

## Chapter 7 Trustee Audit Process Turns 25!

by Suzanne Hazard, Deputy Assistant Director,  
Chapter 7 Oversight, Executive Office for U.S. Trustees

The United States Trustee Program (Program) has conducted onsite reviews and audits of panel trustees since the Program expanded nationwide in 1988. Some trustees who read this article may remember when Program staff and staff from the Office of the Inspector General visited them every two years to ensure that strong internal controls and other safeguards were in place and operating effectively. Weaknesses identified in some of those early onsite reviews and audits resulted in changes to the *Handbook for Chapter 7 Trustees (Handbook)* to provide enhanced guidance to trustees for establishing and maintaining adequate procedures for administering assets, monitoring case progress, protecting estate funds and reporting on the financial aspects of case administration.

As trustees embraced and implemented the stronger financial policies and procedures described in the *Handbook*, the reports submitted by trustees became more accurate and reliable. In 1997, former Executive Office for United States Trustees Director Jerry Patchan determined that the frequency of onsite reviews and audits could be reduced without harming the integrity of the bankruptcy system. Most trustees are now visited every four years for an audit conducted by an independent certified public accountant or a United States Trustee Field Exam (field exam) conducted by United States Trustee staff.

Today, the Program's audit process remains one of its most important trustee oversight tools. This article discusses updates and enhancements to the audit process.

### Updates and Enhancements

The foundation for the audit and field exam is the set of procedures crafted by the Program's Office of Oversight. We periodically update these procedures to improve the audit process, increase efficiency and ensure the audits and field exams focus on the most important financial aspects of bankruptcy case administration. The audit procedures were updated most recently during the summer of 2012 because of the new *Handbook*, which became effective on October 1, 2012.

Trustees receiving audits and field exams during 2013 will likely notice the following changes from their previous audit or field exam.

- The Internal Control Questionnaire is simplified and shortened from 20 pages to 10 pages. We hope trustees find it more user-friendly, easier to understand and less time-consuming to complete.
- Some of the less significant inquiries, such as whether the "u" designation has been used on the Individual Estate Property Record and Report (Form 1) to identify unscheduled assets, have been removed to enable auditors and field examiners to focus on other important areas of the audit/exam.

- Trustees will no longer be asked to explain why a trustee distribution report (TDR) has not been filed with the court within nine months of the date of the trustee final report (TFR) as listed on the Summary Interim Asset Report (Form 3). This finding implied that distributions were untimely when this was often not the case or was due to circumstances beyond the trustee's control. The Program will continue to monitor the timeliness of case closing through its other oversight procedures.
- The sampling criteria have been changed to help ensure that the auditors and field examiners focus on the most significant assets and transactions handled by the trustee.
- The procedures for Internet auctions and sales, trustee disbursements and computer security have been updated to account for *Handbook* changes.
- The auditors and field examiners have been asked to provide more details regarding the trustee's response to each finding and to indicate clearly when the trustee does not have a response.
- The report is now provided to the trustee in Microsoft Word<sup>®</sup> to facilitate the audit and field exam closure process. The trustee's response is inserted within the body of the report, saving trustee time and allowing United States Trustee staff to review and respond to audit reports and field exam reports more efficiently.

In addition, the report includes a new paragraph intended to reduce confusion about the purpose and scope of the audit or field exam. The paragraph states that the audit or field exam is based upon procedures developed by the Office of Oversight and deals primarily with financial management of estate property and, to a lesser extent, the overall administration of cases. It notes that other important aspects of overall trustee performance are not addressed in detail by an audit, but are addressed by the United States Trustee through the trustee performance review process.

### Trends in Audit Findings

The Program has collected information about the type and frequency of audit and field exam findings since the 1990s. Table 1 compares the top 10 findings from 2000-2003 to their ranking today.

### **Table 1. Comparison of Audit Findings.**

Description of Finding	Rank 2000-2003	Rank 2012
Cash receipts log not properly maintained	1 <sup>st</sup>	25 <sup>th</sup>
Bank accounts not properly reconciled	2 <sup>nd</sup>	2 <sup>nd</sup>
Invoices/support not canceled to prevent duplicate payment	3 <sup>rd</sup>	>25 <sup>th</sup>
Scheduled assets per Form 1 do not match the debtor's schedules	4 <sup>th</sup>	1 <sup>st</sup>
Receipts log not periodically traced to bank statements	5 <sup>th</sup>	>25 <sup>th</sup>
Miscellaneous Form 1 errors	6 <sup>th</sup>	5 <sup>th</sup>
Insufficient segregation of duties	7 <sup>th</sup>	20 <sup>th</sup> (tie)
Transactions not adequately described on the cash receipts and disbursements record (Form 2)	8 <sup>th</sup>	15 <sup>th</sup>
Assets discovered by the trustee not recorded or properly identified on Form 1	9 <sup>th</sup>	4 <sup>th</sup>
Untimely deposits	10 <sup>th</sup>	20 <sup>th</sup> (tie)

These data show that controls over incoming receipts have become stronger. Receipts are consistently and promptly recorded in the cash receipts log and are promptly deposited to maintain effective control over the funds, provide an audit trail and deter theft. Trustees are supervising the receipt and deposit process by tracing a sample of receipts from the log to bank statements.

The audit process also shows that, in general, accounting duties are segregated to the extent possible in a chapter 7 trustee operation and trustees are adequately supervising their staff.

The most frequent findings in recent years pertain to the accuracy of Form 1. The auditors and field examiners find that Form 1 does not match the debtor's schedules, is not updated for amendments and does not reflect the current status of case administration. Since this report is relied upon to summarize information about assets administered in the case and the tasks that must be completed to close the case, the Program will continue to emphasize Form 1 accuracy during training, audits and other oversight procedures. Trustees should establish internal office procedures to review and update Form 1 on an ongoing basis, and should carefully review these reports before submitting them to the United States Trustee and filing them with the court.

The second most frequent finding continues to be bank reconciliations. As noted in Table 1, bank reconciliations have claimed this spot for more than a decade. More than 60 percent of the 2012 audits and field exams included a finding about bank reconciliations. The most common findings in this category are that the reconciliations are not properly documented and are not timely prepared. There is extensive guidance for preparing bank reconciliations in the Supplementary Materials for the *Handbook* on the Program's Web site at [http://www.justice.gov/ust/eo/private\\_trustee/library/chapter07/index.htm](http://www.justice.gov/ust/eo/private_trustee/library/chapter07/index.htm). If you have suggestions for clarifying or improving this guidance, please share them with your local United States Trustee office.

### Responding to Findings

The procedures designed to ensure that trustees address the findings identified by auditors and field examiners and prevent their recurrence are an important component of the Program's audit process.

The United States Trustee sends the audit or field exam report to the trustee with a request to correct each finding and provide a written response describing the trustee's corrective action. In some instances, United States Trustee staff go to the trustee's office to verify the corrective action. Once a local field office is satisfied that the findings have been sufficiently addressed, the office notifies the United States Trustee, who recommends to the Office of Oversight that the audit or field exam be "closed." The Office of Oversight completes its own review of the documentation to ensure all findings have been addressed and the audit closure process is applied consistently throughout the country. The Office of Oversight depends upon the trustee's representation that the cause of the findings has been identified and corrected, and will not recur.

Unfortunately, each year more than 50 percent of the audits and field exams mention that at least one previously reported finding was either not corrected as promised or recurred in the current audit/exam. The Program is focusing on ways to reduce recurring findings as part of its ongoing oversight responsibilities. One way that a trustee can reduce the likelihood of repeat findings is to periodically review her responses to prior audits and field exams to ensure that the promised corrective actions remain in effect. This is particularly necessary when there is staff turnover. In addition, it is not sufficient merely to correct the particular finding for the case reviewed by the auditor. A trustee also should consider whether systemic issues must be addressed to prevent the mistake from recurring.

### Conclusion

Audits and field exams are critical tools for ensuring that trustees perform their fiduciary duties and safeguard bankruptcy estate funds. As demonstrated by changes to audits and field exams over the years, the Program continues to refine the process to enhance effectiveness and create efficiencies. Trustees are encouraged to work in coordination with their United States Trustee to identify ways to further improve the process, with the goal of achieving sustainable results.