

## **Field Exams and OIG Audits – A Brief Report on the Most Common Problems**

by

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In the Summer 2000 issue of *NABTalk*, Clarkson McDow, the U.S. Trustee in Region 4, introduced the UST Field Examination (“Field Exam”). The Field Exam, which became effective October 1, 1999, is an improved tool for United States Trustees to use when reviewing chapter 7 trustee office procedures and case administration. It can also be used by panel trustees to review the efficiency and security of their own trust operations. The Program alternates the Field Exam with audits performed by the Department of Justice’s Office of the Inspector General (OIG). A chapter 7 trustee should anticipate receiving either a Field Exam or an OIG audit (“OIG Audit”) at least every four years.

Now that the Field Exam has been in place for over two years, there is sufficient information available to provide some guidance on the most prevalent problems encountered, to highlight some of the key areas of concern to the U.S. Trustee, and to suggest ways that trustees might better prepare for their next Field Exam or OIG Audit. In part, this article responds to a request from trustees at the UST/NABT liaison meeting last September that the Executive Office publish a list of some of the more common deficiencies and highlight particular concerns.

### **Overview of the Audit/Exam Process**

Both the OIG Audit and the Field Exam begin with a questionnaire for the trustee to complete and return. The Internal Control Questionnaire (ICQ) focuses on banking, receipts, disbursements, segregation of duties, computer security, and file maintenance, and is used to commence either an OIG Audit or a Field Exam. A second questionnaire is added for the Field Exam, which focuses more on case administration than the OIG Audit. The Asset Administration Questionnaire (AAQ) seeks information regarding case tracking and asset administration.

For both the OIG Audit and the UST Field Exam, the auditors/examiners visit the trustee’s office for three to five days and review numerous aspects of the trustee’s operation. They interview the trustee and staff about internal controls and review a sample of cases, assets, and transactions. The OIG Audit focuses primarily on the areas covered by the ICQ, while the Field Exam is broader in scope and covers matters included in both the ICQ and AAQ.

The *Handbook for Chapter 7 Trustees* is the foundation of the audit/exam process. Trustees are well-prepared for the OIG Audit or the Field Exam if they are familiar with the Handbook and have implemented its provisions, especially those in Chapters 6, 8, and 9. A trustee can measure “audit preparedness” at any time by working through these questionnaires, which can be

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obtained from the United States Trustee or from the Program's web site at:  
<http://www.usdoj.gov/ust/library/chapter07/ch7lib.htm>.

## **OIG Audit and Field Exam Results**

From October 1, 1999, through September 30, 2001, 386 OIG Audits and 194 Field Exams were conducted. Typically, an OIG Audit or Field Exam will result in eight to 15 findings. A "finding," "exception," or "deficiency" means that the auditor/examiner has found an instance where the trustee has not followed the Handbook, has made an error, or has not followed U.S. Trustee guidelines and procedures.

In addition to providing a list of findings, the OIG Audit and Field Exam reports include the case name and number and a description of each finding to help the trustees and U.S. Trustee staff address the problems. The reports also contain an overall "opinion" in the case of an OIG Audit, or "conclusion" in the case of a Field Exam, about the trustee's cash handling, financial record keeping and reporting procedures, and asset administration procedures, and whether they are adequate to safeguard bankruptcy estate funds and property in accordance with the Handbook and sound business practices. The three possible conclusions are "adequate," "adequate, except for (certain findings)," or "inadequate because of (certain findings)."

During the past two years, 13 inadequate opinions have been issued in OIG Audits and 16 "inadequate" conclusions have been issued in Field Exams. This is out of a total of 580 OIG Audits and Field Exams. Thus, the "inadequate" opinion or conclusion is quite rare, but it generally has serious consequences, most commonly resulting in suspension.

It is a rare examination or audit where there are no findings. Indeed, out of 580 examinations and audits in the last two years there were only nine that had no findings whatsoever. Even if there are some findings or exceptions, a trustee can still receive an "adequate," although they also tend to be rare. The vast majority of reports are issued as "adequate, except for." This raises the question for trustees and U.S. Trustees alike: "What are the most common problems?"

## **Most Frequent Audit and Exam Concerns**

Following are some of the most frequent OIG Audit and Field Exam findings. Some of the findings are of special concern to U.S. Trustees because they suggest that estate assets may be at risk or that the estate is not being administered in a way that will maximize the benefit to creditors. The combined number of findings and exceptions is in parentheses.

### *Case Administration Issues*

- Higher yield investments not considered/used or estate funds not invested at all (136).
- No or inadequate system for tracking receivables (107).
- Sale or settlement without notice or court order (66).
- Assets not timely investigated and pursued (65).
- Assets not timely liquidated or collected (60).
- Inadequate supervision of professionals (57).

## *Reporting Issues*

- Form 1 errors, including failure to list all scheduled and unscheduled assets and failure to accurately reflect the current status of estate assets (648).
- Transactions not recorded on Forms 1 and 2 (197).
- Transactions not adequately described on Form 2 (171).
- Transactions not properly cross-referenced between Forms 1 and 2 (136).

## *Internal Control Issues*

- Cash receipts log not properly maintained (466), along with the trustee not tracing receipts per the log to the bank statements and Form 2 (204).
- Bank accounts not timely or properly reconciled and reviewed (417).
- Invoices and support for disbursements not approved by trustee and cancelled to prevent duplicate payment (171), plus disbursements without court order (74).
- Insufficient segregation of duties (173).
- Untimely deposits (146).
- Computer passwords known to others/not changed annually (136).
- Insufficient computer backup procedures (134).

## **Findings Most Likely to Result in an “Inadequate”**

Due to their serious nature, any one of the following findings may result in an “inadequate” opinion or conclusion. When these findings are present, the United States Trustee will take immediate action to address the situation because of the potential loss of estate funds.

- Commingling estate funds with business, professional, or personal funds. Bankruptcy-related funds, including cash, earnest monies, and funds received with a settlement offer, should never be deposited to a trustee’s law firm trust account or other non-estate account, even for a short time. (See Handbook 9-1, 9-18, and Appendix G.) There were 58 instances of commingling estate funds.
- No or minimal supervision of employees who handle estate funds and record keeping. As a fiduciary, trustees are entrusted with the safekeeping of estate assets. This includes establishing and maintaining strong internal controls and computer security measures that discourage malfeasance. (See, especially, Handbook 9-11 and 9-15.) There were 14 specific findings where the trustee was cited for not actively supervising employees. In addition, there were 40 instances where the computer system was not considered secure and 21 instances where the trustee and/or trustee’s staff did not know how to operate the computer system.
- A signature stamp is used to sign checks or is not under the sole control and custody of the trustee. Estate checks must be manually signed by the chapter 7 trustee. Since the presence of a signature stamp in a trustee’s office increases the chance of it being used for unauthorized purposes, it is important that the trustee maintain control of it and know when it is being used. (See Handbook 9-19 and 9-20.) There were 14 situations where a signature stamp was used to sign checks or the stamp was accessible to the trustee’s staff.
- The trustee cannot account for estate assets. The trustee has the duty and responsibility to

insure and safeguard all estate property and property that comes into the trustee's hands by virtue of his or her appointment to a case. (See Handbook 6-3.) There were 17 instances when undeposited funds were found in estate files or other insecure locations. There were 35 instances of untimely, inadequate, or no inventory of estate assets, 46 instances when estate assets or records were not secured or were untimely secured, and eight instances when auctioneers did not timely turn over auction proceeds.

- One or more blank checks were signed by the trustee. Checks must be payable to a definite payee and for a specific amount, before being signed by the trustee. There were two instances of "pre-signed" checks, plus one instance when a check was made payable to "cash" and one situation where counter checks or money orders were used. Notably, these instances occurred in FY 2000; no such incident was identified during FY 2001 audits and exams.

While any one of the foregoing findings would be sufficient to warrant an "inadequate" opinion or conclusion, depending on severity, potential harm to the estates, or actual harm to the estates, these are more commonly found in combination with numerous other findings or exceptions that may be less severe. Usually, it is the totality of the circumstances that leads the reviewer/auditor to issue an "inadequate" opinion or conclusion.

Even if the examiner/auditor determines that the result should be "adequate, except for," the findings may be either relatively minor or perilously close to those that would result in an "inadequate" opinion or conclusion. Similarly, a trustee can receive a relatively clean OIG Audit, but because that OIG Audit does not address asset or case administration, find that on a Field Exam there are numerous and serious concerns raised over asset administration procedures.

## **Conclusion**

Trustees can use the ICQ and the AAQ questionnaires to monitor their operations. By design, the ultimate determination of whether a Field Exam is "inadequate" has been left to the considered judgment of the U.S. Trustee. The U.S. Trustees recognize the importance of the Field Exam and have worked to make the Field Exam as well as the OIG Audit as fair and as consistent as possible.

Although oversight tools may seem burdensome, trustees can also use the process to make their trust operations more secure, more efficient, and more profitable. If the information is accurately entered at the beginning of the process and accurately tracked in the course of administration, there will be fewer problems and errors in the trustee's final report. In short, audits and exams are better viewed not as something that the trustee passes or fails, but as tools for monitoring and improving internal controls and asset administration.