

Bankruptcy audits and their recent indefinite suspension.

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The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 gave the US Trustee's office the power to audit consumer bankruptcy cases for fraud and abuse. It was to identify "material misstatements" to root out fraud and abuse.

The way it worked in practice in the past was that an accounting firm notified the debtor that the case had been selected for audit. The notice would request certain documents, such as tax returns, bank statements, and pay advices (pay stubs) to be provided within a certain period of time. If you did not provide the documents/information, there was a problem. Upon receipt of the documents/information, the accounting firm conducted the audit, presumably performing the same calculations the debtor and his attorney would perform, and assess whether there were material misstatements. In the US Trustee's 2012 it described what the auditors do. It stated in part:

An audit consists of a comparison between selected items on a debtor's originally filed bankruptcy papers and documents produced by the debtor at the request of the audit firm. Audit firms also conduct at least two searches using commercially and publicly available database services to look for unreported assets and to verify the market value of assets.

There are 2 ways that a bankruptcy case can be audited. One is simply random. The other is called an exception audit. The US Trustee's report described the 2 types of audits in this way:

Random audits are selected randomly from all consumer bankruptcy cases within a federal judicial district. In contrast, cases designated for exception audit must meet specific criteria established by the USTP. These criteria are based on income or expenditures greater than a statistical norm for the district where the case was filed, as specified under uncodified section 603(a)(2)(C) of the BAPCPA.

The US Trustee's 2012 annual report shows that material misstatements were found in about 16% of consumer cases that were randomly audited and in 31% of cases selected for an exception audit. A material misstatement was found in twenty-five percent of case overall. Although this does not mean that the US Trustee's office took substantive action upon the finding of a material misstatement, such as seeking to object to the debtor's discharge, but it certainly is something you want to avoid if you are a debtor.

In March of this year the US Trustee's office made the following announcement, in part, concerning audits:

As authorized in Section 603(a) of Public Law 109-8, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the United States Trustee Program (USTP) established procedures for independent audit firms to audit petitions, schedules, and other information in consumer bankruptcy cases. Pursuant to 28 U.S.C. § 586(f), the USTP contracted with independent accounting firms to perform audits in cases designated by the USTP.

Due to budgetary constraints, the USTP has indefinitely suspended its designation of cases subject to audit and has notified the independent accounting firms performing the audits.

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Despite the fact that audits have been suspended for now, an audit is just one component of the bankruptcy system designed to ensure that debtors are honest, forthcoming, and accurate. It is still imperative to make sure a debtor handles a filing correctly. In the event that you are considering engaging an attorney to represent you in a bankruptcy, please feel free to call.

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