

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, 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:

Year	Amount
2005	\$550,000
2006	575,000
2007	610,000
2008	620,000
2009	630,000

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

Assets

Cash	\$10,000
Automobile	50,000
Personal Property	60,000
Boat	100,000
Collectables	350,000
House	600,000
Pension	210,000
Interest in Professional Corporation	<u>1,200,000</u>

Total Assets \$2,580,000

Liabilities

Automobile Loan	\$25,000
Home Mortgage	400,000
Pension Loan	<u>15,000</u>

Total Liabilities \$440,000

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:

Expected Net Worth =

$$\frac{(\text{Age} - 10 \text{ years}) \times \text{Current Yearly Pretax Household Income}}{10}$$

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

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

Dr. Sterling is hoping to replace the income that he earns as a surgeon. In 2009, he reported \$630,000 income from his medical practice. He is stating that he can no longer work in his chosen occupation, as a surgeon, because of debilitating depression.

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.

The Personal Statement reveals several unusual accounts, amounts and patterns. The net worth of \$2,140,000 may be high for an average family, but, for a high-earning family, this net worth seems somewhat low.

Several asset amounts appear low. The Cash balance of \$10,000 seems low. The House, listed at \$600,000, may not be as fancy as one would expect. The Pension of \$210,000 seems too small for someone who has been a surgeon for many years. The Interest in Professional Corporation, by far the largest asset at \$1,200,000, is most likely the investment that Dr. Sterling has in his clinic business. Initially, it is difficult to say if this asset is too small or too large.

On the liability side, all of the amounts seem unusually high or strange. The Automobile Loan of \$25,000 is unusual, in that a high-earning professional should be able to pay cash for a car, or pay off a car loan quickly. The Home Mortgage of \$400,000 is 2/3 of the home's value of \$600,000. One would think that Dr. Sterling could have paid off more of this debt. The Pension Loan of \$15,000 is also troubling, in that a high-income person should not need to borrow against the pension.

The assets are smaller than expected and the liabilities are larger than expected. Therefore, net worth is smaller than expected. Dr. Sterling and his family have not increased their assets and decreased their liabilities as much as would be expected.

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

It is possible to suggest that all the accounts could be investigated. Here is a list of the accounts with comments on each:

Cash, balance of \$10,000: The balance seems low for a high-income family. The family should have more cash, on hand, or in the bank in checking and savings accounts, or in money market funds.

Automobile, balance of \$50,000: This balance seems reasonable, for one automobile. A surgeon would be expected to drive a nice car.

Personal Property, balance of \$60,000: This balance seems low. This account probably includes furniture, fixtures, clothing and personal effects. This family should be able to afford expensive furniture and nice clothing.

Boat, balance of \$100,000: This balance needs a careful look. The boat could be very nice. An appraisal may be suggested to establish the value.

Collectables, balance of \$350,000: This balance needs more explanation. Collectables could be a variety of objects, for instance, artwork, jewelry, glassware or guns. This is an account that could be easily overstated or understated. An appraisal may be suggested to establish the value.

House, balance of \$600,000: This balance seems low. A high-earning professional typically owns a more expensive and luxurious home than does Dr. Sterling.

Pension, balance of \$210,000: This balance seems low. Dr. Sterling has worked as a surgeon for many years and should have more invested in his pension.

Interest in Professional Corporation, balance of \$1,200,000: This balance needs a careful look. This account represents Dr. Sterling's interest in his business. This is an account that could be easily overstated or understated. An appraisal may be necessary to establish the value.

Automobile Loan, balance of \$25,000: This balance is too high. Dr. Sterling should be able to pay cash for a car, or pay off the car loan quickly.

Home Mortgage, balance of \$400,000: This balance is too high. Someone making as much money as Dr. Sterling should be able to pay off more of the home mortgage. The mortgage represents 2/3 of the value of the home.

Pension Loan, balance of \$15,000: This balance is too high. A person making as much money as does Dr. Sterling should not have to borrow against his pension.

Note to Instructors: Students will probably focus on just a few of the accounts. We recommend that instructors emphasize the general idea that assets seem somewhat low and liabilities seem somewhat high, resulting in a net worth that is lower than expected. Some points to start with could be the house, with its relatively low value and relatively high mortgage; the collectables, which are not described at all; and the auto loan and the pension loan, debt which should have been paid off easily. An important point is that there is a troubling pattern in the Personal Statement.

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?

The Personal Statement is missing some accounts that would be typical for a high-income family. Some of these accounts are:

Investments in Stocks and Bonds: Investments in stocks and bonds would be very common for a high-income family. Dr. Sterling should have been able to make some investments in stocks and bonds.

Another Car: The Personal Statement shows only one automobile. A high-income family usually would have two or three cars.

Investments in Other Real Estate: A high-income family often owns real estate in addition to their primary residence. The Sterlings did not report a vacation home, such as a condo in Florida or a chalet in Colorado, or land held for building a house in the future.

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.

Stated Value of the Home: \$600,000

Expected Value of the Home:

Take Home Pay (using the most recent salary amount, and computing the after-tax pay):
 $\$630,000 - (\$630,000 \times 40\%) = \$630,000 - 252,000 = \$378,000$

$\$378,000 \times 2 = \$756,000$

The Stated Value of the Home, \$600,000, is less than the Expected Value of the Home, \$756,000. The difference is \$156,000.

Dr. Sterling's house is not as expensive as expected.

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

Expected Net Worth =

$$\frac{(\text{Age} - 10 \text{ years}) \times \text{Current Yearly Pretax Household Income}}{10}$$

Stated Net Worth = \$2,140,000

$$\begin{aligned} \text{Expected Net Worth} &= \frac{(59 - 10) \times \$630,000}{10} = \frac{49 \times \$630,000}{10} = \frac{\$30,870,000}{10} \\ &= \$3,087,000 \end{aligned}$$

The Stated Net Worth, \$2,140,000, is less than the Expected Net Worth, \$3,087,000. The difference is \$947,000.

Dr. Sterling's net worth is not as high as expected.

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

See above.

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

I am concerned about Dr. Sterling and his disability insurance claim. His claim looks suspicious. At this time, I cannot say that his claim is fraudulent, as I do not have enough information to make that determination. However, I do see a troubling pattern. Dr. Sterling and his family have not accumulated the level of wealth that would be expected of a high-income family. As indicated in Questions 2, 3, 4, and 5, they have not built up their assets, say, with stocks and bonds, an expensive home, a second home, and a second car. They have not paid down their liabilities, and owe a sizable amount on the home mortgage, and smaller, but strange, amounts on their automobile and pension loans.

As an insurance investigator, I want to learn what Dr. Sterling is spending his money on. Apparently, he is not spending his money to build up his assets and pay down his debts. He claims that he is suffering from debilitating depression. This may be true. However, it is also possible that he is struggling with an addiction, and spending his money on gambling, drugs, or alcohol. Or, perhaps he wants a way out of his stressful, demanding career. Or, he might want a way to help pay for his retirement, since he has not saved much.

Assuming that I could continue my investigation, I want to figure out what Dr. Sterling is spending his money on. This will help me determine whether he is suffering from debilitating depression or trying to manage another problem.

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

Many sources of information would be useful in this case. Some of these sources of information are:

- *disability insurance policy*
- *tax returns for the family*
- *tax returns for the business*
- *W-2 tax forms showing wages*
- *bank statements*
- *credit card statements*
- *legal documents related to professional corporation*
- *appraisal report for the Sterlings' collectables*
- *appraisal report for the Sterlings' house*
- *appraisal report for Dr. Sterling's interest in professional corporation*
- *letter from physician treating Dr. Sterling for his depression*
- *interview with Dr. Sterling*
- *interview with Mrs. Sterling*
- *interviews with the children, Lauren and A. J.*
- *interviews with employees of the clinics*

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

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

Account # 1714 9600 4444 **Albert Sterling, MD** **VIP Platinum** **Since 2002**

Beginning Balance	\$45,100.00
-Payments	-\$27,800.00
+Purchases	\$31,300.00
+Finance Charge	<u>\$1,200.00</u>
=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
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Transactions

10-Jan-10	Java Joe Coffee Shop Chicago	\$	14.00
14-Jan-10	Boca Chica Restaurant Chicago		590.00
15-Jan-10	Brooks Brothers Evanston		3,699.00
18-Jan-10	Delta Airlines CHICA VEGAS FLTS 3489, 2378 FST CLS RT		2,100.00
20-Jan-10	Access Check #17 Cash		12,000.00
25-Jan-10	Mirage Hotel Las Vegas Deluxe Suite Jan 18-25		8,397.00
29-Jan-10	Continental Airlines RES—4 Flts 345, 458 First Class Rd Tr Atlantic City		4,500.00

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.

Exhibit 5: Appraisal Report for the Sterlings' Home

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.

	2009	2008	2007	2006	2005
Statement of Activities					
Revenue, gains and other support:					
Net medical service revenue	\$ 2,100,000	\$ 2,050,000	\$ 2,500,000	\$ 2,220,000	\$ 2,150,000
Investment returns allocated to current activities	(50,000)	(120,000)	100,000	50,000	48,000
Contributions available for current activities	15,000	20,000	40,000	38,000	35,000
Other	<u>81,000</u>	<u>80,000</u>	<u>110,000</u>	<u>105,000</u>	<u>95,000</u>
Total revenue, gains and other support	\$ 2,146,000	\$ 2,030,000	\$ 2,750,000	\$ 2,413,000	\$ 2,328,000
Expenses:					
Salaries and benefits	1,300,000	1,290,000	1,260,000	1,180,000	1,150,000
Supplies and facilities	470,000	450,000	510,000	480,000	450,000
Provision for uncollectible accounts	45,000	41,000	55,000	48,000	46,500
Finance and investment expenses	<u>12,000</u>	<u>12,000</u>	<u>18,000</u>	<u>16,000</u>	<u>15,500</u>
Total expenses	\$ 1,827,000	\$ 1,793,000	\$ 1,843,000	\$ 1,724,000	\$ 1,662,000
Income from current activities	\$ 319,000	\$ 237,000	\$ 907,000	\$ 689,000	\$ 666,000
Non-current and other items:					
Contributions not available for current activities, net	\$ 10,000	\$ 10,000	\$ 25,000	\$ 20,000	\$ 18,000
Unallocated investment returns, net	(125,000)	(300,000)	250,000	125,000	120,000
Pension and postretirement expenses	<u>(24,000)</u>	<u>(22,000)</u>	<u>(30,000)</u>	<u>(28,000)</u>	<u>(26,500)</u>
Total noncurrent and other items	\$ (139,000)	\$ (312,000)	\$ 245,000	\$ 117,000	\$ 111,500
Increase in net assets	<u>\$ 180,000</u>	<u>\$ (75,000)</u>	<u>\$ 1,152,000</u>	<u>\$ 806,000</u>	<u>\$ 777,500</u>

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

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

The additional information adds to my concern about the validity of the disability income claim. The Exhibits are addressed in order:

Exhibit 1: The disability income policy shows that Dr. Sterling would receive \$30,000 per month, or \$360,000 per year, if he were considered to be disabled. This annual support of \$360,000 would be less than his most recent earnings of \$630,000. However, he would still be able to finance a very nice lifestyle or fund other activities.

Exhibit 2: The credit card statement for January 2010 shows some large amounts. The beginning balance is \$45,100 and the ending balance is \$49,800. The payment is \$27,800, the purchases are \$31,300, and the finance charge is \$1,200. There is a large purchase, \$3,699, at Brooks Brothers, probably clothing. The expenditures related to Las Vegas are more interesting—the first-class round trip airline tickets for \$2,100 and the hotel suite for \$8,397. There are also first-class round trip airline tickets to Atlantic City for \$4,500. Both Las Vegas and Atlantic City are prime gambling spots. The item of most concern is the \$12,000 access check. This is a large amount of cash borrowed from the credit card company, Finance One Bank.

The information on this credit card statement suggests that Dr. Sterling likes to gamble. Also, the credit card balance is not shown as a liability on the Personal Statement. I would like to know why this balance was not included.

Exhibit 3: The amount for wages and salaries, \$630,000, in 2009, matches the amount provided by Dr. Sterling. The federal income tax withholding, \$189,000, is 30% of the wages, and the state tax withholding, \$63,000, is 10%. The GPIC file reports that the combined federal and state income tax rates are approximately 40%. The W-2 is consistent with the related information in the file.

Exhibit 4: The interview with Dolores Jones, office manager of the downtown Chicago clinic, gives insights into Dr. Sterling's behavior. She reports that he has been "somewhat moody lately," and that he snapped at the office staff and some patients. She thinks he is tired. She does not know his family well enough to say if there are issues at home.

Exhibit 5: The appraisal letter gives a value for the house of \$625,000. The stated value is \$600,000. The appraiser, Barbara Belle, mentions that the house has a small lot and lacks a swimming pool. The implication is that other houses in the neighborhood have larger lots and swimming pools, and this is consistent with the finding in Phase 1, that Dr. Sterling's house is not as expensive as could be expected. There is a difference of \$25,000 between the stated value and the appraised value. This difference may not indicate a problem, as home values change over time and with economic conditions. However, the current appraisal value of \$625,000 should be used in the Personal Statement.

Exhibit 6: The statements of activities for 2005-2009 are useful in understanding Dr. Sterling's business. The financial results are somewhat unstable. Usually, amounts on these statements grow in a small but steady way, with consistent relationships between accounts. Dr. Sterling's business shows significant fluctuations. For instance, net medical service revenue increased steadily from \$2,150,000 in 2005, to \$2,220,000 in 2006, and to \$2,500,000 in 2007. Then, there was a significant decrease to \$2,050,000 in 2008 and a slight increase to \$2,100,000 in 2009. A similar pattern can be seen in total revenue, gains and other support. In 2007, this amount was at its highest, with \$2,750,000, and in 2008, this amount was at its lowest, with \$2,030,000.

The income from current activities was highest, \$907,000, in 2007 and lowest, \$237,000, in 2008. There was even a decrease in net assets, \$75,000, in 2008.

The relationships between the accounts are inconsistent. For example, total expenses were 87% of total revenue, gains and other support in both 2009 and 2008, but 74% in 2007. This result primarily is the result of salaries and benefits, which increased over the years, even when revenues dropped or grew slowly.

The year, 2008, appeared to be difficult. The business experienced significant decreases in all revenue accounts, but not corresponding decreases in the expense accounts. Net assets decreased.

The unstable financial results are troubling. Perhaps the clinics are getting harder to manage. Perhaps Dr. Sterling needs to hire some additional surgeons so the business can grow. Or, maybe Dr. Sterling cannot keep up for some reason.

Overall Impression of the Exhibits: I had been concerned, from the analysis in Phase 1, that Dr. Sterling is spending a lot of money somewhere. The information from some of these Exhibits adds to my concern. I need to consider the possibility that Dr. Sterling has a gambling addiction. The credit card statement, Exhibit 2, shows large amounts spent on trips to gambling destinations, and a large cash advance, probably to spend in the casinos. The office manager, Dolores Jones, reports that Dr. Sterling has been moody and snappy with office staff and patients, in Exhibit 4. This behavior could be attributed to the stress over losing money while gambling. To be fair, this behavior could also be attributed to depression. The financial statements for the clinics, Exhibit 6, show an unusual pattern, in that revenues and income grew from 2005 to 2007, then dropped in 2008, and then recovered somewhat in 2009. Again, this pattern could suggest that Dr. Sterling is dealing with some sort of problem—depression, gambling, or both.

2. What should you do now?

My next step would be to get a letter, or, even better, an interview, with the physician who is treating Dr. Sterling for his depression. The disability income claim is based on Dr. Sterling's assertion that he can no longer work, due to debilitating depression. Therefore, it is very important to understand the nature and extent of the depression, and to document this understanding in the file.

I will also pursue other sorts of information. I will request tax returns for the family and the business, bank statements, and legal documents for the professional corporation, such as articles of incorporation and the corporate charter. I will require an appraisal of Dr. Sterling's interest in the professional corporation. A more general survey of a surgeon's salary in relation to his or her clinic's revenue may also be helpful in this case, in order to determine the reasonableness of Dr. Sterling's salary in recent years. I will also schedule interviews with Dr. Sterling's wife and children, and with several other employees in the clinics.

This additional information will allow me to better understand the financial, personal, and professional issues that Dr. Sterling is dealing with. It will help me determine the validity of his disability income claim—a determination that Dr. Sterling is unable to work due to debilitating depression, or that he wants this income for other reasons.

Conclusion

Students use various forensic accounting skills in this case. They assume the role of an insurance investigator who is determining the validity of a disability income claim from Dr. Albert Sterling, a high-income surgeon who claims to be suffering from depression. The focus of the investigation is to learn more about Dr. Sterling's spending habits. To make the case more realistic, students identify what additional evidence would be useful, and they can receive several more pieces of information. At the end of the case, there will not be a final determination on the claim, but students certainly will have suspicions about Dr. Sterling and his intention in submitting a disability income claim. He might be suffering from depression, but he also might be trying to manage a gambling problem.

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