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U.S. DISTRICT COURT
N.D. OF ALABAMA

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF ALABAMA

SOUTHERN DIVISION

CR-03-J-0183-S

UNITED STATES OF AMERICA	)
	)
v.	)
	)
ANGELA C. AYERS	)
CATHY C. EDWARDS	)
REBECCA KAY MORGAN	)
VIRGINIA B. VALENTINE	)

INFORMATION

The United States Attorney charges, that at all times material to this Information:

COUNT ONE
Conspiracy to Commit Wire Fraud, Securities Fraud and False Books and Records
Title 18, United States Code, Section 371

INTRODUCTION

1. Defendant **ANGELA C. AYERS** was employed at HealthSouth Corporation. ("HealthSouth") since 1994 in various capacities in the accounting department. In 2002, he was promoted to the position of Vice President. Defendant **CATHY EDWARDS** was employed at HealthSouth since 1993 in various capacities in the accounting department. In 2001, she was promoted to Vice President. Defendant **REBECCA KAY MORGAN** was employed at HealthSouth since 1987 in various capacities in the accounting department. Around 1999, she was promoted to Group Vice President. Defendant **VIRGINIA B. VALENTINE** was employed at HealthSouth since 1995 in various capacities in the accounting department. In 2000, she was

promoted to Assistant Vice President.

2. HealthSouth was a corporation organized under the laws of the State of Delaware with its headquarters in Birmingham, Alabama. HealthSouth claimed to be the nation's largest provider of outpatient surgery, diagnostic imaging and rehabilitative healthcare services with approximately 1800 locations in all 50 states, Puerto Rico, the United Kingdom, Australia, and Canada. HealthSouth's common stock was listed on the New York Stock Exchange.

3. HealthSouth was an issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934 ("the Act"). To sell securities to members of the public and maintain public trading of its securities in the United States, HealthSouth was required to comply with the provisions of the federal securities laws, including Section 13(a) of the Act (Title 15, United States Code, Sections 78m(a) and 78o(d)) and the regulations promulgated thereunder, that were designed to ensure that the company's financial information was accurately recorded and disclosed to the public.

4. Under provisions of the federal securities laws and the regulations promulgated thereunder, HealthSouth was required to, among other things: (a) File with the SEC annual financial statements audited by an independent accountant; (b) file with the SEC quarterly updates of its financial statements that disclosed its financial condition and the results of its business operations for each three-month period; (c) make and keep books, records, and accounts that accurately and fairly reflected the transactions and dispositions of the company's assets; and (d) devise and maintain a system of internal accounting controls sufficient to provide – (i) reasonable assurances that the company's transactions were recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles

("GAAP") and other criteria applicable to such statements and to maintain the accountability of assets; and (ii) reasonable assurances that the recorded accountability for assets was compared with the existing assets at reasonable intervals and appropriate action was taken with respect to any differences.

5. From 1986, when HealthSouth issued its initial public offering, it filed quarterly reports, called Forms 10-Q, and annual reports, called Forms 10-K, with the United States Securities and Exchange Commission ("SEC"), which is located in Washington, D.C. These reports were transmitted directly and indirectly from HealthSouth's offices in Birmingham, Alabama to the offices of RCI Group, Inc. in Washington, D.C., a filing agent that assists companies in electronically filing periodic reports with the SEC, and were thereafter transmitted electronically to and filed electronically with the SEC, where they were available to the investing public.

CERTAIN RELEVANT ACCOUNTING PRINCIPLES

6. Public companies, such as HealthSouth, typically report the financial results of their operations in financial statements that include both an Income Statement and a Balance Sheet. A company's Income Statement reports, among other things, revenue recognized, expenses incurred, and income earned during a stated period of time – usually for a fiscal quarter or fiscal year. Within an Income Statement, expenses are generally subtracted from revenues to calculate net income. A company's Balance Sheet reports, among other things, the assets and liabilities of a company at a point in time, usually at the end of a fiscal quarter or the end of a fiscal year.

7. In preparing and maintaining the company's books and records, HealthSouth's accounting staff employed certain accounting principles and financial statement line items specific to healthcare services providers. One such Income Statement line item was "contractual adjustments." The contractual adjustments account is a revenue allowance account that estimates the difference between the gross amount charged to the patient and the amount that various healthcare insurers will pay for a specific treatment. HealthSouth deducted this amount from gross revenues to derive net revenues, which were reported on HealthSouth's periodic reports filed with the SEC. Since GAAP generally require that any increase in revenue or decrease in expenses be matched with either an increase in assets or decrease in liabilities on the Balance Sheet, any manipulation of the contractual adjustment account resulting in an increase in revenues would require a corresponding entry on the Balance Sheet.

HEALTHSOUTH'S COMMUNICATIONS WITH INVESTORS

8. The management of many public companies, including HealthSouth, provided "guidance" to the investing public regarding anticipated earnings per share for upcoming reporting periods. Relying in part on a company's "guidance," many professional securities analysts then disseminated to the public their own estimates of the company's expected performance. These "earnings estimates" or "analyst expectations" were closely followed by investors. Often, if a company announces earnings that fail to either meet or exceed analyst expectations, the price of the company's securities will decline.

9. Numerous analysts of major Wall Street investment firms followed HealthSouth's performance and issued "guidance" estimates regarding its expected earnings. These analysts considered, among other things, HealthSouth management's "guidance" concerning estimated

revenue, income and earnings per share, to gauge HealthSouth's performance, financial condition, and to predict HealthSouth's expected earnings. Similarly, market participants and members of the investing public considered and relied upon HealthSouth's periodic financial statements, including the reports filed with the SEC, and guidance, concerning actual operating results.

HEALTHSOUTH'S EARNINGS SHORTFALLS

10. A group of HealthSouth's senior officers, which included the then Chief Executive Officer (the "CEO"), and officers who would become the Chief Operating Officer (the "COO"), the Chief Financial Officer (CFO), and others, recognized that HealthSouth's financial results were failing to produce sufficient earnings per share to meet or exceed Wall Street "earning expectations" or "analyst expectations." The difference between HealthSouth's true and correct earnings per share and the Wall Street expectations was referred to internally at HealthSouth as the "gap" or "hole." The senior officers and others recognized that the earnings shortfall created a substantial risk that, unless HealthSouth's earnings per share were artificially inflated, HealthSouth's earnings would fail to meet analyst expectations and the market price of HealthSouth's securities would likely decline.

THE CONSPIRACY

11. Senior officers of HealthSouth, including William T. Owens, Weston L. Smith, and Emery Harris, formed and took part in a conspiracy to violate the laws of the United States, that is a conspiracy to:

(a) devise and attempt to devise a scheme and artifice to defraud and to obtain money and property by means of material false and fraudulent pretenses, representations and promises, and to knowingly transmit and cause to be transmitted, by means of wire communication, in interstate and foreign commerce, writings, signs, signals and sounds

for the purpose of executing such scheme and artifice in violation of Title 18, United States Code, Section 1343;

(b) willfully and knowingly make and cause to be made false and misleading statements of material fact in applications, reports and documents required to be filed under the Securities and Exchange Act of 1934 and the rules and regulations thereunder in violation of Title 15, United States Code, Sections 78m(a) and 78ff and Title 17, Code of Federal Regulations, Sections 240.13a-1; 13a-13 and 13b2-2; and

(c) willfully and knowingly falsify books, records and accounts of HealthSouth in violation of Title 15, United States Code, Sections 78m(b) (2) (A) & (B), 78m(b) (5) and 78ff and Title 17, Code of Federal Regulations, Section 240.13b2-1.

Between in or about 1994 and in or about 2003, within Jefferson County in the Northern District of Alabama and elsewhere, the defendants,

ANGELA C. AYERS,
CATHY C. EDWARDS,
REBECCA KAY MORGAN,
and
VIRGINIA B. VALENTINE,

knowingly and willfully joined and became members of the aforesaid conspiracy.

THE MANNER AND MEANS OF THE CONSPIRACY

12. It was part of the conspiracy that Owens, Smith, Harris, the defendants, and others would and did engage in a scheme to artificially inflate HealthSouth's publicly reported earnings and the value of its assets.

13. It was further a part of the conspiracy that Owens, Smith, Harris and others would and did provide HealthSouth's CEO with monthly and quarterly preliminary reports showing HealthSouth's true and actual financial results.

14. It was further part of the conspiracy that after reviewing the preliminary reports on HealthSouth's actual monthly and quarterly earnings numbers, Owens, Smith, Harris, and

others would and did direct that HealthSouth's accounting staff find ways to ensure that HealthSouth's earnings per share number met or exceeded Wall Street analyst expectations.

15. It was further part of the conspiracy that members of HealthSouth's accounting staff would and did meet to discuss ways to inflate artificially HealthSouth's earnings in order to meet the Wall Street earnings expectations. These meetings were known as "family" meetings and the attendees were known as the "family." At the meetings the "family" members discussed how members of the accounting staff would falsify HealthSouth's books to fill the "gap" or "hole" and meet the desired earnings. The fraudulent postings used to fill the "gap" or "hole" were referred to as the "dirt."

16. It was further part of the conspiracy that Owens, Smith, Harris, and others would and did direct one or more of the defendants, also members of the accounting staff, to make false entries in HealthSouth's books and records for the purpose of artificially inflating HealthSouth's revenue and earnings. It was further a part of the conspiracy that one or more of the defendants would and did do so.

17. It was further a part of the conspiracy that Owens, Smith, Harris, and others, would and did direct one or more of the defendants to make corresponding false entries to be made in HealthSouth's books and records for the purpose of artificially inflating the value of its assets, including, but not limited to, false entries made to (a) Property, Plant and Equipment ("PP&E") accounts; (b) cash accounts; (c) inventory accounts; and (d) intangible asset (goodwill) accounts. It was further a part of the conspiracy that one or more of the defendants would and did do so.

18. It was further a part of the conspiracy that Owens, Smith, Harris, the defendants

and others would and did know that these entries would and did materially inflate HealthSouth's revenue, and earnings per share, reported to the SEC and the public as described above, and would and did materially inflate the value of the assets of HealthSouth reported to the SEC and the public as described above.

19. It was further a part of the conspiracy that when events required that financial records and reports related to units of HealthSouth, were called for by auditors, purchasers, and others, Owens, Smith, Harris and others would and did direct one or more of the defendants to generate records and reports that would and did back out the false entries. It was further a part of the conspiracy that one or more of the defendants would and did do so.

20. It was further a part of the conspiracy that at the directions of Owens and Smith, one or more of the defendants would and did, for the purpose of deceiving auditors, manufacture false documents for the purpose of supporting false record entries.

21. It was further a part of the conspiracy that one or more of the defendants would and did change codes on accounts to deceive auditors.

OVERT ACTS

22. In furtherance of the conspiracy and to achieve the objects thereof, the conspirators committed and caused to be committed the following acts, among others, in the Northern District of Alabama and elsewhere:

(a) In or about the third week after the last month of each fiscal quarter, from around 1999 through 2002, the defendant AYERS, at the direction of Harris and others, made and caused to be made, false entries into the asset accounts and contractual allowance accounts of HealthSouth, each of which constituted a separate overt act.

(b) In or about the third week after the last month of each fiscal quarter, from 2001 through mid-2002, the defendant EDWARDS, at the direction of Harris and others, made and caused to be made false entries into the asset accounts of HealthSouth, each of which constituted a separate overt act.

(c) In or about the third week after the last month of each fiscal quarter, from 1999 through mid-2002, the defendant MORGAN, at the direction of Owens and others, made and caused to be made false entries in the cash accounts of HealthSouth, each of which constituted a separate overt act.

(d) In or about the third week after the last month of each fiscal quarter, from 1999 through mid-2002, the defendant VALENTINE, at the direction of Harris and others, made and caused to be made false entries in the contractual allowance accounts, and other accounts, of HealthSouth, each of which constituted a separate overt act.

(e) In or about forty-five days after the last month of each fiscal quarter between January 1997 and March 1, 2003, HealthSouth caused quarterly financial reports to be filed with the SEC, each filing constituting a separate overt act.

(f) In or about ninety days after the end of each year from 1997 through 2002, HealthSouth caused annual financial reports to be filed with the SEC, each filing constituting a separate overt act.

(h) On or about August 13, 2002, HealthSouth's 10-Q was transmitted by wire from Birmingham, Alabama to Washington, D.C.

(i) On or about November 13, 2002, a statement certifying that HealthSouth's 10-Q for the third quarter of 2002 fairly presented, in all material respects, the financial condition and

results of operations of HealthSouth was transmitted by wire from Birmingham, Alabama to Washington, D.C.

All in violation of Title 18, United States Code, Section 371.

COUNT TWO
Wire Fraud
Title 18, United States Code, Sections 2 and 1343

The United States Attorney re-alleges paragraphs 1 though 22 of Count One of this Information as though fully set out herein, and further charges:

1. Officers at HealthSouth devised a scheme to defraud as described in the foregoing paragraphs.

2. On or about November 13, 2001, in Jefferson County in the Northern District of Alabama, and elsewhere, the defendants,

CATHY EDWARDS
and
REBECCA KAY MORGAN,

being aware of the aforesaid scheme, did, for the purpose executing the same, knowingly and wilfully cause the wire transmission of HealthSouth's Form 10-Q for the third quarter of 2001 in interstate commerce, that is, from Birmingham, Alabama to Washington, D.C., for filing with the SEC.

All violation of Title 18, United States Code, Sections 1343 and 2.

COUNT THREE
Forfeiture
Title 18, United States Code, Section 981(a)(1)(C) &
Title 28, United States Code, Section 2461(c)

The United States Attorney further charges:

1. That Counts One and Two of this Information are incorporated by reference herein for the purpose of alleging criminal forfeiture pursuant to Title 18, United States Code, Section 981(a)(1)(C) and Title 28, United States Code, Section 2461(c).

2. As a result of the foregoing offenses alleged in Count One of this Information, the defendants,

ANGELA C. AYERS,
CATHY C. EDWARDS,
REBECCA KAY MORGAN,
and
VIRGINIA B. VALENTINE,

each shall forfeit to the United States any property constituting or derived from proceeds traceable to said violations committed by each defendant respectively. Such forfeitable interests include, but are not limited to, any and all interest and proceeds derived therefrom.

3. If any of the property described above as being subject to forfeiture pursuant to Title 18, United States Code, Section 981(a)(1)(C), and Title 28, United States Code, Section 2461(c), as a result of any act or omission of the defendant,

(1) cannot be located upon the exercise of due diligence;

(2) has been transferred to, sold to, or deposited with a third person;

(3) has been placed beyond the jurisdiction of the Court;

(4) has been substantially diminished in value; or

(5) has been commingled with other property that cannot be subdivided without difficulty;

it is the intent of the United States, pursuant to Title 21, United States Code, Section 853(p), to seek forfeiture of any other property of said defendant, up to the value of the above forfeitable property.

All pursuant to Title 18, United States Code, Section 981(a)(1)(C) and Title 28, United States Code, Section 2461(c).

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