

## **Make the Most of Your Next Trustee Audit**

by

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Audits, field exams, trustee interim reports (TIRs) and performance reviews are four of the important tools the Program uses to measure a trustee's compliance with his or her fiduciary and other duties. Each panel trustee receives an audit conducted by an independent Certified Public Accountant at least once every eight years.<sup>1</sup> They normally alternate every four years with the field exam conducted by U.S. Trustee staff, but a trustee may receive two or more CPA audits in a row.

In Fiscal Year (FY) 2010, approximately 200 trustees will receive a CPA audit, 100 trustees will receive a field exam, all 1,100 trustees will submit a TIR, and about 500 trustees will receive a biennial trustee evaluation. This article will focus on audits, although much of the discussion that follows applies equally well to field exams, TIRs and trustee evaluations.

### Common Audit Findings

From FY 2004 through FY 2008, nearly 1,000 audits were conducted, resulting in more than 10,000 findings. The most common finding in the audits performed during that period was that assets on Form 1 did not match the debtor's schedules. For example, assets were omitted, values differed or new information was not recorded when schedules were amended by the debtor. Recently we have noticed an increase in duplicate listings of assets, which may occur when assets are automatically uploaded to Form 1 by the trustee's software and Form 1 is not subsequently reviewed by the trustee and staff.

Form 1 tells the story about what is happening in the case, and trustees should strive to keep it as up-to-date as possible. The form provides a snapshot of the trustee's case administration; it shows the assets and values listed by the debtor, assets discovered by the trustee, the trustee's assessment of those assets and values, how much has been collected, and what is left to do before the case can be concluded. This information is important to the United States Trustee, the court and other parties in interest. To prevent error, trustees should not rely solely on their software programs and should establish internal office procedures to review and update Form 1 as events occur in the case.

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<sup>1</sup> These audits were conducted by the Department of Justice's Office of the Inspector General prior to FY 2004.

The use of inaccurate uniform transaction codes (UTCs) on Form 2 was the second most common finding. UTCs are seven-digit codes implemented in 2002 to track estate receipts and disbursements. They are akin to a bookkeeping system's chart of accounts and today form the backbone of trustee software programs and the new uniform final reports. Forty-four percent of audits reported at least one Form 2 transaction that had inaccurate UTCs. The accuracy of the chapter 7 distribution statistics collected by the Program depends upon the accuracy of the UTCs. To increase the accuracy rate, trustees should establish internal office procedures to periodically review UTCs and correct them as needed. This will not only facilitate the trustee's preparation of the final report at the end of the case, but also assure accurate chapter 7 trustee distribution statistics.

About half of the audit reports had at least one repeat finding, meaning that a finding in the current audit was similar to a finding in a prior audit or field exam. Some repeat findings were ministerial in nature, and therefore, of less concern, such as the failure to update the value of an asset on Form 1 after the debtor filed amended schedules. Other types of repeat findings were more substantive. Repeat substantive findings, especially when they occurred after a trustee pledged to correct the issue, are quite serious. For example, one trustee was cited in a prior audit for weak internal controls, including the failure to restrict who can view and modify the password and other security settings in the trustee's software program. The trustee provided the U.S. Trustee with a corrective action plan and the audit was closed. Despite the corrective action plan, in the next audit the trustee was cited for the very same internal control weakness.

Several kinds of findings are considered so important (material) that if an auditor uncovers them, the result may be an "inadequate" audit opinion. Some of these material findings are shown in Table 1. An "inadequate" opinion is rendered when the auditor determines that the trustee's accounting and cash management practices and procedures are inadequate for the safeguarding of bankruptcy estate funds in accordance with the *Handbook for Chapter 7 Trustees (Handbook)*. An "inadequate" opinion requires that the trustee be suspended from the active rotation for receiving new cases. A trustee who is suspended from active case assignments due to an inadequate opinion cannot be returned to the rotation without the approval of the Principal Deputy Director of the Executive Office for U.S. Trustees.

**Table 1. Audit Findings That May Lead to “Inadequate” Opinion - Summary of Findings Based on Audits Conducted During the Period FY 2004-2008<sup>2</sup>**

Description of Finding	Frequency of Occurrence
Asset not timely investigated, pursued, liquidated or collected	96
Inadequate supervision of professionals	41
Estate funds commingled with non-estate accounts	32
Untimely, inadequate, or no inventory of estate assets	22
Assets not secured or untimely secured	21
Undeposited funds found in estate file or other unsecure location	18
Trustee or staff cannot operate computer system	15
Trustee or auctioneer cannot account for all assets	6
Trustee does not actively supervise employees	6
Signature stamp not controlled by trustee or used to sign checks	5
Trustee not the sole authorized signer on estate accounts	3
Checks issued payable to cash or bearer	2
No computer security or access controls	2

Tips for a Successful Audit

A few simple practices can help the trustee audit proceed as smoothly as possible. Some of these suggested practices relate to advance preparation, while others pertain to the audit itself.

The first step in preparing for an audit is to compare your internal controls and procedures to those set forth in Chapter 9 of the *Handbook*. The Internal Control Questionnaire located on our website 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) will help you conduct an honest appraisal of your systems and procedures. The correct answer for nearly every question on this form is “yes.” If you can honestly answer “yes” to the questions, your operation should be in good shape for an audit.

The next step is to review various documents to correct common errors and avoid repeating past mistakes. Since Form 1 errors are the most common finding, review your forms to ensure they are complete, accurate and up to date. In addition, verify the

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<sup>2</sup> These findings are organized in order of frequency. One finding, “assets sold to insiders or related parties,” is grounds for an “inadequate” opinion, but is excluded from the chart because there were no occurrences during FY 2004 through FY 2008.

accuracy of UTCs. It is also a good idea to look at findings from past audits, field exams, and TIR reviews for areas to focus on to avoid repeat deficiencies.

Most important, do not wait until the auditor calls to prepare for the audit. Your normal office routine should include timely deposits, bank reconciliations, and pursuit of assets; supervision of staff and professionals; documentation of case progress reviews and asset administration decisions; protection of estate assets; and information security measures that limit unauthorized access to case management data, sensitive documents and personally identifiable information.

During the audit, it is important for the trustee to be present as much as possible. If section 341 meetings are scheduled on the date proposed by the auditor, it is advisable to ask the auditor to reschedule. However, in order for the audit to be conducted timely, the rescheduled date should be as close to the original date as possible.

It is also helpful to provide the auditors a comfortable place to work and to show them where to find things in your office. Typically, the auditors are present for two to three days. We realize this may disrupt the normal functioning of your office, and we appreciate your cooperation.

### Conclusion

Audits are an important oversight tool for the Program, and we take them very seriously. They are also an important tool for trustees, because they enable you to have an independent third party assess how well you and your staff are implementing internal control procedures and adhering to policies in the *Handbook*.

We hope that the information presented in this article will help you successfully prepare for your next audit. If you have any questions about the audit process, please contact your local U.S. Trustee field office.