

Case Study – Embezzlement at Sanchou College

- Internal Controls
- Embezzlement
- History of Nepotism
- Issues with
 - Asset Procurement
 - Asset Custody
 - Record Keeping Procedures
 - Cash Receipt Procedures



CE

Embezzlement at Sanchou College Discussion Questions



- Did the existing procedures related to assets and cash violate any of the internal control principles?
- How does the public bidding improve the effectiveness of asset procurement procedures?
- What internal control procedures would you recommend to remedy the control deficiencies related to tuition receipt and refund policy?
- How does the tone set by top management influence the effectiveness of internal controls?
- What changes would you make if you were the president of Sanchou?

Embezzlement at Sanchou College

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INTRODUCTION

“April 28, 2003. United Daily News. An employee at Sanchou College was caught stealing tuition refund money, the police authorities said. They did not release the name of the employee as the matter is under investigation. The suspect had been working in the Evening School Division of the school since 1998 and was responsible for tuition receipts and refunds. Apparently, the embezzlement was going on for several years. The incident came to light when the suspect requested a tuition refund on behalf of five students and an alert employee, who was helping him with the refund, noticed that he had seals of those five students, one of whom had died recently. She became suspicious and reported the matter to her supervisor who immediately called the police. The school has been under the supervision of the Ministry of Education for many years due to mismanagement and infighting among members of the school board.”

Dan Wu, the president of Sanchou, read the news over and over again as he was having his morning coffee. He had been informed the previous evening that police had been called on campus. Later in the day, he called an emergency staff meeting to discuss the embezzlement. “Why did it happen? How much money did he take?” Dan asked his staff. He wondered whether the Weekend School and the Short-term Programs Division had similar problems, and what accounting policies and internal control procedures should be put in place to prevent recurrence of such incidents in the future. At the end of meeting, he asked Fong Pam, the dean¹ of the Accounting Division, to investigate what led to the embezzlement and to determine how much money had been stolen.

Once the meeting was over, Dan reflected back on the history of the school.

A BRIEF HISTORY OF THE SCHOOL

Sanchou College, a nonprofit educational institution, was founded in 1971. It started as a five-year junior college with an enrollment of about a thousand students. The enrollment grew steadily over the next two decades (see Table 1). To meet the growing demand from non-traditional students, the college added evening, weekend, and short-term programs. In 2002, the Ministry of Education² approved Sanchou’s request to become a four-year college.

The board of Sanchou had nine members including the chairman, each with a six-year term. The board appointed a president who had the overall responsibility for the school. Most members of the board and the president came from the Shawn family. Ken Shawn was the founding president of Sanchou. After his death in 1982, his brother Wan Shawn became president. In 1991, when Wan was near retirement, he asked his niece, Sue Dong, to prepare to take over. Sue’s father had donated large sums of money to the school, and

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¹ In Taiwan, unlike the U.S., where only the head of a school or college is known as the dean, the heads of administrative departments also carry the title of dean.

² In Taiwan, the Ministry of Education sets the standards for accreditation. It also evaluates a school’s performance every three years for continuing accreditation. To move from one level to another, schools must reapply for accreditation. The Ministry also approves the tuition and fee structure and the appointment of members of the school board and, in certain cases, grants subsidies.

Table 1
Student Enrollment, Faculty and Staff, and Tuition Revenue

Academic Year	Students	Faculty and Staff	Revenue (TWD)
1995-96	5,252	269	\$312,438,132
1996-97	5,795	292	337,406,334
1997-98	6,350	302	363,513,838
1998-99	6,963	325	398,738,960
1999-00	7,329	321	405,820,878
2000-01	7,735	390	447,518,658
2001-02	8,388	437	488,417,844
2002-03	8,918	485	562,820,149

she had been the chairperson of the school board since 1988. However, under the rules of the Ministry of Education, she needed administrative experience before she could become president. To meet this requirement, she started to take an active role in the school administration. As her involvement in school affairs became deeper, she faced a barrage of problems:

1. Faculty and students were very dissatisfied with the service provided by the staff. Most of the staff was hired based on connections with the management and not on the basis of qualifications and experience.
2. Many assets such as computers, laboratory instruments, and furniture were moved from one department to another and, in some cases, were treated as personal belongings by the staff.
3. Wan pressured faculty to limit the number of failing grades to about fifteen percent of class size. Faculty who refused to comply found that some students had graduated despite receiving failing grades. There were rumors that some students bribed administrative staff and faculty to receive their diplomas.
4. School rules did not allow students to go off campus for lunch if they had classes in the afternoon. These students had to eat lunch at the school cafeteria. Similarly, students had to buy textbooks from the school bookstore. Profits from the cafeteria and bookstore went to the president's account even though the staff was on the school payroll.

In 1996, Sue surprised everyone by filing a lawsuit against Wan, the president, charging him with mismanagement of school funds and receiving kickbacks from publishers. The Ministry of Education stepped in and asked Wan to step down pending the outcome of the court case. The

school board appointed Suan Lin, a faculty member, as interim president. As a signal of reform, Suan formed an internal audit team consisting of faculty members from all departments. However, members of the audit team were not required to have knowledge of accounting.

Over the next few years, Sanchou underwent numerous personnel and administrative changes. Personnel changes were primarily aimed at removing people who were considered close to former president Wan Shawn, while administrative changes were made to address any perceived weaknesses in internal controls. Exhibit 1 summarizes the timeline of events and personnel changes. Following is a brief summary of these changes.

In 1996, Lien Song, the dean of the General Affairs Division and a Wan loyalist, was replaced by Ming Hu, a lecturer who was considered close to Sue Dong. However, Ming spent most of his time trying to uncover any evidence of wrongdoing or fraud and pressured staff to do the same. In 1998, amid rising complaints, Ming was removed from his post and was replaced by Ban Young.

In 1999, the Ministry of Education³ appointed Horn Shawn as chairman of the school board. Horn was a retired president of a public school. Sue remained on the board as a representative of the Shawn family. The school board appointed Wen Din (1998-99) and later Mar Hung (1999-2000) as interim presidents before hiring Dan Wu as president in 2001.

Beginning with Wen's presidency, students were allowed to buy textbooks from off-campus suppliers. Mar introduced Sanchou to ISO 9000 certification. Under ISO 9000, total quality management (TQM) self-assessment teams were formed so that administrative efficiency could be improved. The team members were heads of various divisions. However, most members, lacking any knowledge of accounting, were unwilling to assess the Accounting and Financial Services Divisions. Dan embarked on re-engineering administrative functions in order to improve their efficiency. He outsourced the running of the school cafeteria to outside contractors. All accounts related to the school cafeteria and bookstore were closed, and any remaining funds were transferred to the school account.

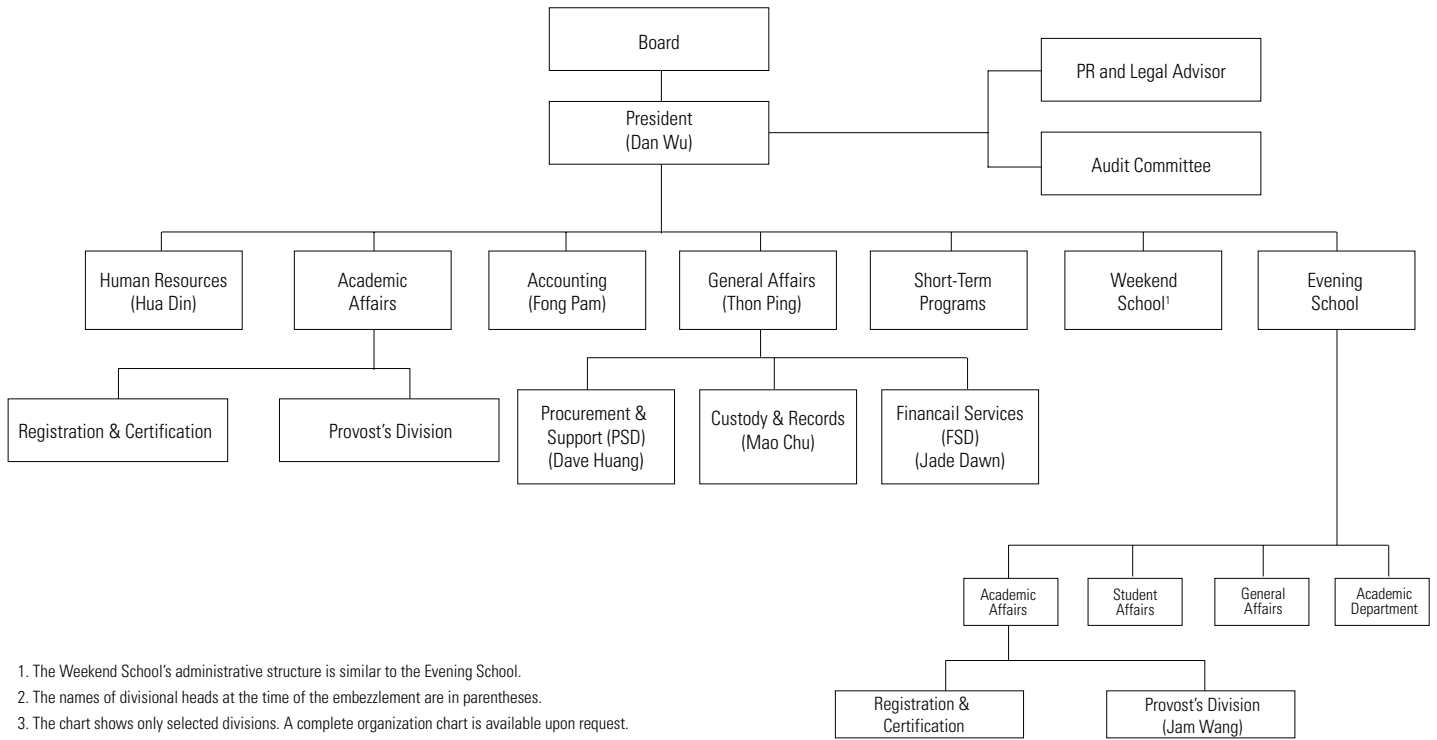
Figure 1 provides the (partial) administrative structure of the college as it existed in 2003. Exhibit 2 describes the responsibilities of selected divisions, the school board, and the Ministry of Education for the same time period.

³ When the lawsuit was filed, the Ministry of Education had also become involved in the appointment of board members. However, the Ministry let existing board members complete their terms.

Exhibit 1: Timeline of Events

Academic Year	Event(s)
1971-72	• Ken Shawn founded SanChou
1982-83	• The board appointed Wan Shawn as the president
1988-89	• The board elected Sue Dong as its chairperson
1996-97	• Sue Dong filed an embezzlement lawsuit against Wan Shawn • The board appointed Suan Lin as interim president • Ming Hu was hired as the dean of general affairs
1998-99	• The board appointed Wen Din as interim president • Ban Young was hired as the dean of general affairs
1999-00	• The board appointed Mar Hung as interim president • Jon Chao was hired as the dean of accounting • The Ministry of Education appointed Horn Shan as the chairman of the board • Taiwan was rocked by an earthquake
2000-01	• The board appointed Dan Wu as president
2001-02	• Jade Dawn was hired as the head of Bursar's Division • Mao Chu was hired as the head of the Custody and Records Division • SanChou received accreditation as a four-year college
2002-03	• Fong Pam was hired as the dean of accounting • Embezzlement by Tan Chen was uncovered

Figure 1: Partial Administrative Structure



1. The Weekend School's administrative structure is similar to the Evening School.
 2. The names of divisional heads at the time of the embezzlement are in parentheses.
 3. The chart shows only selected divisions. A complete organization chart is available upon request.

Exhibit 2: Responsibilities of Selected Divisions, the School Board, and the Ministry of Education

Accounting Division

- Preparing and monitoring of annual budget, project budgets, and long-term (3- and 5-year) capital budgets
- Preparing monthly, quarterly, and yearly financial statements
- Coordinating with the Financial Services Division on receipts, disbursements, financing, and investment activities
- Coordinating with the academic departments and administrative divisions on capital and operating expenses, financial analysis, and cost control
- Coordinating with the Custody and Records Division for accounting of school property
- Ensuring proper documentation of projects that receive subsidies from the Ministry of Education
- Providing actuarial employee pension fund and benefits figures to the Ministry of Education
- Developing and implementing accounting policies, procedures, and reporting systems
- Implementing and coordinating internal control procedures with other divisions
- Coordinating with independent accountants to audit the school's financial statements

Financial Services Division

- Cash receipts and disbursements
- Coordinating with the Accounting Division on tuition receipts, disbursements, financing, and investment activities
- Operating bank accounts
- Working with the Accounting Division on bank reconciliation and on financial reporting
- Coordinating with the Accounting, Registration and Certification, and Provost's Divisions on students' tuition and fee receipts and refunds
- Cooperating with the Accounting Division on implementing the accounting policies and systems
- Coordinating with the Accounting Division on execution of projects subsidized by the Ministry of Education
- Coordinating with the Procurement and Support Division and the Construction and Maintenance Division on payment to contractors
- Helping the Human Resources Division in computing salaries and benefits
- Coordinating with the Registration and Certification and Accounting Divisions to gather and submit data on student enrollment to the Ministry of Education
- Coordinating with the Accounting Division and the Human Resource Divisions on the remittance of pension funds to the Ministry of Education
- Coordinating with the Registration and Certification Division and the Provost's Divisions on administering student scholarship rewards

Procurement and Support Division

- Procurement of supplies and equipment as well as services such as consultants' advice, transportation, equipment rentals, maintenance agreements, and other contractual services for all academic and administrative units
- Business and auxiliary services including parking, vending, and student dormitory
- Ensuring safety and physical management of campus.

Custody and Records Division

- Documentation of school property
- Coordinating with the Accounting, Procurement and Support, and Construction and Maintenance Divisions on tagging and accounting for school property, including property subsidized by the Ministry of Education

Provost's Division

- Implementing the rules and regulations of the Ministry of Education and the school on course offerings and credits
- Coordinating with academic departments, including short-term programs and weekend programs, on course offerings
- Coordinating with the Registration and Certification and Financial Services Divisions on the receipt and refund of student tuition and fees
- Coordinating with the Registration and Certification Division on student records
- Preparing statistical reports related to course offerings and credits and submitting them to the Ministry of Education

Human Resources Division

- Employment and hiring of faculty and administrative employees
- Designing and implementing personnel policies including grant awards, benefits, and pensions to faculty and administrative employees
- Coordinating with the Accounting Division and academic departments to ensure compliance with the conditions of the subsidies received from the Ministry of Education
- Coordinating with the Financial Services Division on faculty and administrative employees' monthly salary and benefit payments

Board of Directors

- Hiring the president of the college
- Reviewing and approving the annual budget, including hiring of faculty and staff, funding of academic programs, and sponsorship of annual events
- Reviewing and approving long-term strategic plans, including introduction of new programs, termination of existing programs, and addition of new facilities
- Acting as a liaison with the Ministry of Education for obtaining government subsidies, for approval for new academic programs, and for ensuring continuing accreditation
- Attending annual or special board meetings

Ministry of Education

- Overseeing all colleges and universities
- Evaluating the credentials of colleges and universities for accreditation/re-accreditation
- Granting subsidies for capital projects
- Approving new programs or terminating existing academic programs
- Approving tuition and fee structure
- Approving appointment of board members of schools and colleges

In the remainder of the case, we describe the existing procedures, including any changes made over time, related to assets and cash.

ASSETS PROCUREMENT, CUSTODY, AND RECORD-KEEPING PROCEDURES

The Procurement and Support Division (PSD) was responsible for the purchase of all assets including computers, furniture, instruments, and office or lab supplies. The faculty and staff often complained that purchased items did not meet their specific needs, were delivered late, and were of poor quality. The PSD was supervised by the dean of the General Affairs Division. If a department wanted to purchase a capital item, it would prepare a purchase request. The head of the department would approve the request and send it to the PSD. The PSD would identify and select a supplier and place an order for the requested item. When the supplier delivered the item, the PSD would deliver the item to the department that had made the request and forward a copy of the invoice to the Accounting Division.

Before 1995, Sanchou did not have complete asset records or formal procedures for asset procurement and disposal. There was no capital budgeting process in place. Instructions for the purchase of assets or their disposal usually came from the president's office.

Once purchased, the asset remained on the books at cost because no depreciation expense was ever recorded. According to Mei Yao, the former dean of accounting, "If a division did not ask for disposal, the asset would still show on the books." A physical verification of assets had never been conducted. No single individual had been assigned the responsibility of the custody of assets. As a result, nobody knew whether the assets appearing on the books physically existed or not.

In 1995, the Ministry of Education began subsidizing Sanchou. As a condition for the subsidy, the Ministry required Sanchou to (1) have a capital budget and establish public bidding procedures for equipment financed with subsidies, (2) follow the government guidelines for asset disposal, and (3) have the school's financial statements audited.

Although Sanchou did not always purchase assets through public bidding as required by the Ministry, it did have a capital budget. The budget was somewhat misleading because divisions often had assets that did not show up in their capital budgets. When external auditors came, these assets were temporarily moved to the divisions where they belonged under the capital budget so as not to raise the auditors' suspicion.

In 1999, Jon Chao replaced Mei as the dean of accounting. Jon was a CPA, and his expertise in accounting

had landed him this job. He led the Accounting Division's drive to have a genuine capital budget. Any new asset was automatically placed under the user division's capital budget.

In the same year (1999), Taiwan suffered a major earthquake. The earthquake damaged Sanchou's buildings and destroyed many of its assets. Most of the records, including files related to assets, were also lost. In 2001, Mao Chu was appointed as the head of the Custody and Records Division. She needed to distinguish between assets bought before and after 1999 so that she could follow the government's guidelines for disposal of assets that were damaged by the earthquake. Her task was complicated because no complete records existed before 1999, and many of the records that had existed were lost in the earthquake.

In 2002, the Custody and Records Division was given the responsibility of keeping records relating to the assets of all divisions. It was also assigned the task of carrying out a physical verification of all assets. To assist the Custody and Records Division, one person in each division was also made responsible for keeping the records of its own assets.

CASH RECEIPT PROCEDURES

The Financial Services Division (FSD) received cash and checks from all the other divisions (the Provost's, Short-term Programs, and General Affairs Divisions) and schools (the Day, Evening, and Weekend Schools). One staff member of the FSD deposited them in the bank on a daily basis.

During the registration period, the FSD issued pre-numbered registration forms to students who used them to pay their tuition directly to Sanchou's bank. Under this arrangement, the bank gave two copies of the tuition receipt to the student and sent one copy directly to the FSD. The students were required to retain one copy and submit the other copy to the Registrar's Office as evidence of tuition payment. However, some students lost their registration forms and receipts. In such cases, the FSD had to check with each of the three schools to verify the number of credits taken by the student in order to calculate the tuition payable by the student.

Another problem was that the schools did not gather information about student enrollment and credit hour production. Instead, they claimed their enrollment figures were the same as the FSD records showed. The Accounting Division recorded tuition and fee revenue based on the receipts that the FSD provided.

Students who did not pay tuition to the bank during the registration period had to pay it directly to their respective schools (Day, Evening, or Weekend). The Day School students paid tuition to the FSD. The Evening and Weekend

School students, however, paid tuition to their respective Provost's Division. The Day School students paid tuition by the semester, but the Evening and Weekend School students paid tuition based on credit hours. For the sake of adhering to the school budget and for convenience, the Evening School students were required to pay tuition for 18 credits, and the Weekend School students were required to pay tuition for 12 credits in advance. The FSD found that sometimes these schools gave students tuition receipts without any running serial number or even forgot to issue a receipt. Similar cases occurred in the Short-term Programs Division.

If students added courses beyond what they had paid for, they would pay the additional tuition to their respective Provost's Division. Similarly, if students dropped courses, they would ask for a refund. To compute the amount of tuition refund, the FSD had to check the number of credits taken by students with the Provost's Division of the Evening and Weekend Schools. Once the amount was determined, the Evening and Weekend Schools made the refund.

In 2002, Jade Dawn, head of the FSD, suggested to Jon Chao, the dean of the Accounting Division, that each school should issue pre-numbered tuition receipts with three copies—one for the student, one for the FSD, and one for the Accounting Division. She also suggested that Jon's division should supervise the registration procedures and determine tuition revenue, rather than passively recording it based on the FSD's records. Jon did not accept these suggestions. He told Jade that it was her responsibility to make sure that the FSD received all of the cash from other divisions. In 2003, Fong Pam replaced Jon Chao as the dean of Accounting Division.

DISCOVERY OF EMBEZZLEMENT

In March 2003, Zu Lee, a staff member of the FSD, noticed that Tan Chen, a member of the Evening School staff, had only submitted about TWD 50,000 of late tuition. In the past, late tuition receipts had ranged between TWD 350,000 and TWD 400,000. In early April, Tan requested the refund of tuition for five students who had dropped courses or withdrawn from the programs. Zu informed Tan that he should submit the entire late tuition money to the FSD before the tuition refund could be processed. Tan said that he had given the remaining amount of the late tuition money to his supervisor, Jam Wang. When Zu went to Tan's office to process the tuition refund, she noticed that Tan had the seals of five students.⁴ These were the same five students whose tuition refund requests were being processed. When Zu asked Tan about this, he replied that

the students had asked him to claim tuition refunds on their behalf. The only problem with his explanation was that one of the five students had recently died. Zu knew this because the mother of the deceased student had come to the FSD to claim her grievance⁵ only a few days earlier.

Zu immediately went to her supervisor, Jade Dawn, and informed her that Tan had the seals of five students, including one belonging to a deceased student, in his possession. She also told her that she suspected that Tan did not turn in the entire amount of late tuition receipts. Jade asked Jam Wang, Tan's supervisor, whether he had received the remaining late tuition money from Tan. He replied in the negative. Jade related the entire incident to Fong Pam, the dean of the Accounting Division. Fong immediately called the police to inform them about the incident.

REQUIRED

After reading the case, prepare a written response to the following questions:

- 1a. Review the existing procedures related to assets and cash. Do they violate any of the internal control principles?
- 1b. How does public bidding improve the effectiveness of asset procurement procedures?
- 1c. Is the use of the seal an effective internal control?
2. What internal control procedures would you recommend to remedy the control deficiencies related to tuition receipt and refund procedures?
3. How does the tone set by top management influence the effectiveness of internal controls?
4. What changes, if any, would you make if you were the president of Sanchou?

You will also be called upon to participate in the class discussion on the case.

⁴ A seal is a design or emblem that belongs exclusively to the user. It usually has the user's name. In Taiwan, the use of personal seals for any official purpose is common, although for any legal purpose, hand-written signatures have the same validity. Before signing a document, people put their personal seal on the document to authenticate it. Because fake seals can be easily made, one can register his/her seal with a government agency to protect legal documents or contracts. Sanchou did not require students to get their seals registered before they could use them to ask for a tuition refund. This situation was unusual in that the students had apparently given their seals to Tan Chen.

⁵ When an incident causes students or their parents severe psychological or economic suffering, the Ministry or the school gives them a lump-sum amount as a token of condolence. The amount ranges from TWD 10,000 to TWD 100,000.

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