

Independent Audits: Where Perception and Reality Hit the Road

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Everyone is talking about audits today--financial audits, computer audits, forensic audits, and let's not forget, Enron's audit. While the light currently shines bright on this important management tool, the fact is that the independent audit and the disclosure it brings have been an integral component of corporate success for a very long time.

The real and the perceived benefit that independent audits bring to this country's marketplace is *integrity*. Companies benefit from the level of confidence that consumers, insurers, creditors, and investors feel when their financial statements receive clean audit opinions from external auditors. On the flip side, corporations may not survive an "adverse" audit opinion. For nine years, I worked in the Justice Department's Antitrust Division where I saw adverse opinions while performing "failing firm analyses." The disclosure found in an adverse audit opinion often could complete the downward spiral to a company's demise: loss of current investors, inability to attract new investors, loss of affordable bank financing, and a cessation of accounts receivable financing, to name a few significant financial repercussions. Clearly, independent auditors perform a vital service to businesses and to the entire financial system.

Audits play a similar role in maintaining public confidence in the operations of the nation's bankruptcy system. For example, audits of the 183 chapter 13 standing trustees, who administer almost \$4 billion dollars, show the success of our joint efforts to ensure that systems and safeguards of every kind are in place. These safeguards include procedures establishing sound internal controls, safe computer systems, secure banking arrangements, and more.

The integrity of our audit system is grounded in the use of independent auditors who are selected by the U.S. Trustee Program through a national bidding process. This mirrors the procedure followed for publicly traded companies where an audit committee of the Board of Directors, rather than company management, has the authority and responsibility to select, evaluate, and replace the independent auditor. Additionally, auditors of standing trustee operations may not work for more than five years on an individual contract. This ensures that the auditors do not lose their independence or the appearance of independence by developing, over a period of time, close working relationships with those employed by the trust operation.

Also, independent auditors understand that the audit is being performed on behalf of numerous clients--in our case, the standing trustee, the operation's insurance and bonding companies, the United States Trustee, and the creditors and debtors, as beneficiaries of the bankruptcy system. Indirectly, of course, the creditors and debtors are paying for the independent audit. The independent auditors follow a Statement of Work that is designed by the U.S. Trustee Program and is available to every standing trustee. The majority of standing trustees are on the same five-year audit cycle. When their new auditors are selected, but before the audits are conducted, we hold joint meetings with representatives from the NACTT, the Program, and

the audit firms to describe the Chapter 13 financial and operating environment. One further note: In their financial audit of the annual report the auditors will disclose any material misstatements they identify, but they cannot give an absolute assurance that there is no fraudulent activity. This is because of the concealment aspects of fraudulent activity, such as falsification of documents or computer records. Obviously, those committing fraud will do whatever is possible to prevent detection.

Another benefit independent audit firms bring is that the auditors must comply with their own strict industry standards. National and state regulatory bodies promulgate audit rules and practices, practitioners are licensed, and disciplinary penalties and sanctions are imposed when the rules are violated. Again, this goes to the heart of integrity and maintaining public confidence, by ensuring that every audited entity receives the same type of review and the same thoughtful deliberations regardless of the audit firm that issues the opinion. The standards promulgated by the American Institute of Certified Public Accountants (AICPA) define the several types of “qualified” opinions, including the very rare adverse opinion. According to the industry standard, an adverse opinion means that the qualification is so material that the auditor finds that the entity’s financial statements do not present fairly the entity’s financial position, results of operations, or cash flows.

While rare, adverse opinions are issued, even with the audits of the chapter 13 trusts. As required by AICPA standards, they have been rendered when funds cannot be accounted for or cannot be traced to an estate. We have confidence and I believe that you, as standing trustees, want to have confidence that your auditors provide this disclosure as soon as possible whenever circumstances dictate. The vast majority of standing trustees receive unqualified opinions, but when there is a problem, the standing trustee and the United States Trustee need to know about it and get to work. An audit with qualifications is a call to action--to find the cause of the problem and implement the solution.

We all share a common interest in protecting funds, ensuring efficiency and productivity, serving a multitude of participants, and very importantly, securing the integrity of the bankruptcy system. Independent audits are an important tool to help accomplish these goals and enhance management and accountability.