

# Interstate Business College: A Case Study in Fraud Examination

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**ABSTRACT:** This case is based on an actual fraud that occurred and provides you with an opportunity to develop fraud examination skills, which include document examination, searching public records, financial statement analysis, and communicating the results of your work. Such skills benefit all accounting students regardless of the career path they may choose (e.g., a fraud investigator, an auditor, a consultant, a tax accountant). This case also: (1) exemplifies the complexity often found in fraud cases, and (2) illustrates how fraud examinations differ from financial statement audits. While some of the names of the parties involved have been changed, no facts in the case have been altered. Interstate Business College (IBC), founded in 1912, collapsed in the wake of allegations of top management fraud. The allegations became public when 23 former students filed a lawsuit against the director and owner of IBC, alleging misappropriation of student funds. You will assume the role of the fraud investigator hired by their attorney to determine if there is evidence to support their claim. Upon completion of the case, you will have a sense of the amount of documents, detail, and work involved when resolving fraud allegations.

## BACKGROUND

Interstate Business College (IBC) was founded in Fargo, North Dakota, in 1912.<sup>1</sup> IBC offered vocational programs of two years or less in various business skill areas such as medical administrative assisting, secretarial, accounting, business communications, typing, travel, legal assisting, and computers. Susan K. Jacobsen began teaching at IBC in Fargo in 1976 while completing her accounting degree at Moorhead State University. She later became the school's financial aid administrator and eventually director. She also had a three-year option to buy the school, which she exercised in 1982.<sup>2</sup> In 1983 she established a second campus in Bismarck, North Dakota. Both campuses were fully accredited by the Accrediting Commission of the Association of Independent Colleges and Schools of Washington, D.C. The IBC mission was twofold: to prepare men and women for positions in business and to supply employers with office personnel.

Running IBC soon became a family affair. Susan's mother graduated from IBC-Fargo with a medical assistant degree and worked as the registrar at IBC-Bismarck before moving on to the position of assistant director. Tony Greenbelt, Susan's nephew, served as the director of IBC-Fargo, where Susan's husband taught computer programming. Her brother, Rod Wienz, was the director of IBC-Bismarck.

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<sup>1</sup> While the facts of this case have not been altered, the names of people involved have been changed.

<sup>2</sup> Susan held the largest ownership interest in IBC. Some of her family and friends were also owners.

IBC prospered under Susan's ownership. The student population had grown from a mere 44 students in 1976 when Susan began teaching at IBC to over 200 students by 1982. In November of 1989, IBC-Fargo moved to a new \$1.5 million, 23,000 square-foot facility that had 22 classrooms. As a result of this success, Susan became somewhat of a local celebrity. The mayors of Fargo and Bismarck officially proclaimed February 22, 1991 to be "Susan K. Jacobsen Day" in both cities. Both mayors commended her for her contributions and the dedicated effort she put forth in the field of education for the past 15 years.

That same year, Susan was featured on the cover of a local magazine, *The Area Woman*. As reported in the accompanying article (Holtan 1991), Susan Jacobsen explained the general demographic characteristics of IBC's student body: "At any given time, 40–50 percent of our students are single parents, divorced mothers, displaced farmers, displaced homemakers, and individuals on unemployment or with vocational disabilities. They are individuals who need to get training in a short period of time so they can re-enter the job market to support themselves and their families. Most are making great sacrifices just to be able to afford school in the first place. Without federal assistance for our students, many would not be able to attend." By 1997, IBC employed 80 faculty and staff personnel in full-time and part-time positions, and its enrollment had grown to 325 students.

The article also mentioned numerous other awards Susan had won, provided a brief biographical background, and included statements of her life philosophy. "I guess I want to be remembered as someone who kept her integrity intact," Susan was quoted as saying. "I believe in the quote, 'The person who gives up integrity can never get it back.' I never want my 85-year-old grandmother, Bregida, to be embarrassed by anything she reads in the paper 'bout her Susie." The article closed by revealing that Susan wears a gold unicorn around her neck and has a painting of a unicorn hanging on her office wall. Both were gifts from her employees. The reporter enthusiastically wrote, "They say to her—you are unique, one of a kind."

In January 1998 IBC closed its doors and filed for bankruptcy. College officials blamed the financial problems on two recent harsh winters, the past spring's flooding, and declining enrollments. "When it storms and goes below zero, cars don't start and students don't get to jobs and school," Susan was quoted as saying on the local news. "And when students drop out, IBC doesn't receive, or has to reimburse, their tuition and financial aid payments," she explained.

Several months prior to the bankruptcy filing, 23 former IBC students had filed a lawsuit against Susan Jacobsen, alleging misappropriation of funds occurring at IBC from 1989 through 1997.<sup>3</sup> In addition, the former students alleged that IBC personnel routinely made misrepresentations of material facts to them concerning the following issues: (1) transferability of IBC credits to four-year colleges; (2) responsibility for fees such as medical association dues; (3) the types of jobs students would be qualified for after graduation; (4) the quality of instruction at IBC; (5) accreditation status of IBC programs; and (6) placement procedures.<sup>4</sup>

The plaintiffs' attorneys have engaged you, an aspiring fraud examiner, to help resolve the plaintiffs' allegations involving misappropriations of students' funds and misrepresentations of material facts. Specifically, the attorney requested that you perform three separate tasks to help resolve the allegations. First, review and reconcile documentary evidence to determine that all charges against and payments credited to the plaintiffs' accounts during their enrollment at IBC are legitimate and for the agreed-upon amounts. Second, review the financial records to determine that all payments made from IBC funds were for legitimate business purposes. Third, compute the net worth of

<sup>3</sup> Misappropriation of funds involves the intentional, illegal, and/or unauthorized use of the property or funds of another person for personal gain by someone entrusted to look after those funds or property.

<sup>4</sup> A misrepresentation of material facts requires proving that the defendant deliberately made false statements to induce the intended victim to part with money or property.

Susan Jacobsen and her husband.<sup>5</sup> As the fraud examiner in this case, you will perform each of these three tasks by responding to questions included at the end of each of the tasks as described below.

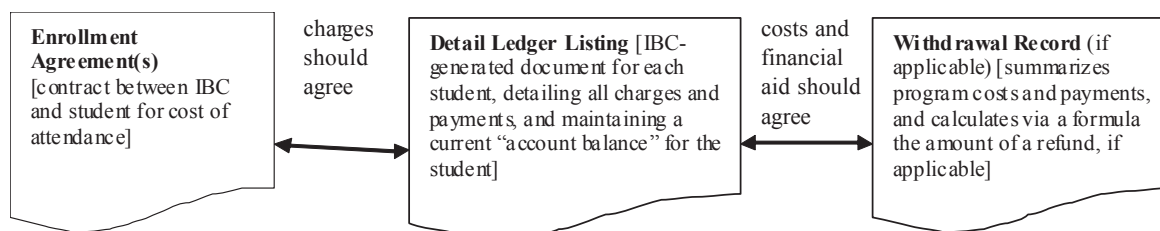
### TASK 1: ANALYSIS OF PLAINTIFFS' ACCOUNTS

Documents maintained in student files include an IBC Enrollment Agreement, a Withdrawal Record (if applicable) that includes a refund calculation work sheet, and a Detail Ledger Listing. The Enrollment Agreement is signed by the student and the IBC admissions representative, indicating the desired course of study, expected completion date, cost of attendance at IBC, and personal information about the student (name, social security number, address, etc.). The Withdrawal Record is a document published by the U.S. Department of Education Student Financial Assistance Programs (SFAP) that must be completed when a student withdraws before completing his/her program of study. The Withdrawal Record summarizes information about program costs, payments/disbursements, and determines the amount of a *pro rata* or federal refund. This document must be filed with the U.S. Department of Education SFAP. The Detail Ledger Listing is an IBC-generated document that summarizes information about charges and payments to individual student accounts. This document maintains a current "account balance" for all students enrolled at IBC and provides information for billing purposes. There should be no discrepancy between the information in a student's Withdrawal Record and the student's Detail Ledger Listing. The costs charged in the student's Detail Ledger Listing should equal the costs indicated on the Enrollment Agreement, as illustrated in Exhibit 1.

#### File #1: Shawn Davison

The first student file you select to review is that of Shawn Davison. Two Enrollment Agreements are in the file. Both agreements are dated September 11, 1995, even though the first agreement indicates Shawn enrolled in the medical administrative assistant program on February 6, 1995, with an expected completion date of June 14, 1996. The total cost of attendance was calculated to be \$10,020, as shown in Exhibit 2. The second Enrollment Agreement indicated that Shawn added word processing to her course of study. The total cost of attendance was now calculated to cost \$12,100 (see Exhibit 2). While you are not a handwriting expert, you note that Shawn's signature on each enrollment agreement does not appear to be the same. Shawn withdrew on March 15, 1996.

**EXHIBIT 1**  
**Agreement of Documents Chart**



<sup>5</sup> In order to prove fraud, one must show the perpetrator personally gained from the fraud. The Association of Certified Fraud Examiners defines fraud as "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets." If it cannot be shown that the perpetrator personally gained from the fraud, there will be no prosecution. Thus, it was relevant for the investigators in this case to complete both the second and third tasks.

The file also contains a Detail Ledger Listing, printed on April 4, 1996, and a Withdrawal Record, prepared on March 28, 1996. The Detail Ledger Listing is reproduced in Exhibit 3.

IBC recorded on Shawn's Withdrawal Record that the following payments had been received: Federal Pell Grant, \$3,377; Subsidized Federal Direct Stafford Loan, \$4,760; Unsubsidized Federal Direct Stafford Loan, \$6,400; and a Federal Supplemental Educational Opportunity Grant (SEOG), \$100.<sup>6</sup> Further, the Withdrawal Record indicates that \$5,552 was paid to the student and that the difference of \$9,085 was retained by IBC.<sup>7</sup> Total institutional costs (i.e., tuition, fees, and books plus overhead costs such as depreciation on buildings and equipment, utilities, and other general administrative costs) recorded on the Withdrawal Record were \$4,480.42.

The Withdrawal Record contains a work sheet to be completed in order to calculate the amount of the refund to the Student Financial Aid Program, if any. Exhibit 4 contains the work sheet prepared by IBC on Shawn's Withdrawal Record.

## File #2: Lisa Morrison

The second student file you review is that of Lisa Morrison. Lisa's Enrollment Agreement indicates that she enrolled in both the medical assistant program and the word processing program on October 3, 1988. She dropped the word processing option on August 17, 1989 and graduated on November 8, 1989.

The costs of attendance per both Enrollment Agreements are shown in Exhibit 5 and her Detail Ledger Listing is reproduced in Exhibit 6. Lisa's file also contained photocopies of the front side of two IBC checks payable to Lisa Morrison for \$61.00 (dated October 5, 1989) and \$478.29 (dated October 23, 1989). Investigators were unable to locate the canceled checks or find any evidence that the checks cleared IBC's bank account.

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### EXHIBIT 2 Summary Information from Shawn Davison's Enrollment Agreements

	<u>1st Enrollment Agreement<sup>a</sup></u>	<u>2nd Enrollment Agreement<sup>b</sup></u>
Total Tuition	\$ 8,750.00	\$10,500.00
Textbooks (approximate)	970.00	1,300.00
Application Fee	0.00	0.00
Lab Fee	200.00	200.00
General Fee	75.00	75.00
<b>TOTAL BALANCE DUE</b>	<u><u>\$10,020.00<sup>c</sup></u></u>	<u><u>\$12,100.00<sup>c</sup></u></u>

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<sup>a</sup> The first program Shawn enrolled in was the Medical Administration Assistant program, which she started on February 6, 1995.

<sup>b</sup> The second enrollment agreement resulted from Shawn adding the Word Processing program, which she began on September 11, 1995; she withdrew from IBC on March 15, 1996.

<sup>c</sup> These amounts were handwritten by the IBC admissions representative on the Enrollment Agreement as the total balance due.

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<sup>6</sup> A Federal Pell Grant and a Federal Supplemental Educational Opportunity Grant, unlike a loan, do not have to be repaid by the student. With a subsidized loan, the student is not charged any interest before repayment begins or during authorized deferment periods (i.e., the federal government "subsidizes" the interest during these periods). With an unsubsidized loan, the student is charged interest from the time the loan is disbursed until it is fully repaid.

<sup>7</sup> IBC receives the funds from the lending and granting agencies, and the loan and grant money is then used for the student's educational expenses and some of the student's living expenses. IBC distributes to the student the amount for the living expenses via a periodic stipend check.

**EXHIBIT 3**  
**Shawn Davison's Detail Ledger Listing<sup>a</sup>**

<u>Date</u>	<u>Item</u>	<u>Payments</u>	<u>Charges</u>	<u>Balance</u>	<u>Comments</u>
02/01/95	Book Fees		126.00	126.00	
02/01/95	Book Fees		3.00	129.00	Tax
02/06/95	Tuition		10,500.00	10,629.00	
02/06/95	General Fee		75.00	10,704.00	
02/06/95	Medical Assoc. Fee		50.00	10,754.00	
02/27/95	Pell 94/95	383.00		10,371.00	
03/05/95	Student Stipend	(310.00)		10,681.00	
03/07/95	Pell 94/95	767.00		9,914.00	
03/08/95	Stafford 1st Yr.	1,260.00		8,654.00	
03/08/95	Stafford 1st Yr.	1,260.00		7,394.00	
03/08/95	Unsub Staff 1st Yr.	1,920.00		5,474.00	
03/08/95	Book Fees		368.75	5,842.75	
03/10/95	Unsub Staff 1st Yr.	1,920.00		3,922.75	
04/05/95	Student Stipend	(310.00)		4,232.75	
05/05/95	Student Stipend	(310.00)		4,542.75	
06/05/95	Student Stipend	(310.00)		4,852.75	
06/12/95	Book Fees		186.00	5,038.75	
06/27/95	Book Fees		5.00	5,043.75	Tax
07/05/95	Student Stipend	(310.00)		5,353.75	
06/08/95	Student Stipend	(620.00)		5,973.75	
08/05/95	Student Stipend	(620.00)		6,593.75	
08/07/95	Pell 94/95	767.00		5,826.75	
08/07/95	Tech Fees		255.00	6,081.75	
08/07/95	Tech Fees		15.30	6,097.05	Tax
09/05/95	Student Stipend	(310.00)		6,407.05	
09/12/95	Book Fees		66.00	6,473.05	
09/16/95	Stafford 2nd Yr.	1,680.00		4,793.05	
09/16/95	Unsub Staff 2nd Yr.	1,920.00		2,873.05	
09/15/95	Pell 95/96	730.00		2,143.05	
09/15/95	SEOG 95/96	100.00		2,043.05	
09/19/95	Book Fees		78.00	2,121.05	
09/19/95	Book Fees		(46.00)	2,075.05	
09/27/95	Student Stipend	(310.00)		2,385.05	
10/05/95	Student Stipend	(310.00)		2,695.05	
10/02/95	Book Fees		63.00	2,758.05	
10/02/95	Book Fees		(46.00)	2,712.05	
10/10/95	Tech Fees		276.00	2,988.05	
10/10/95	Tech Fees		16.56	3,004.61	Tax
10/05/95	Book Fees		33.00	3,037.61	
09/25/95	Tuition Adj.		(1,750.00)	1,287.61	
10/30/95	Student Stipend	(310.00)		1,597.61	

*(continued on next page)*

**EXHIBIT 3 (continued)**  
**Shawn Davison's Detail Ledger Listing<sup>a</sup>**

<u>Date</u>	<u>Item</u>	<u>Payments</u>	<u>Charges</u>	<u>Balance</u>	<u>Comments</u>
11/07/95	Book Fees		25.75	1,623.36	
12/05/95	Student Stipend	(620.00)		2,243.36	
12/09/95	Stafford 2nd Yr.	1,680.00		563.36	
12/09/95	Unsub Staff 2nd Yr.	1920.00		(1,356.64)	
12/11/95	Pell 95/96	730.00		(2,086.64)	
12/12/95	Book Fees		164.00	(1,922.64)	
12/12/95	Book Fees		0.30	(1,922.34)	Tax
12/14/95	Student Stipend	(310.00)		(1,612.34)	
01/05/96	Student Stipend	(155.00)		(1,457.34)	
01/09/96	Tech Fees		276.00	(1,181.34)	
01/09/96	Tech Fees		16.56	(1,164.78)	Tax
01/04/96	Student Stipend	(155.00)		(1,009.78)	
02/05/96	Student Stipend	(141.00)		(868.78)	
03/05/96	Student Stipend	(141.00)		(727.78)	
03/11/96	Book Fees		55.00	(672.78)	
03/13/96	Book Fees		50.00	(622.78)	

<sup>a</sup> The information on this Detail Ledger Listing is reproduced exactly as it appears on the original computer printout.

### **File #3: Stephanie Baker**

Stephanie Baker's file is the third file you review. This student completed the medical assistant and word processing programs on June 17, 1994. She returned to IBC on March 27, 1995, to enroll in a second course of study, the medical executive administrative assistant. She graduated from this program on March 15, 1996. Stephanie's program costs per her Enrollment Agreements are detailed in Exhibit 7, and her Detail Ledger Listings for both programs are shown in Exhibits 8 and 9.

As you reviewed Stephanie's file, you could not find any supporting documentation for the \$159.50 refund check credited to her Detail Ledger Listing to show that this credit was paid to Stephanie, nor could you find this canceled check in IBC's bank statement. However, regarding her second program, Stephanie's file contained photocopies of the front of each of the three checks that her Detail Ledger Listing indicated had been made payable to her. The file also had a photocopy of a check dated January 8, 1996, made payable to "EDPMTS" for \$195.00, with a description on the check that stated "Pell Refund—Stephanie Baker" along with her social security number. The only documentation in the file relating to the \$916.00 and \$767.00 refunds noted on the Detail Ledger Listing was a "Notice of School Termination of Student Borrower" form, which listed the two check numbers and the refund information. Your search of IBC's bank statements failed to uncover any of these six canceled checks.

The fact that IBC apparently was refunding grant money warrants further investigation. Students are not obligated to repay grant money. However, Stephanie also had received several thousand dollars in student loans, which she will be required to repay, so she would have benefited by returning the loan money first. You decide to look into this issue more closely by calling the local university's assistant director of financial services, Jeanne Erickson. According to Jeanne, refunds of grant money would be required in two situations: (1) If the student withdraws before completing the chosen academic program, or (2) if the total financial aid (including grant money) exceeds total school-related expenses. However, in the second case, the student loan money should be refunded before refunding any grant money.



**EXHIBIT 4**  
**Shawn Davison's Refund Work Sheet, as Calculated by IBC**

**Formula Printed on Refund Calculation  
 Work Sheet (Dept. of Education form)**

**IBC's Calculations for Shawn  
 Davison's Account<sup>a</sup>**

**STEP ONE: Unpaid Charges**

**STEP ONE: Unpaid Charges**

Total Institutional Costs  
 (from Withdrawal Record)  
 – Total Aid Paid to Institution's Costs  
 (also from Withdrawal Record)  
 = Scheduled Cash Payment  
 – Student's Cash Paid  
 = UNPAID CHARGES

\$ 4,480.42  
 – 9,085.00  
 (4,604.58)  
 0.00  
 (4,604.58)

**STEPTWO: Amount Retained**

**STEPTWO: Amount Retained**

Total Institutional Costs  
 (from Withdrawal Record)  
 × % Allowed to Retain  
 (from refund policy being used)  
 = Initial Amount Retained  
 – UNPAID CHARGES  
 (from Step One)  
 = AMOUNT RETAINED

\$ 4,480.42  
 × 75%  
 \$ 3,360.32  
 6,381.80  
 \$ 9,742.12

**STEPTHREE: Refund Amount**

**STEPTHREE: Refund Amount**

Total Paid to Institutional Costs  
 (from Withdrawal Record)  
 – Amount Retained  
 (from Step Two)  
 = REFUND AMOUNT  
 RETURNED TO SFA PROGRAMS

\$ 9,085.00  
 – 9,742.12  
 \$ (657.12) *STUDENT OWES<sup>b</sup>*

<sup>a</sup> The information on this refund work sheet is reproduced exactly as it appears on the original work sheet located in IBC's files, including any errors.

<sup>b</sup> Handwritten.

**Questions for Task 1**

1. Based on the information you have gathered during your first task, what discrepancies/irregularities exist in Shawn Davison's file? Show your calculations.
2. What discrepancies/irregularities can you identify in Lisa Morrison's file? Show your calculations. Do you have any other concerns in regards to Lisa's file?
3. What discrepancies/irregularities can you identify in Stephanie Baker's file? What additional documentation would you like to have? Do you have any additional concerns regarding Stephanie's file?
4. Does any of the evidence you gathered in questions 1 through 3 either confirm or refute the allegations you have been engaged to resolve? If IBC officials were to try to explain away your evidence as merely "incompetent bookkeeping," how might your evidence overcome their incompetence defense? Explain and defend your answer.

**EXHIBIT 5**  
**Summary Information from Lisa Morrison's Enrollment Agreements**

	<u>1st Enrollment Agreement<sup>a</sup></u>	<u>2nd Enrollment Agreement<sup>b</sup></u>
Total Tuition	\$ 5,000.00	\$ 4,000.00
Textbooks (approximate)	500.00	390.00
Application Fee	25.00	25.00
Lab Fee	50.00	50.00
General Fee	75.00	75.00
<b>TOTAL BALANCE DUE</b>	<u><u>\$ 5,650.00</u></u>	<u><u>\$4,540.00</u></u>

<sup>a</sup> The first programs Lisa enrolled in were the Medical Assistant program and the Word Processing program, which she started on October 3, 1988.

<sup>b</sup> Lisa's program changed when she dropped the Word Processing program on August 17, 1989; she graduated on November 8, 1989.

5. Assume that you have reviewed the files of the remaining 20 plaintiffs and have identified numerous, varied discrepancies. Given that the attorney who engaged you is not an accountant, how might you effectively communicate to the attorney in your fraud report all of the numerous discrepancies/irregularities you have identified? (Do not prepare a fraud report; rather, describe how you would organize it.<sup>8</sup>)

**TASK 2: REVIEW OF IBC FINANCIAL RECORDS**

The second task you have been engaged to perform is that of reviewing the IBC financial records to determine that all payments made from IBC funds were for legitimate business purposes. You decide to start by selecting a sample of two months (November and December 1995) and reviewing the IBC general fund checks for this period. Your review suggests that nine of the canceled checks from these two months were for nonbusiness purposes. For each of these checks, no supporting documentation existed and Susan was unable to provide any support or explanation for the purchases. These questionable payments include the following checks: four checks payable to Susan Jacobsen for a total of \$14,500; one check payable to American Express for \$24,887.42; one check payable to a travel agency for a Las Vegas vacation in the amount of \$3,844.25; two checks payable to stores in local malls for a total of \$1,725.00; and another check payable to a liquor store for \$298.95.

**Financial Statements**

Next, you obtain the IBC-Fargo audited financial statements for the years 1993–1996, as well as the IBC-Fargo financial statements for the six-month period ending June 30, 1997 (see Exhibits 10 and 11, respectively). IBC had a \$1.2 million loan along with a \$600,000 line of credit with a local bank. The loan agreement required IBC to annually submit audited financial statements for review by the bank's loan officer. Loan agreement covenants also required IBC to maintain a current ratio of

<sup>8</sup> If you were to prepare a report, note that the tone of the report should be professional, without any accusatory language. The fraud examiner must pay careful attention to language use so that there are no subjective, inflammatory, or libelous comments in the report. A court of law determines guilt, not the examiner. In fact, the Association of Certified Fraud Examiners includes the following as part of its Code of Professional Ethics: "A Certified Fraud Examiner, in conducting examinations, will obtain evidence or other documentation to establish a reasonable basis for any opinion rendered. No opinion shall be expressed regarding the guilt or innocence of any person or party" (ACFE 2003).



**EXHIBIT 6**  
**Lisa Morrison's Detail Ledger Listing**

<u>DATE</u>	<u>ITEM</u>	<u>PAYMENTS</u>	<u>CHARGES</u>	<u>BALANCE</u>	<u>COMMENTS</u>
09/25/88	GSL	1,247.35		(1,247.35)	
10/03/88	Book Fees		237.00	(1,010.35)	
10/03/88	Book Fees		6.00	(1,004.35)	
10/04/88	Tuition		5,000.00	3,995.65	
10/04/88	General Fee		75.00	4,070.65	
10/04/88	Medical Assoc. Fee		50.00	4,120.65	
10/04/88	Application Fee		25.00	4,145.65	
10/04/88	Lab Fee		50.00	4,195.65	
10/04/88	NDSL	234.00		3,961.65	
11/03/88	Book Fees		68.00	4,029.65	
12/30/88	GSL	1,246.40		2,783.25	
01/02/89	NDSL	233.00		2,550.25	
02/12/89	Book Fees		37.00	2,587.25	
02/27/89	Book Fees		1.00	2,588.25	
03/23/89	Supplemental Loan	800.00		1,788.25	
03/25/89	Student Stipend	(800.00)		2,588.25	
04/03/89	NDSL	233.00		2,355.25	
06/09/89	Supplemental Loan	3,000.00		(644.75)	
06/09/89	Student Stipend	(3,000.00)		2,355.25	
07/07/89	Book Fees		98.00	2,453.25	
07/07/89	Book Fees		(37.00)	2,416.25	
08/03/89	Stafford Loan	1,929.24		487.01	
08/07/89	Book Fees		58.70	545.71	
09/12/89	Book Fees		115.00	660.71	
09/23/89	Pell 89/90	384.00		276.71	
10/18/89	Pell 89/90	766.00		(489.29)	
10/20/89	Supplemental Loan	2,000.00		(2,489.29)	
10/05/89	Difference Check	(61.00)		(2,428.29)	
10/23/89	Difference Check	(478.29)		(1,950.00)	
10/30/89	Student Stipend	(1,950.00)		0.00	

**EXHIBIT 7**  
**Summary Information from Stephanie Baker's Enrollment Agreements**

	<u>1st Enrollment Agreement<sup>a</sup></u>	<u>2nd Enrollment Agreement<sup>b</sup></u>
Total Tuition	\$ 8,670.00	\$ 2,910.00
Textbooks (approximate)	950.00	452.00
Application Fee	25.00	0.00
Lab Fee	200.00	0.00
General Fee	75.00	0.00
<b>TOTAL BALANCE DUE</b>	<u><u>\$ 9,920.00</u></u>	<u><u>\$ 3,362.00</u></u>

<sup>a</sup> The first program Stephanie enrolled in was the Medical Administration Assistant with Word Processing program that she started on December 28, 1992, and she graduated from the program on June 17, 1994.

<sup>b</sup> The second program Stephanie enrolled in was the Executive Administrative Assistant-Medical program, which she started on March 27, 1995; she graduated from this program on March 15, 1996.

**EXHIBIT 8**  
**Stephanie Baker's Detail Ledger Listing: First Program**

<u>DATE</u>	<u>ITEM</u>	<u>PAYMENTS</u>	<u>CHARGES</u>	<u>BALANCE</u>	<u>COMMENTS</u>
12/28/92	Tuition		8,670.00	8,670.00	
12/28/92	Application Fee		25.00	8,695.00	
12/28/92	Lab Fee		200.00	8,895.00	
12/28/92	General Fee		75.00	8,970.00	
12/28/92	Medical Assoc. Fee		50.00	9,020.00	
12/29/92	Book Fees		238.00	9,258.00	
01/01/93	Pell 92/93	800.00		8,458.00	
01/15/93	Student Payment	25.00		8,433.00	cash
01/15/93	Stafford 1st Yr.	1,207.96		7,225.04	
02/15/93	Book Fees		115.50	7,340.54	
03/01/93	Stafford 1st Yr.	1,207.04		6,133.50	
04/01/93	Pell 92/93	800.00		5,333.50	
06/28/93	Pell 92/93	800.00		4,533.50	
07/23/93	Book Fees		78.00	4,611.50	
09/01/93	Stafford 2nd Yr.	1,265.00		3,346.50	
10/01/93	SEOG 93/94	300.00		3,046.50	
10/01/93	Pell 93/94	767.00		2,279.50	
11/08/93	Book Fees		129.00	2,408.50	
12/01/93	Stafford 2nd Yr.	1,265.00		1,143.50	
01/01/94	Pell 93/94	767.00		376.50	
01/09/94	Book Fees		69.00	445.50	
02/23/94	Book Fees		81.00	526.50	
04/01/94	Pell 93/94	766.00		(239.50)	
04/01/94	Book Fees		80.00	(159.50)	
06/09/94	Student Stipend	(159.50)		0.00	

at least 1.0 each year and limited officers' salaries to no more than \$300,000 per year. From 1993–1996, IBC's financial statements received an unqualified audit opinion from Mary Charles, a local sole practitioner CPA. For comparison purposes, you request financial statements for the six-month period ending June 30, 1997 from IBC-Bismarck (included in Exhibit 11). No financial statements were ever produced after the June 30, 1997 statements.

As you glance over the financial statements, one item that jumps out at you is both the current and long-term "Notes Receivable—Related Parties" shown for each year. You discover there are no disclosures pertaining to the related-party receivables in the footnotes to the financial statements.

Because the financial statements had received an unqualified audit opinion each year, you requested from Mary Charles the work papers in support of the opinions rendered, but she refused to produce them. Consequently, you were forced to obtain a court order requiring that Ms. Charles produce the IBC audit work papers. She engaged an attorney and fought the court order. After three months of delays, the judge threatened to put Ms. Charles in jail for contempt of court, which prompted her to finally produce the work papers. Your subsequent review of the working papers uncovered the following anomalies:

- Date discrepancies were found on 33 working papers, indicating that the work papers had been created in 1998 instead of in the years 1993–1997 as would be expected.

<b>EXHIBIT 9</b>					
<b>Stephanie Baker's Detail Ledger Listing: Second Program</b>					
<b>DATE</b>	<b>ITEM</b>	<b>PAYMENTS</b>	<b>CHARGES</b>	<b>BALANCE</b>	<b>COMMENTS</b>
03/27/95	Tuition		2,910.00	2,910.00	
03/27/95	Book Fees		139.30	3,049.30	
03/27/95	Pell 94/95	383.00		2,666.30	
04/08/95	Tech Fees		276.00	2,943.30	
04/08/95	Tech Fees		16.56	2,958.86	Tax
04/27/95	Stafford	864.00		2,094.86	
04/27/95	Unsub. Staff.	984.00		1,110.86	
05/20/95	Book Fees		55.00	1,165.86	
06/06/95	Stafford	864.00		301.86	
06/06/95	Unsub. Staff.	984.00		(682.14)	
06/26/95	Pell 94/95	767.00		(1,449.14)	
07/05/95	Student Stipend	(1,362.00)		(87.14)	
09/10/95	Book Fees		67.00	(20.14)	
12/18/95	Direct Sub. Loan	565.00		(585.14)	
12/18/95	Direct Unsub. Loan	720.00		(1,305.14)	
12/25/95	Pell 95/96	780.00		(2,085.14)	
01/04/96	Rural Minnesota CEP, Inc.	1,440.00		(3,525.14)	
01/05/96	Student Stipend	(1,568.00)		(1,957.14)	
01/08/96	Pell Refund	(195.00)		(1,762.14)	
02/15/96	Direct Sub. Loan	564.00		(2,326.14)	
02/15/96	Direct Unsub. Loan	720.00		(3,046.14)	
02/15/96	Difference Check	(1,362.44)		(1,683.70)	
02/15/96	Refund Adj.		0.70	(1,683.00)	
03/05/96	Pell Refund	(767.00)		(916.00)	
03/10/96	Unsub. Staff. Refund	(916.00)		0.00	

- Handwriting styles on the audit work papers clearly came from two different people, with one style appearing to match the handwriting of Robert Knapper, a CPA who had been the controller at IBC until it filed for bankruptcy in January 1998. After IBC closed its doors, Robert Knapper was hired by Ms. Charles and was in her employ when the court ordered her to produce the IBC audit work papers.
- A substantial number of working papers were referenced in the 1996 audit program but could not be located among the documents subpoenaed from the CPA. You now suspect that, due to the contempt of court charge hanging over her head, she simply ran out of time in fabricating the work papers supporting the 1996 audit.

Your review of the working papers also reveals that the auditor did not audit the related-party receivables to determine: (1) the nature of the transactions that created the receivables, and (2) the collectibility of the receivables. Further, you learn that the related-party receivables represent cash amounts that Susan Jacobsen and other officers received from IBC. You then obtain Susan's canceled IBC payroll checks, as well as those of her husband, Gary. Gary's job title at IBC is Data Processing Manager, but he has also served as an instructor at times. His educational background consists of a diploma from IBC in 1984, and an Associate Degree from Northwestern Electronics Institute in 1974. After reviewing several personnel files, you discover that the average instructor receives an annual salary of approximately \$25,000, and must have earned at least a master's degree. Relevant information from four of the monthly payroll check stubs you inspected is given in Exhibit 12.

**EXHIBIT 10**  
**IBC-Fargo Balance Sheets**  
**December 31 Year-End**

	<u>1996</u>	<u>1995</u>	<u>1994</u>	<u>1993</u>
Cash—Unrestricted	\$ 410,588	\$1,279,570	\$1,004,183	\$ 536,193
Cash—Restricted	707	34,147	65,000	0
Contracts Receivable, Students	695,905	2,253,590	1,910,591	2,105,293
Accounts Receivable, Other	196,402	47,808	6,091	9,878
Accounts Receivable, Related Party				1,500
Notes Receivable, Related Parties	49,768	50,200	36,000	322,843
Interest Receivable, Related Party				34,750
Inventory—Books and Supplies	55,564	57,149	62,037	54,727
Prepaid Expenses	5,673	25,221	21,105	14,883
<i>Total Current Assets</i>	<u>\$1,414,607</u>	<u>\$3,747,685</u>	<u>\$3,105,007</u>	<u>\$3,080,067</u>
Furniture and Equipment, Net	\$ 427,550	\$ 409,074	\$ 340,913	\$ 274,185
Leasehold Improvements, Net	180,682	187,089	189,830	197,856
Library, Net	8,339	9,659	9,019	6,138
<i>Total Fixed Assets</i>	<u>\$ 616,571</u>	<u>\$ 605,822</u>	<u>\$ 539,762</u>	<u>\$ 478,179</u>
Goodwill	\$ 36,000	\$ 36,000	\$ 36,000	\$ —
Notes Receivable, Related Parties	482,615	469,694	403,182	27,425
Deposits	8,902	5,902	0	0
Perkins Matching Fund	87,549	86,699	73,495	57,938
Long-Term Investments	370,071	270,071	250,269	302,269
Notes Receivable, Students	0	10,000	0	0
<i>Total Other Assets</i>	<u>\$ 985,137</u>	<u>\$ 878,366</u>	<u>\$ 762,946</u>	<u>\$ 387,632</u>
<b>Total Assets</b>	<b><u>\$3,016,315</u></b>	<b><u>\$5,231,873</u></b>	<b><u>\$4,407,715</u></b>	<b><u>\$3,945,878</u></b>
Accounts Payable, Trade	\$ 542,985	\$ 448,083	\$ 145,829	\$ 149,369
Tuition Refunds Payable	0	59,209	36,668	30,052
Notes Payable, Current	59,950	80,590	73,433	44,240
Payroll Taxes Payable	0	13,584	13,164	8,989
Accrued Salaries and Wages	134,352	117,401	36,310	44,893
Unearned Tuition	675,470	2,736,338	2,401,370	2,799,719
Other Current Liabilities	0	116,532	0	2,630
<i>Total Current Liabilities</i>	<u>\$1,412,757</u>	<u>\$3,571,737</u>	<u>\$2,706,774</u>	<u>\$3,079,892</u>
Long-Term Liabilities	1,165,325	1,028,923	1,108,577	331,717
<i>Total Liabilities</i>	<u>\$2,578,082</u>	<u>\$4,600,660</u>	<u>\$3,815,351</u>	<u>\$3,411,609</u>
Common Stock	1,000	1,000	1,000	1,000
Retained Earnings	437,233	630,213	591,364	533,269
<i>Total Stockholders' Equity</i>	<u>\$ 438,233</u>	<u>\$ 631,213</u>	<u>\$ 592,364</u>	<u>\$ 534,269</u>
<b>Total Liabilities and Equity</b>	<b><u>\$3,016,315</u></b>	<b><u>\$5,231,873</u></b>	<b><u>\$4,407,715</u></b>	<b><u>\$3,945,878</u></b>

*(continued on next page)*

**EXHIBIT 10 (continued)**  
**IBC-Fargo Income Statements and Balance Sheets**

	December 31 Year-End			
	<u>1996</u>	<u>1995</u>	<u>1994</u>	<u>1993</u>
<b>EDUCATIONAL INCOME</b>				
Gross Tuition	\$3,788,926	\$4,430,504	\$4,194,067	\$4,112,342
Less:				
Tuition Refunds	485,095	417,224	335,803	258,108
Textbook Costs	187,414	265,258	254,343	273,029
Notebook Rental Costs	533,723	218,277	0	0
Total Deductions	<u>1,206,232</u>	<u>900,759</u>	<u>590,146</u>	<u>531,137</u>
Net Educational Income	\$2,582,694	\$3,529,745	\$3,603,921	\$3,581,205
<b>EDUCATIONAL EXPENSES</b>				
Instructional Salaries	\$ 468,824	\$ 728,553	\$ 844,358	\$ 640,017
Instructional Expense	294,738	158,140	244,788	227,397
Student Recruitment	186,539	203,520	200,795	279,260
Depreciation Expense	63,252	73,398	62,414	67,110
Occupancy Expense	361,736	498,370	534,735	506,752
Administrative Salaries	151,572	522,265	727,121	693,698
Officer Salaries	85,652	503,526	338,718	324,000
Administrative Expense	745,410	556,038	374,207	474,942
Student Personnel Services	52,877	89,180	100,159	112,318
Total Educational Expense	<u>2,410,600</u>	<u>3,332,990</u>	<u>3,427,295</u>	<u>3,325,494</u>
Net Educational Income	\$172,094	\$196,755	\$176,626	\$255,711
Interest Income (Expense)	<u>(73,141)</u>	<u>(41,906)</u>	<u>(14,532)</u>	<u>(9,120)</u>
Net Income before Taxes	\$ 98,953	\$ 154,849	\$ 162,094	\$ 246,591
Income Tax Expense	<u>(23,088)</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Income after Taxes	<u><u>\$75,865</u></u>	<u><u>\$154,849</u></u>	<u><u>\$162,094</u></u>	<u><u>\$246,591</u></u>

To determine the reasonableness of Susan's salary, you telephone the president and executive director of a comparable business college in Utah. This business college averaged enrollment of approximately 300 students, making it very similar in size to IBC. The president of the Utah business college stated that a "generous" salary for the president/executive director of a business college would be \$90,000–\$100,000.

### Employee Interviews

After reviewing the financial statements and the canceled checks, you decide to interview four former IBC employees about the alleged IBC fraud. The employees you select to interview are those who might have some knowledge of the fraud but you do not consider them to be accomplices in perpetrating it because there is no evidence that any of them personally gained from the alleged fraud (see footnote 5). You arrange interviews with the following four employees:

- Rondi Kosellman, an instructor at IBC for 15 years;
- Barb Rosenbush, the IBC receptionist/secretary from December 1987–May 1990;
- Carla Braatenberg, a clerk in the IBC financial aid department from 1983–1991; and

**EXHIBIT 11**  
**IBC-Fargo and IBC-Bismarck Income Statements and Balance Sheets**  
**for the Six Months Ended June 30, 1997**

	<u>Fargo</u>	<u>Bismarck</u>
EDUCATIONAL INCOME		
Gross Tuition	\$1,316,366	\$ 424,183
Less:		
Tuition Refunds	0	0
Textbook Costs	74,061	29,749
Notebook Rental Costs	180,728	24,580
Total Deductions	<u>254,789</u>	<u>54,329</u>
Net Educational Income	<u>\$1,061,577</u>	<u>\$ 369,854</u>
EDUCATIONAL EXPENSES		
Instructional Salaries	\$ 223,133	\$ 132,636
Instructional Expense	66,217	26,940
Student Recruitment	61,432	47,004
Depreciation Expense	33,000	11,200
Occupancy Expense	180,408	82,500
Administrative Salaries	249,028	39,662
Officer Salaries	107,251	30,000
Administrative Expense	122,752	18,321
Student Personnel Services	14,169	8,887
Total Educational Expense	<u>1,057,390</u>	<u>397,150</u>
Net Educational Income	\$ 4,187	\$ (27,296)
Interest Income (Expense)	<u>(77,288)</u>	<u>(821)</u>
Net Income before Taxes	\$ (73,101)	\$ (28,117)
Income Tax Expense	<u>0</u>	<u>0</u>
Net Income after Taxes	<u><u>\$ (73,101)</u></u>	<u><u>\$ (28,117)</u></u>
ASSETS		
Cash—Unrestricted	\$ (131,105)	\$ (273)
Cash—Restricted	100,378	329
Contracts Receivable, Students	212,456	100,758
Accounts Receivable, Other	226,285	31
Notes Receivable, Related Parties	48,058	0
Inventory—Books and Supplies	40,482	19,223
Other Current Assets	38,156	2,694
Total Current Assets	<u>\$ 534,710</u>	<u>\$ 122,762</u>
Furniture and Equipment, Net	\$ 287,436	\$ 103,828
Leasehold Improvements, Net	157,098	23,866
Library, Net	6,522	2,302
Total Fixed Assets	<u>\$ 451,056</u>	<u>\$ 129,996</u>
Goodwill	\$ 36,000	\$ —
Notes Receivable, Related Parties	671,538	0
Deposits	8,902	0
Perkins Matching Fund	87,549	0
Long-Term Investments	370,071	
Notes Receivable, Students	0	-4
Total Other Assets	<u>1,174,060</u>	<u>-4</u>
Total Assets	<u><u>\$2,159,826</u></u>	<u><u>\$ 252,754</u></u>

(continued on next page)



**EXHIBIT 11 (continued)**  
**IBC-Fargo and IBC-Bismarck Income Statements and Balance Sheets**  
**for the Six Months Ended June 30, 1997**

	<u>Fargo</u>	<u>Bismarck</u>
<b>LIABILITIES and EQUITY</b>		
Accounts Payable, Trade	\$ 510,196	\$ 56,186
Notes Payable, Current	50,451	0
Payroll Taxes Payable	123,993	0
Accrued Salaries and Wages	193,813	0
Unearned Tuition	6,209	2,947
Other Current Liabilities	26,600	0
<i>Total Current Liabilities</i>	<u>\$ 911,262</u>	<u>\$ 59,133</u>
Notes or Bonds Payable	58,788	0
Mortgage Payable	196,383	0
Inter Div Entries	-214,107	214,107
Other Long-Term Liabilities	850,000	0
<i>Total Liabilities</i>	<u>\$1,802,326</u>	<u>\$ 273,240</u>
Common Stock	1,000	0
Retained Earnings	356,500	-20,486
<i>Total Stockholders' Equity</i>	<u>\$ 357,500</u>	<u>\$ (20,486)</u>
<b>Total Liabilities and Equity</b>	<u><b>\$2,159,826</b></u>	<u><b>\$ 252,754</b></u>

**EXHIBIT 12**  
**Jacobsen Pay Stub Information**

<u>Payroll Date</u>	<u>Payee</u>	<u>Earnings</u>	<u>Deductions</u>
Dec. 1, 1993	Susan Jacobsen	Salary \$27,000.00	Federal Tax \$900.00
		Other Income 3,771.00	State Tax 100.00
			Cash Advance 5,000.00
			Cash Advance 3,771.00
			<u>Net Pay = \$21,000.00</u>
	(Gross Year to Date = \$328,271.00)		
July 1, 1994	Susan Jacobsen	Salary \$27,000.00	Federal Tax \$528.50
			State Tax 80.00
			Cash Advance 5,000.00
			<u>Medicare Tax 391.50</u>
			<u>Net Pay = \$21,000.00</u>
	(Gross Year to Date = \$189,000.00)		
August 15, 1995	Susan Jacobsen	Cash Advance \$10,139.00	None
			<u>Net Pay = \$10,139.00</u>
	(Gross Year to Date = \$10,139.00)		
Dec. 1, 1995	Gary Jacobsen	Salary \$4,100.00	Federal Tax \$410.50
			Soc. Sec. Tax 254.20
			Medicare Tax 59.45
			State Tax 57.47
			<u>401K 205.00</u>
			<u>Net Pay = \$ 3,113.38</u>
	(Gross Year to Date = \$49,700.00)		

- Judy Klinknail, an IBC admission counselor/representative from January 1989–June 1990.

The employee interviews uncover the following information:

- Rondi stated that Susan Jacobsen traveled frequently, including destinations such as Paris, Hawaii, Las Vegas, San Francisco, and Arizona. Rondi knew that Susan had purchased a Rolex watch, and Susan once invited Rondi to join her on a bus trip to a casino for a weekend of gambling. Rondi knew of Susan's love for gambling because Susan had a five-gallon jar in her office filled with matchbooks from all the casinos she had visited. In fact, Susan bragged about her collection of matchbooks and would show it to anyone in her office. On the weekend trip, Rondi noticed that Susan drank excessively, but she had heard that Susan had a drinking problem. Rondi had heard about misappropriations of students' financial aid money, but had no direct knowledge of this theft occurring. She also commented that Susan managed "by intimidation" when dealing with IBC employees and students.
- Barb stated that she and Carla Braatenberg paid Susan Jacobsen's credit cards with IBC funds and "were just floored at some of her extravagant expenditures." Barb knew of trips Susan had taken to Europe and Aspen, Colorado. When Susan returned from her Paris trip, she gave the office staff sweatshirts purchased in France. Barb also stated that Susan had given her nephew a Rolex watch and had "treated herself" to a diamond ring upon achieving an enrollment of 400 students. She stated that Susan frequently purchased expensive clothing from a local shopping mall.
- Carla said she went on a trip to New Orleans, where Susan purchased artwork on a credit card. When Carla paid the credit card bills at IBC, she noticed the amounts were very large and personal expenditures were included. Although Susan and Gary Jacobsen were divorced in February 1998 after 29 years of marriage, Carla reported that she heard Susan state, in March 1998, that she would like to go to Seattle to live with Gary and work somewhere, after which she would like them to live at their lakeside cabin.
- Judy claimed she went on two trips with Susan Jacobsen, one to Seattle and the other to Florida. On both trips, they went deep-sea fishing, shopping, and stayed in four-star hotels. There was one half-hour business meeting during each of these trips. She also stated she was instructed by Susan to "do or say anything, true or not, to meet" the weekly quota for student recruitment. For example, she was instructed to say "you don't need a four-year degree for this job," when in fact the student would need a four-year degree for the particular job desired.

Judy's comment about being told to say anything to meet the weekly quota for student recruitment prompts you to locate several IBC graduates from the past few years and interview them about their employment opportunities upon graduation. In each case, the students tell you that IBC officials misrepresented to them that the IBC program would qualify them for various employment opportunities. For example, students in the medical assistant program were told that upon graduation they would be qualified for employment with either of the two major hospitals in town. In reality, the students found they were no more qualified for these jobs than someone walking in off the streets. Even with their IBC degree, the students still had to complete an in-house medical assistant program offered by the hospital just the same as someone who held no degree from IBC.

## Questions for Task 2

6. Use the IBC financial statements and perform the following tasks:
  - a. Calculate the following ratios: (1) Administrative and Officer Salaries to Instructional Salaries for both IBC-Fargo and IBC-Bismarck, and (2) Administrative Expenses to Net Educational Income for both campuses.
  - b. In order to investigate whether the IBC-Fargo or the IBC-Bismarck ratios calculated above were reasonable, you decided to determine the relationship between these various accounts

- at another university. In this case, the fraud examiner called the Director of the Budget Office at State University and learned that total administrative and officer salaries at SU were about 57 percent of total instructional salaries for the 1998–1999 academic year, (i.e., the year of your investigation). Thus, you are comfortable assuming the IBC-Bismarck ratios calculated above are reasonable. Given that assumption, estimate the excessive expenditures for Administrative and Officer Salaries and for Administrative Expenses at IBC-Fargo.
- c. Perform a vertical analysis of the IBC-Fargo income statements for 1993–1996 and compute the following relationships: (1) Net Educational Income as a percentage of Gross Tuition Revenue, and (2) Officer Salaries as a percentage of Gross Tuition Revenue.
  - d. Perform a horizontal analysis of the IBC-Fargo income statements for 1994 and 1995 and calculate the percentage change in the following accounts: (1) Gross Tuition, (2) Instructional Salaries, (3) Officer Salaries, (4) Instructional Expense, and (5) Administrative Expense. What anomalies does your analysis reveal?
  - e. Identify any other unusual relationships or ratios and perform a horizontal and a vertical analysis of the questionable accounts you identified.
  - f. Based on your above review of the IBC financial statements, did you uncover any evidence that either confirms or refutes the allegations you have been engaged to resolve? Explain and defend your answer.
7. After inspecting the pay stubs, what concerns will you communicate to the attorney?
  8. Considering the results of your analysis in questions 6 and 7, what concerns do you have about the quality of the audits conducted on IBC's financial statements? What additional actions, if any, do you recommend?

### TASK 3: NET WORTH COMPUTATION

To complete your third task, you first obtain a personal financial statement of Susan and Gary Jacobsen, prepared in 1992 by the IBC controller, Robert Knapper, for the Small Business Association. This statement calculated Susan and Gary's net worth to be almost \$1,900,000. To gather current financial information, you start by obtaining mortgage documents pertaining to IBC, Gary Jacobsen, and/or Susan Jacobsen at the County Register's Office. Eleven documents were obtained, all listing their personal residence as collateral. Your investigation reveals that they own two properties: their principal residence in Fargo has a market value of \$319,000 and outstanding mortgages totaling \$778,700, and a lakeside cottage has a market value of \$60,000 and outstanding mortgages of \$107,300.

Next, you visit the Treasurer's Office at the County Courthouse, and receive a computer-generated printout showing the amount of property tax owed by and collected from the Jacobsens from 1991–1997. You discover they owe \$87,406 in property taxes to the county as of June 1998.

Frequent newspaper and local television news reports in early 1998 state that the IRS has filed tax liens totaling \$706,450 against IBC for employee federal withholding taxes, Social Security taxes, and unemployment taxes IBC owes the federal government. The IRS also filed liens of \$250,905 against the Jacobsens for personal income taxes they owe from 1995 and 1996. The North Dakota Tax Department filed liens of \$32,207 for unpaid sales and state income taxes.

From your surveillance of their residence, you learn that the Jacobsens drive five vehicles: a 1992 Honda Prelude SI, a 1992 Honda Accord EX, and 1996 Range Rover Discovery, a 1991 GMC Jimmy S-15, and a 1994 GMC Sonoma. Your discussions with the local car dealerships reveal that the 1996 Range Rover Discovery is leased. By reviewing the Uniform Commercial Code (UCC) filings you discover that both Hondas are fully paid for, but \$4,000 and \$12,000 are owed on the

1991 GMC Jimmy S-15 and the 1994 GMC Sonoma, respectively.<sup>9</sup> Using the Kelley Blue Book website (<http://www.kbb.com>) you estimate the market values of the four owned vehicles to total about \$20,940.

Gary and Susan Jacobsen were in the process of obtaining a divorce and, consequently, their personal residence was for sale. To assist you in your net worth analysis, you decide to pose as a potential purchaser of the home.<sup>10</sup> During a tour of the house, you videotape the contents of the Jacobsen home, which include a baby grand piano with gold trim, expensive furniture, a billiards room, numerous works of art, and a fully equipped exercise room with wall-to-wall mirrors. You conservatively estimate the value of this personal property to be at least \$100,000. The Jacobsens were divorced on February 25, 1998, and you obtain a copy of their divorce agreement that listed the division of the couple's assets and liabilities. The document indicates that they also own a residence in Tucson, Arizona with a market value of \$153,000 and an outstanding mortgage of \$100,000.

### Questions for Task 3

9. Compute Susan and Gary Jacobsen's estimated net worth as of June 1998. Does this evidence either confirm or refute the allegations you have been engaged to resolve? Explain and defend your answer.

### EPILOGUE

In the aftermath of IBC's collapse, prosecutors obtained criminal indictments against Susan Jacobsen based on the following charges:

1. Six counts for failure to file or pay state taxes
2. Conspiracy to commit loan fraud against the Small Business Administration (IBC applied for a \$125,000 disaster assistance loan to replace flood damaged computers at Aaker's Business College—which was owned by Susan's brother—in Grand Forks but diverted the money for personal use)
3. Illegally transferring \$125,000 in SBA loan money from one school's bank account to another
4. Failure to repay \$546,000 in unused financial aid to the Department of Education
5. Failure to refund \$368,000 owed to students
6. 19 counts of grand theft for stealing \$500 each from 19 students' financial aid accounts

In a plea agreement hearing before the judge, prosecutors argued that Ms. Jacobsen "drained huge amounts of money from the schools to pay herself an exorbitant salary, buy homes, expensive clothes and jewelry, eat lavish meals, and support alcohol and gambling habits ... While students were eating macaroni and cheese, the defendant was eating caviar." Examples of extravagant living presented to the court included:

- \$27,000 per month salary
- IBC paid Susan's personal credit card bills, which totaled \$190,000 in a six-month period
- \$18,241 spent on clothes in one day in Washington, D.C.
- A \$5,000 IBC credit card cash advance was used to gamble in a Las Vegas casino
- \$1,200 spent on one meal in Washington, D.C.

When Susan tried to rationalize and shift the blame for her conduct to her subordinates the judge retorted, "You have no right to rationalize your conduct. You were the boss. You were responsible."

<sup>9</sup> Filings under the UCC are made at the state and county level and contain information regarding non-real-estate mortgages such as loans made to individuals or businesses for the purchase of equipment, furniture, automobiles, and other types of personal property.

<sup>10</sup> Posing as a potential purchaser is not illegal or unethical. Information about the value of the Jacobsens' personal property was needed to estimate their net worth, and there was no other reliable method by which to obtain this information. Before posing as a potential purchaser, however, the fraud examiner first checked with plaintiffs' attorney to determine if he was within his legal rights to do that and the attorney assured him that he was. Further, the attorney informed him that evidence obtained in such a manner would be admissible in court.

He then added that her lifestyle, extravagant by anyone's standards, was "a slap in the face to students and the community."

In August 1999, Susan Jacobsen pleaded guilty to charges 1, 4, and 5 above, was sentenced to eight years in prison, and was ordered to pay \$914,000 in restitution. The remaining charges were dropped. In October 2001 she was paroled to the state of Washington. Upon release Susan professed her innocence and claimed she still owed \$3 million, including \$1 million to the Internal Revenue Service. Susan said her future plans were uncertain, but she was considering working on a doctorate degree.

Three other people pleaded guilty to felony counts in connection with the IBC fraud:

- **Gary Jacobsen**, Susan's husband and IBC data processing manager. Pleaded guilty to conspiracy to commit loan fraud against the Small Business Administration. He was sentenced to three years of supervised probation, with six months of home confinement with electronic monitoring, and ordered to complete 100 hours of community service.
- **Robert Knapper**, CPA, IBC controller and chief financial officer. Pleaded guilty to conspiracy to commit loan fraud against the Small Business Administration and to embezzling \$200,000 in student loan money. He was sentenced to three years of supervised probation, with six months of home confinement with electronic monitoring, and ordered to complete 100 hours of community service.
- **Bryan Norbert**, a salesman for Corporate Technologies who prepared a false invoice in an effort to cover up the SBA loan fraud when the SBA audited the loan proceeds. Pleaded guilty to mail fraud, since he sent the false invoice via the U.S. postal service. He was sentenced to two years of supervised probation and ordered to complete 100 hours of community service.

#### **Additional Question:**

10. Who ultimately was harmed by Susan Jacobsen's actions?

### **APPENDIX**

Instructors of forensic accounting/fraud examination courses may wish to add the following question to this case:

1. Prepare a list of interview questions you would like to ask each of the four employees you arranged to interview in Task 2.

For some brief background reading that will provide students with a foundation to assist them in answering this question, see Buckhoff and Hansen (2001) or Hansen and Buckhoff (2000).



## CASE LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

### Introduction and Objectives

Accounting practitioners and academicians alike are encouraging university instructors to include a specific course devoted to fraud examination in the accounting curriculum (e.g., Melancon 2002; Carozza 2002). Prior research identified a total of 19 different universities that offered a specific course on fraud in the late 1990s (Peterson and Reider 2001; Buckhoff and Schrader 2000). However, pedagogical materials are starting to appear for a fraud examination course (e.g., Albrecht 2002) and many universities are now beginning to offer courses in fraud examination. For example, approximately 150 universities are currently participating in the Association of Certified Fraud Examiners Higher Education Program and are offering a dedicated course in fraud examination.<sup>11</sup>

While there are several published fraud case studies with auditing-related issues (e.g., Knapp 2001; Boockholdt 2000; Calderon et al. 2000; Lindberg 1999), there are very few cases that provide students with the opportunity to develop fraud examination skills. Durtschi (2003) wrote a fictional case where students gain experience in recognizing and investigating employee fraud in a firm's financial books. However, that case requires a significant time commitment on the part of the instructor to respond to student inquiries via email as students investigate the fraud and require additional information from the instructor. The primary objective of this case, an account of an actual fraud that was investigated by one of the authors, is to allow students to develop additional basic skills needed in fraud investigations, without a significant time commitment on the part of the instructor. Specifically, students will develop skills in document examination (Task 1), interview preparation (optional question in Appendix), financial statement analysis (Task 2), and report writing (Task 1). In addition, students will develop an understanding of information that can be obtained from a search of public records (Task 3). A secondary objective is to impress upon students the complexity that is often involved in a fraud case, as well as to demonstrate the difference between a fraud examination and an audit of financial statements. IBC is a true case of fraud and the data has not been changed. While not all of the facts of this case are presented here due to space limitations, upon completion of the case students should have some sense of the overwhelming amount of documents, detail, and work involved when investigating a case of alleged fraud.

### Implementation Guidance

The instructor may use this case early in a fraud examination course as an introduction to the various complex issues involved in a fraud investigation, or toward the end of the course as a comprehensive case study. Further, this case can also be used in an introductory or advanced auditing class, as it illustrates the difference between a fraud examination and financial statement audit, and can provide students with a heightened awareness of an environment full of fraud-risk factors (see Exhibit 13), as well as the egregious lengths some business people will go to in order to commit fraud. In addition, it clearly demonstrates the crucial importance of auditing financial statements in accordance with professional standards.

### Instructor Feedback

Two instructors at different universities have used this case in their courses to test the value of this case as a learning tool. The instructors agree that the case achieved its objectives. In addition, while the students were challenged, they also enjoyed the "real-world" case study.

The first instructor used this case in a graduate-level advanced auditing course since that instructor was in the process of developing a fraud examination course. The use of the case in this manner would be similar to using the case early in a fraud examination course, since none of

<sup>11</sup> The ACFE Higher Education Program offers free educational materials to schools that wish to teach their students about fraud investigation and detection. This offer has been extended through at least the end of 2004, so the number of universities participating in the program will likely increase even more.



**EXHIBIT 13**  
**Fraud Risk Factors Present at IBC<sup>a</sup>**

	<b>Fraudulent Financial Reporting</b>	<b>Misappropriation of Assets</b>
<b>Incentives/Pressures</b>	To satisfy loan covenants To maintain accreditation To conceal internal theft	Extravagant lifestyle Gambling habit Alcohol problem
<b>Opportunity</b>	Inadequate oversight by independent auditor Significant and unusual transactions at year-end Inadequate controls for ensuring integrity of financial reporting Domination of management by a single person	Large amounts of financial aid money flowing through IBC Irrational ratios (e.g., officer salaries and admin. expenses) Inadequate controls for safeguarding assets and protecting students Domination of management by a single person
<b>Attitudes/Rationalization</b>	Lack of ethical standards The auditor didn't question the financial statements so they must be OK Accounting rules are flexible, we can bend them but not break them	Lack of ethical standards Felt like she deserved or earned what she stole Nobody is being hurt by this, except the government and it doesn't care

<sup>a</sup> These fraud risk factors are presented by classification of the three elements that make up the "fraud triangle," as discussed in SAS No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA 2002).

the graduate auditing students had taken a course specializing in fraud examination. Rather, these graduate students had received only two weeks of basic introductory fraud topics in an accounting information systems course two years earlier. This instructor noted that the students showed a high level of interest when discussing the case. The discussion was lively and students asked many questions. Several students expressed some surprise that a fraud examiner is not bound by any professional accounting standards such as GAAS. Rather, the role of the fraud examiner is very different from that of an auditor and is to simply find evidence and then report the facts to support or disprove any allegations. This instructor believed that the case is also appropriate to use in an auditing class for several reasons. First, the case is an excellent example to illustrate the differences between an audit and a fraud examination. Second, the negligent audits performed by the CPA can be used to demonstrate the value and importance of several generally accepted auditing standards and professional ethics.

This case was also used as a learning tool in a subsequent semester by this same instructor in a graduate-level course on fraud examination, as well as by a second instructor at a different university for the same course. Both instructors noted that the students enjoyed the opportunity to apply their course material to an actual case of fraud, and many students commented on how the case helped to pull together much of the material covered in class in a true-life example and caused them to think creatively. The most common words that students used to describe the case were "challenging," "valuable," "informative," "interesting," and "fun." Overall, the students did a good job of arriving at correct solutions to the case questions. Student suggestions relating to the flow of the case and the information presented were collected and included in this version.

We have found that, in an auditing course, one class period is sufficient time to discuss the case. In a fraud examination course students have been exposed to some of these issues, and half a class

period suffices for discussion. Our experience is that the amount of out-of-class time to work the case varies, depending upon the amount of effort students put into their analysis. Based on this experience, students who turn in the most detailed and well-thought-out analyses will probably spend about 6–7 hours out of class on the assignment. Students with less detailed analyses might spend approximately 3–4 hours working on the case.

Using the assignment in subsequent semesters and ensuring students have done the case on their own is always problematic, especially with cases containing real, unaltered data. We suggest first that the instructor require the assignment to be typed, which will prevent students from copying correct answers on their assignment as it is discussed in class prior to turning it in. However, discussing the assignment in class prior to collecting it allows the students to see how well they did. In addition, not returning the assignments to students after grading will also help to preserve the integrity of the assignment.

### ***Student Feedback***

The student comments, verbal and written, were overwhelmingly positive. The following specific comments are representative of what the students wrote about this case:

- “I never realized how much was involved with a fraud examination case. I am very interested in pursuing this as a career option because of the variety and challenge I can see in this field!”
- “There was a lot of information to plow through, but I think that is good practice. I’m sure that in the real world, the amount of information to sort through is unbelievable.”
- “I liked the fact that this was a true case and it gave me an idea as to what can actually happen. It’s hard to believe that one person can be so greedy and hurt so many people, but I know I can’t assume everyone is just like me.”
- “This case catered to the ‘secret detective’ in all of us, and I loved it! I especially liked how I had to really think about the information in front of me, what it proved, and what additional information I needed.”
- “My favorite part was having to pour through the records and come up with answers on my own, without having a textbook to guide me and give me the way to figure out the answer. Since I’m sure this is what I’ll have to deal with as a CPA, my confidence has improved that I’ll be able to do that.”

### **TEACHING NOTES**

Teaching Notes are available through the American Accounting Association’s new electronic publications system at <http://aaahq.org/ic/browse.htm>. Full members can use their personalized usernames and passwords for entry into the system where the Teaching Notes can be reviewed and printed.

If you are a full member of AAA and have any trouble accessing this material please contact the AA headquarters office at [office@aaahq.org](mailto:office@aaahq.org) or (941) 921-7747.

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