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WHY TRUSTS NEED PROPER FINANCIAL ACCOUNTS

As trustees we are frequently confronted with arguments according to which keeping proper financial accounts would be expendable. For any professional trustee the answer is obvious clear: proper financial accounts are not only recommended, but compulsory.

Being competitive with regard to the cost of trust is a fundamental element for a trustee's success. For this reason some trustees may be tempted to compromise on the need to keep proper financial accounts, especially when settlors, beneficiaries or their advisors do not recognize the need and added value of keeping financial accounts, e.g. in addition to the bank statements that are available anyway. Trustees may take comfort from the fact that the trust instrument gives them the freedom to do so and by asserting that the year-end bank valuations, list of incoming/outgoing transactions are providing sufficient information for the beneficiaries. Also, some trustees do not have the in-house expertise to prepare and review the trust accounts and justify the same by mentioning that the "clients" are anyway not willing to pay this additional cost.

What gets often omitted is that trustees are under an irreducible legal obligation to give account of their stewardship of the assets under their control, which includes the assets held in underlying companies. This core duty includes the bookkeeping as well as the production of trust accounts. The purpose of the trust accounting is to demonstrate that all transactions (e.g. distributions, sales and purchases of securities, cash transactions, proper allocation of costs, etc.) have been handled in accordance with the terms of the trust instrument and the applicable trust law. There must be an assurance that all transactions are documented and that the trust's financial position is correctly reproduced. Bank statements are not meant to provide this type of information.

Financial accounts provide the trustees with an accurate history of financial transactions so that the trustees are able to report to the beneficiaries or other parties like the protectors (in case they have the right to receive this information) the actual financial positions. The ongoing booking of all transactions enables the trustee to be up to date and to give a periodic summary of the balance sheet, capital and income accounts even compared with previous periods. It might not be mandatory to produce annual or periodical financial statements, but this is generally seen as best practice.

Year-end bank statements and valuations do not provide the full information trustees might need due to the simple fact they are not financial accounts. Capital gains and losses are regularly incorrect, income and capital accounts are not split or often inappropriate and the applicable tax rules not considered. However, trustees need a correct analysis of the capital gains and losses, the historical cost and a split between the income and capital accounts since this might be foreseen in the trust deed and mandaris

is the basis for the correct tax declaration of a beneficiary (income or capital distributions). Financial accounts will distinguish the purpose of a payment (distribution, loan) which can reduce the tax burden of the recipient and facilitates to fill in the tax return. Bank statements or valuations do not provide all this relevant information and therefore the consequences of not doing trust accounting can be serious, both for the trustee and the beneficiary.

While the applicable trust law rarely prescribes a specific accounting, trust accounting is not dispensable. Having to catch up on a past omission, because of the need to present tax declaration (e.g. because of tax declarations after moving to another jurisdiction), the sale of an underlying company, the transfer of trusteeship, in case of a court order, for new investments, change of custodian bank, audit and CRS purposes or the reconciliation with underlying companies may prove to be much more costly or even impossible. Finally, only proper financial accounts will enable a trustee to assess whether a distribution is possible under the terms of the trust and to deliver accurate CRS reporting.

Mandaris can provide you with additional information if needed or can prepare trust accounting for you. If you have any questions please do not hesitate to contact us.

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