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Understanding Fiduciary Accounting for Trustees

Purpose of an Accounting:

A Trustee has a legal obligation under New York State law to maintain accurate records of all the Trust's income, expenses, and disbursements.[1] Thus, it is vitally important that you keep all important documents and Statements relating to the Trust together in a safe place.

Without maintaining these records thoroughly and accurately, it will be impossible for you to provide the annual Statements and Accountings that are required of you as Trustee.[2] An Accounting is a document that details all the facets of a Trust's transactions with respect to the Trust's property and administration while a Statement is a less formal summary of the same information. Fortunately, most of the Trusts drafted by this office contain language that frees you of the responsibility to produce unsolicited Trust Statements and Accountings to minimize your liability in case you fail to do so regularly.

There are two principal parties who are entitled to request an Accounting, the beneficiaries (current and future) and the Trustee: [3]

1. Generally, when a beneficiary requests an Accounting, they want to see that the Trust assets have been managed appropriately including receipts and expenses and that the Trustee has not been negligent in the performance of his fiduciary duties.

2. The Trustee, on the other hand, may seek to compel an Accounting of the Trust in order to prove that he has correctly discharged his duties.[4] A Trustee employs the accounting as a means of being released from further liability to the beneficiaries of the Trust. Until he obtains such a release, he is personally liable for damages to the Trust caused by his inattention or malfeaseance. This is very important, for example, when the Trustee seeks to resign, so that the successor Trustee may assume his role with the knowledge and confidence that he will not be held accountable for his predecessor's acts.

1 Klein v. Horowitz, 270 N.Y.S 834 (A.D. 1st Dept 1931)
2 New York State, Surrogate's Court Procedure Act (SCPA) Articles 2306, 2308, & 2309
3 New York State, Surrogate's Court Procedure Act (SCPA) Article 2205
4 New York State, Surrogate's Court Procedure Act (SCPA) Article 2208

In order to accomplish these purposes, the Accounting details all the transactions of the Trust through various schedules that are divided topically. Asset schedules will describe the Trust's property as well as any increase or decrease in its value since the Trust's inception. Administration expense schedules will show the various fees that have been paid to individuals or companies that have provided assistance to the Trust, for example, the fees paid to an accountant for the preparation of tax returns. Other schedules describe the sources and amount of Trust income, new investments made on behalf of the Trust, taxes paid by the Trust, commissions paid to the Trustee, and disbursements to beneficiaries.[5]

Types of Accountings:

An Accounting can take several forms:

1. Informal Accountings are normally acceptable in most circumstances, especially when there is a trusting relationship between the Trustee and the beneficiaries. An informal Accounting contains summaries, rather than in-depth schedules, of the Trust's transactions, assets, and liabilities. This form of Accounting is also appealing because it can be prepared more easily and is relatively inexpensive to produce. This type of accounting is the standard and most commonly used form.

2. Formal Accountings contain full and complete Schedules of all transactions as discussed above, and are necessary when the beneficiaries or Trustee desire more detail than is available from an informal Accounting. Formal Accountings are more expensive to produce than informal ones, as the required detail demands greater time and accuracy.

3. Judicial Accountings will be necessary if the Trust is ever the subject of actual or potential litigation or if the Trustee desires Court approval of his handling of the Trust, with the attendant release from liability. Here, formal accounting Schedules are submitted in a court proceeding for judicial approval. Such procedures can be costly depending if there are objections to the accounting. A judicial accounting can only be compelled by a beneficiary or a Trustee, and it is the only way for a Trustee to be released from liability for certain. For beneficiaries, a judicial accounting is the only way they have to correct an accounting they feel is wrong after negotiations have failed. If the Court agrees that the accounting is incorrect, it can either compel adjustments of the Schedules or establish the basis for legal action against the Trustee for mismanaging the assets

5 New York State, Surrogates Court Procedure Act (SCPA) Form No 13

The Management of Trust Property, Beneficiaries, and Remaindermen:

At all times, your actions as Trustee are governed by the New York State Prudent Investor Standard.[6] In order to comply with this law, you must consider the intentions of the Grantor[7] as well as the needs of the entire portfolio and develop an investment strategy that will allow you to make the necessary disbursements to the Trust's beneficiaries.[8] The requirements of the Prudent Investor Statute were more fully laid out in the copy of the ***New York Prudent Investor Statute*** and explained in the Memo entitled ***Understanding Fiduciary Responsibilities*** that we sent to you as part of the original Trust Administration Package. If you require another copy, we will gladly forward one to you.

The Prudent Investor Standard should be thought of as a level of conduct, and not a guarantee of a particular result.[9] The decisions made by the Trustee are evaluated "in light of facts and circumstances prevailing at the time of the decision or action or a Trustee."[10] Thus, you will not be held liable for disappointing investment results since this statute recognizes that market trends and other factors are beyond your control. As Trustee, you are authorized to delegate tasks to other agents whom you believe will be able to better serve the needs of the Trust. For example, you may find it helpful to obtain investment counsel that will help the Trust to achieve optimum performance despite whatever fluctuations may occur in the market.

It is also wise to keep a journal of which vehicles you choose to invest the Trust's money in and why you chose them. This will provide a written record in the event that your decisions are ever called into question at a later date. The journal may be kept in either a notebook or on your computer however, if you choose to keep it on your computer, it is advisable to also keep a hard copy with the Trust files, in case of an unforeseeable computer malfunction.

Naturally conflicting loyalties in how you choose to manage and invest the money will have an important impact on both the beneficiaries and remaindermen. The remaindermen are individuals that have a future interest in the principal of the Trust, while beneficiaries have a present interest in the income and / or the principal of the Trust. The conflict between the two parties can be illustrated through the example of the selection of investment vehicles. Those that generate income but do not appreciate in value would be advantageous to the current beneficiaries. Likewise, an investment strategy that concentrates on asset appreciation but did not provide any income to the Trust would be most beneficial to the Remaindermen.

For similar reasons, it is important that you differentiate between the corpus, or principal, of the Trust and the income. As explained above, this is because certain beneficiaries may only be entitled to receive the income of the Trust, while others (the remaindermen) may have an interest in the corpus. Thus, it is also essential that the Trustee determine and keep track of which costs are paid out of the income of the Trust, and which are paid from to corpus, as this can have a significant effect on the amount of money received by each party. However, because of modern

6 New York State, Estates, Powers, and Trusts Law (EPTL) Article 11-2.3
7 New York State, Estates, Powers, and Trusts Law (EPTL) Article 11-2.3(b)(2)
8 New York State, Estates, Powers, and Trusts Law (EPTL) Article 11-2.3(b)(3)(A)
9 New York State, Estates, Powers, and Trusts Law (EPTL) Article 11-2.3(b)(1)
10 New York State, Estates, Powers, and Trusts Law (EPTL) Article 11-2.3(b)(1)

the flexibility built into the Trust, and modern Trust laws, the potential for conflict over expenses has been significantly reduced, although it is still legally significant.

When an Accounting is Necessary:

An accounting can be made at any point in the life of the Trust. However, they are often made upon the occurrence of a major event, such as the death of a beneficiary, or the death or resignation of a Trustee. Accountings are also made at the termination of the Trust. When an accounting is made at this time, it is known as a Final Accounting, whereas if it is made at any other point, it is deemed an Intermediate Accounting. Accountings can also be made to facilitate the preparation and filing of income and gift tax returns.

Who is Responsible for Producing the Accounting:

Although it is the responsibility of the Trustee to compile all of these sources and use the information they contain to produce the Accounting, it is common for the Trustee to retain professional assistance to produce the Accounting for them. This is considered to be a legitimate expense of administering the Trust, and the cost can be charged directly to the principal of the Trust, so that the Trustee is not burdened with the cost personally.[11] In addition, these expenses may be income tax deductible to the Trust.

Always check The Trust Agreement:

Don't forget, the Trust Agreement frequently will have provisions which are intended to assist the Trustee to understand and comply with their obligations to Account. Your attorney can help you to understand these further, in the context of the specific circumstances and beneficiaries for whom the Trustee acts.

[11] In Re Sutta's Estate, 1941 N.Y. Misc. LEXIS 1359 (Sur. Ct. New York County 1941