

Annual Audits, Reports on Prescribed Procedures, Are Useful Management Tools for Trustees

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Introduction

Annual Auditor's Reports of chapter 13 standing trustees, combined with Reports on Prescribed Procedures, are a critical element in the United States Trustee's oversight of standing trustee operations. They provide key information on the adequacy of internal controls over trust funds, the accuracy of the amounts disclosed in the annual report, and trustee compliance with U.S. Trustee Program (Program) policies and guidelines.

While a primary purpose of any audit is to ensure that controls are in place to protect and account for assets, there are other benefits that accrue to standing trustees from the audits and reports. This article will review the development of standing trustee audits and reports of prescribed procedures, and discuss the benefits to the Program and to the standing trustees.

History of Requirement

A brief history of the development of standing trustee audits and reports on prescribed procedures may be helpful, especially to those standing trustees appointed in the last 10 to 15 years. Initially, standing trustee audits were simply reviews of the annual reports generated by the standing trustees following the end of the fiscal year. The audit was designed to provide reasonable assurance that the annual report was free of material misstatement. The auditor's report noted weaknesses in internal controls only if they could affect, in a material way, the accuracy of the amounts in that annual report.

Between 1995 and 1999, the Program investigated three misappropriations of trust funds by chapter 13 trust employees, and conducted five management reviews that examined trustee operations in detail. In nearly all cases, the Program discovered that the trustees had poor controls over funds and procedures. These deficiencies had not been identified in the audits, and were arguably outside the scope of the audit work.

Based on these findings, the Program reviewed the audit services being performed to determine whether they provided an adequate review of standing trustee operations in view of the Program's oversight responsibilities. The Program determined that, while the audits performed their specific function of ensuring that the annual report was free of material misstatement, they did not substantively address issues such as internal controls. Because bank accounts were the only asset listed on the annual report, the audits typically focused on cash rather than procedures. In fact, some audit firms indicated they did not rely on internal controls to form an opinion on the audit. This led to the Program's development of the Report on Prescribed Procedures to be performed by the audit firm as a supplement to the annual audit.

Benefits of Reports

The combination of the two reports has resulted in a management tool of significant benefit to both standing trustees and United States Trustees. The auditor verifies that the practices and policies the standing trustee has put in place to protect the funds and ensure the integrity of the case data are adequate and that they minimize the risk of mistakes, irregularities and potential fraud. Any problems can be identified promptly and addressed by the standing trustee, with the United States Trustee following up to ensure all findings are adequately resolved.

The following examples demonstrate how an audit combined with a report on prescribed procedures can benefit the standing trustee. In both cases, the auditors' reviews performed a useful function in alerting the standing trustees to weaknesses in procedures. In the first example, the auditor interviewed the standing trustee and staff, and was provided with written policy to document the procedures in the trust office. The auditor determined that certain of those procedures were not being followed. This may have resulted from inadequate training, informal arrangements between employees or even shortcuts developed to handle a growing caseload. The standing trustee may not have been aware that procedures had been modified. Nevertheless, the employees' failure to follow written procedures can lead to inconsistent practices among employees, mistakes in case administration and vulnerabilities in internal controls. In this example, the trustee may have needed to tighten his or her supervision of employees and to implement a formal training program for all employees to ensure they were trained consistently and correctly.

In another example, the auditor addressed a situation where employees' job responsibilities changed as the trustee's caseload increased. However, the access rights of employees were not modified to reflect their different responsibilities, which allowed some employees the ability to change information beyond what was necessary for the performance of their duties. With overly broad access, an employee can circumvent existing internal controls. To reduce this risk, the standing trustee should perform annual reviews of employee access to various case administration fields in the computer system. In this case, the report on prescribed procedures indicated that the standing trustee did not perform this annual review. The trustee could reduce the likelihood of fraud or other irregularities by reviewing employee access regularly and restricting it as appropriate.

Eight Critical Management Reports

Auditors also review whether certain management reports are run and reviewed timely. In 2010, with the assistance of standing trustees, the Program identified eight management reports as critical to the discovery of mistakes, irregularities and potential fraud. Accordingly, the Program requires standing trustees to run and review these reports monthly:

- Creditor name change error report – Identifies where the payee's name on a check does not match the name in the master creditor database.
- Balances over \$100,000 – Identifies cases with a balance on hand in excess of \$100,000.

- Activity in closed cases – Identifies any activity in cases where the final report has been issued.
- No disbursement over 90 days for confirmed cases with funds on hand – Identifies cases with a hold on disbursements.
- Out of balance reports – Identifies cases where the fund balance per system does not equal receipts minus disbursements.
- Negative balance reports – Identifies cases that have disbursed more than the funds available.
- Suspense account reconciliation report -- Identifies total receipts and disbursements to be reviewed in conjunction with reconciliation.
- Large check report – Identifies all disbursement checks over an amount specified by the standing trustee.

Some of these reports were developed to address weaknesses found after investigating misappropriations by trust employees. Others detect errors that affect the proper distribution of funds. For example, as noted above, one report looks for confirmed cases with funds on hand where there has been no disbursement in 90 days. While it is possible that litigation is holding up distributions, it is also possible that there was a data entry error in the case and funds should have been disbursed. If the latter, the standing trustee's duty is to disburse those funds promptly to the intended creditors. A large buildup of funds can be a tempting target for a potential wrongdoer.

Another critical report identifies cases with negative balances, that is, cases where more funds have been disbursed than are available. An employee may have posted a receipt twice so the system indicates that more money is available for disbursement than actually is. A negative balance presents a problem for the standing trustee, who has to recover the funds erroneously disbursed. The trustee may need to alter procedures and/or provide additional employee training.

Standing trustees run a number of reports, some on a daily basis, to monitor the thousands of cases they administer. For the most part, standing trustees were reviewing these or similar reports before the requirement was imposed in 2010. The new requirement set a standard for all standing trustees based on the best practices of many of their peers.

Conclusion

The purpose of the chapter 13 standing trustee Auditor's Report and Report on Prescribed Procedures is to assure the United States Trustee, the standing trustee and the public that estate funds held in trust are protected and are distributed correctly. The audit of the annual report combined with the report on prescribed procedures offers the standing trustee and the United States Trustee a much more complete picture of the strengths and weaknesses in the standing trustee's office, as a tool to reinforce strengths and to identify and resolve weaknesses. The benefit of the audit and report on prescribed procedures is to focus on potential errors and departures from trustee-approved procedures. If a standing trustee receives a clean audit, it provides a level of assurance that the policies and procedures the standing trustee has developed are being followed and are working.