognition, the name of the business was maintained as Miami Rehabilitation Services.
Canada Health owned and operated numerous nursing homes, assisted living centers, and other health care providers in the United States and Canada. In 2005, Canada Health began to experience losses in the United States. Its difficulty had stemmed from operational problems, Medicare and Medicaid reimbursement declines, and liability issues. Juan could definitely relate. At that point, Juan and one of his partners were able to repurchase the business. Juan bought two locations and Don Smith bought one location. They closed the remaining locations. This time, each individual purchased their locations separately. However, they again retained the trade name, Miami Rehabilitation Services.

Juan turned his thoughts to how problems were always arising in the billing and collection side of the business. These problems were the reason he and Don decided to establish a separate company to handle these functions. As he thought back on it, he remembered the frustration that he had experienced each year as the third party payers had reduced reimbursement for physical therapy services while at the same time the claims filing process continued to become more complicated. Estimating revenues became harder and harder. Juan and Don decided that they would create a separate billing company to handle the reimbursement for their three clinics. They had named it MS Billing (MSB). The ownership was fifty-fifty. Juan remembered how he thought MSB would be able to focus more closely on collections and reimbursement with the third party payers. Later in 2007, Juan closed one of his two locations. MSB’s office was then located within walking distance to Juan's remaining MRS location.

**THE NEW EMPLOYEE AND THE DISCOVERY**

Juan started to think about how Canada Health had run into trouble and several of the recent bankruptcies of healthcare providers that he had heard about from his physician friends. Juan felt he was now in a similar position. For Juan, the big issue was survival in a business where the healthcare provider was being squeezed out by the third party payers. By 2007, payments from the third party payers represented nearly all of the company’s revenue. Juan had not been feeling good about the payment percentages they were receiving from these third parties, but he had to accept it. It seemed that the percentages were very inconsistent. In September 2009, he hired a new employee to work part-time as a second accounts receivable coordinator. After a few weeks on the job, Angelita López approached Juan because something didn’t seem right.
Angelita: Juan, I offered to pick up the mail and receipts from the two physical therapy clinics, but Helen said it was on her way home and she liked doing it. She seemed adamant that she would do it.

Juan: That is kind of interesting. Helen has always been a good employee and I am sure she is just trying to be helpful. However, if I recall that job was assigned to María Vega, my office manager.

Juan was wondering why he didn’t act quicker when approached with his new employee’s concern. Although he and Angelita started to look at the books and records after business hours, he wasn’t able to put his finger on the problem. Juan spoke with Angelita a week later.

Juan: What you are starting to find kind of scares me. Business has been really tough these past few years and I seem to have been spending less and less time managing the operations of the clinic and more and more time seeing patients. It seemed that things in the office were going so smoothly so I didn’t get involved.

Angelita: I am not sure yet what I have found, but if you give me a little time, I am happy to continue to investigate.

Juan: Yes, I think that would be good, but at this point, let’s keep the investigation between us.

They had looked at the bank statements together, and there was a lot of inconsistency. Some of the deposit slips were incomplete, and some were missing signatures. Together, they totaled some of the slips, and compared the bank copies with the office copies. They quickly noticed that the totals did not match. (See Exhibit 1). By quickly analyzing the difference between the two deposit slips in just this one case he started to get nervous. A quick comparison showed him just how bad this might be. (See Exhibit 2). Juan started to realize that there was very little control over the deposit slip books. The deposit slips were not sequentially numbered, and that was making it difficult to verify the deposit activity. Based on their efforts, Juan concluded that at least $1,400 had been stolen. Juan was really angry with himself. He simply could not understand how the deposits could have been wrong and why the office manager had not made the discovery. How was his newest employee able to develop this suspicion when he had practically been clueless? (Please see Exhibits 1 and 2).
HELEN, THE ACCOUNTS RECEIVABLE COORDINATOR

Helen Fagan was MRS’s primary accounts receivable coordinator. Juan recollected that Helen was an employee that he and his partner had essentially inherited from one of their previous partners. She had worked for the organization since 1997. Except for one earlier period, around 2002, just after they split the practices, Juan remembered that Helen had complained to her co-workers about being underpaid so he met with her and discussed the situation.

Juan: Helen, what is going on here? I have heard you complaining about your pay to others in the office. We discussed your compensation after the organization’s split and you decided to stay with me. I felt that your compensation level was appropriate. You have always been a satisfactory employee, but your pay is what it is and talking with others isn’t going to raise it.

Helen: I know this was wrong, I really enjoy working here, but things have been pretty tight at home with medical expenses you know.

Juan: I know that things are tough, they are for all of us, but if I hear you complaining again about your pay at work I will fire you on the spot. Are we clear?

Helen: Yes, Juan I am really sorry. I really need this job, it will not happen again.

Helen got the message and stopped. It was at this point that Juan remembered that $600 was stolen from the business in 2003. Juan had no idea who had committed the theft. However, there was one woman who was suspected. She quit the company because the suspicions were widely known. Juan recalled how this woman said, “You all are crazy for thinking that I stole that $600.” The scene created quite a commotion. Unfortunately, her resignation ended the inquiry.

Then there were the previous rumors about Helen’s husband having a substance abuse problem. Her husband was a painter. Juan also recalled that money was always an issue. Helen and her husband had three children. He thought about all her comments related to the oldest child’s learning problems. She often spoke about his hyperactive behavior, and how they had tried several different schools. The second child had juvenile diabetes. He thought again about the time that he had confronted her about her complaining. Juan always imagined how difficult that must have been. There were many occasions when Helen had to take time from work for the child’s doctor visits. Juan thought about other things like the fact that Helen, her husband, and their children lived with Helen’s parents. She drove an old car, and she was always having
money problems. She never seemed to be wearing any new clothes. This was despite the fact that he and his partner had paid periodic bonuses to their employees for obtaining certain business goals. After he talked to her in 2002 Helen’s attitude had improved and she received the bonuses when they were given out. If Helen had stolen the money, he could not figure out what she had done with it. He had never noticed any changes in Helen that would have tipped him to the fact that she was stealing money. It just did not make sense that she could have been the perpetrator.

For a moment, Juan considered the tasks that he knew Helen did on a daily basis. He was aware that she collected the mail from the post office box, she opened the mail, and she collected the patients’ co-payments from the two physical therapy clinics. Helen also posted the payments into the patient account computer software system. He knew that these payments included both cash and checks. He also knew that she totaled the payments received from the clinics and through the mail, and he knew that she completed the bank deposit slips and prepared the deposit. Helen made the bank deposits twice weekly on her way home.

Juan began to wonder why the office manager wasn’t checking Helen’s work. He knew that this is not the way he had designed Helen’s job. She was doing practically everything. He was disappointed that he had never really followed that question closer. This was his business, why had he become so removed from the financial operations? Honestly, as the reimbursements got tight, he had to let a therapist go, and after all he had hired people that he thought he could trust. He knew that he had placed too much trust in his staff. Juan and his wife Isabella had strong values, and Juan expected that everyone operated with the same set of values. That was not looking to be the case.

Juan also recalled how the daily front desk logs listed patient and payment information. He knew that the front desk receptionist was supposed to tally the log amounts at the end of each day. The logs included whether the patient payments were cash, check, or credit card. Copies of patient receipts were attached to the logs. In retrospect he remembered several occasions when Helen tallied the log amounts instead of the receptionist. He knew he should have questioned that activity at the time; however, he failed to do so. Her involvement in the tallying activity was again contrary to the policy that he and his partner at MSB, Don, had established.

Helen also printed two computer reports daily that listed the payments received by mail and payments received at the clinics. These reports were supposed to be used to verify that all
payments had been posted and deposited. He did not recall any discussion on the office manager’s part about those reports being reviewed. Furthermore, when he and Angelita had tried to determine the amount of the theft, the reports were not found. In addition to these reports, Helen also made and received collection calls from patients. On a monthly basis, Helen would prepare a “write-off” list, and Juan would review the list. Occasionally, Juan would ask that an account be referred for collection. Beyond that, Juan didn’t recall any further involvement on his or the office manager’s part. Where was his office manager when all of this was happening? Was she just a bad supervisor, or was she involved? 

Juan never thought that something might have been wrong when Isabella, Juan’s wife, complained bitterly about the waste of the time it had been for her to sit with Helen and learn her job. Isabella had volunteered to substitute for Helen during the upcoming birth of her baby. Juan reluctantly recalled his wife’s displeasure with Helen and his unwillingness to act:

**Isabella:** I am really getting tired of Helen’s attitude. I really wanted to help when she had the baby. A mother needs to spend time with a newborn. Instead she is bound and determined to immediately return to work. Doesn’t she get any time off to have a baby?

**Juan:** Yes, she has accrued sick leave but she has always refused to take it.

**Isabella:** I asked her numerous times to explain her job to me, but each time she had an excuse. She has never taught me anything about her job. Helen will not let anyone into her world.

**Juan:** I don’t understand what the big deal is. She is not planning on being gone more than a day or two.

Juan also remembered the fact that Helen had not relinquished the post office box key despite the fact that she had been asked several times. He even thought about all the times he walked past Helen’s desk and repeatedly noticed uncashed checks. He could not understand in his mind how he had come to accept that as common practice. He was beginning to get angry with himself. He got even more upset when he realized that he had noticed Helen making mistakes recently. Then, he was unable to remember her asking for any vacation time, EVER.

Suddenly, it hit Juan like a load of bricks. He recalled a discussion with his friend, Will, who had bought a business in Tampa.

**Will:** You remember when I bought the restaurant; I decided to keep all of the employees that were there. Some of them, including waitresses had been there
over 15 years. I figured things were good and the business valuation had come in like I expected.

Juan: Yeah, so what’s your point?

Will: Well I did not do any background screening on the employee that had been doing all of the bookkeeping and payroll. It turns out that she had a criminal record, had been stealing from the previous owner and just carried this on when I took over the business. How was I supposed to know?

Juan: Oh my, so what happened?

Will: Well, the employee messed up her plan when she got pregnant and was planning on a single day of leave. Unfortunately for her that day happened to be payroll day, and a substitute employee discovered that “wonderful bookkeeper” had been embezzling money all along.

Juan was kicking himself for not putting two and two together earlier. The similarities were startling. The pregnancy, Helen’s unwillingness to let anyone into her world, and her refusal to relinquish the post office box key were all creating a sinking feeling in Juan’s stomach. Over and over and over, he kept reflecting on how angry Isabella had been after trying to train with Helen.

MARIA, THE OFFICE MANAGER

María Vega had worked for Juan and Don for approximately seven years prior to her leaving in 2002. She was rehired as the office manager for MSB in 2005. María was responsible for managing the office staff and maintaining the control environment. She was also responsible for handling Medicare and workers’ compensation accounts, reconciling bank statements, and entering information into the accounting system. Although María did check the copies of bank deposit slips against the bank statement amounts, she didn’t compare the bank deposit slip copies to the office copies. Had she completed this step, she would have discovered the theft.

In Juan’s mind, Helen was clearly involved with the missing $1,400. He was trying to determine if María was involved. He simply couldn’t understand why María had not discovered the theft. He reflected on policies that he and his partner had established long ago. He realized that so many of those polices hadn’t been followed in years. Juan never had any kind of performance review system in place. This might have contributed to why policies hadn’t been followed. Also, Helen always seemed to volunteer for additional responsibility, particularly
when money was involved. Was it possible that María and Helen had acted together to steal the money? At this point, it seemed like a distinct possibility.

**BUSINESS DECISIONS**

It was close to midnight, and Juan was tired and frustrated. He called Isabella again and explained,

Juan: I want to stay at the office a little longer to work through this problem.

Isabella: Juan, don’t you remember how upset I was about the time when I tried to train with Helen….? Juan, everything is going to be okay. Do you want me to come to the office?

Juan: No, I need to sort this out myself.

After the call, Juan reflected on some of the decisions his partner, Don, and he had made in the early days of the billing company’s establishment. Juan recalled one of the first decisions they made was to purchase the software to perform the patient billing function. There were so many vendors and programs to select from. Juan considered himself better suited to handle the clinical side of the business. He was also very comfortable making personnel decisions. His previous partners, including Don, were self-proclaimed business experts. At one point, Juan remembered how his previous partners would micro-manage expenses particularly when an equipment purchase was being considered. The partners rationalized this approach by the belief that they didn’t want to spend money on anything they or their staff could do. Juan remembered that this was the primary reason why Don persuaded Juan not to purchase the available report generation features offered by Health Payment Computer Services. These features included reports that separated patient payments from third party payments. The features also separated the payments by cash, check, and credit card. Juan now realized that if he had purchased these software features, it would have been much easier to determine an estimate of the missing money. At this point, his system only showed historic billings and payments.

When María reviewed and reconciled the monthly bank statements, she would pass them along to the CPA. Juan seldom ever looked at the bank statements. Juan also recalled that he and Don had consulted with their CPA about the software. The CPA, who provided tax preparation and bookkeeping services as well as preparing monthly financial statements, did not seem all that engaged in helping to decide on the new software.
Juan: Don and I are considering buying some new software that has a number of different flavors. I am not really sure what features we should be looking at.

CPA: I know. This stuff is even confusing to me. The only thing I really want you to pay attention to is how the G/L relates to the tax module. You know right now my staff and I have to do a lot of data entry and we would rather not because your system is not compatible with ours.

Juan: The vendor has lots of options including one that will allow us to better track revenues by payor type. They have even offered to come by and make a presentation for us. Are you interested in attending?

CPA: Like I said that stuff is all really great for complex businesses. Your business is pretty simple. My recommendation is just make sure that they include a download module so that I can complete the tax filing.

Reflecting back Juan wondered why the CPA had never offered to provide other services. Perhaps there might have been something she could have offered that would have prevented the theft. At least he might have been able to better understand what had been stolen. Juan thought about comments from his neighbor, an accounting professor at a nearby university. The neighbor had mentioned from time to time how CPA firms had diversified their businesses and offered many types of consulting services specifically for small businesses, but since his CPA seemed content to prepare the basic financial statement, quarterly tax filings and the annual tax return, he figured there was no need to spend any extra money.

Juan remembered when he suggested the purchase of a credit card processing machine to his partner. Don objected because of the $500 price. María also objected. Don claimed they would never be able to recover that investment; however, his presumption was wrong. They found that more and more customers preferred to pay with credit cards, and the two found it necessary to buy a second machine. Juan realized that the credit card machine certainly must have reduced the amount of the theft. The arrangement with the credit card machine provider caused the credit card amounts to be deposited directly to the companies’ bank accounts.

For a moment, Juan thought about why he and his partners never completed any background verification of their employees. He realized that Helen and María had both been employed prior to Canada Health’s ownership; however, he and Don had never discussed doing a background check. He remembered some radio advertisements for local firms that completed
those types of checks. He wondered if a check would have uncovered any unfavorable information. Perhaps they should have paid better attention to all current employees.

THE DAY’S EVENTS

At that point, Juan reflected on the day’s beginning. The day had started with the packing of all the evidence in boxes and placing the boxes on Helen’s desk. Juan and Isabella were in the office early waiting for the police, Helen, and María to arrive. They were prepared for the confrontation. Helen arrived and unsuccessfully tried her door key. Juan had changed the locks the previous evening. She had brought her new born baby to work that day, and she questioned why her key didn’t work. After Juan let her in, Helen went in and out several times to ensure she had everything the baby needed. Helen noticed all the boxes on her desk and questioned Juan about them. He replied, “We are going to have to talk about that.”

María arrived next, and she was suspicious immediately. Isabella was seldom at the office in the morning. María also noticed the boxes. Then two police officers arrived. One officer took Juan, Isabella, and Helen into one office. Juan was amazed how Helen maintained the straightest face during some very intense questioning by the officer. It was as if she had been in this position before. The other officer questioned María, and the officer determined that María was negligent in her oversight but not involved in the theft. After several hours of questioning, the police officers told Juan and Isabella that they didn’t have anything concrete and were unable to make an arrest. María was feeling appropriately guilty, and she was blowing off steam. Helen went home.

THE NEXT STEP

By now, it was as if Juan had been in a terrifying daydream for several hours. He was exhausted. He left the office and arrived home fifteen minutes later. Isabella was waiting and once again offered her support. She wanted to know what they were going to do. Juan said they would talk about it in the morning. They could survive a loss of $1,400 if that was all it was, but what if it was more, how much more?
Discussion Questions

1. Like fuel, air, and heat come together to make fire, the likelihood of fraud increases when the three elements of the fraud triangle come together. Analyze how the three elements of the fraud triangle are important and how all three elements were present in Helen’s case.

2. In 2006, The Committee of Sponsoring Organizations (COSO) published a small company version of their 1992 Internal Control – Integrated Framework model to help small public companies improve their internal control systems. The basis for this model is that internal control is composed of five interrelated components. Control activities represent one of the five components. Define control activities and discuss at least two control activities and their application or lack of application in MRS and MSB’s case.

3. Two other components of COSO’s model are the control environment and monitoring. Name and describe at least three recommendations that you would make regarding these two components.

4. Brainstorm about the red flags that Juan and Maria missed during the commission of this financial fraud. Describe how you would go about conducting a forensic audit of Juan’s records.

5. With regard to segregation of duties, what recommendations would you make to Juan and his partner to improve this control activity?

6. Analyze how the accounting system is both a preventive and detective control.

The solution to these questions can be obtained from the authors.
Exhibit 1: Deposit Slips

Bank Copy

Office Copy
### Exhibit 2: Deposit Reconciliation

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