PASSING OF ACCOUNTS & FIDUCIARY ACCOUNTING

Reviewing Accounts: What Lawyers Need to Look For Tips & Traps

Tracey Phinnemore – WEL PARTNERS

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**

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Introduction to Accounts

- Fiduciary has a duty to maintain records – responsible to account in accordance with governing documents
- High standard to account, especially if compensation is being claimed
- Governing document provides guidance
- Duty to act in good faith in the interest of all beneficiaries
- Fiduciary is responsible re treatment of all transactions

Distinguishing between income and capital

- Form of accounts, Rule 74.17(3) (separate as to income and capital – Rule states only required if governing document dictates but as a practice accounts in court format are generally always separate as to income and capital)
- Even hand rule between capital and income beneficiaries
- Account entries dealing with Capital and Income

What are Considered Capital Entries?

- What are capital entries?
  - Capital Receipts would be the realization of original assets and the profits/gains on the sale of any trustee investments.
  - Capital Disbursements would be related to the administration of the Estate and the capital losses on investments (i.e. funeral expenses, debts, legal fees, legacies, etc.). Certain expenses could be split between capital and revenue at discretion of trustee (i.e. large repair or renovation to rental property)

What are Considered Revenue Entries?

- What are revenue entries?

    - Revenue Receipts would include income received on original assets and trustee investments (i.e. interest, rental income, dividends., in the case of guardianship/POA accounts – pension or disability income)

    - Revenue disbursements would include any expenses associated with the earning of that income (i.e. Investment management fees, bank fees). Generally income tax owing would be a revenue disbursement, however, if tax is related to capital gains would be a capital disbursement

- Payments and benefits by corporations – *Form rule (not all dividends are revenue)

Receipts by corporations to shareholders

- Whether a dividend is reported as capital or income in estate accounts depends on the **form** of the dividend declared by the corporation **NOT** the **substance** (the "*form rule*")
- Capital dividend would be options to purchase shares, redeem or retract shares, issue of new shares ("stock split")
- Revenue dividend would be reporting of business profits

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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

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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

- That assets are invested, secure and that there is capital growth
- Whether investment policy undertaken was reasonable and adhered to (and made pursuant to a written investment plan)
- Opening and closing balances – is there unexplained erosion of $$ or unacceptable growth rate

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Capital beneficiary – Account Review

- 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/fees of agent (deductible from compensation?)

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

- 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

HOW TO CONDUCT A THOROUGH

ANALYSIS

Pre-Review

- **Read the governing documents** (Will/Codicil/Trust/Management Plan)
- Was there an earlier Order or Judgment that amended the governing document? If there is a previous Judgment on Passing of Accounts review carry forward amounts, including assets and investments.

Summary

- Start at the Summary page
  - Do the numbers add up?
  - If this is not the first accounting, check the carry forward balances
  - Check the closing balances (receipts/disbursements/investments) to ensure that they match the summary numbers
  - Does the total net amount of the capital and revenue accounts equal the investments and cash on deposit in bank accounts?

Original Assets

- Is there a statement of Original Assets at opening and closing of accounts
- Are all assets listed? Pay attention to digital assets
- If not the first passing, review previous Judgment and original assets remaining (do they match the opening statement?)
- If original assets have been sold/redeemed/transferred – can you easily track in capital receipts (i.e. cross referenced with capital receipt transaction number)?

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Liabilities

Liabilities

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

Capital Account -Receipts & Disbursements

- Can you track the sale/disposition of each original asset in capital receipts?
- Real estate transactions – gross or net values reported? (need all supporting vouchers)
- Expenses/disbursements - have all supporting vouchers to review?
  - Any capital encroachments? Permitted? Reasonable?
  - Capital gains and losses properly recorded (in capital account and not in investment account)? Are losses/gains reasonable?

Revenue Account – Receipts & Disbursements

- Check the original asset and investment list to examine whether interest and dividends have been received in a timely fashion and recorded properly.
- Expenses/disbursements – reasonable? Supporting vouchers available?
- Income distributions mandatory or discretionary?
- Dividends – properly recorded?

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Investment Account

- Does the investment account balance including the number of shares or units at the end of the accounting period? (should be straight receipt and disbursement of investments, any capital gain/loss or income on the investments to be recorded in capital or revenue)
- Lack of investments over long period of time (duty to convert)

Compensation

- Does the statement of compensation properly calculate compensation on the capital receipts and disbursements and revenue receipts and disbursements and, in accordance with instrument (Will), statute (SDA) or common law?
- Entitled to care and management fee and properly calculated?
- Any interim compensation ("pre-taking")?
- Fees to be deducted from compensation? (fees paid to other professionals performing executors duties)
- Fees being calculated on transfers? Large assets?
- HST payable?

Vouchers

- Ensure that there are supporting vouchers for all transactions (cancelled cheques, invoices, bank and investment statements, appraisals, etc.)

COMMON ERRORS

TO WATCH OUT FOR (TIPS/TRAPS)

Tips and Traps

- Accuracy – check the math!
- Lack of Detail – incomplete information, missing assets or time periods
- Provisions of governing document not complied with i.e. budget in Management Plan
- Mutual funds – this asset/investment is commonly not recorded properly, digital assets not recorded
- Un-compensable transactions not deducted prior to calculating compensation

WHAT QUALIFIES AS

AN INADEQUATE ACCOUNTING

INADEQUATE ACCOUNTING

- Rule 74.17 sets out detailed rules for form of accounts, do they comply with Rule?
- Red Flags to watch out for:
- Incomplete and inaccurate values of assets
- Missing details/transactions/vouchers 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, non-arms length transactions, delegation of duties
- Even hand rule – is trustee favouring certain beneficiaries
- Missing vouchers/interim (“pre-taken”) compensation

RULE 74.17 – FORM OF ACCOUNTS

- Rule 74.17 sets out detailed rules for form of accounts, do the accounts comply with Rule?
- Rule 74.17 of The Rules of Civil Procedure– Form of Accounts
  - (1) Estate trustees shall keep accurate records of the assets and transactions in the estate and accounts filed with the court shall include,
  - a) on a first passing of accounts, a statement of the assets at the date of death, cross-referenced to the entries in the accounts that show the disposition or partial disposition of the assets;
  - b) on any subsequent passing of accounts, a statement of the assets on the date the accounts for the period were opened, cross-referenced to the entries in the accounts that show the disposition or partial disposition of the assets, and a statement of the investments, if any, on the date the accounts for the period were opened;
  - c) an account of all money received, but excluding investment transactions recorded under clause (e);

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RULE 74.17 (CONTINUED)

- d) an account of all money disbursed, including payments for trustee's compensation and payments made under a court order, but excluding investment transactions recorded under clause (e);

- e) where the estate trustee has made investments, an account setting out,

  - (i) all money paid out to purchase investments,

    - (ii) all money received by way of repayments or realization on the investments in whole or in part, and

    - (iii) the balance of all the investments in the estate at the closing date of the accounts;

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RULE 74.17 (CONTINUED)

- h) a statement of all assets in the estate that are unrealized at the closing date of the accounts;
- g) a statement of all money and investments in the estate at the closing date of the accounts;
- h) a statement of all liabilities of the estate, contingent or otherwise, at the closing date of the accounts;
- i) a statement of the compensation by the estate and, where the statement of compensation includes a management fee based on the value of the assets of the estate, a statement setting out the method of determining the value of the assets;
- j) such other statements and information as the court requires.
- (2) The accounts required by clauses (1)(c)(d) and (e) shall show the balance forward for each account.
- (3) Where a will or trust deals separately with capital and income, the accounts shall be divided to show separately receipts and disbursements with respect of capital and income.

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RULE 74.17 (Continued)

- So, to be in compliance with Rule 74.17 what should a court format set of accounts include? Your index for your accounts would include:

- 1. Summary (which will summarize receipts/disbursements with list of cash and investments – amounts only)
- 2. Statement of Original Assets (at the opening date of the accounts)
- 3. Capital Receipts
- 4. Capital Disbursements
- 5. Revenue Receipts
- 6. Revenue Disbursements
  - 7. Investment Account (investments as at the opening date of the accounts, receipts and disbursements and statement of investments as at the closing date of the accounts)
- 8. Statement of Unrealized Original Assets (as at the closing date of the accounts)
- 9. Statement of Liabilities (at the open and close of the accounts - contingent or otherwise)
- 10. Statement of Compensation

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Sample Summary Page

- George Smith Estate
- Date of Death –January 1, 2010
- Estate Accounts for the period January 1, 2010 to December 31, 2020
- **Summary**
- Capital Receipts $2,580,000.00
- Capital Disbursements
$1,145,000.00
$1,435,000.00
- Revenue Receipts $ 385,000.00
- Revenue Disbursements $
167,750.00
$ 217,250.00
- Total **$1,652,250.00**

- Investments $1,569,400.00
- Cash on Hand
RBC Account 123456 $ 82,250.00
- Total **$1,652,250.00**

Sample Statement of Original Assets

- GEORGE SMITH ESTATE Statement of Original Assets as at January 1, 2010

- Bank Accounts Disposition

- TD Canada Trust, Branch 1234
  Chequing Account (sole) 1234-5678 $ 2,670.00 CR#1

- Bank of Montreal, Branch 4321
  Savings Account (sole) 4321-8765 $ 10,500.00 CR#2

$ 13,170.00

- Investments

- 5000 Common Shares of ABC Inc.
  (sole owner) @ $35.50 per share $ 177,500.00 CR#3

- 2500 Class A Shares of ABC Inc.
  (sole owner) @ 75.85 per share $ 189,625.00 CR#4

$ 367,125.00

- Real Estate

- 123 Main Street, Toronto (sole owner) $2,100,000.00 CR#5

- Other

- Jackson Smith painting ("Girl on Water") $ 130,000.00 (as per appraisal from JJ Ritchie 31-01-2010)

Summary/Conclusion

- A fiduciary (which includes an Estate Trustee, Trustee, Guardian for Property or Attorney for Property) has a duty to maintain continuous, comprehensive, detailed and accurate records of their management of assets. If a fiduciary chooses or is compelled to pass accounts, the Rules are very specific as to the form of accounts (74.17) and the duty to account is a high standard, especially if a professional trustee and compensation is being claimed. Not only must the accounting be accurate and thorough the fiduciary must keep all supporting vouchers and these must be available for inspection.

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The End

THANK YOU!

Resources

- http://welpartners.com/resources/WEL-Fiduciary-Accounting-Red-Flags-checklist.pdf
- http://welpartners.com/resources/WEL-on-fiduciary-accounting.pdf