LEGAL UPDATE

ACCOUNTING TO BENEFICIARIES

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Introduction

Lawyers experienced in the field of estate administration agree that most complaints made about persons responsible for the administration of estates arise out of the failure of such persons to give a proper accounting for what they have done. This Legal Update is written to give them an understanding of their obligations. In the balance of this Update, such persons will be referred to as "trustees".

A Fiduciary Duty

Trustees who have accepted the responsibility of managing the affairs of others are in a **fiduciary** position with respect to them. This means that they must show utmost good faith in acting on their behalf. They are not allowed to mix their personal business or money with that of the beneficiaries. In any situation where there is a conflict of interest between what is good for the trustee and what is good for the beneficiaries, the trustee must act in the best interests of the beneficiaries, even though that might result in loss to him personally. In any situation where what is good for the trustee is also good for the beneficiaries, the trustee cannot do what is proposed without a Court Order authorizing the action. Subject to any provision to the contrary in the document creating the trust (be it will, power of attorney, inter vivos trust, or otherwise) the trustee cannot, nor can any member of his family, borrow money from the assets being administered. Similarly the trustee cannot, nor can any member of his family, purchase any of the assets being administered. This is more fully discussed in the April, 1996, Legal Update entitled "Administration of an Estate". A copy of that Legal Update can be given to you on request.

You may remember the problems that Mr. Spiros got into when, in acting as one of the executors of the estate of Harold Ballard, he purchased shares of Maple Leaf Gardens from the Ballard estate. The action against him, brought by the Public Guardian and Trustee on behalf of the beneficiaries, was settled before it reached the courtroom. The settlement cost him many millions of dollars in addition to the original purchase price. In addition to this he no doubt incurred enormous legal fees. He could have avoided most of his problems, and saved a great deal of money and adverse publicity if he had obtained approval for his actions in advance.

What Is An Accounting?

Stated briefly, an accounting is a procedure whereby a trustee tells the people on whose behalf he was acting what assets he received, how he dealt with them, what money he received, what money was spent, why it was spent, and what money is left over to be divided among them.

Why Is An Accounting Needed?

An accounting is needed to protect both the beneficiaries of a trust and the trustee.

A beneficiary wants (1) to know how much he is to receive, (2) to be sure that he or she is getting the money he or she is entitled to receive, and (3) that the trustee has acted honestly and in his best interests.

A trustee wants to be sure that the beneficiaries are satisfied with what he has done and that each of them have received the amount that is properly due to them. In addition, a trustee is not entitled to receive any compensation until the beneficiaries consent to his taking it. A trustee does not normally ask for such consent until he gives an accounting for his actions.

Persons Liable to Account

Trustees who must give an accounting to beneficiaries are not limited to those who administer the estate of a person who has died (now called estate trustees, but more commonly known as executors and administrators). Persons who handle the affairs of another pursuant to a power of attorney, persons who are appointed by a Court to act as guardian of the property of a mentally incompetent person (formerly known as committees), persons appointed by a Court to act as guardians of the property of minors, and persons appointed as trustees of an inter vivos trust are also under an obligation to account to beneficiaries for their administration of property under their control.

Methods of Accounting

A trustee may account to beneficiaries two ways:

1. Formally; or

2. Informally.

Informal Accounts

Informal accounts, which are by far the most common, normally take the form of a letter from the trustee to each beneficiary outlining the assets that he received at the beginning, what was done with those assets, the money received in the form of interest or dividends before the assets were sold, the money received on the sale of any assets, the money disbursed, the reason the money was disbursed, a calculation of the balance on hand, and a calculation of the share of each beneficiary.

Formal Accounts

A formal accounting is done in a procedure known as a "passing of accounts". The accounts are prepared in Court form, and submitted to a judge of the Court for audit. Notice of the audit is given to all interested parties. If no one objects to the accounts, no one need appear before the Judge, who will issue a judgment based on the accounts as submitted. If someone objects to the accounts or to the compensation claimed, the trustee and the person objecting must appear before the judge on the date fixed for passing the accounts. The judge will give directions at that time as to how he will deal with the complaint.

A trustee **must** pass his accounts before a Court in the following circumstances.

1. If beneficiaries who receive informal accounts refuse to sign a release releasing the trustee from future claims arising out of his administration of an estate, a trustee must pass his accounts to obtain Court approval for what has been done.

2. If beneficiaries are upset with the manner in which a trustee has dealt with an estate they may demand a formal accounting.

3. If the estate being administered involves beneficiaries who do not have capacity to sign a release, the trustee must pass his accounts to obtain Court approval for what has been done. These include estates involving minors, persons who are mentally incompetent, and absentees (beneficiaries whose identity is known but who cannot be located).

While it happens from time to time that a trustee must pass his accounts, it is more common to have him pass his accounts on his own initiative where he is not required to do so. The most common situation is where, in the administration of an estate, he is paying income to a life tenant (usually a widow during her lifetime) and on the death of the life tenant is required to divide the residue among other persons (normally the children of the person creating the trust). In this situation accounts are usually passed every three to five years.

The reason a trustee may want pass his accounts in these circumstances is because it is not uncommon to have beneficiaries, who were quite happy in the early years of the administration of an estate, to become unhappy later on. There are many instances where such unhappiness is first expressed fifteen to twenty years after the trust was first established. If they then require a formal passing of accounts and the trustee has not passed them from time to time during his administration, he must then prepare them in Court form from day one. That becomes a very difficult, expensive, and time consuming task. Sometimes it is an impossible task because records have become lost.

Another reason a trustee may wish to pass his accounts is because he may know that at some time in be future he will wish to resign as trustee. If he has not passed his accounts from time to time, and the beneficiaries do not have capacity to give a formal release, he must pass his accounts before resigning to protect himself and his estate from future claims.

There can also be a problem if a trustee dies without having passed his accounts from time to time during his administration. If the beneficiaries of the trust do not know what has been happening and do not know what the assets of the trust are, the estate of the deceased trustee may become responsible for the cost of preparing accounts, and in the case of any doubt, personal assets of the deceased trustee will be attributed to the trust.

What Records Must a Trustee Keep?

Whether the final accounting is in formal or informal form, a trustee must keep many records and documents. He must obtain and keep originals of all deeds, mortgages, life insurance policies, bank books, investment certificates, bonds, debentures, share certificates and all other documents that evidence the assets that he is administering, prepare an inventory of all such assets, prepare and keep a record of all money received and disbursed, and a record of all investments that he makes. In addition he is required to retain all bank deposit books, bank statements, brokers statements, statements of account rendered to the trust, cheques, receipts and vouchers, income tax returns, and notices of assessment issued with respect to each return until such time as he obtains a release from all beneficiaries, or until he has passed his accounts and a Judgment based on such passing has been issued. Thereafter, he should retain the originals of all securities that he is holding, all bank books, etc. for use in any future period of accounting. Needless to say, everything should be retained until Revenue Canada has issued a clearance certificate for purposes of distribution.

The Inventory

A proper inventory of all assets that come into the hands of the trustee at the beginning of his administration of the estate is the basis for all accounting, whether it be formal or informal. It is impossible to stress too strongly how much care should be taken to ensure that all assets are included and are properly described.

Real estate should be described in the inventory by showing the description of the owner on the deed, a brief legal description, a municipal address, the date and registration number of the registration of the deed, particulars of any encumbrances, including balances owing, payments to be made, and maturity date, and an estimated fair market value on the first day of the administration.

Mortgages should be described by the name and address of the person owing the money, the date of registration and the registration number, a brief legal description, the original principal amount and interest rate, the balance owing on the first day of the administration, the current interest rate if it has changed, the expected payments, and the maturity date. Any documents extending the period of time should also be noted showing the same information.

Bank accounts should be described to show the name of each bank, each branch address, each account number, and the balance in each account on the first date of the administration.

Life insurance should be identified by the name and address of the insurer, each policy number, the named insured if it is other the estate, whether or not a named insured is holding the money in trust for the estate, and the amount payable on the first day of the administration.

Investment certificates, bonds, and debentures, should be identified by the name and address of the issuing company, the certificate number, the face value, the interest rate, the dates upon which interest is payable, the date of last payment of interest, and the maturity date.

Shares in the capital stock of publicly traded corporations should be identified by the name of the corporation that issued the shares, the name and address of the transfer agent, the certificate number, the number of shares represented by each certificate, the type of shares represented by each certificate, and the fair market value of each certificate at the close of trading on the first day of the administration.

Shares in the capital stock of private corporations should be identified by the name and address of the corporation issuing the shares, the number and type of shares, the names and addresses of other shareholders, an estimate of the value of the shares, and a calculation showing how that estimate is determined. Copies of any shareholder agreements should be obtained.

In the case of a farming operation, the inventory should include a list and valuation of the equipment, a list of the livestock and value of same, and an estimate of the value of harvested produce.

Pensions and superannuation payments should be identified by the name and address of the institution paying the pension or superannuation, the pension or superannuation number used to identify it, the amount and frequency of payment, whether or not any further payments are to be made, and the amount of any unpaid benefits.

Motor vehicles should be identified by year of manufacture, make, model, and estimated fair market value.

Household goods and furniture should be valued as of the first day of the administration.

Receipts

A record should be kept of all money received. The record should identify the source and date of each receipt. For example, if there are several investment certificates issued by one trust company, and a cheque is issued by that company paying interest due on one of them before the certificates have been redeemed, the record should show on which certificate the interest was paid. The same applies to bank interest, interest on bonds, and dividends. When an asset is sold, the record should identify the asset, show the date the money was received and all expenses incurred in selling it such as real estate commissions, etc..

If several cheques are deposited into a bank account at the same time, the record should set out the source and amount of each cheque, so that the cheques received and deposited can be reconciled with the entries in the bank account.

Disbursements

Debts paid should be identified by date, name of payee, amount, and reason for payment. Invoices received and receipts for payment should be retained. If payment has been made by cheque, and the account on which the payment was made is one that returns the cheques to the trustee, the returned cheques can serve as the receipt for payment.

Investments

If the trustee is invests money that he has received, a record must be kept to show the date and amount of each investment made. If the investment is in the form of a bond, debenture, investment certificate or treasury bill, the record must include the name and address of the issuer, certificate number, face value, interest rate, date of payments, amount paid, and maturity date. If the investment is in the form of shares in the capital stock of a publicly traded corporation, the record must include date and purchase price paid for such securities, including brokers commission, the name and address of the issuing corporation, and the number and type of shares acquired. Money received on the maturity or sale of securities should also be recorded to show the date of sale, the net proceeds received, the security sold, etc., so that it can be identified against original assets in the inventory or investments made by the trustee.

The expenses incurred on the purchase or sale must also be recorded.

Trustee Act

Before making any investment, the trustee must determine whether or not he is bound by the provisions of the Trustee Act in making investments. If the document creating the trust (the will, power of attorney, Court Order, trust document) is silent, he is so bound. If he is bound, he cannot make any investments that are not permitted by that Act. If he is not bound by that Act, he is bound by the "prudent person" rule. He must also, in investing money, keep an even hand between the interests of the life tenant and the beneficiaries who are to receive their benefit on the death of the life tenant.

Preparation of Accounts

It is the responsibility of the trustee to keep proper accounts, and is one of the things that is included in his compensation. If he wishes to employ someone else to prepare them, he must pay that person for doing so from his compensation.

Passing Accounts

Court form accounts required for a formal passing of accounts include the following.

1. An Original Asset Account, which is a list of the assets in the original inventory.

2. A Capital Receipts Account, which is an account of the gross receipts received on the sale, redemption, or maturity of the original assets. For those assets that are originally in the form of money (bank accounts, uncashed cheques, cash) the original amounts in the account are used. This account also shows any capital gains received on the sale of investments.

3. A Capital Disbursements Account which is an account of the debts that have been paid that are charged against the capital assets of the property being administered either by law or by the document creating the trust.
   This account also shows any capital losses incurred in the sale of investments.

4. A Revenue Receipts Account which is an account showing all interest and dividends received, and all other periodic payments that are normally considered to be income. It also includes income received from securities in which the trustee has invested.

5. A Revenue Disbursements Account which is an account showing all payments made that are charged against revenue. This includes income tax payments and bank charges.

6. An Investment Account which is an account showing the money paid out in the purchase of securities and the money received on the sale or maturity of securities.

7. A statement of all original assets that remain in the hands of the trustee at the end of the accounting period and a list of all securities the trustee has purchased and remain in his hands at the end of the accounting period.

8. A statement of all debts that are owing but not paid at the end of the accounting period.

9. The trustees claim for compensation.

It is beyond the scope of this Update to show the method of keeping these accounts in Court form.

The Cost of Accounting

Normally the legal fees charged on an accounting, either informal or formal, as opposed to the preparation of the accounts themselves, is done at the expense of the fund being administered.

If the trustee passes his accounts, and no one objects to the accounts, the legal fees are determined by a Tariff of Fees established pursuant to the Estates Act. The tariff is based on the total gross receipts received by the trustee in the accounting period. The following is the tariff now in force.

If receipts are less than $50,000.00	$600.00
If receipts are $50,000.00 or more but less than $100,000.00	800.00
If receipts are $100,000.00 or more but less than $500,000.00	1,500.00
If receipts are $500,000.00 or more but less than $1,000,000.00	2,000.00
If receipts are $1,000,000.00 or more but less than $1,500,000.00	2,500.00
If receipts are $1,500,000.00 or more	3,000.00

Court fees charged to the trust are in addition to this, and these are also based on the gross receipts.

If someone who receives notice objects to the accounts, and as a result a hearing is held on the return date, or if the judge directs the trial of an issue to determine whether or not the objection is a proper one, there will be additional fees charged
the amount of which will be in the discretion of the Court if they are not agreed upon in advance.

Conclusion

Trustees who are aware of their fiduciary duties and of their obligation to account, and who keep good and understandable accounts that can be shown to beneficiaries on request, rarely get into difficulty. When there is a breakdown of these requirements, however, they may find themselves in an unpleasant adversarial position with the beneficiaries which is not to the advantage of either of them.

Even when there is no difficulty, if the assets to be administered are to be administered over a long period of time, trustees should pass their accounts every few years to protect themselves and their estates from claims of beneficiaries who may become unhappy at some future time with how matters have been dealt with.

DISCLAIMER:

This Legal Update is provided as an information service to our clients and is a summary of legal matters. It is not meant to be a legal opinion. Readers are cautioned not to act on information provided herein without seeking specific legal advice with respect to their unique circumstances. Comments and suggestions are welcome.

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