



General Government Division

B-279802

April 22, 1998

The Honorable Martin T. Meehan
House of Representatives

Subject: Personal Bankruptcy: The WEFA Report on the Financial Costs of Bankruptcy

Dear Mr. Meehan:

This letter responds to your request that we evaluate the reasonableness of the assumptions and the reliability of the conclusions of the February 1998 report by the WEFA Group on the financial costs of personal bankruptcy.¹

SCOPE AND METHODOLOGY

In reviewing the WEFA report, our objective was to assess the strengths and limitations, if any, of the report's assumptions and methodology for estimating the 1997 financial costs of personal bankruptcy. We used our methodological expertise and well-established research standards in reviewing the report. Our comments and observations are based solely on the information provided in the report regarding the report's purpose, data, assumptions, methodology, and findings. We attempted to discuss our observations about the report with the WEFA report's authors, but were unable to do so.

BACKGROUND

Personal bankruptcy filings have set new records in each of the last 2 years. There is little agreement on the causes for such high bankruptcy filings in a period of relatively low unemployment, low inflation, and steady economic growth. Nor is there agreement on such issues as the number of bankruptcy filers who could pay a "substantial" portion of their debts, or the current costs of bankruptcy filings to creditors and the bankruptcy system.

¹WEFA Group, The Financial Costs of Personal Bankruptcy (Feb. 1998).

Debtors who file for personal bankruptcy usually file under chapter 7 or chapter 13 of the bankruptcy code. Generally, debtors who file under chapter 7 of the bankruptcy code seek a discharge of their eligible debts. Debtors who file under chapter 13 submit a repayment plan, which must be confirmed by the bankruptcy court, for paying all or a portion of their debts over a 3-year period unless for cause the court approves a period not to exceed 5 years.

Under the bankruptcy code, debts are classified as secured (such as mortgage and auto loans secured by the property financed by the loan), unsecured priority (such as alimony and child support), or unsecured nonpriority (such as credit card and medical debts). Generally, debtors who file for personal bankruptcy under chapter 7 seek a bankruptcy court discharge of their eligible dischargeable debts. Following the bankruptcy court's discharge, a debtor is no longer financially responsible for the debts that were discharged. However, some debts are not dischargeable in bankruptcy, and the debtor remains financially responsible for these debts after all other eligible debts have been discharged by the bankruptcy court. Nondischargeable debts include child support, alimony, certain back taxes, and certain student loans.

Debtors may voluntarily agree to pay (reaffirm) one or more of their eligible dischargeable debts. For a debt secured by property, such as an auto loan, the debtor must surrender the property if he or she does not reaffirm the debt.² The creditor whose loan was secured by the property, such as an auto loan, is entitled to receive the proceeds from the sale of the surrendered property, up to the full value of the outstanding loan.

Chapter 7 cases are classified as "asset" or "no-asset" cases. A chapter 7 debtor is permitted to retain certain "exempt" assets in bankruptcy proceedings, such as a certain amount of equity in the debtor's principal residence. Exempt assets vary by state. Chapter 7 filers who have additional, "nonexempt" assets must surrender those assets to the bankruptcy trustee, who is to convert the assets to cash for distribution to creditors. The cases of debtors who have no nonexempt assets are called no-asset cases because the debtors have no assets that can be liquidated to pay creditors. Cases of debtors who do have nonexempt assets are called asset cases. Proceeds from the conversion of a chapter 7 debtor's nonexempt assets are distributed to creditors in a statutorily defined order—unsecured priority followed by unsecured nonpriority. Eligible dischargeable debts that remain unpaid after the distribution of all available proceeds from the sale of the debtors' nonexempt assets are usually discharged. Historically, the vast majority of chapter 7 debtors have no nonexempt assets available for liquidation.

²The debtor may "redeem" the property by paying in one lump sum the full fair market value of the collateral or may "reaffirm" the debt with the consent of the secured creditor and retain the property under the terms and conditions to which both debtor and creditor have consented.

The WEFA report estimated the costs to creditors and the bankruptcy system—including bankruptcy courts and trustees—of bankruptcy filings in 1997. The report estimated that total financial losses from all bankruptcy filings in 1997 were about \$44.3 billion, including creditor losses of about \$42 billion and bankruptcy system costs of about \$2.3 billion. The report estimated that the largest creditor losses, about \$35 billion, were for unsecured nonpriority debts—\$29.3 billion from chapter 7 debtors and \$5.6 billion from chapter 13 debtors (see table 1). The \$2.3 billion in bankruptcy system costs included estimates of debtors' legal representation costs; creditors' post-bankruptcy filing collection costs; and the costs of the bankruptcy courts, bankruptcy trustees, and other professionals, such as the trustees' attorneys.

Table 1: Total Estimated 1997 Debt, Total Estimated Debt Repaid, and Total Estimated Loss to Creditors, by Type of Debt for Chapter 7 and Chapter 13 Bankruptcy Filers (Dollars in Billions)

Bankruptcy chapter	Type of debt			Total
	Secured	Unsecured priority	Unsecured nonpriority	
Chapter 7				
Estimated total debt	\$38.8	\$1.9	\$29.8	\$70.6 ^a
Estimated debt repaid	32.0	1.5	0.5	34.0
Estimated creditor losses	6.8	0.4	29.3	36.4 ^a
Chapter 13				
Estimated total debt	45.1	1.5	6.5	53.1
Estimated debt repaid	45.1	1.5	0.9	47.5
Estimated creditor losses	0.0	0.0	5.6	5.6

^aIndividual entries in the report did not add to total due to rounding.

Source: WEFA report.

RESULTS IN BRIEF

The WEFA report included three basic national estimates for 1997: (1) the total amount of secured, unsecured priority, and unsecured nonpriority debt held by all debtors who filed for bankruptcy under chapter 7 or chapter 13; (2) total creditor losses in each debt category based on the estimated percent of the total debt in each category that chapter 7 and chapter 13 debtors would repay; and (3) the total legal, court, and collection costs incurred by debtors, the bankruptcy system, and creditors, respectively. As the WEFA report noted, the report's estimates were based on "a variety of data sources and assumptions regarding industry and government practices." A number of these data sources and assumptions were discussed only in general terms. Without a more detailed

explanation, it is difficult to assess the reliability of the data used; the reasonableness of the report's assumptions; and, thus, the accuracy of the report's estimates of creditor losses and bankruptcy system costs in 1997.

It is important to note that the National Bankruptcy Review Commission concluded that there is a general lack of reliable, accurate data on the bankruptcy system, and the data that are available are splintered among several central reporting agencies and the 94 bankruptcy districts.³ Thus, researchers who wish to explore specific bankruptcy issues—such as the amount and type of debts repaid in bankruptcy—must either gather the needed data from a variety of sources, such as bankruptcy court and trustee files, or rely on more readily available substitute data that the researchers believe would reasonably approximate the actual data. WEFA relied on data that it believed would reasonably approximate actual debt levels, debt repayments, and bankruptcy system costs for those debtors who filed for bankruptcy under chapter 7 or chapter 13 of the bankruptcy code in 1997. However, WEFA did not fully explain why the data and assumptions used were appropriate compared to available alternatives.

In our review we identified two categories of issues: (1) strengths and limitations that could be assessed from the information provided in the report and (2) potential strengths and limitations that could not be fully assessed because the report provided insufficient data on which to base an assessment.

The report provided the most detailed information on its method of estimating the debts held by those who filed for personal bankruptcy in 1997 under chapter 7 or chapter 13 of the bankruptcy code. We identified four major concerns with regard to these debt estimates. First, the data on debtors' income and debts were from the information debtors provided on their schedules of estimated income and debts that they filed with their bankruptcy petitions. The National Bankruptcy Review Commission's October 1997 report noted that there has been no empirical study of the accuracy of the financial data initially reported by bankruptcy debtors, and it recommended random audits of such data. Second, the sample of bankruptcy debtors used to develop the national debt estimates came from only 3 (chapter 13) or 4 (chapter 7) of the more than 180 bankruptcy court locations. As the WEFA report noted, this sample of debtors may not be representative of all bankruptcy debtors nationally for the period from which the sample was drawn. Thus, one should view with considerable caution national estimates based on this sample. Third, the sample of bankruptcy petitions was drawn from bankruptcy petitions filed in various periods in 1991, 1992, and 1993. Even if the sample used were statistically representative of all chapter 7 and chapter 13 filers nationally in one or more of these years, there is potential error in using the debt profile of those who filed for bankruptcy under chapter 7 and chapter 13 in 1991, 1992, or 1993 to estimate the debts of debtors who filed for bankruptcy in 1997. This is because debt profiles of those who filed for bankruptcy under chapter 7 and chapter 13 in 1997 may be different from the profiles of the debtors who filed for bankruptcy in 1991, 1992 or 1993. Fourth, using a measure of national income, the report adjusted the debts of those debtors in its sample to develop a

³Bankruptcy: The Next Twenty Years (Oct. 20, 1997).

national estimate of the debts held by those who filed for bankruptcy. The report provided little explanation for why this measure was used, and we were unable to determine whether this adjustment was appropriate and reasonable. However, given the report's methodology for estimating creditor losses, the net effect of this adjustment was probably to reduce, not increase, the report's estimate of total creditor losses from bankruptcy in 1997.

The report offered insufficient information on which to assess the overall reasonableness and reliability of the report's estimates of creditor losses from chapter 7 and chapter 13 bankruptcy filers in 1997. The report's basic assumption was that creditor losses could be estimated as the amount of average debt per debtor that could be repaid or possibly repaid through the liquidation of the debtor's assets. The assumptions about the amount of debt that could be repaid through asset liquidation were based on a variety of information sources. These included credit industry studies, interviews with lenders, and data from an investor's service on the average amount of mortgage debt repaid when a debtor defaults on his or her home mortgage. The WEFA report provided little discussion of these data sources and of the methodology used in the studies cited to support its assumptions. Thus, there is little information on which to assess the overall reasonableness of the report's debt repayment assumptions.

Similarly, the report provided little detailed information about how it estimated bankruptcy system costs. For example, on the basis of what the report termed "anecdotal evidence," the report assumed that the average court costs of a chapter 13 case were twice those of a chapter 7 case. The report provided only a limited discussion of how it determined bankruptcy court costs, including the fees paid to trustees and professionals. Collection costs were based on a credit industry study that apparently was not verified. The report excluded bankruptcy filing fees from its calculations, which could potentially have had the effect of somewhat overstating bankruptcy system costs. This is because the filing fees paid by chapter 7 and chapter 13 debtors fund part of the expenses of the federal judiciary and the trustee system. If the 1,311,983 chapter 7 and chapter 13 debtors who filed for bankruptcy in fiscal year 1997 had each paid the full filing fee, the federal judiciary would have received about \$92 million and the trustee system about \$95 million to defray their expenses. Another \$37 million would have been deposited into the general fund of the U.S. Treasury.

The WEFA report concluded that its assumptions were conservative, and, therefore, that its estimates of the financial costs of bankruptcy "represent a lower bound on the total economic costs of bankruptcy." For the reasons discussed, we cannot determine whether the report's conclusion is valid, and we believe the report's estimates of creditor losses and bankruptcy system costs should be interpreted with caution.

ESTIMATED 1997 DEBT PROFILE OF CHAPTER 7
AND CHAPTER 13 DEBTORS BASED ON NONRANDOM
SAMPLE AND UNVALIDATED ASSUMPTIONS

Of the three principal estimates included in the WEFA report, the report provided the most detailed information regarding its methodology for estimating the total secured, unsecured priority, and unsecured nonpriority debts of debtors who filed for bankruptcy in 1997 under chapter 7 and chapter 13 of the bankruptcy code. The data on debtors' estimated income and debts were based on the information debtors reported on the schedules they filed with their bankruptcy petitions. The accuracy of the data in debtors' initial schedules is unknown. Noting that no empirical study has been done to assess the accuracy of these data, the National Bankruptcy Review Commission recommended random audits of debtors' schedules of estimated income, estimated expenses, and debts.

Moreover, the sample of debtors who formed the foundation for the WEFA report's estimates was not designed to be a nationally representative sample. The sample from which WEFA developed the data on debtors' average debts was based on petitions from four bankruptcy court locations for chapter 7 debtors and three locations for chapter 13 debtors. This sample was also used in the February 1998 Ernst & Young report on debtors' ability to pay,⁴ and we commented on the sample's limitations in testimony earlier this year.⁵ The sample included 5,364 chapter 7 debtor petitions (in Boston, Chicago, Los Angeles, and Nashville); and 1,734 chapter 13 bankruptcy debtor petitions (in Boston, Los Angeles, and Nashville).⁶ The Los Angeles petitions were drawn in late 1991 and early 1992 and the petitions in the remaining locations during various periods in 1993.⁷ Consequently, the petitions in the sample do not reflect the same time period in all four locations. The sample was not based on scientific random sampling techniques and was not designed to be representative of all chapter 7 or chapter 13 filings nationally or of all filings in each location for the year from which samples were drawn. Thus, national estimates based on the data in this sample should be viewed with considerable caution.

⁴Ernst & Young, LLP, Chapter 7 Bankruptcy Petitioner's Ability to Pay: Additional Evidence from Bankruptcy Petition Files (Feb. 1998).

⁵Personal Bankruptcy: The Credit Research Center and Ernst & Young Reports on Debtors' Ability to Pay (GAO/T-GGD-98-79, March 12, 1998).

⁶It should be noted that the WEFA and Ernst & Young reports have different totals for the number of chapter 7 filers in the sample. WEFA reported 5,634 chapter 7 filers, and Ernst & Young reported 5,722. We do not know the basis for the difference.

⁷The WEFA report did not include information on the dates on which the sample was drawn. Ernst & Young's February 1998 report did show the dates on which the sample of chapter 7 petitions was drawn.

Using the data on secured, unsecured priority, and unsecured nonpriority debts from the debtors schedules of debts, the WEFA report developed average debt profiles of chapter 7 and chapter 13 debtors in each location. The report then developed weighted debt profiles for chapter 7 debtors and chapter 13 debtors in all the sample locations combined (four locations for chapter 7 debtors and three locations for chapter 13 debtors). To develop this weighted debt profile, the data from each location were weighted according to each location's proportion of the total filings in all four locations. For example, Los Angeles accounted for about 61 percent of the final weighted debts for chapter 7 filers in the sample because Los Angeles accounted for about 61 percent of all chapter 7 filings in the four locations combined.⁸ The weighted debt averages were adjusted for inflation to convert the averages to 1997 dollars.

To develop debt profiles for all chapter 7 and chapter 13 bankruptcy filers nationally in 1997, the WEFA report made one additional adjustment to the weighted sample data. The report compared weighted per capita income for chapter 7 and chapter 13 debtors in the four sample districts combined to per capita income in the nation. For chapter 7 filers in the sample, weighted per capita income was 5 percent higher than the national per capita income. For chapter 13 filers in the sample, however, weighted per capita income was 20 percent lower than national per capita income. On the basis of this comparison, the report reduced the average debt for chapter 7 filers by about 5 percent and increased the average debt for chapter 13 filers by about 20 percent. The effect of these adjustments was to reduce total average debt per chapter 7 filer by \$3,717 and increase total average debt per chapter 13 filer by \$23,669, as shown in table 2. This adjustment was based on the "assumption that per capita income is the best possible indicator of average debt in bankruptcy." By making this adjustment, WEFA was making the implicit assumption that among bankruptcy filers average debt is directly proportional to per capita income. We have no basis on which to evaluate the reasonableness of this assumption, nor does the WEFA report discuss the basis for the assumption. The adjusted debt levels for each type of debt—secured, unsecured priority, and unsecured nonpriority—were multiplied by the number of chapter 7 and chapter 13 filers in 1997 to obtain a national estimate for each debt category.

⁸Although the report did not provide data for each location, it did note that Los Angeles accounted for 61 percent and Nashville 4.3 percent of all chapter 7 filing in the four locations combined. The Federal Judicial Center provided us data which showed that in fiscal year 1997 146,976 chapter 7 bankruptcy petitions were filed in the four locations combined. These filings were distributed among the four locations as follows: Central District of California (Los Angeles), 61.1 percent; Northern District of Illinois (Chicago), 21.4 percent; District of Massachusetts (Boston), 13.2 percent; and Middle District of Tennessee (Nashville), 4.3 percent.

Table 2: Weighted Average Debt Per Chapter 7 and Per Chapter 13 Bankruptcy Filer, by Type of Debt, Before and After the Adjustment Based on National Per Capita Income

Type of Debt	Chapter 7		Chapter 13	
	Weighted average debt per filer		Weighted average debt per filer	
	Before adjustment	After adjustment	Before adjustment	After adjustment
Secured	\$43,131	\$41,086	\$96,509	\$116,616
Unsecured priority	2,089	1,990	3,133	3,786
Unsecured nonpriority	33,146	31,574	13,961	16,870
Total	\$78,366	\$74,650	\$113,603	\$137,272

Source: WEFA report.

Adjusting the debt base on which creditor losses were calculated had the effect of reducing estimated chapter 7 creditor losses by about 5 percent and increasing the estimated chapter 13 creditor losses by about 20 percent. The net effect of these adjustments was probably to marginally reduce the report's total estimated creditor losses from chapter 7 and chapter 13 debtors combined. As shown earlier in table 1, the WEFA report estimated that total creditor losses in 1997 were about \$42 billion—\$36.4 billion from chapter 7 debtors and \$5.6 billion from chapter 13 debtors. If the report's original weighted debt estimates were used as the basis for estimating losses, the estimated losses from chapter 7 debtors would have been about 5 percent higher (about \$38.3 billion) than those used in the report, and the estimated losses from chapter 13 debtors about 20 percent lower (about \$4.6 billion). Thus, total estimated creditor losses would have been about \$42.9 billion, or about 2 percent more than the estimate used in the report.

The WEFA report's debt profiles for those debtors who filed for bankruptcy under chapter 7 or chapter 13 in 1997 were based on data from a sample of debtors who filed for bankruptcy at various periods in 1991, 1992, and 1993. However, the debt profiles of those who actually filed for bankruptcy in 1997—whether in the four sample locations or nationally—may vary from the debt profiles of those debtors who filed in 1991, 1992, or 1993. For example, 25 percent or more of all new cars and trucks are now leased, rather than purchased. Vehicle leases may be a more common form of automobile debt for debtors who filed bankruptcy in 1997 than it was for those debtors who filed for bankruptcy when the sample was drawn. Obligations for automobile leases would not be listed as secured debt on debtors' bankruptcy schedules; such obligations would be listed

as unexpired leases on a schedule different from that used to list secured debts.⁹ To the extent such differences exist, the total debts of chapter 7 and chapter 13 debtors in 1997 could be different from the total used in the report, and the distribution of total debts among secured, unsecured priority, and unsecured nonpriority debts could also be different.

In summary, the final weighted 1997 average debt profiles used in the WEFA report were of uncertain reliability and accuracy. The initial data used to develop the profiles were derived from a sample of petitions filed in only 4 of the more than 180 bankruptcy court locations. As the report noted, "the results here should be considered with the understanding that the original sample was not necessarily representative of the nation." Moreover, the report offered no empirical basis for its assumption that "per capita income is the best possible indicator of average debt in bankruptcy" and, thus, can be used to "more accurately represent the national personal bankruptcy picture."

REPORT PROVIDED LITTLE DETAIL ABOUT
THE BASIS FOR THE REPORT'S
KEY DEBT REPAYMENT ASSUMPTIONS

The WEFA report estimated that creditor losses from chapter 7 debtors in 1997 totaled about \$36.4 billion and losses from chapter 13 debtors totaled about \$5.6 billion (see table 1). It should be emphasized that there is little reliable data on the amount of debt repaid by those who file for bankruptcy. The WEFA report estimated credit losses "as the amount of average total debt per person less the amount that is repaid or possibly repaid through asset liquidation in bankruptcy." The report included virtually no discussion as to why this assumption would be expected to provide a reasonable estimate of debt repayment and, thus, creditor losses in bankruptcy.

The report used a variety of sources for its assumptions regarding the percentage of secured, unsecured priority, and unsecured nonpriority debt that chapter 7 and chapter 13 debtors would repay. As shown in table 3, the WEFA report assumed that the only creditor losses from chapter 13 debtors would be from unsecured nonpriority debts, such as debts for credit cards and medical bills. The report assumed that creditors would incur some losses in each category of debt for chapter 7 debtors, but the greatest losses would be from unsecured nonpriority debts.

⁹Debtors' auto and other vehicle lease obligations would be listed on Schedule G "Executory Contracts and Unexpired Leases." Debts owed on vehicle loans would be listed on Schedule D "Creditors Holding Secured Claims."

Table 3: WEFA Report Assumptions Regarding the Percent of Secured, Unsecured Priority, and Unsecured Nonpriority Debt That Chapter 7 and Chapter 13 Debtors Would Repay

Type of debt	Percent of debt assumed to be repaid:	
	Chapter 7 debtors	Chapter 13 debtors
Secured	84% for homeowners 50% for nonhomeowners	100%
Unsecured priority	100%, except for student loans, which were assumed to be repaid at 50%	100%
Unsecured nonpriority	about 1%	14.2%

Source: WEFA report.

The report used a variety of sources for its debt repayment assumptions. These included an investor service (losses on foreclosed mortgages), several automobile lenders (losses on defaulted auto loans), and credit card industry studies (losses on unsecured priority debt). The report provided little information about the data sources used for its assumptions. Without more detailed information about the basis for the report's debt repayment assumptions, it is difficult to assess the reasonableness of those assumptions. However, we can offer some observations on the report's (1) estimate of the secured debt repaid by chapter 7 debtors, (2) estimate of the percentage of unsecured priority debt repaid, and (3) the chapter 13 disposition data used to estimate the percent of unsecured nonpriority debt chapter 13 debtors would repay.

Estimate of Chapter 7 Homeowner Rate Affected Estimate of Secured Debt Repaid by Chapter 7 Debtors

The report's estimate of the amount of secured debt repaid by chapter 7 debtors was affected by its assumption about the proportion of such debtors who were homeowners. This is because the report assumed that homeowners would repay 84 percent and nonhomeowners 50 percent of their secured debt. The report's assumption about the proportion of chapter 7 debtors who were homeowners was based on its four-city sample of debtors. In that sample, homeowners were identified as those chapter 7 debtors who reported home mortgages on their bankruptcy petitions. The two sample locations that contributed the greatest weight to the report's estimate of chapter 7 homeowner rates—Los Angeles and Chicago—also had lower homeowner rates than the other two locations in the sample. The sample of Los Angeles and Chicago debtors reported homeowner rates of 19 percent and 18 percent, respectively; Nashville reported 24 percent and Boston 38 percent. To the extent that Los Angeles and Chicago homeowner rates were lower

than the national average for chapter 7 filers in 1997, the report would have underestimated the amount of secured debt repaid by chapter 7 debtors (given the methodology used).

Report's Estimate for Repayment of Unsecured Priority Debt Appears Reasonable In Part

The WEFA report assumed that chapter 13 debtors would repay 100 percent of their unsecured priority debt and chapter 7 debtors would repay 100 percent, except for student loans, half of which would be repaid. The report's assumption was that these debts are, for the most part, nondischargeable in bankruptcy, and, thus, debtors remain financially responsible for them following the close of their bankruptcy cases. Unsecured priority debts may consist of debts that are nondischargeable in bankruptcy, such as child support, alimony, and certain back taxes. However, not all unsecured priority debts are nondischargeable. In addition, not all nondischargeable debts would be listed as unsecured priority debts. For example, nondischargeable student loans (generally those with government guarantees or subsidies) would be appropriately listed as unsecured nonpriority debts.

There is little empirical data on the amount of unsecured priority debt that is dischargeable or the amount of dischargeable unsecured priority debt that chapter 7 or chapter 13 debtors repay. To the extent that unsecured priority debt is also nondischargeable debt, the WEFA report's assumptions about the repayment of unsecured priority debt seem reasonable. However, to the extent that unsecured priority debt is dischargeable, the WEFA report may underestimate or overestimate the amount of debt repaid.

Unsecured Nonpriority Debt

The report assumed that chapter 7 debtors would repay about 1 percent of their unsecured nonpriority debt and chapter 13 debtors would repay 14.2 percent. The estimate for chapter 7 debtors was based on the assumption that asset cases (about 5 percent of all chapter 7 cases) would repay 40 percent of their unsecured nonpriority debt; and nonasset cases (which the report assumed to be about 95 percent of all chapter 7 cases) would repay nothing. However, the report did not explain the basis for this assumption, and there is little reliable baseline data on which to assess the accuracy of this assumption.

For chapter 13 debtors, the repayment estimate was based on a more complicated set of assumptions. The estimate was essentially based on a weighted average using a VISA analysis (shown in table 4) on the outcome of chapter 13 cases (e.g., successfully completed); and the percentage of unsecured debt repaid in those cases within each outcome category (e.g., 20 percent in successfully completed plans). The WEFA data on the percentage of chapter 13 plans that are successfully completed, dismissed, or converted to chapter 7 are very similar to the data from a 1994 Administrative Office of U.S. Courts (AOUSC) study of chapter 13 cases. The AOUSC report, based on the results

of more than 900,000 chapter 13 cases over a 10-year period, found that about 36 percent of chapter 13 plans were successfully completed; about 14 percent were converted to chapter 7; and about 49 percent were dismissed. We have no information on which to evaluate the debt repayment estimates for the chapter 13 cases in each outcome category (e.g., successfully completed).

Table 4: Methodology WEFA Report Used to Estimate the Amount of Unsecured Nonpriority Debt Repaid by Chapter 13 Bankruptcy Filers

Outcome of plan	Percent of those who file under chapter 13	Percent of unsecured nonpriority debt repaid
Repayment Plan Completed	35	20.0
Dismissed and refiled under chapter 13	15	14.0
Dismissed, debts charged off	35	13.7
Converted to chapter 7	15	2.0
Total	100	14.2^a

^aReflects weighted average of percent of case outcomes in each category multiplied by the average percent of debt repaid by the cases in that category.

Source: WEFA report.

ESTIMATES OF LEGAL, COURT, AND COLLECTION COSTS NOT CLEARLY EXPLAINED OR DOCUMENTED

The WEFA report estimates that the total legal, court, and collection costs of bankruptcy were about \$2.3 billion in 1997. This estimate was based on a variety of data sources and assumptions, some of which are discussed in only general terms in the report. For example, the legal costs for filers were based on a 1997 VISA bankruptcy petition study, but no details about this study were provided.

The WEFA report stated that estimated court costs were based on the costs of administering and running the bankruptcy court, including salaries for judges, support staff, and clerks; and expenses for professionals, including the trustees, the trustees' attorneys, other professionals, and their related expenses. These costs were estimated at about \$418 per chapter 7 case and about \$837 per chapter 13 case. However, the report did not provide a clear explanation for how the costs per chapter 7 case were derived. On the basis of anecdotal evidence that suggested that the court costs for debtors who filed under chapter 13 were about twice the costs of chapter 7 filers, the report estimated chapter 13 court costs by doubling the estimate for chapter 7 filers.

An example of the type of information that would be needed to assess the report's estimates include the total number of 1997 chapter 7 cases used in the analysis—a number we could not find in the report. Only the 5 percent of chapter 7 cases that the report assumed were asset cases would normally incur costs for the trustees' attorneys, other professionals, and their related expenses because such costs are usually associated with the liquidation of debtors' nonexempt assets. Moreover, generally the greater the value of the assets, the higher the costs associated with liquidating those assets, in part because trustee and auctioneer compensation is tied to the value of the assets liquidated. Because the report provided so few details on how court and other bankruptcy system costs were calculated, we were unable to assess whether the assumptions used to estimate these costs were reasonable.

The report excluded filing fees from its calculation of court and trustee costs. However, debtor bankruptcy filing fees contribute substantial sums to the costs of bankruptcy system operations. Table 5 shows the components of the total fee paid by chapter 7 and chapter 13 debtors when they file their bankruptcy petitions. Of the \$175 fee charged chapter 7 debtors at filing, \$70 is used to offset the judiciary's cost; and \$90 is used to offset trustee costs, including the basic \$60 per case trustee fee. In chapter 13 cases, \$70 of the \$160 paid by the debtor at filing is used to offset the judiciary's cost; and \$30 is used for the U.S. Trustee Fund. In fiscal year 1997, if each chapter 7 and chapter 13 debtor had paid the applicable fees, the fees would have offset about \$92 million of the judiciary's costs and about \$95 million of trustee costs. Altogether, chapter 7 and chapter 13 filing fees could have contributed as much as \$187 million toward the costs of the bankruptcy system in fiscal year 1997. In addition, approximately \$37 million could have been available for deposit into the general fund of the U.S. Treasury. However, the actual amount collected in 1997 is probably somewhat lower because not all chapter 7 and chapter 13 debtors may pay the entire fee at the time of filing, and, in certain circumstances, the filing fee for chapter 7 debtors may be waived.¹⁰

¹⁰See, for example, Federal Judicial Center, Implementing and Evaluating the Chapter 7 Filing Fee Waiver Program, Report to the Committee on the Administration of the Bankruptcy System of the Judicial Conference of the United States (1998).

Table 5: The Bankruptcy Filing Fees Paid by Chapter 7 and Chapter 13 Debtors, Their Use, and Their Potential Contribution to Bankruptcy System Costs in Fiscal Year 1997

Filing fees and their use	Chapter 7 cases		Chapter 13 cases		Total chapter 7 and chapter 13 cases combined
	Amount per case	Total all cases filed in 1997 ^a	Amount per case	Total all cases filed in 1997 ^a	
Judiciary	\$40	\$37,047,320	\$40	\$15,432,000	\$52,479,320
Judiciary (noticing)	30	27,785,490	30	11,574,000	39,359,490
Subtotal, judiciary	70	64,832,810	70	27,006,000	91,838,810
Case trustee	60	55,570,980	NA	NA	55,570,980
U.S. Trustee fund	30	\$27,785,490	30	11,574,000	39,359,490
Subtotal, trustees	90	83,356,470	30	11,574,000	94,930,380
General fund of the U.S. Treasury	15	13,892,745	60	23,148,000	37,040,745
Total	\$175	\$162,082,025	\$160	\$61,728,000	\$223,810,025

Legend:

NA = not applicable

Note: Calculations based on 926,183 chapter 7 filings and 385,800 chapter 13 filings in fiscal year 1997.

Source: GAO analysis of data provided by the Federal Judicial Center.

Collection Costs Based on VISA Data

The WEFA report's estimate of the costs of collection expense for unsecured credit accounts was based on VISA's 1997 Issuer Benchmark Study, which we have not seen. The report estimated that the average collection expense was \$32 per account and that each bankruptcy filer had an average of five accounts, for a total of about \$160 per bankruptcy filer. We have no information on which to assess this estimate.

CONCLUSION

The WEFA report used a variety of data sources and assumptions to develop its estimates of the financial costs of bankruptcy. The final weighted 1997 debt profiles used in the report were of uncertain reliability and accuracy. The initial data used to develop the debt profiles were derived from a sample of petitions filed in only 4 of the more than 180 bankruptcy court locations nationwide. The report noted, and we agree, that the sample

was not necessarily representative of the nation. Moreover, the amount and type of debts owed by those who filed for bankruptcy in 1997 may be different from the debts of those who filed for bankruptcy in 1991, 1992, or 1993, when the sample was drawn. In addition, a number of the report's assumptions were based on studies that we have not had an opportunity to examine. The report did not always clearly explain how it derived specific estimates, such as those for court costs. In such cases, the report did not provide sufficient information to enable us to assess the reasonableness of the assumptions and methodology used for the estimate. The WEFA report concluded that its assumptions were conservative, and, therefore, that its estimates of the financial costs of bankruptcy "represent a lower bound on the total economic costs of bankruptcy." For the reasons discussed above, we cannot determine whether the report's conclusion is valid, and we believe the report's estimates of creditor losses and bankruptcy system costs should be interpreted with caution.

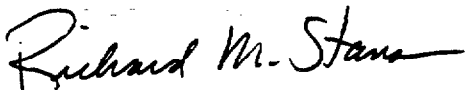
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We are providing copies of this report to the Chairman and Ranking Minority Member of the Senate and House Committees on the Judiciary; the Chairman and Ranking Minority Member of the Subcommittee on Commercial and Administrative Law, House Committee on the Judiciary; and the Chairman and Ranking Minority Member of the Subcommittee on Administrative Oversight and the Courts, Senate Committee on the Judiciary. We will also make copies available to others upon request.

Major contributors to this report were William Jenkins, Jr., Assistant Director, General Government Division, and Yesook Merrill, Office of Chief Economist.

If you have any questions, please call me at 512-8777.

Sincerely yours,



Richard M. Stana
Associate Director
Administration of Justice Issues

(188637)

1. The first part of the document discusses the importance of maintaining accurate records of all transactions and activities. It emphasizes that proper record-keeping is essential for ensuring transparency and accountability in financial operations. This section also highlights the role of internal controls in preventing fraud and errors.

2. The second part of the document focuses on the implementation of robust risk management strategies. It outlines various risk assessment techniques and provides guidance on how to identify, measure, and mitigate potential risks. The text stresses the need for a proactive approach to risk management to protect the organization's assets and reputation.

3. The third part of the document addresses the importance of effective communication and reporting. It discusses the need for clear and concise communication channels and the role of regular reporting in keeping stakeholders informed. This section also touches upon the importance of data security and the need for strong cybersecurity measures.

4. The fourth part of the document discusses the importance of continuous improvement and innovation. It encourages organizations to regularly review their processes and procedures to identify areas for improvement and to embrace new technologies and practices. This section also highlights the importance of fostering a culture of innovation and learning within the organization.

5. The fifth part of the document discusses the importance of ethical conduct and corporate social responsibility. It emphasizes the need for organizations to adhere to high ethical standards and to be transparent in their operations. This section also touches upon the importance of contributing to the community and the environment through various social responsibility initiatives.

6. The sixth part of the document discusses the importance of talent management and employee development. It outlines strategies for attracting, retaining, and developing top talent. This section also highlights the importance of providing ongoing training and development opportunities to ensure that employees are equipped with the skills and knowledge needed to succeed in a rapidly changing business environment.

7. The seventh part of the document discusses the importance of financial management and budgeting. It provides guidance on how to develop a realistic budget and how to monitor and control expenses. This section also touches upon the importance of maintaining a strong financial position and the need for regular financial reviews.

8. The eighth part of the document discusses the importance of legal and regulatory compliance. It outlines the various laws and regulations that organizations must adhere to and provides guidance on how to ensure compliance. This section also highlights the importance of staying up-to-date on changes in the legal and regulatory landscape.

9. The ninth part of the document discusses the importance of strategic planning and goal setting. It outlines the process of developing a clear and concise strategic plan and provides guidance on how to set and track key performance indicators. This section also highlights the importance of having a long-term vision and the need for regular strategic reviews.

10. The tenth part of the document discusses the importance of crisis management and business continuity planning. It outlines the steps to take in the event of a crisis and provides guidance on how to develop a robust business continuity plan. This section also highlights the importance of having a clear communication plan in place to ensure that all stakeholders are kept informed during a crisis.

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