

PASSING OF ACCOUNTS & FIDUCIARY ACCOUNTING

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Reviewing Accounts:

What lawyers need to look for – we will cover

- **Guidelines for distinguishing between income and capital**
- **How to conduct a thorough analysis – which numbers need to add up where?**
- **Common errors to watch out for**
- **What qualifies as inadequate accounting**

Distinguishing between income and capital

- Introduction to Accounts – Chapter 7 – page 189
- Account entries dealing with Capital and Income
- Trustee's Record Keeping obligation
- Reviewing governing documents in conjunction with Accounts (as referred to in Chapter 3 – page 135)
- Even hand rule
- Payments and benefits to corporations – Form rule

Introduction to Accounts

- Duty to maintain records – some delegation but ultimately trustee responsible to account in accordance with governing documents
- Governing document provides guidance – is there a memorandum of wishes
- Duty to act in good faith in the interest of beneficiaries
- Trustee responsible re treatment of transactions

Classes of beneficiaries

Income beneficiary

- Life tenant e.g. spouse, child(ren)
- Charity – ongoing trust

Capital beneficiary

- Contingent beneficiary, e.g. spouse, child(ren) or charity (as a residuary beneficiary)

Capital beneficiary

- Concerned that assets invested are secure and that there is capital growth
- If task of investing is delegated to an agent – must be made pursuant to a written plan for investment property

Capital beneficiary

- Identify any tasks delegated by trustee
 - Express provision in governing document
 - Nature, physical location and size of asset
 - Expertise of trustee *vis a vis* asset
 - Common business practice
- If agent used – review invoices of agent

Capital beneficiary – Account Review

- Check whether investment policy undertaken was it reasonable and adhered to
- Check opening and closing balances – is there unexplained erosion of \$\$ or unacceptable growth rate – make enquiries
- If delegated to third party – did trustee monitor agent's performance

Income beneficiary

- Are income distributions mandatory or discretionary – are trustees to consider factors?
- To whom and when are income distributions to be made?
- Is trustee directed to prefer interests of one beneficiary over another?
- Are expenses allocated between capital/revenue?

Even hand - review dispositive clauses

- ...”maintain my wife in a manner in which she was accustomed to living in” prior to testator’s death
- Authorizing capital encroachments in a generous manner OR only in exceptional circumstances
- Clause which expressly directs preferential interest of one class of beneficiary over another

Receipts by corporations to shareholders

- Payments from corporations to their shareholders are **dividends**
- Whether a dividend is capital or income depends on the **form** of the dividend declared by the corporation **NOT** the **substance**
- This is called the “*form rule*”

Capital/income dividend

- A rolling back of profits into the Company e.g.
 - Options to purchase shares
 - Payments to redeem or retract shares
 - Issue of new shares (i.e. stock dividends)

These are treated as **capital** in the trustee's hands and recorded as such in the Accounts

Capital/income dividend

- A payment of business profits – whether cash or kind is considered **income** and recorded under Revenue Receipts in the Accounts
- The *form rule* is sometimes disregarded if it causes a particularly unjust result e.g. if a corporation is wound up and its entire assets are distributed by way of an ordinary dividend

Corporate distribution

- Because it is the **form not substance** that matters, it remains
 - Task of trustee to allocate appropriately in the Accounts
 - Trustee must still investigate the directors' resolutions or other corporate acts to determine the nature of the payment

HOW TO CONDUCT A THOROUGH ANALYSIS

Pre-Review

- Read the governing documents.
- Was there an earlier Order or Judgment?

Assets/Liabilities

Original Assets

- The Accounts should record the assets held at the beginning and end of the accounting period

Liabilities

- Do the accounts include a list of the liabilities at the beginning and end of the accounting period?

Capital/Revenue

Capital Account

- When the original assets are realized, their receipt is recorded in capital receipts.
- Are the entries properly recorded in the capital account?

Revenue Account

- Check the asset and investment list to examine whether interest and dividends have been received in a timely fashion and recorded properly.

Investments

Investment Account

- Does the investment account balance including the number of shares or units at the end of the accounting period?

Summary

- Does the total net amount of the capital and revenue accounts equal the investments and cash on deposit in bank accounts?

Compensation

- Does the statement of compensation properly calculate compensation on the capital receipts and disbursements and revenue receipts and disbursements?

Vouchers

- If necessary, request and review supporting vouchers



COMMON ERRORS

TO WATCH OUT FOR

Tips and Traps

- Accuracy – check the math!
- Lack of Detail – missing assets or time periods
- Provisions of governing document not complied with e.g. budget in Management Plan
- Un-compensable transactions not deducted prior to calculating compensation



WHAT QUALIFIES AS

AN INADEQUATE ACCOUNTING

INADEQUATE ACCOUNTING

- Incomplete and inaccurate values of assets
- Missing details/transactions of concern to your client
- Lack of investments over long period of time (duty to convert – duty to keep even hand)
- Co-mingling of funds
- Missing vouchers/pre-taken compensation

Requirement to account

- Executors and trustees are required to keep an accurate record of the assets and transactions of the estate or trust. If the trustee chooses or is compelled to apply to court to pass accounts, the *Rules of Civil Procedure* mandate that they must be set out in a particular format.

Proper Accounting

Zimmerman v. Fenwick (indexed as Zimmerman v. McMichael) 2010
ONSC 2947

[para 34] A trustee must make a proper accounting as a condition precedent to being awarded compensation. Without a proper accounting, the court is unable to assess the conduct of the fiduciary and to determine the compensation to which he or she is entitled. Where a trustee is found to have failed to keep proper accounts and to have been grossly indifferent to his/her fiduciary obligations, he/she may be disentitled to compensation:

Widdifield on Executors and Trustees, above, at p. 13-7; Gibson (Re), [1930] M.J. No. 34, [1931] 1 D.L.R. 159 (C.A.); Picov Estate (Re), [2000] O.J. No. 682 (S.C.J.).

Summary / Conclusion

THANK YOU!

